

# **CONTACT EXPLORATION INC.**

## **SECOND QUARTER SHAREHOLDERS' REPORT AS AT SEPTEMBER 30, 2007**

### **MANAGEMENT'S DISCUSSION AND ANALYSIS**

The following discussion and analysis is a review of operations, current financial position and outlook for the Company and should be read in conjunction with the unaudited quarterly financial statements for the three months ended September 30, 2007, the audited financial statements for the year ended March 31, 2007 and management's discussion and analysis for the quarter ended June 30, 2007.

Statements in this document may contain forward-looking information. Estimates provided for fiscal 2008 and beyond are based on assumptions of future events and actual results could vary significantly from these estimates. The reader is cautioned that assumptions used in the preparation of such information may prove to be incorrect. Events or circumstances may cause actual results to differ materially from those predicted as a result of numerous known and unknown risks, uncertainties, and other factors, many of which are beyond the control of the company. The reader is cautioned not to place undue reliance on this forward-looking information.

The terms "cash flow" and "cash flow from operations" in this discussion should not be considered an alternative to cash flow from operating activities as determined in accordance with Canadian generally accepted accounting principles ("GAAP"). The Company presents cash flow and cash flow per share, which are calculated in the same manner as earnings per share, and are non-GAAP measures. The statements of cash flow in the unaudited financial statements present the reconciliation between earnings and cash flow. All figures related to hydrocarbon reserves, production, pricing or similar matters are calculated by converting natural gas to the oil-equivalent amount at a rate of 6,000 cubic feet (6 mcf) to 1 barrel of oil equivalent (boe).

### ***ABBREVIATIONS***

bbl	barrels of oil
boe	barrels of oil equivalent
BCF	billion cubic feet
mcf/d	thousand cubic feet per day
Boe/d	barrels of oil equivalent per day
NGLs	natural gas liquids
CBM	coalbed methane
GORR	gross overriding royalty

### **OPERATIONS UPDATE**

Contact Exploration Inc. ("Contact" or the "Company") is a junior oil and gas company that is listed as "CEX" on the TSX Venture Exchange on the Frankfurt Stock Exchange as Symbol: C9N or via ISIN: CA2109111039.

## **COMPANY STRATEGY**

Contact's primary focus has been producing from and exploring for oil and gas reservoirs onshore in Atlantic Canada. Going forward the corporate focus is shifting to include a balanced portfolio of exploration, exploitation or production of known reserves, and evaluation of new opportunities both within our core area and elsewhere. Over the last four years Contact has acquired and currently holds over 1 million acres in this region through a combination of farm-ins and land sales. Our working interests vary from 30% to 100% and on average we have a 75% working interest and operate the majority of the exploration and production blocks. Contact's strategy in the region has been to acquire the land and add value through front-end exploration with our experienced exploration team. On some plays this may include reviewing all past exploration information, coming up with a new exploration model and a concise approach to move the prospect forward. When Contact gets to the "drill ready" stage we usually bring in partners to finance portions of the drilling while maintaining its status as operator of the play. With growth in production volumes and booked reserves, we are moving to utilize our production expertise in underexploited reservoirs and acquire new prospects in which to utilize these skills.

In the past, Contact has been successful in bringing in partners to shoot approximately 200 kilometres of two-dimensional seismic and drill a number of exploratory wells, most recently the Shenstone G75-2328 well in South Stoney Creek, New Brunswick. This work has brought us to a very advanced stage in the exploration for and production of oil and gas in this region and we continue to pursue partnerships to advance our exploration projects.

Currently Contact is focusing the majority of its capital on the 100% owned New Brunswick plays in and around Stoney Creek. The Stoney Creek plays have high potential impact to Contact and with production now commenced, it offers a growing component of cash flow.

