

ARSENAL ENERGY INC.

Annual Information Form
Year Ended December 31, 2003

June 5, 2004

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GLOSSARY OF SELECTED TERMS

The following are selected abbreviations and definitions of terms used herein:

“ABCA” means the *Business Corporations Act* (Alberta);

“AIF” means this annual information form of Arsenal effective December 31, 2003;

“Arsenal” means Arsenal Energy Inc., an Alberta corporation;

“boe” means barrels of oil equivalent natural gas converted at 6 mscf of natural gas per barrel of oil (The use of the term BOEs may be misleading, particularly if used in isolation. A BOE conversion ratio of 6Mcf:1bbl is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead);

“boe/day” means barrels of oil equivalent per day;

“bopd” means barrels of oil per day;

“Effective Date” means the effective date of the information contained in the AIF being December 31, 2003;

“GLJ” means Gilbert Lausten Jung Associates Ltd.;

“GLJ Report 2003” means the reserve report prepared by GLJ with an effective date of December 31, 2003;

“mboe” means thousands of barrels of oil equivalent;

“mbtu” means thousands of British Thermal Units;

“mcf” means thousands of cubic feet;

“mscf” means thousands of standard cubic feet;

“mscf/day” means thousands of standard cubic feet per day;

“mstb” means thousands of stock tank barrels;

“NGL’s” means natural gas liquids including condensate;

“NI 51-101” means National Instrument 51-101 - Standards of Disclosure for Oil and Gas Activities of the Canadian Securities Administrators;

“Preparation Date” means the date of preparation of the GLJ Report 2003, being May 18, 2004;

“stb” means stock tank barrel.

References to oil, gas, natural gas liquids, reserves (gross, net, proved, probable, possible, developed, developed producing, developed non-producing, undeveloped), constant prices and costs, forecast prices and costs, operating costs, development costs, future net revenue and future

income tax expenses shall, unless expressly stated to be to the contrary, have the meaning attributed to such terms as set out in NI 51-101, Companion Policy 51-101CP and all forms referenced therein.

MONETARY REFERENCES

All monetary references contained in this AIF are in Canadian dollars unless otherwise specified.

FORWARD LOOKING STATEMENTS

This AIF contains forward-looking statements. These statements relate to future events or Arsenal's future performance. All statements other than statements of historical fact are forward-looking statements. In some cases, forward-looking statements can be identified by terminology such as "may", "will", "should", "expect", "plan", "anticipate", "believe", "estimate", "predict", "potential", "continue", or the negative of these terms or other comparable terminology. These statements are only predictions. Actual events or results may differ materially. Undue reliance should not be placed on these forward-looking statements, as there can be no assurance that the plans, intentions or expectations upon which they are based will occur. By its nature, forward-looking information involves numerous assumptions, known and unknown risks and uncertainties, both general and specific, that contribute to the possibility that the predictions, forecasts, projections and other forward-looking statements will not occur.

Although Arsenal believes that the expectations reflected in the forward-looking statements are reasonable, there can be no assurance that such expectations will prove to be correct. Arsenal cannot guarantee future results, levels of activity, performance, or achievements. Moreover, Arsenal does not assume responsibility for the accuracy and completeness of the forward-looking statements.

Statements relating to "reserves" or "resources" are deemed to be forward-looking statements, as they involve the implied assessment, based on certain estimates and assumptions, that the resources and reserves described can be profitably produced in the future. All forward-looking statements contained in this AIF are expressly qualified by this cautionary statement. Arsenal is not under any duty to update any of the forward-looking statements after the date hereof to conform such statements to actual results or to changes in Arsenal's expectations.

INCORPORATION

Arsenal Energy Inc. (the “**Corporation**” or “**Arsenal**”) was formed by the amalgamation of Arsenal Capital Inc. (“**Arsenal Capital**”) and A. C. Global Capital Corp. pursuant to a certificate of amalgamation issued under the ABCA on October 18, 2002 (the “**ACG Amalgamation**”). Subsequent to the ACG Amalgamation, Arsenal amalgamated with Legend Capital Corp. pursuant to a certificate of amalgamation issued under the ABCA on May 29, 2003 (the “**Legend Amalgamation**”) and continued to be named Arsenal Energy Inc.

The head office of the Corporation is located at 1820, 330 - 5th Avenue SW, Calgary, Alberta T2P 0L4. The registered office of the Corporation is located at 1000, 400 - 3rd Avenue SW, Calgary, AB T2P 4H2.

GENERAL DEVELOPMENT OF THE BUSINESS OF THE CORPORATION

Description of the Business

The Corporation is a Calgary based resource company engaged in the exploration, development and production of oil and natural gas reserves in Western Canada. The strategy of the Corporation is to acquire land and explore for oil and natural gas in the Western Canadian Basin.

History and Significant Acquisitions and Dispositions

Pursuant to the ACG Amalgamation, each common share of A. C. Global Capital Corp. and each common share of Arsenal Capital was converted into 0.8 common shares of Arsenal. As part of the ACG Amalgamation, Arsenal assumed the obligations undertaken by Arsenal Capital Inc. with respect to a Conveyance Agreement dated May 1, 2002 between True Energy Inc. (“**True**”) and Arsenal Capital (the “**Conveyance Agreement**”), an Amending Agreement dated June 17, 2002 among True, Arsenal Capital and Patch Energy Inc. (“**Patch**”), a Farmout and Joint Operating Agreement dated May 1, 2002 among True, Arsenal Capital and Patch (the “**Farmout and Joint Operating Agreement**”) and a letter amending agreement dated June 20, 2002 among True, Arsenal Capital and Patch (collectively, the “**Acquisition Agreements**”). Pursuant to the Acquisition Agreements, Arsenal (through Arsenal Capital) completed an acquisition (the “**Acquisition**”) from True of oil and gas interests in certain properties located in the North Dodsland and Kerrobert areas of west central Saskatchewan on October 17, 2002 (the “**Properties**”).

Arsenal acquired the oil and gas interests in the Properties for an adjusted purchase price of \$439,832 paid in cash and work commitments, upon the terms and conditions of the Conveyance Agreement and Farmout and Joint Operating Agreement and their respective amending agreements. Pursuant to the Acquisition, Arsenal now owns a 4.98678% working interest in the North Dodsland Voluntary Unit.

In the fall and winter of 2002, Arsenal completed a 10 well drilling program at Kerrobert, Saskatchewan. All 10 wells (3.75 net) were completed as Viking oil wells and were put on production in early January. In September 2003 an additional 9 Viking oil wells (3.375 net) were completed and put on production.

Pursuant to the Legend Amalgamation, each 1.3875 pre Legend Amalgamation share of Arsenal was converted into 1 post Legend Amalgamation share of Arsenal, and each 2.63759225 Legend shares was converted into 1 post Legend Amalgamation share of Arsenal. After the Legend Amalgamation, there were approximately 5,965,836 Arsenal common shares issued and outstanding.

On February 25, 2004, Arsenal completed the acquisition of Orange Exploration Inc. (“**Orange**”). At the time of the acquisition, Orange held a 10% working interest in a number of oil and gas properties in

Saskatchewan which, following the acquisition, became interests of Arsenal. In consideration for the outstanding securities of Orange Arsenal issued an aggregate of 1,850,000 common shares of Arsenal, at a deemed price of \$0.50 per common share and an aggregate of 1,200,000 share purchase warrants of Arsenal.

Trends

There are no trends, commitments, events or uncertainties known to management that can reasonably be expected to have a material effect on the Corporation's business, other than the trends, events and uncertainties facing oil and gas producers in Canada. See also "Risk Factors".

NARRATIVE DESCRIPTION OF THE BUSINESS

The Corporation is an Alberta based corporation actively engaged in and focused on the exploration, development, exploitation, acquisition and production of crude oil, natural gas and natural gas liquids.

Principal Properties

The following is a description of the Corporation's principal properties as at the Effective Date. Unless otherwise stated, any references in this section to reserve volumes or production figures from the properties are based on the Corporation's working interest therein before deduction of applicable royalties in the proved and probable reserves as at December 31, 2003 as estimated in the GLJ Report 2003 in respect to the oil and gas reserves of the Corporation.

