



Arsenal Energy Inc.

News Release

ARSENAL ANNOUNCES FIRST QUARTER 2007 OPERATING AND FINANCIAL RESULTS

FOR IMMEDIATE RELEASE

CALGARY, May 15, 2007 – Arsenal Energy Inc. (“Arsenal or the Company”) (TSX: “AEI”) (FRANKFURT: A1E) is pleased to announce the results of operations for the three-month period ended March 31, 2007.

FIRST QUARTER CORPORATE HIGHLIGHTS

- Cashflow of \$1.8 million for the three months ended March 31, 2007.
- Average production of 1,846 boe/d.
- Initiation of the drilling phase of the exploration program in Egypt.
- Seismic acquisition program commenced in North Dakota to assess the potential of the Bakken zone.
- Negotiated farm-in agreement at Evi providing access to up to 5,120 acres in a core area under attractive terms.

For the first quarter ended March 31, 2007, Arsenal reported a 59 percent increase in gross revenue from oil and gas sales of \$8.38 million versus \$5.28 million in the same period in 2006. The increase in revenue reflects the impact of a 25 percent year – over – year increase in production and the successful implementation of Arsenal’s strategy to increase the amount of light oil and natural gas in its production mix. Operating costs increased from \$1.87 million in first quarter of 2006 to \$3.03 in first quarter of 2007 due the increased production and costs associated with work over programs undertaken in the first quarter of 2007. For the first quarter of 2007, Arsenal reported a net loss of \$7.99 million (\$0.11 per share) versus a net loss of \$0.85 million (\$0.02 per share) in the same period last year. The loss in the first quarter of 2007 is primarily due to a \$4.8 million write down of goodwill, and additional depletion of \$1.5 million which is attributable to the drilling expenditures for the SET-1 well in Egypt.

SELECTED FINANCIAL AND OPERATIONAL INFORMATION

FINANCIAL	Three Months Ended March 31	
	2007	2006
Financial		
Funds from operations ¹	1,842,010	957,218
Per unit - basic	0.03	0.02
Per unit - diluted	0.02	0.02
Bank debt	20,929,082	11,128,145
Operating costs per boe	17.87	14.05
Operating netbacks per boe	19.88	16.74
Market		
Shares outstanding		
End of period	73,642,173	65,528,875
Weighted average - basic	73,642,173	46,466,361
Weighted average - diluted	73,986,422	47,598,407
Shares trading		
High	0.99	1.88
Low	0.61	1.38
Close	0.61	1.41
Average daily volume	205,000	137,000
OPERATIONS		
Daily production (average)		
Crude oil (bbl)	1,466	1,333
NGLs (bbl)	40	40
Natural gas (mcf)	2,034	600
Total (boe) ²	1,846	1,474
Realized commodity prices (\$Cdn.)		
Total crude oil (bbl)	45.65	38.83
NGLs (bbl)	51.42	49.77
Natural gas (mcf)	7.62	9.00
Average (boe) ²	45.79	44.02
Reference pricing		
WTI (U.S./bbl)	58.16	63.48
AECO gas (\$Cdn./mcf)	7.07	8.79
Foreign Exchange (\$U.S./\$Cdn.)	1.17	1.15

¹ Funds from operations before change in non-cash working capital is not a recognized measure under Canadian generally accepted accounting principles. Management uses funds from operations before change in non-cash working capital to analyze performance and considers it a key measure as it demonstrates the Company's ability to generate the cash necessary to fund future capital investments and to repay debt. Funds from operations before change in non-cash working capital has been defined by the Company as net earnings (loss) plus the addback of non-cash items (depletion, depreciation and accretion, stock-based compensation, future income taxes and unrealized foreign exchange) and excludes the change in non-cash working capital related to operating activities. Arsenal's determination of funds from operations before change in non-cash working capital may not be comparable to that reported by other companies. Arsenal also presents funds from operations before change in non-cash working capital per share whereby amounts per share are calculated using weighted average shares outstanding consistent with the calculation of earnings per share.

² The term barrels of oil equivalent ("boe") may be misleading, particularly if used in isolation. A boe conversion ratio of six thousand cubic feet per barrel (6mcf/bbl) of natural gas to barrels of oil equivalence is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead. All boe conversions in the report are derived from converting gas to oil in the ratio mix of six thousand cubic feet of gas to one barrel of oil.