## **FIRST QUARTER HIGHLIGHTS**

- Received the results of the evaluation of the Stoney Creek oil and gas reserves by the independent firm of Martin & Brusset Associates of Calgary. As stated in the reserves report, conducted in adherence with National Instrument 51-101 of the Canadian Securities Administrators, Contact's 100% working interest Stoney Creek field is estimated to contain proved and probable reserves of 1,207,000 barrels of oil and 6.525 billion cubic feet of natural gas. These estimated reserves, when discounted at 10% using constant pricing, gave a net present value for the field of \$31,242,000 – net before taxes and royalties.
- Commenced drilling on the Shenstone G75-2328 to test the Hiram Brook, Fredericks Brook and Dawson Settlement formations.
- Completed the drilling on the Shenstone G75-2328 at a depth of 2180 metres, suspending the well for future deepening or evaluation. As a result of the data gathered during drilling, a more detailed evaluation of the regional geology and geophysics was carried out.
- Announced an optimization operation in the Stoney Creek field, where 14 applications for a field re-work program have been submitted to the New Brunswick government. The re-works are selected for potential of production from underutilized or bypassed zones.
- Commenced drilling the first well on the Windsor Block in Nova Scotia, operated by Contact's 70% working interest partner Triangle Petroleum Corporation. This well, the Kennetcook #1, is the first of two wells to be drilled on the Windsor Block.
- Completed the drilling of the Kennetcook #1 well on September 13, 2007 at a total depth of 1360 metres, with a core section of 400 metres being obtained for analysis. The zone of interest in the well was determined to be over 100 metres in thickness, with a secondary zone of 80 metres

in thickness. Core analysis, rock property determination, geochemical analysis, gas content determination and desorption properties are all being conducted on the cored interval samples and a completion, including a fracture stimulation, are being planned for the well.

- Relinquished the Bras d'Or Block (636,000 acres) and Wallace Station Block (293,000 acres) in Nova Scotia on September 15<sup>th</sup>, as was anticipated and noted in previous quarterly reports.

## **CORE PROPERTY UPDATE**

### **New Brunswick**

#### **Stoney Creek (74,568 acres)**

Contact has acquired a 100% working interest in approximately 74,568 acres of leases and licenses located 15 kilometres south of Moncton, New Brunswick, in an area known as the eastern Moncton sub basin. This area lies adjacent to and includes the Stoney Creek field (5500 acres), which produced approximately 800,000 barrels of oil and 28 bcf of gas between 1909 and 1991. Here, the Albert Formation of the late Devonian to Tournaisian Horton Group records the deposition of thick sequences of deep lake, organic rich shales and lake margin fluvio-deltaic sandstones. The former represent an excellent petroleum source rock while the latter constitute productive reservoirs. As of June 2007 the field has been put back into production, exploiting the proved and probable reserves of 1,207,000 barrels of oil and 6.525 billion cubic feet of natural gas. Also included in this acreage is the exploratory South Stoney creek acreage.

During the second quarter of the fiscal year, Contact has completed the following work at Stoney Creek:

- Continued production from the four producing wells in the field
- Optimized production operations and continued fine tuning the 24 hour operation of wells
- Applied to the New Brunswick government for work-over permits for 14 prioritized existing shut-in wells
- Shipped approximately 2850 barrels of crude oil from the Stoney Creek facility during the quarter.

During the second quarter of the fiscal year, Contact completed the following other activities in New Brunswick, primarily in South Stoney Creek:

- Completed a farm-out agreement with Shoal Point Energy Limited for the exploration drilling of South Stoney Creek.
- Drilled the Shenstone G75-2328 exploration well to a depth of 2,180 metres, along with 40% working interest partner Shoal Point Energy Limited

## **Nova Scotia Blocks**

### **Windsor Block (515,000 acres)**

This 515,000 acre block covers the Kennetcook Basin, onshore Maritimes Basin, Nova Scotia. Two main play types are recognized, and the block has been subdivided into an East and West Block. On the East Block, shallow Horton potential has been identified by previous drilling and seismic programs. The Noel #1 well, drilled in 1975, encountered gas shows in the Cheverie and Horton Bluffs Formations of the Horton Group, at depths between 350m and roughly 1,000m. No hydrocarbons were produced but good permeability and porosity were indicated from testing and logging. Other old wells and more recent stratigraphic tests by Northstar Energy have also encountered gas in the Horton section, but a lack of complete logging and testing has precluded the identification and characterization of the reservoir zones.

In the East Block, Devon Energy has assigned its remaining interest to Contact in exchange for a 3% GORR, leaving Contact with a 100% working interest.

In the recent cycle of exploration (1999-2002) two new seismic datasets have been acquired over this area. Northstar Energy shot a grid in 2000 which was a vast improvement over older data. Contact acquired 40 km of 2-D seismic in 2002 to firm up drilling targets.

