

MANAGEMENT DISCUSSION AND ANALYSIS

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, 2009. It should be read in conjunction with the audited consolidated financial statements for the year ended December 31, 2008 and other operating and financial information contained herein. This MD&A is dated May 14, 2009.

The financial data presented herein has in part been derived from the Company's annual audited consolidated financial statements prepared in accordance with Canadian Generally Accepted Accounting Principles ("GAAP") and in accordance with accounting policies as set out in Notes 3 and 4 to the Company's annual consolidated financial statements. The reporting currency is the Canadian dollar.

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

Tables might not add due to rounding.

Disclosure Controls and Procedures

The Company has established disclosure controls and procedures for the timely and accurate preparation of financial and other reports. Disclosure controls and procedures are designed to provide reasonable assurance that material information required to be disclosed is recorded, processed, summarized and reported within the periods specified by applicable securities regulations and that information required to be disclosed is accumulated and communicated to the appropriate members of management and properly reflected in the Company's filings. Consistent with the concept of reasonable assurance, the Company recognizes that the relative cost of maintaining these disclosure controls and procedures should not exceed their expected benefits. As such, the Company's disclosure controls and procedures can only provide reasonable assurance, and not absolute assurance, that the objectives of such controls and procedures are met. The Chief Executive Officer and the Chief Financial Officer oversee this evaluation process and have concluded that the design and operation of these disclosure controls and procedures are not effective in providing reasonable assurance that material information required to be disclosed by the Company in reports filed with Canadian securities regulators is accurate and complete and filed within the periods required due to the material weaknesses identified in internal controls over financial reporting as noted below. The Chief Executive Officer and the Chief Financial Officer have individually signed certifications to this effect. There were no changes during the first quarter of 2009 in disclosure controls and procedures.

Internal Controls over Financial Reporting

The Chief Executive Officer and Chief Financial Officer of Arsenal are responsible for designing and ensuring the operating effectiveness of internal controls over financial reporting or causing them to be designed and operating effectively under their supervision in order to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with Canadian GAAP. Arsenal's management has assessed the design and operating effectiveness of internal controls over financial reporting.

While Arsenal's Chief Executive Officer and Chief Financial Officer believe the Company's internal controls and procedures provide a reasonable level of assurance that they are reliable, an internal control system cannot prevent all errors and fraud. It is management's belief that any control system, no matter how well conceived or operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met.

During the design and operating effectiveness assessment certain material weaknesses in internal controls over financial reporting were identified, as follows:

- Management is aware that there is a lack of segregation of duties due to the small number of employees dealing with general administrative and financial matters. However, management believes that at this time the potential benefits of adding employees to clearly segregate duties do not justify the costs associated with such increase;
- Many of Arsenal's information systems are subject to general control deficiencies including a lack of effective controls over spreadsheets, access and documentation. The Company expects that some deficiencies will continue into the future; and
- Arsenal does not have full-time in-house personnel to address all complex financial and non-routine tax issues that may arise. It is not deemed as economically feasible at this time to have such personnel. Arsenal relies on external experts for review and advice on complicated financial issues and for tax planning, tax provision and compilation of corporate tax returns.

These weaknesses in internal controls over financial reporting result in a more than remote likelihood that a material misstatement would not be prevented or detected. Management and the Board of Directors work to mitigate the risk of material misstatement; however, management and the Board do not have reasonable assurance that this risk can be reduced to a remote likelihood of a material misstatement. There were no changes during the first quarter of 2009 to material weaknesses in internal controls over financial reporting.

Forward-Looking Statements

Certain statements contained within the Management's Discussion and Analysis, and in certain documents incorporated by reference into this document, constitute forward looking statements. These statements relate to future events or our future performance. All statements other than statements of historical fact may be forward looking statements. Forward looking statements are often, but not always, identified by the use of words such as 'seek', 'anticipate', 'budget', 'plan', 'continue', 'estimate', 'expect', 'forecast', 'may', 'will', 'project', 'predict', 'potential', 'targeting', 'intend', 'could', 'might', 'should', 'believe' and similar expressions. These statements involve known and unknown risks, uncertainties and other factors that may cause actual results or events to differ materially from those anticipated in such forward looking statements.

In particular, this MD&A contains the following forward-looking statements pertaining to, without limitation, the following: Arsenal's production volumes and the timing of when additional production volumes will come on stream; Arsenal's realized price of commodities in relation to reference prices; future commodity prices; the Company's future royalty rates and the realization of royalty incentives; the impact of the New Royalty Framework on the Company's future royalties; Arsenal's expectation of reducing operating costs on a per unit basis; the relationship of Arsenal's interest expense and the Bank of Canada interest rates; increases in general and administrative expenses and recoveries; future development and exploration activities and the timing thereof; the future tax liability of the Company; the expected decrease in the depletion, depreciation and accretion rate; the estimated future contractual obligations of the Company and the amount expected to be incurred under its farm-in commitments; the future liquidity and financial capacity of the Company; and its ability to fund its working capital and forecasted capital expenditures. In addition, 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.

With respect to the forward-looking statements contained in the MD&A, Arsenal has made assumptions regarding: future commodity prices; the impact of royalty regimes and certain royalty incentives, the timing and the amount of capital expenditures; production of new and existing wells and the timing of new wells coming on-stream; future

proved finding and development costs; future operating expenses including processing and gathering fees; the performance characteristics of oil and natural gas properties; the size of oil and natural gas reserves; the ability to raise capital and to continually add to reserves through exploration and development; the continued availability of capital, undeveloped land and skilled personnel; the ability to obtain equipment in a timely manner to carry out exploration and development activities; the ability to obtain financing on acceptable terms; the ability to add production and reserves through exploration and development activities; and the continuation of the current tax and regulation.

We believe the expectations reflected in those forward looking statements are reasonable but no assurance can be given that these expectations will prove to be correct and such forward looking statements included in, or incorporated by reference into, this MD&A should not be unduly relied upon. These statements speak only as of the date of this MD&A or as of the date specified in the documents incorporated by reference into this Management's Discussion and Analysis, as the case may be. The actual results could differ materially from those anticipated in these forward looking statements as a result of the risk factors set forth below and elsewhere in this Management's Discussion and Analysis: volatility in market prices for oil and natural gas; counterparty credit risk; access to capital; changes or fluctuations in production levels; liabilities inherent in oil and natural gas operations; uncertainties associated with estimating oil and natural gas reserves; competition for, among other things, capital, acquisitions of reserves, undeveloped lands and skilled personnel; stock market volatility and market valuation of Arsenal stock; geological, technical, drilling and processing problems; limitations on insurance; changes in environmental or legislation applicable to our operations, and our ability to comply with current and future environmental and other laws; changes in income tax laws or changes in tax laws and incentive programs relating to the oil and gas industry; and the other factors discussed under "Risk Factors" in the following annual MD&A. Readers are cautioned that the foregoing lists of factors are not exhaustive. The forward looking statements contained in this MD&A and the documents incorporated by reference herein are expressly qualified by this cautionary statement. The forward-looking statements contained in this document speak only as of the date of this document and Arsenal does not assume any obligation to publicly update or revise them to reflect new events or circumstances, except as may be required pursuant to applicable securities laws.

