



2008 MANAGEMENT'S DISCUSSION AND ANALYSIS

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The following Management's Discussion and Analysis ("MD&A") as provided by the management of Midnight should be read in conjunction with the audited Consolidated Financial Statements and accompanying notes for the years ended December 31, 2008 and 2007. Additional information relating to Midnight, including a detailed reserve analysis, will be included in our Annual Information Form, which may be found on SEDAR at www.sedar.com.

Basis of Presentation – The financial data presented below has been prepared in accordance with Canadian Generally Accepted Accounting Principles ("GAAP"). The reporting and the measurement currency is the Canadian dollar. For the purpose of calculating unit costs, natural gas is converted to a barrel equivalent ("boe") using six thousand cubic feet of natural gas equal to one barrel of oil unless otherwise stated. The following MD&A compares the results of the year ended December 31, 2008 ("2008") to the year ended December 31, 2007 ("2007") and the results of the three months ended December 31, 2008 ("Q4 2008") to the three months ended December 31, 2007 ("Q4 2007") and the results of the three months ended September 30, 2008 ("Q3 2008").

Non-GAAP Measurements - Within the Management's Discussion and Analysis references are made to terms commonly used in the oil and gas industry. Funds from operations, funds from operations per share and netbacks are not defined by GAAP in Canada and are referred to as non-GAAP measures. Funds from operations per share is calculated based on the weighted average number of common shares outstanding consistent with the calculation of net income per share. Netbacks equal total revenue less royalties and operating and transportation expenses calculated on a per boe basis. Management utilizes these measures to analyze operating performance and leverage. Funds from operations is not intended to represent operating profit for the period nor should it be viewed as an alternative to operating profit, net income, cash flow from operations or other measures of financial performance calculated in accordance with Canadian GAAP. Funds from operations is commonly referred to as cash flow by research analysts and is used to value and compare oil and gas companies and is frequently included in published research when providing investment recommendations. Total boes are calculated by multiplying the daily production by the number of days in the period.

The following table reconciles cash flow from operations to funds from operations which is used in the MD&A:

(\$000's)	Q4 2008	Q4 2007	Q3 2008	2008	2007
Cash flow from operations	7,563	6,026	7,031	26,853	21,413
Abandonment expenditures	484	17	-	554	167
Changes in non-cash working capital	(3,365)	(1,145)	892	(881)	(206)
Funds from operations	4,682	4,898	7,923	26,526	21,374

Forward Looking Statements - Certain statements contained within the Management's Discussion and Analysis, and in certain documents incorporated by reference into this document, constitute forward looking statements. These statements relate to future events or our future performance. All statements other than statements of historical fact may be forward looking statements. Forward looking statements are often, but not always, identified by the use of words such as "seek", "anticipate", "budget", "plan", "continue", "estimate", "expect", "forecast", "may", "will", "project", "predict", "potential", "targeting", "intend", "could", "might", "should", "believe" and similar expressions. These statements involve known and unknown risks, uncertainties and other factors that may cause actual results or events to differ materially from those anticipated in such forward looking statements.

In particular, this MD&A contains the following forward-looking statements pertaining to, without limitation, the following: Midnight's production volumes and the timing of when additional production volumes will come on stream; Midnight's realized price of commodities in relation to reference prices; future commodity prices; the Company's future royalty rates and the realization of royalty incentives; the impact of the New Royalty Framework on the Company's future royalties; Midnight's expectation of reducing operating costs on a per unit basis; the relationship of Midnight's interest expense and the Bank of Canada interest rates; increases in general and administrative expenses and recoveries; future development and exploration activities and the timing thereof; the future tax liability of the Company; the expected decrease the depletion, depreciation and accretion rate; the estimated future contractual obligations of the Company and the amount expected to be incurred under its farm-in commitments; the future liquidity and financial capacity of the Company; and its ability to fund its working capital and forecasted capital expenditures. In addition, statements relating to "reserves" or "resources" are deemed to be forward looking statements, as they involve the implied assessment, based on certain estimates and assumptions, that the resources and reserves described can be profitably produced in the future.

With respect to the forward-looking statements contained in the MD&A, Midnight has made assumptions regarding: future commodity prices; the impact of royalty regimes and certain royalty incentives, the timing and the amount of capital expenditures; production of new and existing wells and the timing of new wells coming on-stream; future proved finding and development costs; future operating expenses including processing and gathering fees; the performance characteristics of oil and natural gas properties; the size of oil and natural gas reserves; the ability to raise capital and to continually add to reserves through exploration and development; the continued availability of capital, undeveloped land and skilled personnel; the ability to obtain equipment in a timely manner to carry out exploration and development activities; the ability to obtain financing on acceptable terms; the ability to add production and reserves through exploration and development activities; and the continuation of the current tax and regulation.

We believe the expectations reflected in those forward looking statements are reasonable but no assurance can be given that these expectations will prove to be correct and such forward looking statements included in, or incorporated by reference into, this MD&A should not be unduly relied upon. These statements speak only as of the date of this MD&A or as of the date specified in the documents incorporated by reference into this Management's Discussion and Analysis, as the case may be. The actual results could differ materially from those anticipated in these forward looking statements as a result of the risk factors set forth below and elsewhere in this Management's Discussion and Analysis: volatility in market prices for oil and natural gas; counterparty credit risk; access to capital; changes or fluctuations in production levels; liabilities inherent in oil and natural gas operations; uncertainties associated with estimating oil and natural gas reserves; competition for, among other things, capital, acquisitions of reserves, undeveloped lands and skilled personnel; stock market volatility and market valuation of Midnight stock; geological, technical, drilling and processing problems; limitations on insurance; changes in environmental or legislation applicable to our operations, and our ability to comply with current and future environmental and other laws; changes in income tax laws or changes in tax laws and incentive programs relating to the oil and gas industry; and the other factors discussed under "Risk Factors" in the following annual MD&A. Readers are cautioned that the foregoing lists of factors are not exhaustive. The forward looking statements contained in this MD&A and the documents incorporated by reference herein are expressly qualified by this cautionary statement. The forward-looking statements contained in this document speak only as of the date of this document and Midnight does not assume any obligation to publicly update or revise them to reflect new events or circumstances, except as may be required pursuant to applicable securities laws. This Management's Discussion and Analysis is dated as of March 18, 2009.

Selected Annual & Quarterly Information

Set out below is selected annual information for Midnight for the last three years:

Financial (000's, except for per share amounts)	2008	2007	2006
Petroleum and natural gas sales	\$ 49,577	\$ 43,153	\$ 39,688
Cash flow from operations	26,853	21,413	25,260
Funds from operations	26,526	21,374	21,999
Per share			
– Basic	0.56	0.45	0.53
– Diluted	0.56	0.45	0.53
Net income (loss)	\$ 4,589	\$ (1,219)	\$ 45
Per share			
– Basic	0.10	(0.03)	0.00
– Diluted	0.10	(0.03)	0.00
Petroleum and natural gas additions	\$ 36,167	\$ 27,330	\$ 61,752
Property disposition	(30,371)	-	-
Long-term debt	18,844	28,934	17,938
Net debt	8,730	28,374	21,974
Total assets	177,056	164,681	152,833
Shares outstanding			
Basic	46,175	47,595	47,828
Diluted	50,318	52,600	53,548
Operations			
Average daily production			
Natural gas (mcf/d)	5,651	6,050	7,755
Oil & NGLs (bbls/d)	892	1,090	866
Combined (boe/d)	1,834	2,098	2,158
Netback (\$/boe)	\$ 45.69	\$ 34.48	\$ 31.79

Set out below is selected information by quarter for Midnight for the last eight quarters:

Financial (000's, except for per share amounts)	2008				2007			
	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1
Petroleum and natural gas sales	\$ 7,828	\$ 14,930	\$ 15,576	\$ 11,243	\$ 10,811	\$ 10,439	\$ 11,009	\$ 10,894
Cash flow from operations	7,563	7,031	3,802	8,457	6,026	6,510	833	8,044
Funds from operations	4,682	7,923	8,684	5,237	4,898	4,920	6,069	5,487
Per share								
– Basic	0.10	0.17	0.18	0.11	0.10	0.10	0.13	0.11
– Diluted	0.10	0.17	0.18	0.11	0.10	0.10	0.13	0.11
Net income (loss)	\$ 760	\$ 1,647	\$ 2,174	\$ 8	\$ (19)	\$ (827)	\$ 51	\$ (424)
Per share								
– Basic	0.02	0.03	0.05	0.00	(0.00)	(0.02)	0.00	(0.01)
– Diluted	0.02	0.03	0.05	0.00	(0.00)	(0.02)	0.00	(0.01)
Petroleum and natural gas additions	\$ 13,423	\$ 6,417	\$ 4,695	\$ 11,632	\$ 8,092	\$ 3,217	\$ 3,439	\$ 12,582
Property disposition	(30,371)	-	-	-	-	-	-	-
Net debt	8,730	29,536	31,042	34,996	28,374	24,886	26,577	29,170
Total assets	177,056	172,180	172,905	169,706	164,681	160,573	161,537	159,594
Shares outstanding								
Basic	46,175	47,423	47,423	47,423	47,595	47,828	47,828	47,828
Diluted	50,318	53,591	53,543	52,430	52,600	52,953	53,168	53,001
Operations								
Average daily production								
Natural gas (mcf/d)	5,465	6,097	5,799	5,239	5,573	5,981	5,769	6,891
Oil & NGLs (bbls/d)	803	941	942	883	1,036	1,050	1,185	1,090
Combined (boe/d)	1,714	1,957	1,908	1,756	1,965	2,047	2,146	2,239
Netback (\$/boe)	\$ 28.96	\$ 54.12	\$ 57.66	\$ 39.67	\$ 34.39	\$ 33.77	\$ 37.37	\$ 32.45