Through a farmout agreement with Oiltec Resources Ltd., a well was drilled in the third quarter of fiscal 2004 in the West Block. The well was terminated at 496 m after encountering salt at the top of the seismically-defined target interval, and did not penetrate into the underlying Windsor reef target. Contact was carried for a 10% working interest and earned an additional 5.5% by paying 9% of the drilling and abandonment costs of the well. Interests earned by Contact and Oiltec pertained in the West Block (322,540 acres) to the depth drilled. Contact continues to believe that highly prospective reef targets exist here and plans to continue exploration with the acquisition of 3D seismic data, and the deepening of the 2003 well to test the undrilled reef target. Prior to the end of the third quarter, Contact acquired Oiltec's remaining interest in the Windsor block bringing our working interest to 100%.

As announced on June 11th, 2007, Contact entered into a farmout agreement with Triangle Petroleum Corporation (Elmworth Energy) to explore for shale gas on Contact's Windsor exploration block. This is a follow-up to an extensive study that Triangle performed last year which identified a large potential shale gas resource. As part of the agreement, Triangle has begun to test for shale gas potential by drilling the Kennetcook #1 to a depth of 1360 metres, and subsequent to fiscal quarter end by drilling the Kennetcook #2. Contact is carried through the drilling, completion and testing of the Kennetcook #1. Contact will retain an after-earned 30% working interest.

### **Cumberland Coal Bed Methane (178,000 acres)**

This 178,000 acre block, in north-western Nova Scotia, was jointly acquired with Amvest Nova Scotia, Inc., with each company owning 50% of the rights to explore for coal gas. Previous exploratory work on these lands by Amvest included the drilling of two stratigraphic test wells. The prospect lies at depths of 600 metres to 2,200 metres within coal-bearing intervals of the Springhill Mines and Joggins Formations of the Westphalian-aged Cumberland Group. The coals are ranked as high-volatile A to medium-volatile bituminous, and occur in the northeast to southwest-trending Athol syncline, which affects Carboniferous rocks in the area.

In 2004, Contact signed an option agreement with Stealth Ventures Ltd. whereby Stealth would have to elect, prior to March 31, 2005, to drill a horizontal well to earn 50% of Contact's interest in the block.

This option was exercised and Stealth has committed to spend \$1.6 million to drill a well on the block by December 31, 2005. Furthermore, Stealth has signed an agreement with Amvest to take over Amvest's 50% interest in the block.

The operator drilled one horizontal well on this property by March 2006. The well successfully drilled a 430 metre horizontal leg within the #6 coal seam. Sproule and Associates Limited of Calgary Alberta completed a report recognizing 1.183 tcf of discovered CBM resource on the Cumberland Exploration Permit. Accordingly, Contact's net working interest share of the Cumberland property resource would be 295 BCF. This well was completed during the quarter and placed on production test.

Two additional wells have been drilled on this property. The first well, referred to as Coalmine Brook #12 drilled a 738 metre horizontal coal section in the #2 seam. The next well, referred to as Coalmine Brook #13 drilled a 1000 metre horizontal coal section in the #3 seam. We now have three horizontal wells drilled in three different coal seams.

Before December 31, 2006 all three wells were placed on production test for evaluation. There is no assurance that commercial production of these wells will occur with present technology and further completion work may be required.

At the end of 2006, Contact elected to convert its working interest into a royalty interest and receive a cash payout and assumption of debt totalling approximately \$750,000. This decision was made because Contact felt that commercial production was not going to be realized in the foreseeable future.

The operator has indicated its plans to fracture stimulate one of the wells in the next quarter to determine if commercial production can be obtained.

Contact has a 1.5% non-convertible overriding royalty on this property.

### **Bras d'Or Block (636,000 acres) and Wallace Station Block (293,000 acres)**

As anticipated and noted in previously quarterly reports, Contact has given notification to the Nova Scotia government that it has elected not to continue holding this acreage, as of September 15, 2007

### **Newfoundland**

#### **Parsons Pond Block (32,290 acres) and Portland Creek Block (38,040 acres)**

These blocks are located in the mid-Ordovician dolomite play on the Great Northern Peninsula of western Newfoundland and are held 50% and 80% respectively by Contact. They also lie in the productive "inversion fairway", equivalent to the northern landfall of the Appalachian fold-and-thrust belt, which is an important producing area in the southern Appalachians. The area contains four important play types: (1) structural traps within dolomitized platform carbonates of the St. George Group, which have produced oil at rates greater than 2,000 bopd on the nearby Port au Port Peninsula, (2) stratigraphic traps associated with hydrothermal dolomitization along sub-vertical fault trends ("Trenton-Black River" type), (3) dolomitized deep-water carbonates (breccias and calcarenites) which stratigraphically overlie the platform, and (4) massive, deep water sandstones, which are generally low in inherent porosity and permeability, but which are highly fractured.

