

**Arbour Energy Inc.**  
**Management Discussion and Analysis**  
**September 30, 2005**

**Overview**

The following Management Discussion and Analysis (“MD&A”) of the financial results of Arbour Energy Inc. should be read in conjunction with the accompanying audited financial statements and related notes for the year ended December 31, 2004.

For the purpose of reporting production information, reserves and calculating unit prices and costs, natural gas volumes have been converted to a barrel of oil equivalent (“boe”) using six thousand cubic feet (“mcf”) to one barrel of oil. A boe conversion ratio of 6:1 is based upon an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead. This conversion conforms with NI 51-101. Boes may be misleading, particularly if used in isolation.

Additional information related to the Company is available for view on SEDAR at [www.sedar.com](http://www.sedar.com), or by requesting further information from the Company’s head office in Calgary.

**Description of Business**

Arbour Energy Inc. was incorporated under the Business Corporations Act (Alberta) on April 9, 2001 to carry on exploration and development of crude oil and natural gas reserves.

**Operations and Capital Expenditures**

The Company was reorganized during the first six months of 2004 after the Company was removed from bankruptcy protection. The Company resumed normal operations after it’s proposal under the Bankruptcy Act was accepted and settlement of all debts were funded.

On May 31, 2004, the Company entered into a preliminary agreement with Crazy Hill Resources Ltd. to acquire a producing oil and gas property near Drayton Valley, Alberta comprised of six wells producing oil of 44 BOPD and gas of 60 MCFD. The agreed purchase price was \$1,000,000 consisting of \$350,000 cash and 650,000 common shares at \$1.00 per share. Closing took place on November 1, 2004.

In May, the Company also purchased a 45% working interest in a Farmout Agreement in the Meekwap area in Alberta for one oil well. The purchase price

consisted of \$67,500 in cash and 157,500 common shares. After further testing, Arbour has elected not to tie in the well.

The Company has participated in drilling a shallow gas development well in the Kirkpatrick Lake area of Alberta. The capital cost was \$55,000 for a 50% interest and is capable of producing 60 MCFD. Tie in occurred in July of 2005. A second successful well has been drilled on the same section and will be tied in early in 2006. Arbour also purchased a 50% interest in 3 additional wells in the same area effective September 1, 2004 for \$175,000 cash and 150,000 shares in the company. Production is currently 80 mcf/d net to Arbour.

In August 2004, the Company entered into a \$10,000,000 loan agreement with Merendon Mining Corporation Ltd., a private company incorporated in Alberta. Arbour has an option to purchase 5% of the issued and outstanding shares of Tarsands Recovery Ltd., an entity engaged in development of technology to enhance oil recovery from the Western Canadian Tar Sands, in exchange for the principal balance of the loan plus accrued interest, if any, as well as the issuance of 5,000,000 common shares of the Company. The term of the loan is 10 years. In the first nine months of 2005, Arbour advanced an additional \$27,673,900 to Merendon Mining.

In November, Arbour purchased a 50% interest in 2 sections of developable land in the Bow Island area in Alberta for \$40,000. The Corporation is also bidding on additional land in the area. The drilling program has been delayed until 2006 until it is determined which blocks of land are successfully acquired.

During the first quarter of 2005 Arbour acquired all of the issued shares of Canadian Oilsands Recovery Enterprises Ltd. ("COREL") for \$5,300,000 plus 5,000,000 common shares. COREL holds the master operating license relating to certain oilsands recovery technology. The original intention to build a commercial plant in the summer of 2005 has been delayed for several months. The site for the plant has been changed to a more advantageous site in Alberta and the company is presently awaiting government approvals.

In January 2005, the Company has also established a US subsidiary, Arbour Energy USA, Inc. It has merged with Biltmore Enterprises Inc., a Nevada Corporation. Biltmore Enterprises Inc. changed its name to Arbour Energy U.S., Inc. As a result of the transactions the company is the majority shareholder of a subsidiary listed over the counter in the United States.

In 2005, Arbour shifted its focus to international oil and gas opportunities where the values per dollar invested appear significantly higher than in North America. On September 1, 2005, the Corporation announced that it had concluded negotiations to enter into two substantial oil and gas transactions including offshore shallow gas concessions and a block of existing onshore oil wells. Both potential acquisitions are located in what is generally referred to as Southeast

Asia. Arbour has first right of refusal to participate in other international bids being made in India, Africa, and the Middle East. Technical advisers are currently substantiating reserve estimates and, once completed, formal contracting will be carried out. This process is expected to be completed by the end of 2005. To date the Corporation has spent \$634,000 on the process.

