



Arsenal Energy Inc.

News Release

ARSENAL ANNOUNCES FIRST QUARTER 2008 OPERATING AND FINANCIAL RESULTS

Arsenal is pleased to report its Q1 2008 results. Arsenal is highly leveraged to the rising oil prices and narrowing heavy oil differentials that occurred during the first quarter of 2008. Arsenal's cash flow is up sharply from Q4, when prior period adjustments and one time provisions reduced cash from operations to zero. Realized prices have continued to rise in the second quarter. Production volumes are also rising in the second quarter, as exploration successes from the last two quarters come on line. Management anticipates reporting another large increase in cash flow in Q2.

HIGHLIGHTS

- Average production of 1725 boe/d vs. 1685 boe/d in Q4
- Operating netbacks of \$32.82/boe vs. \$21.73/boe in Q4
- Quarterly cash flow from operations of \$3.8 million vs. nil in Q4
- Quarter end total debt + working capital deficiency of \$18.7 million vs. \$20.7 million at Dec 31, 2007.

PROFIT/LOSS

Arsenal showed a loss of \$488,026 for the first quarter. Arsenal decided to write off the remaining \$495,650 of value on the books for its Egyptian concession. Excluding that write off, Arsenal would have shown a small profit.

OPERATIONS IN REVIEW

Arsenal's exploration strategy of focusing on internally generated grassroots plays is beginning to show results. The company has established three key exploration areas at, Evi Alberta, East Central Alberta, and Stanley North Dakota. In the first quarter, Arsenal participated in the drilling of 8 gross (5.5 net) wells resulting in 7 gross (4.5 net) oil wells and one (1 net) dry hole. Arsenal expects to drill 9 (8.5 net) wells in the second quarter, all in East Central Alberta.

EVI

By the end of Q1 all of Arsenal's production was tied in to the battery acquired in Q4. Operating cost savings should be evident in Arsenal's second quarter results. Two (0.75 net) new successful wells were drilled and placed on production at 600 (250 net) bbls/d. Arsenal's total production for the area is now approximately 400bbls/d of light sweet crude. Two (0.75 net) locations have been selected for drilling in the third quarter and Arsenal has an additional 4 locations in inventory.

EAST CENTRAL ALBERTA

At Galahad, Arsenal drilled two (2 net) oil wells in Q1. Those two wells and a Glauconitic gas well drilled in Q4 were tied in to a company owned facility at the end of March. Net Galahad production has risen from approximately 150 boe/d in February, 2008 to about 400 boe/d currently. In addition, Arsenal shot and interpreted a new 3D seismic program on offsetting lands. The program has identified a large structure that will be tested in Q2.

Arsenal participated in two (0.8 net) wells at Alderson in Q1. One well encountered a thick glauconitic oil zone that tested gas at 750 mcf/d and oil at 50 bbls/d. The operator is examining tie in options. The second well is marginal and will likely be abandoned.

The Q4 discovery well at Consort (100% WI) continues to produce at over 100 bbls/d. Arsenal plans to drill three offset wells in early June, and depending on results a battery may be constructed. Arsenal has additional leads on this trend.

The company has developed plays on three other East Central Alberta properties. Arsenal has three drill ready locations at Wildmere, two at Provost, and two at Princess. These wells will likely be drilled late in the second quarter or in the third quarter.

STANLEY

Arsenal has 1896 net acres of Bakken deep rights held by production. Bakken drilling continues all around Arsenal's land base. Production results from properties surrounding Arsenal's property released to date vary from 100bbls/d to 2000bbls/d. The company has budgeted three gross (0.5 net) Bakken wells for 2008. The first well (23.4% WI) is scheduled to spud November of 2008.

EGYPT

Arsenal continues its review of strategic alternatives for Egypt. Industry interest in the concession has been low to date, and therefore, management has made the decision to write off the remaining value.

COMMODITY PRICING

In Q4 of 2007 Arsenal's blended mix of production received an average sale price of \$53.92/boe. Rising oil prices and narrowing heavy oil differentials resulted in an increase to \$72.04/boe in the first quarter. Mid April pricing for Arsenal's mix is in the range of \$95/boe.

OPERATING EXPENSES

Operating costs averaged \$22.65/boe during the first quarter. Arsenal's production mix is dominated by heavy oil and low rate light oil. These properties have higher operating costs than average for the basin. Over the medium term, production from new wells and disposition of small noncore properties should slowly average down operating expenses.

CASH FLOW

Cash flow from operations for the first quarter was \$3.8 million or \$0.05/share. The large increase from Q4 2007 is due to higher realized prices, higher volumes, a better quality production mix, and a decrease in one time charges and prior period adjustments.

DEBT

In the second quarter of 2007 Arsenal made a strategic decision to move towards a more conservative financial model. Arsenal will target a ratio of total debt plus working capital deficiency to cash flow of one to one. The ratio for Q1 was 1.23:1.

OUTLOOK

Arsenal's leverage to higher oil prices and lower heavy oil differentials should translate into much improved operating netbacks and cash flow in the second quarter. Production volumes for the second quarter should be approximately 2000 boe/d and that cash flow for the second quarter should be in excess of \$8 million.

Over the next six months Arsenal has a very exciting exploration and development program. The capital budget has been increased to \$22 million for 2008 with \$17 million remaining to be spent. Arsenal has plans to drill 16 gross (13.5 net) wells by yearend. This would include high impact wells at Evi, Galahad, Consort and the Bakken in North Dakota.

SUMMARY OF OPERATING & FINANCIAL RESULTS

FINANCIAL	Three Months Ended March 31	
	2008	2007
Financial		
Funds from operations ¹	3,789,705	1,842,010
Per unit - basic	0.05	0.03
Per unit - diluted	0.05	0.03
Bank debt (excluding debentures)	(15,344,257)	(20,929,082)
Operating costs per boe	22.65	18.26
Operating netbacks per boe	32.82	19.30
Market		
Shares outstanding		
End of period	89,181,542	73,642,173
Weighted average - basic	83,937,976	73,642,173
Weighted average - diluted	84,155,310	73,986,422
Shares trading		
High	0.73	0.99
Low	0.40	0.61
Close	0.64	0.61
Average daily volume	197,010	205,000
OPERATIONS		
Daily production (average)		
Heavy oil (bbl)	552	708
Crude oil and NGL's (bbl)	863	794
Natural gas (mcf)	1,864	2,065
Total (boe) ²	1,725	1,846
Realized commodity prices (\$Cdn.)		
Heavy oil (bbl)	65.78	39.89
Crude oil and NGL's (bbl)	85.96	59.45
Natural gas (mcf)	7.42	7.67
Average (boe) ²	72.04	49.44
Reference pricing		
WTI (U.S.\$/bbl)	97.87	58.16
AECO gas (\$Cdn./mcf)	7.20	7.17
Foreign Exchange (\$U.S./\$Cdn.)	1.00	1.12

- (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 add back 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.

MANAGEMENT DISCUSSION AND ANALYSIS

INTRODUCTION AND LIMITATIONS

Basis of presentation

The following is management's discussion and analysis ("MD&A") of Arsenal Energy Inc.'s ("Arsenal" or the "Company") unaudited operating and financial results for the three months ended March 31, 2008. It should be read in conjunction with the audited financial statements for the year ended December 31, 2007 and other operating and financial information contained herein. This MD&A is dated May 6, 2008.

The financial data presented herein has in part been derived from the Company's annual audited financial statements prepared in accordance with Canadian Generally Accepted Accounting Principles ("GAAP") and in accordance with accounting policies as set out in Note 3 to the Company's financial statements. The reporting and the measurement currency is the Canadian dollar.

Effective January 1, 2008, Arsenal adopted with prospective effect certain new accounting standards introduced as part of GAAP as follows:

Financial Instruments

In December 2006, the Accounting Financial Standards Board issued two new sections in relation to financial instruments: Financial Instruments – Disclosures, and Financial Instruments – Presentation. These new standards have replaced – Financial Instruments – Disclosure and Presentation. The new disclosure standard increases the Company's disclosure regarding the risks associated with financial instruments and how these risks are managed.

Capital Disclosures

The Company has adopted new standards for "Capital Disclosures", which requires the Company to disclose its objectives, policies and processes for managing capital. See "Bank Debt, Liquidity and Capital Resources".

Goodwill

The Company has adopted new standards for "Goodwill and Intangible Assets", which defines the criteria for the recognition of intangible assets.

Additional information regarding Arsenal's financial and operating results may be obtained on the internet at www.sedar.com.