Boe Presentation

For the purpose of calculating unit costs, natural gas is converted to barrel of oil equivalent ("Boe" or "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", "netbacks" and "netbacks per Boe" are not defined by GAAP in Canada and are regarded as non-GAAP measures. Measurement of funds from operations is detailed on the Consolidated Statement of Cash Flows, specifically; it is cash flow before the change in non-cash operating working capital and asset retirement expenditures. Funds from operations should not be considered as an alternative to, or more meaningful than cash flow from operating activities as determined in accordance with GAAP as an indicator of the Company's performance. The Company's determination of funds from operations may not be comparable to that reported by other companies. 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.

The following table reconciles cash from operating activities to funds from operations which is used in the MD&A:

(\$Cdn.)	Three Months Ended March 31		
	2009	2008	% Change
Cash provided by operating activities	6,977,985	1,108,715	529
Asset retirement obligations settled	253,142	8,441	2,899
Change in non-cash working capital	3,084,143	2,680,990	15
Funds from operations	10,315,270	3,798,146	172

Netbacks equal total revenue less royalties, operating costs and transportation, calculated on a commodity and 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.

Company Highlights

During the first quarter of 2009, the Company continued its integration of GEOCAN Energy Inc. ("GEOCAN") acquired on October 8, 2008. This integration involved familiarization with the properties from both an operating and from an accounting perspective and an amalgamation of GEOCAN on January 1, 2009.

As a consequence of the GEOCAN acquisition and the impending change to IFRS, it was determined that an accounting system upgrade was required and in the first quarter of 2009, Arsenal converted and upgraded their accounting system.

During the quarter, the Company monetized its commodity contracts in-place at December 31, 2009 receiving \$9.1 million cash in the quarter. Proceeds were used primarily to reduce debt.

On February 15, 2009, the Company redeemed \$3,480,000 of convertible debentures at maturity.

In March 2009, the Company spud its second well at a 20% working interest on its high impact Bakken acreage in Stanley, North Dakota. Additionally Arsenal spud a Bakken well at a 13% working interest on its acreage in Lindahl, North Dakota.

Company production for the first quarter of 2009 averaged 2,330 Boe per day versus 2,516 Boe per day for the fourth quarter of 2008. The decline related to wells shut-in for either economic reasons or due to severe weather conditions.

During Q1 2009, no purchases were made by the Company under the Normal Course Issuer Bid announced in October 2008.

In March 2009, the Company adopted a Shareholders Rights Plan designed to ensure fair treatment of Arsenal shareholders by providing more time than is afforded under existing Canadian legislation to properly evaluate any unsolicited takeover bid and to seek possible alternatives to maximize value for all shareholders.

At March 31, 2009, Arsenal had total bank debt and working capital deficiency of \$40.1 million on a \$55.0 million facility. The amount of the facility is subject to a borrowing base test performed on a periodic basis by the lender to be completed by May 31, 2009. The Company expects its facility to be reduced.

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".

The Company operates in the United States under, Arsenal Energy USA Inc., and produced an average of 476 Boe per day in Q1 2009 versus 404 Boe per day in Q1 2008 and in Canada under Arsenal Energy Inc., and produced an average of 1,854 Boe per day in Q1 2009 versus 1,321 Boe per day in Q1 2008.

OPERATIONAL AND FINANCIAL RESULTS

PRODUCTION AND REVENUE

Average Daily Production

The Company has production in the provinces of British Columbia, Alberta and Saskatchewan in Canada (80% of total Q1 2009 production) and in the state of North Dakota in the US (20% of total Q1 2009 production). The US production is expected to increase as a percentage of total production as the Company continues to participate in the drilling of additional high impact Bakken oil wells in North Dakota.

Production for the first quarter of 2009 averaged 2,330 Boe per day versus 1,725 Boe per day in the first quarter of 2008. The increase in production is primarily attributed to the acquisition of GEOCAN in October 2008 and increased production volumes from the Company's Bakken well in North Dakota. Production during the quarter was lower than expected as a result of a decision to shut-in certain wells due to low commodity prices, due to adverse weather conditions in North Dakota and to the Bakken well in Stanley, North Dakota being shut-in temporarily in order to equip the well. Normal production declines were offset by 2008 drilling at Evi, Alderson and Galahad.

With the acquisition of GEOCAN in late 2008 natural gas production increased as a percentage of total production.

Production Profile and Per Unit Prices

Production	Three Months Ended March 31		
	2009	2008	% Change
Heavy oil (bbl/d)	761	552	38
Light oil and NGLs (bbl/d)	995	863	15
Natural gas (mcf/d)	3,441	1,864	85
Total (boe/d)	2,330	1,725	35

Production split			
Heavy oil	32%	32%	-
Light oil and NGLs	43%	50%	(14)
Natural gas	25%	18%	39

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		
	2009	2008	% Change
Prices - Before Commodity Contracts			
Heavy oil	41.30	65.78	(37)
Light oil and NGLs (bbl)	38.69	85.96	(55)
Natural gas (mcf)	5.23	7.42	(30)
Total (boe)	38.01	72.04	(47)

(\$Cdn.)	Three Months Ended March 31		
	2009	2008	% Change
Reference Pricing			
WTI Cushing (\$U.S./bbl)	42.51	97.92	(57)
Oil Edmonton Light (\$Cdn./bbl)	50.29	98.32	(49)
Heavy Oil Lloyd blend (\$Cdn./bbl)	42.80	76.49	(44)
AECO gas (\$Cdn./mcf)	5.49	5.46	1
NYMEX gas (\$U.S./mmbtu)	4.91	8.03	(39)
Foreign exchange (\$Cdn./\$U.S.)	0.80	1.00	(20)

The Company received an average price per Boe during Q1 2009 of \$38.01 per Boe a decrease of 47% from \$72.04 per Boe received during Q1 2008. The decreases in commodity prices received by the Company are reflective of the decline in commodity prices over the comparative periods.

