// It's a new world for junior oil and gas companies in Western Canada.

In recent years, supportive capital markets and commodity pricing made it possible to grow and create shareholder value through a conventional exploration model. In 2008, however, that changed dramatically. Our focus is now on repeatable, lower cost resource plays.

Not every company has the expertise to manage this strategic shift. **ProspEx does.**

When it comes to finding upside in a tough market,

X marks the spot.

strategy

// shift to resource plays to generate profitable, sustainable growth

Growing through a conventional exploration approach can be effective for smaller companies in a favorable market. However, in today's market, conventional exploration takes too long, costs too much and involves substantial geologic uncertainty.

assets

// add value to quality assets at reasonable cost

Consistent with this evolving strategy, ProspEx will transition our asset base from one suited to conventional exploration to one geared to repeatable plays.

people

// apply big-company technical experience on a smaller scale

Since our inception in 2004, ProspEx has been successful in attracting management and technical staff with decades of experience garnered at larger, technically driven companies. For 2009, these same skills are precisely what the market situation demands.

marks the spot for an evolving strategy for growth with capital preservation. In 2009, ProspEx will move to plays that allow for lower costs with greater predictability, repeatability and scalability.

marks the spot for a repositioned asset base suited to growth with a lower risk profile. Our Kakwa asset offers the opportunity for multi-well development using horizontal wells. Building on acquisitions made in 2008, our Ricinus property in West Central Alberta has considerable growth potential with a repeatable model. ProspEx's long-standing technical expertise will add value to these assets while minimizing capital needs.

marks the spot for a technically driven management team with the experience to execute the ProspEx strategy. With high-potential plays like Kakwa and Ricinus, technical expertise is the key to adding value. Our team has the skills and expertise to deliver results and succeed in a tough market.

// corporate profile

ProspEx Resources Ltd. ("ProspEx" or the "Company") is a Canadian junior oil and gas company focused on exploration, development and production of natural gas. The Company's activities are concentrated in the deep basin gas fairway along the western edge of the province of Alberta. Incorporated in 2004, ProspEx's historical strategy was one of conventional exploration, complemented by acquisitions of assets in the Company's core operating areas. More recently, ProspEx moved to a strategy centered on the development of repeatable resource plays, again complemented by acquisitions.

// annual general meeting

The annual general meeting of ProspEx Resources will be held on Tuesday, May 12, 2009 at 10:00 a.m. in the Lecture Theatre of The Metropolitan Centre, 333 – 4 Avenue SW, Calgary, Alberta.

// financial highlights

(UNAUDITED)

Year ended December 31	2008	2007
Financial *($000)*		
Oil and gas revenue	**76,705**	63,534
Net earnings (loss)	**7,560**	(1,091)
Cash flow [1]	**44,326**	35,997
Total assets	**202,984**	175,765
Total net debt [2]	**51,422**	37,719
Net earnings (loss) per share *($ PER SHARE)*		
Basic	**0.13**	(0.02)
Diluted	**0.13**	(0.02)
Cash flow per share *($ PER SHARE)* [1]		
Basic	**0.78**	0.67
Diluted	**0.76**	0.64
Weighted average common shares *(000)*		
Basic	**57,054**	54,095
Diluted	**58,101**	56,318

[1] Cash flow is defined as cash flow from operations before changes in operating non-cash working capital.

[2] Total net debt is defined as long-term debt less working capital (or plus working capital deficiency) excluding unrealized financial instrument gain (loss) and associated future tax assets (liabilities).

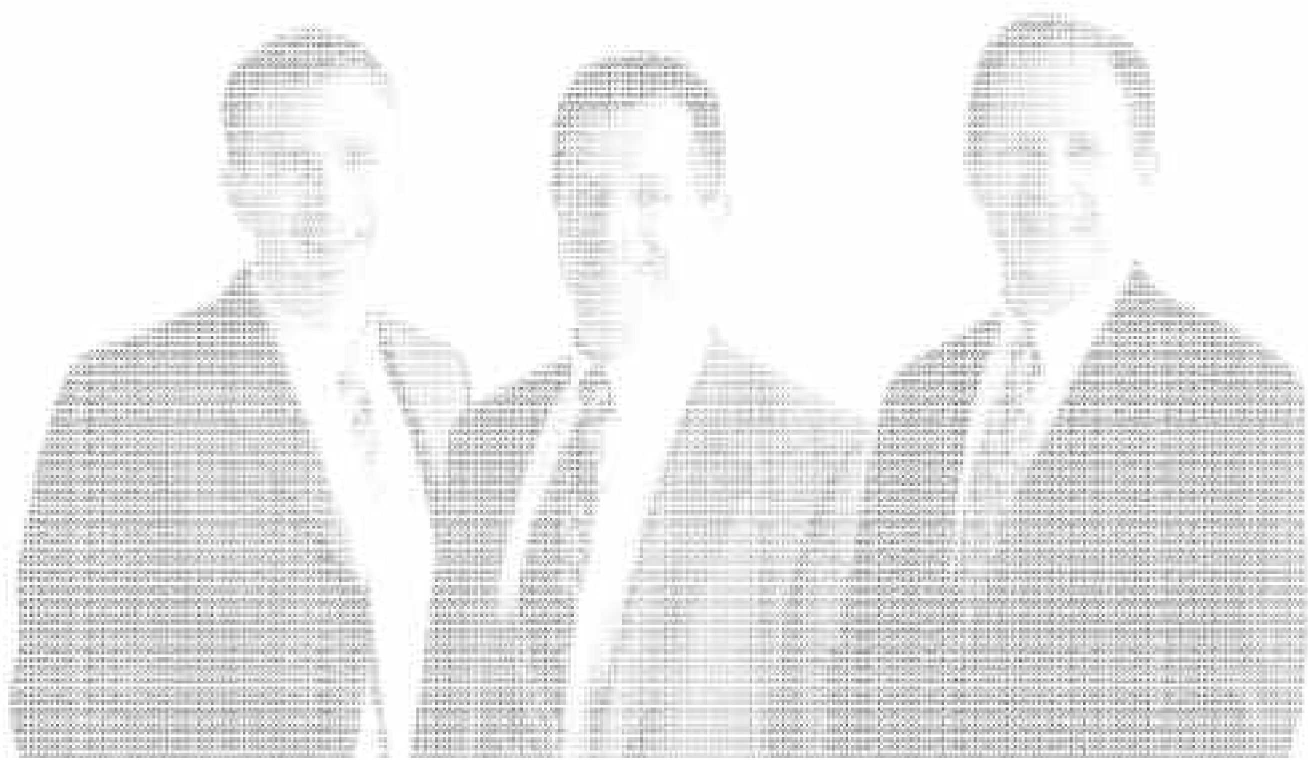
Cash flow and total net debt do not have a standardized measure prescribed by Canadian generally accepted accounting principles and therefore may not be comparable with measures for other companies.

// operating highlights

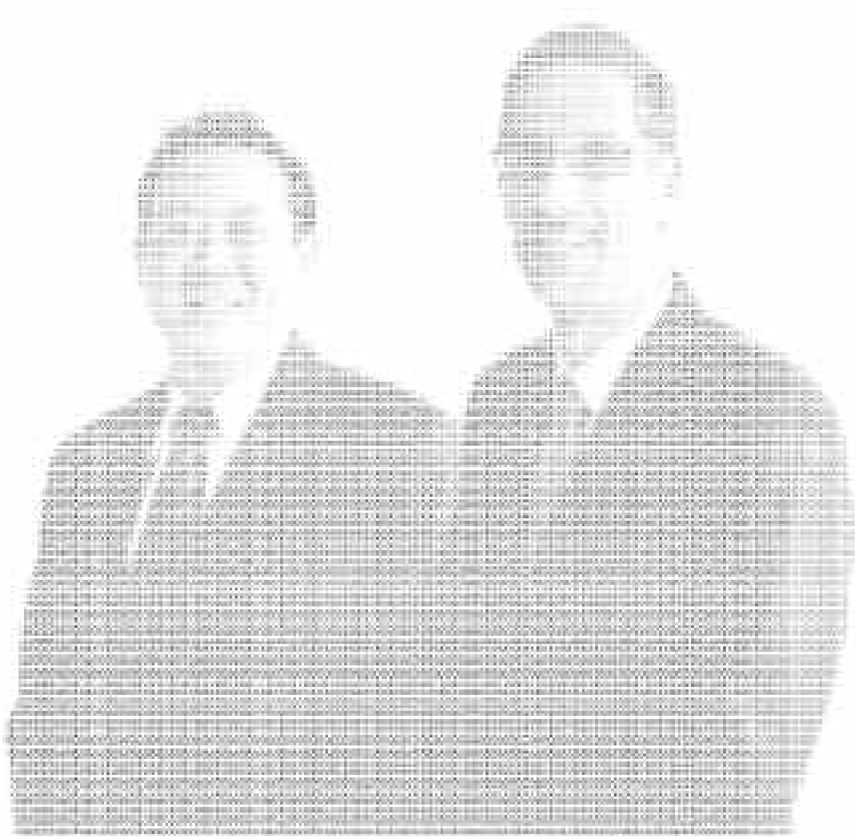
(UNAUDITED) Year ended December 31	**2008**	2007
Production Volumes		
Natural gas *(MCF/D)*	**18,562**	19,838
Natural gas liquids *(BBLS/D)*	**707**	468
Crude oil *(BBLS/D)*	**74**	125
Total *(BOE/D)*	**3,875**	3,899
Sale Prices		
Natural gas *($/MCF)*	**8.32**	7.12
Natural gas liquids *($/BBL)*	**66.58**	50.12
Crude oil *($/BBL)*	**109.59**	75.09
Total *($/BOE)*	**54.08**	44.65
Netbacks *($/BOE)*		
Price	**54.08**	44.65
Unrealized financial instrument gain (loss)	**0.43**	(2.01)
Royalties	**(10.51)**	(6.57)
Operating costs	**(7.78)**	(7.97)
Transportation	**(0.97)**	(0.95)
General and administrative	**(2.14)**	(2.16)
Total *($/BOE)*	**33.11**	24.99
Capital *($000S)*		
Drilling and completions	**27,612**	26,718
Facilities	**11,288**	12,381
Land and lease	**6,818**	4,383
Seismic	**3,168**	2,416
Capitalized general and administrative	**2,602**	2,652
Net property acquisition/disposition	**9,226**	–
Other capital assets	**168**	160
Total	**60,882**	48,710
Drilling Activity		
Gross wells	**23**	48
Net wells	**12.2**	26.3

BOE may be misleading, particularly if used in isolation. A BOE conversion value of six thousand cubic feet of gas to one barrel of oil is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead.

// president's message



It's a new world for junior oil and gas companies in Western Canada. With the combined impact of the crisis in financial markets and the fall of commodity prices in 2008, these are indeed challenging times. While some companies are content to ride it out and hope for better conditions, ProspEx is proactively changing our strategy to suit this new world. Rather than continuing to rely



// PROSPEX TEAM **From left to right:**
Jean-Paul H. Lachance – *Vice President, Engineering,*
Peter C. Parkinson – *Vice President, Land,*
R. Bruce McFarlane – *Vice President, Exploration,*
George D.K. Yee – *Vice President, Finance,*
Chief Financial Officer and Corporate Secretary,
John W. Rossall – *President and Chief Executive Officer*

on a conventional growth model for exploration and production, we will focus on repeatable opportunities that offer economies of scale. As we will discuss throughout this annual report, ProspEx has the assets, the strategy and the technically minded leadership team necessary to succeed and grow in this new environment.

This emphasis on repeatable projects is often referred to as a resource play approach. While the term resource play can apply to many different assets, we use it to describe any asset offering a repeatable prospect inventory and economies of scale.

A resource play strategy differs significantly from conventional exploration. In the conventional exploration strategy, we used our technical expertise to identify unique drilling opportunities where higher productivity wells could be drilled, and used the results of each well to fine-tune the location of subsequent wells. This allowed ProspEx to triple our production over our first three years as a company. As our production base grew, however, the cycle time inherent in the technical evaluation process made it difficult to maintain a pace of capital spending that would grow the Company without taking undue risks.

In the resource play model, the key is to focus on assets where a small number of initial exploration wells prove up a much larger inventory of firm locations that can be drilled with a multi-well program approach. This not only reduces the cost per well due to economies of scale, but accelerates the pace of development drilling and thus facilitates production growth, compared to the one-well-at-a-time conventional model. This development drilling may utilize vertical wells, or horizontal drilling with multi-stage fracturing technology. We believe that horizontal drilling and completion technology has come of age in the Western Canadian basin, and are moving to adopt more of this approach.

While this strategy is a new one for ProspEx, it builds on the foundations of our past success. We will still be operating largely in the gas-saturated, Cretaceous-age rocks of the deep basin fairway of western Alberta, an area in which our management and technical teams have worked for years or decades. We understand the geology of this area, and have every reason to believe that our skills and experience will continue to effectively support our chosen strategy. Our existing assets lie entirely within this deep basin fairway, considered by most to be the premier area for gas exploration and development in western Canada and the home of many large resource play developments.

Our current asset base supports this new approach in several key areas. At Kakwa in the Deep Basin, drilling success in 2008 has defined a fairway which we believe offers the opportunity for multi-well development utilizing horizontal wells. Having delineated this fairway with vertical wells, we plan to pilot-test the horizontal drilling concept this summer. Exploratory drilling in Kakwa has also identified a second trend which may be amenable to horizontal development in the longer term.

At Ricinus in West Central Alberta, acquisitions of partner interests in 2008 have consolidated our land position. Purchases of Crown land have also extended our land base. Ricinus now offers more material growth potential for ProspEx, both in extending and infilling established trends and pursuing new exploratory opportunities.

We have always been prudent managers of the Company's finances. In light of the current business environment, we believe that capital preservation is paramount, and are working to maintain financial flexibility by restricting capital spending to less than forecasted cash flow, and by selling assets that do not offer opportunities consistent with our evolving strategy. We also reduced our staff count early in 2009, and are taking other steps to manage costs.

The capital preservation imperative will have a clear impact on capital allocation decisions in 2009. Capital spending will be targeted at securing and testing opportunities to advance our new strategy. Our plan is to increase the opportunity set available to the Company once business conditions improve, rather than cannibalize our existing prospect inventory to grow production in the short term.

At the moment there is an apparent desire in capital markets for consolidation in the junior oil and gas space, in order to create larger, more liquid companies with better diversification of assets and economies of scale. We are very aware of the advantages that a larger entity might enjoy.

However, we also believe that any M&A opportunity should bring with it some advantages beyond size alone – some competitive or strategic advantage, or assets that complement our existing positions or our strategy. We feel that this kind of transaction will create value for shareholders over the long term, and we will continue to search for such an opportunity.

The challenges of today's business environment seem daunting at times. Given the uncertainties of the future, the temptation, as some have put it, is to 'hunker down' and do nothing but survive until better times return. That is not our approach. We believe that management teams have a responsibility to proactively address their situations, update their strategies and set a direction for their organizations. We will continue to do our utmost in this regard.

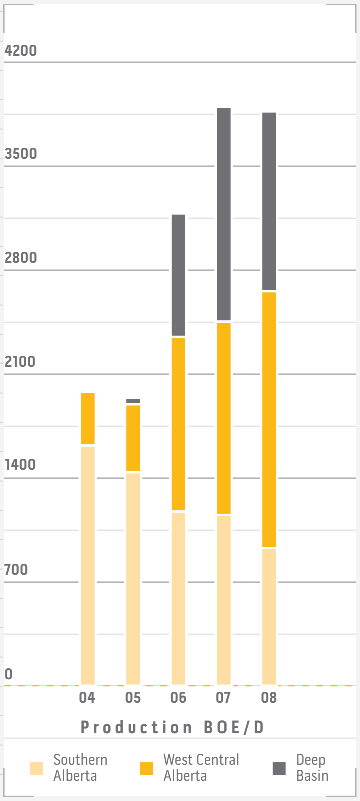
It has been said that crisis equals opportunity, a statement that might have been made with 2009 in mind.