Forward-Looking Statements

Certain information set forth in this document, including management's assessment of Arsenal's future plans and operations, contains forward-looking statements. By their nature, forward-looking statements are subject to numerous risks and uncertainties, some of which are beyond the Company's control, including the effect of general economic conditions, industry conditions, volatility of commodity prices, currency fluctuations, imprecision of reserve estimates, environmental risks, competition from other industry participants, the lack of availability of qualified personnel or management, stock market

volatility and ability to access sufficient capital from internal and external sources. Readers are advised that the assumptions used in the preparation of such information, although considered reasonable at the time of presentation, may prove to be imprecise and, as such, undue reliance should not be placed on forward-looking statements. Arsenal's actual results, performance or achievement could differ materially from those expressed in, or implied by, these forward-looking statements.

Boe Presentation

For the purpose of calculating unit costs, natural gas is converted to barrel of oil equivalent ("Boe") using six thousand cubic feet ("Mcf") of natural gas to one barrel of oil unless otherwise stated. Boe may be misleading, particularly if used in isolation. A Boe conversion ratio of six Mcf to one barrel ("Bbl") is based on an energy equivalency method primarily at the burner tip and does not represent a value equivalency at the wellhead. (This conversion conforms to National Instrument 51-101). References to natural gas liquids ("NGLs") in this MD&A include condensate, propane, butane and ethane and one barrel of NGLs is considered to be equivalent to one barrel of crude oil equivalent (Boe).

Non-GAAP Financial Measurements

Within the MD&A, references are made to terms having widespread use in the oil and gas industry in Canada. The measures discussed are widely accepted measures of performance and value within the industry, and are used by investors and analysts to compare and evaluate oil and gas exploration and producing entities. "Funds from operations", "funds from operations per share" and "netbacks" are not defined by GAAP in Canada and are regarded as non-GAAP measures. Measurement of funds from operations is detailed on the Statement of Cash Flows, specifically; it is cash flow before the change in non-cash operating working capital. Funds from operations per share is calculated based on the weighted average number of common shares outstanding consistent with the calculation of net earnings per share. Netbacks equal total revenue less royalties, transportation and operating costs, calculated on a Boe basis. Total Boe is calculated by multiplying the daily production by the number of days in the year or quarter as the case may be.

The Company

Arsenal was incorporated under the laws of the province of Alberta.

The Company is continuing its focus on rationalizing its asset base and is exploring in areas that will provide the Company with a longer reserve life base. In addition, the Company is focusing on reducing field operating costs in Canada and the US and is determining how to capitalize on its high impact Bakken targets in North Dakota, US.

The Company participated in the drilling of 8 gross (5.5 net) wells in the first quarter of 2008 resulting in 7 gross (4.5 net) oil wells and 1 gross (1.0 net) dry and abandoned well. Total capital expenditures in the first quarter were \$5,087,725. Production for the first quarter of 2008 averaged 1,725 Boe/d.

The Company has two active subsidiaries, Arsenal Energy USA Inc., a company that holds the Company's US assets, and Quadra Energy Ltd., a company that holds the Company's Egyptian assets.

Arsenal Energy Inc.'s common shares are listed and posted for trading on the Toronto Stock Exchange under the symbol "AEI" and on the Frankfurt Stock Exchange under the symbol "A1E".

OPERATIONAL AND FINANCIAL RESULTS

PRODUCTION AND REVENUE

Average Daily Production

The Company has production in the provinces of Alberta and Saskatchewan in Canada (77% of total production) and in the state of North Dakota in the US (23% of total production).

Production for the first quarter of 2008 increased to 1,725 Boe/d up 2% from 1,685 Boe/d in Q4 2007 but down 7% from 1,846 Boe/d produced in Q1 2007. Normal production declines from Q4 2007 to Q1 2008 were offset by Q1 2008 drilling success, the impact of which will begin to be realized in Q2 2008 and following quarters. The decline in production from Q1 2007 to Q1 2008 was primarily the result of normal production declines.

Approximately 77% (1,321 Boe/d) of the Company's production comes from the Canadian operation with the US contributing the remaining 23% (404 Boe/d). The Company has been attempting to change its product mix with emphasis in the Q4 2007 and Q1 2008 drilling program targeting light oil in Canada. With the drilling success in the first quarter of 2008, a slightly higher proportion of production is expected in future from the Canadian asset base.

Light oil now comprises approximately half of the Company's production base up from approximately 43% of the Company's production base in the first quarter of 2007.

	Three Months Ended March 31		
	2008	2007	% Change
Heavy oil (bbl/d)	552	708	(22)
Crude oil and NGL's (bbl/d)	863	794	9
Natural gas (mcf/d)	1,864	2,065	(10)
Total (boe/d)	1,725	1,846	(7)

Production split

Heavy oil	32%	38%	(17)
Crude oil and NGL's	50%	43%	16
Natural Gas	18%	19%	(3)

Production Profile and Per Unit Prices

The Company's production base in Canada is now almost balanced between heavy and light oil. Heavy oil comprises 42% of total oil production and 52% of total Canadian production. The US production during the first quarter of 2008 was 88% (356 barrels per day) light crude oil. Crude oil is sold under 30-day evergreen contracts while natural gas production is sold in the spot market.

(\$Cdn.)	Three Months Ended March 31		
	2008	2007	% Change
Prices - Before Derivatives			
Heavy oil	65.78	39.89	65
Crude oil and NGL's (bbl)	85.96	59.45	45
Natural gas (mcf)	7.42	7.67	(3)
Total (boe)	72.04	49.44	46

	Three Months Ended March 31		
	2008	2007	% Change
Reference Pricing			
WTI Cushing (\$U.S./bbl)	97.87	58.16	68
Oil Edmonton Light (\$Cdn/bbl)	98.16	67.71	45
Heavy oil Lloyd blend (\$Cdn/bbl)	70.19	48.40	45
AECO C daily spot (\$Cdn./mcf)	7.20	7.17	0
NYMEX gas (\$U.S./mmbtu)	8.07	6.90	17
Foreign exchange (\$U.S./Can)	1.00	1.12	(11)

Average Boe prices increased 26% from Q4 2007 and 46% from Q1 2007 to average \$72.04 per Boe for the current quarter. This average price per Boe increase is attributable primarily to a 65% increase in the price received for heavy oil due to price increases and a narrowing of the differential between heavy oil and light oil and an increase in the price of light oil. The differential between heavy and light crude for Q4 2007 was \$31.73 per barrel versus \$21.43 per barrel for Q1 2008. These differentials should narrow during the spring and summer months thereby increasing heavy oil prices and netbacks.

The prices received by the Company reflect the market movement of the various commodities.

In Q1 2008, the Company realized increased crude oil prices. This increase is due to the 2007 and Q1 2008 increase in the average price of West Texas Intermediate ("WTI"). Over the comparative quarters, WTI increased 68% to average of \$97.87 US per barrel in Q1 2008 versus and average of \$58.16 US per barrel in Q1 2007.

Production by Area

	Three Months Ended March 31				
	2008		2007		% Change
	Boe/d	% of Total	Boe/d	% of Total	
Canada					
Maidstone	212	12	178	10	19
Galahad	105	6	175	9	(40)
Wildmere	124	7	140	8	(11)
Evi	199	12	179	10	11
Others	680	39	783	42	(13)
Total Canada	1,321	77	1,455	79	(9)
US					
Stanley	126	7	116	6	9
Lindahl	81	5	65	4	24
Tioga	47	3	52	3	(9)
Others	150	9	157	9	(5)
Total US	404	23	390	21	4
Total Boe/d production	1,725	100	1,846	100	(7)

Production Revenue

(\$Cdn.)	Three Months Ended March 31		
	2008	2007	% Change
Heavy oil	3,303,112	2,542,635	30
Crude oil & NGL's	6,746,635	4,246,006	59
Natural gas sales	1,259,404	1,425,814	(12)
Oil and gas revenues	11,309,151	8,214,455	38
Loss on forward contracts	(524,886)	-	-
Oil and gas revenue after hedging	10,784,265	8,214,455	31
Per boe	68.70	49.44	39

Total oil and gas revenue in Q1 2008 increased 38% from Q1 2007 to \$11,309,151 from \$8,214,455 in Q1 2007 primarily due to the increased average price received for heavy (up 65%) and light (up 45%) oil.

In February 2008, the Company put in place a financial contract covering 200 barrels of oil per day for the period March 1, 2008 to December 31, 2009 at \$97.55 Canadian per barrel. During the first quarter of 2008, the price of WTI increased almost daily. As a result of this price increase, the Company recorded a realized hedging loss on this contract for the month of March of \$48,773 and an unrealized hedging loss on the remaining term of the contract of \$476,113.

In April 2008, the Company put in place a financial contract covering an additional 100 barrels of oil per day for the period June 1, 2008 to December 31, 2009 at \$109.80 Canadian per barrel.

