



**Q1**

For the three months ended March 31, 2005

QUARTERLY REPORT

## PRESIDENT'S MESSAGE

***"The highlight of the first quarter was the continued success of our natural gas drilling program. Following up on our great start in 2004, Midnight's exploration program continues to deliver excellent results."*** stated Fred Woods, President of Midnight. ***"In addition, we are growing our production base and with strong commodity prices delivering solid financial results."***

## OPERATIONS

Midnight Oil Exploration Ltd. ("Midnight") enjoyed a successful first quarter of 2005, continuing where we left off in 2004, drilling 11 (2.5 net) natural gas wells with 100% success in the quarter. Since inception in December 2004, we have drilled 16 (3.9 net) wells with 100% success.

Midnight continues to pursue an aggressive deep gas drilling program with over two-thirds of our (net) wells drilled being exploratory tests having an average well depth over 2,700 metres (8,900 feet). Through this successful drilling program, we have increased our production over 50% from 700 boe per day in December 2004 to over 1,100 boe per day in May 2005.

Midnight has a large multi-year prospect inventory focusing on the large reserve potential in its two core areas on the Peace River Arch and West Central area of Alberta. These areas provide a risk balanced opportunity base for our future growth. Our Peace River Arch prospects are more of the traditional high potential Midnight prospects while our West Central program is a large scale development exploitation with our joint venture partner Daylight Energy.

### Peace River Arch

Midnight's Peace River drilling program is divided into three main regions; our Deep Basin Program, our Halfway Triassic program, and our Light Oil program. During the first quarter of 2005, Midnight was successful on 5 gross (1.8 net) wells out of 5 gross (1.8 net) wells drilled and participated in a number of new pool discoveries.

Our Deep Basin Program results were the highlight of our first quarter. This program targets the multi-zone targets in the Cretaceous and is supported by the deeper "resource play" potential of the Cadomin that extends from the Wapiti area up to Cutbank Ridge B.C.

The heart of Midnight's Deep Basin Program is centered at Wapiti and targets the multi-zone, high productivity potential of the Cretaceous. At Red Rock (50% W.I.) and Wapiti (50% W.I.) Midnight drilled new pool discoveries and with the lands acquired during the quarter, Midnight continues to grow its prospect inventory adding production and opportunities on these plays.



At Cutbank Ridge, Midnight (50% W.I.) made a multi-zone new pool gas discovery. This new pool discovery supported our extension of the Cadomin prospect fairway into a high potential multi-zone area. Potential for the deeper Cadomin play is in the range of a 1 to 2 bcf supplemented by shallower zones with similar reserve targets. We were unable to complete this well before break-up, but depending on weather and access restrictions we plan to return to this area this summer to complete the well and drill two additional wells. Pipeline access is within one mile of our well and we anticipate completion and tie-ins during the summer. Based on the results of this first well Midnight acquired additional lands and now holds over 13,300 gross (9,500 net) acres.

Our deeper Halfway Triassic exploration program is centered at Beaverlodge where Midnight also targets multi-zone potential of the shallower Cretaceous. During the first quarter Midnight successfully completed and commenced tie-in on a new pool discovery (Midnight 35%) in the Triassic. This well was a follow-up on our earlier successful program by the Midnight team drilled during 2003 and 2004 in this area. Initial testing indicates the well is capable of production in excess of 2 mmcf per day. This well should be placed on-stream during the second quarter. These results have added an exciting new exploration target in this area that Midnight plans to pursue during the balance of the year.

Also in the Peace River Arch area, at Elsworth, we have a new light oil discovery. Our first well (38% W.I.) has been placed on-stream in the second quarter at rates over 50 bbls per day. This is a new prospect we have developed jointly with Daylight Energy that has follow-up potential. We have a two stage multi-well development program planned. This summer we will drill up to four wells and based on the results could drill an additional 8 wells in the fall/winter.

During the first quarter Midnight, continued to deliver excellent drilling results with 5 gross (1.8 net) wells, resulting in 5 gross ( 1.8 net) gas wells and a 100% success rate. Due to spring break-up and shortages of certain equipment, some wells are awaiting tie-in during the second quarter.