Midnight has a balanced portfolio of light oil and sweet natural gas that has consistently delivered solid production without additional capital from increased debt or increased capital from equity. Net income and funds from operations have fluctuated with the changes in commodity prices and Midnight has consistently maintained high netbacks. Growth in petroleum and natural gas sales and funds from operations are derived by the combination of increased oil and natural gas production and strong commodity prices. In Q4 2008 Midnight disposed of its low working interest non-core West Central assets to help fund the exploration and development of its multi-zone Deep Basin tight gas resource play in the Peace River Arch area of Alberta. This strategy will allow us to focus our efforts and capital on this play targeting for anticipated increase in gas production in Q2 2009. Midnight has increased its asset base spending \$63.5 million during the past 8 quarters funded primarily through this property disposition, farm-outs and funds from operations. Midnight has not raised any additional equity in the last eight quarters and has purchased and cancelled 1,652,700 common shares under its normal course issuer bids. Q2 2008 set a new record for petroleum and natural gas sales and funds from operations with record setting prices for oil and NGLs and the second highest natural gas price realized by Midnight. During Q3 2008 realized commodity prices declined eight percent with a corresponding decrease in petroleum and natural gas sales. The recent global economic downturn has driven commodity prices down a further 40 percent in Q4 2008 versus Q3 2008. Combined with the disposition of approximately 550 boe/d of production on October 31, 2008, petroleum and natural gas sales declined 48% in Q4 2008. The Company has not used any commodity hedges and its realized prices are a function of prevailing world and North American commodity prices which have been, and continue to be extremely volatile.

Production

Production for 2008 averaged 1,834 boe/d consisting of 5,651 mcf/d of natural gas and 892 boe/d of oil and natural gas liquids ("NGLs") representing a 13% decrease from 2007 average production. This was primarily the result of a restricted capital program (share buyback, reduced net debt and property sales) as we moved our program to focus on opportunities added along the Deep Basin Tight Gas resource play fairway. On October 31, 2008, Midnight disposed of its interests in its non-core West Central assets which produced approximately 550 boe/d, which reduced annualized production by

approximately 90 boe/d. On the oil side, Midnight cutback its program in its light oil property at Red Earth area and drilled only 1 gross (0.25 net) oil well during the year. As a result of natural declines, the property disposition in West Central that accounted for approximately 30 bbls/d and limited investment, the annual oil production decreased 157 boe/d. On the gas side, the limited capital program offset natural declines as natural gas and NGLs production averaged 1,080 boe/d in 2008 compared to 1,187 boe/d in 2007 primarily as a result of the sale of our West Central assets. The largest portion of the capital program and the majority of production additions occurred in Q4 of 2008 and as such production declines outweighed the benefits of additions in the yearly boe/d average which accounts for the decrease.

Production for Q4 2008 averaged 1,714 boe/d a 12% decrease from Q3 2008. Production decreased with the sale of Midnight's West Central assets effective October 31, 2008 which reduced production by approximately 366 boe/d for the quarter. During Q4, Midnight began adding production from its earlier activities in the Peace River Arch with four (1.6 net) new wells coming on production during the quarter contributing approximately 200 boe/d to the average quarterly production. Oil production decreased 109 boe/d from Q3 2008 with field disruptions and some field optimization projects Midnight opted to delay in response to the large decrease in oil price. Total production decreased 251 boe/d from Q4 2007 with oil and liquids production accounting for 233 boe/d of the decrease. This decrease is a result of natural declines on our oil properties and minimal capital expenditures being directed towards oil in 2008.

Midnight's 2008 and 2009 winter capital program has enjoyed good success with anticipated production additions to exceed declines and the boe's disposed of in 2008 and generate increased production volumes when they are placed on-stream later in the year. On March 3, 2009 the Alberta government announced an incentive package that will reduce the near term royalty rate for new production brought on stream after April 1, 2009 to 5%. In order to maximize the benefit of these incentives, Midnight has opted to delay the start up of their new wells until after this date and therefore Q1 2009 production will average approximately 1,500 boe/d.

The following table outlines our production volumes for the periods indicated below:

Production	Q4 2008	Q4 2007	Q3 2008	2008	2007
Natural Gas (mcf/d)	5,465	5,573	6,097	5,651	6,050
Oil (bbls/d)	683	820	792	754	911
NGLs (bbls/d)	120	216	149	138	179
Total (boe/d)	1,714	1,965	1,957	1,834	2,098

Commodity Pricing

Canadian natural gas prices are influenced by the overall North American supply and demand balance including imports of liquefied natural gas, actual and forecast weather and seasonal changes, Canadian and U.S. storage levels and transportation capacity. Canada exports to the U.S. more natural gas than it consumes and as a result U.S. domestic market dynamics significantly affect Canadian gas prices. Recently U.S. domestic supply significantly increased with the development of new drilling and completion technology that resulted in production gains from new and large scale tight gas and shale gas developments in numerous areas in the U.S.

Midnight markets most (99%) of its gas in Alberta with a mix of daily and monthly pricing and therefore has a high correlation to Alberta spot prices. For 2008, Midnight's realized natural gas price was \$8.53 per mcf (2007 - \$6.68) a 6% (2007 - 6%) premium to the Alberta daily spot price which was achieved as a result of both the average heating value of the gas and the mix or combination of gas sold at daily or monthly prices. In periods of declining prices, natural gas sales that are based on the monthly index receive a higher price as the monthly index generally represents the prior months' average of the daily prices.

World oil prices have been volatile and dynamic over the past number of years with the trend expected to continue. Near term and long term oil prices are determined by daily free trading of the commodity on various world wide commodity exchanges and are influenced by actual and forecast global economic activity that affects global supply and demand. The

principal trading exchange that affects Midnight's oil price is the U.S. benchmark West Texas Intermediate at Cushing, Oklahoma ("WTI") price. Midnight's realized oil price has a high correlation to the Edmonton Par benchmark price which generally has a high correlation to WTI adjusted by the Canadian to U.S. dollar exchange rate as well as transportation costs and quality adjustments. Midnight's oil is light, sweet crude which is a high quality crude and has tracked appropriately to the Edmonton par benchmark. For 2008, Midnight received a price of \$102.49 per bbl (2007 - \$74.70) compared to the Edmonton par benchmark price of \$102.66 per bbl (2007 - \$77.00). 2008 was an extremely volatile year for crude oil prices which reached record highs and peaked at US \$147.27 per bbl in July of 2008 and then dramatically declined for the rest of the year and were as low as US \$32.41 per bbl in December of 2008. This dramatic decline in prices is somewhat mitigated by a sharp decline in the Canadian dollar compared to the US dollar from a high of \$1.030 Cdn/US in February 2008 to a low of \$.0.769 Cdn/US in December.

Prices for Natural Gas Liquids have their own market dynamic. NGLs include condensate, pentane, butane and propane. While prices for condensate and pentane have a relatively strong correlation to oil prices, prices for butane and propane trade at varying discounts due to the local market conditions of supply and demand. During 2008, Midnight realized 64% of the Edmonton par benchmark price, which is consistent with our realized price in 2007 which was 68% of the benchmark.

Midnight did not buy or sell any commodity or currency hedges during 2008 or 2007 and did not have any outstanding at December 31, 2008.

Midnight's realized price for commodities has tracked with the appropriate benchmark prices and are expected to continue with this correlation in 2009. The following table outlines benchmark prices compared to Midnight's realized prices:

Prices and Marketing	Q4 2008	Q4 2007	Q3 2008	2008	2007
Benchmark Prices					
Alberta spot (\$/mcf)	\$ 6.62	\$ 6.01	\$ 7.69	\$ 8.06	\$ 6.32
WTI oil (\$US/bbl)	59.06	90.57	118.23	99.92	72.33
Cdn/US average exchange rate	0.828	1.020	0.961	0.943	0.936
Edmonton Par (\$/bbl)	\$ 63.62	\$ 86.89	\$ 122.74	\$ 102.66	\$ 77.00
Midnight's Realized Price					
Natural gas (\$/mcf)	\$ 6.96	\$ 6.17	\$ 8.64	\$ 8.53	\$ 6.68
Oil (\$/bbl)	61.63	85.23	121.45	102.49	74.70
NGLs (\$/bbl)	40.95	58.26	75.48	65.87	52.36
Combined oil & NGLs (\$/bbl)	58.54	79.62	114.18	96.81	71.04
Total (\$/boe)	\$ 49.65	\$ 59.81	\$ 82.91	\$ 73.87	\$ 56.34

Petroleum and Natural Gas Sales

Petroleum and natural gas sales totalled \$49.6 million for 2008 compared to \$43.2 million in 2007 despite lower production in 2008. Record oil prices increased the Company's sales in the year with oil sales increasing 14% despite a 17% decline in oil production. The total increase in sales of \$6.4 million is due to increased realized prices which increased sales by \$11.7 million and was offset by lower production volumes which decreased sales by \$5.3 million. Q4 2008 sales decreased from Q3 2008 as production decreased with the sale of our West Central assets and realized prices decreased from \$82.91 per boe to \$49.65 per boe. Q4 2008 sales decreased \$3.0 million from the comparative period in 2007 with both a decrease in realized prices and lower production volumes in the current year.