North Dodsland Viking Voluntary Unit No. 1

The North Dodsland Viking Voluntary Unit No. 1 is part of the regionally extensive Dodsland Viking oil field in west central Saskatchewan. The Viking sand is near shore marine sand that is approximately five to six meters thick in the productive area. The sand is typically very fine, to fine grained sequence that grades upwards from a shaley laminated, bioturbated sand sequence to a more massive sand and less shale sequence. The effective date of the acquisition by Arsenal in the North Dodsland Viking Voluntary Unit No. 1 is May 1, 2002. The properties were acquired from True for cash consideration of \$450,000 (adjusted purchase price of \$439,832).

Pursuant to the Conveyance Agreement, Arsenal purchased a 4.98678% working interest in the North Dodsland Viking Unit No. 1. This interest includes all petroleum and natural gas rights to the base of Viking.

All of the wells on the North Dodsland Viking Voluntary Unit No. 1 are connected via pipeline into batteries at 12-21-31-21 W3 and 12-24-31-22 W3. These pipelines are known as the MidSask Pipelines and are operated by Flint Hills Resources Ltd. Natural gas is also gathered to the pipelines, separated and sold through Transgas Limited. Natural gas was sold at an average price of \$4/mcf in May, 2002 and the average oil price in May, 2002 was CDN \$38.41 per barrel, based on oil pricing at the wellhead.

Oil from the North Dodsland Viking Voluntary Unit No. 1 is tank treated and trucked to Kerrobert. Various batteries in the pool are pipeline connected to MidSask Pipelines, operated by Flint Hills Resources Ltd. Oil quality is at approximately 37° API. Sulphur content is approximately 0.025%. Natural gas heat in quality is approximately 1050 BTU.

Kerrobert Viking Properties

Pursuant to the Farmout and Joint Operating Agreement, Arsenal participated in the drilling of 10 Viking oil wells in the Kerrobert Area in west-central Saskatchewan with True as the operator. Arsenal paid a 46.75% interest in all drilling, completing and equipping costs to earn a 37.5% working interest in each spacing unit drilled (40 acres). The lands included in the Farmout and Joint Operating Agreement are Sections 13, 15, 23, 25 and 26 and Twp. 33, Rge. 24 West of the Third Meridian and Section 8 in Twp. 33, Rge. 23, West of the Third Meridian. The Effective Date of the Farmout and Joint Operating Agreement is May 1, 2002.

In September 2003 an additional 9 Viking oil wells (3.375 net) were completed and put on production.

The Kerrobert Viking properties are part of the regionally extensive Kerrobert Viking marine sand sequence. The Kerrobert Viking sand is geologically similar to the Dodsland Viking sand, but is next occurring sequence in the geological development of the Viking system in the Kindersley area.

Oil from the Kerrobert Viking properties are tank treated and trucked to Kerrobert. Various batteries in the pool are pipeline connected to MidSask Pipelines, operated by Flint Hills Resources Ltd. Oil quality is at approximately 37° API. Sulphur content is approximately 0.025%. Natural gas heat in quality is approximately 1050 BTU.

All leases pertaining to the lands included in the Farmout and Joint Operating Agreement are past the primary term but held by production.

Environmental

The Corporation believes that it is in substantial compliance with existing environmental laws and regulations applicable to it and is not aware of any proposed environmental legislation or regulations with which it would not be in material compliance. However, the natural gas and crude oil industry may in the future become subject to more stringent environmental protection rules. This could increase the cost of doing business and may have a negative impact on earnings in the future.

Employees/Consultants

The Corporation has two consultants who collectively attend to the management and daily operations of the Corporation. Additional consultants are retained from time to time on a contract basis as needed.

Competitive Environment

The Corporation is in the business of the exploration, development and production of natural gas and crude oil reserves and is in the relatively early stage of development of such business. As such, the Corporation competes in a very competitive marketplace.

STATEMENT OF RESERVES DATA AND OTHER OIL AND GAS INFORMATION

The GLJ Report 2003 evaluates the proved and probable crude oil, natural gas and NGL reserves attributable to Arsenal's interests in its properties and net present value of estimated future cash flow from such reserves, based on both forecasted and constant price and cost assumptions. The reserves information contained in the GLJ Report 2003 was prepared and is presented in accordance with the requirements of NI 51-101.

In preparing its report, GLJ obtained basic information from Arsenal, which included land data, well information, geological information, reservoir studies, estimates of on-stream dates, contract information, current hydrocarbon product prices, operating cost data, capital budget forecasts, financial data and future operating plans. Other engineering, geological or economic data required to conduct the evaluation and upon which the GLJ Report 2003 is based, was obtained from public records, other operators and from GLJ's non-confidential files. The extent and character of ownership and the accuracy of all factual data supplied for the independent evaluation, from all sources, was accepted by GLJ as represented by Arsenal.

The following tables, based on the GLJ Report 2003, show the estimated share of Arsenal's crude oil, natural gas and NGL reserves in its properties and the net present value of estimated future net revenue for these reserves, using constant and forecast prices and costs as indicated. **All evaluations of the present value of estimated future net revenue in the GLJ Report 2003 are stated after provision for estimated future capital expenditures, well abandonment and reclamation costs (including the offsetting salvage value of tangible equipment after abandonment) but prior to income taxes and indirect costs and do not necessarily represent the fair market value of the reserves. The recovery and reserve estimates of Arsenal's oil, NGL and natural gas reserves provided herein are estimates only and there is no guarantee that the estimated reserves will be recovered. Actual reserves may be greater than or less than the estimates provided herein.**

References to oil, gas, natural gas liquids, reserves (gross, net, proved, probable, possible, developed, developed producing, developed non-producing, undeveloped), constant prices and costs, forecast prices and costs, operating, costs, development costs, future net revenue and future income tax expenses shall, unless expressly stated to be to the contrary, have the meaning attributed to such terms as set out in NI 51-101, Companion Policy 51-101CP and all forms referenced therein.

Summaries of reserves and net present values of future net revenues presented herein on the basis of constant prices and costs forecasts have been based on an average crude oil price of \$40.81 per barrel (Edmonton D2/S2), an average natural gas reference price of \$5.83 per mmbtu and an average natural gas liquids price of \$34.31 per barrel. Summaries of reserves and net present value of future net revenues presented on the basis of forecast prices and costs have been based on a crude oil price ranging between \$43.00 and \$44.50 per barrel (Edmonton D2/S2), a natural gas reference price ranging between \$6.30 and \$6.65 per mmbtu and a natural gas liquids price ranging between \$33.81 and \$45.31 per barrel.

In accordance with the requirements of National Instrument 44-101, attached hereto are the following appendices:

- Appendix A: Report on Reserves Data by Independent Qualified Reserves Evaluator in Form 51-101F2 which includes certain information estimated using forecast prices and costs based on January 1, 2004 pricing assumptions
- Appendix B: Report of Management and Directors on Oil and Gas Disclosure in Form 51-101F3

**Summary of Oil and Gas Reserves
as at December 31, 2003**

Constant Prices And Costs

| | Oil | | NGLs | | Natural Gas | |
|--------------------------------|--------------------------------|------------------------------|--------------------------------|------------------------------|---------------------------------|-------------------------------|
| | Gross ⁽¹⁾ (mstb) | Net ⁽²⁾ (mstb) | Gross ⁽¹⁾ (mstb) | Net ⁽²⁾ (mstb) | Gross ⁽¹⁾ (mmscf) | Net ⁽²⁾ (mmscf) |
| Proven Developed Producing | 184.5 | 173.3 | 3.6 | 3.6 | 71.9 | 71.9 |
| Proved Developed Non-Producing | - | - | - | - | - | - |
| Proved Undeveloped | - | - | - | - | - | - |
| Total Proved | 184.5 | 173.3 | 3.6 | 3.6 | 71.9 | 71.9 |
| Probable Additional | 18.5 | 16.2 | 0.1 | 0.1 | 2.5 | 2.5 |
| Proved and Probable | 203.0 | 189.5 | 3.7 | 3.7 | 74.4 | 74.4 |

Notes:

- (1) Gross Reserves means Arsenal's working interest (operating and non-operating) share before deduction of royalties and income taxes.
- (2) Net Reserves means Arsenal's working interest (operating and non-operating) share after deduction of royalties but before deduction of income taxes.