#### West Central Alberta

In its West Central area, Midnight's operations are primarily focused on the large joint venture with Daylight Energy. In this area, Midnight holds 205,000 gross acres (75,000 net acres) and has a large multi-year development and exploitation program to augment its exploration program on the Peace River Arch.

At Pine Creek we continued our multi-well development exploitation program of this high potential area. Primary targets of this program are Bluesky, Gething and Nordegg. These wells will produce at rates of 1 to 4 mmcf per day with ultimate recoverable reserves of 2 to 5 bcf gross on a per well basis. This is an excellent multi-well multi-zone project for Midnight as we have over 90 gross wells in inventory targeting new drilling and re-completion operations ranging from the Belly River to the Leduc. For 2005 we plan a 20 to 30 joint well program with Daylight Energy.

At Caroline, Midnight (50% W.I.) drilled a successful multi-zone new pool discovery. This well will be tied-in during the second quarter. We anticipate rates of over 1 mmcf per day and ultimate recoverable reserves of 2 to 3 bcf. We plan a further drilling operation this year on this opportunity.

In our West Central area we drilled 6 gross (0.7 net) wells, resulting in 100% success rate. Similarly with our activities on the Peace River Arch certain of our wells are awaiting tie-in due to surface access restrictions from spring break-up.

## **OUTLOOK**

The Midnight team has a demonstrated track record of successful exploration in the Peace River Arch/Deep Basin. Combined with the vast opportunity base in our West Central area we have an excellent risk balanced portfolio of opportunities that form a solid foundation for continued growth.

In the second quarter drilling and construction activity will be hindered by spring break-up in both our core areas. We will continue to work on tying-in our earlier natural gas discoveries on the Peace River Arch and West Central Alberta and increasing our production.

Our early success has expanded our large prospect base throughout our lands in both West Central Alberta and the Peace River Arch. We have \$21.5 million remaining in our capital budget of \$30 million. We have targeted these funds to drill an additional 15 to 20 net wells to increase production to over 2,300 boe per day by the end of 2005 and to average in the range of 1,650 to 1,750 boe per day for all of 2005.

Midnight's highly successful first quarter drilling program combined with our expanded land base of over 150,000 net undeveloped acres solidifies our future potential. We have a very positive outlook for our continued solid growth and our potential as a junior oil and gas exploration company. We are very optimistic about our opportunities and look forward to the next steps in the growth of Midnight.

*Signed: "Fred Woods"*

**Fred Woods**  
**President and Chief Executive Officer**

May 3, 2005

## MANAGEMENT'S DISCUSSION AND ANALYSIS

The following discussion and analysis as provided by the management of Midnight Oil Exploration Ltd. ("Midnight") as of May 3, 2005, should be read in conjunction with the unaudited interim financial statements and accompanying notes for the period ended March 31, 2005 and the audited financial statements and accompanying notes for the period ended December 31, 2004. As we commenced operations on November 29, 2004 we have no comparable figures for the three months ended March 31, 2005.

*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.*

*Non-GAAP Measurements - Within the Management Discussion and Analysis references are made to terms commonly used in the oil and gas industry. Cash flow and cash flow per share are not defined by GAAP in Canada and are referred to as non-GAAP measures. Cash flow represents funds from operations as detailed on the Statement of Cash Flows. Cash flow 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 costs calculated on a boe basis. Total boes are calculated by multiplying the daily production by the number of days in the period.*

*Forward Looking Statements - Certain information regarding Midnight Oil Exploration Ltd. set forth in this document, including management's assessment Midnight's future plans and operations, contains forward looking statements that involve substantial known and unknown risks and uncertainties. By their very nature, these forward looking statements are subject to numerous risks and uncertainties, certain of which are beyond Midnight's control. Actual results could differ materially from those currently anticipated due to any number of factors including such variables as new information regarding recoverable reserves, volatility of commodity prices, competition from other producers, environmental, legislative, regulatory and political changes along with other factors discussed in our annual information form. Accordingly, no assurance can be given that any events anticipated by the forward looking statements will transpire or occur, or if any of them do, what the impact to Midnight will be.*

### **Relationship with Daylight Energy Trust ("Daylight")**

In conjunction with the Plan of Arrangement, Midnight and Daylight entered into an Administrative and Technical Services Agreement which provides for the sharing of services required to manage Midnight's activities and govern the allocation of general and administration expenses between the entities. The Administrative and Technical Services Agreement has no set termination date and will continue until terminated by either party with three months prior written notice. Under this agreement, Daylight receives payment for certain technical and administration services provided to Midnight on a cost recovery basis as well as reimbursement for any costs incurred on Midnight's behalf. Pursuant to the Administrative and Technical Services Agreement, \$141,000 of fees were charged relating to general and administration activities and \$372,000 of fees were charged relating to capital expenditures for the three months ended March 31, 2005.