Production by Area

AREA	Three Months Ended March 31			
	2009		2008	
	Boe/d	% of Total	Boe/d	% of Total
Canada				
Maidstone (heavy oil)	101	4	212	12
Galahad (light oil and solution gas)	208	9	105	6
Wildmere (heavy oil)	144	6	124	7
Chauvin/Ribstone (GEOCAN)	207	9	-	-
West Current (GEOCAN)	101	4	-	-
Evi (light oil)	161	8	199	12
Others	932	40	680	39
Total Canada	1,854	80	1,321	77
US				
Stanley (light oil)	223	10	126	7
Lindahl (light oil)	64	3	81	5
Tioga (light oil)	50	2	47	3
Others	139	5	150	9
Total US	476	20	404	23
Total boe/d production	2,330	100	1,725	100

As a result of the GEOCAN acquisition, the percentage of oil and natural gas production originating in Canada increased quarter over comparative quarter. Due to the ongoing development of Arsenal's high impact Bakken play in North Dakota it is expected that the percentage of production from the US will increase in the future.

Oil and Gas Revenue

(\$Cdn.)	Three Months Ended March 31		
	2009	2008	% Change
Heavy oil	2,650,720	3,303,112	(20)
Light oil and NGLs	3,699,366	6,746,635	(45)
Natural gas sales	1,619,827	1,259,404	29
Oil and gas revenues	7,969,913	11,309,151	(30)
Gain (loss) on commodity contracts	295,187	(524,886)	(156)
Oil and gas revenue after hedging	8,265,100	10,784,265	(23)
Per Boe after hedging	39.42	68.70	(43)

Total oil and gas revenue in Q1 2009 decreased 30% to \$7,969,913 from Q1 2008 (\$11,309,151) and decreased 26% from Q4 2008 (\$10,724,915). The Q1 2009 decrease from Q1 2008 is due to the 47% decrease in the average price per Boe before hedging as production over the comparative periods increased 35%. The production increase was not sufficient to offset the significant price reductions realized over the comparative periods.

The Company monetized commodity contracts in Q1 2009 receiving \$9,085,144 in cash. At December 31, 2008, these contracts were recorded in the financial statements at \$9,045,804 as unrealized commodity contracts.

As at March 31, 2009, the Company had one financial commodity contract outstanding entered into in February 2009 to sell 1,000 GJ per day of natural gas for the period January 1, 2010 to December 31, 2010 at \$6.78 per GJ. At March 31, 2009, the Company had recorded an unrealized gain on this commodity contract of \$255,847.

(\$Cdn.)	Commodity	Production	CDN \$	Three Months Ended March 31, 2009			
				Gain (Loss)			
	Sold	Per Day	Price	Terminates	Realized	Unrealized	Total
	Oil (barrels)	200	97.55	Dec 31, 2009	(194,697)	-	(194,697)
	Oil (barrels)	200	125.80	July 31, 2010	(351,302)	-	(351,302)
	Gas (Gj)	1,000	7.46	Dec 31, 2009	585,339	-	585,339
	Gas (Gj)	1,000	6.78	Dec 31, 2010	-	255,847	255,847
	Gain on commodity contracts				39,340	255,847	295,187

In April 2009, the Company entered into a financial contract selling 100 barrels of oil per day for the period May 1, 2009 to April 30, 2010 at \$72.60 Canadian per barrel and in May 2009 entered into a financial contract selling 100 barrels of oil per day for the period May 1, 2010 to April 30, 2011 at \$79.50 Canadian per barrel.

Royalties

(\$Cdn.)	Three Months Ended March 31		
	2009	2008	% Change
Heavy oil	596,653	521,215	14
Light oil and NGLs	961,073	1,318,278	(27)
Natural gas sales	241,672	237,290	2
Total royalties	1,799,398	2,076,783	(13)
% of gross oil and gas revenue	23%	18%	28
Per boe	8.58	13.23	(35)

During the first quarter of 2009, the Company paid \$1,799,398 or 23% of oil and gas revenues in royalties compared to \$2,076,783 or 18% in the first quarter of 2008. The decline in royalties paid reflects the lower prices

received in the current period. The increase in the royalty rate is due to the expiration of the royalty holiday for which some of the wells drilled in late 2007 and 2008 qualified and due to freehold mineral tax adjustments recorded that related to an earlier period.

For the current quarter, the heavy oil royalty averaged 23%, the light oil and NGL royalty rate averaged 26% and natural gas royalties averaged 15%.

On a Boe basis, royalties decreased 35% due primarily to lower commodity prices.

In 2008, the Alberta Government announced its New Royalty Framework and subsequent thereto a number of changes and revisions to the New Royalty Framework that took effect January 1, 2009 and a Transitional Royalty Plan. It is not expected that these changes and revisions will have a major effect on the Company's royalties other than to result in some volatility in rates as commodity prices change. A Q1 2009 announcement by the Alberta Government on a "three point incentive program" to encourage additional drilling reduces royalty rates on new wells drilled to 5% for a period of one year and provides a credit of \$200.00 per meter drilled. The Company is reviewing its projects and has identified some drilling locations that maximize the value of this program to the Company and will, if funds are available, attempt to drill these projects in late 2009.

Operating Expenses

(\$Cdn.)	Three Months Ended March 31		
	2009	2008	% Change
Heavy oil	1,099,631	1,791,467	(39)
Light oil and NGLs	1,790,815	1,586,090	13
Natural gas	765,118	178,071	330
Total operating expenses	3,655,564	3,555,628	3
Per boe	17.43	22.65	(23)

Operating costs increased 3% to \$3,655,564 in Q1 2009 from \$3,555,628 in Q1 2008 despite a 35% increase in average production. For Q1 2009, operating costs averaged \$17.43 per Boe versus \$22.65 per Boe in Q1 2008 and \$22.90 per Boe in Q4 of 2008. Operating costs on a Boe basis are down as a result of the Company's ongoing operating cost review process, the sale or shut-in of high operating cost properties, the acquisition of GEOCAN whose operating costs on an BOE basis were lower than Arsenal's and the addition of low operating cost production in North Dakota.

The Company has reviewed and continues to review both its operating costs and is implementing initiatives to further reduce operating costs. This review has included the purchase of some properties in order to achieve economies of scale and the sale of other high cost non-core properties over which we have little control. In addition, the Company is examining its field operations and equipment specifications to maximize production and lower costs. The Company is expecting to further reduce operating costs in 2009.

Transportation Expenses

(\$Cdn.)	Three Months Ended March 31		
	2009	2008	% Change
Heavy oil	115,521	-	-
Light oil and NGLs	43,211	-	-
Natural gas	52,642	-	-
Total operating expenses	211,374	-	-
Per boe	1.01	-	-

(1) No transportation incurred in 2008

Transportation expenses totaled \$211,374 (\$1.01 per Boe) in Q1 2009 and include gathering, processing and transmission in British Columbia, gas service costs (firm and interruptible) in Alberta and clean oil trucking in Alberta and Saskatchewan. These costs are primarily related to the GEOCAN properties.