In general, reservoirs are widely interposed with deep-water, marine source rocks, creating favourable source-reservoir-trap scenarios. Over the last century, shallow production of light, low-sulphur oil

occurred near seeps around the shores of ponds in the area. Approximately 300 km of good quality seismic data collected in the 1990's has enabled the identification of drilling targets in the various play types. Contact holds two of the three large blocks currently under license in this area.

In the winter of 2004, Contact operated a continuous-core well (Parsons Pond #1) to test one of the seismically-defined shallow dolomitized breccia targets (type 3) above. The reservoir target was not found beneath a section of massive sandstones and tight, deep-water carbonates within the Humber Arm Allochthon. The borehole encountered numerous hydrocarbon shows in natural fractures. The core is presently undergoing evaluation prior to a decision on testing the prospective intervals. The discovery of hydrocarbons in the fractures in general points to a potentially large fractured reservoir play in the area which will require further mapping and evaluation.

Velocity information gathered from the core will enable more accurate depth mapping of the mid-Ordovician platform prospects over both the Parsons Pond and Portland Creek blocks. Contact and partners plan to acquire further 2D and possibly 3D seismic data in the area, which will enable better definition of platform targets in particular. Exploration in the next year may also include the planning of a platform test, and mapping and characterization of the fractured allochthon play. Pooling of lands with a block between the two Contact blocks is also being considered. Contact is currently in discussion with a third party to option our interest in these blocks so that two exploratory wells may be drilled on the combined blocks in the future.

#### **Highlands Block (88,900 acres)**

This 88,900 acre (35,560 ha) block lies within the Carboniferous Bay St. George Sub-basin, part of the large Maritimes Basin of eastern Canada and is held 100% by Contact. The block is in the early stages of exploration and has undergone no seismic or drilling. It contains the Lower Carboniferous Windsor bioherm (reef) play, which is currently being explored by Contact and partners in Nova Scotia, where the Company has been successful in using seismic data to identify reef targets. As is important in Nova Scotia, reef facies outcrop on the Highlands property and display open-framework texture and high inter and intra-particle porosity, and are petroliferous. Marine source rocks are also present from the same section and are believed to be mature on the property. Contact believes the block presents multiple oil target potential. The Company has designed a 40 km 2D seismic program and it is seeking partners to participate in the acquisition of this data. If no partners are found this block will expire in February 2008.

#### ***RESERVES***

Contact retained an independent engineering firm to prepare a reserves report as at March 31, 2007, a summary of which is provided as follows

**REMAINING RESERVES – AS AT MARCH 31, 2007**  
*(January 1, 2007 prices and escalations)*

	Gas Mmcf	Oil Mmbl	Undisc. M \$	10% M \$
<i>(Before Income Tax)</i>				
<i>Reserves Category</i>				
<i>Proved Developed</i>				
<i>Proved</i>	0	0	0	0
<i>Non-Producing</i>	0	70	2,987	1,781
<i>Proved Undeveloped</i>	629	42	2,957	1,836
<i>Total Proved</i>	629	112	5,944	3,617
<i>Probable</i>	5,895	1,095	65,341	26,176
<i>Total Proved and Probable</i>	6,524	1,207	71,285	29,793
<i>Possible</i>	0	0	0	0
<b><i>Total</i></b>	6,524	1,207	71,285	29,793

	<b>Second Quarter Ended September 30, 2007</b>	Second Quarter Ended September 30, 2006
<b>Operating</b>		
Average Production		
Natural Gas (mcf per day)	0	0
Oil (bbl per day)	31.12	0
Average Sales Prices		
Natural Gas (\$ per mcf)	0	NA
Oil (\$ per boe)	74.43	NA
<b>Financial</b>		
Petroleum & Natural Gas sales	\$ 213,098	\$ 0
Funds Flow from operations	\$ (85,388)	\$ (99,687)
Per basic & diluted share	\$ (0.002)	\$ (0.003)
Net loss	\$ (252,522)	\$ (153,853)
Working Capital	\$ 514,605	\$ 1,396,257
Capital Expenditures	\$ 1,102,981	\$ 4,615,355
Shareholders' Equity, June 30	\$ 5,459,458	\$ 12,542,192