As a result of this technical services arrangement, the majority of the Company's accounts receivable and accounts payable as at March 31, 2005 are due from (to) Daylight.

## Highlights

The financial and operational highlights are provided for the periods indicated below:

<b>Financial</b> (000's, except for share amounts)	<b>For the three months ended March 31, 2005</b>	<b>For the period November 29, 2004 to December 31, 2004</b>
Petroleum and natural gas sales (net of transportation)	\$ 3,170	\$ 976
Royalties	702	211
Operating expenses	782	249
Net backs	\$ 1,686	\$ 516
Cash flow from operations	1,529	397
Per share – Basic	0.06	0.02
– Diluted	0.06	0.02
Net income	\$ 160	\$ 15
Per share – Basic	0.01	0.00
– Diluted	0.01	0.00
Additions to capital assets	\$ 8,565	\$ 2,680
Net debt (surplus)	4,134	(2,902)
Total assets	45,106	42,120
Shares outstanding		
Basic	26,327,829	26,327,829
Diluted	28,821,162	28,661,162
<b>Operations</b>		
Average daily production		
Natural gas (mcf/d)	3,924	3,549
NGLs & crude oil (bbls/d)	135	132
Combined (boe/d)	788	723
Average prices received		
Natural gas (\$/mcf)	\$ 6.92	\$ 7.00
NGLs & crude oil (\$/bbl)	58.71	50.75
Combined (\$/boe)	\$ 44.64	\$ 43.58
Royalties (\$/boe)	9.89	9.40
Operating expenses (\$/boe)	11.03	11.14
Netback received (\$/boe)	\$ 23.72	\$ 23.04

## Petroleum and Natural Gas Sales

For the three months ended March 31, 2005, petroleum and natural gas sales totaled \$3,170,000 and was comprised of natural gas sales of \$2,444,000, natural gas liquid sales of \$381,000, crude oil sales of \$332,000 and royalty income of \$13,000.

Production for the same period was 788 boe per day and was comprised of 3,924 mcf per day and 80 bbls per day of natural gas liquids and 55 bbls per day of oil, providing a production mix of 83% natural gas, 10% natural gas liquids and 7% light quality crude oil.

The base of Midnight's production is comprised of the assets acquired through the Plan of Arrangement. During the three month period, 687 boe per day of production was from these assets, focused in the West Central area of Alberta, with the remaining 101 boe per day coming from new production focused in the Peace River Arch.

The following tables outline our production sales, volumes, and average sales price for the three months ended March 31, 2005.

	<b>Petroleum and Natural Gas Sales (000's)</b>	<b>Production</b>
Natural Gas	\$ 2,444	3,924 mcf/d
Oil	332	55 bbl/d
Liquids	381	80 bbl/d
Royalty income	13	-
<b>Total</b>	<b>\$ 3,170</b>	<b>788 boe/d</b>

<b>Prices and Marketing</b>	<b>Three months ended March 31, 2005</b>	
<b>Benchmark Prices</b>		
AECO gas (\$/mcf)	\$	6.86
WTI oil (\$US/bbl)		49.85
Cdn/US average exchange rate		0.82
Edmonton Par (\$Cdn/bbl)		61.16
<b>Midnight's Average Selling Price, net of transportation</b>		
Natural gas (\$/mcf)	\$	6.92
NGLs & crude oil (\$/bbl)		58.71
<b>Total (\$/boe)</b>	<b>\$</b>	<b>44.64</b>

Midnight markets its natural gas on a daily spot market basis at various delivery points in Alberta and therefore the average AECO spot market price in Canadian dollars per mcf is an appropriate benchmark for our gas.

Midnight did not buy or sell any commodity or currency hedges during the period.