Royalties

(\$Cdn.)	Three Months Ended March 31		
	2008	2007	% Change
Royalties	2,076,783	1,974,286	5
% of gross oil and gas revenue	18	24	(24)
Per boe	13.23	11.88	11

During the first quarter of 2008, the Company paid \$2,076,783 or 18% of oil and gas revenues in royalties versus \$1,974,286 or 24% in the first quarter of 2007. The Q1 2008 royalty rate is consistent with that experienced in Q4 2007. During both quarters, the Company put on production wells that qualified for a royalty holiday. It is expected that rates will rise during the year. Crown and state royalties totaled 8% of oil and gas revenues and freehold and other royalties totaled 10% of oil and gas revenues. The royalty rate per Boe went up from \$11.88 per Boe in Q1 2007 to \$13.23 per Boe in Q1 2008 due to the increase in oil prices. Oil royalty averaged \$25.02 per barrel while natural gas royalties averaged \$1.35 per mcf.

Operating Costs

(\$Cdn.)	Three Months Ended March 31		
	2008	2007	% Change
Operating expense	3,555,628	3,034,004	17
Per boe	22.65	18.26	24

Operating costs increased 17% in Q1 2008 to \$3,555,628 from \$3,034,004 in Q1 2007. On a Boe basis, operating costs in Q1 2008 were \$22.65 per Boe versus \$18.26 per Boe in Q1 2007, an increase of 24%. Operating costs for the Company's operations are higher for heavy oil than light oil, averaging \$35.95 per barrel versus \$20.34 for light oil. Heavy oil operating costs are high due to the cost to operate the wells which are almost all single well batteries. This results in high costs for propane, trucking of oil, water and emulsion and maintenance and repairs.

Operating costs for natural gas were \$0.91 per mcf for Q1 2008.

The Company has reviewed and is continuing to review and implement initiatives to bring operating costs to a more acceptable level. This has included the purchase of some properties in order to achieve economies of scale. In addition, the Company is examining its field operations and equipment specifications to maximize production and lower costs.

Operating Netback

(\$Cdn. per boe)	Three Months Ended March 31		
	2008	2007	% Change
Net revenue after derivatives	68.70	49.44	39
Royalties	(13.23)	(11.88)	11
Operating expenses	(22.65)	(18.26)	24
Operating netback	32.82	19.30	70

The operating netback realized during the first quarter of 2008 was \$32.82 per Boe versus \$19.30 per Boe for the first quarter of 2007. The increased crude price in Q1 2008 was partially offset by higher operating costs quarter over comparative quarter. On an individual product basis, the net back for heavy oil was \$19.90, for light crude was \$48.42 and for natural gas was \$5.17 for the first quarter of 2008.

Operating netbacks should continue to increase in Q2 2008 due to higher commodity prices and further control and management of operating costs.

General and Administrative

(\$Cdn.)	Three Months Ended March 31		
	2008	2007	% Change
Gross expenditures	1,441,310	1,327,757	9
Overhead recovery	(112,437)	(190,883)	(41)
Capitalized overhead	(57,500)	(191,800)	(70)
Net general and administrative expense	1,271,373	945,074	35
Net general and administrative per boe	7.65	5.69	35

Gross general and administrative expenditures increased 9% from the first quarter of 2007 to \$1,441,310 for 2008. General and administrative expenditures related to the Company's Egypt operation totaled \$136,282 for Q1 2008. In Q1 2007, these general and administrative expenses were capitalized to property plant and equipment. Excluding the general and administrative expenses related to Egypt, gross general and administrative expenses for Q1 2008 remained constant when compared to Q1 2007. The Company experienced increases in reservoir engineering fees, audit fees and paid a severance to a former employee. Overhead recovery declined 41% quarter over comparative quarter. The Company operated four 100% working interest wells in the first quarter of 2008. On a net basis, general and administrative costs increased 35% during the first quarter of 2008.

Interest Expense

(\$Cdn.)	Three Months Ended March 31		
	2008	2007	% Change
Gross expenditures	1,441,310	1,327,757	9
Overhead recovery	(112,437)	(190,883)	(41)
Capitalized overhead	(57,500)	(191,800)	(70)
Net general and administrative expense	1,271,373	945,074	35
Net general and administrative per boe	7.65	5.69	35

Interest is paid on the Company's revolving demand loan at prime plus 0.40% as net debt to trailing cash flow (cash flow for the last quarter annualized) exceeded 1.25:1 (see "Bank Debt, Liquidity and Capital Resources – Demand Operating Loan Facility"). The facility averaged approximately \$10.8 million for the first quarter of 2008 versus approximately \$19.0 million during the first quarter of 2007. During the quarter, the draw on credit facility increased from its December 31, 2007 balance of \$8.9 million to a high of \$15.2 million in mid-March 2008. The facility was reduced in late March by oil and gas revenues and by the proceeds from the private placement to close the quarter at \$9.2 million.

The Company is currently in negotiations with its lender regarding an increase in its facility based on reserve additions and price increases during the current quarter.

Interest on the Company's line of credit decreased 51% from \$288,817 in Q1 2007 to \$142,751 in Q1 2008 primarily as a result of the lower average borrowings under the facility.

Interest on Convertible Debentures

(\$Cdn.)	Three Months Ended March 31		
	2008	2007	% Change
Interest on debentures	69,409	68,646	1
Per boe	0.44	0.41	7

The Company pays interest at 8% per annum on the \$3,480,000 of convertible debentures acquired in the Tiverton acquisition. Interest is paid semi-annually on June 30 and December 31 and totaled \$69,409 for Q1 2008.

For the quarter ended March 31, 2008, the Company recorded \$25,631 of accretion expense relating to the amortization of the discount of the debenture. (see "Convertible Debentures" below).

Depletion Depreciation and Accretion

(\$Cdn.)	Three Months Ended March 31		
	2008	2007	% Change
Depletion, depreciation and accretion	3,466,048	4,790,019	(28)
Per boe	22.08	28.83	(23)

Depletion, depreciation and accretion for the current quarter totaled \$3,466,048 or \$22.08 per Boe versus \$4,790,019 or \$28.83 per Boe for Q1 2007 and \$21.64 for Q4 2007. The comparative quarter decrease results from the sale in June of Tower Creek and ceiling test write downs in 2007. During the first quarter of 2008, the Company added more proven reserves from drilling in Canada than it produced during the quarter thereby reducing the depletion rate in Canada from \$28.94 per Boe for the fourth quarter of 2007 to \$26.80 per Boe for the first quarter of 2008.

Property Impairment

(\$Cdn.)	Three Months Ended March 31		
	2008	2007	% Change
Property impairment	495,650	1,554,682	(68)
Per boe	3.16	9.36	(66)

In late 2007, Arsenal made a decision to seek strategic alternatives for its concession in Egypt. During the first quarter, the Company sought professional assistance in evaluating various alternatives including further participation in the upcoming drilling as well as the sale of its entire interest. As a result of the process, the Company did not receive any bids for the assets and determined that the project did not warrant additional drilling as the chances of success were low. As a result of this process, in the first quarter of 2008, the Company wrote off the remaining carrying amount of its Egypt property, recording a property impairment of \$495,650. During the first quarter of 2007, as a result of drilling a dry hole, the Company wrote down the carrying amount of its Egypt property by \$1,554,682.

Goodwill

Goodwill is the residual amount that results when the purchase price of an acquired business exceeds the fair value of the net identifiable assets and liabilities of the acquired business. Goodwill is stated at cost and is not amortized. The goodwill balance is assessed for impairment each year end or more frequently if events or changes in circumstances indicate that the asset may be impaired. The test for impairment is conducted by comparing the book value to the fair value of the reporting entity, Impairment is charged to income in the period it occurs.

In Q1 2007, the Company compared the deemed fair value of goodwill to the carrying amount of goodwill. As a result of this test, the Company wrote off \$4,791,561 in goodwill in the first quarter of 2007.

Stock-based Compensation

(\$Cdn.)	Three Months Ended March 31		
	2008	2007	% Change
Compensation expense	109,926	362,957	(70)
Per boe	0.70	2.18	(68)

The Company accounts for its stock-based compensation program using the fair-value method. Under this method, compensation expense related to this program is recorded in the statement of operations over the vesting period of the options.

During February 2008, the Company granted 1,296,000 options at \$0.60 per share to officers and employees. These options vest over eighteen months. Also in February 2008, 25,000 options issued at \$0.42 were exercised for proceeds of \$10,500. During the quarter 50,000 options issued at \$0.42, 150,000 options at \$1.13 and 150,000 at \$1.30 were forfeited.

Stock-based compensation expenses for the three months ended March 31, 2008 totaled \$109,926 versus \$362,957 in 2007. On a Boe basis, stock-based compensation for the period ended March 31, 2008 totaled \$0.70 per Boe versus \$2.18 per Boe for the same period in 2007. The decrease in the absolute number and in the per Boe number results from reaching the end of the vesting period and therefore the expense recognition for most options issued in prior periods and from the inclusion of approximately half of the current period for options issued in mid February 2008.