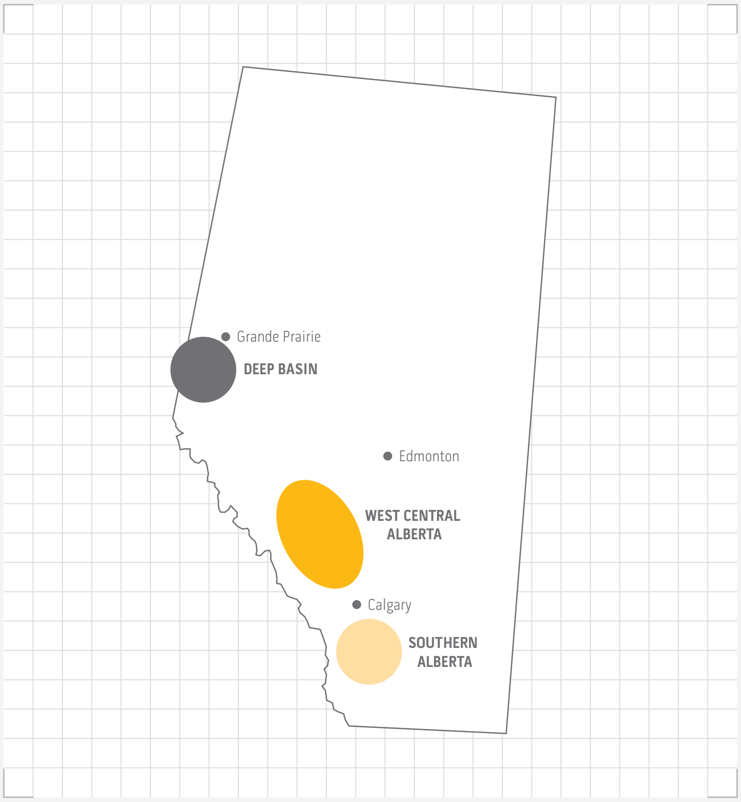
ProspEx operates in some of the most desirable areas in Alberta, and we believe that the distress in the industry will allow us to secure new growth opportunities and position the Company to prosper in better days ahead. We look forward to meeting these challenges head on, and thank our shareholders for their continued support.

John W. Rossall
President and Chief Executive Officer
ProspEx Resources Ltd.
March 16, 2009

// operations overview

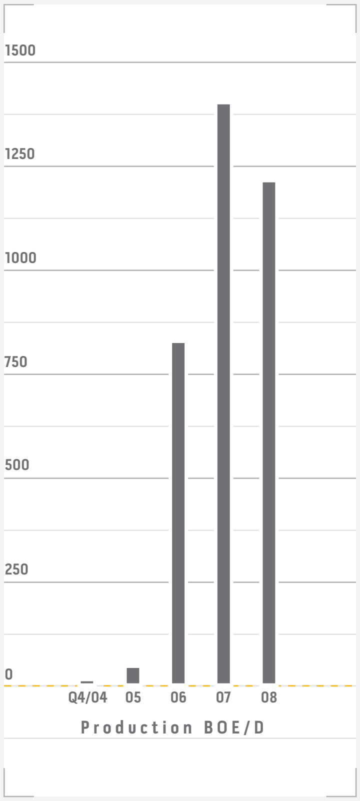
ProspEx owns rights to approximately 122,000 net undeveloped acres of land, largely located within the gas-saturated deep basin fairway along the western margin of Alberta. Since our inception in 2004, the Company has grown 'through the drill bit' and through smaller asset acquisitions. Our strategy has evolved to respond to changes in the oil and gas business environment. Over the past year we have moved to a model that emphasizes repeatable, scalable development compared to the previous one-well-at-a-time approach. This model builds on elements of our past success, both in terms of our deep basin technical expertise and the assets within our portfolio upon which we will focus our new strategy. In this section, we will review 2008 operations and future plans for our core development areas.

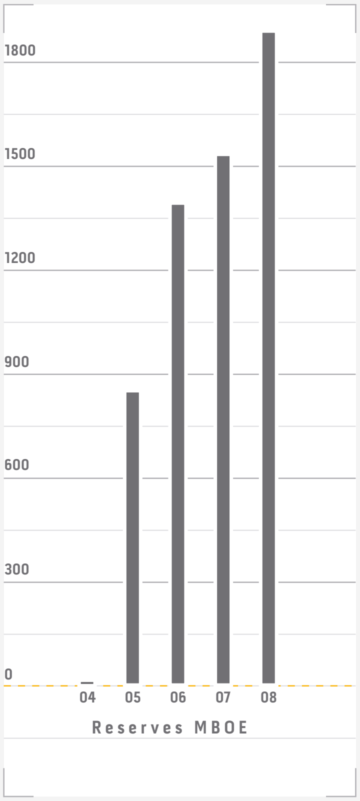




DEEP BASIN Located just south of Grande Prairie in northwestern Alberta, the Deep Basin is one of the premier natural gas exploration and development areas in Western Canada. This area offers multiple productive horizons in a pervasively gas-saturated environment with the potential to drill higher productivity wells. Within this area ProspEx controls 31,000 net acres of undeveloped land. The Deep Basin is a key growth area for ProspEx, accounting for 40 percent of 2008 exploration and production capital spending, and 31 percent of the Company's 2008 production.

Drilling activity in the Deep Basin typically targets sweet, gas-bearing formations of Cretaceous age, such as the Cadotte, Falher, Gething and Cadomin. In 2008 ProspEx drilled eight (4.6 net) wells in the Deep Basin, all of which were cased for completion as gas wells. Six (3.7 net) of these wells were in the Kakwa area within the Deep Basin. Kakwa will continue to be the Company's focus area in 2009. Also in the Deep Basin, ProspEx holds mineral rights at Wapiti, Gold Creek and Elmworth that offer stacked multi-zone drilling locations, often anchored by resource play opportunities such as the Cadomin formation.

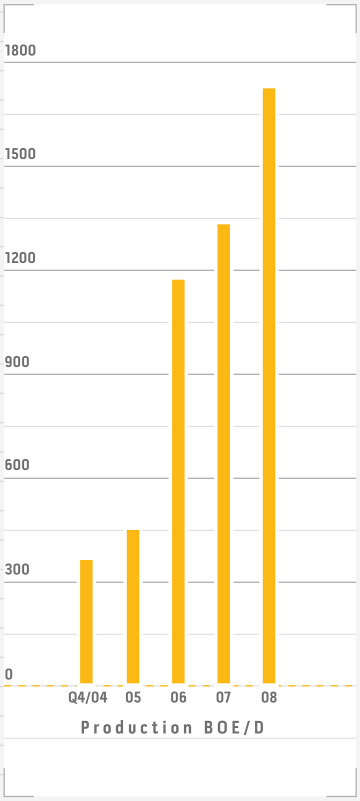


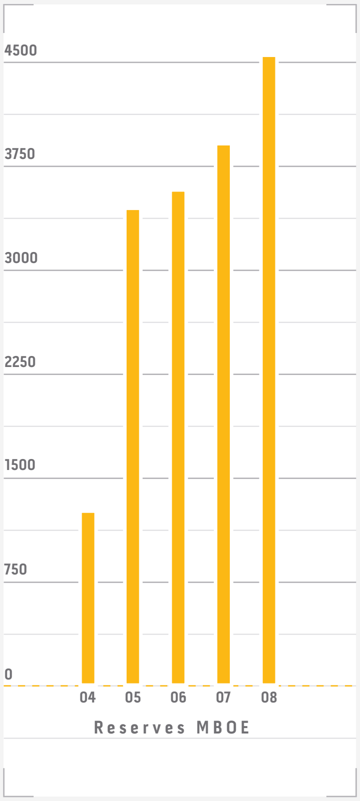


WEST CENTRAL ALBERTA ProspEx owns 80,000 net acres of undeveloped lands in West Central Alberta, located within four areas: Ricinus, Harmattan, Willesden Green and Garrington. West Central Alberta is ProspEx's second growth area, attracting 47 percent of exploration and production capital spending in 2008. Production from West Central Alberta was 45 percent of the 2008 corporate total. Drilling activity in West Central Alberta is oriented toward sweet, pervasively gas-bearing formations, with the majority of wells targeting the Cardium formation.

In 2008, ProspEx drilled six (5.0 net) wells in West Central Alberta, all of which were completed as gas wells. Five of these six wells were drilled for the Cardium formation at Ricinus and Harmattan. ProspEx completed its development of the Cardium at Harmattan in 2008, and expects that future activity in West Central Alberta will be focused on the Ricinus area.

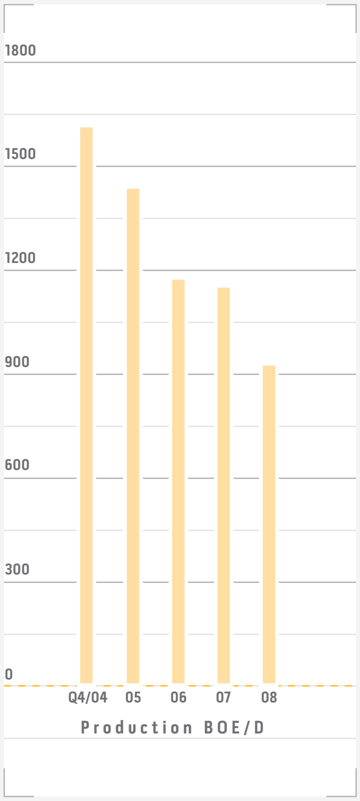
Elsewhere in West Central Alberta, the Company has land positions in Willesden Green and Garrington, where the primary targets are the Glauconitic, Ostracod and Viking as well as the deeper Rock Creek and Elkton formations.

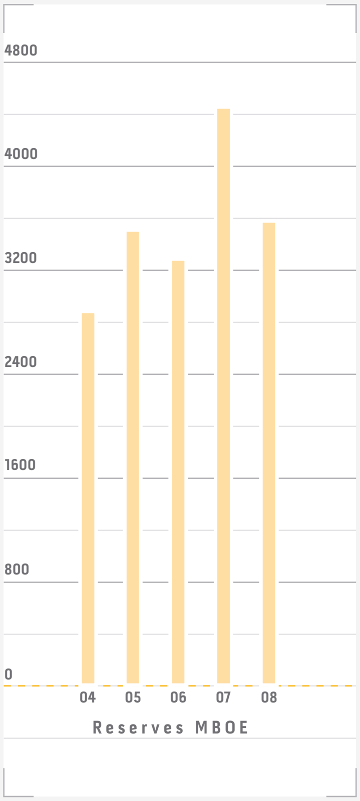




SOUTHERN ALBERTA This is ProspEx's smallest core area, with 24 percent of the Company's 2008 production and 9 percent of exploration and production capital spending in 2008. In Southern Alberta the Company has a large land position (approximately 100 sections in total) at Medallion, located 30 kilometres south of Calgary. Medallion offers a resource play style of opportunity, with a series of stacked channels in the Belly River formation providing relatively low-risk development drilling over a broad area.

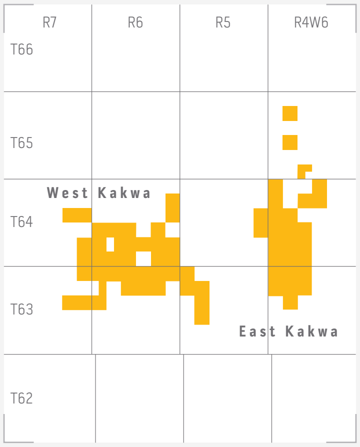
In 2008, ProspEx participated in a modest eight-well (2.3 net) drilling program in Medallion, with all activity operated by industry partners. Given the lower productivity of this shallow gas play, ProspEx directed capital to the Deep Basin and West Central Alberta areas, which were seen as offering better investment opportunities. Medallion plays a different role, providing a stream of lower decline production and cash flow to fund growth opportunities elsewhere in our asset base. However, ProspEx has continued to develop a resource play-based prospect inventory in Medallion, with approximately 160 net locations identified. The Company believes significant value could be realized by developing these locations, given an environment of higher natural gas prices and better access to capital than we see today.





// KAKWA

The Company has a large land position of 21,000 net undeveloped acres in the Kakwa area of the Deep Basin, in two contiguous blocks known as East Kakwa and West Kakwa. The Kakwa area was the focus of much of our capital program in 2008, and we expect that this will continue to be the case through 2009. This area will take the lead in our transition to a resource play strategy.

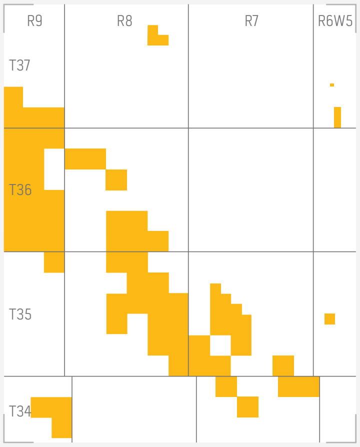


The primary targets in Kakwa are thick channels in the Falher formation of Cretaceous age. Drilling locations in these channels are selected using careful processing and interpretation of three-dimensional (3D) seismic coupled with geological mapping. In East Kakwa, the focus of the 2008 program was to delineate a Falher channel discovered early in the year. Four (2.4 net) wells were drilled, all of which were successfully completed with initial production rates of 300 to 2,000 thousand cubic feet ("mcf") per day. All of these wells encountered a gas-bearing Falher channel up to 20 metres thick. These drilling results, along with the seismic interpretation, point to a large opportunity that can be exploited with a repeatable drilling program. The focus of the 2009 program will be on continued delineation of the trend, along with a pilot test of horizontal drilling utilizing multi-stage fracturing techniques. ProspEx believes that considerable improvement in production rates and reserves can be realized by horizontal drilling in a reservoir that is thick enough to provide a large resource.

In West Kakwa, two (1.4 net) wells were drilled in 2008. The first well was drilled in early 2008 for a deeper target but was cased for secondary uphole potential. A second well, drilled utilizing 3D seismic at the end of the year, encountered a thick but low-porosity Falher channel. An additional well drilled in early 2009 encountered a similar Falher reservoir, four kilometres southwest of the initial discovery. Given the better reservoir quality encountered to date and shallower drilling depths in East Kakwa, ProspEx's initial focus will be on delineation and horizontal development of East Kakwa.

// RICINUS

ProspEx holds a total of 32,000 net acres of land in the area that offers a repeatable opportunity in the Cardium formation. In 2008, ProspEx consolidated its interests in Ricinus in two separate transactions, spending $14.6 million to acquire 1.2 million boe of Proved plus Probable reserves and 420 boe per day of production.



These acquisitions increased the Company's interest in existing Ricinus wells from an average of approximately 20 percent to 90 percent. ProspEx also expanded its land position with purchases at Crown land sales, adding 5,360 net acres of new lands over the year.

Three (3.0 net) wells were drilled in 2008, all of which were successful, with initial production rates of 100 to 400 boe per day from each well. One of these wells extended the producing trend to the southeast, while the other two were infill wells, increasing the density of drilling within the producing trend.

Ricinus offers three distinct types of opportunity: infill drilling within the currently defined trend, extension of the existing trends and the opportunity to explore for new producing trends analogous to the existing production. The two wells drilled in 2008 are examples of the infill drilling opportunity, that is, drilling within the boundaries of the existing trend to increase production and reserves. ProspEx also holds land on trend with existing production, mostly to the northwest, where wells can be drilled to extend the limits of existing production. The Company also owns mineral rights on lands where our technical work suggests that entirely new trends may be discovered. Collectively, these opportunities provide a significant inventory of future drilling locations to ProspEx.