## Royalties

Royalties for the three months ended March 31, 2005 totaled \$702,000 representing 22.1% of revenues or \$9.89 per boe. The royalty rate represents a 2% increase over the period ended December 31, 2004 rate of 21.6% as we have brought on new production that is subject to a higher rate than the base production acquired in the Plan of Arrangement. We expect our overall royalty rate to increase slightly throughout 2005 as we bring on new production that is subject to higher royalty rates than our current production mix. During the period, gas royalties averaged 23%, associated liquids averaged 25% and oil averaged 16%.

## Operating Expenses

Operating costs for the period totaled \$782,000 or \$11.03 per boe. The operating costs for the three months ended March 31, 2005 are consistent with the period ended December 31, 2004 operating cost of \$11.14 per boe. As we bring on new production at lower operating costs, we expect our per boe cost to decrease to average \$9 to \$10 per boe for 2005.

## Other Income

Other income is comprised of interest income of \$18,000. For the majority of the period ended March 31, 2005, we had a positive cash balance, earning interest income. At March 31, 2005, we are in a debt position and expect to incur interest expense for the remainder of the year.

## General and Administration Expenses

During the period, net general and administration ("G&A") expenses totaled \$141,000 or \$1.99 per boe. Midnight's general and administration expenses have been allocated based on the Administrative and Technical Service Agreement with Daylight. The Technical Services Agreement enables Midnight to use the Daylight personnel to manage its operations. Through this agreement, Midnight is able to take advantage of Daylight's low overhead cost structure. Midnight is charged administration for its direct activities, and for its proportionate share of overhead based on production and capital spending. Capitalized G&A is derived directly from the capital portion of the Technical Service Agreement. Capitalized general and administration costs represent 4% of Midnight's capital program for the period.

The components of general and administration expense is as follows:

<b>General and Administration Expenses</b> (\$000's)	<b>Three months ended March 31, 2005</b>
Direct general and administration	\$ 35
Technical service fee from Daylight	529
Overhead recoveries from Daylight	(51)
Capitalized general and administration	(372)
Net general and administrative	\$ 141
\$/boe	\$ 1.99

We expect to maintain the annual net general and administrative budget in the \$2 to \$3 per boe range for 2005.

## Depletion, Depreciation and Accretion

For the three months ended March 31, 2005, depletion and depreciation of the petroleum and natural gas assets and the accretion of the asset retirement obligation was \$1,128,000. On a per boe basis, depletion, depreciation and accretion was \$15.90 per boe.

## Stock-Based Compensation

The Company applies the fair value method for valuing stock option grants and warrants. Under this method, compensation cost attributable to all share options granted and warrants issued are measured at fair value at the grant and issuance date and expensed over the vesting period with a corresponding increase to contributed surplus. For the three months ended March 31, 2005, Midnight recognized stock-based compensation expense of \$54,000. Midnight's unamortized portion of stock-based compensation totaled \$691,000 at March 31, 2005.

## Taxes

The future tax expense for the three months ended March 31, 2005 was \$218,000 resulting in an effective tax rate of 58%. The difference in the expected rate of 37.6% and the effective rate is from permanent differences relating to stock based compensation and the difference between non-deductible crown royalties and the resource allowance.

Midnight has no current income taxes payable and is under the corporate exemption level for Large Corporation's Tax. Midnight does not expect to become taxable on an income tax basis in 2005. The Company has approximately \$42.6 million in tax pools to shelter taxable income in future years.

## Cash Flow and Net Income

Cash flow from operations totaled \$1,560,000 before abandonment expenditures of \$31,000 for the three months ended March 31, 2005 period. Cash flow per basic and diluted share was \$0.06 for the period. Net income for the period totaled \$160,000. Net income per share on a basic and diluted basis was \$0.01.

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

(\$/boe)	Three months ended March 31, 2005	November 29, 2004 to December 31, 2004
Sales price	\$ 44.64	\$ 43.58
Royalties	9.89	9.40
Operating expenses	11.03	11.14
Operating netback	\$ 23.72	\$ 23.04
General and administration	1.99	5.63
Interest (income)	(0.25)	(0.53)
Cash flow netback	\$ 21.98	\$ 17.94
Depletion, depreciation and accretion	15.90	14.70
Stock-based compensation	0.75	0.68
Future tax	3.07	1.89
Net income	\$ 2.26	\$ 0.67

The following table outlines the factors leading to the change in cash flow and net income for the three months ended March 31, 2005 compared to the period from November 29, 2004 to December 31, 2004.