Operating Netback

(\$Cdn.)	Three Months Ended March 31		
	2009	2008	% Change
Heavy			
Revenue	38.70	65.76	(41)
Royalty	8.71	10.38	(16)
Operating	16.06	35.66	(55)
Transportation	1.69	-	-
Netback per barrel	12.25	19.72	(38)
Light oil and NGL's			
Revenue	41.31	85.91	(52)
Royalty	10.73	16.79	(36)
Operating	20.00	20.20	(1)
Transportation	0.48	-	-
Netback per barrel	10.10	48.93	(79)
Gas			
Revenue	5.23	7.42	(30)
Royalty	0.78	1.40	(44)
Operating	2.47	1.05	135
Transportation	0.17	-	-
Netback per mcf	1.81	4.98	(64)
Boe			
Revenue	38.01	72.04	(47)
Royalty	8.58	13.23	(35)
Operating	17.43	22.65	(23)
Transportation	1.01	-	-
Netback per Boe	10.99	36.16	(70)

The operating netback (before hedging activities) for Q1 2009 was \$10.99 per Boe for Q1 2009 versus \$36.16 per Boe for Q1 2008. This 70 per cent reduction as was the reduction in the individual commodity netbacks, the result of lower commodity prices.

Increased oil and natural gas prices, and slightly lower operating costs were responsible for the increased netback in 2008. On an individual product basis, the net back for heavy oil declined the least during the current quarter to \$12.25 per barrel versus \$19.72 per barrel for Q1 2008 due to lower differentials during the period. Average light crude netback was \$10.10 per barrel for Q1 2009 versus \$48.93 per barrel in the comparable quarter in 2008. For natural gas the Q1 2009 netback was \$1.81 versus \$4.98 per mcf for Q1 2008. The Company received an adjustment for prior year processing fees that increased natural gas operating costs in the current period.

General and Administrative Expenses

(\$Cdn.)	Three Months Ended March 31		
	2009	2008	% Change
Gross expenditures	1,106,116	1,441,310	(23)
Overhead recovery	(54,000)	(112,437)	(52)
Capitalized overhead	(87,900)	(57,500)	53
Net general and administrative expense	964,216	1,271,373	(24)
Net general and administrative per boe	4.60	8.10	(43)

For Q1 2009, gross general and administrative expenditures decreased 23% to total \$1,106,116 when compared to \$1,441,310 for Q1 2008. On a net basis, costs were also lower by 24% to total \$964,216 for the current quarter. On a Boe basis, the Company reduced costs for the quarter from \$8.10 per Boe in Q1 2008 to \$4.60 per Boe for Q1 2009. A portion of this reduction is attributed to the disposition of the Company's interest in Egypt. In Q1 2008, the Company paid \$136,282 of general and administrative expenses related to this operation. General and administrative expenses in Q1 2008 also included a severance paid to a former employee. In 2009, the Company incurred one-time costs related to its accounting system conversion and additional costs for the integration of GEOCAN. The Company as a result of its move into the larger GEOCAN office space paid and may continue to pay higher costs associated with its office rent but has undertaken a detailed strict and rigid review of all general and administrative expenses with the expectation that general and administrative costs will be lower in future quarters.

Overhead recovery decreased in the current quarter to \$54,000 from \$112,437 in Q1 2008. This reduction is directly related to the Company's level of reinvestment activity. Although the Company participated in the drilling of two wells in North Dakota, it did not operate either well.

The Company capitalizes overhead directly related to exploration and development activities. For Q1 2009, the Company's capitalized overhead, excluding stock based compensation, was \$87,900 versus \$57,500 in Q1 2008. This increase is attributed to additional geological staff added in mid 2008.

Finance Charges

(\$Cdn.)	Three Months Ended March 31		
	2009	2008	% Change
Bank line interest	226,849	142,751	59
Per boe	1.08	0.91	19

Finance charges include interest and fees paid on the Company's Credit Facility, interest paid on the Company's unspent flow-through share obligation and other interest charges. Total financing charges increased 59% to

\$226,849 for Q1 2009 (\$142,751 for Q1 2008) primarily as a result of the higher average balance outstanding offset by an refund of interest paid on prior years flow-through share obligations.

Interest is paid on the Company's revolving demand loan at rates ranging from prime plus 0.10% to prime plus 1.00% on prime based loans, from the base rate plus 1.35% to 2.25% on guaranteed notes and from the Libor base rate plus 1.35% to 2.25% on Libor based loans. The interest rate is set based on the net debt to trailing funds flow (funds flow for the last quarter annualized) ratio.

During Q1 2009, bank borrowings were based on a rate of prime plus 0.25% for prime based loans and on a rate for guaranteed notes of the guaranteed note base rate plus 1.50%. Average borrowing under the facility for the current quarter was approximately \$40.5 million versus approximately \$44.1 million during the fourth quarter of 2008 and \$10.8 million for the comparative quarter. The GEOCAN acquisition accounted for the increase in the Facility quarter over quarter.

Interest on Convertible Debentures

(\$Cdn.)	Three Months Ended March 31		
	2009	2008	% Change
Interest on debentures	34,323	69,409	(51)
Per boe	0.16	0.44	(63)

The Company paid interest semi-annually on June 30 and December 31 at 8% per annum on the \$3,480,000 of convertible debentures acquired in a prior acquisition.

For the quarter ended March 31, 2009, the Company paid \$34,323 (\$69,409 – Q1 2008) of interest on the debentures and recorded \$16,911 of accretion expense (\$25,631 – Q1 2008) relating to the amortization of the discount on the debentures.

The debentures were redeemed on February 15, 2009.

Depletion Depreciation and Accretion

(\$Cdn.)	Three Months Ended March 31		
	2009	2008	% Change
Depletion, depreciation and accretion	6,583,248	3,466,048	90
Per boe	31.40	22.08	42

Depletion, depreciation and accretion for the current quarter totaled \$6,583,248 an increase of 90% from \$3,466,048 for Q1 2008. This increase results from a 35% increase in production in 2009 over 2008 and from a higher rate per Boe due to the GEOCAN acquisition in October 2008. On a Boe basis the rate increased 42% in Q1 2009 to \$31.40 per Boe versus \$22.08 per Boe for Q1 2008. The increase per Boe results primarily from higher industry finding and development costs over the period and from the acquisition of GEOCAN. Based on the purchase price allocation of approximately \$59.9 million to property plant and equipment and proved reserves of 1.7 million Boe, the depletion and depreciation rate for the GEOCAN purchase is \$35.24 per Boe. The Company expects to convert some of the GEOCAN probable reserves to proven once prices recover and drilling restarts.