**Summary of Net Present Value of Future Net Reserves
as at December 31, 2003**

**Constant Pricing and Costs
(in Cdn\$ thousands)**

| | Before Tax | | | | | After Tax | | | | |
|--------------------------------|---------------|------|------|------|------|---------------|------|------|------|------|
| | Discounted At | | | | | Discounted At | | | | |
| | 0% | 5% | 10% | 15% | 20% | 0% | 5% | 10% | 15% | 20% |
| Proven Developed Producing | 3119 | 2047 | 1601 | 1353 | 1189 | 2940 | 2002 | 1588 | 1348 | 1187 |
| Proved Developed Non-Producing | | | | | | | | | | |
| Proved Undeveloped | | | | | | | | | | |
| Total Proved | 3119 | 2047 | 1601 | 1353 | 1189 | 2940 | 2002 | 1588 | 1348 | 1187 |
| Probable Additional | 390 | 224 | 159 | 121 | 97 | 301 | 186 | 139 | 110 | 90 |
| Proved and Probable | 3509 | 2271 | 1760 | 1474 | 1286 | 3241 | 2188 | 1727 | 1458 | 1277 |

Total Future Net Revenue as at December 31, 2003

(Undiscounted)

**Constant Prices and Costs
(In Cdn\$ thousands)**

| | Proved | Proved Plus Probable |
|-------------------------------------|--------|----------------------|
| Revenue | 7951 | 8715 |
| Royalties | 706 | 826 |
| Operating Costs | 3953 | 4206 |
| Abandonment Costs | 173 | 173 |
| Development Costs | 0 | 0 |
| Net Revenue Before Income Tax | 3119 | 3510 |
| Income Tax Expense | 178 | 268 |
| Future Net Revenue After Income Tax | 2941 | 3242 |

**Net Present Value of Future Net Revenue
By Production Group as at December 31, 2003
(Discounted At 10%)
Constant Prices and Costs
(In Cdn\$ thousands)
(Before Income Taxes)**

| RESERVE CATEGORY | Oil | Natural Gas and NGL's | Total |
|----------------------|-------------|--------------------------|-------------|
| Proved | 1601 | | 1601 |
| Probable Additional | 159 | | 159 |
| Proved Plus Probable | <u>1760</u> | | <u>1760</u> |

**Summary of Oil And Gas Reserves
as at December 31, 2003
Forecast Prices and Costs**

| | Oil | | NGLs | | Natural Gas | |
|--------------------------------|--------------------------------|------------------------------|--------------------------------|------------------------------|---------------------------------|-------------------------------|
| | Gross ⁽¹⁾ (mstb) | Net ⁽²⁾ (mstb) | Gross ⁽¹⁾ (mstb) | Net ⁽²⁾ (mstb) | Gross ⁽¹⁾ (mmscf) | Net ⁽²⁾ (mmscf) |
| Proven Developed Producing | 127 | 118 | 2 | 2 | 45 | 45 |
| Proved Developed Non-Producing | - | - | - | - | | |
| Proved Undeveloped | - | - | - | - | - | - |
| Total Proved | <u>127</u> | <u>118</u> | <u>2</u> | <u>2</u> | <u>45</u> | <u>45</u> |
| Probable Additional | 15 | 15 | | | | |
| Proved and Probable | <u>142</u> | <u>133</u> | <u>2</u> | <u>2</u> | <u>45</u> | <u>45</u> |

Notes:

- (1) Gross Reserves means Arsenal's working interest (operating and non-operating) share before deduction of royalties and income taxes.
- (2) Net Reserves means Arsenal's working interest (operating and non-operating) share after deduction of royalties but before deduction of income taxes.

**Summary of Net Present Value of Future Net Revenue
as at December 31, 2003
Forecast Prices and Costs
(In Cdn\$ thousands)**

| | Before Tax Discounted At | | | | | After Tax Discounted At | | | | |
|--------------------------------|-----------------------------|-------------|-------------|-------------|-------------|----------------------------|-------------|-------------|-------------|-------------|
| | 0% | 5% | 10% | 15% | 20% | 0% | 5% | 10% | 15% | 20% |
| Proven Developed Producing | 1683 | 1371 | 1186 | 1063 | 974 | 1683 | 1371 | 1186 | 1063 | 974 |
| Proved Developed Non-Producing | | | | | | | | | | |
| Proved Undeveloped | | | | | | | | | | |
| Total Proved | <u>1683</u> | <u>1371</u> | <u>1186</u> | <u>1063</u> | <u>974</u> | <u>1683</u> | <u>1371</u> | <u>1186</u> | <u>1063</u> | <u>974</u> |
| Probable Additional | 222 | 148 | 111 | 88 | 73 | 222 | 148 | 111 | 88 | 73 |
| Proved and Probable | <u>1905</u> | <u>1519</u> | <u>1297</u> | <u>1151</u> | <u>1047</u> | <u>1905</u> | <u>1519</u> | <u>1297</u> | <u>1151</u> | <u>1047</u> |

**Total Future Net Revenue as at December 31, 2003
(Undiscounted)
Forecast Prices and Costs
(In Cdn\$ thousands)**

| | <u>Proved</u> | <u>Proved Plus Probable</u> |
|-------------------------------------|--------------------|---------------------------------|
| Revenue | 5329 | 5971 |
| Royalties | 546 | 628 |
| Operating Costs | 2892 | 3226 |
| Abandonment Costs | 207 | 211 |
| Development Costs | 0 | 0 |
| Net Revenue Before Income Tax | <u>1684</u> | <u>1906</u> |
| Income Tax Expense | <u>0</u> | <u>0</u> |
| Future Net Revenue After Income Tax | <u><u>1684</u></u> | <u><u>1906</u></u> |

**Net Present Value of Future Net Revenue
By Production Group as at December 31, 2003
(Discounted at 10%)
Forecast Prices And Costs
(In Cdn\$ thousands)
(Before Income Taxes)**

| RESERVE CATEGORY | <u>Oil</u> | <u>Natural Gas and NGL's</u> | <u>Total</u> |
|----------------------|--------------------|----------------------------------|--------------------|
| | Proved | 1186 | |
| Probable Additional | <u>111</u> | | <u>111</u> |
| Proved Plus Probable | <u><u>1297</u></u> | | <u><u>1297</u></u> |

Summary of Pricing Assumptions as at December 31, 2003

GLJ employed the following price and exchange rate and inflation rate assumptions as of December 31, 2003 in estimating Arsenal's reserves data using constant prices and costs.

Constant Prices and Costs

| Year Ended December 31 | <u>Oil</u> | | <u>Natural Gas</u> | | <u>NGL's</u> | <u>Inflation Rate</u> | <u>Exchange Rate</u> |
|---------------------------|--|---|---|---|-------------------------------|---------------------------|--------------------------|
| | <u>West Texas Intermediate at Cushing (\$US/stb)⁽¹⁾</u> | <u>Alberta Par Price (Edmonton) (Cdn\$/stb)⁽²⁾</u> | <u>Chapman Gas Reference Price (\$/mmbtu)⁽³⁾</u> | <u>AECO Spot Gas (\$/mmbtu)⁽⁴⁾</u> | <u>(\$/bbl)⁽⁵⁾</u> | <u>% Per Annum</u> | <u>\$US/\$Cdn</u> |
| 2003 | 30.96 | 43.51 | 6.33 | 6.49 | 36.68 | 0 | 0.7738 |