Further to the negotiations concluded on September 1, 2005, Arbour has entered into a preliminary arms-length agreement with Perma Securities, S.A., an international company, to acquire their Malaysian subsidiary, Bengal Oil & Gas Ltd. The vendor represents that the oil and gas assets being acquired have significant proven reserves and that it will arrange additional financing to carry out the initial development program. The subject properties are in Myanmar. Technical advisors are currently evaluating the data. Subject to various conditions, including due diligence review, Arbour has agreed to pay \$25,000,000 plus 60,000,000 common shares in the company. The Company cautions that there is significant work to be done before its board can determine whether it is in the best interests of the shareholders to proceed with this acquisition. Management and company consultants are making site visits to examine the assets and technical experts are reviewing existing engineering reports. Title to the property will have to be confirmed, as will the financial status and records of the target company. In addition, Arbour will have to confirm the existence and terms of the proposed financing the vendor is arranging to complete the first development phase. The Company will also have to examine and then determine whether the foreign country risks are acceptable. Since the share issuance may result in a change of control of the Company, the agreement may also be subject to regulatory and shareholders' approval which would take place at a meeting to be held early in 2006.

During the first nine months of the year, the company has raised \$27,053,421 by way of the issue of 20,039,571 series one preferred shares at \$1.35 per share.

## **Results of Operations**

The financials are consolidated with Canadian Oilsands Recovery Enterprises Ltd. ("COREL") as the Company acquired all issued shares of COREL at the beginning of the year. COREL is in the developing stages of certain oil sands recovery technology.

The Company also incorporated a private Barbados corporation, Arbour Energy Caribbean Ltd. The Company also purchased a subsidiary, Arbour Energy U.S. Inc. which in turn merged with Biltmore Enterprises Inc., a Nevada Corporation in the United States. As a result of the transactions the Company is the majority shareholder of a subsidiary listed in the United States. Neither company is yet active in their respective businesses.

## Production

Volume	Three months ended			Nine months ended		
	Sept 30		Change	Sept 30		Change
	2005	2004	%	2005	2004	%
Crude oil (bbl/d)	28.4	1.1	2482	28.85	1.2	2304
Natural gas (mcf/d)	151.7	11.9	1175	118.68	18.0	559
Natural gas liquids (bbl/d)	0.03	0.1	-0.7	0.04	0.0	
Total boe/d	53.73	3.4	1480	48.66	4.4	1006

With the acquisition of five producing properties in the last two months of 2004, production increased from 4.4 boe per day in 2004 to 48.66 boe per day in 2005, an 1006% increase. Production from the Kirkpatrick Lake properties also has been increasing steadily through the year. Production revenues increased from \$47,202 in 2004 to \$697,496 in 2005, an 1378% increase. The third quarter production was up 10% compared to the nine month average again due to increased production in the Kirkpatrick area.

Interest income, which did not exist in 2004, was \$476,992 as a result of a \$10,000,000 loan made in mid 2004 and further advances of \$21,473,900 during the first nine months of 2005.

Production Expenses	Three months ended			Nine months ended		
	Sept 30		Change	Sept 30		Change
	2005	2004	%	2005	2004	%
Oil and gas	189,247	6,145	2980%	317,602	23,834	1233%
Corel	62,853	-		182,771	-	
	252,100	4,547		500,373	23,834	

Oil and gas production expenses increased from \$23,834 in 2004 to \$317,602 in 2005, a 1233% increase also as a result of increased output with the acquisition of new producing properties. Also, the Corel operating expenses did not exist in 2004. The quarterly Corel expenses remain consistent. Significant well service costs were expended during the third quarter mainly on the 8-34 and 10-34 Pembina wells.

General and administrative expenses increased significantly from \$209,518 in 2004 to \$893,030 in 2005. Of the \$893,030, \$54,156 is attributable to Arbour USA, \$6,639 to Arbour Caribbean and \$30,971 to COREL. The Company remains focused on new acquisitions, in North America and offshore, as well as raising capital, all of which afforded increased operating expenses over last year.

Depletion was \$258,485 compared with \$4,598 in 2004 due to increased production levels as discussed above.