<b>Change in Cash Flow and Net Income (000's)</b>	<b>Cash flow</b>	<b>Net income</b>
Period ended December 31, 2004	\$ 397	\$ 15
Increase (decrease) in revenue:		
Additional production volumes	1,688	1,688
Change in prices, net of royalties	14	14
Change in other income	6	6
 (Increase) decrease in expenses:		
Operating	(533)	(533)
Transportation	(2)	(2)
General and administration	(15)	(15)
Stock-based compensation	-	(39)
Depletion, depreciation and accretion	-	(799)
Future tax	-	(175)
Abandonment expenditures	(26)	-
Quarter ended March 31, 2005	\$ 1,529	\$ 160

### Equity

During the quarter, Midnight granted 160,000 stock options to non-executive employees with an average exercise price of \$3.75 per share. The options vest equally over three years and expire five years from the date of grant. Midnight intends to limit option grants under its Stock Option Plan to 5% of the number of outstanding Midnight shares until December 1, 2005 and to 7.5% of the number of outstanding Midnight shares until December 1, 2006.

Midnight recognized, \$54,000 of stock based compensation expense during the quarter relating to warrants issued on the initial private placement and for the stock options granted during the quarter.

<b>Share Information</b> (000's)	<b>March 31, 2005</b>
Shares outstanding	
Basic	26,328
Diluted	28,821
 Weighted average shares outstanding	
Basic	26,328
Diluted	26,714

As at May 3, 2005 the Company had outstanding 26,327,829 common shares, 982,000 stock options and 2,183,333 warrants. Subsequent to the quarter end, Midnight granted 822,000 options to non-executive employees at the market price of \$3.30 per share. The options vest equally over three years and expire five years from the date of grant.

## Capital Expenditures

For the three months ended March 31, 2005, Midnight drilled 11 (2.5 net) natural gas wells with a 100% success rate. During the period, Midnight also increased its undeveloped land base by adding 8,500 net undeveloped acres of land. Midnight began focusing in the Peace River Arch with \$7.3 million of the total expenditures in the quarter focused in this area. During the three months ended March 31, 2005, Midnight incurred \$8,565,000 of expenditures as follows:

<b>Capital Expenditures</b> (\$000's)	<b>Three months ended March 31, 2005</b>	
Land	\$	1,327
Geological and geophysical		372
Drilling		4,365
Completions		1,780
Facilities pipelines and equipment		721
Petroleum and natural gas expenditures	\$	8,565

## Liquidity and Capital Resources

Midnight Oil Exploration Ltd. was listed as a senior producer on the Toronto Stock Exchange on December 2, 2004 trading under the symbol "MOX". The Company's market capitalization at March 31, 2005 was \$105.6 million.

<b>Trading History on the TSX</b>	<b>Three months ended March 31, 2005</b>		<b>December 2, 2004 to December 31, 2004</b>	
High	\$	4.98	\$	4.20
Low	\$	3.06	\$	3.20
Close	\$	4.01	\$	3.40
Volume (000's)		7,363		6,559

At March 31, 2005, Midnight had net debt of \$4.1 million. Midnight's has a credit facility available of \$8 million. The credit facility is available by way of Canadian and US dollar prime rate based loans, bankers' acceptances, Libor borrowings and letters of credit. The facility is available on a revolving basis until June 30, 2005. 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. The credit facility bears interest at the bank prime rate and is secured by a \$50 million first floating charge debenture and a general securities agreement.

Midnight anticipates that it will make substantial capital expenditures for the acquisition, exploration, development and production of petroleum and natural gas reserves in the future. To execute its 2005 capital of program of \$30 million, the Company will require additional debt or equity financing. Failure to obtain such financing on a timely basis could cause Midnight to delay its capital program and as a result potentially forfeit its interest in certain properties or miss certain acquisition opportunities. If Midnight's revenues from its production decrease as a result of lower oil and natural gas prices or otherwise, it will affect Midnight's ability to expend the necessary capital to

replace its reserves or to maintain its production. If Midnight's cash flow from operations is 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.