	<b>Second Quarter Ended September 30, 2007</b>	Second Quarter Ended September 30, 2006
Common shares outstanding (as at September 30)	<b>37,958,385</b>	33,562,300
Diluted number of shares outstanding (as at September 30)	<b>38,138,648</b>	35,353,327
Weighted average number of shares outstanding (as at September 30)	<b>37,958,385</b>	32,410,126

## Second Quarter Ended September 30, 2007 (fiscal 2008) Financial and Operating Results

### Financial Results in Detail

	<b>Second Quarter Ended September 30, 2007</b>	Second Quarter Ended September 30, 2006	%
	\$	\$	change
Combined oil & natural gas revenue	<b>213,098</b>	0	NA
Royalties (net of ARTC)	<b>16,485</b>	(5,646)	NA
Production Expenses	<b>90,307</b>	(9,623)	NA
Field Netback	<b>106,306</b>	NA	NA
Interest Income	<b>16,209</b>	30,386	(47)
General & administrative expense	<b>207,903</b>	145,342	43
Depletion & depreciation	<b>72,563</b>	1,876	NA
Loss before income tax	<b>(252,522)</b>	(116,843)	116
Income Tax (expense) recovery	<b>0</b>	(37,010)	(100)
Net Earnings (loss)	<b>(252,522)</b>	(153,853)	64
Funds flow from operations	<b>(85,388)</b>	(99,687)	(14)

### Production Summary

	<b>Second Quarter Ended September 30, 2007</b>	Second Quarter Ended September 30, 2006	%
			change
<b>Production</b>			
Oil boe/d	<b>31.12</b>	0	NA
Natural gas (mcf/d)	<b>0</b>	0	NA
Total (boe/d)	<b>31.12</b>	0	NA

	<b>Second Quarter Ended September 30, 2007</b>	Second Quarter Ended September 30, 2006	%
			change
<b>Average Sales Price</b>			
Oil (\$/boe)	<b>74.43</b>	0	N/A
Natural gas (\$/mcf)	<b>0</b>	0	N/A
Total (\$/boe)	<b>74.43</b>	0	N/A
% oil	<b>100%</b>	0	N/A

## Production

Contact's average production for the three-months ended September 30, 2007 was 31.23 boe/d. As Contact had no production for the second quarter of the prior year, comparison to the prior period is not possible.

## Oil and Natural Gas Revenues

Revenues from crude oil and natural gas sales for the quarter ended September 30, 2007 totalled \$213,098. As Contact had no production for the second quarter of the prior year, comparison to the prior period is not possible.

## Royalties

Royalty expense for the first quarter of fiscal 2008 was \$16,485; this translated to \$5.76 per boe. As Contact had no production for the second quarter of the prior year, comparison to the prior period is not possible. Note, the royalty expense in the comparative period is negative due to an over accrual from the previous quarter. The royalties translated to 7.7% of revenue in the three months ended September 30, 2007.

## Operating Expenses and Netbacks

Operating costs per unit of production averaged \$31.54 per boe in quarter ended September 30, 2007 with no corresponding comparative for the period ended September 30, 2006 due to non-production. Total operating costs of \$90,307 (compared to \$30,907 resulted in field netback of \$106,306 or \$37.13 per boe. These production costs included approximately \$17,000 in surface rental costs for shut-in wells that are not part of our active production lease, but have been included for consistency.

## General and Administrative Expenses

In second quarter fiscal 2008 gross general and administrative costs, before capitalization, was \$78.22 per boe with no corresponding amount in the second quarter of fiscal 2007. The net cost of \$207,903 compared to \$145,342 in the second quarter of fiscal 2007, was after capitalization of \$16,050, compared to \$18,500 in the second quarter of fiscal 2007. General and administrative costs increased by \$62,561 primarily as the result of increased activity resulting in additional management overhead as well as increased costs in accounting, audit and legal fees. Contact continues to closely monitor and control these costs.

## General and Administrative Expenses

	Second Quarter Ended September 30, 2007 (\$)	Second Quarter Ended September 30, 2006 (\$)	% Change
Gross	223,953	164,842	37
Capitalized	16,050	18,500	(13)
Net	207,903	145,342	43
Per boe gross	78.22	NA	NA
Per boe net	72.62	NA	NA

## Interest Income and Expense

Net interest income was \$16,209 for the second quarter of fiscal 2008, compared to \$30,386 for the second quarter of fiscal 2007.

## Depreciation and Depletion

Depreciation and depletion is based upon capital expenditures, production rates and reserves. Contact recorded \$72,563 compared to \$1,876 in the second quarter of fiscal 2007. The current period amounts to \$25.34 per boe with no corresponding amount in the comparative period.