With newly issued convertible preferred shares with a 5.75% cumulative annual dividend, the Company has accrued \$1,107,911 of interest in the first nine months of 2005. While this expense is required for accounting purposes, no amount is payable unless a dividend is declared by the Board of Directors of the company. There were no interest expenses in the comparative period of 2004.

Accretion expenses of \$6,741 were accrued for the nine months ending September 2005 with the acquisitions of producing properties.

An unrealized gain on foreign exchange of \$16,375 occurred as a result of consolidation with the USA and Caribbean companies.

The overall loss for the first nine months of 2005 was \$1,576,687 as compared to a loss of \$190,898 in 2004.

### Quarterly Results

	Q3	2005 Q2	Q1	Q1	2004 Q2	Q3	Q4	2003 Q1
Total Revenue	522,467	357,657	294,364	196,251	17,615	15,871	13,716	17,856
Loss before extraordinary items	(680,467)	(391,309)	(504,881)	(457,683)	(78,062)	(34,472)	(31,019)	(1,380,921)
Per share	(0.035)	(.05)	( 0.03)	( 0.06)	( 0.01)	( 0.00)	( 0.01)	( 0.28)
Net Loss	(680,467)	(391,309)	(504,881)	(457,683)	(78,062)	(34,472)	(31,019)	(1,380,921)
Per share	(0.035)	(.05)	( 0.03)	( 0.06)	( 0.01)	( 0.00)	( 0.01)	( 0.28)

The loss in the 2005 quarters is a result of the Company becoming increasingly active in production operations as well as raising significant capital. Production revenue of \$177,765, \$193,905 and \$325,826 in the first, second and third quarters respectively showed increases as oil prices moved from an average of \$59.71 in the first quarter, \$63.47 in the second quarter and \$72.67 in the last. Production also increased during the third quarter with increased production from the Kirkpatrick Lake properties.

During the first nine months of 2005, the Company raised \$27,053,422 from the sale of preferred shares. As a result, the Company has a healthy working capital at September 30, 2005 of \$789,800.

## **Liquidity**

The Company continues to raise capital under the preferred share offering memorandum. Arbour raised \$27,739,720 (after share subscriptions receivable) from the placement of 20,039,571 redeemable preferred shares. The preferred shares are convertible to common shares but have been recorded at the fair value without the conversion feature. The difference between the principal amount of \$27,053,421 and the fair value of \$24,913,986 is \$2,139,435 and has been recorded in contributed surplus as the fair value of the conversion feature of the preferred shares.

The Company had a healthy working capital at September 30, 2005 of \$789,800. The positive working capital is a result of the placement preferred shares. Management is of the opinion that there is sufficient cash for both the short term and the long term to meet current capacity. As funds are available through share placements, the Company anticipates further acquisitions of oil and gas properties.

## **Capital Resources**

There are no major capital commitments as at September 30, 2005. However, management entered into an agreement to purchase all of the issued shares of Canadian Oilsands Recovery Enterprises Ltd. for \$10,300,000 effective January 1, 2005. Payment of the purchase price was \$5,300,000 cash and the issuance of 5,000,000 common shares at \$1.00 each of the shares of Arbour. Cash payments of \$2,520,000 have been made as at September 30, 2005 and will continue to be made monthly at the rate of \$120,000 until August 1, 2007 with the final payment of \$20,000 on September 1, 2007. The Company will fund the acquisition through internally generated cash flow from operations and through new equity issues as required.

## **Off-Balance Sheet Arrangements**

As of September 30, 2005, the Company has no off-balance sheet arrangements.

## **Related Party Transactions**

During the first nine months of 2005 the Company incurred the following related party transactions:

- 1) Directors' fees paid for the first nine months of 2005 of \$95,300.
- 2) Management fees and salary paid to the CEO of the Company in the amount of \$69,000 and \$9,000 for a vehicle allowance.

- 3) Loans of \$211,695 relating to the purchase of shares on the exercise of stock options by directors.

The above transactions are in the normal course of operations.

## **Financial Instruments**

### *Credit concentration*

During 2004, the Company entered into a loan agreement with Merendon Mining Corporation Ltd., a private company incorporated in Alberta, for \$10,000,000. The loan interest is initially at 3.5% and escalates at a rate of 0.5% per year. The Company has an option to purchase 5% of the issued and outstanding shares of Tarsands Recovery Ltd., a private company incorporated in Alberta engaged in development of technology to enhance oil recovery from the Western Canadian Tar Sands, in exchange for the principal balance of the loan. The Company has a charge on those shares as security for the loan. During 2005, the Company entered into an additional loan agreement with Merendon and advanced \$21,473,900. Interest of \$414,045 has been accrued for the nine months ending September 30, 2005. If Merendon was unable to meet its obligations, or if the security was insufficient to recover the recorded value of the loan plus accrued interest, the impact on the Company could be material and could impact its ability to continue as a going concern. As at September 30, 2005, management does not believe that there are any concerns with respect to the collectibility of the loan.