Stock-based Compensation Expense

(\$Cdn.)	Three Months Ended March 31		
	2009	2008	% Change
Stock-based Compensation expense	264,925	109,926	141

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.

In 2009, the Company granted 1,688,000 options at a weighted average price of \$0.205 per share to directors, officers and employees. These options vest annually over three years.

Stock-based compensation expense for the quarter ended March 31, 2009 totaled \$264,925 versus \$109,926 for the comparable quarter in 2008. The increase in the 2009 comparative quarter, results from the timing and valuation of options issued in 2008 and in Q1 of 2009.

During the first quarter of 2009 the Company capitalized to property plant and equipment \$79,366 of stock based compensation representing stock based compensation relating to exploration overhead capitalized.

Income Taxes

The Company recorded a reduction in future income taxes of \$2,215,108 in Q1 2009. Low average commodity prices in the quarter were primarily responsible for the loss before income taxes and the resultant reduction of future income taxes.

At March 31, 2009, \$248,396 relating to the current portion of the unrealized risk management contract and foreign exchange has been recorded as a current future income tax liability and \$11,407,878, has been recorded as non-current future income taxes.

Arsenal does not expect to pay current tax in Canada during 2009 based on existing tax pools available to offset realized commodity contract gains, planned expenditures and current commodity prices. It may however be taxable in 2009 should commodity prices improve significantly over Q1 2009 averages.

In the US, due to the realization of a significant gain on the monetizing of a commodity contract and due to increasing production, the Company may be taxable in 2009. Efforts are underway to minimize the tax impact on the Company's operations.

Funds from Operations and Net Loss

(\$Cdn.)	Three Months Ended March 31		
	2009	2008	Change
Cash provided by operating activities	6,977,985	1,108,715	529
Funds from operations	10,315,270	3,798,146	172
Per share - basic	0.10	0.04	139
- diluted	0.10	0.04	139
Net loss	(3,071,711)	(488,026)	529
Per share - basic	(0.03)	(0.01)	454
- diluted	(0.03)	(0.01)	454

Q1 2009 funds from operations totaled \$10,315,270 (\$0.10 per share basic and diluted) up 172% from Q1 2008. This increase is attributable to \$9,085,144 received in Q1 2009 on settlement of risk management contracts. The effect of the 35% production increase was more than offset by the 47% decrease in average commodity prices received.

Net loss for Q1 2009 increased to \$3,071,711 (\$0.03 per share basic and diluted) from a loss of \$488,026 (\$0.01 per share basic and diluted) in Q1 2008 due to lower average commodity prices in Q1 2009 and higher per unit depletion and depreciation charges.

OUTLOOK

In October 2008, Arsenal acquired all of the outstanding common shares of GEOCAN for \$30.0 million cash, and the issuance of 10,623,498 Arsenal shares. In addition, the Company assumed GEOCAN's bank debt of \$11.0 million, \$2.5 million in working capital deficiency and paid \$0.5 million to cancel GEOCAN's mark to market position on its crude oil hedge. In connection with this transaction, the Company's credit facility was increased from \$17.25 million to \$55.0 million. The Company exited 2008 with debt of \$48.5 million and with unrealized mark to market risk management contracts worth \$9.0 million.

At March 31, 2009, Arsenal had total bank debt and working capital deficiency of \$40.1 million on a \$55.0 million facility. The amount of the facility is subject to a borrowing base test performed on a periodic basis by the lender, based primarily on reserves and using commodity prices estimated by the lender, as well as other factors. The Company's facility was determined at the peak of the 2008 commodity cycle and as a result of commodity price declines since mid-2008, the Company expects and is planning for a significant reduction to the facility. The next such review is scheduled to be completed no later than May 31, 2009.

In response to the decline in commodity prices and the expected reduction in the Company's facility, the Company has cut capital expenditures to those deemed "essential" to preserve the Company's future potential and value, shut-in wells that are uneconomic and, deferred remedial operations required to bring production back on-stream where the payout is longer than one year. In addition Management has further reviewed and reduced both operating and general and administrative expenses, and has sold and is continuing to review for sale non-core properties. In the first quarter of 2009, the Company monetized its risk management contracts with proceeds from the property sales and from the realized commodity contracts used to reduce debt.

Arsenal is an oil levered Company with oil production representing approximately 75% of total production. In an environment of high oil prices, the Company will generate solid revenues and cash flow and will, in addition to reducing debt, be able to undertake a reasonable growth oriented capital expenditure program. In an environment of low oil prices, revenues and cash flows are reduced resulting in a high proportion of cash flow being dedicated to debt reduction. Capital expenditures under this scenario are limited to preserving our interest in our asset base.

The acquisition of GEOCAN and the low commodity price environment in Q4 2008 and in Q1 2009 has required Arsenal to review and examine its combined asset base and has resulted in the categorization of properties into core and non-core properties. The Company is undertaking to divest itself of non-core properties. Since the GEOCAN acquisition in October 2008, the Company has been successful in its disposition of some of these non-core properties and expects to continue to rationalize its asset base into mid-2009. The properties Arsenal expects to retain after this process are generally longer reserve life properties, properties with lower operating costs, properties requiring less day-to-day maintenance and administration and properties with significant upside potential. Until higher oil prices are sustainable, the Company will be dedicating any future capital expenditures primarily to participation in its Bakken play at Stanley, North Dakota. Arsenal's immediate objective is to weather the current downturn and defer other projects until economic conditions improve. We are not prepared to deplete our current inventory of projects and reserves at average Q1 2009 commodity prices. We intend to dedicate cash flow to only high quality projects and to reduce debt.

Funds flow for 2009 (including realized hedging gains) is expected to be between approximately \$20.0 million and \$21.0 million. This projection is based on expected 2009 average production of between approximately 2,100 Boe per day and 2,300 Boe per day using the current 2009 WTI strip price of approximately \$52.70 US per barrel and a Canadian US exchange rate of \$0.83. Arsenal's expected 2009 mix of oil (76%) and natural gas (24%) is expected to generate revenue of approximately \$49.50 per Boe before any adjustments to revenue for hedging activities.

Capital expenditures for 2009 are expected to total between \$10.0 million and \$11.0 million and will depend on commodity prices, the number of wells to be drilled in North Dakota and on drilling in to take advantage of the "three point incentive program". In addition, the Company expects to sell additional non-core properties and realize additional operational efficiencies. As a result, debt is expected to be reduced from the current level of \$40.1 million to between \$31.0 and \$33.0 million at 2009 year end.