// summary of consolidated financial and operational highlights

(UNAUDITED) Year ended December 31	2008	2007	2006
Financial *($000S)*			
Oil and gas revenue	**76,705**	63,534	51,501
Net earnings (loss)	**7,560**	(1,091)	5,080
Cash flow[1]	**44,326**	35,997	27,962
Total assets	**202,984**	175,765	161,736
Total net debt[2]	**51,422**	37,719	32,790
Net earnings (loss) per share *($ PER SHARE)*			
Basic	**0.13**	(0.02)	0.10
Diluted	**0.13**	(0.02)	0.10
Cash flow per share *($ PER SHARE)*[1]			
Basic	**0.78**	0.67	0.56
Diluted	**0.76**	0.64	0.53
Weighted average common shares *(000S)*			
Basic	**57,054**	54,095	50,378
Diluted	**58,101**	56,318	53,004
Production Volumes			
Natural gas *(MCF/D)*	**18,562**	19,838	16,610
Natural gas liquids *(BBLS/D)*	**707**	468	324
Crude oil *(BBLS/D)*	**74**	125	94
Total *(BOE/D)*	**3,875**	3,899	3,186
Sale Prices			
Natural gas *($/MCF)*	**8.32**	7.12	6.92
Natural gas liquids *($/BBL)*	**66.58**	50.12	59.92
Crude oil *($/BBL)*	**109.59**	75.09	71.37
Total *($/BOE)*	**54.08**	44.65	44.29
Netbacks *($/BOE)*			
Price	**54.08**	44.65	44.29
Unrealized financial instrument gain (loss)	**0.43**	(2.01)	2.69
Royalties	**(10.51)**	(6.57)	(7.76)
Operating costs	**(7.78)**	(7.97)	(6.97)
Transportation	**(0.97)**	(0.95)	(0.97)
General and administrative	**(2.14)**	(2.16)	(2.07)
Total *($/BOE)*	**33.11**	24.99	29.21
Capital *($000S)*			
Drilling and completions	**27,612**	26,718	46,893
Facilities	**11,288**	12,381	17,785
Land and lease	**6,818**	4,383	5,230
Seismic	**3,168**	2,416	1,603
Capitalized general and administrative	**2,602**	2,652	1,953
Total exploration & development	**51,488**	48,550	73,464
Property acquisition (disposition)	**9,226**	–	(10,842)
Other capital assets	**168**	160	269
Total	**60,882**	48,710	62,891

[1] Cash flow is defined as cash flow from operations before changes in operating non-cash working capital.

[2] Total net debt is defined as long-term debt less working capital (or plus working capital deficiency) excluding unrealized financial instrument gain (loss) and associated future tax assets (liabilities).

Cash flow and total net debt do not have a standardized measure prescribed by Canadian generally accepted accounting principles and therefore may not be comparable with measures for other companies.

// management's discussion and analysis

This Management's Discussion & Analysis ("MD&A") is management's assessment of the financial and operating results of ProspEx Resources Ltd. ("ProspEx" or the "Company") as well as a prospective view of the Company's activities. The MD&A was prepared as at March 16, 2009 and should be read in conjunction with the audited consolidated financial statements for the year ended December 31, 2008. The consolidated financial statements have been prepared in accordance with generally accepted accounting principles ("GAAP") in Canada. Readers are referred to the discussions detailing "Disclosure Controls and Policies", "Internal Controls Over Financial Reporting", and "Advisories" including "Forward-Looking Statements" contained in the back of this MD&A. Additional information relating to ProspEx, including the Company's Annual Information Form (once filed), can be found at www.sedar.com. The Company anticipates filing its 2008 Annual Information Form prior to March 31, 2009.

VISION, CORE BUSINESS AND STRATEGY

ProspEx is a Canadian junior oil and gas company focused on exploration, development and production of natural gas. The Company's activities are concentrated in the deep basin gas fairway along the western edge of the Province of Alberta. Incorporated in 2004, ProspEx's historical strategy was one of conventional exploration and development, complemented by acquisitions of assets in the Company's core operating areas. More recently, ProspEx has moved to a strategy centered on the development of repeatable opportunities offering economies of scale, again complemented by acquisitions. The Company's head office is located in Calgary, Alberta.

KEY PERFORMANCE DRIVERS

ProspEx's goal is to add value by discovering and developing oil and gas reserves "through the drill bit", coupled with the selective acquisition of new assets. Efforts to achieve this are focused on utilizing experienced staff to develop and evaluate exploration projects while managing risk and controlling costs. Key performance metrics such as production and reserves growth, operating netbacks, finding and development costs and recycle ratios are all monitored.

HIGHLIGHTS OF 2008

Annual average production for 2008 was 3,875 barrels of oil equivalent ("boe") per day, in line with the 2007 annual average of 3,899 boe per day. Although the Company enjoyed drilling success and acquired additional production, the high underlying decline rate of ProspEx's production base made it difficult for the Company to increase production. In 2009, these decline rates are expected to moderate.

Total capital spending in 2008 (including $9.2 million of acquisitions and dispositions) was $60.9 million, below the budget level of $65 million, as capital spending was reduced in late 2008 in response to low natural gas prices and deteriorating conditions in the capital markets. Key capital investment areas for the Company were Kakwa and Ricinus. In Kakwa, the Company made a significant exploration discovery in the first quarter in East Kakwa, and drilled a total of four (2.4 net) successful wells on this trend in 2008. ProspEx also drilled two (1.4 net) wells in West Kakwa exploring for a similar trend with mixed success.

In Ricinus, ProspEx drilled three (3.0 net) wells in 2008, all of which were successful, with initial production rates of 100 to 400 boe per day. The Company also consolidated its interests in Ricinus in two separate transactions; spending $14.6 million to acquire 1,242 thousand barrels of oil equivalent ("mboe") of Proved plus Probable reserves and 420 boe per day of production from partners in the area. These acquisitions increased the Company's interest in existing wells in Ricinus from an average of approximately 20 percent to 90 percent. ProspEx also expanded its land position in Ricinus with purchases at Crown land sales, adding 5,360 net acres of new lands over the year.

Net debt at December 31, 2008 was $51.4 million, not including unrealized gains on financial instruments and associated future taxes. Year end net debt is therefore equivalent to a debt to fourth quarter annualized cash flow ratio of 1.3 years. ProspEx has a $65 million credit facility with a major Canadian chartered bank. This facility was unchanged after the semi-annual review at December 31, 2008. In light of the deteriorating commodity and capital markets, the Company is planning a 2009 capital budget equal to or less than forecasted cash flow.

Business Environment and Outlook

In the fall of 2008, the crisis in global financial markets accelerated, and commodity prices fell precipitously from their springtime highs as the world moved into recession. These forces, coupled with previously announced changes to royalty trust taxation and to the royalty regime in the Province of Alberta, have changed the landscape in which the Company operates. With this changed landscape comes the need to evolve new strategies. Accordingly, ProspEx intends to focus on projects that emphasize repeatable, scalable development where economies of scale can reduce costs. Two properties that fit this new approach within the Company's existing asset base are Kakwa in the Deep Basin and Ricinus in West Central Alberta. Both of these areas demonstrated superior finding and development costs in 2008, and offer a repeatable prospect inventory with economies of scale.

In light of the current business environment, ProspEx believes that capital preservation is paramount, and is working to maintain financial flexibility by restricting capital spending to less than forecasted cash flow, and by selling assets that do not offer opportunities consistent with ProspEx's evolving strategy. The Company also reduced its staff count early in 2009, and is taking other steps to manage costs.

The capital preservation imperative is expected to have a clear impact on capital allocation decisions in 2009. Capital spending will be targeted at securing new opportunities to advance the new strategy and to testing these new ideas. This activity will be oriented towards increasing the opportunity set available to the Company once business conditions improve, rather than cannibalizing existing prospect inventory to grow production in the short term. ProspEx operates in some of the most desirable areas in Alberta, and believes that the distress in the industry will allow the Company to secure new growth opportunities and position the Company to prosper in better days ahead.

RESULTS OF OPERATIONS

Production

Area *(BOE/D)*	**2008**	2007
Deep Basin	**1,214**	1,402
West Central Alberta	**1,726**	1,334
Southern Alberta	**926**	1,152
Other Areas	**9**	11
Total	**3,875**	3,899
By Product		
Natural gas *(MCF/D)*	**18,562**	19,838
Natural gas liquids *(BBLS/D)*	**707**	468
Oil *(BBLS/D)*	**74**	125
Total *(BOE/D)*	**3,875**	3,899

Annual average production for 2008 was 3,875 boe per day, essentially in line with the 2007 annual average of 3,899 boe per day. Despite a successful capital program, production remained flat due to the high underlying production decline rate of successful exploration wells drilled in prior years. The Company estimates its overall decline rate to have been approximately 50 percent per year over the course of 2008. Looking forward, the high decline properties at Wapiti and Harmattan now make up a smaller proportion of overall production. Accordingly, overall production decline rates are expected to be shallower, and are forecast to average 35 percent to 40 percent in 2009.

Offsetting these declines were drilling successes in the East Kakwa and Ricinus areas, supplemented by two property acquisitions in Ricinus. New production additions from these projects were 850 boe per day on an annualized basis in 2008.

Production in 2008 was reduced by the disposition of approximately 110 boe per day of production at Granum in Southern Alberta effective April 1, 2008. In addition, regulatory delays at sour gas projects at Salter and Edson also inhibited production growth.

Commodity Pricing

ProspEx Average Prices		**2008**		2007
Natural gas *($/MCF)*				
Sales price	**$**	**8.64**	$	6.69
Realized (loss) gain on financial instrument		**(0.32)**		0.43
Average net realized natural gas price		**8.32**		7.12
Oil *($/BBL)*		**109.59**		75.09
NGLs *($/BBL)*		**66.58**		50.12
Average realized price *($/BOE)*		**54.08**		44.65
Unrealized financial instrument gain *($/BOE)*		**0.43**		(2.01)
Total average price *($/BOE)*	**$**	**54.51**	$	42.64
Benchmark pricing				
AECO C Spot *($/MCF)*	**$**	**8.14**	$	6.45
Edmonton Par – light oil *($/BBL)*	**$**	**102.13**	$	76.35

The Company realized a net natural gas price of $8.32 per thousand cubic feet ("mcf") in 2008, 17 percent higher than the net realized price for 2007 of $7.12 per mcf. Average natural gas prices rose in 2008 as the AECO C Spot benchmark price was up 26 percent from 2007 to 2008. As a result the Company's average realized natural gas price also rose, but not to the same extent as the benchmark price due to the realization of some financial instrument losses in the year.

The 2008 annual realized oil price increased 46 percent over 2007, which is greater than the 34 percent increase seen in the oil benchmark Edmonton par price. The Company's oil price increase was higher than the benchmark price due to the higher quality of new oil production in the Harmattan area.

The annual average price realized for natural gas liquids ("NGLs") increased 33 percent from $50.12 per barrel in 2007 to $66.58 per barrel in 2008. This increase was due to an increase in the commodity prices received as NGLs prices tend to track oil prices.

Financial Instruments

The Company's strategy is to selectively enter into financial instruments such as forwards, futures, swaps and costless collars in an effort to mitigate the effects of volatile commodity prices and protect cash flow to enable funding of its exploration and development programs. These financial instruments, which are predominantly costless collars, allow the Company to better forecast operating cash flow, in turn providing greater confidence in funding for its operations. In 2008, the Company's risk management program resulted in a net realized loss of $2.2 million for the year compared to a net realized gain of $3.1 million in 2007.

The fair values of unsettled financial instruments are recorded as an asset or liability with the change in the fair value recorded as an unrealized gain or loss in the statements of earnings and cash flows. As a result, changes in the fair value of financial instruments due to fluctuating forward natural gas prices and the purchase or expiration of financial contracts can lead to volatility in net earnings for the period. The financial instruments open as of December 31, 2008 are described in the financial instruments and risk management note to the consolidated financial statements for the year ended December 31, 2008. The fair value of open financial instruments at December 31, 2008 was an asset of $0.8 million compared to an asset of $0.2 million at December 31, 2007 resulting in an unrealized financial instrument gain of $0.6 million for the year.

Revenue

($000S)		**2008**		2007
Natural gas	**$**	**58,653**	$	48,466
Realized (loss) gain on financial instruments		**(2,163)**		3,089
Total natural gas		**56,490**		51,555
Oil		**2,982**		3,428
Natural gas liquids		**17,233**		8,551
Oil and gas revenue		**76,705**		63,534
Unrealized financial instrument gain (loss)		**614**		(2,867)
Total revenue	**$**	**77,319**	$	60,667

Oil and gas revenue for the year ended December 31, 2008 was $76.7 million, representing a 21 percent increase over revenue of $63.5 million in 2007. Revenue was up in the year due to higher commodity prices, offset by a realized loss on financial instruments.

As the Company's production profile shifts from the lower rate, dry gas wells in Southern Alberta to the higher rate, liquids rich wells in the Deep Basin and West Central Alberta areas, the percentage of revenue generated from NGLs continues to increase. Higher shrinkage of gas due to NGLs extraction lead to the percentage of revenue from natural gas dropping to 74 percent in 2008 from 81 percent in 2007. Similarly, the revenue percentage of NGLs was 22 percent in 2008 compared to 14 percent in 2007. The percentage of revenue from oil remained relatively consistent at 4 percent in 2008 compared to 5 percent in 2007.

ROYALTY EXPENSE

($000S, EXCEPT PERCENTAGE AND PER BOE AMOUNTS)		**2008**		2007
Crown	**$**	**10,469**	$	6,219
Freehold and GORR		**4,447**		3,124
Total Royalties	**$**	**14,916**	$	9,343
$ per boe	**$**	**10.51**	$	6.57
As a percentage of oil and gas revenue		**19%**		15%

Royalty expense in 2008 was $14.9 million or 19 percent of oil and gas revenue, compared to $9.3 million or 15 percent of oil and gas revenue for 2007. The 2008 Company royalty rate increased compared to 2007 as the proportion of production from West Central Alberta increased. Royalty rates in West Central Alberta are higher due to freehold royalties, higher well productivity, and greater NGLs yields. In addition, in 2007 the Company received a crown royalty adjustment which lowered the 2007 royalty rate by approximately 2 percent.

Royalties for 2008 were one percent lower than the 20 percent guidance given as some of the higher rate wells that came on production in 2008 were eligible for royalty holiday and therefore did not recognize a royalty expense in the current year.

OPERATING COSTS

		2008		2007
Operating costs *($000S)*	**$**	**11,034**	$	11,341
Operating costs per boe	**$**	**7.78**	$	7.97

Operating costs for the year were slightly lower in comparison to 2007 on a total cost and per unit basis. During the year, operating costs were increasing on a dollar and a per unit basis as the Company's production mix shifted towards higher costs areas in West Central Alberta. This overall shift in production, consistent with the Company's growth strategy, resulted in increases in operating costs during the year but was offset in the fourth quarter by the finalization and reduction of $1.5 million of outstanding processing fees in the Deep Basin.

Operating cost guidance for 2008 was $8.50 per boe.

TRANSPORTATION EXPENSES

		2008		2007
Transportation expenses *($000S)*	**$**	**1,373**	$	1,343
Transportation expenses per boe	**$**	**0.97**	$	0.95

Overall 2008 transportation expense remained consistent compared to 2007 as production volumes for the Company were relatively unchanged.

GENERAL AND ADMINISTRATIVE EXPENSES

($000S)	2008	2007
Gross general and administrative	$ 6,580	$ 6,683
Recoveries	(946)	(951)
Capitalized expenses	(2,602)	(2,652)
Net general and administrative expenses	$ 3,032	$ 3,080
Net general and administrative expenses per boe	$ 2.14	$ 2.16

Gross general and administration costs for 2008 remained consistent compared to 2007 as the Company did not incur any significant changes to its general and administration cost structure in 2008. General and administrative costs in 2008 were in line with guidance of $2.15 per boe for the year.