During the first quarter of 2008 the Company capitalized \$27,595 of stock based compensation to property plant and equipment.

Taxes

(\$Cdn.)	Three Months Ended March 31		
	2008	2007	% Change
Current income taxes	347,850	40,000	770
Future income taxes (reduction)	(264,159)	(1,683,156)	(84)
	83,691	(1,643,156)	(105)
Per boe	0.53	(9.89)	(105)

During Q1 2008, the Company recorded taxes payable on its US operations of \$347,850 (Q1 2007 - \$40,000). At current commodity prices, the Company expects to be taxable in the US in 2008 and is currently exploring various options to reduce the amount of tax paid.

In Canada, during the three month period ended March 31, 2008, the Company reduced future income taxes by \$264,159. Arsenal does not expect to pay current tax in 2008 based on existing tax pools, planned expenditures and current commodity prices. It may however be taxable in 2009 depending on capital expenditures and commodity prices.

A future income tax balance of \$4,637,341 is recorded as a liability as at March 31, 2008.

Outlook

With natural gas prices showing recent improvement and given the improvement in crude oil prices over the past year and the expectation that these prices will remain high, management believes that Arsenal is well positioned to prosper in this higher priced commodity environment.

At March 31, 2008, Arsenal had total debt and working capital deficiency (excluding the convertible debentures of \$3.4 million) of \$15.3 million on a \$17.25 million bank facility. The first quarter capital program of \$5.1 million was very successful adding both reserves and production. The Q1 2008 program was funded from Arsenal's first quarter funds flow and from the private placement in the first quarter of 2008. Arsenal's 2008 capital program, originally forecast to be \$14.1 million, has been increased due to high commodity prices and encouraging drilling results to total \$22.0 million for 2008. The remainder of

2008 program of approximately \$17.0 is expected to be funded by funds from operations and if needed by the Company's available credit facility.

Building on the success of the first quarter drilling program, Arsenal is expecting to average in excess of 2,000 Boe per day in 2008. Debt and working capital deficiency (excluding the convertible debentures of \$3.5 million at maturity) is projected to be between \$15.0 and \$16.5 million as at December 31, 2008. The Company expects the 2008 program to continue to improve the Company's liquidity and operating results. The Company expects to exit 2008 with its total debt within its approved credit facility and its debt to cash flow ratio well within established guidelines.

Summary of Quarterly Results

(\$Cdn.)	2008		2007			2006		
	Q1	Q4	Q3	Q2	Q1	Q4	Q3	Q2
Oil and gas revenue	11309151	8,827,883	7,568,644	7,702,380	7,774,362	9,306,129	8,393,468	7,839,810
Net income (loss)	- 488,026	(2,944,193)	(3,029,332)	(9,406,449)	(7,999,026)	(25,795,319)	(1,200,629)	787,985
Per share - basic	(0.01)	(0.04)	(0.04)	(0.13)	(0.11)	(0.37)	(0.02)	0.01
Per share - diluted	(0.01)	(0.04)	(0.04)	(0.13)	(0.11)	(0.37)	(0.02)	0.01
Funds from operations	3,789,705	134,648	900,028	1,078,581	1,842,009	2,685,843	2,006,566	2,167,425
Per share - basic	0.05	-	0.01	0.01	0.03	0.04	0.04	0.04
Per share - diluted	0.05	-	0.01	0.01	0.03	0.03	0.03	0.04
Total assets	71,608,787	65,097,042	62,288,632	63,745,799	86,839,591	95,462,544	122,327,380	118,007,389
Total debt (1)	15,344,257	17,391,760	14,128,455	10,628,558	20,341,897	19,184,717	20,535,965	17,082,893
Shares outstanding	89,181,542	83,698,042	73,917,173	73,917,173	73,642,173	73,317,173	65,352,403	65,311,501

(1) Excludes convertible debentures of \$3,480,000 due February 2009.

Arsenal's quarterly results have fluctuated significantly in the past eight quarters due to one-time items like tax audits, ceiling test write-downs and recognition of impairment of properties and goodwill. Going forward, it is expected that these items will become less significant and have a lesser impact, if any on operations. While quarterly results will fluctuate somewhat quarter over quarter due to commodity prices, especially due to the differentials in heavy oil, the Company does maintain a fairly straight production rate and has reasonably flat and predictable operating, general and administrative and interest expenses.

Summary of Annual Results by Country

(\$Cdn.)	Canada	United States	Egypt	Corporate	Total Company
Revenue					
Oil and gas	8,338,056	2,971,095	-	-	11,309,151
Realized hedging loss	-	(48,773)	-	-	(48,773)
Unrealized hedging loss	-	(476,113)	-	-	(476,113)
	8,338,056	2,446,209	-	-	10,784,265
Royalty expenses, net of ARTC	(1,082,464)	(994,319)	-	-	(2,076,783)
	7,255,592	1,451,890	-	-	8,707,482
Other operating revenue	(32)	1,594	-	-	1,562
	7,255,560	1,453,484	-	-	8,709,044
Expenses					
Operating	2,949,276	606,352	-	-	3,555,628
General and administrative	-	-	-	1,271,373	1,271,373
Interest expense	-	-	-	142,751	142,751
Convertible debenture interest	-	-	-	69,409	69,409
Foreign exchange	(415,807)	4,653	388,117	-	(23,037)
Convertible debenture accretion	-	-	-	25,631	25,631
Depletion, depreciation, and accretion	3,293,920	167,163	4,965	-	3,466,048
Property, plant and equipment impairment	-	-	495,650	-	495,650
Stock-based compensation	109,926	-	-	-	109,926
	5,937,315	778,168	888,732	1,509,164	9,113,379
Income (loss) before taxes	1,318,245	675,316	(888,732)	(1,509,164)	(404,335)
Income taxes					-
Provision for current income taxes	-	347,850	-	-	347,850
Provision for future income taxes (reduction)	(264,159)	-	-	-	(264,159)
	(264,159)	347,850	-	-	83,691
Net Income (loss)	1,582,404	327,466	(888,732)	(1,509,164)	(488,026)
Production					
Heavy oil (bbl/d)	552	-			552
Crude oil and NGL's (bbl/d)	506	356			862
Natural gas (mcf/d)	1576	288			1864
Total (boe/d)	1321	404			1725
Production split					
Heavy oil	42%	-			32%
Crude oil and NGL's	38%	88%			50%
Natural Gas	20%	12%			18%
Prices - \$ Cdn					
Heavy oil	65.78	-			65.78
Crude oil and NGL's	85.84	86.31			85.96
Natural Gas	7.57	6.64			7.42
Average (Boe)	69.41	80.80			72.04

Bank Debt, Liquidity and Capital Resources

Capital Management

In order to continue the Company's ongoing exploration and development program, the Company must maintain a strong capital base. A strong capital base results in increased market confidence, an essential factor in maintain existing shareholders and in attracting new investors. The Company's commitment is to establish and maintain a strong capital base to ensure the Company has access to the equity and debt markets when deemed advisable. In order to maintain a strong capital base, the Company continually monitors the risk reward profile of its exploration and development projects and the economic indicators in the market including commodity prices, interest rates and foreign exchange rates. It then determines increases or decreases to its capital budget.

The Company considers shareholders equity, bank debt and working capital as components of its capital base. The Company can access or increase capital through the issuance of shares, through bank borrowings, that are based on reserves, and by building cash reserves by reducing its capital expenditure program.

The Company monitors its capital based primarily on its debt to annualized cash flow ratio. Debt includes bank debt plus or minus working capital. Annualized cash flow is calculated as cash flow from operations before changes in non-cash working capital from the Company's most recent quarter multiplied by four. The Company's strategy is to maintain this ratio at 1 : 1. This ratio may increase somewhat depending on the timing and nature of the Company's activities. To facilitate the management and control of this ratio, the Company prepares an annual operating and capital expenditure budget. The budget is updated when critical factors change. These factors include economic factors such as the state of equity markets, changes to commodity prices, interest rates and foreign exchange rates and non economic factors such as drilling results and production profiles. The Company's board of directors approves the budget and changes thereto.

At March 31, 2008, the Company's debt to equity ratio was 1 : 1. The ratio is generally higher at the end of the first quarter as Q1 represents a higher capital expenditure quarter than the second quarter. The increased activity level results in the Company carrying a higher debt load at March 31, 2008. In addition, the production additions from the first quarter program are expected to contribute to increase funds flow and therefore reduce the ratio during the second quarter to a more acceptable level.

The Company's credit facility has certain financial covenants that, without the written consent of the lender, would result in a breach of the agreement. The Company cannot permit:

the working capital ratio to fall to below greater than 1 : 1 and

the ratio of net debt to trailing funds flow annualized to exceed 3 : 1.