While commodity prices have gone through a major correction in the past few months, the impact of the recently announced Alberta royalty incentives is expected to be favourable in some circumstances. With this incentive, and based on current prices for crude oil the Company has projects attractive enough to meet our economic threshold. Arsenal's management believes with Arsenal's inventory of projects and drilling locations, the Company can continue to grow through its selective exploration program in this current commodity environment. The additional production volumes from GEOCAN and from wells being brought on-stream in Q4 2008, and the realization of commodity contracts should offset to some degree the cash flow reduction from lower prices. Production in 2009 will be positively impacted by the drilling of at least two wells in North Dakota in Q1 2009, the tie-in of the Galahad wells (fall of 2009, if natural gas prices improve), the drilling of wells at Evi, Alberta, and from an extensive work over program that was completed on both Arsenal and GEOCAN properties during the current quarter. The Company is undertaking a property rationalization process, resulting in some non-core properties being sold in 2008 and in Q1 2009 and is hoping to sell additional non-core properties during 2009 in order to lower debt and to concentrate the Company's effort on core properties.

Summary of Quarterly Results

(\$Cdn.)	2009	2008				2007		
	Q1	Q4	Q3	Q2	Q1	Q4	Q3	Q2
Oil and gas revenue	7,969,913	10,724,915	15,766,815	16,678,644	11,309,151	8,827,883	7,568,644	7,702,380
Net income (loss)	(3,071,711)	6,974,803	10,028,193	(1,925,853)	(488,026)	(2,944,193)	(3,029,332)	(9,406,449)
Per share - basic	(0.03)	0.08	0.11	(0.02)	(0.01)	(0.04)	(0.04)	(0.13)
Per share - diluted	(0.03)	0.08	0.11	(0.02)	(0.01)	(0.04)	(0.04)	(0.13)
Funds from operations	10,315,270	11,316,461	8,093,159	8,083,001	3,798,146	134,648	1,000,012	1,078,581
Per share - basic	0.10	0.13	0.09	0.09	0.05	-	0.01	0.01
Per share - diluted	0.10	0.13	0.09	0.09	0.05	-	0.01	0.01
Total assets	131,477,316	143,723,628	78,546,339	72,989,632	71,113,137	65,097,402	62,288,632	63,745,799
Total debt (1)	40,124,195	48,479,097	13,384,766	14,266,267	18,709,928	20,731,800	17,468,428	13,943,031
Shares outstanding	101,249,646	101,249,646	90,786,148	90,719,815	89,181,542	83,698,042	73,917,173	73,917,173

(1) Includes convertible debentures outstanding unless paid (paid February 2009) but excludes risk management contracts and future income taxes whether current or long term.

Arsenal's quarterly results have fluctuated significantly in the past eight quarters due to the GEOCAN acquisition, production increases, some significant one-time items like tax audits being recorded and then reversed, ceiling test write-downs and recognition of impairment of properties and goodwill. More recently, commodity prices have been very volatile and have been responsible for wide swings in operating income and the Company's hedges have, more recently, resulted in significant realized and unrealized losses and then reversing, due to the reduction in commodity prices, to realized and unrealized gains. For Arsenal, quarterly results will continue to fluctuate somewhat and will depend on property dispositions, the movement in commodity prices particularly for oil and the differentials in heavy oil. Given a more stable commodity market, the Company expects that its recent acquisition coupled with improved operational efficiencies and emphasis on only core properties will lead to more comparative and stable results going forward.

Contractual Obligations

In the ordinary course of business, the Company enters into various contractual obligations, including the following:

- purchase of services
- royalty agreements
- operating agreements
- processing and treating agreements
- right-of-way and road use agreements
- lease obligations for office space
- flow-through share agreements

All such contractual obligations reflect market conditions at the time of contract and do not involve related parties.

Obligations with a fixed term are as follows:

(\$Cdn.)

	2009	2010	2011	2012	2013
Revolving demand operating loan	40,581,832	-	-	-	-
Lease of office premises	474,144	632,192	632,192	368,779	-
Flow-through share obligations	3,900,000	-	-	-	-
Total	44,955,976	632,192	632,192	368,779	-

Summary of Results by Country

Three Months Ended March 31, 2009

	Canada	United States	Corporate	Total Company
Revenue				
Petroleum and natural gas	6,348,461	1,621,452	-	7,969,913
Gain (loss) on financial commodity contracts	489,884	(194,697)	-	295,187
	6,838,345	1,426,756	-	8,265,100
Royalties	(1,302,049)	(497,349)	-	(1,799,398)
	5,536,296	929,407	-	6,465,702
Other income	160	660	-	820
	5,536,456	930,067	-	6,466,522
Expenses				
Operating	3,015,576	639,988	-	3,655,563
Transportation	211,374	-	-	211,374
General and administrative	739,346	224,871	-	964,216
Finance charges	176,849	50,000	-	226,849
Convertible debenture interest	34,323	-	-	34,323
Foreign exchange loss (gain)	(251,179)	47,110	-	(204,069)
Convertible debenture accretion	16,911	-	-	16,911
Depletion, depreciation, and accretion	6,161,268	421,980	-	6,583,248
Stock-based compensation	264,925	-	-	264,925
	10,369,393	1,383,948	-	11,753,341
Loss before income taxes	(4,832,937)	(453,881)	-	(5,286,819)
Income taxes				
Future income tax reduction	-	-	(2,215,108)	(2,215,108)
Net loss	(4,832,937)	(453,881)	2,215,108	(3,071,711)

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 maintaining existing shareholders and in attracting new investors. The Company is committed to establishing and maintaining 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. Arsenal's convertible debentures were redeemed in February 2009 funded by an increase in bank debt. 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 funds flow ratio and its debt to equity ratios. Debt includes bank debt, plus or minus working capital. Annualized funds flow is calculated as cash flow from operations before changes in non-cash working capital and asset retirement expenditures from the Company's most recent quarter multiplied by four adjusted, if required by increasing or decreasing commodity price expectations. The Company's strategy is to maintain this ratio at 1 : 1. This ratio may increase or decrease somewhat depending on the timing and nature of the Company's activities and commodity prices. During periods of extreme commodity price declines, high drilling activity or after large property or corporate acquisitions, it is expected that the ratio would increase and during periods of high commodity prices and low activity levels, the ratio would decrease. The Company's focus in these instances is to concentrate on bringing the ratio back into line. The Company prepares an annual operating and capital expenditure budget. The budget is updated when critical factors change and actual results are realized. Critical 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, 2009, the Company's debt (excluding the Company's risk management contracts and current future income taxes whether assets or liabilities) to funds flow (Q1 2009 annualized) was 0.97 : 1 and its debt to equity ratio was 0.70 : 1, both within established guidelines. The debt to forward cash flow ratio at June 30, 2009 is not expected to be within the ratio of 1 : 1 as established in the management strategy guidelines. Based on the significant and continuing deterioration of commodity prices, the impact of these declines on future cash flows and the potential reduction in the Company's lending base, the Company expects to have a reduction in the current credit facility. Plans, including the Q1 2009 monetization of the commodity contracts, the sale of non-core properties, additional hedging and the deferral of exploration are currently being developed to deal with this issue.