	Second Quarter Ended September 30, 2007 (\$)	Second Quarter Ended September 30, 2006 (\$)	% Change
Depletion & depreciation	72,563	1,876	NA

## Net Loss

Contact had a loss of \$252,522 in the second quarter of fiscal 2008, compared to a loss of \$153,853 in second quarter of fiscal 2007, or (\$0.006) per share in the second quarter of fiscal 2008 compared to (\$0.005) per share in the second quarter of fiscal 2007.

	Second Quarter Ended September 30, 2007 (\$)	Second Quarter Ended September 30, 2006 (\$)	% Change
Earnings (loss)	(252,522)	(153,853)	64
Earnings (loss) per boe	(88.20)	NA	NA
Earnings (loss) per basic & diluted share	(0.006)	(0.005)	20

## Funds Flow From Operations

Contact's funds flow from operations for the second quarter of fiscal 2008 was (\$85,388) compared to the second quarter of fiscal 2007 of (\$99,687). Funds flow for second quarter of fiscal 2008 translates to (\$0.002) per share, in comparison to (\$0.003) per share for second quarter of fiscal 2007.

	<b>Second Quarter Ended September 30, 2007 (\$)</b>	Second Quarter Ended September 30, 2006 (\$)	%
			Change
Funds Flow	(85,388)	(99,687)	14
Funds Flow per boe	(29.82)	NA	NA
Funds Flow per basic & diluted share	(0.002)	(0.003)	33

## Capital Expenditures

	<b>Second Quarter Ended September 30, 2007 (\$)</b>	Second Quarter Ended September 30, 2006 (\$)
Drilling & completions	1,038,143	4,460,354
Equipment	48,191	90,938
Capitalized G&A	16,050	12,000
Adjustments to Asset Retirement	6,486	(66,852)
Land & Seismic	22,892	58,384
Other Miscellaneous and Adjustments	511	60,531
Total capital expended	1,132,273	4,615,355

The Company drilled one well in the first quarter of of fiscal 2008 and no wells in the first quarter of fiscal 2007.

## Second Quarter, Fiscal 2008 Drilling Activity

	Exploration		Development		Total		Success	W.I.
	Gross	Net	Gross	Net	Gross	Net	Rate (%)	(%)
2007	1	0.6			1	0.6	N/A*	60

\*Well suspended

## Equity

There was no new equity issued during the three months ended September 30, 2007.

As at September 30, 2007, Contact had 37,958,385 common shares issued and outstanding.

## Stock Options/Warrants

No new stock options or warrants were granted during the three months ended September 30, 2007.

## Risk and Liquidity

Contact's business plan has been to grow through exploration for oil and natural gas. Contact's principal risks, as an exploration company, are that it must find and develop economic petroleum production

efficiently and be able to fund the associated capital expenditures. Contact relies on equity and debt financing. If any components of the business plan should be missing the company may not be able to continue executing the entire business plan.

Exploration projects are reviewed at a very early stage from all aspects including: corporate fit, environmental issues, timing, costs and reward potential. Identified risks are addressed and excessive risks are mitigated before any project is approved.

Operational risk is mitigated by addressing the continued development of a new or established reservoir, on a go-forward basis, in the same careful and calculated manner that Contact's professionals have addressed exploration risk. Reserves are produced based on the amount of capital employed, production practices and reservoir quality. Contact evaluates reservoir development based on timing and the amount of additional capital required and the expected change in production volumes.

Finding and development costs are controlled when capital is employed effectively on an economic basis.

Corporate assets are also protected through adequate corporate insurance as well as a proactive approach to all safety and environmental issues.

### **Contractual Obligations**

Contact conducts all work in Atlantic Canada on the basis of work commitments. The Company has the option to carry out the work themselves, bring in partners or relinquish the acreage. The Company has no contractual obligations other than these work commitments. Gross and net work commitments for fiscal 2008 are estimated at approximately \$458,000 and \$452,000. Gross and net work commitments for the remainder of the life on all lease obligations are estimated at approximately \$1,627,000 and \$1,528,000. Should the Company decide not to continue work commitments on any exploration block, the costs expended on the block may become impaired and any related deposit may be forfeited.

### **Off-balance Sheet Arrangements**

Contact does not have any arrangements that would be excluded from the balance sheet.