The following table outlines our production sales for the periods indicated below:

Petroleum and Natural Gas Sales (000's)	Q4 2008	Q4 2007	Q3 2008	2008	2007
Natural Gas	\$ 3,497	\$ 3,165	\$ 4,844	\$ 17,637	\$ 14,740
Oil	3,873	6,432	8,852	28,275	24,852
NGLs	452	1,156	1,033	3,332	3,414
Royalty income	6	58	201	333	147
Total	\$ 7,828	\$ 10,811	\$ 14,930	\$ 49,577	\$ 43,153

Royalties

Royalty payments are made by producers of oil and gas to the owners of the mineral rights on our leases that include provincial governments (Crown) and freehold landowners as well as to other third parties by way of contractual overriding royalties.

Royalties averaged 21.8% of revenue in 2008 compared to 15.9% of revenue in 2007. Natural gas royalties were 16.3% of revenue in 2008 compared to only 6.3% of revenue in 2007 as the Company received less gas cost allowance ("GCA") credits in the current year. In 2008 gas royalties averaged 23% of revenue without GCA compared to 22% in 2007. Oil royalties increased to 24.7% of revenue in 2008 as during 2007, the Company had a number of wells that received a Third Tier Exploratory Royalty Exemption and no similar exemptions were recorded in 2008. Q4 2008 royalties were 19.4% of revenue which is similar to Q3 2008 rates which were 21.2% of revenue. The Q4 2007 average royalty rate of 15.3% was lower than the current period due to higher GCA credits in 2007.

The following tables outline our royalties by type and by commodity:

Royalties by Type (000's)	Q4 2008	Q4 2007	Q3 2008	2008	2007
Crown	\$ 1,150	\$ 1,403	\$ 2,792	\$ 9,467	\$ 6,036
Gross overriding and other	365	246	379	1,327	818
Total	\$ 1,515	\$ 1,649	\$ 3,171	\$ 10,794	\$ 6,854
\$/boe	\$ 9.61	\$ 9.12	\$ 17.61	\$ 16.08	\$ 8.95
% of revenue	19.4	15.3	21.2	21.8	15.9

Royalties by Commodity	Q4 2008	Q4 2007	Q3 2008	2008	2007
Natural Gas					
000's	\$ 583	\$ (50)	\$ 792	\$ 2,881	\$ 923
% of revenue	16.7	(1.6)	16.4	16.3	6.3
Oil					
000's	\$ 798	\$ 1,350	\$ 2,253	\$ 6,977	\$ 4,961
% of revenue	20.6	21.0	25.5	24.7	20.0
NGLs					
000's	\$ 134	\$ 349	\$ 126	\$ 936	\$ 970
% of revenue	29.6	30.2	12.2	28.1	28.4

New Royalty Framework ("NRF")

On October 25, 2007, the Alberta government announced its intent to increase crown royalties through the New Royalty Framework ("NRF"). The NRF was legislated in November 2008 and took effect January 1, 2009. The NRF calculates royalty rates based on an individual wells production, depth and the commodity reference price and eliminates royalty incentives and holiday programs with the exception of specific programs relating to deep oil and natural gas drilling programs. The sliding scale royalty calculation is based on a broader range of commodity prices where the price component of royalties increases up to maximum prices of approximately \$120/bbl for oil and \$16/GJ for natural gas. The minimum crown rate under the NRF is 5% and has a maximum royalty rate of 50%.

Subsequent to the legislation of the NRF, the Transitional Royalty Plan ("TRP") was introduced by the government in response to the economic downturn and declining commodity prices. Wells drilled on or after November 19, 2008 that meet certain depth criteria have the option to continue under the old royalty framework until December 31, 2013 when all wells will convert to NRF. The government also announced additional deep gas drilling incentives where wells drilled to a vertical depth greater than 2,500 meters qualify for certain incentives based on the measured depth of the well. Midnight does not anticipate a significant benefit from the TRP as most of its new wells would receive a greater benefit from the deep gas drilling incentives under NRF. On March 3, 2009 a further short term program was announced to encourage additional activity in the province's conventional oil and gas sectors. For new wells spud on or after April 1, 2009 and rig released

before April 1, 2010 the Company may receive a royalty credit of \$200/metre drilled. These credits are applied to the Company's corporate royalty liability and can be used to shelter up to 50% of Midnight's Alberta Crown royalty liability. A new well incentive program was also announced for new wells which come on production after April 1, 2009. This program caps a well's royalty at 5% for the first 12 months of production or for the first 50,000 bbls or 500 mmcf produced, whichever comes first. To obtain maximum benefit under this latter program, Midnight has or will delay putting on production a number of wells from its winter drilling program which were planned to be on production from periods ranging from March 9 to March 31, 2009.

With the implementation of the NRF and the latest government announcement in 2009, we expect our royalty structure to change dramatically. The NRF calculates individual well royalties based on the wells production and depth and also based on the crown reference price for the commodity. Because Midnight is drilling high-impact deep-gas wells and expects to achieve strong growth in 2009, it is harder to predict the corporate impact on its royalty rates. Midnight is targeting deep gas in the Peace River Arch and expects to put on-stream a number of high productivity wells, but also expects to take advantage of the deep gas incentives and the new well incentives recently announced. Midnight expects its Q1 2009 overall royalty rate to increase over Q4 2008 to approximately 22% but then drop dramatically in Q2 2009 to between 15% and 17% which includes the increase in gross overriding royalties being paid out to third parties on some of our new production additions in the Deep Basin. The estimated royalty rates are based on many assumptions, the actual royalty rates may differ significantly as the rates will vary based on commodity prices, production profiles of new and existing wells, the depth of new wells drilled along with the application of incentives received.

Operating and Transportation Expenses

Operating and transportation expenses totaled \$8.1 million (\$12.10/boe) in 2008 compared to \$9.9 million (\$12.91/boe) for 2007 representing a decrease of 6% on a boe basis. Transportation costs decreased 45% to \$0.69/boe for 2008 compared to \$1.25/boe for 2007. Midnight's operating and transportation costs decreased in the current year as it commissioned its water handling facilities at Red Earth in Q1 of this year which reduced trucking charges, third party handling charges for water disposal and equipment rentals. Q4 2008 operating and transportation costs totaled \$1.7 million which is lower than Q3 2008 and consistent with the decline in production volumes. Operating and transportation charges decreased from Q4 2007 as the prior year had non-recurring charges related to third party processing charges for 2007 and 2006. We expect our operating costs in 2009 to continue to decrease on a boe basis as we increase our natural gas production that will initially have lower overall operating costs on a per unit basis.

Operating and Transportation Expenses (000's)	Q4 2008	Q4 2007	Q3 2008	2008	2007
Operating	\$ 1,683	\$ 2,746	\$ 1,934	\$ 7,654	\$ 8,930
Transportation	64	200	80	465	956
Total	\$ 1,747	\$ 2,946	\$ 2,014	\$ 8,119	\$ 9,886
Operating (\$/boe)	\$ 10.67	\$ 15.19	\$ 10.74	\$ 11.41	\$ 11.66
Transportation (\$/boe)	0.41	1.11	0.44	0.69	1.25
Total (\$/boe)	\$ 11.08	\$ 16.30	\$ 11.18	\$ 12.10	\$ 12.91

Interest Expense

2008 interest expense totalled \$1,372,000 on average bank debt for the period of \$28.7 million for an effective interest rate of 4.9%. This compares to interest expense of \$1,573,000 in 2007 which included \$248,000 of interest on our unspent flow-through share obligation with no similar amount incurred in 2008. Excluding the interest on the unspent flow-through share obligation, 2007 interest expense totalled \$1,325,000 on average bank debt of \$22.9 million for an effective interest rate of 5.8%. The effective interest rate has decreased from 2007 with the corresponding decrease to the bank's prime rate. Our Q4 2008 interest expense totalled \$257,000 for an effective interest rate of 4.7% compared to interest on bank debt of \$369,000 for Q4 2007 for an effective interest rate on bank debt of 5.9%. Our credit facility bears interest at the bank's prime rate plus a stamping fee or at Bankers' Acceptance rates plus a stamping fee based on the Company's debt to

cash flow ratio as defined in the credit facility. The effective interest rate on our bank debt has historically fluctuated with the changes in the Bank of Canada rates. In 2008, the stamping fees increased with each review of the credit facility due to pressure on the commercial banks resulting from the global credit crisis, which has reduced the impact of the reduction in the Bank of Canada rates. We expect our interest expense will fluctuate with the average bank debt balance and our effective interest rate will continue to fluctuate with the Bank of Canada's rates, but with a larger spread due to higher stamping fees. With the sale of the West Central assets on October 31, 2008 and the related sale of a portion of our Daylight Resources Trust Units our average debt balance decreased to \$24.8 million for Q4 2008. In Q1 2009, the Company sold the remainder of the Daylight Resources Trust Units and used the proceeds to reduce long-term debt, but expects bank debt will increase for the balance of 2009 as capital expenditures are expected to be in excess of cash flow (see further discussion below in Liquidity and Capital Resources section).