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

the working capital ratio (as defined in the agreement to include the unutilized portion of the facility) to fall to below 1 : 1.

At March 31, 2009, the Company is in compliance with this covenant.

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, 2009, the Company had a demand operating loan facility in the amount of \$55.0 million. Debt under the facility, includes bank debt and working capital but excludes the risk management contracts and future income tax (whether assets or liabilities) amounted to \$40.1 million at March 31, 2009. Included in debt under the facility are U.S. \$10,000,000 (CAD - \$12,613,000) Libor based loans at interest rates based on Libor plus 1.5%.

The facility can be utilized in either Canadian or US dollars. Interest is paid on the Company's revolving demand loan at a rates ranging from Canadian or US prime plus 0.10% to 1.00% on prime based loans, from the base rate plus 1.35% to 2.25% on guaranteed notes and from the Libor base rate plus 1.35% to 2.25% on Libor based loans. The interest rate is set based on the net debt to trailing funds flow (funds flow for the last quarter annualized) ratio.

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, a continuing guarantee from the Company's US subsidiary in the form of a Mortgage Security Agreement and Letter of Undertaking limited to \$13,000,000.

The Company is in compliance with its bank covenants at March 31, 2009.

With the decline in petroleum and natural gas prices since the Company's last evaluation, it is expected that the lending value of the Company's reserves will decline and that the operating loan facility will be reduced. The review of the facility is to be completed no later than May 31, 2009. During Q4 2008 and Q1 2009, the Company crystallized the oil and natural gas commodity contracts put in-place during 2008. The Company currently has three commodity contracts; a contract to sell 1,000 GJ per day of for the period January 1, 2010 to December 31, 2010 at \$6.78 per GJ, a contract to sell 100 barrels of oil per day for the period May 1, 2009 to April 30, 2010 at \$72.60 Canadian per barrel, and a contract to sell 100 barrels of oil per day for the period May 1, 2010 to April 30, 2011 at \$79.50 Canadian per barrel. Additional commodity contracts may be put in-place, depending on changes in commodity prices and the determination of the Company's revised credit facility.

Convertible Debenture

The Company, as part of the Tiverton acquisition in 2006, assumed \$3,480,000 face value of convertible debentures. The convertible debentures were 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, represented the holder's conversion right and was included in Shareholders' Equity. The remaining balance being \$3,110,000 was classified as debt and accreted over the remaining period to maturity.

Interest on the debentures at 8% was paid semi-annually on June 30th and December 31st of each year. The debentures matured on February 15, 2009. The Company redeemed the convertible debentures on February 15, 2009 from funds available on its line of credit and transferred the component originally allocated to equity to contributed surplus \$370,000.

Liquidity

The sudden and severe decline in commodity prices in Q4 2008 and Q1 2009 and the limited access to equity markets have affected management's approach and operating strategy. As noted, it is expected that the Company's Demand Operating Loan Facility will be reduced as future cash from operations is reduced due to lower prices than when the line was negotiated. At current commodity prices, the Company will generate excess funds from operations. These excess funds will, depending on various factors, be allocated to debt reduction and essential capital programs.

The Company believes it will have the financial resources necessary to both reduce debt to an acceptable level and to complete its 2009 proposed capital program. In the event that commodity prices, interest or exchange rates, or other factors negatively impact funds flow from operations, the Company would plan to reduce the proposed 2009 capital program so that the Company's debt stays within its expected credit facility.

In order to ensure that funds were available for its 2009 capital program, the Company has in-place certain commodity hedges.

Share Capital

At March 31, 2009 and as of the date of this MD&A, the Company has 101,249,646 common shares and 9,049,000 options outstanding. In January 2009, the Company issued 1,688,000 options at \$0.205 to directors, officers and employees. No shares or options have been issued since March 31, 2009.

Common shares	Three Months Ended March 31		Year Ended December 31	
	Shares	Amount (\$)	Shares	Amount (\$)
Balance - beginning of year	101,249,646	93,515,925	83,698,042	81,676,603
Issued to acquire Geocan	-	-	10,623,498	8,445,681
Issued on exercise of options	-	-	283,251	90,217
Allocated from contributed surplus	-	-	-	60,490
Private placement of common shares	-	-	1,249,300	787,059
Private placement of flow-through shares	-	-	5,555,555	4,000,000
Tax effect of flow-through shares	-	(1,040,000)	-	(1,356,625)
Share issue costs	-	-	-	(392,062)
Tax effect of share issue costs	-	-	-	127,425
Forgiveness of loan	-	-	-	225,000
Normal course issuer bid	-	-	(160,000)	147,863
Balance - end of year	101,249,646	92,475,925	101,249,646	93,515,925

In October 2008, the Company announced approval to purchase up to 4,539,307 of its common shares by way of a normal course issuer bid (NCIB) through the facilities of the Toronto Stock Exchange. The 4,539,307 shares represent approximately 4.5% of the 101,249,646 currently issued and outstanding common shares of the Corporation. In accordance with the rules of the Toronto Stock Exchange ("TSX") the daily repurchase limit under the NCIB is 40,463 shares. In November 2008, the TSX increased that daily limit to 80,926 until March 31, 2009. The purchases may commence on October 16, 2008 and will terminate on October 15, 2009, or on such earlier date as the Corporation may complete its purchases pursuant to a notice of intention to be filed with the Toronto Stock Exchange or provide notice of termination. Purchases will be made by Arsenal in accordance with applicable regulatory requirements and the price which Arsenal will pay for any such common shares will be the market price of such shares at the time of acquisition. To March 31, 2009, the Company had purchased and cancelled 160,000 at an average price of \$0.195 per share in 2008.

In March 2009, the board of directors adopted a shareholder rights plan which is designed to ensure fair treatment of the Company's shareholders by providing shareholders more time than is afforded under existing Canadian legislation to properly evaluate any unsolicited takeover bid and to seek possible alternatives to maximize value for all shareholders. The Company is not aware of any pending or contemplated takeover bids.

Related Party Transactions

An officer of the Company is a partner in a law firm that provides legal services to the Company. In Q1 2009, the Company incurred a total of \$44,407 for legal fees and disbursements.

All related party transactions occur in the normal course of operations and have been recorded at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

Capital Expenditures

(\$ Cdn.)	Three Months Ended March 31, 2009
Property dispositions	(839,375)
Land	348,298
Seismic	29,157
Drilling and completions	1,748,748
Capitalized general and administrative	87,900
Production equipment, facilities and tie-ins	360,958
Other	102,647
Total property plant and equipment additions	2,677,708
Non-cash additions	(102,647)
Capital expenditures	2,575,061

During Q1 2009, the Company participated in the drilling of 2 gross (0.33 net) wells. The wells were both drilled in North Dakota and were still drilling at quarter end.