The Company's share capital is not subject to external restrictions.

There were no changes in the Company's approach to capital management during the period.

Demand Operating Loan Facility

At March 31, 2008, the Company has available a demand operating loan facility in the amount of \$17,250,000. Debt, including working capital deficiency but excluding the convertible debenture, amounted to \$15,344,257 at March 31, 2008. Funds from operations for the first quarter of 2008 totaled \$3,789,705 resulting in a debt to funds from operations (Q1 2008 annualized) of 1 : 1 (debt including convertible debentures to funds from operations (Q1 – 2008 annualized) is 1.23 : 1). At December 31, 2007, this ratio was 4.4 : 1 based on 2007 funds from operations. The decrease in 2008 results from applying the proceeds from the private placement of \$3,843,738 completed in late March 2008 to reduce funds borrowed under the line of credit and from increased funds flow during the current quarter. During 2007, the Company experienced a number of one time negative adjustments that reduced cash flow during the year. Management's objective is to maintain this ratio at or close to the current ratio of 1 : 1.

The facility can be utilized in either Canadian or US dollars, bears interest at Canadian or US bank prime plus 0.25%, increasing to Canadian or US bank prime plus 0.40% if net debt to trailing cash flow (cash flow for the last quarter annualized) exceeds 1.25:1. The facility is secured by a fixed and floating charge debenture providing a fixed charge over all present and after acquired petroleum and natural gas interests and a floating charge over all lands and a continuing guarantee from the Company's US subsidiary in the form of a Mortgage Security Agreement and Letter of Undertaking limited to \$8,000,000.

At December 31, 2007, the Company was in breach of two covenants under its loan agreement. The Company was in breach under the working capital covenant of no less than 1 : 1 and the net debt to trailing cash flow covenant. The bank waived these defaults at December 31, 2007 conditional on the Company being in compliance as of March 31, 2008. The Company is in compliance with its bank covenants at March 31, 2008.

Convertible Debenture

The Company, as part of the Tiverton acquisition in 2006, assumed the obligations under \$3,480,000 face value of convertible debentures. The convertible debentures are a debt security with an embedded conversion option and were segregated into a debt and equity component based on the respective fair value of each at the date of acquisition. The equity component, calculated at \$370,000, represents the holder's conversion right and was included in Shareholders' Equity. The remaining balance being \$3,110,000 was classified as debt and is being accreted over the remaining period to maturity.

Interest accrues on the debentures at 8% 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. If the holder exercises the conversion right, they will receive accrued and unpaid interest up to and including the conversion date.

It is expected that the Company will repay the convertible debentures on February 15, 2009 from funds available on its then available line of credit.

Liquidity

The Company believes that with its current banking facilities, its funds flow from operations and with the issuance of equity to date this year, it has the financial resources necessary to complete its proposed capital program. In the event that commodity prices, interest or exchange rates, or other factors negatively impact funds flow from operations, or the Company is unable to raise the required equity funds, the Company would plan to reduce the proposed capital program so that the Company's debt remains within its existing banking facilities.

In order to ensure that funds were available for its 2008 capital program, the Company completed a private placement in April that raised gross proceeds of \$4,787,059 (\$3,843,738 of these funds were received in March). In order to solidify a portion of the Company's cash flow projection, the Company in

February sold forward 200 barrels of oil per day for the period March 1, 2008 to December 31, 2009 at \$97.55 Canadian per barrel and in April sold an additional 100 barrels of oil per day for the period June 1, 2008 to December 31, 2009 at \$109.80 Canadian per barrel.

Share Capital

At March 31, 2008, the Company has 89,181,542 common shares and 4,679,919 options outstanding. Since March 31, 2008, 300,000 additional options have been issued at \$0.62 per share.

In March 2008, the Company issued 959,800 common shares at \$0.63 for gross proceeds (before commission and expenses) of \$604,674. An officer of the Company subscribed for 150,000 shares for gross proceeds of \$94,500. In March 2008, the Company issued 4,498,700 flow-through shares for gross proceeds (before commission and expenses) of \$3,239,064.

The terms of the share issue require the Company to renounce to subscribers Canadian Exploration Expenditures in the amount of \$3,239,064 to be incurred prior to December 31, 2009.

Arsenal's 4,979,919 options outstanding have a weighted average exercise price of \$0.79. At March 31, 2008, 2,745,586 options were exercisable at a weighted average price of \$0.96 per share. During Q1 2008, 25,000 options were exercised at an exercise price of \$0.42, 350,000 options were forfeited at a weighted average exercise price of \$1.10 and 1,296,000 stock options were issued at an exercise price of \$0.60 to officers and employees.

The following table outlines the common share issues and option exercises during the period:

Common shares	March 31, 2008		March 31, 2007	
	Shares	Amount (\$)		
Balance - beginning of year	83,698,042	81,901,603	73,642,173	80,516,169
Private placement of common shares	959,800	604,674	-	-
Private placement of flow-through shares	4,498,700	3,239,064	-	-
Tax effect of flow-through shares	-	(1,356,625)	-	(2,660,120)
Share issue costs	-	(280,951)	-	-
Tax effect of share issue costs	-	91,375	-	-
Issued on exercise of options	25,000	10,500	-	-
Allocated from contributed surplus	-	8,218	-	-
Shares issued	89,181,542	84,217,858	73,642,173	77,856,049
Shares held in escrow	-	(225,000)	-	(225,000)
Balance - end of year	89,181,542	83,992,858	73,642,173	77,631,049

Capital Expenditures

(\$ Cdn.)	Total
Property and land acquisitions	360,253
Seismic	238,104
Drilling and completions	2,501,863
Capitalized general and administrative	99,445
Production equipment, facilities and tie-ins	1,711,689
Other	176,371
Total capital expenditures	5,087,725

During the three month ended March 31, 2008, the Company participated in the drilling of 8 gross (5.55 net) wells, all in Canada. Capital additions totaled \$5,087,725 of which \$4,884,840 are cash additions and \$202,885 were non cash additions. Non cash additions included asset retirement obligations on Q1 drilling and capitalized stock based compensation.

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. In 2007, the Company participated in the drilling of two wells and is required to drill an additional well in 2009 at an estimated cost to the Company of \$1,000,000. If a well is not drilled, the Company will lose its interest in the concession.

Flow-through shares

Pursuant to a flow-through share financing in late 2007, the Company committed to spend \$4,174,240 on qualifying expenditures by December 31, 2008. As at March 31, 2008, the Company has expended approximately \$3,947,649 leaving \$226,591 to be incurred prior to December 31, 2008.

Pursuant to a flow-through share financing in the first quarter of 2008, the Company committed to spend \$3,239,064 on qualifying expenditures by December 31, 2009. None of these eligible expenditures had been incurred as at March 31, 2008.

ARSENAL ENERGY INC.

Interim Consolidated Balance Sheets

As at

	March 31, 2008	December 31, 2007
Assets		
Current assets:		
Accounts receivable	\$ 8,608,743	\$ 3,789,284
Reclamation bonds	179,740	173,577
Property, plant and equipment (note 4)	62,324,654	61,134,541
	<u>\$ 71,113,137</u>	<u>\$ 65,097,402</u>
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 12,053,446	\$ 10,510,147
Revolving demand loan (note 6)	11,899,554	10,670,897
Convertible debentures (note 9)	3,365,671	-
	<u>27,318,671</u>	<u>21,181,044</u>
Convertible debentures (note 9)	-	3,340,040
Asset retirement obligations (note 7)	3,942,895	3,697,721
Future income taxes	4,637,341	3,621,900
	<u>35,898,907</u>	<u>31,840,705</u>
Shareholders' equity:		
Common shares (note 8)	83,992,858	81,676,603
Contributed surplus (note 8(i))	3,560,269	3,430,965
Common share conversion rights (note 9)	370,000	370,000
Deficit	(52,708,897)	(52,220,871)
	<u>35,214,230</u>	<u>33,256,697</u>
	<u>\$ 71,113,137</u>	<u>\$ 65,097,402</u>

Basis of presentation (note 1)

Segmented information (note 11)

Commitments and contingencies (note 12)

Subsequent event (note 13)

See accompanying notes to interim consolidated financial statements.

ARSENAL ENERGY INC.