OPERATIONS REVIEW

EGYPT

In February, Arsenal initiated a two well drilling program on the 5.625 million acre Nuqra concession. The first well, SET-1, was drilled to a total depth of approximately 4,500 feet. The well encountered an excellent trap and reservoir rock, however no hydrocarbons were encountered and the well was plugged and abandoned. Upon completion of SET-1, the drilling rig was moved to the second location, NARMER-1, approximately 17 miles from Set-1. The NARMER-1 well was drilled to 8,860 feet and tested a separate structure with Cretaceous and Jurassic potential. This well encountered strong hydrocarbon shows and reservoir potential in the Cretaceous sands from 1,250 to 2,750 feet, however the well logs indicated that the sands were water bearing. The well was targeting Jurassic sands and was not optimally located for a Cretaceous target. The hydrocarbon shows, at the shallower Cretaceous depth, indicate a reduced risk and cost of future exploration drilling. NARMER-1 has confirmed that hydrocarbons are being generated in this under explored basin. The seismic data is currently being remapped to identify Cretaceous targets for a possible future drilling program. The NARMER-1 well has been plugged and abandoned. Plans for a third contingent well to be drilled later this year have been cancelled as it was targeting a Jurassic prospect similar to NARMER -1. The drilling rig was released on May 11 to the operator of the adjacent exploration block where a test well targeting a Cretaceous formation is expected to be drilled. Arsenal and its partners will utilize the SET-1 and NARMER-1 data, and data from the well on the offsetting prospect, to reassess the concession and determine the next phase of drilling. The two test wells drilled to date satisfy the current drilling requirements for the concession until July 17, 2009 and the concession can be extended until July 17, 2012 with an exploration commitment of two additional wells.

NORTH DAKOTA

Production has remained stable throughout the first quarter at 390 boe/d. During the last few years, a large, technology driven oil play has developed targeting the Williston Basin Bakken formation. Low permeability in the Bakken has limited its development in the past; however new fracture stimulation technology for horizontal wells has advanced the play. In 2006, the play expanded into Mountrail County of North Dakota where Arsenal has its existing production base with an average working interest of 98% in the Stanley field. Five horizontal wells, two north and three south of Arsenal's lands, have been drilled by other operators with average initial production rates of 800 bbls/d of oil each. The oil is light, sweet and free of water. Arsenal has recently acquired a 3D survey over its Stanley lands and plans to spud its first horizontal well in the fourth quarter of 2007. We are currently acquiring and reviewing seismic data to identify drilling targets for our 2007 and 2008 capital expenditure program in North Dakota.

EVI

In the first quarter, Arsenal entered into a farm-in agreement where the Company can earn a 100 percent interest in up to eight contiguous sections (5,120 acres) of prospective lands. The first well will earn 1,280 acres and each well thereafter will earn an additional 1,280 acres subject to a non-convertible gross overriding royalty. In addition, Arsenal has a two-year seismic option and subsequent drilling option on another two sections of prospective lands immediately offsetting this acreage. The farmin significantly increases our land position and gave us access to the 3D seismic covering the acreage. Since the fourth quarter of 2005 Arsenal has participated in eight wells based on 3D seismic, with a 75% success rate. Current production from Evi is approximately 250 net boe/d of light, sweet crude.

LLOYDMINISTER

Production at Lloydminster increased slightly from the fourth quarter of 2006 to approximately 800 boe/d as a result of workovers completed late in the year. During the first quarter, one oil well was drilled and completed on the Wildmere prospect and one oil well was successfully drilled at Lashburn. The Lashburn well is scheduled be completed and brought into production after spring break-up. Success in these wells has set up ten to twelve additional locations with year around access.

TOWER CREEK

Tie-in operations have commenced on the 2-21 well and production is anticipated to begin in June 2007 at approximately 25 mmscf/d (400 boe/d net to Arsenal). The operator has given notice to partners that the second well, a 4,500 meter Wabamun test identified by the same 3D seismic program, will spud in late May or early June. The Company will pay 17.142% of costs through completion for a 13.1385 % working interest in this well. If successful, this well can be brought into production quite quickly, as it will tie into the 2-21 facilities approximately 4.5 km away.

COMMODITY PRICING

The West Texas Intermediate crude oil benchmark declined 3% from USD\$60 per barrel in the fourth quarter of 2006 to USD\$58 per barrel in the first quarter of 2007. Crude oil prices during the first quarter demonstrated considerable volatility due to demand/supply dynamics, timing of US refineries turnarounds and geopolitical uncertainties.

The heavy crude oil differential averaged 27% for the first quarter of 2007 compared to 45% for the first quarter of 2006, and 35% for the fourth quarter of 2006. We believe the narrowing of the differential from the comparable periods in 2006 was primarily due to the removal of logistical constraints in moving crude oil from the Chicago area to markets in the United States Gulf Coast. We have initiated discussions with strategic partners to find new markets for our heavy crude oil in order to mitigate the impact of supply and demand shocks on the heavy crude oil market and exposure to the differential.

NYMEX natural gas prices averaged USD\$6.90 per mmbtu for the first quarter of 2007, an increase of 5% from US\$6.61 per mmbtu for the fourth quarter of 2006. The increase in prices was primarily due to colder winter temperatures in the key northeastern United States market during February and March, which more closely reflected historical averages, and the production volume impact of an overall reduction in natural gas drilling activity in Western Canada. Reduced drilling activity and production volumes decreased natural gas inventories closer to historical levels. We view the forward outlook for natural gas pricing as extremely favorable for producers.

OUTLOOK

With average production in the first quarter of 1,846 boe/d and approximately 500 boe/d currently behind pipe, execution of our 2007 capital program will ensure that we can offset natural declines and achieve our target exit rate of 2,500 boe/d.