DEPLETION, DEPRECIATION AND ACCRETION

	2008	2007
Depletion, depreciation and accretion *($000S)*	$ 33,084	$ 33,889
Depletion, depreciation and accretion per boe	$ 23.33	$ 23.81

Depletion, depreciation and accretion expense ("DD&A") per boe decreased by 2 percent from $23.81 in 2007 to $23.33 for 2008, as the cost of adding reserves in 2008 was slightly lower than historical costs.

INTEREST AND BANK CHARGES

Interest and bank charges remained consistent at $1.9 million in 2008 compared with $2.0 million in 2007, as the increase in average debt levels was offset by a reduction in interest rates.

STOCK-BASED COMPENSATION

Stock-based compensation expense decreased to $0.8 million in 2008 from $1.2 million in 2007. This decrease is due to a lower number of stock options issued in 2008.

INCOME TAXES

The Company had a future income tax expense of $3.7 million in 2008 as compared to a reduction in future income tax of $0.4 million in 2007. This rise in future income tax expense is due to higher profitability levels as the rise in natural gas prices during the year resulted in an increase in net earnings.

ProspEx has met its commitment to incur $8.0 million in qualifying Canadian exploration expenditures related to the December 2007 flow-through share financing.

Estimated tax pools as at December 31:

($000S)	2008	2007
Canadian oil & gas property expense	**$ 39,153**	$ 29,300
Canadian development expense	**34,457**	32,097
Canadian exploration expense	**31,448**	37,035
Undepreciated capital cost	**44,699**	43,735
Other	**4,837**	4,853
	$ 154,594	$ 147,020

NET INCOME AND CASH FLOW

The Company realized net earnings of $7.6 million in 2008, compared to an annual net loss of $1.1 million in 2007. The increase in net income was the result of higher commodity prices, offset by increases in royalty expense.

Full year cash flow was up 23 percent from $36.0 million in 2007 to $44.3 million in 2008. As production volumes remained consistent year over year, the increase in cash flow can be attributed to the increase in overall commodity prices in 2008 compared to 2007.

CAPITAL EXPENDITURES

($000S)	2008	2007
Drilling and completions	**$ 27,612**	$ 26,718
Facilities	**11,288**	12,381
Land and lease	**6,818**	4,383
Seismic	**3,168**	2,416
Capitalized G&A	**2,602**	2,652
Total exploration & development	**51,488**	48,550
Net property acquisitions & dispositions	**9,226**	–
Other capital assets	**168**	160
Total capital expenditures	**$ 60,882**	$ 48,710

The Company invested $51.5 million in exploration and development activities in 2008. This was a slight increase in expenditures compared to $48.6 million in 2007. Of the $51.5 million in exploration and development activity, $20.8 million was spent in the Deep Basin, $18.1 million in West Central Alberta and $4.4 million in Southern Alberta.

In the Deep Basin a total of eight (4.6 net) wells were drilled, all of which were cased for completion as gas wells. This program was highlighted by the discovery of a productive Falher channel trend in East Kakwa. Four (2.4 net) wells were drilled in this trend, all of which encountered a gas-bearing Falher channel with a thickness up to 20 metres. These wells were successfully completed for gas production with initial production rates of 300 to 2,000 mcf per day.

These successful drilling results, along with the seismic interpretation, point to opportunity that can be exploited with a repeatable drilling program, potentially utilizing horizontal drilling with multi-stage fracturing techniques. Reserves bookings for the East Kakwa wells were based on drainage areas of only 80 to 180 acres, indicating the potential for infill drilling in sections where an initial well has already been drilled. Based on existing wells and interpretation of 3D seismic, ProspEx has mapped 16 (8 net) incremental drilling locations (both infill and trend extension) on lands controlled by the Company, assuming a drilling density of two wells per section. The focus of the 2009 program will be on continued delineation of the trend, along with a pilot test of horizontal drilling utilizing multi-stage fracturing techniques. ProspEx has received regulatory approval to drill up to four wells per section in 16 sections of land in the East Kakwa trend.

In West Kakwa, two (1.4 net) wells were drilled in 2008. The first well was drilled for deeper formations early in 2008, and was cased for secondary uphole potential. A second well, drilled utilizing 3D seismic at the end of the year, encountered a thick but low-porosity Falher channel. An additional well drilled in early 2009 encountered a similar Falher reservoir, four kilometres to the southwest of the initial discovery. Given the better reservoir quality encountered to date and shallower drilling depths in East Kakwa, ProspEx's initial focus will be on delineation and horizontal development of East Kakwa.

In West Central, three (3.0 net) wells were drilled in Ricinus in 2008, all of which were successful, with initial production rates of 100 to 400 boe per day. One of these wells extended the producing trend to the southeast, while the other two were infill wells within the producing trend.

There were eight (2.3 net) wells drilled in the Southern Alberta area in 2008. All of these wells were drilled by partners as the Company focused its capital spending in the Deep Basin and West Central Alberta areas.

At Salter, ProspEx is awaiting regulatory approval for the relicensing of the existing pipeline to accommodate production from the horizontal well drilled in the first quarter of 2008. The Company hopes to receive this approval in the second quarter of 2009, which will allow this well to come on stream at a facilities restricted rate of 2 million cubic feet ("mmcf") per day. ProspEx has a 40 percent working interest in the production from this well.

At Edson, tie-in operations for an exploratory well drilled in the first quarter of 2008 have been deferred by the operator until additional drilling can be completed in order to justify the large capital expense associated with this project.

In 2008, the Company was more active in the acquisition and disposition market as it concluded $9.2 million of acquisition and divestiture activity. At the start of the year the Company acquired assets in the Ricinus area of Alberta with production of approximately 360 boe per day for approximately $11.5 million. In the second quarter, ProspEx divested non-operated natural gas assets in Granum in the Southern Alberta area for proceeds of $5.6 million. These Granum assets consist of five (1.0 net) producing wells with then current production of approximately 110 boe per day. In the third quarter, the Company closed an acquisition of additional partner interests in the Ricinus area for consideration of $3.4 million including approximately 60 boe per day of net production and 400 net acres of undeveloped land.

OIL AND GAS RESERVES DATA

An independent evaluation of ProspEx's reserves at December 31, 2008 was conducted by GLJ Petroleum Consultants Ltd. ("GLJ") and prepared in accordance with the reporting guidelines of National Instrument 51-101 of the Canadian Securities Administrators ("NI 51-101"). Under NI 51-101, the estimate most likely to be accurate for reserves is the Proved plus Probable ("P+P") calculation. In the GLJ report, the total Company interest P+P reserves were estimated to be 51.3 billion cubic feet ("bcf") of natural gas and 1,487 thousand barrels ("mbbls") of oil and NGLs for a total of 10,043 mboe at December 31, 2008. The complete reserves disclosure as required under NI 51-101, will be contained in ProspEx's 2008 Annual Information Form, to be filed on SEDAR on or before March 31, 2009.

Proved Producing reserves at December 31, 2008 were estimated to be 5,387 mboe, an increase of 25 percent compared to the 4,303 mboe of Proved Producing reserves estimated at December 31, 2007.

In 2008, ProspEx added 1,564 mboe of P+P reserves as a result of the Company's drilling program. In the Deep Basin, 696 mboe of reserves were added in 2008, mostly due to drilling success in East Kakwa. In West Central Alberta, 792 mboe of reserves were added, with 436 mboe in the Ricinus area. In Southern Alberta, 76 mboe of reserves were added as the Company did not pursue a significant capital program in this area in 2008.

In 2008, ProspEx acquired assets in the Ricinus area in West Central Alberta in two separate acquisitions, and divested assets in the Granum area in Southern Alberta. In aggregate, these activities resulted in the addition of 863 mboe of P+P reserves at an aggregate net cost of $9.2 million.

Reported reserves included a downward revision to reserves on a Proved basis of 389 mboe, and a downward revision of 879 mboe on a P+P reserves basis. The largest revisions were at Harmattan and Garrington in West Central Alberta, and at Medallion in Southern Alberta. A small positive revision to reserves was recorded in the Deep Basin.

At Harmattan, production performance from the Cardium W Pool was less than anticipated, resulting in a negative revision of 504 mboe on a P+P reserves basis. At Garrington, production from a partner operated well drilled in 2007 also declined more rapidly than expected, resulting in a downward revision of 185 mboe on a P+P reserves basis.

At Medallion, the fuel gas consumed to power compression facilities used to run the Company's low pressure gathering system is essentially a constant volume, therefore with declines in production the fuel gas volume becomes a higher percentage of overall production. There was a negative revision of 221 mboe to P+P reserves at Medallion, mostly to account for the greater "shrinkage" of produced gas.

The Company replaced 140 percent of 2008 production on a Proved reserves basis, and 109 percent of 2008 production on a P+P reserves basis. Reserves growth over the year was 8.5 percent on a Proved basis and 1.3 percent on a P+P basis. Reserves per fully diluted share increased by 5 percent on a Proved basis and decreased 2 percent on a P+P basis.

The Proved reserve life index at December 31, 2008, calculated using fourth quarter 2008 production on an annualized basis, was 5.4 years. The P+P reserve life index was 7.6 years. Reserve life index is calculated by dividing the reserves balance at year end by the annualized production rate during the prior quarter.

Finding, development and acquisition ("FD&A") costs were $29.46 per boe on a Proved reserves basis, and $36.33 per boe on a P+P reserves basis, including revisions and future development costs.

Recycle ratio is the ratio of operating netback to finding and development and acquisition costs, and is a measure of the economic efficiency of the capital program. A recycle ratio of 1.18 was achieved on a Proved reserves basis, and 0.96 on a P+P reserves basis.

ProspEx achieved markedly different finding and development cost performance across its asset base. In West Kakwa and at Edson, the Company spent $11.3 million, or 19 percent of total capital spending, on exploration that did not result in material reserves bookings. In West Kakwa, ProspEx spent $5.7 million to drill two exploratory wells. No reserves were booked to either of these wells, although ProspEx believes that the low porosity channel encountered in the second well may be a potential horizontal drilling candidate, once the technology of horizontal drilling has been proven on the Company's East Kakwa lands.

At Edson, the Company spent $3.4 million on land and seismic and $2.2 million to drill and complete one (0.35 net) well. The Company's independent reserves engineers have recognized 297 mboe (104 mboe net) of P+P reserves for this well.

While ProspEx continues to believe that over the long term the Edson and West Kakwa assets may provide profitable drilling opportunities, current results do not support material reserves bookings and have therefore contributed to higher finding and development costs.

In contrast, ProspEx achieved much better FD&A costs at East Kakwa and Ricinus. In East Kakwa, the Company spent $10.6 million in 2008, approximately 17 percent of total capital spending, and achieved finding and development costs of approximately $19.00 per boe on a P+P reserves basis. While this is reflective of economic performance, ProspEx believes that finding and development costs can be improved with horizontal drilling, and plans to pilot test this concept in the third quarter of 2009.

At Ricinus, the Company drilled three (3.0 net) wells with aggregate finding and development costs of approximately $16.40 per boe on a P+P reserves basis. In addition, ProspEx closed two acquisitions in the area with acquisition costs of approximately $11.80 per boe, on a P+P reserves basis. Including the acquisitions and the drilling program, FD&A costs in Ricinus were approximately $13.00 per boe on a P+P basis, including revisions and future development capital.

ProspEx believes that the results achieved in 2008 at East Kakwa and Ricinus demonstrate the potential of these assets to add value. Together, these two properties accounted for 55 percent of total capital spending, and generated superior finding and development costs. However, finding and development cost performance in other areas brought total corporate finding and development costs up to unacceptable levels. As discussed previously, ProspEx's future capital program will be directed towards areas such as East Kakwa and Ricinus that offer repeatable drilling opportunities.

Reserve Balance

Company Interest (working interest plus royalties receivable)

DECEMBER 31, 2008 (FORECASTED PRICES)	Oil (MBBLS)	NGLs (MBBLS)	Natural Gas (MMCF)	Oil Equivalent (MBOE)
Proved Producing	27	959	26,408	5,387
Proved Developed Non-Producing	–	104	4,105	788
Proved Undeveloped	–	25	5,636	964
Total Proved	27	1,087	36,149	7,139
Proved Plus Probable [1]	34	1,453	51,336	10,043

[1] Columns may not add due to rounding

Company Interest Reserves Reconciliation

	Proved			Proved Plus Probable		
	Oil & NGLs (MBBLS)	Natural Gas (MMCF)	Oil Equivalent (MBOE)	Oil & NGLs (MBBLS)	Natural Gas (MMCF)	Oil Equivalent (MBOE)
Opening Balance – Jan. 1, 2008	986	33,554	6,578	1,368	51,267	9,913
Drilling additions and improved recovery	305	7,908	1,623	352	7,272	1,564
Technical revisions & economic factors	(114)	(1,653)	(389)	(214)	(3,988)	(879)
Acquisitions/Divestitures	223	3,134	745	267	3,579	863
Net additions	414	9,389	1,979	405	6,863	1,548
Production	(286)	(6,794)	(1,418)	(286)	(6,794)	(1,418)
Closing balance – Dec. 31, 2008 [1]	1,114	36,149	7,139	1,487	51,336	10,043

[1] Columns may not add due to rounding

Performance Metrics

	Total Proved	Proved Plus Probable
Capital *($000S)*		
Future development capital		
January 1, 2008	23,032	36,599
December 31, 2008	20,617	32,117
Change in future development capital	(2,415)	(4,482)
Exploration & development capital	51,488	51,488
Total 2008 capital expenditures	49,073	47,006
Acquisition & disposition capital	9,226	9,226
Total 2008 capital expenditures including acquisitions	58,299	56,232
Reserves		
Net reserves additions for the period *(MBOE)* (excluding acquisitions & dispositions)	1,234	685
Net reserves additions for the period *(MBOE)* (including acquisitions & dispositions)	1,979	1,548
2008 Finding & Development Costs *($/BOE)*	39.77	68.62
2008 Finding, Development & Acquisition Costs *($/BOE)*	29.46	36.33
2007 Finding & Development Costs *($/BOE)*	26.01	21.09
2007 Finding, Development & Acquisition Costs *($/BOE)*	26.01	21.09
Three Year Average Finding & Development Costs *($/BOE)*	30.96	32.58
Three Year Average Finding, Development & Acquisition Costs *($/BOE)*	28.76	29.86
Operating Netback *($/BOE)*	34.82	34.82
Finding & Development & Acquisition Costs *($/BOE)*	29.46	36.33
2008 Recycle Ratio	1.18	0.96
Overall net reserves added *(MBOE)*	1,979	1,548
Production *(MBOE)*	1,418	1,418
2008 Reserves Replacement *(%)*	140%	109%
Reserves at Dec. 31, 2008 *(MBOE)*	7,139	10,043
Fourth Quarter Production *(BOE/D)*	3,587	3,587
2008 Reserves Life based on fourth quarter production annualized *(YEARS)*	5.4	7.6

Present Value of Cash Flows

ProspEx's reserves were evaluated using GLJ's December 31, 2008 price forecast. Cash flows are prior to income taxes and general and administrative expenses. Undeveloped land values are not included. Well abandonment costs have been included for wells that have reserves assigned.

	Discount Rate			
($000S)	0%	5%	10%	15%
Proved Producing	166,803	136,665	116,395	101,860
Proved Developed Non-Producing	20,663	15,187	11,904	9,762
Proved Undeveloped	14,420	10,257	7,335	5,220
Total Proved [1]	201,886	162,109	135,633	116,842
Total Proved plus Probable	291,709	220,702	176,970	147,636

[1] Columns may not add due to rounding

LIQUIDITY & CAPITAL RESOURCES

At December 31, 2008 ProspEx had the following resources available to fund its capital expenditure program.