Forecast Prices and Costs

| Year Ended December 31 | Oil | | Natural Gas | | NGL's | Inflation Rate | Exchange Rate |
|---------------------------|--|--|--|---|-------------------------|----------------|---------------|
| | West Texas Intermediate at Cushing (SUS/stb) ⁽¹⁾ | Alberta Par Price (Edmonton) (Cdn\$/stb) ⁽²⁾ | Alberta Gas Reference Price (\$/mmbtu) ⁽³⁾ | AECO Spot Gas (\$/mmbtu) ⁽⁴⁾ | (\$/bbl) ⁽⁵⁾ | % Per Annum | \$US/\$Cdn |
| Historical | | | | | | | |
| 2002 | 26.08 | 40.33 | 3.88 | 3.88 | 36.91 | 2.2 | 0.637 |
| 2003 | 31.07 | 43.66 | 6.13 | 6.49 | 38.33 | 2.8 | 0.721 |
| Forecast | | | | | | | |
| 2004 | 34.25 | 44.75 | 6.30 | 6.40 | 38.58 | 1.5 | 0.750 |
| 2005 | 29.00 | 37.75 | 5.25 | 5.30 | 30.92 | 1.5 | 0.750 |
| 2006 | 27.00 | 35.25 | 4.95 | 4.95 | 28.08 | 1.5 | 0.750 |
| 2007 | 25.00 | 32.50 | 4.75 | 4.75 | 25.33 | 1.5 | 0.750 |
| 2008 | 25.00 | 32.50 | 4.75 | 4.75 | 25.33 | 1.5 | 0.750 |
| 2009 | 25.00 | 32.50 | 4.75 | 4.75 | 25.33 | 1.5 | 0.750 |
| 2010 | 25.50 | 33.00 | 4.85 | 4.85 | 25.83 | 1.5 | 0.750 |
| 2011 | 25.75 | 33.50 | 4.95 | 4.95 | 26.33 | 1.5 | 0.750 |
| 2012 | 26.25 | 34.00 | 5.05 | 5.05 | 26.75 | 1.5 | 0.750 |
| 2013 | 26.50 | 34.50 | 5.15 | 5.15 | 27.17 | 1.5 | 0.750 |
| 2014 | 27.00 | 35.00 | 5.20 | 5.20 | 27.58 | 1.5 | 0.750 |
| 2015 | 27.41 | 35.53 | 5.28 | 5.28 | 28.00 | 1.5 | 0.750 |
| 2016 | 27.82 | 36.06 | 5.36 | 5.36 | 28.42 | 1.5 | 0.750 |
| 2017 | 28.23 | 36.60 | 5.44 | 5.44 | 28.84 | 1.5 | 0.750 |
| 2018 | 28.66 | 37.15 | 5.52 | 5.52 | 29.28 | 1.5 | 0.750 |
| 2019 | 29.09 | 37.70 | 5.60 | 5.60 | 29.72 | 1.5 | 0.750 |

Notes:

- (1) West Texas Intermediate quality (D2/S2) crude landed at Cushing, Oklahoma.
- (2) Equivalent price for light sweet crude (D2/S2) landed Edmonton, Alberta after exchange of \$0.750 \$US/\$Cdn and transportation differential of \$0.50 per stock tank barrel.
- (3) Alberta Gas Reference price represents the average of all system and direct (spot and firm) sales.
- (4) Spot price at the AECO-NIT (Nova Inventory Transfer) point at Suffield, Alberta.
- (5) Natural gas liquids blended mix price assuming typical liquid composition of 40% propane, 30% butane and 30% pentanes plus.

Reconciliation of Company Net Reserves by Product Type

The following table sets forth a reconciliation of Arsenal's total net proved, probable and proved plus probable reserves as at December 31, 2003 against such reserves as at December 31, 2002 based on forecast price and cost assumptions.

Forecast Prices and Costs

| | Light and Medium Oil | | | Natural Gas | | |
|---------------------|-------------------------|---------------------------|---|-------------------------|---------------------------|---|
| | Net Proved (mdbl) | Net Probable (mdbl) | Net Proved Plus Probable (mdbl) | Net Proved (mscf) | Net Probable (mscf) | Net Proved Plus Probable (mscf) |
| December 31, 2002 | 163 | 9 | 172 | 76 | 3 | 79 |
| Drilling Additions | 34 | 8 | 42 | 0 | 0 | 0 |
| Acquisitions | 0 | 0 | 0 | 0 | 0 | 0 |
| Technical Revisions | (48) | (2) | (50) | (31) | 0 | (31) |
| Production | (22) | 0 | (22) | 0 | 0 | 0 |
| December 31, 2003 | <u>127</u> | <u>15</u> | <u>142</u> | <u>45</u> | <u>3</u> | <u>48</u> |

Reconciliation of Changes in Present Value of Net Revenue

The following table sets forth a reconciliation of the estimate of the net present value of future net revenue attributable to Arsenal's reserves as evaluated in the GLJ Report 2003 as at December 31, 2003 against the estimate of such amount as at December 31, 2002, calculated before tax using a discount rate of 10% and constant pricing and cost assumptions.

| | Company Total |
|--|----------------------|
| Estimated Future Net Revenue at December 31, 2002 | 1655 |
| Net Change in Sales and Transfer Prices, Production Costs and Royalties Related to Future Production | (67) |
| Change Resulting from Acquisition of Reserves | 0 |
| Estimated Future Net Revenue at December 31, 2003 | 1588 |

ADDITIONAL INFORMATION RELATING TO ARSENAL'S RESERVE DATA

Undeveloped Reserves

The following table summarizes the volumes of Arsenal's proved undeveloped reserves and probable undeveloped reserves that were attributed in each of the most recent three financial years (being the only two years that Arsenal had reportable reserves).

| Year Ended December 31 | Oil | | | | Natural Gas | | | | NGL's | | | |
|---------------------------------------|----------------------------|--------------------------|-------------------------------|--------------------------|----------------------------|--------------------------|-------------------------------|--------------------------|----------------------------|--------------------------|-------------------------------|--------------------------|
| | Proved | | Probable⁽¹⁾ | | Proved | | Probable⁽¹⁾ | | Proved | | Probable⁽¹⁾ | |
| | (mdbl) | | (mdbl) | | (mmscf) | | (mmscf) | | (mdbl) | | (mdbl) | |
| | Gross⁽²⁾ | Net⁽³⁾ | Gross⁽²⁾ | Net⁽³⁾ | Gross⁽²⁾ | Net⁽³⁾ | Gross⁽²⁾ | Net⁽³⁾ | Gross⁽²⁾ | Net⁽³⁾ | Gross⁽²⁾ | Net⁽³⁾ |
| 2003 ⁽⁴⁾ | - | - | 18.5 | 16.2 | - | - | 2.5 | 2.5 | - | - | 0.1 | 0.1 |
| 2002 ⁽⁵⁾ | - | - | 19.0 | 18.0 | - | - | 6.6 | 6.6 | - | - | 0 | 0 |

Notes:

- (1) For the purposes of this table, all of Arsenal's probable reserves have been classified as probable undeveloped reserves.
- (2) Gross reserves consists of Arsenal's share of the classified reserves before deduction of royalties, production taxes or their equivalent.
- (3) Net reserves consist of Arsenal's share of the classified reserves after deduction of all royalties, production taxes or their equivalent but before deduction of income taxes.
- (4) Information derived from the GLJ Report 2003.
- (5) Information derived from a Reserve and Economic Evaluation prepared by Gilbert Lausten Jung Associates Ltd. dated February 3, 2003 (with an effective date of January 1, 2003).

The following discussion generally describes the basis on which Arsenal attributes Proved and Probable Undeveloped Reserves and its future plans for developing such reserves.

Proved Undeveloped Reserves

Proved undeveloped reserves are generally those reserves related to wells that have been tested and not yet tied-in, wells drilled near the end of the fiscal year or wells further away from Arsenal's gathering system. In addition, such reserves may relate to planned infill drilling locations. The majority of these reserves are planned to be on stream within a two year timeframe.

Probable Undeveloped Reserves

Probable undeveloped reserves are generally those reserves tested or indicated by analogy to be productive, infill drilling locations and lands contiguous to production. The majority of these reserves are planned to be on stream within a two year timeframe.

Significant Factors and Uncertainties

The process of estimating oil and gas reserves is complex. It requires significant judgments and decisions based on available geological, geophysical, engineering and economic data. These estimates may change substantially as additional data from ongoing development activities and production performance becomes available and as economic conditions impacting oil and gas processing and costs change. The reserve estimates contained herein are based on current production forecasts, prices and economic conditions and are evaluated by GLJ, an independent engineering firm.

As circumstances change and additional data become available, reserve estimates also change. Estimates made are reviewed and revised, either upward or downward, as warranted by the new information. Revisions are often required due to changes in well performance, prices, economic conditions and governmental restrictions.