Interim Consolidated Statements of Operations and Deficit

Three months ended March 31

	2008	2007
Revenue:		
Petroleum and natural gas	\$ 11,309,151	\$ 8,214,455
Realized loss on commodity contract	(48,773)	-
Unrealized loss on commodity contract	(476,113)	-
Royalties	(2,076,783)	(1,974,286)
	8,707,482	6,240,169
Other income	1,562	1,283
	8,709,044	6,241,452
Expenses:		
Operating	3,555,628	3,056,906
General and administrative	1,271,373	945,074
Finance charges	142,751	288,817
Interest on debentures	69,409	68,646
Unrealized foreign exchange gain	(23,037)	(528)
Convertible debenture accretion	25,631	25,500
Depletion, depreciation and accretion	3,466,048	4,790,018
Property, plant and equipment impairment (note 4)	495,650	1,554,683
Goodwill impairment (note 4)	-	4,791,561
Stock-based compensation (note 8(h))	109,926	362,957
	9,113,379	15,883,634
Loss before income taxes	(404,335)	(9,642,182)
Income taxes:		
Current income taxes	347,850	40,000
Future income tax reduction	(264,159)	(1,683,156)
	83,691	(1,643,156)
Net loss for the period	(488,026)	(7,999,026)
Deficit, beginning of period	(52,220,871)	(28,841,871)
Deficit, end of period	\$ (52,708,897)	\$ (36,840,897)
Loss per share-basic and diluted (note 8(f))	\$ (0.01)	\$ (0.11)

See accompanying notes to interim consolidated financial statements.

ARSENAL ENERGY INC.

Interim Consolidated Statements of Cash Flows

Three months ended March 31

	2007	2006
Cash provided by (used in):		
Operations:		
Net loss for the period	\$ (488,026)	\$ (7,999,026)
Add (subtract) items not affecting cash:		
Unrealized loss on commodity contract	476,113	—
Depletion, depreciation and accretion	3,466,048	4,790,018
Property, plant and equipment impairment	495,650	1,554,683
Goodwill impairment	—	4,791,561
Future income tax reduction	(264,159)	(1,683,156)
Convertible debenture accretion	25,631	25,500
Stock-based compensation	109,926	362,957
Unrealized foreign exchange gain	(23,037)	(528)
Asset retirement obligations settled	(8,441)	—
	3,789,705	1,842,019
Net change in non-cash working capital (note 10)	(2,680,990)	2,707,528
	1,108,715	4,549,537
Financing:		
Issue of shares for cash	3,843,738	—
Issue of shares for cash on exercise of stock options	10,500	—
Share issue expenses	(280,951)	—
Revolving demand loan	1,228,657	(893,903)
Net change in non-cash working capital (note 10)	1,749,266	—
	6,551,210	(893,903)
Investments:		
Additions to property and equipment	(4,884,840)	(2,999,189)
Sale of property	10,000	—
Net change in non-cash working capital (note 10)	(2,785,085)	(656,445)
	(7,659,925)	(3,655,634)
Change in cash during the period	—	—
Cash, beginning of period	—	—
Cash, end of period	\$ —	\$ —

Supplemental information (note 10)

See accompanying notes to interim consolidated financial statements.

ARSENAL ENERGY INC.

Notes to Interim Consolidated Financial Statements

As at March 31, 2008 and three months ended March 31, 2008 and 2007

1. Basis of presentation:

These interim unaudited consolidated financial statements of Arsenal Energy Inc. (“Arsenal” or the “Company”) have been prepared by management in accordance with accounting principles generally accepted in Canada, the same accounting principles and methods as used in the financial statements for the year ended December 31, 2007 except as described below. The interim consolidated financial statement note disclosures do not include all disclosures applicable for annual financial statements. Accordingly, the interim consolidated financial statements should be read in conjunction with the audited consolidated financial statements and the notes thereto contained in the Company’s annual report for the year ended December 31, 2007. These interim consolidated financial statements include the accounts of Arsenal and its wholly owned subsidiaries.

The future operations of the Company are dependant on its ability to successfully explore, develop, and produce economically viable reserves and market petroleum products from its properties, raise capital to supports its activities and meet its obligations, including its flow-through commitments (note 12), and receiving the continued financial support of its lender. As at March 31, 2008, the Company has a working capital deficiency of \$18.7 million and has incurred significant losses to date. Management believes that it does have the continued financial support of its lender to enable the Company to continue its activities in the normal course of operations.

These financial statements have been prepared on the basis that the Company will be able to discharge its obligations and realize its assets in the normal course of business at the values at which they are carried in these financial statements.

Management believes that the going concern assumption is appropriate for these financial statements. If this assumption were not appropriate, adjustments to the carrying amounts of the assets and liabilities, revenues and expenses and the balance sheet classifications used may be necessary.

Changes in accounting policies:

Capital Disclosures

On January 1, 2008, the Company adopted the new standards for Capital Disclosures requiring disclosures regarding an entity’s objectives, policies, and processes for managing capital. These disclosures include a description of what the company manages as capital, the nature of externally imposed capital requirements, how the requirements are incorporated into the company’s management of capital, whether the requirements have been complied with, or consequences of non-compliance and an explanation of how the company is meeting its objectives for managing capital. In addition, quantitative data about capital and whether the company has complied with all capital requirements are also required (see note 5).

Financial Instruments – Disclosures and Presentation

On January 1, 2008, the Company adopted the new standards relating to “Financial Instruments – Disclosures” and “Financial Instruments – Presentation”, which replaced the previous standard “Financial Instruments – Disclosure and Presentation”.

The new disclosure standard outlines the disclosure requirements for financial instruments and non-financial derivatives. The guidance prescribes an increased importance on risk disclosures associated with recognized and unrecognized financial instruments and how such risks are managed. Specifically, it requires disclosure of the significance of financial instruments for a company’s financial position. In addition, the guidance outlines revised requirements for the disclosure of qualitative and quantitative information regarding exposure to risks arising from financial instruments.

The new presentation standard requirements are relatively unchanged from the previous presentation requirements.

2. Related party transactions:

The Company issued shares in a prior year to a former officer and director of the Company, the proceeds of which will be recognized if and when received. At March 31, 2008, \$225,000 (December 31, 2007 - \$225,000) of these shares are held in escrow and recorded against share capital.

An officer of the Company is a partner in a law firm that provides legal services to the Company. During the first quarter of 2008, the Company recorded a total of \$93,093 (December 31, 2007 - \$265,837) for legal fees and disbursements. As at March 31, 2008 accounts payable and accrued liabilities include \$91,509 (December 31, 2007 - \$142,170) relating to these payments.

In March 2008, an officer participated in the flow-through share offering of the Company on the same terms as the other subscribers (see note 8).

3. Risk management and financial instruments:

a) Commodity price risk management:

The Company had one crude oil sales contract fixing the price of future production of 200 barrels per day at CDN \$97.55 per barrel. The contract is effective March 1, 2008 and terminates December 31, 2009. As at March 31, 2008, the Company recorded a realized loss of \$49,966 and an unrealized loss and current liability of \$476,113. A \$1.00 change in the NYMEX WTI Canadian price would increase or decrease the loss by \$128,000.

b) Fair value of financial instruments:

The Company’s exposure under its financial instruments is limited to financial assets and liabilities, all of which are included in these financial statements. The fair values of financial assets, liabilities, and convertible debentures that are included in the balance sheet approximate their carrying amounts.

c) Credit risk:

A substantial portion of the Company’s accounts receivable are with customers and joint interest partners in the oil and gas industry and are subject to normal industry credit risks.

Credit risk is the risk of financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Company’s

receivables from joint interest partners and petroleum and natural gas marketers. As at March 31, 2008 the Company's receivables consisted of \$4,296,731 (December 31, 2007 - \$1,687,201) from joint interest partners, \$4,331,613 (December 31, 2007 - \$2,272,215) of receivables from petroleum and natural gas marketers and \$402,715 (December 31, 2007 - \$252,184) of other trade receivables.

Receivables from petroleum and natural gas marketers are normally collected on the 25th day of the month following production. The Company's policy to mitigate credit risk associated with these balances is to establish marketing relationships with large purchasers. The Company historically has not experienced any collection issues with its petroleum and natural gas marketers. Joint interest receivables are typically collected within one to three months of the joint interest bill being issued to the partner. The Company attempts to mitigate the risk from joint interest receivables by obtaining partner approval of significant capital expenditures and payment of cash advances prior to expenditure. However, the receivables are from participants in the petroleum and natural gas sector, and collection of the outstanding balances are dependent on industry factors such as commodity price fluctuations, escalating costs and the risk of unsuccessful drilling, in addition further risk exists with joint interest partners as disagreements occasionally arise that increase the potential for non-collection. The Company does not typically obtain collateral from petroleum and natural gas marketers or joint interest partners; however the Company does have the ability to withhold production from joint interest partners in the event of non-payment.

The carrying amount of accounts receivable represents the maximum credit exposure. The Company has an allowance for doubtful accounts as at March 31, 2008 and at December 31, 2007 of \$422,316. This allowance for doubtful accounts was provided during the year ended December 31, 2007.

d) Foreign currency exchange risk:

The Company is exposed to foreign currency fluctuations as crude oil and natural gas prices received are referenced to U.S. dollar denominated prices, and revenues earned and costs incurred in the United States and Egypt are denominated in U.S. dollars.

e) Interest rate risk:

The Company is exposed to interest rate risk to the extent that bank debt is at a floating rate of interest.