### **Related Party Transactions**

For the six months ended September 30, 2007, the Company incurred \$36,000 (2006 – \$nil) in directors fees from a director of the Company. The Company also incurred \$nil (2006 - \$36,000) in legal fees from a firm in which the same director is the principal. These fees have been included in general and administrative expenses.

For the six months ended September 30, 2007, the Company incurred \$39,000 (2006 - \$48,500) for management services from private companies of which a director of the Company is the principal shareholder. Of this amount, \$28,050 (2006 - \$18,500) has been capitalized to petroleum and natural gas properties and the remainder included in general and administrative expenses. The Company also incurred \$8,000 (2006 - \$2,000) for engineering services from private companies of which the same director is the principal shareholder. Of this amount \$8,000 (2006 - \$nil) has been capitalized to petroleum and natural gas properties and \$nil (2006 - \$2,000) included in general and administrative expenses.

For the six months ended September 30, 2007, the Company incurred \$6,000 (2006 - \$41,000) for geological services from a private company in which a director of the Company is the principal

shareholder. These fees have been included in accounts as additions to petroleum and natural gas properties.

For the six months ended September 30, 2007, the Company incurred \$36,000 (2006 - \$60,000) for land consulting services from a private company controlled by an officer of the Company. These fees have been included in the accounts as additions to petroleum and natural gas properties.

For the six months ended September 30, 2007, the Company incurred \$42,000 (2006 - \$nil) for geological consulting services from a private company in which an officer of the Company is the principal shareholder. These fees have been included in the accounts as additions to petroleum and natural gas properties. The Company also incurred \$16,000 (2006 - \$nil) for well site supervision services from a private company in which the same officer is the principal shareholder. These fees have been included in the accounts as additions to petroleum and natural gas properties.

For the six months ended September 30, 2007 the Company incurred \$24,500 (2006 - Nil) for management services from a private company in which an officer and director of the Company is the principal shareholder. These fees have been included in general and administrative expenses. The Company also incurred \$28,000 (2006 - \$nil) for equipment rental from a company in which the same director and officer has a significant interest. These fees have been included in the accounts as additions to petroleum and natural gas properties.

All of the above transactions are considered to be in the normal course of operations and have been recorded at their exchange amounts, which is the amount of consideration established and agreed to by the related parties.

## **Critical Accounting Estimates**

### *Proved Oil and Gas Reserves*

Under National Instrument 51-101 ("N.I. 51-101"), "proved" reserves are those reserves that can be estimated with a high degree of certainty to be recoverable (it is possible that the actual remaining quantities recovered will exceed the estimated proved reserves). In accordance with this definition, the level of certainty targeted by the reporting company should result in at least a 90% probability that the quantities actually recovered will equal or exceed the estimated reserves. There was no such consideration of probability under National Policy ("NP") 2B. In the case of "probable" reserves, which are obviously less certain to be recovered than proved reserves, N.I. 51-101 states that it must be equally likely that the actual remaining quantities recovered will be greater or less than the sum of the estimated proved plus probable, the reporting company must believe that there is at least a 50% probability that the quantities actually recovered will equal or exceed the sum of the estimated proved plus probable reserves. The implementation of N.I. 51-101 has resulted in a more rigorous and uniform standardization of reserve evaluation.

Proved plus probable reserves as defined in N.I. 51-101 are viewed by many industry participants as being comparable to the "established" reserves definition that was used historically. Under the previous rules, the established reserves category was generally calculated on the basis that proved plus half of probable reserves (as those terms were defined in NP 2B) represented the best estimate at the time.

The process of establishing reserves requires significant judgments and decisions based on available geological, geophysical, engineering and economic data. These estimates may change substantially as additional data from ongoing development activities and production performance becomes available and as economic conditions impacting oil and gas prices and costs change.

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

Although every reasonable effort is made to ensure that reserve estimates are accurate, reserve estimation is an inferential science. As a result, the subjective decisions, new geological or production information and a changing environment may impact these estimates. Revisions to reserve estimates can arise from changes in year-end oil and gas prices, and reservoir performance.

#### *Depletion Expense*

The Company uses the full cost method of accounting for exploration and development activities. In accordance with this method of accounting, all costs associated with exploration and development are capitalized whether or not the activities funded were successful. The aggregate of net capitalized costs and estimated future development costs, less estimated salvage values, is amortized using the unit-of-production method based on estimated proved oil and gas reserves.

An increase in estimated proved oil and gas reserves would result in a corresponding reduction in depletion expense.