Although every reasonable effort is made to ensure that reserve estimates are accurate, reserve estimation is an inferential science. As a result, the subjective decisions, new geological or production information and a changing environment may impact these estimates. Revisions to reserve estimates can arise from changes in year-end oil and gas prices and reservoir performance. Such revisions can be either positive or negative. The reserve estimates of Arsenal's oil, NGL and natural gas reserves provided in this AIF are estimates only and there is no assurance or guarantee that the estimated reserves will be recovered. Actual reserves may be greater or less than the estimates provided herein. See "Risk Factors".

Future Development Costs

The following table sets out the development costs deduced in the estimation of future net revenues attributable to proved reserves (using both constant prices and costs and forecast prices and costs) and proved plus probable reserves (using forecast prices and costs only).

| YEAR | Constant Prices and Costs | Forecast Prices and Costs | |
|------------------------|------------------------------|---------------------------|----------------------------------|
| | Proved Reserves | Proved Reserves | Proved Plus Probable Reserves |
| | Cdn\$thousands | Cdn\$thousands | Cdn\$thousands |
| 2004 | 0 | 0 | 0 |
| 2005 | 0 | 0 | 0 |
| 2006 | 0 | 0 | 0 |
| 2007 | 0 | 0 | 0 |
| 2008 | 0 | 0 | 0 |
| Remaining Years | 0 | 0 | 0 |
| Total Undiscounted | 0 | 0 | 0 |
| Total Discounted (10%) | 0 | 0 | 0 |

On May 13, 2004, Arsenal completed a private placement of 1,000,000 flow-through common shares at a price of \$1.00 per share for proceeds of \$1.0 million. The proceeds of the private placement, when combined with internally generated cash flow, is expected to be sufficient to fund future exploration and development costs for the next year. Should the private placement proceeds and cash flow not be

sufficient to fund future exploration and development costs, Arsenal may defer some of its exploration and development plans.

OTHER OIL AND GAS INFORMATION

Crude Oil and Natural Gas Wells

The following table summarizes Arsenal's interest, as at December 31, 2003, in producing and non-producing crude oil and natural gas wells.

| Location | Oil | | | | Gas | | | |
|---------------|----------------------|--------------------|----------------------|--------------------|----------------------|--------------------|----------------------|--------------------|
| | Producing | | Non-Producing | | Producing | | Non-Producing | |
| | Gross ⁽¹⁾ | Net ⁽²⁾ | Gross ⁽¹⁾ | Net ⁽²⁾ | Gross ⁽¹⁾ | Net ⁽²⁾ | Gross ⁽¹⁾ | Net ⁽²⁾ |
| Saskatchewan | 137 | 13 | - | - | | | | |
| | - | - | - | - | | | | |
| COMPANY TOTAL | 137 | 13 | 0 | 0 | 0 | 0 | 0 | 0 |

Notes:

- (1) "Gross Wells" are all wells in which Arsenal has an interest.
- (2) "Net Wells" are the aggregate percentage of Arsenal's interest in Gross Wells.

Oil and Gas Properties

For a summary of Arsenal's major producing and exploration properties as at the most recently completed financial year see "Narrative Description of the Business - Principal Properties" section of this AIF above.

Forward Contracts and Financial Instruments

Arsenal has no forward contracts or financial instruments.

Abandonment and Reclamation Costs

Arsenal uses its internal historical costs to estimate its abandonment and reclamation costs when available. The costs are estimated on an area by area basis. The industry's historical costs are used when available. If representative comparisons are not readily available, an estimate is prepared based on the various regulatory abandonment requirements.

Arsenal has 13 net wells for which it expects to incur abandonment and reclamation costs. The total of such costs, forecast net of estimated salvage value, is \$173 thousand (undiscounted) and \$56 thousand (discounted at 10%) in respect of proved reserves. 100% of such amounts were deducted as abandonment and reclamation costs in estimating future net revenue of the Corporation in respect of proved reserves disclosed above. Reserve report calculations have assumed that abandonment costs of \$6,000 will be incurred by Arsenal in 2004, \$3,000 in 2006 and \$7,000 in 2011.

Tax Horizon

Arsenal was not required to pay any tax during the year ended December 31, 2003. Based on a strategy of re-investing fully all internally generated cash flow in exploration and development programs, and based on the commodity prices used in the GLJ Report 2003, Arsenal estimates that it will not be required to pay income taxes until at least 2006.

Acquisition, Exploration and Developments Costs Incurred

The following table sets out Arsenal's property acquisition, exploration and development costs for the fiscal year ended December 31, 2003.

| | Property Acquisition Costs | | Exploration Costs | Development Costs |
|------------------|----------------------------|----------|-------------------|-------------------|
| | Proved | Unproved | | |
| | (In Cdn\$ thousands) | | | |
| Saskatchewan | 0 | 0 | 27 | 788 |
| British Columbia | - | - | - | |
| Total | 0 | 0 | 27 | 788 |

Exploration and Development Drilling Activity

The following table sets out the number of exploration and development wells in which Arsenal has an interest, on a gross and net basis.

| | Year Ended December 31, 2003 | | | |
|---------------|------------------------------|--------------------|----------------------|--------------------|
| | Exploratory | | Development | |
| | Gross ⁽¹⁾ | Net ⁽²⁾ | Gross ⁽¹⁾ | Net ⁽²⁾ |
| Crude Oil | - | - | 137 | 13 |
| Natural Gas | | | | |
| Dry/Abandoned | - | - | - | - |
| Total | | | 137 | 13 |

Notes:

- (1) "Gross Wells" are wells in which Arsenal has an interest.
- (2) "Net Wells" are the aggregate percentage of Arsenal's interest in Gross Wells.
- (3) Include Exploration or Development Wells that were dry and abandoned.

Future Anticipated Exploration and Development Activities

In 2004, Arsenal plans to participate for a 25% interest in the drilling of an exploration well in the cretaceous structure which is believed to have significant gas potential. In addition to this exploration well, Arsenal currently plans to re-enter and develop a number of low-risk shut-in wells situated on its existing acreage. Joint ventures with third parties may be used to supplement the cost of this re-entry drilling program. In 2004, subject to seismic and land acquisition, Arsenal plans to participate in an exploratory multi-well drilling program.

Production Estimates

The following table sets out Arsenal estimated production of oil, natural gas and NGL's for fiscal year ended December 31, 2004 as set out in the GLJ Report 2003.

Net Future Production Estimates Constant Prices And Cost

| | Estimated Production For Year Ended December 31, 2004 | | | | | |
|---------------|---|---------------------|--------------------|---------------------|--------------|---------------------|
| | Oil (mdbl) | | Natural Gas (mmcf) | | NGL's (mdbl) | |
| | Proved | Proved and Probable | Proved | Proved and Probable | Proved | Proved and Probable |
| Saskatchewan | 50 | 50 | 6 | 6 | 0 | 0 |
| Company Total | 50 | 50 | 6 | 6 | 0 | 0 |

Production History

The following table sets out, by country, on a quarterly basis for the year ended December 31, 2003, Arsenal's average daily production volume, prior to royalties, and the prices received, royalties paid, production costs incurred and netbacks on a per unit of volume basis for each product type.

Average Daily Production Information

| | Three Months Ended, 2003 | | | | 12 Months Ended |
|---------------------------------------|--------------------------|---------|--------------|-------------|-----------------|
| | March 31 | June 30 | September 30 | December 31 | December 31 |
| Average Daily Production | | | | | |
| Oil & NGL's (boe/day) ⁽¹⁾ | 50.8 | 44.6 | 62.4 | 75.4 | 58.3 |
| Natural Gas (mcf/day) | 6.2 | 5.5 | 6.4 | 5.9 | 6.0 |
| Total (boe/day) ⁽¹⁾ | 51.8 | 45.5 | 63.5 | 76.4 | 59.3 |
| Average Net Price (Cdn\$/bbl) | 50.84 | 40.66 | 39.89 | 38.84 | 42.05 |
| Aggregate Sales (net of royalties) | 194,319 | 136,979 | 199,417 | 226,175 | 756,890 |
| Operating Expenses | 63,157 | 47,829 | 49,885 | 91,322 | 252,193 |
| Netback Received | 131,162 | 89,150 | 149,532 | 134,853 | 504,697 |

Note:

(1) The barrels of oil equivalent has been calculated on the basis of 1 boe to 6 mcf of gas.