Interest Expenses (000's)	Q4 2008	Q4 2007	Q3 2008	2008	2007
Interest	\$ 257	\$ 369	\$ 369	\$ 1,372	\$ 1,573
Total (\$/boe)	\$ 1.63	\$ 2.04	\$ 2.05	\$ 2.05	\$ 2.05

General and Administration Expenses

2008 cash general and administration ("G&A") totalled \$4,293,000 compared to \$3,645,000 in 2007. Q4 2008 G&A expense totalled \$1,012,000 which was slightly lower than the \$1,128,000 realized in Q4 2007. Direct G&A increased over 2007 as Midnight continued to hire professional staff to ensure it had a full complement of individuals to pursue its opportunities. Salaries increased an average of 5% during the year and bonuses totalling 13% of eligible annualized base salaries were paid out in Q3 2008. 2008 direct G&A also includes approximately \$0.8 million relating to Midnight common shares that were purchased on the open market in Q3 2008 and issued to all employees of the Company as long-term incentive compensation. The purchase of the shares has been accounted for as a cash expense. Overhead recoveries increased substantially in Q4 2008 as the Company commenced its operated Deep Basin drilling program. The largest portion of Midnight's cash G&A is comprised of salaries and benefits and as such, Midnight's cash G&A will depend on the staffing levels in 2009 along with any changes to salaries and bonuses. In addition, Midnight has separated all services from Daylight which will cause direct G&A to increase slightly in 2009. The per boe cost will be significantly affected by future production volumes.

The components of general and administration expense are as follows:

General and Administration Expenses (000's)	Q4 2008	Q4 2007	Q3 2008	2008	2007
Direct G&A	\$ 1,815	\$ 1,796	\$ 2,390	\$ 7,599	\$ 6,414
Overhead recoveries	(237)	(58)	(51)	(609)	(181)
Capitalized G&A	(566)	(610)	(886)	(2,697)	(2,588)
Cash G&A	\$ 1,012	\$ 1,128	\$ 1,453	\$ 4,293	\$ 3,645
Stock-based compensation	144	153	143	551	565
Net G&A	\$ 1,156	\$ 1,281	\$ 1,596	\$ 4,844	\$ 4,210
Cash G&A (\$/boe)	\$ 6.42	\$ 6.24	\$ 8.07	\$ 6.40	\$ 4.76
Stock-based compensation (\$/boe)	0.91	0.85	0.79	0.82	0.74
Net G&A (\$/boe)	\$ 7.33	\$ 7.09	\$ 8.86	\$ 7.22	\$ 5.50

Stock options have an exercise price equal to the market price on the date of grant. Once options have vested, the optionee may purchase shares from the Company at this exercise price. The Company does not incur any cash costs when granting options nor when options are exercised, but does record a cost in its financial statements. The Company applies the fair value method for valuing stock option grants. Under this method, compensation costs attributable to all share options granted are measured at fair value at the grant date and expensed over the vesting period with a corresponding increase to contributed surplus. The Company capitalizes the related stock-based compensation associated with employee salaries that are capitalized. For 2008, Midnight recognized stock-based compensation expense of \$962,000 of which

\$411,000 was capitalized compared to 2007 expense of \$930,000 of which \$365,000 was capitalized. Since inception, the Company has recorded \$3,120,000 in stock based compensation and no warrants or options have been exercised. During 2008, Midnight granted 1,218,000 stock options with a weighted average fair value of \$0.46 per option using the Black-Scholes option pricing model. These options were granted at an average exercise price of \$1.28 per option. Midnight's unamortized portion of stock-based compensation is \$1.1 million at December 31, 2008. No stock options have been exercised since the inception of Midnight; 1,981,000 stock options have vested and are exercisable at an average exercise price of \$2.63 per share.

Depletion, Depreciation and Accretion

For Q4 2008, depletion, depreciation and accretion ("DD&A") was \$5.3 million (\$33.92/boe) compared to \$5.9 million (\$32.64/boe) in Q4 2007 and \$5.5 million (\$30.55/boe) in Q3 2008. For the year 2008, DD&A totalled \$21.5 million (\$31.98/boe) compared to \$23.7 million (\$30.95/boe) for the year 2007. Midnight has excluded \$23.1 million from the depletion base related to unproved properties in 2008 compared to \$24.1 million in 2007. Future development costs of \$13.7 million have been added to the depletion base in 2008 compared to \$12.3 million in 2007. The Company's West Central assets were removed from the depletion base at a cost of \$20.26 for proven reserves which is lower than the historical carrying cost resulting in a higher depletion and depreciation rate per boe in Q4 2008. Going forward the Company's drilling program is focused in the Deep Basin where historically it has been able to add reserves at low finding and development costs. The Company anticipates that its DD&A rate will decrease with continued drilling in this area.

Depletion, Depreciation and Accretion (000's)	Q4 2008	Q4 2007	Q3 2008	2008	2007
Depletion and Depreciation	\$ 5,305	\$ 5,850	\$ 5,447	\$ 21,265	\$ 23,513
Accretion	44	50	54	203	196
Total	\$ 5,349	\$ 5,900	\$ 5,501	\$ 21,468	\$ 23,709
Depletion and Depreciation (\$/boe)	\$ 33.64	\$ 32.36	\$ 30.25	\$ 31.68	\$ 30.69
Accretion (\$/boe)	0.28	0.28	0.30	0.30	0.26
Total (\$/boe)	\$ 33.92	\$ 32.64	\$ 30.55	\$ 31.98	\$ 30.95

Investments and Other Income

Investments are comprised of the Trust Units received from the disposition of the West Central assets to Daylight Resources Trust (TSX-DAY.UN). Midnight considers the units to be financial assets and accounts for them as held for trading determining fair values based on quoted market prices. At December 31, 2008 Midnight held 2,690,200 Trust Units with a fair value of \$21,010,000 based on Daylight's closing price on December 31, 2008 of \$7.81 per unit. The Company disposed of 1,059,800 Trust Units during the year ended December 31, 2008 for proceeds of \$8,108,000. A gain of \$454,000 was realized on the disposition. Midnight also recognized an unrealized gain of \$1,583,000 based on the fair value of the trust units at December 31, 2008. In January 2009, the Company disposed of the remaining trust units for \$21,489,000 and used the proceeds to reduce long-term debt.

During the year ended December 31, 2008, the Company recorded \$1,360,000 of distribution income from the trust units in other income. Seismic sales makes up the balance of the other income to total \$1,527,000 in 2008 compared to \$179,000 in 2007.

Taxes

For the 2008 year, future tax expense was \$1,955,000 compared to a future tax reduction of \$1,681,000 for the 2007 year. For the 2008 year the Company had income before taxes of \$6,544,000 versus a loss before taxes of \$2,900,000 for the 2007 year. In addition, during Q4 2007 Federal Bill C-28 was enacted reducing the general federal corporate tax rates to 15% by 2012 from the 2007 rate of 22.12%. Midnight recorded a reduction to its future taxes of \$962,000 in 2007 due to this change in enacted tax rates. The Q4 2008 future tax expense was \$466,000 compared to \$632,000 in Q3 2008 and a

future tax reduction of \$1,136,000 in Q4 2007. The difference between the expected rate of 29.5% and the effective rate for 2008 relates primarily to the tax rates differences, a capital gain from the disposition of assets and from permanent differences from stock-based compensation.

Midnight does not expect to become taxable on an income tax basis in 2009 and has approximately \$111 million in tax pools to shelter taxable income in the future. These tax pool balances are subject to change as tax returns are completed, annual claims are made, and reclassification of items between categories may occur.

Tax Pools (000's)	2008
Canadian exploration expense & non-capital losses	\$ 31,000
Canadian development expense	26,300
Canadian oil and gas property expense	24,500
Undepreciated capital cost	27,800
Share issue costs	1,500
Total	\$ 111,100

Funds from Operations and Net Income

For Q4 2008, funds from operations totalled \$4.7 million or \$0.10 per basic and diluted share. Funds from operations for Q4 2007 totalled \$4.9 million or \$0.10 per basic and diluted share and \$7.9 million or \$0.17 per basic and diluted share for Q3 2008. For the 2008 year, funds from operations totalled \$26.5 million or \$0.56 per basic and diluted share, compared to funds from operations of \$21.4 million or \$0.45 per basic and diluted share for the 2007 year.