($000S)	
Working capital deficiency	(10,027)
Long-term debt	(40,807)
Bank facilities available	65,000
Total capital resources	14,166

The Company anticipates that it will continue to have adequate liquidity to fund future working capital and its 2009 capital program from operating cash flow and the capital resources listed in the table above.

Bank Debt

At December 31, 2008 the Company had a $65.0 million credit facility with a Canadian chartered bank. The facility is available by way of Canadian prime and US base rate loans, LIBOR advances, bankers' acceptances and letters of credit. Canadian dollar prime rate loans, US dollar base rate loans, and LIBOR advances bear interest at Canadian prime, US base rate or LIBOR, as applicable, plus a margin dependant upon the Company's debt/cash flow ratio as calculated in the previous quarter. Stamping fees for bankers' acceptances are based on a rate adjusted over the term to maturity plus a margin as described above. The margins and stamping fees varied from 3.01 percent to 5.88 percent in 2008 compared to 5.39 percent to 6.12 percent in 2007. The credit facility is fully revolving until June 30, 2009 and may be extended at the mutual agreement of ProspEx and its lender for an additional year. If the credit facility is not extended, a repayment is required on July 1, 2010. This facility is secured by a $200 million demand debenture and a first floating charge on all petroleum and natural gas assets of ProspEx.

Subsequent to the year end the semi-annual review of the credit facility was completed, which resulted in no changes to the $65.0 million credit facility limit.

Share Capital

As at December 31, 2008, ProspEx had 57,385,162 common shares (2007 – 56,453,422), 2,016,269 warrants (2007 – 2,716,145), and 5,160,387 options (2007 – 4,655,917), issued and outstanding. Each warrant and option, upon exercise, entitles the holder to one common share.

As at March 16, 2009, ProspEx had 57,385,162 common shares, 2,016,269 warrants and 5,102,887 options issued and outstanding.

Subsequent Events

Effective February 1, 2009 the Company disposed of certain non core properties in the Wapiti area of Alberta. These properties consist of four (2.0 net) producing wells, with current net production of approximately 30 boe per day and 3,160 net acres of undeveloped land. The consideration paid to the Company was $2.1 million subject to normal closing adjustments.

Contractual Obligations

The Company has committed to certain payments over the next five years as follows:

Payments due *($000S)*	2009	2010	2011	2012	2013	Thereafter
Long-term debt	$ –	$ 40,807	$ –	$ –	$ –	$ –
Building lease	973	1,212	1,230	1,235	1,235	309
Processing fees	400	379	63	–	–	–
Transportation	673	79	–	–	–	–
Other	16	7	–	–	–	–
Total	$ 2,062	$ 42,484	$ 1,293	$ 1,235	$ 1,235	$ 309

The Company has met its commitment to incur $8.0 million in qualifying Canadian exploration expenditures related to the December 2007 flow-through share financing.

OFF-BALANCE SHEET ARRANGEMENTS

The Company has not entered into any off-balance sheet transactions.

SELECTED QUARTERLY FINANCIAL INFORMATION AND FOURTH QUARTER ANALYSIS

The following table highlights selected financial performance measures and results of the Company for each of the three month reporting periods from January 1, 2007 to December 31, 2008:

	Q4 2008	Q3 2008	Q2 2008	Q1 2008	Q4 2007	Q3 2007	Q2 2007	Q1 2007
Average Daily Production								
Natural Gas *(MCF/D)*	**16,868**	18,379	19,957	19,064	19,690	21,743	21,108	16,757
NGLs *(BBLS/D)*	**719**	722	851	536	515	548	513	290
Oil *(BBLS/D)*	**57**	65	108	68	125	82	210	83
Total *(BOE/D)*	**3,587**	3,850	4,285	3,781	3,922	4,254	4,241	3,166
Netbacks *($/BOE)*								
Price	**$ 45.59**	55.65	63.00	50.50	44.09	40.89	45.48	49.38
Unrealized financial instrument gain (loss)	**(1.10)**	23.36	(7.13)	(13.13)	(2.75)	(0.45)	3.96	(11.34)
Royalties	**(8.18)**	(12.98)	(11.97)	(8.57)	(5.41)	(7.79)	(3.97)	(9.85)
Operating costs	**(4.58)**	(7.76)	(8.39)	(10.17)	(8.06)	(8.42)	(7.86)	(7.38)
Transportation	**(1.00)**	(0.91)	(1.00)	(0.96)	(0.86)	(0.89)	(1.01)	(1.03)
General and Administrative	**(1.43)**	(2.55)	(2.02)	(2.53)	(2.32)	(2.00)	(2.13)	(2.24)
Total *($/BOE)*	**$ 29.30**	54.81	32.49	15.14	24.69	21.34	34.47	17.54
E&D Capital Spending *($000S)*	**$ 12,797**	12,693	8,615	17,383	9,090	13,053	7,751	18,656
Benchmark pricing								
AECO C Spot *($/MCF)*	**6.69**	7.75	10.22	7.90	6.14	5.18	7.07	7.40
Edmonton Par – light oil *($/BBL)*	**63.21**	121.74	126.07	97.50	86.42	79.95	71.93	67.09
Selected Financial Results *($000S, EXCEPT PER SHARE AMOUNTS)*								
Oil and gas revenue	**$ 15,046**	19,714	24,567	17,378	15,906	16,004	17,553	14,071
Net earnings (loss)	**487**	6,923	2,261	(2,110)	(180)	(1,352)	2,235	(1,794)
Basic per share	**$ 0.01**	0.12	0.04	(0.04)	0.00	(0.03)	0.04	(0.03)
Diluted per share	**$ 0.01**	0.12	0.04	(0.04)	0.00	(0.03)	0.04	(0.03)

SUMMARY OF QUARTERLY RESULTS

Overall quarter to quarter results are driven and influenced by many factors. The three main drivers are capital spending, production and commodity prices.

Capital spending is typically more heavily weighted to the winter drilling months, and therefore the fourth and first quarters of the year usually represent approximately 60 percent of the exploration and development budgets. The second quarter of each year usually has minimal capital spending, reflecting surface access restrictions due to spring break up conditions. Production additions typically lag capital spending by one or two quarters, resulting in production peaks in the second quarter of each year.

As previously mentioned production is a main driver of overall quarterly results. Production is not only influenced by production additions as a result of capital programs, but also by natural production declines as production from existing wells diminishes over time. With respect to the Company's overall quarterly production profile, production tends to peak in the second quarter of each year, reflecting new production additions from the winter drilling programs, and the subsequent quarters reflect declining production as natural production decline rates come into play.

World-wide commodity price environments have a significant influence on the overall Company's quarterly results. The Company is an overall price-taker in the oil & gas industry and as a result, world prices drive overall Company revenues. In recent times, as seen in the quarterly "Benchmark Prices", overall prices have been quite volatile and as a consequence quarterly total net oil and gas revenues follow these fluctuations. The Company uses financial instruments to reduce the exposure to commodity price fluctuations. Unrealized financial instrument gains and losses can fluctuate significantly when commodity prices change abruptly, as mark to market adjustments are booked each quarter.

FOURTH QUARTER HIGHLIGHTS

Production

Production in the fourth quarter of 2008 averaged 3,587 boe per day, a 7 percent decrease compared to third quarter 2008 production of 3,850 boe per day. Facility issues impacted fourth quarter production, with approximately 200 boe per day lost over the quarter due to mechanical failures at third party operated facilities at Ricinus and Wapiti, coupled with freezing problems at the Company's Medallion facility due to cold weather in late December.

Oil and gas revenue

Oil and gas revenue for the three months ended December 31, 2008 was $15.0 million, representing a 5 percent decrease over revenue of $15.9 million for the same period of 2007. Revenue was down relative to the third quarter of 2008 due to decreased production for reasons noted above, as well as a decrease in average sales prices.

During the fourth quarter of 2008, both the Company's natural gas prices as well as the AECO C Spot prices for natural gas increased by 9 percent compared to the fourth quarter of 2007. The Company's fourth quarter 2008 realized gas price includes an additional $0.38 per mcf realized from hedging gains while the fourth quarter of 2007 had hedging gains of $0.46 per mcf.

Financial instrument gains/losses

Realized financial instrument gains were down 28 percent in the fourth quarter of 2008 to $0.6 million from $0.8 million for the same quarter in 2007.

In the fourth quarter of 2008 the Company reported a $0.4 million unrealized loss on financial instruments. This is down 63 percent from the $1.0 million unrealized loss on financial instruments in the fourth quarter of 2007. The fair values of unsettled financial instruments are recorded as a current asset or liability with the change in the fair value recorded as an unrealized gain or loss in the statements of earnings and cash flows. As a result, changes in the fair value of financial instruments due to fluctuating forward natural gas prices and the purchase or expiration of financial contracts can lead to volatility in net earnings for the period.

Royalty expense

Royalty expense in the fourth quarter of 2008 was $2.7 million or 18 percent of oil and gas revenue, compared to $2.0 million or 12 percent of oil and gas revenue in the same period of 2007. In the fourth quarter of 2007 there were large royalty holidays recognized in the West Central Alberta and Deep Basin areas. The increase in royalties as a percentage of oil and gas revenue was the result of the expiration of these holidays as well as the production shift from the lower rate Southern Alberta area to the higher rate West Central Alberta area.

Depletion, depreciation and accretion

DD&A per boe for the fourth quarter of 2008 was consistent with the same period of 2007 with rates of $24.23 per boe in 2007 and $24.30 per boe in 2008. The cost of adding Proved reserves over the past twelve months was consistent relative to historical levels.

Operating expenses

The Company's unit operating costs decreased during the fourth quarter of 2008 compared to the same period of 2007 due to a finalization of previously accrued processing fees in the Deep Basin area, which resulted in a $1.5 million reduction in operating costs. Unit operating costs in the Deep Basin were substantially lower in the fourth quarter of 2008 compared to 2007, as mentioned. Southern Alberta unit operating costs increased while West Central Alberta unit operating costs decreased mostly due to changes in the volumes in those areas.

Transportation expenses

Transportation expense per boe remained unchanged at $0.3 million from the fourth quarter of 2008 compared to the same period of 2007.

General and administrative expenses

Expensed general and administration costs decreased for the fourth quarter of 2008 to $0.5 million, compared to the $0.8 million in the corresponding period in 2007 due to the finalization of 2008 salary and bonus expenses.

Interest and bank charges

Interest and bank charges totaled $0.4 million for the fourth quarter of 2008 compared with $0.5 million for the fourth quarter of 2007. The decrease in 2008 interest expense over the prior year resulted from the lower interest rates experienced in 2008.

Stock-based compensation

Stock-based compensation expense decreased from $0.3 million in the fourth quarter of 2007 to $0.1 million in the fourth quarter of 2008. This decrease was due to the reduction of the number options issued in the fourth quarter of 2008.

Income taxes

In the fourth quarter of 2008, the Company had an income tax expense of $0.6 million compared to income tax reduction of $0.5 million for the same period of 2007. The increase in income taxes from the fourth quarter of 2007 to the same period of 2008 is due to the $1.1 million in net earnings reported in 2008.

Net earnings (loss) and basic and diluted earnings (loss per share)

During the final quarter of 2008, the Company recorded net earnings of $0.5 million compared to a net loss of $0.2 million for the comparable period of 2007. The increase in net income was due to a combination of lower operating costs and lower unrealized financial instrument losses, offset by decreased production, higher depletion costs and higher royalty expense.

Net earnings or losses are affected by production volumes, operating netback, taxation rates, the risk management program and the Company's depletion charge which is a result of the Company's success in adding new proven oil and natural gas reserves.

Cash flow

Cash flow for the fourth quarter of 2008 increased 2 percent to $9.6 million from $9.4 million in the same period of 2007. The increase in cash flow is the result of higher netback prices offset by reduced production, resulting in higher net earnings in 2008.

Capital Expenditures

The Company invested $12.8 million in capital expenditures during the fourth quarter of 2008 compared to $9.1 million in the fourth quarter of 2007. Of the $12.8 million in 2008 capital expenditures, $9.5 million was spent in the Deep Basin, $2.3 million in West Central Alberta and $1.2 million in Southern Alberta. This compares to the fourth quarter of 2007 capital spending of $1.3 million in the Deep Basin, $2.7 million in West Central Alberta and $4.5 million in Southern Alberta. This change in capital spending to the Deep Basin is a reflection of the Company's focus on drilling at its Kakwa property.

OPERATIONAL AND OTHER BUSINESS RISKS

Need to Replace and Grow Reserves

The future oil and natural gas production of ProspEx, and therefore future cash flows, are highly dependent upon ongoing success in exploring the Company's current and future undeveloped land base, exploiting the current producing properties, and acquiring or discovering additional reserves. Without reserve additions through exploration, acquisition or development activities, reserves and production will decline over time as reserves are depleted.

The business of discovering, developing, or acquiring reserves is capital intensive. To the extent that cash flow from operations are insufficient and external sources of capital become limited or unavailable, the ability of ProspEx to make the necessary capital investments to maintain and expand its oil and natural gas reserves may be impaired.

There can be no assurance that ProspEx will be able to find and develop or acquire additional reserves to replace and grow production at acceptable costs.

Exploration, Development and Production Risks

Oil and natural gas exploration involves a high degree of risk, 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 ProspEx will result in new discoveries of oil and 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 ProspEx depends on its ability to find, acquire, develop and commercially produce oil and natural gas reserves. No assurance can be given that ProspEx will be able to continue to locate satisfactory properties for acquisition or participation. Moreover, if such acquisitions or participations are identified, ProspEx 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 operations conditions may adversely affect the production from successful wells. These conditions include delays in obtaining government approvals or consents, shut-ins of connected wells resulting from extreme weather conditions, insufficient storage, processing 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.

Reserve Estimates

The production forecast and recoverable estimates contained in the GLJ report of December 31, 2008 are only estimates and the actual production and ultimate recoverable reserves from the properties may be greater or less than the independent estimates of GLJ.

There are numerous uncertainties inherent in estimating quantities of reserves and cash flows to be derived there from, including many factors that are beyond the control of ProspEx. The reserve and cash flow information set forth herein represent estimates only. The reserves and estimated future net cash flow from the assets of ProspEx have been independently evaluated effective December 31, 2008 by GLJ. These evaluations include a number of assumptions relating to factors such as initial production rates, production decline rates, ultimate recovery of reserves, timing and amount of capital expenditures, marketability of production, future prices of oil and natural gas, operating costs and royalties and other government levies that may be imposed over the producing life of the reserves. These assumptions were based on price forecasts in use at the date the relevant evaluations were prepared and many of these assumptions are subject to change and are beyond the control of ProspEx. Actual production and cash flows will vary from these evaluations, and such variations could be material. The foregoing evaluations are based in part on the assumed success of exploitation activities intended to be undertaken in future years. The reserves and estimated cash flows contained in such evaluations will be reduced to the extent that such exploitation activities do not achieve the level of success assumed in the evaluations.

Volatility of Oil and Natural Gas Prices

The operational results and financial condition of ProspEx will be dependent on the prices received for oil and natural gas production. Oil and natural gas prices have fluctuated widely during recent years and are determined by supply and demand factors, including weather and general economic conditions as well as conditions in other oil and natural gas regions. Any decline in oil and natural gas prices could have an adverse effect on the operations, proved reserves, and financial conditions of ProspEx and could result in a reduction of the net production revenue of ProspEx causing a reduction in its oil and gas acquisition and development activities. In addition, bank borrowings that might be made available to ProspEx are typically determined in part by the borrowing base of the reserves of ProspEx. A sustained material decline in prices from historical average prices could reduce the borrowing base of ProspEx, therefore reducing the bank credit available to ProspEx and could require that a portion of such bank debt be repaid.