Virtually all of the Company's accounts receivable are with customers in the oil and gas industry and are subject to normal industry credit risks.

### *Interest rate risk*

This is the risk that the value of a financial instrument might be adversely affected by a change in the interest rates. The loan receivable and redeemable preferred shares are at fixed interest rates thereby minimizing cash flow and interest rate exposure. In seeking to minimize the risks from interest rate fluctuation, the Company manages exposure through its normal operating and financing activities.

### *Fair value of financial instruments*

The carrying amount of cash and cash equivalents, share subscriptions receivable, notes receivable, accounts receivable, accrued interest payable, accounts payable and accruals approximates their fair value due to the short-term maturities of these items.

As at year end, the carrying values of the loan receivable and redeemable preferred shares approximate their fair value.

## **Business Risks**

### ***Competitive Conditions***

Arbour is a member of the petroleum industry, which is highly competitive on all levels. The Company competes with other companies for all of its business inputs, including exploration and development prospects, access to commodity markets, experienced technical personnel and available capital.

The Company strives to be competitive by maintaining a strong financial condition and by utilizing current technologies to enhance exploration, development and operational activities. The Company recognizes that it is a small player in the industry and, as such, seeks profitable joint venture relationships in order to access the technical and industry expertise of other companies.

Arbour competes with others in this area, bidding for mineral rights at Crown land sales and acquiring producing properties and working interests in projects already partly owned. To mitigate the effects of competition, Arbour generally tries to obtain operatorship and to own as large a working interest as possible in its producing properties to control the access to, and timing of, its field operations, particularly drilling.

### ***Environmental Considerations***

The Company is pro-active in its approach to environment concerns. Procedures are in place to ensure that the utmost care is taken in the day to day management of its oil and gas properties. All government regulations and procedures are followed. The Company believes in well abandonment and site restoration in a timely manner to ensure minimal damage to the environment and lower overall costs to the Company.

The Company's estimated asset retirement obligations are provided using the Canadian Institute of Chartered Accountants' new recommendations. Under the new recommendations, an asset retirement obligation is recognized at fair value when incurred, and a concurrent asset retirement cost is capitalized to the related asset and amortized to income over its estimated useful life. At September 30, 2005, the Company had \$267,384 of asset retirement obligations.

## **Risk Factors**

### ***Dividends***

The Company has paid no dividends on its shares since incorporation.

## ***Commodity Prices***

The Company's revenues, future rate of growth, results of operations, financial condition and ability to borrow funds or obtain additional capital, as well as the carrying value of its properties, are substantially dependent upon prevailing prices of oil and natural gas. Historically, the markets for oil and natural gas have been volatile, and such markets are likely to continue to be volatile in the future. Prices for oil and natural gas are subject to wide fluctuation in response to relatively minor changes in the supply of and demand for oil and natural gas, market uncertainty and a variety of additional factors that are beyond the control of the Company. These factors include the level of consumer product demand, weather conditions, domestic and foreign governmental regulations, the price and availability of alternative fuels, political conditions in the Middle East, the foreign supply of oil and natural gas, the price of foreign imports and overall economic conditions. It is impossible to predict future oil and natural gas price movements with certainty. Declines in oil and natural gas prices may materially adversely affect the Company's financial condition, liquidity, ability to finance planned capital expenditures and results of operations.

## ***Resource Exploration and Development***

Drilling with respect to the oil and gas properties in which the Company has an interest are at an exploratory stage and involve the drilling of test wells which may not be successful or economic. Resource exploration and development is a speculative business and involves a high degree of risk, which even a combination of experience, knowledge and careful evaluation may not be able to avoid. There is no assurance that even if commercial quantities of oil and gas are discovered, that an oil and gas property will be brought into commercial production.

The discovery of oil and gas reserves is dependent upon a number of factors not the least of which is the technical skill of the exploration personnel involved. The commercial viability of oil and gas reserves, once discovered, is also dependent upon a number of factors which may be beyond the control of the Company, including marketability and price, proximity to infrastructure, government regulations and environmental protection requirements.