Net income for Q4 2008 was \$760,000 (\$0.02 per basic and diluted share) compared to a net loss of \$19,000 in Q4 2007 and net income of \$1,647,000 (\$0.03 per basic and diluted share) in Q3 2008. For the 2008 year, net income was \$4,589,000 (\$0.10 per basic and diluted share) compared to a net loss of \$1,219,000 (\$0.03 loss per basic and diluted share) for the 2007 year.

The changes in non-cash working capital and abandonment expenditures are taken into consideration for cash flow from operations but are not accounted for in funds from operations.

The following table summarizes the net income on a barrel of oil equivalent basis for the periods indicated.

(\$/boe)	Q4 2008	Q4 2007	Q3 2008	2008	2007
Sales price	\$ 49.65	\$ 59.81	\$ 82.91	\$ 73.87	\$ 56.34
Royalties	9.61	9.12	17.61	16.08	8.95
Operating expenses	10.67	15.19	10.74	11.41	11.66
Transportation expenses	0.41	1.11	0.44	0.69	1.25
Operating netback	\$ 28.96	\$ 34.39	\$ 54.12	\$ 45.69	\$ 34.48
General and administration	6.42	6.24	8.07	6.40	4.76
Interest	1.63	2.04	2.05	2.05	2.05
Other income	(8.78)	(0.99)	-	(2.28)	(0.23)
Cash flow netback	\$ 29.69	\$ 27.10	\$ 44.00	\$ 39.52	\$ 27.90
Depletion, depreciation and accretion	33.92	32.64	30.55	31.98	30.95
Stock-based compensation	0.91	0.85	0.79	0.82	0.74
Gain on investments	(12.92)	-	-	(3.03)	-
Future tax (reduction)	2.96	(6.28)	3.51	2.91	(2.19)
Net income (loss)	\$ 4.82	\$ (0.11)	\$ 9.15	\$ 6.84	\$ (1.60)

The following table provides reconciliations to the change in funds from operations and net income for Q4 2008 to Q4 2007 and for the 2008 year to the 2007 year.

Change in Funds from Operations and Net Income (Loss) (000's)	Q4 2008 to Q4 2007		2008 Year to 2007 Year	
	Funds from Operations	Net Income (Loss)	Funds from Operations	Net Income (Loss)
Comparative period	\$ 4,898	\$ (19)	\$ 21,374	\$ (1,219)
Increase (decrease) in revenue:				
Change in production volumes	(1,381)	(1,381)	(5,337)	(5,337)
Change in prices	(1,602)	(1,602)	11,761	11,761
Change in royalties	134	134	(3,940)	(3,940)
Change in other income	1,206	1,206	1,348	1,348
(Increase) decrease in expenses:				
Operating	1,063	1,063	1,276	1,276
Transportation	136	136	491	491
Interest	112	112	201	201
Cash general and administration	116	116	(648)	(648)
Stock-based compensation	-	9	-	14
Depletion, depreciation and accretion	-	551	-	2,241
Gain on investments	-	2,037	-	2,037
Taxes	-	(1,602)	-	(3,636)
Current period	\$ 4,682	\$ 760	\$ 26,526	\$ 4,589

Capital Expenditures

2008 capital expenditures totalled \$36.2 million compared to \$27.3 million for 2007. During 2008 the Company drilled 21 gross (5.1 net) natural gas wells and 1 (0.25 net) oil well for a 100% success. Midnight's capital investments during the year focused on its Deep Basin program, both acquiring the land and commencing the robust winter drilling program. In Q4 2008 the Company commenced drilling its deep tight gas resource play in this area. During 2008 Midnight drilled 7 gross (4.2 net) natural gas wells in the Deep Basin spending \$12.5 million in the area. The remaining 14 gross (0.9) natural gas wells were drilled in our West Central Area where we spent \$4.1 million prior to the disposition of the property in October. In Red Earth we drilled one oil well and completed and commissioned the water handling facilities.

Midnight's winter program is comprised of drilling, completing and putting on production nine gross (3.7 net) wells; completing and/or recompleting 6 gross (4.5 net) previously drilled wells and tying in one additional well in Elsworth. To fund this program, on October 31, 2008 the Company disposed of its interest in the West Central property to Daylight for \$2,000,000 and 3.75 million Daylight Resources Trust Units (see further discussion below in Liquidity and Capital Resources section). The disposition resulted in a \$30.4 million reduction to petroleum and natural gas assets.

In addition to the cash capital expenditures discussed above, we have capitalized \$411,000 of stock-based compensation and the related future tax liability of \$139,000 for 2008 consistent with the exploration salaries that we have added to our property base. Midnight had approximately 125,300 net acres of undeveloped land at December 31, 2008, which excludes unearned lands on farm-ins.

The following table highlights the breakdown of expenditures by category for the periods indicated:

Capital Expenditures (000's)	Q4 2008	Q4 2007	Q3 2008	2008	2007
Land	\$ 55	\$ 352	\$ 844	\$ 1,220	\$ 625
Land disposition	-	-	-	-	(1,996)
Geological and geophysical	620	629	1,566	3,922	3,379
Drilling	5,691	4,299	1,465	13,588	13,437
Completions	4,665	1,821	2,170	10,733	6,154
Facilities, pipelines and equipment	2,216	985	372	6,508	5,684
Office and other	176	6	-	196	47
Total expenditures	\$ 13,423	\$ 8,092	\$ 6,417	\$ 36,167	\$ 27,330
Property disposition	(30,371)	-	-	(30,371)	-
Total net expenditures	\$ (16,948)	\$ 8,092	\$ 6,417	\$ 5,796	\$ 27,330

Equity

During 2008, Midnight issued 1,218,000 stock options, 67,500 options were forfeited and no options were exercised. At December 31, 2008, the Company had 4,142,500 stock options outstanding at an average exercise price of \$2.21 per share – of these, 1,981,499 have vested and are exercisable at an average exercise price of \$2.63 per share. On November 29, 2008 the Company had 2,013,333 warrants that expired without being exercised.

On October 15, 2007, 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 4,320,826 common shares during this bid and Midnight purchased and cancelled a total of 405,200 shares at an average price of \$1.12 per share. On November 7, 2008, Midnight filed a second notice with the TSX to make a normal course issuer bid. 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. Under this bid in 2008, Midnight purchased and cancelled 1,247,500 shares at an average price of \$0.80 per share. As a result, during the year 2008 the basic shares declined from 47,595,129 to 46,175,129 a 3% decline and the fully diluted shares declined 4% from 52,600,462 to 50,317,629. To date in 2009 no additional shares have been purchased or cancelled.

At March 18, 2009, the Company had 46,175,129 common shares, 4,177,500 stock options outstanding. The average exercise price of stock options outstanding is \$2.19 per share.

Share Information (000's)	Q4 2008	Q4 2007	Q3 2008	2008	2007
Shares outstanding					
Basic	46,175	47,595	47,423	46,175	47,595
Diluted	50,318	52,600	53,591	50,318	52,600
Weighted average shares outstanding					
Basic	46,867	47,754	47,423	47,291	47,809
Diluted	46,867	47,754	47,609	47,291	47,809

Liquidity and Capital Resources

Midnight Oil Exploration Ltd. is listed as a senior issuer on the Toronto Stock Exchange trading under the symbol "MOX". The Company's market capitalization at December 31, 2008 was approximately \$34.6 million. The market has experienced a high degree of volatility and with the global market crisis the Company has seen a decrease in its market capitalization to a low of approximately \$28 million. At March 18, 2009 the market capitalization was approximately \$35.1 million.

Trading History on the TSX	Q4 2008	Q4 2007	Q3 2008	2008	2007
High	\$ 1.40	\$ 1.45	\$ 2.49	\$ 2.49	\$ 2.39
Low	\$ 0.60	\$ 0.92	\$ 1.22	\$ 0.60	\$ 0.92
Close	\$ 0.75	\$ 1.08	\$ 1.35	\$ 0.75	\$ 1.08
Volume (000's)	13,404	9,987	13,332	41,847	22,336

At December 31, 2008, Midnight had drawn \$18.8 million on its \$28 million credit facility and had a working capital surplus of \$10.1 million for a net debt position of \$8.7 million.

West Central Property Disposition

Midnight assembled a large land base in the Deep Basin and planned an aggressive drilling and completion program this winter. In order to expedite this program and provide financial flexibility Midnight sold its non-core assets in the West Central area of Alberta to Daylight Resources Trust ("Daylight") in exchange for \$2.0 million and 3.75 million trust units of Daylight. Midnight's West Central assets accounted for approximately 550 boe/d of Midnight's production and 2.1 million boe of proved plus probable reserves. The sale was effective October 1, 2008 and closed on October 31, 2008. Midnight sold the trust units into the market between November 10, 2008 and January 22, 2009 and realized an average price of \$7.89/unit and received \$29.6 million plus \$1.36 million in distribution proceeds.