ProspEx uses the full cost method of accounting for oil and natural gas properties. Under this accounting method, capitalized costs are reviewed on a quarterly basis for impairment to ensure that the carrying amount of these costs is recoverable based on expected future cash flows. To the extent that such capitalized costs (net of accumulated depreciation and depletion) less future taxes exceed the present value of estimated future net cash flows from the proved oil and natural gas reserves of ProspEx, those excess costs would be required to be charged to operations.

Royalties

ProspEx is required to pay the Crown or other royalty owners for commodities produced. Crown royalty payments are subject to change and any changes may have an adverse impact on the profitability of a project. In October of 2007, the Alberta Government proposed changes to the royalty framework in Alberta. Such royalty framework, as amended, has been enacted and is effective as at the start of 2009. The Company believes that with the current pricing environment the impact on overall netbacks and net asset values will be modest.

On March 3, 2009, the Government of Alberta announced a three-point incentive program. This incentive program includes a drilling royalty credit for new oil and natural gas wells drilled between April 1, 2009 and March 31, 2010, providing a $200-per-metre-drilled royalty credit to companies on a sliding scale based on their production levels from last year. There is also a new well incentive program that provides a maximum 5 percent royalty rate for the first 12 months of production from new wells that begin producing oil or natural gas between April 1, 2009 and March 31, 2010 to a maximum of 50,000 barrels of oil or 500 million cubic feet of natural gas. The province of Alberta will also invest $30 million in a fund committed to abandonment and reclamation projects where there is no legally responsible or financially able party to deal with the clean-up of inactive wells. The Company is evaluating the impact of these recently announced proposals, and believes that they may create modest reductions in Crown royalties payable in 2009 and 2010.

Operational Hazards and Other Uncertainties

Oil and natural gas exploration operations are subject to all the risks and hazards typically associated with such operations, including hazards such as fire, explosion, blowouts and oil spills, each of which could result in substantial damage to oil and natural gas wells, production facilities, other property and the environment or in personal injury. In accordance with industry practice, ProspEx is not fully insured against all of these risks, nor are all such risks insurable. Although ProspEx will maintain liability insurance, where available, in an amount which it considers adequate and consistent with industry practice, the nature of these risks is such that liabilities could exceed policy limits, in which event ProspEx could incur significant costs that could have a material adverse effect upon its financial condition.

Business interruption insurance may also be purchased for selected facilities, to the extent that such insurance is available. Oil and natural gas production operations are also subject to all the risks typically associated with such operations, including premature decline of reservoirs and the invasion of water into producing formations.

Oil and natural gas exploration and development activities are dependant on the availability of drilling and related equipment in the particular areas where such activities will be conducted. Demand for such equipment or access restrictions may affect the availability and/or cost of such equipment to ProspEx and may delay exploration and development activities. To the extent ProspEx is not the operator of its oil and gas properties, ProspEx will be dependent on other operators for timing of activities related to non-operating properties and will be largely unable to direct or control the activities of the operators.

Although property title reviews will be done according to industry standards prior to the purchase of most oil and natural gas producing properties or the commencement of drilling wells, such reviews do not guarantee or certify that an unforeseen defect in the chain of title will not arise to defeat the claim of ProspEx which could result in a reduction of the revenue received by ProspEx.

Competition

There is strong competition relating to all aspects of the oil and natural gas industry. ProspEx will actively compete for capital, skilled personnel, undeveloped land, reserve acquisitions, access to drilling rigs, service rigs and other equipment, access to processing facilities, pipelines and refining capacity, and in all other aspects of its operations with a substantial number of other organizations, many of which may have greater technical and financial resources than ProspEx.

Key Personnel

The success of ProspEx will depend in large measure on certain key personnel. The loss of the services of such key personnel could have a material adverse affect on ProspEx. ProspEx does not have key person insurance in effect for management. The contributions of these individuals to the immediate operations of ProspEx are likely to be of central importance. In addition, the competition for qualified personnel in the oil and natural gas industry is intense and there can be no assurance that ProspEx will be able to continue to attract and retain all personnel necessary for the development and operation of its business.

Environmental Risks

The oil and natural gas industry is subject to environmental regulation pursuant to a variety of international conventions and Canadian federal, provincial and municipal laws, regulations, and guidelines. A breach of such regulations may result in the imposition of fines or issuances of clean-up orders in respect of ProspEx or its assets. Such regulation may be changed to impose higher standards and potentially more costly obligations on ProspEx. There can be no assurance that future environmental costs will not have a material adverse effect on ProspEx.

CRITICAL ACCOUNTING ESTIMATES

ProspEx's significant accounting policies are contained in note 1 to the consolidated financial statements. Certain of these policies are recognized as critical because in applying these policies management is required to make judgments, assumptions and estimates that have a significant impact on the financial results of ProspEx. The estimates used in applying these critical accounting policies have been discussed with the Audit Committee and are outlined below.

Oil and Gas Reserves

One hundred percent of the Company's P+P oil and gas reserves as of December 31, 2008 were evaluated and reported on by an independent qualified reserves evaluator. The process of estimating oil and gas reserves is, however, complex and is subject to uncertainties and interpretations. Estimating reserves requires significant judgments based on available geological and reservoir data, past production and operating performance and forecasted economic and operating conditions. These estimates may change substantially as additional data from ongoing development, testing and production becomes available, and due to unforeseen changes in economic conditions which impact oil and gas prices and costs. The Company's reserves and revisions to those reserves have a significant impact on net earnings as they are a key component in calculating depletion of oil and gas assets and oil and gas asset impairments.

Asset Impairment

ProspEx follows the Canadian Institute of Chartered Accountants ("CICA") Accounting Guideline 16 for full cost oil and gas accounting. In accordance with full cost accounting, a ceiling test is performed on a quarterly basis, to test for impairment. An impairment loss may be 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 oil and 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 used in testing for impairment are based on a number of estimates, the two most significant being future prices and reserves. The uncertainty in reserves is discussed above. The Company estimates its future prices based on the forward market, adjusted for basis, quality and transportation at the end of the period for the first ten years, after which the estimate of price is determined by the Company's independent reserve evaluator. Although these price estimates are independent of the Company, they are still subject to significant volatility. Operating costs are estimated using current operating costs per barrel plus an inflation factor.

Certain costs related to unproven properties are excluded from costs subject to depletion until proven reserves have been determined or their value is impaired. These properties are reviewed quarterly and any impairment is transferred to the costs being depleted.

Asset Retirement Obligation

The Company records a liability for the legal obligation associated with the retirement of long-lived assets and a corresponding increase in the related asset in accordance with the method outlined by the CICA. The future liability is comprised of estimates of future costs to abandon and restore a well site and natural gas processing plants. The estimation of these costs is based on engineering estimates using current costs and technology and in accordance with current legislation and industry practice. These estimates are reviewed annually and could impact net earnings through an adjustment to the depletion, depreciation and amortization rate used by the Company.

Income Taxes

ProspEx follows the asset and liability method of accounting for income taxes. At the end of each reporting period, the Company estimates its tax pool balances and quantifies differences between the tax pools and the accounting balances. ProspEx's income and other tax liabilities require interpretation of complex laws and regulations. All tax filings are subject to audit and potential reassessment after the lapse of time. Accordingly, the actual income tax asset or liability may differ significantly from that estimated and recorded by ProspEx.

NEW ACCOUNTING PRONOUNCEMENTS

Accounting Standards Adopted and Recent Pronouncements

Financial Instruments – Effective January 1, 2008 the Company adopted the new accounting standards for disclosure required under CICA Handbook Section 3862 "Financial Instruments – Disclosures", which applies to both recognized and unrecognized financial instruments. These disclosures, which include the nature and extent of risks arising from financial instruments, are included in note 8 of the December 31, 2008 financial statements of the Company.

Capital Disclosures – Effective January 1, 2008, ProspEx adopted the new requirements of the CICA for disclosure of the Company's objectives, policies and processes for managing capital (Section 1535) as discussed in note 8 of the December 31, 2008 Financial Statements.

Convergence with International Reporting Standards (IFRS) – On February 13, 2008, the Canadian Accounting Standards Board confirmed that the effective date for the convergence of Canadian Generally Accepted Accounting Principles ("GAAP") for publicly accountable entities to International Financial Reporting Standards will be 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 an impairment test, under IFRS standards, be conducted at the transition date.

Although the amended IFRS 1 standard would provide relief, the changeover to IFRS represents a significant change in accounting standards and the transition from current Canadian GAAP to IFRS will be a significant undertaking that may materially affect the Company's reported financial position and reported results of operations.

In response, the Company has completed its high-level IFRS changeover plan and is establishing a preliminary timeline for the execution and completion of the conversion project. The changeover plan was determined following a preliminary assessment of the differences between Canadian GAAP and IFRS and the potential effects of IFRS to accounting and reporting processes, information systems, business processes including internal controls over financial reporting and external disclosures.

During the next phase of the project, scheduled to take place during 2009, the Company will perform 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, select from transitional options and determine 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 business activities and processes. Staff training programs will continue in 2009 as the project unfolds.

DISCLOSURE CONTROLS AND POLICIES

Disclosure controls and procedures have been designed to ensure that information required to be disclosed by the Company is accumulated and communicated to the Company's management as appropriate to allow timely decisions regarding required disclosure. The Company's Chief Executive Officer and Chief Financial Officer have concluded, based on their evaluation as of December 31, 2008, that the Company's disclosure controls and procedures as at such date are effective to provide reasonable assurance that material information related to the Company, including its consolidated subsidiary, is made known to them by others within those entities. It should be noted that while the Company's Chief Executive Officer and Chief Financial Officer believe that the Company's disclosure controls and procedures provide a reasonable level of assurance that they are effective, they do not expect that the disclosure controls and 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.

INTERNAL CONTROLS OVER FINANCIAL REPORTING

The Chief Executive Officer and Chief Financial Officer of the Company have caused under their supervision the design of internal controls over financial reporting ("ICFR"), and have evaluated the design and effectiveness of those controls. Based on this evaluation, the Chief Executive Officer and Chief Financial Officer of the Company have concluded that the design and effectiveness of the Company's ICFR as of December 31, 2008, provides reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with Canadian GAAP.

ICFR has inherent limitations no matter how well designed such controls may be. Control systems can only provide reasonable, not absolute, assurance that the objectives of the control systems are met.

There were no changes to the Company's ICFR during 2008.

ADVISORIES

Non-GAAP Measures

Within the MD&A references are made to terms commonly used in the oil and gas industry. The following terms are not defined by GAAP in Canada and are referred to as non-GAAP measures.

1. Cash flow is defined as cash flow from operations before the change in non-cash working capital. The MD&A contains the term "cash flow" which should not be considered an alternative to, or more meaningful than "cash flow from operations" as determined in accordance with GAAP. The Company considers cash flow to be a key measure as it demonstrates the Company's ability to generate the cash necessary to fund capital projects and to repay debt. Cash flow presented does not have any standardized meaning prescribed by Canadian GAAP and therefore it may not be comparable with the calculation of similar measures for other entities. Cash flow per share is calculated using the same weighted average number of common shares for the period as used in calculating the net earnings per share calculation.
2. Netbacks equal total revenue less royalties, operating costs and general and administrative costs on a boe basis. Total boes are calculated by multiplying the daily production by the number of days in the period.

Reserves

Reserves replacement ratio is calculated by dividing the sum of the reserves added, plus or minus any revisions, and dividing by the production volume over the period.

Reserve life index is calculated by dividing the reserves balance at year end by the annualized production rate during the prior quarter.

BOE

Barrel of oil equivalent amounts have been calculated using a conversion rate of six thousand cubic feet of gas to one barrel of oil. The term "boe" may be misleading if used in isolation. A boe conversion ratio of one barrel of oil to six mcf of gas is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the well head.

Finding and Development Costs

The aggregate of the exploration and development costs incurred in the most recent financial year and the change during that year in estimated future development costs generally will not reflect total finding and development costs related to reserve additions for that year.

Forward-looking Information

Certain information regarding ProspEx including, without limitation, management's assessment of future plans and operations, constitutes forward-looking information or statements under applicable securities law and necessarily involves assumptions regarding factors and risks that could cause actual results to vary materially, including, without limitation, assumptions and risks associated with oil and gas exploration, development, exploitation, production, marketing and transportation, loss of markets, volatility of commodity prices, currency fluctuations, royalty rates, decline rates, imprecision of reserve estimates, environmental risks, competition, incorrect assessment of the value of acquisitions, failure to realize the anticipated benefits of acquisitions and ability to access sufficient capital from internal and external sources.

The reader is cautioned that these factors and risks are difficult to predict and that the assumptions used in the preparation of such information, although considered reasonable by ProspEx at the time of preparation, may prove to be incorrect. Accordingly, readers are cautioned that the actual results achieved will vary from the information provided herein and the variations may be material. Readers are also cautioned that the foregoing list of assumptions, factors and risk is not exhaustive. Additional information on the foregoing assumptions, risks and other factors that could affect ProspEx's operations or financial results are included in ProspEx's public disclosure documents on file with Canadian securities regulatory authorities. In particular see ProspEx's MD&A and the Risk Factors and Industry Conditions sections of ProspEx's 2008 Annual Information Form. ProspEx's reports may be accessed through the SEDAR website (www.sedar.com), at ProspEx's website (www.psx.ca) or by contacting the Company directly. Consequently, there is no representation by ProspEx that actual results achieved will be the same in whole or in part as those set out in the forward-looking information.

Furthermore, the forward-looking information and statements contained in this MD&A are made as of the date of this MD&A, and ProspEx does not undertake any obligation to update publicly or to revise any of the included forward-looking information and statements, whether as a result of new information, future events or otherwise, except as required by law. The forward-looking information and statements contained herein are expressly qualified by this cautionary statement.

// management's report

Management has prepared the consolidated financial statements in accordance with accounting principles generally accepted in Canada. If alternative accounting methods exist, management has chosen those methods it deems most appropriate in the circumstances. Financial statements are not precise as they include certain amounts based on estimates and judgments. Management believes such estimates have been based on careful judgments and have been properly reflected in the accompanying consolidated financial statements. Management has also prepared the financial information presented elsewhere in the annual report and ensured that it is consistent with information in the consolidated financial statements.

ProspEx Resources Ltd. maintains internal accounting and administrative controls designed to provide reasonable assurance that the financial information is relevant, reliable and accurate and that assets are appropriately accounted for and adequately safeguarded.

The Board of Directors is responsible for reviewing and approving the consolidated financial statements and Management's Discussion and Analysis and, primarily through its Audit Committee, ensures that management fulfills its responsibilities for financial reporting.

The Audit Committee is appointed by the Board and is composed of Directors who are not employees of the Company. The Audit Committee meets periodically with management and with the external auditors to satisfy themselves that management responsibilities are being properly discharged, to review the consolidated financial statements and to recommend approval of the consolidated financial statements to the Board. The Audit Committee also considers, for review by the Board and approval by the shareholders, the engagement or reappointment of external auditors.

KPMG LLP, the external auditors, has audited the consolidated financial statements in accordance with the auditing standards generally accepted in Canada on behalf of the shareholders. KPMG LLP has full and free access to the Audit Committee.

John W. Rossall
President and Chief Executive Officer
Calgary, Alberta
March 16, 2009

George D.K. Yee
Vice President, Finance & Chief Financial Officer

// auditors' report

TO THE SHAREHOLDERS OF PROSPEX RESOURCES LTD.