While not the operator of exploration programs on its resource properties, the Company does participate in operations that are subject to the risks normally incidental to the operation and development of resource properties, including the drilling of such properties. In respect of oil and natural gas well, unexpected formations or pressures, blow-outs and fires could be encountered, all of which could result in personal injuries, loss of life and damage to property for which the Company may be ascribed some responsibility. In accordance with customary industry practice, the Company may not be able to or may elect not to insure against all such risks.

Certain oil and gas properties in which the Company has an interest may be difficult to access during break-up or inclement weather, which are risks normally encountered by most industry participants.

Certain of the Company's operations and assets may be located in other foreign jurisdictions other than Canada and the United States. The differences and uncertainties of political stability, foreign legal requirements and systems as well as foreign currency fluctuations and repatriation rules are risks that the Company faces.

### ***Title Matters***

The Company has investigated its rights to participate in the exploration and development of its various resource properties and to, the best of its knowledge, those rights are in good standing. No assurance, however, can be given that applicable governments will not revoke, or significantly alter the conditions of, the applicable underlying grants and authorizations and that such grants and authorizations will not be challenged or impugned by third parties.

### ***Competition***

The oil and gas industry is intensely competitive and the Company must compete in all aspects of its business with a substantial number of other companies which have greater technical or financial resources. As a result, the Company may be unable to acquire rights to exploit additional resource properties on terms it considers acceptable. Accordingly, there can be no assurance that the Company will acquire any interest in additional properties that would yield reserves or result in commercial operations.

### ***Environmental and Other Regulatory Requirements***

All phases of the Company's operations are subject to environmental regulation in the various jurisdictions in which it operates. Environmental legislation is evolving in a manner which will require stricter standards and enforcement, increased fines and penalties for non-compliance, more stringent environmental assessments of proposed projects and a heightened degree of responsibility for companies and their officers, directors and employees. There is no assurance that future changes in environmental regulation, if any, will not adversely affect the Company's operations. Environmental hazards may exist on the properties in which the Company holds interests which are unknown to the Company at present which have been caused by previous or existing owners or operators of the properties.

Government approvals and permits are currently, and may in the future be, required in connection with the operations in which the Company participates.

To the extent such approvals are required and not obtained, exploration and development of the properties may be curtailed or prohibited from proceeding.

Failure to comply with applicable laws, regulations and permitting requirements may result in enforcement actions thereunder, including order issued by regulatory or judicial authorities causing operations to cease or be curtailed, and may include corrective measures requiring capital expenditures, installation of additional equipment, or remedial actions. Parties engaged in operations on resource properties may be required to compensate those suffering loss or damage by reason of the activities thereon and may have civil or criminal fines or penalties imposed for violations of applicable laws or regulations.

### ***Conflicts of Interest***

The directors of the Company are engaged and will continue to be engaged in the search for resource property interests on their own behalf and on behalf of other companies, situations may arise where the directors and officers may be in direct competition with the Company. Conflicts of interest, if any, which arise will be subject to and governed by the procedures described in the *Business Corporation Act* (Alberta) which require a director or officer of a company to disclose any interest in transactions involving the Company and, in the case of directors, to refrain from voting on any matter in respect of such interested transactions unless otherwise permitted under such Act.

### ***Forward Looking Statement***

This discussion and analysis may contain “forward-looking statements” that reflect Arbour Energy’s current expectations and projections about its future results. When used in this MD&A, words such as “estimate”, “intend”, “expect”, “anticipate” and similar expressions are intended to identify forward-looking statements, which, by their very nature, are not guarantees of Arbour Energy’s future operational or financial performance, and are subject to risks and uncertainties and other factors that could cause Arbour Energy’s actual results, performance, prospects or opportunities to differ materially from those expressed in, or implied by, these forward-looking statements. These risks, uncertainties and factors may include, but are not limited to: unavailability of financing, failure to identify a commercially viable oil or gas reserves, fluctuations in the market valuation for oil or gas, difficulties in obtaining required approvals for the development of an oil or gas project and other factors.

Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date of this MD&A or as of the date otherwise specifically indicated herein. Due to risks and uncertainties, including the risks and uncertainties identified above and elsewhere in this MD&A, actual events may differ materially from current expectations. Arbour Energy disclaims

any intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

Calgary, Canada  
December 5, 2005