Additional production from Tower Creek in June is expected to significantly improve our future cash flow and net income. The success of Bakken wells adjacent to our properties in North Dakota has de-risked the play to a more suitable level for a company our size. Based on production levels and reserve additions experienced by our competitors, drilling success in North Dakota could have an immediate and measurable impact on corporate production and cashflow.

RESULTS OF OPERATIONS

PRODUCTION AND MARKETING

Production volumes for the three-month period ended March 31, 2007 increased 25% over the comparable period in 2006. The increase in volume is attributable to the integration of corporate and property acquisitions and new wells drilled during 2006. Production during the first quarter of 2007 has declined from the fourth quarter of 2006 as a result of natural declines.

	Three Months Ended March 31		
	2007	2006	% Change
Crude oil (bbl/d)	1,466	1,333	10
NGL (bbl/d)	40	40	-
Natural gas (mcf/d)	2,034	600	239
Total (boe/d)	1,846	1,474	25
Production split			
Oil & NGLs	82%	93%	(12)
Natural Gas	18%	7%	171

COMMODITY PRICES

Commodity price realizations during the three-month period ended March 31, 2007 increased 4% over the comparable period in 2006. The Company experienced an 18% increase in the crude oil price received over the prior year, despite the WTI benchmark decreasing 8% over the same period. The increase is indicative of the impact of the light oil production at Evi from the discoveries made there in 2006. At March 31, 2007, approximately 33% of corporate production was comprised of light oil, compared to less than 25% in 2006. The heavy oil differential traditionally widens over winter, as demand for heavy crude is highest in the summer. The differential exceeded USD\$20 per barrel for much of the first quarter, and began to decrease starting in March reflecting historical seasonality.

Natural gas prices received by the Company decreased 15% over comparable periods, consistent with declines in the AECO and NYMEX benchmarks. Arsenal anticipates continued historically high crude oil prices while inventory issues may continue to impact natural gas pricing.

(\$Cdn.)	Three Months Ended March 31		
	2007	2006	% Change
Prices - Before Derivatives			
Total crude oil (bbl)	45.65	38.83	18
NGLs (bbl)	51.42	49.77	3
Natural gas (mcf)	7.62	9.00	(15)
Total (boe)	45.79	44.02	4

Reference Pricing

WTI (\$U.S./bbl)	58.16	63.48	(8)
AECO gas (\$Cdn./mcf)	7.07	8.79	(20)
NYMEX gas (\$U.S./mmbtu)	6.90	9.08	(24)
Foreign exchange (\$Cdn./\$U.S.)	1.17	1.15	2

OIL AND GAS REVENUE

Crude oil sales for the three-month period ended March 31, 2007 were 25% higher than the comparable period in 2006, reflecting increased production and higher experienced price realizations. Natural gas sales increased 179% over the comparable period, reflecting the impact of the production acquired from Tiverton in 2006. Other income is comprised of processing fees on facilities and contracts acquired from Tiverton. Revenue per boe increased 24% over the comparable period in 2006, attributable to the production portfolio and the expiry of a forward contract in 2006.

(\$Cdn.)	Three Months Ended March 31		
	2007	2006	% Change
Crude oil sales	6,157,480	4,932,838	25
NGL sales	191,068	179,574	6
Natural gas sales	1,425,814	511,250	179
Other	609,357	61,800	886
Loss on forward contracts	-	(404,134)	(100)
Net oil and gas revenue	8,383,719	5,281,327	59
Per boe	49.37	39.77	24

ROYALTIES

Royalties as a percentage of gross oil and gas revenue were consistent with the comparable period in 2006 at 23%. Royalties per boe for the three months ended March 31, 2007 increased 29% over the comparable period in 2006, reflecting the changed asset portfolio of the Company, with a greater portion of corporate production coming from higher burden natural gas as a result of the Tiverton acquisition. Arsenal expects the corporate royalty rate to remain at 23% of gross oil and gas until the third quarter, as the production from Tower Creek is subject to a one-year royalty holiday and will lower the corporate royalty rate.

For the three months ended March 31, 2007, the Company has accrued \$125,000 relating to Alberta Royalty Tax Credits (ARTC) receivable. Under the 2007 Alberta Provincial budget, ARTC is anticipated to be phased out effective January, 2007, however the implementation of the phase out has not been established, the Company expects it will receive refund for the period.

(\$Cdn.)	Three Months Ended March 31		
	2007	2006	% Change
Royalties	1,974,286	1,193,667	65
% of gross oil and gas revenue	24	23	-
Per boe	11.63	8.99	29

OPERATING COSTS

Operating expenses per boe for the three-month period ended March 31, 2007 increased 27% over the same period in 2006. The increase over the comparative period is attributable to workover programs completed at Lloydminster and Wildmere. Operating expense per boe has dropped slightly from the fourth quarter of 2006, when costs averaged \$18.06 per boe, and have been reduced significantly from the third quarter of 2006, when costs averaged \$21.26. Arsenal expects operating costs to continue to improve in upcoming periods due to these workover programs and increased exposure to lower operating cost production from Tower Creek and Evi.