A decrease in estimated future development costs would result in a corresponding reduction in depletion expense.

Certain costs related to unproved properties may be excluded from costs subject to depletion until proved reserves have been determined or their value is impaired. These properties are reviewed quarterly and any impairment is transferred to the costs being depleted.

#### *Impairment*

The company applies a ceiling test to the capitalized cost of its petroleum and natural gas properties to ensure that the net carrying value does not exceed the estimated value of future net revenues from production of gross proved reserves plus the cost of unproved properties and major development projects excluded from depletion. Net revenues are estimated using forecasted prices, less estimated costs directly associated with the development, production, and sale of reserves. Should the ceiling test result in an excess of carrying value, the Company would then measure the amount of impairment by comparing the carrying amounts of property and equipment to an amount equal to the estimated net present value of future cash flows from proved plus probable reserves, using a risk-free interest rate, and the sale of unproved properties. Any reduction in the net carrying value of petroleum and natural gas properties as a result of the ceiling test is charged to operations.

### *Provision for Asset Retirement Obligations*

The company follows the current recommendations of the Canadian Institute of Chartered Accountants on accounting for asset retirement obligations. The standard requires that the fair value of an asset retirement obligation be recognized in the period in which it is incurred if a reasonable estimate of fair value can be made. The present value of the estimated asset retirement cost is capitalized as part of the carrying amount of the long lived asset. The depreciation of the capitalized asset retirement cost will be determined on a basis consistent with depreciation, depletion and amortization of the long lived asset. With the passage of time, accretion will increase the carrying amount of the asset retirement obligation.

### *Other*

The Company is required to estimate the liability component of the convertible debentures. The Company is also required to estimate the fair market value of stock-based compensation. Both areas have been addressed in the financial statements.

### **New Accounting Standards for 2007**

Effective April 1, 2007, the Company adopted the following new accounting standards issued by the Canadian Institute of Chartered Accountants ("CICA") relating to the recognition, measurement, disclosure and presentation of financial instruments. These new standards have been adopted on a prospective basis with no restatement of prior period financial statements.

#### *(i) Comprehensive income (Section 1530)*

Comprehensive income is the change in shareholders' equity during a period from transactions and other events from non-owner sources. This standard requires certain gains and losses that would otherwise be recognized as part of net income (loss) to be presented in "other comprehensive income" until it is considered appropriate to be recognized in net income (loss). This standard also requires the presentation of accumulated other comprehensive income, and its components. Accordingly, the Company now includes comprehensive income (loss) within its consolidated statement of loss and deficit.

#### *(ii) Financial instruments – Recognition and measurement (Section 3855)*

This standard requires all financial instruments within its scope, including derivatives, to be accounted for at either fair value, or in circumstances where fair value may not be considered the most relevant, at cost or amortized cost. Changes in fair value are recognized in the statement of loss.

All financial assets and liabilities are recognized when the Company becomes a party to the underlying contract. As such, all of the Company's financial assets and liabilities were re-measured in accordance with the new standard as at April 1, 2007. The application of these standards did not result in comprehensive loss differing from net loss for the period presented or in prior periods.

### **SUSEQUENT EVENTS**

During October 2007, the Company entered an agreement to purchase 25 bbl/day of oil production in southeastern Saskatchewan from a private company for a total purchase price of \$200,000 effective October 1, 2007. The Company will operate the majority of the properties and will have an average working interest of 85%

In November, 2007, the Company issued 3,000,000 flow-through shares at \$0.40 per share and 4,000,000 units, at \$0.40 per unit, each unit comprising one common share and one purchase warrant for proceeds of \$2,800,000. Each purchase warrant entitles the holder to purchase one common share at \$0.60 expiring May 2, 2009.

## **MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL STATEMENTS**

The Preparation and presentation of the accompanying financial statements are the responsibility of the Management of the Company. The statements have been prepared in accordance with Generally Accepted Accounting Principles. The financial information elsewhere in the annual report has been reviewed to ensure consistency with that in the financial statements.

Management acknowledges responsibility for the integrity of its financial information. Where appropriate, management has made informed judgments and estimates in accounting for transactions that were not complete at the balance sheet date. Management maintains appropriate systems of internal control. Policies and procedures are designed to give reasonable assurance that transactions are properly authorized, assets are safeguarded and financial records are properly maintained.

Darcy Spady,  
President

Darold H. Parken,  
Director

C:\MyFiles\wp8\L1179\MD&A06-30-07.wpd