Production Volume by Field

The following table discloses for each important field and in total, Arsenal's production volumes for the financial year ended December 31, 2003 for each production type.

| | Oil (bbls) | NGL's (bbls) | Natural Gas (mmcf) | Percent of Total |
|---------------|---------------|-----------------|-----------------------|------------------|
| SASKATCHEWAN | - | - | - | - |
| Kerrobert | 17,352 | 0 | 0 | 80.1 |
| Dodsland | 3,832 | 118 | 218 | 19.9 |
| | - | - | - | - |
| | - | - | - | - |
| COMPANY TOTAL | 21,184 | 118 | 218 | 100.0 |

SELECTED CONSOLIDATED FINANCIAL INFORMATION

The following tables set out certain selected consolidated financial information of Arsenal as at and for the years ended December 31, 2003 and 2002. The selected consolidated financial information has been derived from Arsenal's annual consolidated financial statements, which statements have been audited by KPMG LLP, Chartered Accountants, and such audited annual financial statements are hereby incorporated by reference.

Selected Annual Consolidated Financial Information

| | Years Ended December 31 | |
|---------------------------------------|-------------------------|-------------|
| | 2003 | 2002 |
| | \$(audited) | \$(audited) |
| Revenue | 830,388 | 54,471 |
| Expenses | 1,053,789 | 205,383 |
| Net Income (Loss) ⁽¹⁾ | 223,401 | 150,912 |
| Net Income (Loss) Per Share | .02 | (.03) |
| Total Assets | 2,811,420 | 1,031,038 |
| Total Long Term Financing Liabilities | Nil | Nil |
| Dividends | Nil | Nil |
| Share Capital | 2,163,533 | 784,027 |
| Deficit | (95,499) | (200,098) |

Note:

- (1) Net Income (Loss) is provided on a before tax basis. Net loss on an after tax basis is \$104,599.

Dividend Policy

The Corporation has never paid a dividend on its common shares, does not expect to pay dividends in the near future and has no express or stated policy in respect of the declaration or payment of any such dividends. Any decision to declare and pay dividends on any shares of the Corporation in the future will be made by the board of directors of the Corporation on the basis of the terms and conditions attaching to such shares, the Corporation's earnings, financial conditions and requirements, and other conditions and factors existing at the time and which the board of directors of the Corporation may consider appropriate in the circumstances.

MANAGEMENT'S DISCUSSION AND ANALYSIS

Year Ended December 31, 2003 Compared to Year Ended December 31, 2002

Arsenal had revenues of approximately \$830,388 for the year ended December 31, 2003 compared to \$54,471 the year ended December 31, 2002. In 2003, revenue included petroleum and natural gas sales less royalties of \$830,388. In 2002, revenue included petroleum and natural gas sales less royalties and interest income for a total of \$54,471. Net losses during fiscal 2003 amounted to \$223,401 before tax and \$104,599 after tax, or a gain \$0.02 after tax per share, compared with a loss of \$150,912, or a loss of \$0.03 per share for fiscal 2002.

General and administrative expenses were \$455,505 in 2003 as compared to \$149,951 in 2002. These expenses included professional fees and expenses in relation to Arsenal's prior attempts at completing a Qualifying Transaction, costs in relation to completing the Legend Amalgamation and office and listing expenses.

Operating expenses were \$252,193 in 2003 compared to \$23,253 in 2002. The increased costs were a result of increased production and drilling activity. Depletion, depreciation and site restoration expenses were \$309,844 in 2003 compared to 22,500 in 2002.

Liquidity at December 31, 2003

As of December 31, 2003, the Corporation had approximately \$743,000 in cash assets. This cash position, together with production revenue, an increased bank loan and receivables, will enable the Corporation to continue operations over the short term.

Selected Quarterly Consolidated Financial Information

| | Three Months Ended 2002 | | | |
|----------------------------------|--------------------------------|---------------------|----------------|-----------------|
| | December 31 | September 30 | June 30 | March 31 |
| | \$(unaudited) | \$(unaudited) | \$(unaudited) | \$(unaudited) |
| Revenue | 51,043 | 972 | 1,272 | 1,184 |
| Net Income (Loss) ⁽¹⁾ | (848) | (70,795) | (49,780) | (29,489) |
| Net Income (Loss) per Share | 0.00 | 0.02 | (0.01) | (0.01) |

| | Three Months Ended 2003 | | | |
|----------------------------------|--------------------------------|---------------------|----------------|-----------------|
| | December 31 | September 30 | June 30 | March 31 |
| | \$(unaudited) | \$(unaudited) | \$(unaudited) | \$(unaudited) |
| Revenue | 240,122 | 174,180 | 132,048 | 289,038 |
| Net Income (Loss) ⁽¹⁾ | 55,297 | (810) | (43,823) | 93,935 |
| Net Income (Loss) per Share | 0.02 | 0.00 | (0.01) | 0.02 |

Note:

(1) Net Income (Loss) is provided on a before tax basis.

On January 1, 2004 pursuant to changes in accounting policy the quarterly financial information for all quarters for the year ended December 31, 2003 was restated retroactively to reflect changes to asset retirement obligations and stock based compensation expense (the "**Restatement**"). The restated values for the quarters for the year ended December 31, 2003 are as follows:

| | Three Months Ended 2003 | | | |
|----------------------|--------------------------------|---------------------|----------------|-----------------|
| | December 31 | September 30 | June 30 | March 31 |
| | \$(unaudited) | \$(unaudited) | \$(unaudited) | \$(unaudited) |
| Revenue | 240,122 | 174,180 | 132,048 | 284,038 |
| Net Income | (4,867) | (2,690) | (39,624) | 89,736 |
| Net Income Per Share | 0.00 | 0.00 | (0.01) | 0.01 |

Further, the net loss for the year ended December 31, 2003 was also retroactively restated pursuant to the Restatement. The restated value for the net income (loss) as at the year ended December 31, 2003 is \$283,685 before tax.

RISK FACTORS

Exploration, Development and Production Risks

Oil and natural gas exploration involves a high degree of risk and there is no assurance that expenditures made on exploration by the Corporation will result in new discoveries of oil or natural gas in commercial

quantities. It is difficult to project the costs of implementing an exploratory drilling program due to the inherent uncertainties of drilling in unknown formations, the costs associated with encountering various drilling conditions such as over pressured zones and 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.

Future oil and gas exploration may involve unprofitable efforts, not only from dry wells, but from wells that are productive but do not produce sufficient net revenues to return a profit after drilling, operating and other costs. Completion of a well does not assure a profit on the investment or recovery of drilling, completion and operating costs. In addition, drilling hazards or environmental damage could greatly increase the cost of operations, and various field operating conditions may adversely affect the production from successful wells. These conditions include delays in obtaining governmental approvals or consents, shut-ins of connected wells resulting from extreme weather conditions, insufficient storage or transportation capacity or other geological and mechanical conditions. While close 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, cratering, 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.

Insurance

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

Prices, Markets and Marketing of Crude Oil and Natural Gas

Oil and natural gas are commodities for which prices are determined by domestic and world demand, supply and other factors, all of which are beyond the control of the Corporation. World prices for oil and natural gas have fluctuated widely for 25 years. Any material decline in prices could result in a reduction of net production revenue. Foreign exchange is a factor as prices and reserve valuations are tied to US dollars while expenses are in Canadian dollars. Certain wells or projects may become uneconomic as a result of a decline in oil prices and natural gas prices, leading to a reduction in the volume of the Corporation's oil and gas reserves. The Corporation might also elect not to produce from certain wells at lower prices. All of these factors could result in a material decrease in the Corporation's future net production revenue, causing a reduction in its oil and gas exploration and development activities. In addition, bank borrowings available to the Corporation are in part determined by the borrowing base of the Corporation. A sustained material decline in prices from historical average prices could reduce the

Corporation's borrowing base, therefore reducing the bank credit available to the Corporation, and could require that a portion of any existing bank debt of the Corporation be repaid.