(\$Cdn.)	Three Months Ended March 31		
	2007	2006	% Change
Operating expense	3,034,004	1,865,285	63
Per boe	17.87	14.05	27

PRODUCT NETBACKS¹

Netbacks for the three-month period ended March 31, 2007 increased 19% over the comparative period in 2006. Higher commodity prices were partially offset by increased royalties and operating costs experienced during the quarter.

(\$Cdn. per boe)	Three Months Ended March 31		
	2007	2006	% Change
Net revenue after derivatives	49.37	39.77	24
Royalties	(11.63)	(8.99)	29
Operating expenses	(17.87)	(14.05)	27
Operating netback	19.88	16.74	19

GENERAL AND ADMINISTRATIVE EXPENSES

General and administrative costs per boe for the three-month period ended March 31, 2007 decreased by 15% over the comparative period in 2006, attributable to the higher production in 2007 over 2006. Arsenal anticipates general and administrative costs to increase in absolute terms, but decrease on a per barrel basis, as the Company continues to grow production while maintaining staffing levels.

(\$Cdn.)	Three Months Ended March 31		
	2007	2006	% Change
General and administrative	1,135,429	1,050,623	8
General and administrative per boe	6.69	7.91	(15)

FINANCE CHARGES

Finance charges for the three month period ended March 31, 2007 increased 188% over the comparative period in 2006, as the Company drew on its credit facility to fund both drilling and acquisition activities during 2006.

(\$Cdn.)	Three Months Ended March 31		
	2007	2006	% Change
Bank line interest	288,817	78,286	269
Per boe	1.70	0.59	188

DEPLETION, DEPRECIATION, AND ACCRETION

Depletion, depreciation and accretion per boe increased 172% for the three-month period ended March 31, 2007 compared to the same period in 2006. The increase is attributable to higher production rates, a significantly higher asset base in 2007 compared to 2006 and the write off of \$1.5 million of drilling expenditures in Egypt.

(\$Cdn.)	Three Months Ended March 31		
	2007	2006	% Change
Depletion, depreciation and accretion	6,344,701	1,822,968	248
Per boe	37.37	13.73	172

GOODWILL IMPAIRMENT

At March 31, 2007, Arsenal compared the deemed fair value of goodwill to the carrying value of goodwill. If the fair value of the Company is less than the carrying value, the impairment loss is measured by allocating the fair value of the Company to the identifiable assets and liabilities at their fair values. The excess of the Company's fair value over the identifiable net assets is the implied fair value of goodwill. If this amount is less than the book value of goodwill, the difference is the impairment amount. As a result of this test, Arsenal wrote off \$4.7 million in goodwill, resulting in a \$nil balance in Goodwill at March 31, 2007.

(\$Cdn.)	Three Months Ended March 31		
	2007	2006	% Change
Goodwill impairment	4,791,561	-	100
Per boe	28.22	-	100

STOCK-BASED COMPENSATION

Stock-based compensation expense for the three-month period ended March 31, 2007 increased 5% in absolute terms, but decreased 16% on a per boe basis over the comparable period in 2006. The increase is attributable to the vesting of options granted in the third and fourth quarter of 2006.

(\$Cdn.)	Three Months Ended March 31		
	2007	2006	% Change
Compensation expense	362,957	345,816	5
Per boe	2.14	2.55	(16)

TAXES

During the three month period ended March 31, 2007, Arsenal reduced future income taxes by \$1.6 million compared to a reduction of \$0.2 million in 2006. A future income tax balance of \$9.5 million is recorded as a liability as at March 31, 2007.

(\$Cdn.)	Three Months Ended March 31		
	2007	2006	% Change
Current income taxes	40,000	13,000	208
Future income taxes (reduction)	(1,683,156)	(239,859)	602
	(1,643,156)	(226,859)	624
Per boe	(9.68)	(1.67)	478

LIQUIDITY

(\$Cdn.)	Three Months Ended March 31, 2007
Sources	
Funds from operations	1,842,010
Change in non-cash working capital - operating items	2,707,528
Change in non-cash working capital - investing items	(656,445)
Total sources of cash	3,893,092
Uses	
Plant, property and equipment additions	(2,999,189)
Decrease in bank debt	893,903

Bank Debt and Working Capital

At March 31, 2007, the Company had \$20.9 million outstanding on its credit facility and a working capital surplus (defined as Accounts Receivable less Accounts Payable) of \$0.4 million, for net debt of \$20.5 million, compared to net debt of \$11.4 million at March 31, 2006. The capital intensive nature of the industry will generally result in the Company having a working capital deficit, however, the Company will maintain a total debt plus working capital deficit below the Company's credit facility limit. At March 31, 2007, the Company had a credit facility limit of \$23.0 million.

At March 31, 2007 the Company is in breach of a covenant governing the Company's banking agreement. Management has informed the bank of the situation and the bank has indicated that they will review the financial statements in order to determine future covenant requirements.