### **Contractual Obligations**

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

<b>Contractual Obligations</b> (\$000's)	<b>Total</b>	<b>Less than 1 Year</b>	<b>1-3 Years</b>	<b>4-5 Years</b>	<b>After 5 Years</b>
Technical service agreement	\$ 917	\$ 917	\$ -	\$ -	\$ -
Long-term debt	590	-	590	-	-
Asset retirement obligations	1,750	58	197	150	1,345
<b>Total Contractual Obligations</b>	<b>\$ 3,257</b>	<b>\$ 975</b>	<b>\$ 787</b>	<b>\$ 150</b>	<b>\$ 1,345</b>

Midnight enters into many contractual obligations in the course of conducting its day to day business. Material contract obligations consist only of our Administrative and Technical Service Agreement with Daylight and our long-term debt with a major bank. The payment terms on the asset retirement obligation is based on an estimated timing of expenditures to be made in future periods which may be subject to change. Midnight has not entered into any firm transportation commitments to date.

### **Application of Critical Accounting Estimates**

The significant accounting policies used by Midnight are disclosed in note 1 to the audited Financial Statements for the period ended December 31, 2004. 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.

### ***Proved 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***

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.

### ***Plan of Arrangement***

As disclosed in Note 2 to the Financial Statements, Midnight acquired assets from Vintage Petroleum Canada, Inc. and Midnight Oil & Gas Ltd. and accounted for these acquisitions using the purchase method based on fair values. The determination of fair value involves numerous estimates. The valuation of petroleum and natural gas assets is based on Midnight's estimate of proved plus probable reserves using estimated forecasted prices at the time of acquisition, plus an estimation of unproved properties. Management also estimates the fair value of other assets and liabilities acquired on the acquisition. This valuation could differ materially by altering the various assumptions which would have impacted the composition of the balance sheet.

### ***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. Accordingly, the actual income tax liability may differ significantly from that estimated and recorded by management.

### ***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.

### ***New Accounting Standards to be Adopted in 2005***

All policies adopted on commencement of our operations are compliant with all new applicable accounting standards.

## Market Guidance

Midnight continued on its exploration focus in the first quarter of 2005. The results of our first quarter program supported our 2005 plan as laid out in our annual report. Production for the year is expected to average between 1,650 and 1,750 boe per day to generate cash flow of \$13.3 to \$14.7 million. As we sign this report, current production has exceeded 1,100 boe per day with an additional 400 boe per day behind pipe. Forecasts are based on gas price of \$6.90 per mcf and WTI oil price of \$48 US/bbl with an exchange rate of \$0.82 for the balance of the year. Midnight expects to decrease operating costs near \$9 per boe while general and administrative expenses are expected to be in the \$2 to \$3 per boe range. Below is a table that shows Midnight's cash flow sensitivity to changes in commodity prices and production.

Sensitivities	GAS		OIL	
	600 mcf/d	\$0.25/mcf	100 bbl/d	\$1WTI/bbl
Effect on cash flow (000's)	\$ 775	\$ 525	\$ 1,100	\$ 90

Dated May 3, 2005

# MIDNIGHT OIL EXPLORATION LTD.

## Balance Sheets

(\$000's)

	March 31, 2005 (unaudited)	December 31, 2004 (audited)
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ -	\$ 5,031
Accounts receivable	1,792	1,132
	1,792	6,163
Future taxes	-	145
Petroleum and natural gas assets (note 1)	43,314	35,812
	\$ 45,106	\$ 42,120
<b>Liabilities and Shareholders' Equity</b>		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 5,336	\$ 3,261
Long-term debt (note 2)	590	-
Future taxes	73	-
Asset retirement obligations (note 3)	576	542
Shareholders' equity:		
Share capital (note 4)	38,240	38,240
Warrants (note 4)	47	47
Contributed surplus	69	15
Retained earnings	175	15
	38,531	38,317
	\$ 45,106	\$ 42,120

See accompanying notes to financial statements.