We have audited the consolidated balance sheets of ProspEx Resources Ltd. as at December 31, 2008 and 2007 and the consolidated statements of earnings (loss), comprehensive earnings (loss) and retained earnings and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

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

KPMG LLP

KPMG LLP
Chartered Accountants
Calgary, Alberta
March 16, 2009

// consolidated balance sheets

(STATED IN THOUSANDS OF DOLLARS) *AS AT DECEMBER 31,*	**2008**	2007
Assets		
Current assets		
Accounts receivable	$ **10,770**	$ 12,900
Prepaid expenses	**693**	988
Unrealized financial instrument gain	**828**	214
	12,291	14,102
Property, plant and equipment, net *(NOTE 3)*	**190,693**	161,663
Total assets	$ **202,984**	$ 175,765
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities	$ **22,078**	$ 22,761
Future income tax liability *(NOTE 4)*	**240**	69
	22,318	22,830
Long-term debt *(NOTE 5)*	**40,807**	28,846
Asset retirement obligation *(NOTE 6)*	**6,462**	5,201
Future income tax liability *(NOTE 4)*	**9,119**	3,145
Total liabilities	**78,706**	60,022
Shareholders' Equity		
Common shares *(NOTE 7)*	**90,802**	90,543
Common share performance warrants *(NOTE 7)*	**1,233**	1,661
Contributed surplus *(NOTE 7)*	**6,758**	5,614
Retained earnings	**25,485**	17,925
Total shareholders' equity	**124,278**	115,743
	$ **202,984**	$ 175,765

Subsequent event *(NOTE 11)*

See accompanying notes to consolidated financial statements.

On Behalf of the Board of Directors:

John W. Rossall
Director

Kyle D. Kitagawa
Director

// consolidated statements of earnings (loss), comprehensive earnings (loss) and retained earnings

(STATED IN THOUSANDS OF DOLLARS, EXCEPT PER SHARE AMOUNTS)
FOR THE YEARS ENDED DECEMBER 31,

	2008	2007
Revenue		
Oil and gas	**$ 76,705**	$ 63,534
Unrealized financial instrument gain (loss)	**614**	(2,867)
Royalties	**(14,916)**	(9,343)
	62,403	51,324
Expenses		
Operating	**11,034**	11,341
Transportation	**1,373**	1,343
Depletion, depreciation and accretion	**33,084**	33,889
General and administrative	**3,032**	3,080
Interest and bank charges	**1,913**	2,047
Stock-based compensation	**750**	1,156
	51,186	52,856
Earnings (loss) before income taxes	**11,217**	(1,532)
Income taxes *(NOTE 4)*		
Future (reduction)	**3,657**	(441)
Net earnings (loss) and comprehensive earnings (loss) for the year	**7,560**	(1,091)
Retained earnings, beginning of year	**17,925**	19,016
Retained earnings, end of year	**$ 25,485**	$ 17,925
Net earnings (loss) per share		
Basic	**$ 0.13**	$ (0.02)
Diluted	**$ 0.13**	$ (0.02)

See accompanying notes to consolidated financial statements.

// consolidated statements of cash flows

(STATED IN THOUSANDS OF DOLLARS) FOR THE YEARS ENDED DECEMBER 31,	2008	2007
Operations		
Net earnings (loss) for the year	$ 7,560	$ (1,091)
Items not involving cash		
Depletion, depreciation and accretion	33,084	33,889
Stock-based compensation	750	1,156
Future income taxes (reduction)	3,657	(441)
Unrealized financial instrument (gain) loss	(614)	2,867
Asset retirement expenditures	(111)	(383)
	44,326	35,997
Changes in non-cash working capital	3,576	(901)
	47,902	35,096
Financing		
Issuance of shares	1,678	8,020
Increase in long-term debt	11,962	12,080
	13,640	20,100
Investing		
Exploration and development expenditures	(51,488)	(48,550)
Property acquisitions	(9,226)	–
Deposit on property acquisition	1,175	(1,175)
Expenditure on asset held for resale	–	937
Other capital expenditures	(168)	(160)
	(59,707)	(48,948)
Changes in non-cash working capital	(1,835)	(6,248)
	(61,542)	(55,196)
Change in cash	–	–
Cash, beginning of year	–	–
Cash, end of year	$ –	$ –

See accompanying notes to consolidated financial statements.

// notes to consolidated financial statements

FOR THE YEARS ENDED DECEMBER 31, 2008 AND 2007

1. SIGNIFICANT ACCOUNTING POLICIES

ProspEx Resources Ltd. ("ProspEx" or the "Company") is engaged in the acquisition, exploration, development and production of oil and natural gas in Canada. ProspEx was incorporated on August 13, 2004 and commenced operations on October 1, 2004 when certain assets of Esprit Exploration Ltd. were transferred to ProspEx under a Plan of Arrangement.

These financial statements have been prepared in accordance with Canadian generally accepted accounting principles. The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reported period. Actual results may differ from these estimates.

(a) Consolidation

The consolidated financial statements include the accounts of the Company and its subsidiary. A substantial portion of the Company's activities are conducted jointly with others and the consolidated financial statements reflect only the Company's proportionate interest in such activities.

(b) Property, Plant and Equipment

The Company follows the full cost method of accounting for exploration and development expenditures whereby all costs relating to the acquisition of, exploration for and development of oil and gas reserves, including asset retirement costs, are capitalized. Such costs include lease acquisition, geological and geophysical analysis, lease rentals on undeveloped properties, drilling both productive and non-productive wells, production equipment and overhead charges directly related to acquisition, exploration and development activities. Proceeds received from disposals of properties and equipment are credited against capitalized costs unless the disposal would alter the rate of depletion and depreciation by more than 20 percent, in which case a gain or loss on disposal is recorded.

Capitalized costs and estimated costs of future development of proved undeveloped reserves are depleted and depreciated by the unit of production method based on estimated gross proved reserves before royalties as determined by independent engineers. The costs of undeveloped properties are excluded from costs subject to depletion until it is determined whether or not proved reserves are attributable to the properties or impairment has occurred. Oil and gas reserves are converted to equivalent units using their relative energy content.

Oil and gas assets are evaluated in each reporting period to confirm that the costs are recoverable and do not exceed the fair value of the properties. The costs are assessed to be recoverable if the sum of the undiscounted cash flows expected from the production of proved reserves and the lower of cost and market of unproved properties exceed the carrying value of the oil and gas assets. If the carrying value of the oil and gas assets is not assessed to be recoverable, 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 future product prices and costs and are discounted using the risk-free rate.

Amortization of capital assets not related to oil and gas assets is provided using the declining balance method at a rate from 20 to 50 percent per annum. Leasehold improvements are amortized using the straight-line method over the terms of the respective leases.

(c) Asset Retirement Obligation

The Company records the fair value of legal obligations associated with the retirement of long-lived tangible assets, such as producing well sites, in the period in which they are incurred and a corresponding increase in the carrying amount of the related long-lived asset. The liability accretes until the Company expects to settle the retirement obligation. The asset retirement costs are depleted using the unit of production method. Actual costs to retire tangible assets are deducted from the liability as incurred.

(d) Income Taxes

The Company follows the asset and liability method of accounting for future income taxes. Under this method, future income tax assets and liabilities are determined based on differences between the amounts reported in the financial statements and the tax basis of the assets and liabilities, and are measured using the currently enacted, or substantively enacted, tax rates and laws expected to apply when these differences reverse.

(e) Stock-based Compensation

Stock options and special performance units granted have been accounted for based on the fair value method. The fair value is measured at the grant date and charged to earnings or capital assets over the vesting period with a corresponding increase in contributed surplus. For awards that vest on a graded basis, compensation cost is recognized on a pro-rata basis over the vesting period. Consideration paid to the Company on exercise of all options is credited to share capital. When stock options and special performance units are exercised, contributed surplus is reduced by the fair value originally attributed to them.

(f) Financial Instruments

A financial instrument is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument to another entity. Upon initial recognition all financial instruments, including derivatives, are recognized on the balance sheet at fair value. Subsequent measurement is then based on the financial instruments being classified into one of five categories: held for trading, held to maturity, loans and receivables, available for sale and other liabilities. The Company has designated its financial instruments into the following categories applying the indicated measurement methods:

Financial Instrument	Category	Measurement Method
Accounts receivable	Loans and receivables	Amortized cost
Accounts payable and accrued liabilities	Other liabilities	Amortized cost
Long-term debt	Other liabilities	Amortized cost
Unrealized financial instrument gains/losses	Other liabilities or receivables as applicable	Fair value

The Company uses derivative financial instruments and commodity price hedges to manage its exposure to volatility in commodity prices. These financial instruments are not used for trading or other speculative purposes.

Gains or losses on commodity price financial instruments designated as hedges are reflected as adjustments to the related revenue when the gain or loss is realized.

Commodity price financial instruments that do not qualify as hedges, or have not been designated as such, are recorded at fair value on inception. Realized gains or losses on these financial instruments are reflected as adjustments to the related revenue when the gain or loss is realized; unrealized gains and losses on these instruments are recognized as adjustments to the related revenue at the end of each reporting period. The estimated fair value of these instruments is based on quoted market prices, or if quotes are not available, third-party market indications and forecasts are used.

(g) Earnings Per Share

The Company uses the treasury stock method to determine the dilutive effect of outstanding stock options, special performance units and warrants. Basic and diluted earnings per share are calculated using the weighted average number of common shares outstanding during the period. Diluted per share amounts reflect the potential dilution that could occur if securities or other contracts to issue common shares were exercised or converted to common shares. Anti-dilutive options and warrants are excluded from the calculation.

(h) Revenue Recognition

Revenue from the sale of crude oil, natural gas and natural gas liquids is recorded when title passes.

(i) Environmental Liabilities

The Company records liabilities on an undiscounted basis for environmental remediation efforts that are likely to occur and where the cost can be reasonably estimated. The estimates, including associated legal costs, are based on available information using existing technology and enacted laws and regulations. The estimates are subject to revision in future periods based on actual costs incurred or new circumstances. Any amounts expected to be recovered from other parties, including insurers, are recorded as an asset separate from the associated liability.

2. CHANGES IN ACCOUNTING POLICIES

(a) Financial Instruments – disclosures

On January 1, 2008, the Company adopted the new accounting standard for financial instruments – disclosures, which applies to both recognized and unrecognized financial instruments. The standards require that disclosure be made of the nature and extent of risks arising from financial instruments and how the Company manages those risks. This adoption did not have any impact on the results of operations or net financial position, as it is a disclosure related standard. These disclosures are included in note 8.

(b) Capital Disclosures

On January 1, 2008, the Company adopted the new accounting standard for disclosure of the Company's objectives, policies and processes for managing capital. This new adoption did not have any impact on the results of operations or net financial position, as it is a disclosure related standard. These disclosures are included in note 8.

3. PROPERTY, PLANT & EQUIPMENT

($000S)	**2008**	2007
Exploration and development properties	**$ 290,757**	$ 229,213
Other	**1,046**	878
	291,803	230,091
Less accumulated depletion, depreciation and amortization	**(101,110)**	(68,428)
Total property, plant and equipment	**$ 190,693**	$ 161,663

At December 31, 2008 oil and gas properties included $24.3 million (2007 – $19.6 million) of unproved properties that have been excluded from the depletion calculation. Future development costs related to proved undeveloped reserves of $20.6 million (2007 – $22.1 million) are included in the depletion calculation.

During 2008 the Company capitalized $3.6 million (2007 – $4.2 million) of overhead and stock-based compensation directly related to acquisition, exploration and development activities.

The Company performed a ceiling test calculation at December 31, 2008 resulting in the undiscounted cash flows from proved reserves and the lower of cost and market of unproved properties exceeding the carrying value of oil and gas assets. The prices used in the ceiling test evaluation of the Company's oil and gas assets are summarized below:

	Gas ($ per thousand cubic feet) [1]	Natural gas liquids ($ per barrel) [1]	Oil ($ per barrel) [2]
2009	6.69	52.07	66.15
2010	7.73	60.55	77.11
2011	8.04	64.43	82.33
2012	7.79	65.71	84.07
2013	7.67	66.96	85.75
2014	9.14	73.98	97.84
2015	9.34	75.49	99.82
2016	9.54	77.02	101.83
2017	9.75	78.58	103.89
2018	9.95	80.17	105.99
2019	10.15	81.78	108.11
2020	+2%	+2%	+2%

[1] Weighted average plantgate price.
[2] Weighted average wellhead price.

4. FUTURE INCOME TAXES

The provision for future income taxes differs from the amount computed by applying the combined expected Canadian Federal and Provincial tax rates to earnings (loss) before income taxes. The reasons for these differences are as follows:

($000S)		**2008**		2007
Earnings (loss) before income taxes	**$**	**11,217**	$	(1,532)
Rate *(%)*		**29.50%**		32.12%
Computed expected provision (reduction) for future income taxes		**3,309**		(492)
Increase (decrease) in taxes resulting from:				
Stock-based compensation expensed		**221**		371
Effect of change in tax rate		**(206)**		(458)
Other		**333**		138
Income tax expense (reduction)	**$**	**3,657**	$	(441)

The current future income tax liability at December 31, 2008 of $0.2 million (2007 – $0.1 million) results from the future tax impact of the unrealized financial instrument gain.

The components of the long term future income tax liability at December 31 are as follows:

($000S)	2008	2007
Property, plant and equipment	$ (10,697)	$ (3,744)
Asset retirement obligation	1,773	509
Share issue costs	305	590
	(8,619)	(2,645)
Valuation allowance	(500)	(500)
Future income tax liability	$ (9,119)	$ (3,145)

At December 31, 2008 the Company had estimated tax pools available to reduce future taxable income of $154.6 million (2007 – $147.0 million). ProspEx has met its commitment to incur $8.0 million in qualifying Canadian exploration expenditures related to the December 2007 flow-through share financing.

Capitalized stock based compensation resulted in an increase to future tax liabilities of $0.3 million during the year ended December 31, 2008 (2007 – $0.4 million).

During the first quarter of 2008, the renouncement of flow-through shares resulted in an increase of future tax liability of $2.2 million (2007 – $4.5 million).

5. LONG-TERM DEBT

At December 31, 2008 the Company had a $65.0 million credit facility with a Canadian chartered bank. The facility is available by way of Canadian dollar prime and US dollar base rate loans, LIBOR advances, bankers' acceptances and letters of credit. Canadian prime rate loans, US base rate loans, and LIBOR advances bear interest at Canadian prime, US base rate or LIBOR, as applicable, plus a margin dependant upon the Company's debt/cash flow ratio as calculated in the previous quarter. Stamping fees for bankers' acceptances are based on a rate adjusted over the term to maturity plus a margin as described above. The margins and stamping fees varied from 3.01 percent to 5.88 percent in 2008 compared to 5.39 percent to 6.12 percent in 2007. The credit facility is fully revolving until June 30, 2009 and may be extended at the mutual agreement of ProspEx and its lender for an additional year. If the credit facility is not extended, a repayment is required on July 1, 2010. This facility is secured by a $200 million demand debenture and a first floating charge on all petroleum and natural gas assets of ProspEx.

Subsequent to the year end the semi-annual review of the credit facility was completed, which resulted in no changes to the $65.0 million credit facility limit.

6. ASSET RETIREMENT OBLIGATION

The Company has estimated the net present value of its total asset retirement obligation at December 31, 2008 to be $6.5 million (2007 – $5.2 million) based on a total future liability of $22.2 million (2007 – $19.0 million). The total future liability was estimated based on the Company's net ownership interest in all wells and facilities, estimated costs to reclaim and abandon the wells and facilities and the estimated timing of when the costs will be incurred. These payments are expected to be made over the next 33 years with the majority of costs incurred between 2029 and 2042. A seven percent discount rate and two percent inflation rate were used to calculate the present value of the asset retirement obligation.

($000S)		2008		2007
Balance at the beginning of the year	$	**5,201**	$	4,157
Liabilities incurred		**814**		560
Change in assumptions		**157**		567
Accretion expense		**401**		300
Liabilities settled		**(111)**		(383)
Balance at the end of the year	$	**6,462**	$	5,201

7. SHAREHOLDERS' EQUITY

(a) Shares authorized

An unlimited number of common shares and non-voting common shares and an unlimited number of preferred shares are authorized for issuance.