Capital expenditures for Q1 2009 totaled \$2,575,061 lower than in previous 2008 quarters as the Company reduced its spending in response to lower commodity prices and restricted capital and credit availability. Of the total expended in Q1 2009, \$1,031,471 was incurred for the drilling of the North Dakota wells. During the quarter, the Company spent funds recompleting wells in BC.

Commitments and Contingencies

Outstanding lawsuits

Various lawsuits have been filed against the Company for incidents which arose in the ordinary course of business. In the opinion of management and legal counsel, the outcome of the lawsuits, now pending, is not determinable or not material to the Company's operations. Should any loss result from the resolution of these claims, such loss will be charged to operations in the year of resolution.

Risk Management

Commodity price risk

Commodity price risk is defined as fluctuations in crude oil, natural gas, and natural gas liquid prices. The Company uses derivative instruments as part of its risk management approach to manage commodity price fluctuations and stabilize cash flows available for future development programs. The Company does not enter into derivative contracts for speculative purposes. During 2008, the Company entered into four crude oil derivative contracts and one natural gas derivative contract. These contracts were monetized during late 2008 and Q1 2009. At March 31, 2009, the Company had one natural gas derivative contract to selling 1,000 GJ of natural gas for the period January 1, 2010 to December 31, 2010 at \$6.78 per GJ. At March 31, 2009, the Company had an unrealized gain on the contract of \$255,847.

In April 2009, the Company entered into a crude oil derivative contract to sell 100 barrels of oil per day from May 1, 2009 to April 30, 2010 at \$78.60 Canadian per barrel. In May, the Company entered into a crude oil derivative contract to sell 100 barrels of oil per day from May 1, 2010 to April 30, 2011 at \$79.50 Canadian per barrel.

Production risk

Production risk relates to the Company's ability to produce, process and transport crude oil and natural gas. To manage this risk to an acceptable level, the Company performs regular and proactive maintenance on its wells, facilities and pipelines. The Company operates approximately 80% of its production, which affords greater control over operations.

Natural Decline and Reserve Replacement Risk

Natural decline risk relates to the Company's ability to replace reserves in excess of annual production declines through development activities such as drilling, well completions, well workovers and other capital activities. The Company manages its business using a portfolio approach whereby capital is allocated across a number of areas so that significant capital is not risked on any one activity. Capital is spent only after strict economic criteria for production and reserve additions are assessed.

The Company's reserves are evaluated on an annual basis by independent third-party consultants reporting to the Company's Reserves Committee of the Board of Directors. The Company's approach is to invest in mature, long-life properties with a high proved producing component combined with low-risk development opportunities where the reserve risk is generally lower and cash flows are more stable and predictable. The Company will engage in wildcat exploration activities only after considerable due diligence has been completed on the play, including geological, geophysical and total capital required.

Environmental Health and Safety Risk

Environment, health and safety risks relate primarily to field operations associated with oil and gas assets. To mitigate this risk, a preventative environmental, health and safety program is in place as well as operational loss insurance coverage. Arsenal employees and contractors adhere to the Company's environment, health and safety program, which is routinely reviewed and updated to ensure that the Company operates in a manner consistent with best practices in the industry. The Board of Directors is actively involved in the risk assessment and risk mitigation process.

Regulation, Tax and Royalty Risk

Regulation, tax and royalty risk relates to changing government royalty regulations, income tax laws and incentive programs impacting the Company's financial and operating results. Management, with the assistance of legal and accounting professionals, stay informed of proposed changes in laws and regulations and proactively respond to and plan for the effects of these changes.

Capital Market Risk

The Company's ability to maintain its financial strength and liquidity is dependent upon its ability to access Canadian capital markets. If Canadian debt or equity markets were to become less accessible to the Company, it may affect the ability of Arsenal to continue to replace production.

Change in Accounting Policies

Accounting Changes

Goodwill and intangible assets

New standards for Goodwill and Intangible Assets effective for fiscal years beginning on or after October 1, 2008, provide guidance on the recognition, measurement, presentation and disclosure for goodwill and intangible assets, other than the initial recognition of goodwill or intangible assets acquired in a business combination. Retroactive application to prior-period financial statements will be required. The Company is still assessing the impact of this new standard on its financial statements. The adoption of this standard has had no impact on the Company's Consolidated Financial Statements.

Future Accounting Changes

Business combinations

New standards for Business Combinations, and related standards for non-controlling interests and consolidated financial statements are effective January 1, 2011 and apply prospectively to business combinations for which the acquisition date is on or after the first annual reporting period beginning on or after January 1, 2011 for the Company. Early adoption is permitted. These standards harmonize the Canadian standards with IFRS.

International Financial Reporting Standards ("IFRS")

In February 2008, the CICA Accounting Standards Board ("AcSB") confirmed the changeover to IFRS from Canadian GAAP will be required for publicly accountable enterprises interim and annual financial statements effective for fiscal years beginning on or after January 1, 2011. The AcSB issued the "omnibus" exposure draft of IFRS with comments due by July 31, 2008, wherein early adoption by Canadian entities is also permitted. The Canadian Securities Administrators ("CSA") has also issued Concept Paper 52-402, which requested feedback on the early adoption of IFRS as well as the continued use of US GAAP by domestic issuers. The eventual changeover to IFRS represents a change due to new accounting standards. The transition from current Canadian GAAP to IFRS is a significant undertaking that may materially affect the Company's reported financial position and results of operations.

The International Accounting Standards Board ("IASB") issued an exposure draft relating to certain amendments and exemptions to IFRS 1 in order to make it more useful to Canadian entities adopting IFRS for the first time. One such exemption relating to full cost oil and gas accounting is expected to reduce the administrative burden in the transition from the current Canadian Accounting Guideline 16 to IFRS. It is anticipated that this exposure draft will not result in an amended IFRS 1 standard until late 2009. The amendment will potentially permit the Company to apply IFRS prospectively to their full cost pool, rather than the retrospective assessment of capitalized exploration and development expenses, with the proviso that a ceiling test, under IFRS standards, be conducted at the transition date.

Although the Company has not completed development of its IFRS changeover plan, when finalized it will include project structure and governance, resourcing and training, an analysis of key GAAP differences and a phased plan to assess accounting policies under IFRS as well as potential IFRS 1 exemptions. The Company anticipates completing its project scoping, which will include a timetable for assessing the impact on data systems, internal controls over financial reporting, and business activities, such as financing and compensation arrangements, during 2009.