### On behalf of the Board:

Signed "Tom Medvedic"

**Director**

Signed "Paul Moynihan"

**Director**

# MIDNIGHT OIL EXPLORATION LTD.

## Statements of Income and Retained Earnings

(\$000's, except per share amounts)

	<b>Three months ended March 31, 2005</b>	
	<b>(unaudited)</b>	
<b>Revenues:</b>		
Petroleum and natural gas sales	\$	3,170
Royalties		(702)
Other income		18
		<u>2,486</u>
<b>Expenses:</b>		
Operating		782
Transportation		3
General and administration		141
Stock-based compensation		54
Depletion, depreciation and accretion		1,128
		<u>2,108</u>
Income before taxes		<u>378</u>
Taxes:		
Future		218
		<u>218</u>
Net income		<u>160</u>
Retained earnings, beginning of period		15
<b>Retained earnings, end of period</b>	<b>\$</b>	<b><u>175</u></b>
Income per share (note 4(c)):		
Basic	\$	0.01
Diluted	\$	<u>0.01</u>

See accompanying notes to financial statements.

# MIDNIGHT OIL EXPLORATION LTD.

## Statement of Cash Flows

(\$000's)

	<b>Three months ended March 31, 2005</b>	
	<b>(unaudited)</b>	
<b>Cash provided by (used in):</b>		
<b>Operations:</b>		
Net income	\$	160
Items not involving cash:		
Depletion, depreciation and accretion		1,128
Stock-based compensation		54
Future taxes		218
Abandonment expenditures		(31)
Funds from operations		1,529
Changes in non-cash working capital		337
		1,866
<b>Financing:</b>		
Increase in long-term debt		590
<b>Investments:</b>		
Petroleum and natural gas additions		(8,565)
Changes in non-cash working capital		1,078
		(7,487)
Changes in cash		(5,031)
Cash, beginning of period		5,031
<b>Cash, end of period</b>	<b>\$</b>	<b>-</b>
Cash taxes paid	\$	-
Cash interest received	\$	18

Cash is defined as cash and cash equivalents.

See accompanying notes to financial statements.

# MIDNIGHT OIL EXPLORATION LTD.

## Notes to Financial Statements

For the three months ended March 31, 2005  
(Tabular amounts are stated in thousands of dollars except share and per share amounts)  
(unaudited)

The interim financial statements for Midnight Oil Exploration Ltd. ("Midnight") 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 financial statements for the period from November 29, 2004 to December 31, 2004. The disclosures provided below are incremental to those included with the audited financial statements for the period from November 29, 2004 to December 31, 2004. The interim financial statements should be read in conjunction with the audited financial statements for the period from November 29, 2004 to December 31, 2004. As we commenced operations on November 29, 2004 we have no comparable figures for the three months ended March 31, 2005.

### 1. Petroleum and natural gas assets:

	March 31, 2005	December 31, 2004
Cost	\$ 44,757	\$ 36,138
Accumulated depletion and depreciation	(1,443)	(326)
Net book value	\$ 43,314	\$ 35,812

During the period, the Company capitalized \$372,000, of general and administration expenses related to exploration and development activities.

The cost of unproven properties at March 31, 2005 of \$15,717,000 has been excluded from the depletion and depreciation calculation. Future development costs of proven reserves of \$3,061,000 have been included in the depletion and depreciation calculation.

### 2. Long-term debt:

Midnight has a revolving term credit facility available up to \$8 million with a Canadian chartered bank. The facility is available on a revolving basis until June 30, 2005. On June 30, 2005, 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 prime rate and is secured by a \$50 million first floating charge debenture and a general securities agreement. At March 31, 2005, \$590,000 was drawn on this facility. The \$8 million borrowing base is subject to a semi-annual and annual review by the bank.

### 3. 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 \$1,750,000 which will be incurred between 2005 to 2054. The majority of the costs will be incurred between 2010 and 2020. An inflation factor of 2% has been applied to the estimated asset retirement cost. A credit-adjusted risk-free rate of 8% was used to calculate the fair value of the asset retirement obligations.

A reconciliation of the asset retirement obligations is provided below:

Balance, December 31, 2004	\$	542
Liabilities incurred		54
Liabilities settled		(31)
Accretion expense		11
Balance, March 31, 2005	\$	576

#### 4. 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, 2004 and March 31, 2005	26,327,829	\$ 38,240

(c) Per share amounts:

Per share amounts have been calculated on the weighted average number of shares outstanding. The weighted average shares outstanding for the three months ended March 31, 2005 were 26,327,829. Diluted per share amounts are calculated based on the diluted weighted average number of shares outstanding. The diluted weighted average shares outstanding for the three months ended March 31, 2005 were 26,713,952 due to the dilutive effect of warrants and stock options.