With the disposition of its West Central properties Midnight's borrowing base was adjusted to \$28 million in January 2009. Midnight's credit facility is available on a revolving basis until May 31, 2009. On this date and 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. On this basis, the bank debt is considered Long-term debt for financial reporting purposes. The credit facility bears interest at the bank's prime rate plus a stamp or Bankers' Acceptances plus a stamp based on the Company's net debt to cash flow ratio, calculated using the two most recent fiscal quarters. The credit facility is based solely on the drawn amount and does not have a covenant relating to the Company's net debt which includes working capital. The facility is secured by a \$50 million first floating charge debenture and a general securities agreement. The \$28.0 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 November 7, 2008 with the next one scheduled for on or prior to May 31, 2009.

The nature of the oil and gas industry requires significant cash outlays to fund capital programs necessary to maintain and increase production and reserves and to acquire strategic oil and gas assets. Midnight acquires access to land through crown land sales, swaps and from farm-in arrangements. Farm-outs such as at Elsworth require third parties to incur costs on behalf of Midnight to earn and retain lands. Farm-ins such as at Bilbo require Midnight to incur costs on behalf of third parties to earn and retain lands. As of December 31, 2008, at Elsworth Midnight's partner was continuing to fulfill its obligation. As of December 31, 2008 at Bilbo, Midnight and its partner had ongoing drilling and completion commitments. Midnight anticipates spending \$14 million to \$18 million in 2009 to fulfil its commitment at Bilbo. The Company expects to have drilled five of the six wells before spring break-up with the remaining well deferred until later in 2009. If the commitments are not fulfilled by Midnight and its partner and the parties are unable to agree to terms, the lands may revert to the farm-out parties. Midnight and its partner are confident of their ability to fulfil this obligation.

As a result of the global economic downturn there is uncertainty in the capital markets and as a result, Midnight anticipates that junior oil and gas companies will be faced with limited access to capital; an increased cost of capital; and increased cost of borrowing. Midnight anticipates that it will have adequate liquidity to fund future working capital and forecasted capital expenditures in 2009 through a combination of cash flow, proceeds from the sale of Daylight Trust Units and additional drawing on its existing credit facility, based on the current price environment. Should commodity prices continue to decline significantly, the Company has the ability to reduce its capital expenditure program accordingly or to farm-out part of its

drilling commitment and/or to sell additional assets. Actual funding alternatives will be influenced by the current market environment and the ability to access capital on reasonable terms, balanced with any investment opportunities presented.

Off Balance Sheet Transactions

There were no off balance sheet transactions entered into during the period, nor are there any outstanding as of the date of this MD&A.

Contractual Obligations

The contractual obligations for which the Company is responsible are as follows:

Contractual Obligations (000's)	Total	Less than 1 Year	1-3 Years	4-5 Years	After 5 Years
Long-term debt	\$ 18,844	\$ -	\$ 18,844	\$ -	\$ -
Asset retirement obligations	4,658	127	306	215	4,010
Total Contractual Obligations	\$ 23,502	\$ 127	\$ 19,150	\$ 215	\$ 4,010

Midnight enters into many contractual obligations in the course of conducting its day to day business. Material contractual obligations consist of our long-term debt with a major bank and our asset retirement obligations. The payment terms on the asset retirement obligations are based on an estimated timing of expenditures to be made in future periods, actual expenditures and when they may occur may differ materially than presented above. Midnight has not entered into any firm transportation commitments to date.

Midnight enters into commitments for capital expenditures in advance of the expenditures being made. The Company also enters into farm-in agreements where it commits to capital expenditures in order to earn and retain certain lands. These are considered routine in nature and form part of normal course of operations for active oil and gas companies and therefore are not included in the table above. We have disclosed in Note 10 to the Consolidated Financial Statements our future obligation on the Bilbo farm-in as we do not earn the lands until all of the wells have been drilled and completed. At December 31, 2008 we had spent \$3.3 million on this commitment and estimate \$14 million to \$16 million will be incurred in 2009 to retain the rights to the lands.

Relationship with Daylight Energy Ltd. ("Daylight")

Midnight and Daylight are considered related, as Daylight's Chairman is a director and officer of Midnight. In addition, a director and officer of Daylight is also a director of Midnight. Although this relationship exists, Midnight operates independently from Daylight. Operating, financing and investing decisions are conducted independently without the advice or influence of the other party and each company's strategic direction is set by their respective Board's, both of which have a majority of independent directors. Midnight and Daylight remain 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 Midnight's business activities and operations. See Note 11 to the Consolidated Financial Statements.

On October 31, 2008, Midnight sold its West Central assets to Daylight for their fair market value and agreed to farm-out a portion of its winter program on standard industry terms. See "West Central Property Disposition" discussed previously in the Liquidity and Capital Resources section and in Note 8 to the Consolidated Financial Statements.

Outlook

Midnight's 2008 capital program focused on assembling a large land base in the Deep Basin of the Peace River Arch, testing the application of new drilling and completion techniques to improve the productive capability of tighter rock and established this area as the key to grow production and reserves for the Company. We have a solid foundation and cash flow from our light oil production from the Red Earth area. Midnight expects continued volatility in commodity prices throughout 2009 from both oil and gas. The disposition of the West Central assets helped to fund our winter drilling program but also decreased our production by 550 boe/d. As a result, we exited the 2008 year at 1,500 boe/d as forecast in our Q3 2008 report. Early results from our Deep Basin program are extremely encouraging and substantiate the tremendous upside of this multi-zone high potential sweet gas resource play, and although we are currently capable, our forecasted exit rate of over 10,000 mcf/d for the first quarter of 2009 has been delayed to the beginning of Q2 2009 to take advantage of the lower royalty rates effective April 1, 2009. Our exploration and development capital program, set at between \$30 million and \$35 million for 2009, will be flexible to respond to changes in gas prices and capital market conditions. In the near term, we expect to invest capital of \$20 million to \$24 million in Q1 2009.

Financial Instruments

Financial instruments comprise cash and cash equivalents, accounts receivable, investments, 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 investments held for trading have a fair value based on quoted market price of \$21,010,000 at December 31, 2008. The Company's long-term debt bears interest at a floating market rate and accordingly the fair market value approximates the carrying value.

Disclosure Controls and Procedures

Disclosure controls and procedures have been designed to ensure that information required to be disclosed by Midnight is accumulated and communicated to the Company's management as appropriate to allow timely decisions regarding required disclosure. Midnight's Chief Executive Officer and Chief Financial Officer have concluded, based on their evaluation as of the end of the period covered by the annual filings, that the Company's disclosure controls and procedures are effective to provide reasonable assurance that material information related to Midnight, including its consolidated subsidiaries, is made known to them by others within those entities.

Internal Control over Financial Reporting ("ICFR")

Midnight's Chief Executive Officer and Chief Financial Officer have designed or caused to be designed under their supervision, internal controls over financial reporting related to the Company to provide reasonable assurance regarding the reliability of Midnight's financial reporting and the preparation of financial statements for external purposes in accordance with Canadian GAAP. The control framework the officers used to design Midnight's ICFR is the Internal Control- Integrated Framework (COSO Framework) published by the Committee of Sponsoring Organizations of the Treadway Commission. As at December 31, 2008 Midnight's Chief Executive Officer and Chief Financial Officer have evaluated or caused to be evaluated under their supervision, the effectiveness of the Company's internal controls over financial reporting and have concluded that these controls are operating effectively.

There were no changes in the Company's internal controls or new weaknesses noted in controls during the year ended December 31, 2008 that have materially affected, or are reasonably likely to affect, the Company's internal controls over financial reporting.

It should be noted that while Midnight's Chief Executive Officer and Chief Financial Officer believe that the Company's disclosure and internal control procedures provide a reasonable level of assurance that they are effective, they do not

expect that the disclosure and internal control procedures will prevent all errors and fraud. A control system, no matter how well conceived or operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met.

Application of Critical Accounting Estimates

The significant accounting policies used by Midnight are disclosed in note 1 to the audited Consolidated Financial Statements for the years ended December 31, 2008 and 2007. Certain accounting policies require that management make appropriate decisions with respect to the formulation of estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. Management reviews its estimates on a regular basis. The emergence of new information and changed circumstance may result in actual results or changes to estimated amounts that differ materially from current estimates. The following discussion identifies the critical accounting policies and practices of the Company and helps assess the likelihood of materially different results being reported.

Reserves

Under the National Instrument 51-101 ("NI 51-101") "Proved" reserves are defined as those reserves that can be estimated with a high degree of certainty to be recoverable. The level of certainty should result in at least a 90 percent probability that the quantities actually recovered will equal or exceed the estimated Proved reserves. It does not mean that there is a 90% probability that the Proved reserves will be recovered; it means there must be at least a 90% probability that the given amount or more will be recovered.

"Proved plus Probable" reserves are the most likely case and are based on a 50 percent certainty that they will equal or exceed the reserves estimated.

These oil and gas reserve estimates are made using all available geological and reservoir data, as well as historical production data. All of the Company's reserves were evaluated and reported on by an independent qualified reserves evaluator. However, revisions can occur as a result of various factors including: actual reservoir performance, changes in price and cost forecasts or a change in the Company's plans. Reserve changes will impact the financial results as reserves are used in the calculation of depletion and are used to assess whether asset impairment occurs. Reserve changes also affect other non-GAAP measurements such as finding and development costs, recycle ratios and net asset value calculations.