4. Property, plant and equipment:

	March 31, 2008	December 31, 2007
Petroleum and natural gas properties	\$ 91,040,077	\$ 87,712,152
Production equipment	13,636,213	11,912,419
	104,676,290	99,624,571
Office furniture, equipment, and other	503,364	488,292
	105,179,654	100,112,863
Accumulated depletion and depreciation	(42,855,000)	(38,978,322)
	\$62,324,654	\$61,134,541

In Canada and United States, costs of unproved properties have been capitalized, and subject to depletion during the first quarter of 2008 and for 2007. For the period ending March 31, 2008, future development costs totaling \$1,408,000 (December 31, 2007 - \$1,400,000) in Canada and \$1,276,800 (December 31, 2007 - \$1,276,000) in the U.S. were included in the depletion calculation.

During the first quarter of 2008, the Company recorded an impairment to its Egyptian property of \$495,650 (2007 - \$1,554,683). As at March 31, 2008, the Company has completely written off its interest in its Egyptian concession.

During 2007, the Company compared the fair value of goodwill to the carrying amount of goodwill. As a result of this test, the Company recorded an impairment to goodwill of \$4,791,561 calculated as the excess of the Company's fair value over the identifiable net assets for its Canadian reporting unit.

For the period ended March 31, 2008, Arsenal capitalized general and administrative expenses of \$99,445 (2007 - \$191,800) including \$27,595 of stock based compensation and \$14,350 of tax related thereto.

5. Capital management:

In order to continue the Company's future exploration and development program, the Company must maintain a strong capital base. A strong capital base results in increased market confidence, an essential factor in maintaining existing shareholders and in attracting new investors. The Company's commitment is to establish and maintain a strong capital base to enable the Company to access the equity and debt markets when deemed advisable. In order to maintain a strong capital base, the Company continually monitors the risk reward profile of its exploration and development projects and the economic indicators in the market including commodity prices, interest rates and foreign exchange rates. It then determines increases or decreases to its capital budget.

The Company considers shareholders equity, bank debt and working capital as components of its capital base. The Company can access or increase capital through the issuance of shares, through bank borrowings, that are based on reserves, and by building cash reserves by reducing its capital expenditure program.

The Company monitors its capital based primarily on its debt to annualized cash flow ratio. Debt includes bank debt plus or minus working capital. Annualized cash flow is calculated as cash flow from operations before changes in non-cash working capital from the Company's most recent quarter multiplied by four. The Company's strategy is to maintain this ratio at 1.23 : 1 (including the convertible debentures). This ratio may increase somewhat depending on the timing and nature of the Company's activities. To facilitate the management and control of this ratio, the Company prepares an annual operating and capital expenditure budget. The budget is updated when critical factors change. These factors include economic factors such as the state of equity markets, changes to commodity prices, interest rates and foreign exchange rates and non economic factors such as the Company's drilling results and its production profile. The Company's board of directors approves the budget and changes thereto.

At March 31, 2008, the Company's debt to cash flow ratio was 1.23 : 1. The ratio is generally higher at the end of the first quarter as Q1 represents a higher capital expenditure quarter than the second quarter. The increased activity level results in the Company carrying a higher debt load at March 31, 2008. The production additions from the first quarter program are expected to contribute to increase cash flow and therefore reduce the ratio during the rest of the year to a more acceptable level.

The Company's credit facility has certain financial covenants that, without the written consent of the lender, would result in a breach of the agreement. The Company cannot permit:

the working capital ratio to fall below 1 : 1 and

the ratio of net debt to trailing cash flow annualized to exceed 3 : 1.

The Company's share capital is not subject to external restrictions.

There were no changes in the Company's approach to capital management during the period.

6. Revolving demand loan:

At March 31, 2008, the Company has available a demand operating loan in the amount of \$17,250,000. The facility can be utilized in either Canadian or U.S. dollars, bears interest at Canadian or U.S. bank prime rate plus 0.25%, increasing to Canadian or U.S. bank prime rate plus 0.40% if net debt to trailing cash flow (cash flow for the last quarter annualized) exceeds 1.25:1. The facility is secured by a fixed and floating charge debenture providing a fixed charge over all present and after acquired petroleum and natural gas interests and a floating charge over all lands and a continuing guarantee from the Company's U.S. subsidiary in the form of a Mortgage Security Agreement and Letter of Undertaking limited to \$8,000,000.

7. Asset retirement obligations:

The following table presents the reconciliation of the beginning and ending aggregate carrying amount of the obligation associated with the retirement of oil and gas properties:

Changes to the asset retirement obligations were as follows:

	March 31, 2008	December 31, 2007
Asset retirement obligations, beginning of period	\$ 3,697,721	\$ 2,638,520
Liabilities settled	(8,441)	(321,190)
Liabilities incurred or acquired	161,300	1,251,400
Change in estimate	17,999	(76,559)
Accretion expense	74,316	205,550
Asset retirement obligations, end of period	\$ 3,942,895	\$ 3,697,721

The total undiscounted amount of estimated cash flows required to settle the obligation at March 31, 2008 is \$8,935,707 (December 31, 2007 - \$8,625,648), which has been discounted using a credit-adjusted risk free rate of 8.0% and an inflation factor of 1.5% for both periods. The majority of these obligations will be incurred between 2014 and 2025; however certain obligations are not anticipated to be incurred until 2035.

8. Shareholder's equity:

a) Authorized:

Unlimited number of common shares

Unlimited number of non-voting preferred shares, issuable in series

b) Issued:

	Three Months Ended March 31, 2008		Year Ended December 31, 2007	
	Number	Amount	Number	Amount
Common shares:				
Balance, beginning of period	83,698,042	\$ 81,901,603	73,642,173	\$ 80,516,169
Issued to acquire property	–	–	275,000	158,000
Issued on exercise of options	25,000	10,500	73,333	14,667
Allocated from contributed surplus	–	8,218	–	146,416
Issued for cash pursuant to private placement	959,800	604,674	–	–
Issued for cash pursuant to private placement of flow-through shares	4,498,700	3,239,064	9,707,536	4,174,240
Tax effect of flow-through shares	–	(1,356,625)	–	(2,660,118)
Share issue costs	–	(280,951)	–	(443,855)
Tax effect of share issue costs	–	91,375	–	142,500
Balance, end of period	89,181,542	84,217,858	83,698,042	81,901,603
Shares held in escrow (note e)	–	(225,000)	–	(225,000)
Balance, end of period	89,181,542	\$ 83,992,858	83,698,042	\$ 81,676,603

In March 2008, the Company issued 959,800 common shares at \$0.63 for gross proceeds of \$604,674. An officer of the Company subscribed for 150,000 shares for gross proceeds of \$94,500.

c) Flow-through shares:

In March 2008, the Company issued 4,498,700 flow-through shares for gross proceeds of \$3,239,064. An insider of the Company subscribed for 20,000 flow-through shares for gross proceeds of \$14,400. The terms of the share issue require the Company to renounce to subscribers Canadian Exploration Expenditures in the amount of \$3,239,064 to be incurred prior to December 31, 2009.

d) Exercise of options:

In February 2008, 25,000 stock options issued at \$0.42 were exercised for proceeds of \$10,500. The related contributed surplus amount of \$8,218 has been added to share capital.

In 2007, 73,333 stock options issued in 2003 at \$0.20 were exercised for proceeds of \$14,667. No adjustment to share capital was required as no prior compensation expense had been recognized.

e) Escrowed shares:

The Company issued shares in a prior year to a former officer and current director of the Company, the proceeds of which will be recognized if and when received. At March 31, 2008,

\$225,000 (December 31, 2007 - \$225,000) of these shares are held in escrow and recorded against share capital.

f) Per share amounts:

The following table shows the weighted average number of common and diluted shares.

	March 31, 2008	March 31, 2007
Basic and diluted:		
(Loss) per share basic and diluted	\$ (0.01)	\$ (0.11)
Shares outstanding:		
Basic	83,937,976	73,642,173
Diluted	83,937,976	73,642,173

The convertible debentures are convertible into 1,539,170 common shares that represents a conversion price of \$2.26 per share. As a result of the high conversion price, they were excluded from the dilution calculation. No adjustments were required to reported earnings in computing diluted per share amounts.

g) Stock options:

The Company has a stock option plan in which the Company may grant options to its directors, officers, employees and consultants for up to 10% of its outstanding common shares. Under the plan, the exercise price of each option granted shall not be less than the market price of the Company's common shares on the date the option is granted and the contractual term of each option is not to exceed five years. All options vest over a period as determined by the board of directors. Stock options are granted periodically throughout the year.