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

Substantial Capital Requirements; Liquidity

The Corporation anticipates that it will make substantial capital expenditures for the exploration, development and production of oil and natural gas reserves in the future. If the Corporation's revenues or reserves decline, the Corporation may have limited ability to expend the capital necessary to undertake or complete future drilling programs. There can be no assurance that debt or equity financing, or cash generated by operations will be available or sufficient to meet these requirements or for other corporate purposes or, if debt equity financing is available, that it will be on terms acceptable to the Corporation. Moreover, future activities may require the Corporation to alter its capitalization significantly. The inability of the Corporation to access sufficient capital for its operations could have a material adverse effect on the Corporation's financial condition, results of operations or prospects.

Environmental Risks

All phases of the oil and natural gas business present environmental risks and hazards and are subject to environmental regulation pursuant to a variety of international conventions and federal, provincial and municipal laws and regulations. Environmental legislation provides for, among other things, restrictions and prohibitions on spills, releases or emissions of various substances produced in association with oil and gas operations. The legislation also requires that wells and facility sites be operated, maintained, abandoned and reclaimed to the satisfaction of applicable regulatory authorities. Compliance with such legislation can require significant expenditures and a breach may result in the imposition of fines and penalties, some of which may be material. Environmental legislation is evolving in a manner expected to result in stricter standards and enforcement, larger fines and liability and potentially increased capital expenditures and operating costs. The discharge of oil, natural gas or other pollutants into the air, soil or water may give rise to liabilities to foreign governments and third parties and may require the Corporation to incur costs to remedy such discharge. No assurance can be given that the application of environmental laws to the business and operations of the Corporation will not result in a curtailment of production or a material increase in the costs of production, development or exploration activities or otherwise adversely affect the Corporation's financial condition, results of operations or prospects.

Reserve Replacement

The Corporation's future oil and natural gas reserves, production, and cash flows to be derived therefrom are highly dependent on the Corporation successfully acquiring or discovering new reserves. Without the continual addition of new reserves, any existing reserves the Corporation may have at any particular time

and the production therefrom will decline over time as such existing reserves are exploited. A future increase in the Corporation's reserves will depend not only on the Corporation's ability to develop any properties it may have from time to time, but also on its ability to select and acquire suitable producing properties or prospects. There can be no assurance that the Corporation's future exploration and development efforts will result in the discovery and development of additional commercial accumulations of oil and natural gas.

Government Regulation

The oil and natural gas industry is subject to extensive controls and regulations imposed by various levels of government. It is not expected that any of these controls or regulations will affect the operations of the Corporation in a manner materially different than they would affect other oil and gas companies of similar size. The current legislation is a matter of public record and the Corporation is unable to predict what additional legislation or amendments may be enacted.

The provincial governments also regulate production in accordance with sound engineering and conservation practices and sometimes establish daily production limits. Production is also limited by pipeline capacities, demand for natural gas and various grades of crude oil and, in limited circumstances, by maximum rate limitations imposed by regulatory authorities to encourage maximum recovery.

MARKET FOR SECURITIES

The Corporation's common stock is listed on the TSX Venture Exchange under the symbol "AEI".

DIRECTORS AND OFFICERS

The following table sets forth the name, municipality of residence, principal occupation for the last five years of the current directors and officers of the Corporation, and year first elected to the board of directors of each of the current directors of the Corporation. The term of office of each director will expire at the end of the next annual meeting of shareholders of the Corporation.

| Name and Municipality of Residence | Present Office and Date First Appointed a Director | Principal Occupation and Positions Held During the Past Five Years |
|---|--|--|
| Michael S. Vandale ⁽¹⁾ Calgary, Alberta | Chairman, Chief Executive Officer, President and Director since May 29, 2003 | Mr. Vandale was the Chairman and President of Sundance Resources Inc., a public corporation listed on the TSX Venture, from June 1996 to August 2000 and from August 2000 to October 2002, and a Director of its successor, True Energy Inc., a public corporation listed on the Toronto Stock Exchange. From 1997 to 1999, director and major shareholder of Mutual Fund Direct Inc. until sold to Altamira. Mr. Vandale is also the sole Shareholder and President of Vandale Oil Inc., a private oil and gas company. |
| William Hews ⁽¹⁾⁽²⁾ Calgary, Alberta | Director since May 29, 2003 | Mr. Hews is currently the President of Fideliter Inc., a consulting and investment company. Mr. Hews served as the President and Chief Operating Officer of Wi-LAN Inc. from September 1999 to January 2001, and as the President to September 2001. Mr. Hews is a director of Wi-LAN Inc. and Sylogist Inc., all public companies; and Rural Connections Inc., a federally incorporated non-profit company. Mr. Hews worked with Nortel Networks rising to VP level in the operations area. |

| | | |
|---|--------------------------------|---|
| Errol Stewart ⁽¹⁾⁽²⁾ Calgary, Alberta | Director since May 29, 2003 | Mr. Stewart has been the President of Era America Resource Corporation, a private oil and gas development and exploration company, since 1993. Mr. Stewart is also the President and a director of Five Star Energy Ltd., a private oil and gas development and exploration company. Mr. Stewart was a founder and director of Scorpion Energy Inc., a private oil and gas development and exploration company, from January 1997 until September 1999 and an officer of Scorpion Energy Inc. from January 1997 to August 1998. |
| David Stadnyk North Vancouver, British Columbia | Director since May 29, 2003 | President and Director of AC Global Capital Corp. since incorporation. President of Patch Energy, a private junior Canadian oil and gas company. President of Praxis Pharmaceuticals an Australian based biotech company. Additionally, Mr. Stadnyk has owned the Team 1040 all sports radio station and the Vancouver Whitecaps soccer club and is presently an owner of the Vancouver Ravens Lacrosse Club. Mr. Stadnyk has been a self-employed businessman for approximately the last 15 years involved in numerous public and private companies. |
| Greg Belzberg Vancouver, British Columbia | Director since May 29, 2003 | President of Bar None Enterprises, BCP Management, BNW Travel Management, Chief Operating Officer of Richter Furniture Manufacturing. |
| Donald B. Edwards Calgary, Alberta | Secretary May 29, 2003 | Lawyer and Partner with Borden Ladner Gervais LLP. |

Notes:

- (1) Members of Arsenal's Audit Committee.
- (2) Members of Arsenal's Reserves Committee.
- (3) Arsenal has proposed three new directors be added to the board of directors at the upcoming meeting of the shareholders of Arsenal to be held on June 29, 2004. For further information see the Management Information and Proxy Circular of Arsenal as filed on SEDAR (www.sedar.com).

As at the date hereof, the directors and officers of the Corporation, as a group, owned directly or indirectly, approximately 2,000,925 common shares of the Corporation or 33.5% of the issued and outstanding common shares of the Corporation. The information not being within the knowledge of the Corporation as to the beneficial ownership of such common shares has been furnished by the directors and officers of the Corporation individually.

Audit Committee

The three-member internal audit committee is responsible for overseeing the financial reporting by management. The current members of the committee are Michael Vandale, William Hews and Errol Stewart. The committee meets with the Corporation's external auditors annually to hear their report on and to discuss management's internal financial control systems and procedures. The committee reviews quarterly and annual financial statements prepared by management prior to presentation to the Board along with their recommendation regarding approval.

Corporate Cease Trade Orders or Bankruptcies

No director, officer or shareholder holding a sufficient number of securities of the Corporation to affect materially the control of the Corporation is, or has been within the past ten (10) years, a director or officer of any other issuer that, while that person was acting in that capacity, was the subject of a cease trade or similar order, or an order that denied the other issuer access to any exemptions under Canadian securities legislation for a period of more than 30 consecutive days or became a bankrupt, made a proposal under any legislation relating to bankruptcy or insolvency or was subject to or instituted any proceedings, arrangement or compromise with creditors or had a receiver, receiver manager or trustee appointed to hold its assets.

Penalties or Sanctions

No director, officer or shareholder holding a sufficient number of securities of the Corporation to affect materially the control of the Corporation has been subject to any penalties or sanctions imposed by a court relating to Canadian securities legislation or by a Canadian securities regulatory authority or has entered into a settlement agreement with a Canadian Securities regulatory authority or been subject to any other penalties or sanctions imposed by a court or regulatory body that would likely be considered important to a reasonable investor in making an investment decision.