(d) Stock options:

On February 14, 2005, Midnight initially granted 160,000 options with a weighted average exercise price of \$3.75 per share. The options vest one third per year over three years on the anniversary of the date granted and expire at the end of five years. There were no options exercisable at March 31, 2005.

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:

	Three months ended March 31, 2005	
Weighted average fair value of options granted	\$	1.39
Risk free interest		4.25%
Estimated hold period prior to exercise		4 years
Expected volatility		40%
Dividend per share	\$	0.00

(e) Warrants:

At March 31, 2005, Midnight had 2,333,333 warrants outstanding with a weighted average exercise price of \$3.00 per share. There were no warrants exercisable at March 31, 2005.

**5. Relationship with Daylight**

In conjunction with the Plan of Arrangement, Midnight and Daylight Energy Trust (“Daylight”) entered into an Administrative and Technical Services Agreement which provides for the shared services required to manage Midnight’s activities and govern the allocation of general and administration expenses between the entities. Under this agreement, Daylight receives payment for certain technical and administration services provided to Midnight on a cost recovery basis. The Administrative and Technical Service Agreement has no set termination date and will continue until terminated by either party upon three months prior written notice to the other party. Pursuant to the Administrative and Technical Services Agreement, \$141,000 of fees were charged relating to general and administration activities and \$372,000 of fees were charged relating to capital expenditures for the three months ended March 31, 2005.

As a result of this technical service arrangement, the majority of the Company’s accounts receivable and accounts payable as at March 31, 2005 are due from (to) Daylight.

**Abbreviations**

/d	per day	mboe	thousand barrels of oil equivalent
bb1(s)	barrel(s)	mmbtu	millions of British thermal units
mbbls	thousand barrels	ARTC	Alberta Royalty Tax Credit
mcf	thousand cubic feet	WTI	West Texas Intermediate crude oil
mmcf	million cubic feet	NGLs	natural gas liquids
bcf	billion cubic feet	Cdn	Canadian
boe	barrels of oil equivalent	US	United States



## CORPORATE INFORMATION

### DIRECTORS

**Paul E. Moynihan**, Chairman of the Board <sup>1,2,3</sup>  
Managing Director and Partner  
Mustang Capital Partners Inc.  
Calgary, Alberta

**Jay D. Squiers** <sup>1,2,3</sup>  
Senior Vice President  
Prudential Capital Group  
Dallas, Texas  
United States

**Tom J. Medvedic** <sup>1,2,3</sup>  
Vice President, Finance and Chief Financial Officer  
Calfrac Well Services Ltd.  
Calgary, Alberta

**Frederick N. Woods**  
President and Chief Executive Officer  
Midnight Oil Exploration Ltd.  
Calgary, Alberta

**Anthony M. Lambert**  
Vice-President, Operations and Chief Operating Officer  
Midnight Oil Exploration Ltd.  
Calgary, Alberta

Members of the following Committees

1 Audit

2 Compensation

3 Reserves

### OFFICERS

**Frederick N. Woods**  
President and Chief Executive Officer

**Anthony M. Lambert**  
Vice-President, Operations and Chief Operating Officer

**Thomas F. Moslow**  
Vice-President, Exploration

**Judith A. Stripling**  
Vice-President, Finance and Chief Financial Officer

**Andrew D. Weldon**  
Vice-President, Land

**Chris von Vegesack**, Corporate Secretary  
Partner  
Burnet, Duckworth & Palmer LLP  
Calgary, Alberta

**Banker**  
Canadian Imperial Bank of Commerce  
Calgary, Alberta

**Legal Counsel**  
Burnet, Duckworth & Palmer LLP  
Calgary, Alberta

**Auditors**  
KPMG LLP  
Chartered Accountants  
Calgary, Alberta

**Evaluation Engineers**  
Gilbert Laustsen Jung Associates Ltd.  
Calgary, Alberta

**Registrar and Transfer Agent**  
Valiant Trust Company  
Calgary, Alberta

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