The following table summarizes the status of the Company's stock option plan as at March 31, 2008 and December 31, 2007 and the changes during the periods ended on those dates:

	Three Months Ended March 31, 2008		Year Ended December 31, 2007	
	Number of options	Exercise price	Number of options	Exercise price
Balance, beginning of period	3,758,919	\$ 0.88	4,527,252	\$ 1.05
Granted	1,296,000	0.60	995,000	0.40
Exercised	(25,000)	0.42	(73,333)	0.20
Forfeited	(350,000)	1.10	(1,690,000)	1.08
Balance, end of period	4,679,919	\$ 0.79	3,758,919	\$ 0.88
Exercisable	2,745,586	\$ 0.96	2,854,752	\$ 1.01

The following table summarizes information about the stock options outstanding and exercisable at March 31, 2008:

Range	Options outstanding		Options exercisable		
	Options Outstanding	Weighted average exercise price	Weighted average remaining Term (years)	Exercisable	Weighted average exercise price
\$ 0.20 - 0.60	2,689,919	\$ 0.51	2.42	780,586	\$ 0.44
\$ 0.61 - 1.25	1,835,000	1.15	2.71	1,810,000	1.14
\$ 1.26 - 2.00	155,000	1.37	2.67	155,000	1.37
Total	4,679,919	\$ 0.79	2.63	2,745,586	\$ 0.96

h) Stock-based compensation expense:

Options granted to employees and non-employees are accounted for using the fair value method. The fair value of stock options granted during 2008 is \$328,019 (\$0.33 per option) as estimated at the date of grant using the Black-Scholes option-pricing model with weighted average assumptions for grants as follows:

	2008	2007
Risk free rate	4.5%	4.5%
Expected life	5 years	5 years
Expected volatility	125%	152%
Expected dividend	nil	nil
Expected forfeitures	nil	nil

The fair value of the options issued will be recognized as stock based compensation expense over the 18 month vesting period of the options.

i) Contributed surplus:

The estimated fair value of the options is amortized and credited to contributed surplus over the option vesting period on a straight line basis. The change in the contributed surplus account is reconciled in the table below:

	Three Months Ended March 31, 2008	Year Ended December 31, 2007
Balance, beginning of period	\$ 3,430,965	\$ 2,422,423
Stock-based compensation expensed	109,926	704,811
Stock-based compensation capitalized	27,596	-
Reclassification on expiry of warrants	-	303,731
Transferred to shareholders' equity	(8,218)	-
Balance, end of period	\$ 3,560,269	\$ 3,430,965

9. Convertible debentures:

Arsenal completed the corporate acquisition of Tiverton on March 14, 2006. A portion of Tiverton's capital structure was comprised of unsecured convertible debentures totaling \$3,480,000. The convertible debentures are a debt security with an embedded conversion option and were segregated into a debt and equity component based on the respective fair value of each at the date of acquisition. The equity component of \$370,000 represents the holder's conversion right and was included in Shareholders' Equity. The remaining balance was classified as debt and is being accreted over the remaining period to maturity to the face value of the debenture. The interest accrues on the debentures at 8%, 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. If the holder exercises the conversion right, they will receive accrued and unpaid interest up to and including the conversion date.

At December 31, 2007, these debentures were classified as long term. At March 31, 2008, the debentures are classified as a current liability as they mature on February 15, 2009.

10. Supplemental cash flow information:

	March 31, 2008	March 31, 2007
Change in non-cash working capital items:		
Accounts receivable and prepaids	\$(4,819,459)	\$ 576,675
Accounts payable and accrued liabilities	1,102,649	2,130,853
	(3,716,810)	2,707,528
Amounts relating to operating activities	(2,452,827)	2,707,528
Amounts relating to investing activities	(3,013,249)	(656,445)
Amounts relating to financing activities	1,749,266	-
	(3,716,810)	2,051,083
Interest and taxes paid:		
Taxes paid	\$ 718,436	\$ -
Interest paid	\$ 600,770	\$ 314,066

11. 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 an identifiable reporting segment by management. The remaining assets and associated revenues are earned in Canada. Business risks and economic indicators are similar across all geographical regions.

2008 (\$CDN)	Canada	U.S.	Egypt
Oil and gas revenue	8,338,056	2,971,095	–
Income (loss) before income taxes	217,384	403,296	(1,025,015)
Operating income	4,306,317	845,537	–
Property, plant, and equipment (note 4)	58,405,682	3,918,972	–
Capital additions (cash and non-cash)	4,992,811	90,309	4,965

2007 (\$CDN)	Canada	U.S.	Egypt
Oil and gas revenue	6,155,069	2,059,386	–
Income (loss) before income taxes	(3,195,908)	115,467	(1,561,741)
Operating income	2,621,989	753,440	–
Property, plant, and equipment (note 4)	70,394,138	3,915,449	5,618,584
Capital additions (cash and non cash)	2,499,708	110,996	388,485

12. Commitments and contingencies:

a) Egyptian concession:

The Company's wholly owned subsidiary Quadra Egypt Ltd. entered into a concession agreement with the Egyptian government in 2004. In 2007, the Company participated in the drilling of 2 wells and is required to drill an additional well in 2009 at an estimated cost to the Company of \$1,000,000. If a well is not drilled, the Company will lose the concession.

b) Flow-through shares:

In connection with the issuance of flow-through shares issued in 2007, the Company is obligated to incur approximately \$230,000 in eligible expenditures by December 31, 2008.

In connection with the issuance of flow-through shares in the first quarter of 2008, the Company incurred a commitment to incur \$3,239,064 of eligible expenditures by December 31, 2009. As at March 31, 2008, none of these eligible expenditures had been incurred.

c) Letter of credit:

During the second quarter of 2006, the Company provided a letter of credit to the Egyptian government for U.S.D\$1.6 million. The letter of credit is to be held until April 10, 2010, or until certain performance measures are achieved by the Company and its partners. The Company has obtained a Performance Security Guarantee ("PSG") from the Canadian government which

guarantees the Company against the call of the bond by the Egyptian government. There is no impact to the existing credit facility of the Company from providing the letter of credit due to the PSG, however the Company incurred approximately \$50,000 in stamping fees to obtain the PSG. As of March 31, 2008, the performance measures have been met and the letter of credit has been cancelled. The Company is awaiting confirmation of the cancellation of the PSG.

13. Subsequent event:

In March 2008, the Company entered into an agreement for the private placement of 289,500 common shares ("Common Shares") at a subscription price of \$0.63 per Common Share and 1,056,855 Flow-Through Common Shares ("Flow-through Shares") at a subscription price of \$0.72 per Flow-Through Share for total gross proceeds of up to \$6,000,000 (the "Offering"). The final closing in April 2008 raised additional gross proceeds of \$943,321 from the sale of Flow-through Shares.

Advisory

Certain statements and information contained in this press release, including but not limited management's assessment of Arsenal's future plans and operations, production, reserves, revenue, commodity prices, operating and administrative expenditures, funds from operations, capital expenditure programs and debt levels contain forward-looking statements. All statements other than statements of historical fact may be forward-looking statements. These statements, by their natures, are subject to numerous risks and uncertainties, some of which are beyond Arsenal's control including the effect of general economic conditions, industry conditions, changes in regulatory and taxation regimes, volatility of commodity prices, escalation of operating and capital costs, currency fluctuations, the availability of services, imprecision of reserve estimates, geological, technical, drilling and processing problems, environmental risks, weather, the lack of availability of qualified personnel or management, stock market volatility, the ability to access sufficient capital from internal and external sources and competition from other industry participants, among other things, capital, services, acquisitions of reserves, undeveloped lands and skilled personnel that may cause actual results or events to differ materially from those anticipated in the forward-looking statements. Such forward-looking statements although considered reasonable by management at the time of preparation, may prove to be incorrect and actual results may differ materially from those anticipated in the statements made and should not unduly be relied on. These statements speak only as of the date of this news release. Arsenal does not intend and does not assume any obligation to update these forward-looking statements, whether as a result of new information, future events or otherwise, except as required by applicable law. Arsenal's business is subject to various risks that are discussed in its filings on the System for Electronic Document Analysis and Retrieval (SEDAR).

In this news release per barrel of oil equivalent ("boe") may be misleading, particularly if used in isolation. A boe conversion ratio has been calculated using a conversion rate of six thousand cubic feet of natural gas to one barrel of oil (6 Mcf: 1 bbl) and is based on an energy equivalency conversion method applicable at the burner tip and does not represent a value equivalency at the wellhead.

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Arsenal Energy's complete Quarterly Information Form, Management Discussion and Analysis, and Financial Statements are posted on SEDAR www.sedar.com or Arsenal's website www.arsenalenergy.com.

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