regulations, costs, technology and industry standards. The period charge is expensed and actual site restoration and abandonment expenditures are charged to the accumulated account as incurred.

(d) Use of estimates:

The amounts recorded for depletion, depreciation and amortization of petroleum and natural gas properties and equipment and the provision for future site restoration and abandonment costs are based on estimates. The ceiling test is based on estimates of proven reserves, production rates, oil and gas prices, future costs and other relevant assumptions. These estimates are subject to measurement uncertainty and the effect on the financial statements of changes in such estimates in future periods could be significant.

(e) Per share amounts:

The Company uses the treasury-stock method to determine the dilutive effect of stock options to other dilutive instruments. Under the treasury-stock method, only "in the money" dilutive instruments impact the fully diluted calculations. In computing diluted earnings per share, no shares are added to the weighted average number of common shares outstanding for the dilutive effect of stock options as they are all anti-dilutive.

(f) Stock based compensation plan:

The Company has a stock based compensation plan, described in the notes. No compensation expense is recognized for these plans when stock options are issued to employees. Any consideration paid by employees on exercise of stock options is credited to share capital. The Company does not purchase stock or stock options from employees as part of its stock-based compensation plan.

(g) Financial instruments:

The Company uses derivative financial instruments from time to time to hedge its exposure to fluctuations in oil and natural gas prices. Gains or losses from these activities are reported as adjustments to the related revenue or expense accounts.

(h) Income taxes:

The company follows the asset and liability method of tax allocation accounting. Temporary differences arising from the tax basis of an asset or liability and its carrying amount on the balance sheet are used to calculate future income tax liabilities or assets. Future income tax liabilities or assets are calculated using tax rates anticipated to apply in the periods that the temporary differences are expected to reverse.

3. Capital Assets:

	Cost	Accumulated Depreciation	Net Book Value
Petroleum and Natural Gas Properties and Equipment	$1,363,540	$ 82,000	$1,281,540
Furniture, Fixtures and Equipment	9,414	$ 700	8,714
	$1,372,954	$ 82,700	$1,290,254

4. Bank Loan:

The Company has available a demand operating loan facility in the amount of $750,000 Bearing Interest of bank prime rates plus 0.5% per annum and secured by a $5,000,000 demand debenture with a first and floating charge on all assets with reductions of $10,000 per month in availability starting May , 2003.

5. Share Capital:

(a) Authorized:
- (i) Unlimited number of common shares; and
- (ii) Unlimited number of preferred shares, issuable in series (of which none have been issued).

(b) Issued Common Shares:

	Number of Shares	Amount
Balance prior to amalgamation October 18, 2002	3,750,000	$ 449,170
On Amalgamation:		
Issued to Arsenal Shareholders	3,000,000	449,170
Issued to AC Global Shareholders	3,660,000	409,748
Amalgamation Costs		(74,891)
Balance March 31, 2003	6,660,000	$ 784,027

(c) Stock Options:

The Company has granted its directors and officers options to acquire 375,000 common shares at an exercise price of $0.20 per share under a stock option plan. The options will expire five years from December 21,2000. Pursuant to the amalgamation the options remain outstanding but were reduced to acquire 299,600 common shares of the Company. In addition, 56,000 of the options were cancelled resulting in 243,600 options outstanding.

6. Related Party Transactions:

During the quarter the company incurred consulting fees of $40,000 to a company controlled by the President of the Company.

Board of Directors

Michael Vandale
President
Calgary, Alberta

Greg Belzberg
Los Angeles, California

William Hews
Calgary, Alberta

David Stadnyk
Vancouver, British Columbia

Errol Stewart
Calgary, Alberta

Legal
Borden Ladner Gervais LLP

Accounting
KPMG LLP

Engineering
Gilbert Lausten Jung

Arsenal Energy Inc.

1820, 330 5th Avenue S.W.
Calgary, Alberta
Canada T2P 0L4
Telephone: (403) 262-4854
Facsimile: (403) 265-6877
E-mail: info@aren.ca

Arsenal Energy Inc.

Financial Statements of

ARSENAL ENERGY INC.

For the quarter ended March 31, 2003

(unaudited)

To The Shareholders:

Arsenal Energy Inc. successfully drilled ten light oil wells (net 3.75 wells) at Kerrobert, Saskatchewan in December 2002. The wells were completed, equipped and put on production in January 2003. Your Company had oil and natural gas sales from the Kerrobert property and our 4.9% working interest in the North Dodsland Viking Voluntary Unit of $273,014.00 during the quarter. Cash flow from operations was $155,135.00 or 2.3 cents per share with a net earning of $93,935.00 or 1.4 cents per share.

The Operator of the Kerrobert project has determined another nine (9) locations (Arsenal net 3.375 wells) to be drilled in the beginning of our fiscal second quarter. Financing for the wells will be provided from a combination of cash flow from existing oil and gas production, bank financing and cash garnered through our acquisition of Legend Capital Corp. We expect further drilling activity at Kerrobert in the third fiscal quarter.