Depletion and Depreciation

The Company follows the full cost method of accounting for oil and natural gas properties. Under this method, all costs related to the acquisition of, exploration for and development of oil and natural gas reserves are capitalized whether successful or not. Depletion of the capitalized oil and natural gas properties and depreciation of production equipment which includes estimated future development costs less estimated salvage values are calculated using the unit-of-production method, based on production volumes in relation to estimated proven reserves.

An increase in estimated proved reserves would result in a reduction in depletion expense. A decrease in estimated future development costs would also result in a reduction in depletion expense.

Unproved Properties

The cost of acquisition and evaluation of unproved properties are initially excluded from the depletion calculation. An impairment test is performed on these assets to determine whether the carrying value exceeds the fair value. Any excess in carrying value over fair value is an impairment. When proved reserves are assigned or a property is considered to be impaired, the cost of the property or the amount of the impairment will be added to the capitalized costs for the calculation of depletion.

Ceiling Test

The ceiling test is a cost recovery test intended to identify and measure potential impairment of assets. An impairment loss is recorded if the sum of the undiscounted cash flows expected from the production of the proved reserves and the lower of cost and market of unproved properties does not exceed the carrying values of the petroleum and natural gas assets. An impairment loss is recognized to the extent that the carrying value exceeds the sum of the discounted cash flows expected from the production of proved and probable reserves and the lower of cost and market of unproved properties. The cash flows are estimated using the future product prices and costs and are discounted using the risk free rate. By their nature, these estimates are subject to measurement uncertainty and the impact on the financial statements could be material. Any impairment as a result of this ceiling test will be charged to operations as additional depletion and depreciation expense.

Asset Retirement Obligations

The Company records a liability for the fair value of legal obligations associated with the retirement of petroleum and natural gas assets. The liability is equal to the discounted fair value of the obligation in the period in which the asset is recorded with an equal offset to the carrying amount of the asset. The liability then accretes to its fair value with the passage of time and the accretion is recognized as an expense in the financial statements. The total amount of the asset retirement obligation is an estimate 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 amount of the estimated cash flows required to settle the asset retirement obligation, the timing of those cash flows and the discount rate used to calculate the present value of those cash flows are all estimates subject to measurement uncertainty. Any change in these estimates would impact the asset retirement liability and the accretion expense.

Income Taxes

The determination of income and other tax liabilities requires interpretation of complex laws and regulations. All tax filings are subject to audit and potential reassessment after the lapse of considerable time. In addition, the Company estimates when its temporary differences are expected to reverse and recognizes its tax assets and liabilities based on the legislated tax rate in those periods. Accordingly, the actual income tax liability may differ significantly from that estimated and recorded by management.

Stock-Based Compensation

The Company applies the fair value method for valuing stock option grants and warrants. This method requires the Company to make estimates of expected stock volatility, the expected hold period prior to exercising options, expected forfeitures of options and expected dividends to be declared by the Company. The calculation of the fair value of stock based compensation is not adjusted for the value actual received by the optionees and warrant holders. The stock-based compensation expense will not represent the actual fair value received by the optionees warrant holders as the fair value is estimated at the time of grant and is not adjusted. Due to the time period and the number of estimates involved, it is likely that the actual value of the options and warrants will differ materially from what has been recorded in the financial statements.

Other Estimates

The accrual method of accounting requires management to incorporate certain estimates including estimates of revenues, royalties and operating costs as at a specific reporting date, but for which actual revenues and costs have not yet been received. In addition, estimates are made on capital projects which are in progress or recently completed where actual costs have not been received by the reporting date. The Company obtains the estimates from the individuals with the most knowledge of the activity and from all project documentation received. The estimates are reviewed for reasonableness and compared to past performance to assess the reliability of the estimates. Past estimates are compared to actual results in order to make informed decisions on future estimates.

Financial Reporting Update

Accounting standards adopted

Effective January 1, 2008, the Company adopted three new accounting standards: Section 1535, Capital Disclosures, Section 3862, Financial Instruments – Disclosures and Section 3863, Financial Instruments – Presentation. Section 1535, requires disclosure of objectives, policies and processes for managing capital, including: quantitative data about the components of capital, whether the Company has complied with all capital requirements and the consequences of non-compliance if the Company has not complied. Sections 3862 and 3863 specify standards of presentation and enhanced disclosures on financial instruments. The adoption of these policies did not impact the measurement of the amounts reported in the Company's financial statements as they primarily relate to disclosures.

Recent pronouncements

In February 2008, the CICA Accounting Standards Board (“AcSB”) confirmed the changeover to IFRS from Canadian GAAP will be required for publicly accountable enterprises for interim and annual financial statements effective for fiscal years beginning on or after January 1, 2011, including comparatives for 2010.

The International Accounting Standards Board (“IASB”) has also issued an exposure draft relating to certain amendments and exemptions to IFRS 1. It is anticipated that this exposure draft will not result in an amended IFRS 1 standard until late 2009. The amendment, if implemented, will permit the Company to apply IFRS prospectively by utilizing its current reserves at the transition date to allocate the Company's full cost pool, with the provision that a ceiling test, under IFRS standards, be conducted at the transition date. The eventual changeover to IFRS represents a change due to new accounting standards. The transition from current Canadian GAAP to IFRS is a significant undertaking that may materially affect the Company's reported financial position and results of operations.

In response, the Company has completed a high-level IFRS transition plan and has established a preliminary timeline for its execution and completion. The Company has performed a preliminary review of the accounting policies of the Company under Canadian GAAP and compared them to IFRS. In 2009, the Company will perform the next phase of the project conducting an in-depth review of the significant areas of difference identified during the preliminary assessment in order to identify all specific Canadian GAAP and IFRS differences and select ongoing IFRS policies. Key areas addressed will also be reviewed to determine any information technology issues, the impact on internal controls over financial reporting and the impact on other business activities including compensation arrangements. Staff training programs have commenced in 2008 and will be ongoing as the project unfolds.

The Company will also continue to monitor standards development as issued by the IASB and the AcSB as well as regulatory developments as issued by the Canadian Securities Administrators, which may affect the timing, nature or disclosure of its adoption of IFRS.

In December 2008, the CICA issued Section 1582, Business Combinations. This section is effective January 1, 2011 and applies prospectively to business combinations for which the acquisition date is on or after the first annual reporting period beginning on or after January 1, 2011 for the Company. Early adoption is permitted. This section replaces Section 1581, Business Combination and harmonizes the Canadian standards with IFRS.

Risk Factors

There are a number of risk factors facing Companies that participate in the Canadian oil and gas industry. A summary of certain risk factors relating to our business are disclosed below, a more exhaustive list is provided in the Risk Factors Section of our Annual Information Form filed on SEDAR at www.sedar.com.

Exploration, Development and Production Risks

Oil and natural gas exploration involves a high degree of risk, for which even a combination of experience, knowledge and careful evaluation may not be able to overcome. There is no assurance that expenditures made on future exploration by Midnight will result in new discoveries of oil or natural gas in commercial quantities. It is difficult to project the costs of implementing an exploratory drilling program due to the inherent uncertainties of drilling in unknown formations, the costs

associated with encountering various drilling conditions such as over-pressured zones, tools lost in the hole and changes in drilling plans and locations as a result of prior exploratory wells or additional seismic data and interpretations thereof.

The long-term commercial success of Midnight will depend on its ability to find, acquire, develop and commercially produce oil and natural gas reserves. No assurance can be given that Midnight will be able to locate satisfactory properties for acquisition or participation. Moreover, if such acquisitions or participations are identified, Midnight may determine that current markets, terms of acquisition and participation or pricing conditions make such acquisitions or participations uneconomic.

Future oil and gas exploration may involve unprofitable efforts, not only from dry wells, but from wells that are productive but do not produce sufficient net revenues to return a profit after drilling, operating and other costs. Completion of a well does not assure a profit on the investment or recovery of drilling, completion and operating costs. In addition, drilling hazards or environmental damage could greatly increase the cost of operations, and various field operating conditions may adversely affect the production from successful wells. These conditions include delays in obtaining governmental approvals or consents, shut-ins of connected wells resulting from extreme weather conditions, insufficient storage or transportation capacity or other geological and mechanical conditions. While diligent well supervision and effective maintenance operations can contribute to maximizing production rates over time, production delays and declines from normal field operating conditions cannot be eliminated and can be expected to adversely affect revenue and cash flow levels to varying degrees.

In addition, oil and gas operations are subject to the risks of exploration, development and production of oil and natural gas properties, including encountering unexpected formations or pressures, premature declines of reservoirs, blow-outs, sour gas releases, fires and spills. Losses resulting from the occurrence of any of these risks could have a materially adverse effect on future results of operations, liquidity and financial condition.