Convertible Debenture

Interest accrues on the debentures at 8% on the debentures, payable semi-annually on June 30th and December 31st of each year. The debentures will mature on February 15, 2009 unless called for redemption earlier by Arsenal. The debentures are convertible by the holders at any time prior to maturity into 1,539,170 shares of the Company, representing a conversion price of \$2.26 per Arsenal share.

The Company can elect to prepay the debenture providing the Company's shares trade above \$2.60 per share for 22 consecutive days. The convertible debentures are a debt security with an embedded conversion option and were segregated into their debt and equity components based on their respective fair values at the date of acquisition. The \$370,000 equity component represents the holder's conversion right and is included in Shareholders' Equity, while the remaining balance has been classified as debt. If the holder exercises the conversion right, they will receive accrued and unpaid interest up to and including the conversion date.

During the first quarter, Arsenal incurred \$25,500 of accretion expense relating to the amortization of the discount of the debenture. In addition, Arsenal accrued \$68,646 in interest charges to the debenture holders relating to interest for the first three months of 2006.

Share Capital

At March 31, 2007, the Company has 73,642,173 shares outstanding, 2,031,000 share purchase warrants with an exercise price of \$2.50 per warrant, and 3,453,363 exercisable stock options with a weighted average exercise price of \$1.03 per share. There were no issuances of shares, warrants or options for the three month period ended March 31, 2007 or subsequently to April 30, 2007.

INTERIM CONSOLIDATED BALANCE SHEETS
(UNAUDITED)

March 31, 2007

December 31, 2006

ASSETS

Current assets		
Accounts receivable	6,705,500	7,282,175
Reclamation bonds	205,919	201,890
Property, plant and equipment (note 5)	79,928,172	83,186,918
Goodwill (note 6)	-	4,791,561
	86,839,591	95,462,544

LIABILITIES

Current liabilities		
Accounts payable and accrued liabilities	6,118,315	4,643,907
Revolving demand loan (note 7)	20,929,082	21,822,985
	27,047,397	26,466,892
Convertible debentures (note 11)	3,288,973	3,263,473
Future income taxes	9,525,169	8,548,207
Asset retirement obligations (note 8)	2,728,787	2,638,520
	42,590,326	40,917,092

SHAREHOLDERS' EQUITY

Common shares (note 9)	77,631,049	80,291,169
Warrants	303,731	303,731
Contributed surplus (note 10)	2,785,381	2,422,423
Common share conversion rights (note 11)	370,000	370,000
Deficit	(36,840,897)	(28,841,871)
	44,249,265	54,545,452
	86,839,591	95,462,544

Future operations (note 2)
Supplemental information (note 12)
Segmented information (note 13)
Commitments and contingencies (note 14)

See accompanying notes to the interim consolidated financial statements.

INTERIM CONSOLIDATED STATEMENTS OF OPERATIONS AND DEFICIT (UNAUDITED)

For the three months ended March 31	2007	2006
REVENUE		
Oil and gas	8,383,719	5,281,327
Royalties expense, net of Alberta Royalty Tax Credit	(1,974,286)	(1,193,667)
	6,409,433	4,087,660
EXPENSES		
Operating	3,034,004	1,865,285
General and administrative	1,135,429	1,050,623
Finance charges	288,817	78,286
Interest on long term debt	68,646	-
Convertible debenture accretion (note 11)	25,500	-
Depletion, depreciation and accretion (note 5)	6,344,701	1,822,968
Goodwill impairment (note 6)	4,791,561	-
Stock-based compensation (note 10)	362,957	345,816
	16,051,616	5,162,977
Loss before income taxes	(9,642,183)	(1,075,317)
Income taxes		
Current income taxes	40,000	13,000
Future income tax reduction	(1,683,156)	(239,859)
	(1,643,156)	(226,859)
Net loss	(7,999,026)	(848,458)
Deficit - beginning of period	(28,841,871)	(1,785,450)
Deficit - end of period	(36,840,897)	(2,633,908)
Loss per share - basic and diluted	(0.11)	(0.02)
Supplemental information (note 12)		
Segmented information (note 13)		

See accompanying notes to the interim consolidated financial statements.

INTERIM CONSOLIDATED STATEMENT OF CASH FLOWS (UNAUDITED)

For the three months ended March 31	2007	2006
Cash flows from operating activities		
Net loss	(7,999,026)	(848,458)
Items not affecting cash		
Depletion, depreciation and accretion	6,344,701	1,822,968
Future income tax expense (reduction)	(1,683,156)	(239,859)
Convertible debenture accretion	25,500	-
Stock-based compensation expense	362,957	345,816
Interest on long term debt	-	(123,249)
Goodwill impairment	4,791,561	-
Unrealized foreign exchange loss	(528)	-
	1,842,010	957,218
Net change in non-cash working capital items (note 12)	2,707,528	(2,062,010)
Net cash from operating activities	4,549,537	(1,104,792)
Cash flows from investing activities		
Additions to property, plant and equipment	(2,999,189)	(2,281,265)
Change in non-cash working capital - investing items (note 12)	(656,445)	(957,863)
Net cash used in investing activities	(3,655,634)	(3,239,128)
Cash flows from financing activities		
Issue of shares for cash upon exercise of warrants	-	59,122
Share issue costs	-	(647,152)
Proceeds from revolving demand loan	(893,903)	4,931,950
Cash provided by financing activities	(893,903)	4,343,920
Change in cash during the period	-	-
Cash - beginning of period	-	-
Cash - end of period	-	-

Supplemental information (note 12)

See accompanying notes to the interim consolidated financial statements.