(b) Common Shares & Common Share Performance Warrants Issued

	2008			2007		
	Number of Shares/Warrants (000S)		**Amount ($000S)**	Number of Shares/Warrants (000S)		Amount ($000S)
Common shares						
Balance at the beginning of the year	**56,453**	$	**90,543**	53,790	$	85,681
Issued on exercise of options	**232**		**747**	72		243
Shares issued on exercise of warrants	**700**		**1,407**	169		353
Flow-through shares issued – December 13, 2007	**–**		**–**	2,170		8,029
Flow-through shares tax adjustment	**–**		**(2,218)**	–		(4,461)
Issue costs, net of future tax reduction of $14 (2007 – $140)	**–**		**(34)**	–		(351)
Shares issued under special performance unit plan	**–**		**–**	252		3
Adjustment to contributed surplus for options exercised	**–**		**357**	–		1,046
Balance at the end of the year	**57,385**	$	**90,802**	56,453	$	90,543
Common share performance warrants						
Balance at the beginning of the year	**2,716**	$	**1,661**	2,908	$	1,778
Exercised	**(700)**		**(428)**	(169)		(104)
Cancelled	**–**		**–**	(23)		(13)
Balance at the end of the year	**2,016**	$	**1,233**	2,716	$	1,661

All outstanding performance warrants entitle the holder to acquire a common share at a price of $1.40 and expire no later than October 1, 2009.

The estimated fair value of the common share performance warrants was recognized as a reduction of the common share capital with a corresponding increase to common share performance warrants.

On December 13, 2007 ProspEx issued 2,170,000 common shares on a flow-through basis at a price of $3.70 per share for total gross proceeds of $8.0 million.

(c) Contributed Surplus

($000S)	2008	2007
Balance at the beginning of the year	**$ 5,614**	$ 4,348
Stock-based compensation	**1,501**	2,312
Exercise of stock options and special performance units	**(357)**	(1,046)
Balance at the end of the year	**$ 6,758**	$ 5,614

(d) Stock Options and special performance units

ProspEx has a stock option plan for directors, officers and employees that provides for the granting of options to acquire common shares. Under the terms of the plan, options normally vest equally over a three-year period, and expire five years after the date of grant. At December 31, 2008, options to acquire 5.2 million (2007 – 5.6 million) common shares were authorized for issuance under the stock option plan. Changes in outstanding options during the year ended December 31, 2008 and 2007 are summarized below:

	2008		2007	
	Options (000S)	**Weighted Average Exercise Price**	Options (000S)	Weighted Average Exercise Price
Outstanding at beginning of year	**4,656**	**$ 3.62**	3,354	$ 3.49
Granted	**907**	**2.64**	1,725	3.96
Exercised	**(232)**	**3.22**	(72)	3.38
Forfeited	**(171)**	**4.29**	(351)	4.06
Outstanding at end of year	**5,160**	**$ 3.44**	4,656	$ 3.62

ProspEx had a special performance unit ("SPU") plan for directors, officers and employees. At December 31, 2007 there were no SPU outstanding, and there was no further activity in 2008 relating to these SPU. Changes in SPU during the year ended December 31, 2007 were as follows:

(000S)	2008	2007
Outstanding at beginning of year	**–**	436
Exercised	**–**	(406)
Forfeited	**–**	(30)
Outstanding at end of year	**–**	–

The following table summarizes stock options outstanding and exercisable at December 31, 2008:

	Options outstanding			Options exercisable	
Range of exercise price	Number of outstanding at year end *(000s)*	Weighted average remaining contractual life (years)	Weighted average exercise price	Number exercisable at year end *(000s)*	Weighted average exercise price
$1.25 – 2.32	296	4.9	$ 1.25	–	$ –
$2.33 – 3.39	2,308	1.6	3.21	1,801	3.22
$3.40 – 4.46	2,556	2.9	3.91	1,176	3.90
	5,160	2.2	$ 3.45	2,977	$ 3.49

The fair value of each stock option and SPU granted is estimated on the date of the grant using the Black-Scholes option pricing model with the following weighted average assumptions for grants as follows:

	2008	2007
Risk-free interest rate	**3%**	4%
Expected life	**5 years**	5 years
Expected volatility	**56%**	44%
Expected dividend yield	**Nil**	Nil

The estimated fair value of stock options granted in 2008 was $1.0 million (2007 – $2.7 million). This estimated fair value is being amortized to earnings and capitalized to property, plant and equipment over the vesting period. A total of $0.8 million (2007 – $1.2 million) of stock and unit-based compensation was recorded against income in 2008 and $0.8 million (2007 – $1.2 million) was capitalized.

(e) Per Share Amounts

Basic per share amounts are calculated using the weighted average number of common shares outstanding during the year. Diluted per share amounts are calculated based on the treasury stock method, which assumes that any proceeds obtained on exercise of options would be used to purchase common shares at the average price during the year. The weighted average number of shares outstanding is then adjusted by this amount.

	2008	2007
Weighted average common shares basic	**57,054,424**	54,094,873
Dilutive securities:		
Stock options	**100,413**	288,204
Performance warrants	**946,482**	1,747,150
Special performance units	**–**	188,075
Diluted	**58,101,319**	56,318,302

For the year ended December 31, 2008, a weighted total of 4,615,261 (December 31, 2007 – 2,871,729) options and warrants were excluded from the diluted calculations as they were anti-dilutive.

8. FINANCIAL INSTRUMENTS, RISK MANAGEMENT AND CAPITAL MANAGEMENT STRATEGY

Overview

The Company has exposure to a number of risks from its use of financial instruments including, without limitation:

- Credit risk
- Liquidity risk
- Market risk
- Foreign currency exchange risk

This note presents information about the Company's exposure to each of the credit, liquidity and market risks and the Company's objectives, policies and processes for measuring and managing risk, and the Company's management of capital. Further quantitative disclosures are included throughout these financial statements.

The Board of Directors has overall responsibility for the establishment and oversight of the Company's risk management framework. The Board has implemented and monitors compliance with risk management policies.

The Company's risk management policies are established to identify and analyze the risks faced by the Company, to set appropriate risk limits and controls, and to monitor risks and adherence to market conditions and the Company's activities.

Credit Risk

Credit risk relates to the Company's receivables from joint venture partners and petroleum and natural gas marketers and the risk of financial loss if a customer, partner or counterparty to a financial instrument fails to meet its contractual obligations. A substantial portion of the Company's accounts receivable are with customers in the energy industry and are subject to normal industry credit risk. The Company generally grants unsecured credit but routinely assesses the financial strength of its partners and marketers.

Receivables from petroleum and natural gas marketers are normally collected on the 25th day of the month following production. The Company sells the majority of its production to two petroleum and natural gas marketers therefore is subject to concentration risk. To date the Company has not experienced any collection issues with its petroleum and natural gas marketers. Joint venture receivables are typically collected within one to three months of the joint venture bill being issued to the partner. The Company attempts to mitigate the risk from joint venture receivables by obtaining joint venturer approval of significant capital expenditures prior to expenditure. The Company does not typically obtain collateral from petroleum and natural gas marketers or joint venturers; however in certain circumstances, it may elect to cash call a joint venturer in advance of the work.

As at December 31, 2008 the Company's receivables consisted of $4.3 million (2007 – $5.3 million) from joint venture partners, $4.2 million (2007 – $5.1 million) of receivables from petroleum and natural gas marketers and $2.3 million (2007 – $2.5 million) of other receivables.

The carrying amount of accounts receivable represents the maximum credit exposure. The Company does not have an allowance for doubtful accounts as at December 31, 2008 or 2007 and did not provide for any doubtful accounts nor was it required to write-off any receivables during the year end ended December 31, 2008 or 2007.

Liquidity risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they are due. The Company's approach to managing liquidity is to ensure, as far as practicable, that it will have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions without incurring unacceptable losses or risking harm to the Company's reputation.

The Company prepares annual capital expenditure budgets, which are regularly monitored and updated as considered necessary. Further, the Company utilizes authorizations for expenditures on both operated and non-operated projects to further manage capital expenditures. To facilitate the capital expenditure program, the Company has a revolving reserve based credit facility, as outlined in note 5. The Company also attempts to match its payment cycle with collection of petroleum and natural gas revenues on the 25th of each month.

The following are the contractual maturities of financial liabilities and associated interest payments due as at December 31, 2008:

Financial Liability *($000S)*		< 1 year	1 – 2 years	2 – 5 years	Thereafter
Accounts payable and accrued liabilities	$	22,078	–	–	–
Long-term debt		–	40,807	–	–
Total	$	22,078	40,807	–	–

Market risk

Market risk is the risk that changes in market prices, such as foreign exchange rates, commodity prices, and interest rates will affect the Company's net earnings or the value of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable limits, while maximizing returns.

The Company utilizes both financial derivatives and physical delivery sales contracts to manage commodity price risks. All such transactions are conducted in accordance with the risk management policy that has been approved by the Board of Directors.

(a) Foreign Currency Exchange Risk

Foreign currency exchange rate risk is the risk that the fair value of financial instruments or future cash flows will fluctuate as a result of changes in foreign exchange rates. Although substantially all of the Company's petroleum and natural gas sales are denominated in Canadian dollars, the underlying market prices in Canada for petroleum and natural gas are impacted by changes in the exchange rate between the Canadian and United States dollars. Given that changes in exchange rate have an indirect influence, the impact of changing exchange rates can not be accurately quantified. The Company had no foreign exchange rate contracts in place as at December 31, 2008.

(b) Commodity Price Risk

Commodity price risk is the risk that the fair value of financial instruments or future cash flows will fluctuate as a result of changes in commodity prices. Commodity prices for petroleum and natural gas are impacted by world economic events that dictate the levels of supply and demand. The Company has attempted to mitigate commodity price risk through the use of financial derivative sales contracts. The Company's contracts in place as of December 31, 2008 are as follows:

Type	Amount (GJ/d)	Term	Price ($/GJ) at AECO	Type
Collar	2,000	November 1, 2008 – March 31, 2009	$7.00 – $8.80	Financial
Collar	2,000	November 1, 2008 – March 31, 2009	$7.00 – $9.15	Financial
Put	2,000	November 1, 2008 – March 31, 2009	$10.00	Financial

During the year ended December 31, 2008 the contracts in place resulted in an unrealized gain of $0.6 million (2007 – $2.9 million loss) and a realized loss of $2.2 million (2007 – $3.1 million gain).

With respect to commodity prices, during the year ended December 31, 2008, a one dollar increase in the price per GJ of natural gas relevant only to the Company's production dedicated to derivative financial instruments would have resulted in a net earnings increase of $0.5 million (2007 – $1.0 million). A one dollar decrease in the price per GJ of natural gas on the same production would have decreased net earnings for the year ended December 31, 2008 by $0.3 million (2007 – $0.1 million).

(c) Interest Rate Risk

Interest rate risk is the risk that future cash flows will fluctuate as a result of changes in market interest rates. The Company is exposed to interest rate fluctuations on its credit facility which bears a floating rate of interest. The Company had no interest rate swaps or financial contracts in place as at or during the year ended December 31, 2008. For the year ended December 31, 2008, a difference in the interest rate of one percent would change net earnings by an estimated $0.3 million (2007 – $0.2 million), assuming all other variables are constant.

Capital Management Strategy

The Company's policy on capital management is to attempt to maintain a prudent capital structure to allow the Company to fund future development. The Company considers its capital structure to include shareholders' equity, bank debt, and working capital.

($000S)	**2008**	2007
Shareholders' equity	**$ 124,278**	$ 115,743
Bank debt	**40,807**	28,846
Working capital deficiency excluding unrealized financial instrument gain or losses and associated future tax assets or liabilities	**10,615**	8,873

The Company manages its capital programs in order to maintain a prudent capital structure as changes in economic conditions occur. The Company may and has from time to time issued shares and adjusted spending to manage current or projected operating cash flows and debt levels.

The Company monitors its capital base using the ratio of net debt to annual operating cash flow. This ratio is calculated as net debt, as defined as long term debt less working capital (or plus working capital deficiency) excluding unrealized financial instrument gain (loss) and associated future tax assets (liabilities), divided by annual cash flow from operations before changes in non-cash working capital. The Company's guideline is to maintain a ratio of approximately 1.0 to 1.0, not exceeding 2.0 to 1.0. This ratio will fluctuate depending on fluctuations of the commodity and business cycles. The Company prepares annual capital expenditure budgets which are updated periodically to monitor this ratio. The annual budget is approved by the Board of Directors with updates reviewed by the Board throughout the year.

As at December 31, 2008 the Company's ratio of net debt to annual operating cash flow was 1.2 to 1.0 (2007 – 1.0 to 1.0).

The Company's share capital is not subject to any external restrictions. The bank debt facility has no restrictions other than the limitation of borrowing under the facility. As at December 31, 2008, the Company is in compliance with all flow-through share expenditure requirements as well as all bank facility requirements.

There have been no changes to the Company's capital management strategy during the year ended December 31, 2008.

9. ADDITIONAL DISCLOSURE

Net cash interest paid during the year was $1.3 million (2007 – $2.5 million). Cash taxes paid during the year was $nil (2007 – $nil).

10. COMMITMENTS

The Company has committed to certain payments over the next five years as follows:

Payments due *($000s)*	2009	2010	2011	2012	2013	Thereafter
Long-term debt	$ –	$ 40,807	$ –	$ –	$ –	$ –
Building lease	973	1,212	1,230	1,235	1,235	309
Processing fees	400	379	63	–	–	–
Transportation	673	79	–	–	–	–
Other	16	7	–	–	–	–
Total	$ 2,062	$ 42,484	$ 1,293	$ 1,235	$ 1,235	$ 309

ProspEx has met its commitment to incur $8.0 million in qualifying Canadian exploration expenditures related to the December 2007 flow-through share financing.

11. SUBSEQUENT EVENT

Effective February 1, 2009 the Company disposed of certain non core properties in the Wapiti area of Alberta. These properties consist of 4 (2.0 net) producing wells, with current net production of approximately 30 boe per day and 3,160 net acres of undeveloped land. The consideration paid to the Company was $2.1 million subject to normal closing adjustments.

12. RECLASSIFICATION

Certain amounts disclosed for prior years have been reclassified to conform to current period presentation.

// shareholder information

OFFICERS

Jean-Paul H. Lachance
Vice President, Engineering

R. Bruce McFarlane
Vice President, Exploration

Peter C. Parkinson
Vice President, Land

John W. Rossall
President and
Chief Executive Officer

George D. K. Yee
Vice President, Finance,
Chief Financial Officer and
Corporate Secretary

DIRECTORS

Brian E. Hiebert (1),(2)
Chairman of the Corporate Governance
and Compensation Committee
President, B&G Energy
Calgary, Alberta

Kyle D. Kitagawa (1),(2)
Chairman of the Audit Committee
Managing Director,
North River Capital Corp.
Calgary, Alberta

Ian MacGregor (1),(2)
President, North West Capital
Calgary, Alberta

John W. Rossall
President and Chief Executive Officer
ProspEx Resources Ltd.
Calgary, Alberta

Stephen J. Savidant
Chairman of the Board of Directors
Independent Businessman
Calgary, Alberta

(1) Member of the Corporate Governance and Compensation Committee

(2) Member of the Audit Committee

INDEPENDENT RESERVES EVALUATOR

GLJ Petroleum Consultants Ltd.
Calgary, Alberta

STOCK EXCHANGE LISTING

The Toronto Stock Exchange
Trading Symbol: PSX

AUDITORS

KPMG LLP
Calgary, Alberta

SOLICITORS

Bennett Jones LLP
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BANKERS

Canadian Imperial Bank
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