Midnight attempts to minimize exploration, development and production risks by utilizing a high-end technical team with extensive experience and multidisciplinary skill sets to assure the highest probability of success in its drilling efforts. Our collaboration of a team of seasoned veterans in the oil and gas business, each with a unique expertise in the various upstream to downstream technical disciplines of prospect generation to operations, provides the best assurance of competency, risk management and drilling success. A full cycle economic model is utilized to evaluate all hydrocarbon prospects. Detailed geological and geophysical techniques are regularly employed including 3D seismic, petrography, sedimentology, petrophysical log analysis and regional geological evaluation. Midnight utilizes not only the publicly available sources of subsurface data and information, but also employs its own proprietary data set of rock core and drill cuttings descriptions to enhance the quality and probability of success of its internally generated plays and prospects. Where possible prospects have multi-zone potential and activity is focused in regions where Midnight's expertise and experience can provide a competitive advantage.

Global Financial Crisis

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

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

Prices, Markets and Marketing of Crude Oil and Natural Gas

Oil and natural gas are commodities whose prices are determined based on world demand, supply and other factors, all of which are beyond the control of Midnight. World prices for oil and natural gas have fluctuated widely in recent years. Any material decline in prices could result in a reduction of net production revenue. Certain wells or other projects may become uneconomic as a result of a decline in world oil prices and natural gas prices, leading to a reduction in the volume of Midnight's oil and gas reserves. Midnight might also elect not to produce from certain wells at lower prices. All of these factors could result in a material decrease in Midnight's future net production revenue, causing a reduction in its oil and gas acquisition and development activities. In addition, bank borrowings available to Midnight are expected to be determined in part by the borrowing base of Midnight. A sustained material decline in prices from historical average prices could limit Midnight's borrowing base, therefore reducing the bank credit available to Midnight, and could require that a portion of any existing bank debt of Midnight be repaid.

In addition to establishing markets for its oil and natural gas, Midnight must also successfully market its oil and natural gas to prospective buyers. The marketability and price of oil and natural gas which may be acquired or discovered by Midnight will be affected by numerous factors beyond its control. Midnight will be affected by the differential between the price paid by refiners for light quality oil and the grades of oil produced by Midnight. The ability of Midnight to market its natural gas may depend upon its ability to acquire space on pipelines which deliver natural gas to commercial markets. Midnight will also likely be affected by deliverability uncertainties related to the proximity of its reserves to pipelines and processing facilities and related to operational problems with such pipelines and facilities and extensive government regulation relating to price, taxes, royalties, land tenure, allowable production, the export of oil and natural gas and many other aspects of the oil and natural gas business.

Midnight has balanced its portfolio between oil and natural gas to help minimize the financial impact of the volatility of the two commodities. The Company's portfolio consists of light quality crude and the majority of its gas is sweet liquids rich natural gas which produces higher netback production helping to mitigate commodity price exposure. Midnight continually monitors the movement of commodity prices, interest rates and adjusts its capital expenditure program accordingly.

Substantial Capital Requirements; Liquidity

Midnight's cash flow from its production and sales of petroleum and natural gas may not, at all times be sufficient to fund its ongoing activities. From time to time, Midnight may require additional financing in order to carry out its oil and gas acquisition, exploration and development activities. Failure to obtain such financing on a timely basis could cause Midnight to forfeit its interest in certain properties, miss certain acquisition opportunities and reduce or terminate its operations. If Midnight's revenues from its production of petroleum and natural gas decrease as a result of lower oil and natural gas prices or otherwise, it may affect Midnight's ability to expend the necessary capital to replace its reserves or to maintain its production. If Midnight's funds from operations are not sufficient to satisfy its capital expenditure requirements, there can be no assurance that additional debt or equity financing will be available to meet these requirements or available on terms acceptable to Midnight.

Midnight's lenders will be provided with security over substantially all of the assets of Midnight. If Midnight becomes unable to pay its debt service charges or otherwise commits an event of default, such as bankruptcy, these lenders may foreclose on or sell Midnight's properties. The proceeds of any such sale would be applied to satisfy amounts owed to Midnight's lenders and other creditors and only the remainder, if any, would be available to Midnight.

Midnight monitors and updates its cash projection models on a regular basis which assists in the timing decision of capital expenditures. Farm-outs of projects may be arranged if capital constraints are an issue or if the risk profile dictates that we wish to hold a lesser working interest position. Equity, if available and if on reasonable terms, may be utilized to help fund our capital program.

Access to Capital

Access to capital has become limited during these times of economic uncertainty. To the extent the external sources of capital become limited or unavailable; Midnight's ability to make the necessary capital investments to maintain or expand oil and gas reserves may be impaired.

Credit Exposure

Recent economic conditions have increased the risk that certain counterparties for our oil and gas sales and our joint venture partners may fail to pay. We mitigate these increased risks through diversification and a review process of the credit worthiness of our counterparties.

Midnight's policy to mitigate credit risk associated with product sales is to maintain marketing relationships with large, established and reputable purchasers that are considered creditworthy. Midnight has not experienced any collection issues with its petroleum and natural gas marketers. Joint venture receivables are typically collected within two to three months of the joint venture bill being issued to the partner. Midnight attempts to mitigate the risk from joint venture receivables by obtaining partner approval of significant capital and operating expenditures prior to expenditure and in certain circumstances may require cash deposits in advance of incurring financial obligations on behalf of joint venture partners. Joint venture receivables are from partners in the petroleum and natural gas industry who are subject to the risks and conditions of the industry. Significant changes in industry conditions and risks that negatively impact partners' ability to generate cash flow will increase the risk of not collecting receivables. Midnight does not typically obtain collateral from petroleum and natural gas marketers or joint venture partners; however the Company does have the ability to withhold production from joint venture partners in the event of non-payment or may be able to register security on the assets of joint venture partners.

Health, Safety and Environment

All phases of the oil and natural gas business present environmental risks and hazards and are subject to environmental regulation pursuant to a variety of federal, provincial and local laws and regulations. Environmental legislation provides for, among other things, restrictions and prohibitions on spills, releases or emissions of various substances produced in association with oil and natural gas operations. The legislation also requires that wells and facility sites be operated, maintained, abandoned and reclaimed to the satisfaction of applicable regulatory authorities. Compliance with such legislation can require significant expenditures and a breach of applicable environmental legislation may result in the imposition of fines and penalties, some of which may be material. Environmental legislation is evolving in a manner expected to result in stricter standards and enforcement, larger fines and liability and potentially increased capital expenditures and operating costs. The discharge of oil, natural gas or other pollutants into the air, soil or water may give rise to liabilities to governments and third parties and may require the Corporation to incur costs to remedy such discharge.

There are potential risks to the environment inherent in the business activities of the Company. Midnight has developed and implemented policies and procedures to mitigate health, safety and environment (HS&E) risks. These policies and procedures include the corporate HS&E policy, the emergency response plans, the HS&E manual, the pipeline operating and maintenance manual and a process for auditing both safety and environmental compliance. Midnight mitigates HS&E risks by maintaining its facilities and complying with all regulations. Regular field inspections are also carried out to ensure that all field personnel and third party contractors comply with all company and regulatory guidelines. An action plan has been developed to ensure inactive wells are suspended properly and abandoned in a timely fashion. The above noted policies

and procedures are designed to protect and maintain the environment and to ensure that the employees, contractors, subcontractors and the public at large are kept safe at all times.

Insurance

Midnight's involvement in the exploration for and development of oil and gas properties may result in Midnight becoming subject to liability for pollution, blow-outs, property damage, personal injury or other hazards. Although Midnight has insurance in accordance with industry standards to address such risks, such insurance has limitations on liability that may not be sufficient to cover the full extent of such liabilities. In addition, such risks may not, in all circumstances be insurable or, in certain circumstances, Midnight may elect not to obtain insurance to deal with specific risks due to the high premiums associated with such insurance or other reasons. The payment of such uninsured liabilities would reduce the funds available to Midnight. The occurrence of a significant event that Midnight is not fully insured against, or the insolvency of the insurer of such event, could have a material adverse effect on Midnight's financial position, results of operations or prospects.

Competition

Midnight actively competes for reserve acquisitions, exploration leases, licenses and concessions and skilled industry personnel with a substantial number of other oil and gas companies, many of which have significantly greater financial and personnel resources than Midnight. Midnight's competitors include major integrated oil and natural gas companies and numerous other independent oil and natural gas companies and individual producers and operators.

Certain of Midnight's customers and potential customers are themselves exploring for oil and natural gas, and the results of such exploration efforts could affect Midnight's ability to sell or supply oil or gas to these customers in the future. Midnight's ability to successfully bid on and acquire additional property rights, to discover reserves, to participate in drilling opportunities and to identify and enter into commercial arrangements with customers will be dependent upon developing and maintaining close working relationships with its future industry partners and joint operators and its ability to select and evaluate suitable properties and to consummate transactions in a highly competitive environment.

Additional Information

Additional information relating to Midnight is filed on SEDAR and can be viewed at www.sedar.com. Information can also be obtained by contacting the Company at Midnight Oil Exploration Ltd., 2500, 144 4th Ave S.W., Calgary, Alberta T2P 3N4 or by email to ir@midnightoil.ca or by accessing the website at www.midnightoil.ca