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

1. SIGNIFICANT ACCOUNTING POLICIES

The unaudited interim consolidated financial statements of Arsenal have been prepared by management in accordance with accounting principles generally accepted in Canada and following the same accounting policies and methods of computation as the consolidated financial statements for the year ended December 31, 2006, except as described in Note 2. The disclosures provided below are incremental to those included with the annual financial statements. The interim financial statements should be read in conjunction with the consolidated financial statements and notes thereto in the Company's Annual Report for the year ended December 31, 2006. 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.

2. FUTURE OPERATIONS

These financial statements have been prepared on a going concern basis, which assumes the Company will continue in operation in the foreseeable future and be able to realize assets and satisfy liabilities in its normal course of business.

For the period ended March 31, 2007, the Company has incurred a loss due to a goodwill impairment test and has a breach of a covenant governing the Company's banking agreement. Arsenal believes that current working capital and cash flow from operations will be sufficient to meet its working capital requirements for 2007. Future operations depend upon the Company's continued ability to generate profitable operations and/or obtain additional financing to fund future operations and to generate positive cash flows from operating activities.

3. CHANGE IN ACCOUNTING POLICIES

Effective January 1, 2007, the Company adopted the new Canadian accounting standards for financial instruments – recognition and measurement; financial instruments – presentation and disclosure, hedging and comprehensive income. The Company has adopted these standards prospectively and as such the comparative interim consolidated financial statements have not been restated. The adoption of these standards had no impact on opening retained earnings or accumulated other comprehensive income.

a) Financial instruments – recognition and measurement

The new standard prescribes when a financial asset, financial liability or non-financial derivative is to be recognized on the balance sheet and at what amount, requiring fair value or cost-based measures under different circumstances. Financial instruments must be classified into one of the following five categories: held-for-trading, held-to-maturity, loans and receivables, available-for-sale financial assets or other financial liabilities. All financial instruments, including derivatives, are measured in the balance sheet at fair value except for loans and receivables, held to maturity investments and other financial liabilities which are measured at amortized cost determined using the effective interest rate method. Subsequent measurement and changes in fair value will depend on their initial classification, as follows: held-for-trading financial assets are measured at fair value and changes in fair value are recognized in net earnings; available-for-sale financial instruments are measured at fair value with changes in fair value recorded in other comprehensive income until the investment is derecognized or impaired at which time the amounts would be recorded in net earnings.

Under adoption of these standards, the Company classified its cash as held-for-trading, which is measured at fair value. Accounts receivable are classified as loans and receivables, which are measured at amortized cost. Accounts payable, revolving demand loan and convertible debentures are classified as other financial liabilities, which are measured at amortized cost.

b) Derivatives

All derivative instruments, including embedded derivatives, are recorded in the statement of earnings at fair value unless exempted from derivative treatment as a normal purchase and sale. All changes in the fair value of derivative instruments are recorded in earnings unless cash flow hedge accounting is used, in which case changes in fair value are recorded in other

comprehensive income. Prior to adoption of the new standards, physical receipt and delivery contracts did not fall within the scope of the definition of a financial instrument and were also accounted for as executory contracts. For the three-month period ended March 31, 2007, Arsenal did not enter into any derivative instrument contracts.

c) Other comprehensive income

The new standards require a new statement of comprehensive income, which is comprised of net earnings and other comprehensive income, which, for the Company, related to changes in gains or losses on derivatives designated as cash flow hedges. The Company has combined this new statement with the statement of earnings.

d) Effective interest rate method

Transactions costs attributable to financial instruments classified as other than held for trading are included in the recognized amount of the related financial instrument and recognized over the life of the resulting financial instrument.

e) Accounting changes

The Company adopted Section 1506 – Accounting Changes, the only impact of which is to provide disclosure of when an entity has not applied a new source of GAAP that has been issued but is not yet effective. This is the case with Section 3862 – Financial Instruments Disclosures and Section 3863 Financial Instruments Presentations that are required to be adopted for fiscal years beginning on or after October 1, 2007. The Company will adopt these standards on January 1, 2008 and it is expected the only effect on the Company will be incremental disclosures regarding the significance of financial instruments for the entity's financial position and performance; and the nature, extent and management of risks arising from financial instruments to which the entity is exposed.