We will continue to evaluate opportunities.

Respectfully submitted on behalf of the Board of Directors,

Michael Vandale
President

ARSENAL ENERGY INC.

Statement of Operations

	March 31 2003 (unaudited)	March 31 2002 (unaudited)
Revenue		
Oil and Gas Sales (Net of Royalties)	$ 273,014	$ 0
Royalty Income	11,024	0
Interest Income	0	1,184
	284,038	1,184
Expenses		
Oil and Gas Production	49,486	0
Depreciation and Depletion	61,200	0
General and Administrative	79,417	30,673
	190,103	30,673
Net (Loss) Earnings	93,935	(29,489)
Retained Earnings (Deficit), Beginning of Period	(200,098)	(49,186)
Retained Earnings (Deficit), End of Period	$ (106,163)	$ (78,675)
Earnings Per Share (Note 4)		
Basic	$ .014	$ –
Diluted	.014	–

See accompanying notes to financial statements

Balance Sheet

	March 31 2003 (unaudited)	March 31 2002 (unaudited)
Assets		
Oil and Gas Sales (Net of Royalties)	$ 273,014	$ 0
Current Assets		
Cash and Short-Term Deposits	$ 2,620	$ 380,027
Accounts Receivable	211,476	187
Prepaid Expense	15,520	0
	229,616	380,214
Capital Assets (Note 3)	1,290,254	0
	$ 1,519,870	$ 380,214
Liabilities and Shareholders Equity		
Current Liabilities		
Accounts Payable	$ 91,006	$ 9,719
Bank Loan (Note 4)	750,000	0
	841,006	9,719
Future Site Restoration	1,000	0
Shareholders' Equity		
Share Capital (Note 5)	784,027	449,170
Retained Earnings (Deficit)	(106,163)	(78,675)
	677,864	370,495
	$ 1,519,870	$ 380,214

See accompanying notes to financial statements

ARSENAL ENERGY INC.

Statement of Cash Flows

	March 31 2003 (unaudited)	March 31 2002 (unaudited)
Cash Provided By (Used In)		
Operations:		
Net (Loss) Earnings	$ 93,935	$ (29,489)
Items Not Involving Cash:		
Depreciation and Depletion	61,200	0
Funds from Operations	155,135	(29,489)
Changes in Non-Cash Working Capital	(211,432)	3,416
	(56,297)	(26,073)
Financing:		
Increase in Bank Debt	410,000	0
Investing:		
Acquisition of Capital Assets	353,332	0
	353,332	0
Increase (Decrease) in Cash and Short-Term Deposits	(371)	(26,073)
Cash and Short-Term Deposits, Beginning of Period	2,991	406,100
Cash and Short-Term Deposits, End of Period	2,620	380,027

ARSENAL ENERGY INC.

Notes to Financial Statement

Quarter ended March 31, 2003 (unaudited)

1. **Incorporation and Organization of the Company:**

   Arsenal Capital Inc. (the "Company") was incorporated under the Business Corporations Act (Alberta) on August 3, 2000 and was classified as a Capital Pool Company as defined in policy 2.4 of the Canadian Venture Exchange. During 2002, the Company completed its "Qualifying Transaction" and the name of the corporation was changed to Arsenal Energy Inc.

2. **Significant Accounting Policies:**

   (a) Petroleum and natural gas properties:

   The Company follows the full cost method of accounting for petroleum and natural gas properties, whereby all costs of exploring for and developing petroleum and natural gas and related reserves are capitalized by cost centre. Such costs include land acquisition costs, cost of drilling both productive and non-productive wells, and geological and geophysical expenses and related overhead.

   Capitalized costs, excluding costs related to unproven properties, are depleted using the unit-of-production method based on estimated proven reserves of petroleum and natural gas before royalties as determined by independent petroleum engineers. For purposes of the depletion of calculation, natural gas reserves and production are converted to equivalent volumes of crude oil based on relative energy content.

   The Company applies a "ceiling test" to capitalized costs to ensure that such costs do not exceed future net revenues from estimated production of proven reserves, using prices and costs in effect at the Company's year end, and the costs of unproven properties less impairment. Future net revenues are undiscounted and are calculated after deducting general and administrative costs, financing costs, income taxes and site restoration and abandonment costs.

   Proceeds from the sale of petroleum and natural gas interests are applied against capitalized costs with no gain or loss recognized unless such a sale would significantly alter the rate of depletion and depreciation.

   (b) Interest in joint ventures:

   A portion of the Company's petroleum and natural gas exploration and development activities are conducted jointly with others and, accordingly, the financial statements reflect only the Company's proportionate interest in such activities.

   (c) Future site restoration and abandonment costs:

   Site restoration and abandonment costs are provided for over the life of the estimated proven reserves on a unit-of-production basis. Costs are estimated each year by management in consultation with the Company's engineers based on current