Personal Bankruptcies

No director, officer or shareholder holding a sufficient number of securities of the Corporation to affect materially the control of the Corporation, or a personal holding company of any such person has, within the past ten years, become bankrupt, made a proposal under any legislation relating to bankruptcy or insolvency, or was subject to or instituted any proceedings, arrangement or compromise with creditors, or had a receiver, receiver manager or trustee appointed to hold the assets of such person.

Conflicts of Interest

Certain directors and officers of the Corporation and its subsidiaries are associated with other reporting issuers or other corporations which may give rise to conflicts of interest. In accordance with the ABCA legislation, directors who have a material interest or any corporation or person who is a party to a material contract or a proposed material contract with the Corporation are required, subject to certain exceptions, to disclose that interest and generally abstain from voting on any resolution to approve the contract. In addition, the directors are required to act honestly and in good faith with a view to the best interests of the Corporation. Some of the directors of the Corporation have either other employment or other business or time restrictions placed on them and accordingly, these directors of the Corporation will only be able to devote part of their time to the affairs of the Corporation.

SUBSEQUENT EVENTS

On January 6, 2004 Arsenal completed a private placement of 2,000,000 common shares issued on a flow-through basis at the price of \$0.70 per common share for gross proceeds of \$1,400,000. Parties related to Arsenal participated in the private placement and acquired a total of 157,152 common shares.

On March 24, 2004, Arsenal completed the acquisition of Orange. At the time of the acquisition, Orange held a 10% working interest in a number of oil and gas properties in Saskatchewan which, following the acquisition, became properties of Arsenal.

On April 14, 2004 Arsenal entered into a letter agreement (the “**Letter Agreement**”) with an unrelated, arm’s length party (the “**Vendor**”) to acquire oil and gas properties in North Dakota, U.S.A. (the “**ND Properties**”) for total cash consideration of \$6.25 million, subject to certain closing adjustments. The ND Properties consist of developed and undeveloped lands, seismic data and production of approximately 400 BOEPD made of 87% oil and 13% natural gas and natural gas liquids at a 6:1 conversion rate.

On May 17, 2004, pursuant to the Letter Agreement, Arsenal entered into a definitive purchase and sale agreement with Vendor to purchase the ND Properties. The closing of the acquisition of the ND Properties is anticipated to close on July 1, 2004 and will have an effective date of January 1, 2004.

ADDITIONAL INFORMATION

The Corporation shall provide the following documents to any person upon request to the Corporation at 1820, 330 - 5th Avenue SW, Calgary, AB T2P 0L4 or, alternatively, the following documents are available on the SEDAR website at www.sedar.com:

1. one copy of this Annual Information Form, together with one copy of any document, or the pertinent pages of any document, incorporated by reference herein;
2. one copy of the audited financial statements of the Corporation for the period ended December 31, 2003, together with the report of the auditors (the “**Financial Statements**”), and one copy of any interim financial statements issued subsequent thereto; and
3. one copy of the Management Information Circular dated May 18, 2004 in respect of the annual and special general meeting of shareholders of the Corporation held on June 29, 2004 (the “**Information Circular**”).

Additional information, including information concerning directors’ and officers’ remuneration and indebtedness, principal holders of common shares, options to purchase common shares, and interests of insiders in material transactions is contained in the Information Circular. Additional financial information is provided in the Financial Statements.

**APPENDIX A
FORM 51-101F2
REPORT ON RESERVES DATA
BY
INDEPENDENT QUALIFIED RESERVES
EVALUATOR OR AUDITOR**

**REPORT ON RESERVES DATA
BY
INDEPENDENT QUALIFIED RESERVES
EVALUATOR OR AUDITOR**

To the board of directors of Arsenal Energy Inc. (the "Company"):

1. We have prepared an evaluation of the Company's reserves data as at January 1, 2004. The reserves data consist of the following:
 - (a) (i) proved and proved plus probable oil and gas reserves estimated as at January 1, 2004, using forecast prices and costs; and
 - (ii) the related estimated future net revenue; and
 - (b) (i) proved oil and gas reserves estimated as at January 1, 2004, using constant prices and costs; and
 - (ii) the related estimated future net revenue.
2. The reserves data are the responsibility of the Company's management. Our responsibility is to express an opinion on the reserves data based on our evaluation.

We carried out our evaluation in accordance with standards set out in the Canadian Oil and Gas Evaluation Handbook (the "COGE Handbook") prepared jointly by the Society of Petroleum Evaluation Engineers (Calgary Chapter) and the Canadian Institute of Mining, Metallurgy & Petroleum (Petroleum Society).
3. Those standards require that we plan and perform an evaluation to obtain reasonable assurance as to whether the reserves data are free of material misstatement. An evaluation also includes assessing whether the reserves data are in accordance with principles and definitions in the COGE Handbook.
4. The following table sets forth the estimated future net revenue (before deduction of income taxes) attributed to proved plus probable reserves, estimated using forecast prices and costs and calculated using a discount rate of 10 percent, included in the reserves data of the Company evaluated by us for the year ended December 31, 2003, and identifies the respective portions thereof that we have audited, evaluated and reviewed and reported on to the Company's board of directors:

| Description and Preparation Date of [Audit/Evaluation/ Review] Report | Location of Reserves (Country or Foreign Geographic Area) | Net Present Value of Future Net Revenue (before income taxes, 10% discount rate) | | | |
|--|--|---|-----------|----------|----------|
| | | Audited | Evaluated | Reviewed | Total |
| April 29, 2004 | Canada | \$0 | \$1,297M | \$0 | \$1,297M |

5. In our opinion, the reserves data respectively evaluated by us have, in all material respects, been determined and are in accordance with the COGE Handbook.
6. We have no responsibility to update this evaluation for events and circumstances occurring after the preparation dates.
7. Because the reserves data are based on judgements regarding future events, actual results will vary and the variations may be material.

Executed as to our report referred to above:

Gilbert Laustsen Jung Associates Ltd., Calgary, Alberta, Canada

Dated April 29, 2004

ORIGINALLY SIGNED BY

Neil I. Dell, P. Eng.
Vice-President

**APPENDIX B
FORM 51-101F3
REPORT OF
MANAGEMENT AND DIRECTORS
ON OIL AND GAS DISCLOSURE**

ARSENAL ENERGY INC.

REPORT OF MANAGEMENT AND DIRECTORS ON RESERVES DATA AND OTHER INFORMATION

Management of the Arsenal Energy Inc. (the "Corporation") is responsible for the preparation and disclosure of information with respect to the Corporation's oil and gas activities in accordance with securities regulatory requirements. This information includes reserves data, which consist of the following:

- (a) (i) proved and proved plus probable oil and gas reserves estimated as at December 31, 2003 using forecast prices and costs; and
- (a) (ii) the related estimated future net revenue; and
- (b) (i) proved oil and gas reserves estimated as at December 31, 2003 using constant prices and costs; and
- (b) (ii) the related estimated future net revenue.

Gilbert Laustsen Jung Associates Ltd., an independent qualified reserves evaluator, has evaluated and reviewed the Corporation's reserves data. The report of the independent qualified reserves evaluator will be filed with securities regulatory authorities concurrently with this report.

The Reserves Committee of the Board of Directors of the Corporation has:

- (a) reviewed the Corporation's procedures for providing information to the independent qualified reserves evaluator;
- (b) met with independent qualified reserves evaluator to determine whether any restrictions affected the ability of the independent qualified reserves evaluator to report without reservation; and
- (c) reviewed the reserves data with management and the independent qualified reserves evaluator.

The Reserves Committee of the Board of Directors has reviewed the Corporation's procedures for assembling and reporting other information associated with oil and gas activities and has reviewed that information with management. The board of directors has, on the recommendation of the Reserves Committee, approved:

- (d) the content and filing with securities regulatory authorities of the Corporation's reserves data and other oil and gas information;
- (e) the filing of the report of the independent qualified reserves evaluators on the reserves data; and
- (f) the content and filing of this report.

Because Corporation's reserves data are based on judgments regarding future events, actual results will vary and the variations may be material.

(signed) "Michael S. Vandale"
Michael S. Vandale
President and Chief Executive Officer

(signed) "William Hews"
William Hews
Director

(signed) "Errol Stewart"
Errol Stewart
Director

Dated: May 18, 2004