4. BUSINESS ACQUISITION

On March 14, 2006 Arsenal acquired all of the issued and outstanding securities of Tiverton Petroleum Ltd. (“Tiverton”). The purchase method of accounting was used for the business combination and the allocation of the purchase price and consideration for the acquisition is as follows:

	Tiverton 2006
Net assets acquired at assigned values:	
Working capital deficiency	(2,112,791)
Property, plant and equipment	42,740,000
Bank debt	(3,700,000)
Convertible debentures	(3,182,473)
Asset retirement obligation	(1,095,000)
Future income taxes	(6,937,798)
Common share conversion rights	(370,000)
Net assets acquired	38,914,366
Financed by:	
Shares issued	38,314,366
Acquisition costs	600,000
Purchase price	38,914,366

5. PROPERTY, PLANT AND EQUIPMENT

	March 31, 2007	December 31, 2006
Property, plant, and equipment	118,852,098	115,819,143
Accumulated depletion, depreciation, and amortization	(38,923,926)	(32,632,225)
	79,928,172	83,186,918

In Canada and the United States, all costs of unproved properties, net of any associated revenues, have been capitalized and depleted during 2007 and 2006. Future development costs totaling \$2.9million were included in the depletion calculation for the three months ended March 31, 2007. Depletion includes costs totaling \$1.5 million relating to drilling activities completed and costs incurred to March 31, 2007 in Egypt. Included in property, plant, and equipment at March 31, 2007 are asset retirement costs of \$2.3 million. For the three months ended March 31, 2007, Arsenal capitalized general and administrative expenses of \$0.11 million.

6. GOODWILL IMPAIRMENT

At March 31, 2007, Arsenal compared the fair value of goodwill to the carrying value of goodwill. As a result of this test, the Company recorded an impairment to goodwill of \$4.8 million calculated as the excess of the Company's fair value over the identifiable net assets for its Canadian and Egyptian reporting units.

7. REVOLVING DEMAND LOAN

At March 31, 2007 the Company has available a demand operating loan in the amount of \$23.0 million. The facility can be utilized in Canadian or US dollars, bears interest on Canadian or US bank prime plus 0.25%, increasing to Canadian or US bank prime plus 0.40% if Net Debt to Annualized Cashflow exceeds 1.25:1. The facility is secured by a fixed and floating charge debenture providing a fixed charge over certain petroleum and natural gas interests and a floating charge over all Canadian and U.S. assets.

At March 31, 2007 the Company is in breach of a covenant governing the Company's banking agreement. Management has informed the bank of the situation and the bank has indicated that they will review the financial statements in order to determine future covenant requirements.

8. ASSET RETIREMENT OBLIGATIONS

The following table presents the beginning and ending aggregate asset retirement obligations associated with the retirement of oil and gas properties:

	Three Months Ended	Year Ended
	March 31, 2007	December 31, 2006
Asset retirement obligations - beginning of period	2,638,520	1,295,500
Liabilities acquired	-	1,095,000
Liabilities incurred	30,300	128,100
Change in estimate	6,967	11,920
Accretion expense	53,000	108,000
Asset retirement obligations - end of period	2,728,787	2,638,520

9. SHAREHOLDERS' EQUITY

Common shares	Three Months Ended		Year Ended	
	March 31, 2007		December 31, 2006	
	Shares	Amount (\$)	Shares	Amount (\$)
Balance - beginning of period	73,642,173	80,516,169	42,556,244	36,839,809
Issued to acquire Tiverton	-	-	23,237,671	38,314,366
Issued for cash	-	-	7,328,148	7,960,963
Cost of shares issued	-	-	-	(1,131,708)
Tax effect of flow-through shares	-	(2,660,120)	-	(2,369,913)
Tax effect of share issue costs	-	-	-	379,625
Issued on exercise of options	-	-	350,000	206,501
Issued on exercise of warrants	-	-	170,110	170,110
Allocated from contributed surplus	-	-	-	146,416
Shares held in escrow ⁽¹⁾	-	(225,000)	-	(225,000)
Balance - end of period	73,642,173	77,631,049	73,642,173	80,291,169

10. STOCK OPTIONS

A summary of the changes in the options outstanding under the Option Plan is as follows:

	March 31, 2007		December 31, 2006	
	Options	Weighted Average Price (\$)	Options	Weighted Average Price (\$)
Balance - beginning of period	4,527,252	1.05	3,592,252	0.99
Granted	-	-	1,535,000	1.10
Exercised	-	-	(350,000)	0.59
Forfeited	-	-	(250,000)	1.13
Balance - end of period	4,527,252	1.05	4,527,252	1.05
Exercisable - end of period	3,453,363	1.03	3,170,585	1.02

The Company incurred non-cash compensation expense of \$362,957 for the three month period ended March 31, 2007 (2006 – \$345,815) related to vested options issued under the Option Plan with a corresponding increase to contributed surplus. When options are exercised by employees, contractors and directors of the Company, the consideration paid is recorded to the shareholders' equity account along with related non-cash compensation expense previously recognized in contributed surplus. The following table reconciles the movement in the contributed surplus balance:

	Three Months Ended		Year Ended	
	March 31, 2007		December 31, 2006	
Balance - beginning of period	2,422,423		1,170,444	
Issuance of stock options	362,957		1,398,395	
Reclassification to common shares on exercise of options	-		(146,416)	
Balance - end of period	2,785,381		2,422,423	

11. CONVERTIBLE DEBENTURE

Interest accrues on the debentures at 8% on the debentures, payable semi-annually on June 30th and December 31st of each year. The debentures will mature on February 15, 2009 unless called for redemption earlier by Arsenal. The debentures are convertible by the holders at any time prior to maturity into 1,539,170 shares of the Company, representing a conversion price of \$2.26 per Arsenal share.

The Company can elect to prepay the debenture providing the Company's shares trade above \$2.60 per share for 22 consecutive days. Interest is payable semi-annually on June 30th and December 31st of each year. The convertible

debentures are a debt security with an embedded conversion option and were segregated into their debt and equity components based on their respective fair values at the date of acquisition. The \$370,000 equity component represents the holder's conversion right and is included in Shareholders' Equity, the remaining balance has been classified as debt. If the holder exercises the conversion right, they will receive accrued and unpaid interest up to and including the conversion date.

12. SUPPLEMENTAL CASH FLOW INFORMATION

	Three Months Ended March 31, 2007	Three Months Ended March 31, 2006
Change in non-cash working capital items		
Operating accounts receivable	576,675	(1,644,313)
Operating accounts payable	2,130,853	(417,698)
Amounts relating to operating activities	2,707,528	(2,062,010)
Amounts relating to investing activities	(656,445)	(957,863)
	2,051,083	(3,019,873)
Taxes paid	-	10,065
Interest paid	314,066	68,946

13. SEGMENTED INFORMATION

A portion of the Company's assets and revenues are earned in the United States and a portion of the Company's assets are located in Egypt, and are monitored as identifiable reporting segments by management. The remaining assets and associated revenues are earned in Canada by Arsenal Energy Inc. The following table outlines key operating results by entity:

(\$ Cdn.)	2007			
	Canada	U.S	Egypt	Total
Oil and gas revenue	6,324,333	2,059,386	-	8,383,719
Income (loss) before income taxes	(8,195,908)	115,467	(1,561,741)	(9,642,183)
Operating income	2,621,989	753,440	-	3,375,429
Property, plant and equipment (note 5)	70,394,138	3,915,449	5,618,584	79,928,172
Capital expenditures (including acquisitions)	2,499,708	110,996	388,485	2,999,189
(\$ Cdn.)	2006			
	Canada	U.S	Egypt	Total
Oil and gas revenue	3,141,274	2,140,053	-	5,281,327
Loss before income taxes	(815,863)	(181,705)	(77,826)	(1,075,394)
Operating income	1,756,454	465,922	-	2,222,376
Property, plant and equipment (note 5)	77,391,835	4,641,762	5,360,232	87,393,829
Capital expenditures (including acquisitions)	2,183,112	98,153	-	2,281,265

14. COMMITMENTS AND CONTINGENCIES

Egyptian Concession

The Company's wholly owned subsidiary Quadra Egypt Ltd. entered into a concession agreement with the Egyptian government in 2004. The agreement requires gross expenditures of USD\$11.0 million over an eight-year period on seismic evaluation, exploratory drilling and developmental drilling. The two test wells drilled to date satisfy the current drilling

requirements for the concession until July 2009 and the concession can be extended until July 2012 with an exploration commitment of two additional wells.

Flow-through shares

The Company has an \$8.1 million flow-through obligation, which will be satisfied through exploratory drilling and seismic shooting in Western Alberta and Central Saskatchewan during 2007.

Letter of Credit

During the second quarter, Arsenal provided a letter of credit to the Egyptian government for USD\$1.6 million. The letter of credit is to be held until April 10, 2010, or until certain performance measures are achieved by Arsenal and its partners. Arsenal has obtained a Performance Security Guarantee ("PSG") from the Canadian government, which guarantees Arsenal against the call of the bond by the Egyptian government. There is no impact to the existing credit facility of Arsenal from providing the letter of credit due to the PSG, however the Company incurred approximately \$50,000 in stamping fees to obtain the PSG.

Certain statements in this material may be "forward-looking statements" including outlook on oil and gas prices, estimates of future production, estimated completion dates of acquisitions and construction and development projects, business plans for drilling and exploration, estimated amount and timing of capital expenditures and anticipated future debt levels and royalty rates. Information concerning reserves contained in this material may also be deemed forward-looking statements as such estimates involve the implied assessment that the resources described can be profitably produced in the future. These statements are based on current expectations, estimates and projections that involve a number of risks and uncertainties, which could cause actual results to differ from those anticipated by Arsenal. This news release is not for distribution in the United States.

The term barrels of oil equivalent ("boe") may be misleading, particularly if used in isolation. A boe conversion ratio of six thousand cubic feet per barrel (6mcf/bbl) of natural gas to barrels of oil equivalence is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead. All boe conversions in the report are derived from converting gas to oil in the ratio mix of six thousand cubic feet of gas to one barrel of oil.

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