Consolidated interim financial statements of

Pacific Stratus Energy Ltd.

June 30, 2007
(Unaudited)

The accompanying unaudited interim consolidated financial statements of the Company have been prepared by and are the responsibility of the Company's management. The Company's independent auditor has not performed a review of these financial statements in accordance with standards established by the Canadian Institute of Chartered Accountants for a review of interim financial statements by an entity's auditor.

Pacific Stratus Energy Ltd.
June 30, 2007

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Pacific Stratus Energy Ltd.

Consolidated statements of operations
for the three and six month periods ended June 30,

(Expressed in thousands of U.S. dollars, except share and per share amounts)
(Unaudited)

	Three months ended June 30,		Six months ended June 30,	
	2007	2006	**2007**	2006
	$	$	**$**	$
Revenues				
Oil and gas	**9,667**	-	**15,345**	-
Royalties	**(388)**	-	**(866)**	-
	9,279	-	**14,479**	-
Operating expenses				
Depletion, depreciation and accretion	**3,703**	-	**10,222**	-
Stock-based compensation	**10,628**	-	**11,019**	-
General and administration	**3,583**	401	**6,607**	639
Operating costs	**2,583**	-	**3,209**	-
	20,497	401	**31,057**	639
Operating loss	**(11,218)**	(401)	**(16,578)**	(639)
Interest expense	**4,799**	-	**5,710**	-
Interest income	**(691)**	21	**(712)**	83
Loss(gain) on foreign exchange	**263**	(392)	**408**	(655)
Other (income)expense	**(18)**	182	**(107)**	194
Loss before income taxes	**(15,571)**	(590)	**(21,877)**	(1,017)
Income tax expense	**1,672**	-	**743**	-
Net loss for the period	**(17,243)**	(590)	**(22,620)**	(1,017)
Basic and diluted loss per share	**(0.45)**	(0.04)	**(0.51)**	(0.08)
Weighted average number of common shares outstanding	**38,591,721**	13,311,815	**44,545,860**	13,162,310

Pacific Stratus Energy Ltd.

Consolidated statement of shareholders' equity

(Expressed in thousands of U.S. dollars, except share and per share amounts)
(Unaudited)

	Common shares		Contributed	Accumulated other comprehensive		
	Shares	Amount	surplus	income	Deficit	Total
		$	$	$	$	$
Balance, December 31, 2006	32,211,268	76,406	11,223	895	(12,760)	75,764
Change in accounting policy (Note 2)	-	-	-	-	(1,156)	(1,156)
Balance, January 1, 2007	32,211,268	76,406	11,223	895	(13,916)	74,608
Net loss	-	-	-	-	(22,620)	(22,620)
Cumulative translation adjustment				(844)		(844)
Exercise of warrants	654,409	2,083	-	-	-	2,083
Exercise of options	416,000	1,574	(560)	-	-	1,014
Exercise of agent compensation options	8,244	18	-	-	-	18
Issued on acquisition	400,000	5,453				5,453
Issued on financing	14,375,000	117,200				117,200
Stock-based compensation	-	-	11,020	-	-	11,020
Balance, March 31, 2007	48,064,921	202,734	21,683	51	(36,536)	187,932

See accompanying notes to the consolidated financial statements.

Pacific Stratus Energy Ltd.

Consolidated balance sheets

(Expressed in thousands of U.S. dollars)
(Unaudited)

	June 30, 2007	December 31, 2006
	$	$
Assets		
Current assets		
Cash and cash equivalents	**82,605**	20,722
Accounts receivable and other (Note 4)	**7,995**	4,922
Oil inventories	**2,330**	762
Future income tax asset	**1,816**	2,777
	94,746	29,183
Restricted cash	**1,783**	823
Property, plant and equipment (Note 5)	**127,074**	93,547
Deferred finance costs	**-**	1,156
Investments	**584**	566
Future income tax asset	**3,467**	3,808
	227,654	129,083
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities	**13,230**	9,170
Income taxes payable	**6,328**	5,603
	19,558	14,773
Asset retirement obligation	**8,059**	3,167
Notes payable (Note 6)	**-**	23,782
Future income taxes	**12,105**	11,597
	39,722	53,319
Contingency (Note 9)		
Shareholders' equity		
Share capital	**202,734**	76,406
Contributed surplus	**21,683**	11,223
Accumulated other comprehensive income (Note 2)	**51**	895
Deficit	**(36,536)**	(12,760)
	187,932	75,764
	227,654	129,083

Continuing operations (Note 1)

Pacific Stratus Energy Ltd.

Consolidated statements of cash flows
for the three and six month periods ended June 30,

(Expressed in thousands of U.S. dollars)
(Unaudited)

	Three Months		Six Months	
	2007	2006	**2007**	2006
	$	$	**$**	$
Operating activities				
Net loss for the period	**(17,243)**	(590)	**(22,622)**	(1,018)
Items not involving cash				
Depletion, depreciation and accretion	**3,703**	3	**10,222**	-
Future income taxes	**1,371**	-	**318**	-
Stock-based compensation	**10,629**	-	**11,020**	-
Foreign exchange (loss) gain	**264**	-	**(1,713)**	-
Accretion of unsecured notes	**4,077**	-	**4,077**	-
Changes in non-cash operating working capital				
Accounts receivable and other	**1,339**	(2,331)	**(469)**	(4,545)
Oil inventories	**400**	-	**(1,569)**	-
Accounts payable and accrued liabilities	**2,213**	107	**3,841**	(2)
Income taxes payable	**1,259**	-	**724**	-
	8,012	(2,811)	**3,829**	(5,565)
Financing activities				
Bridge loan financing	**-**	-	**-**	6,000
Repayment of note	**(28,080)**		**(28,080)**	
Proceeds on exercise of stock options and warrants	**1,578**		**3,335**	
Shares issued for cash, net of issue costs	**122,653**	58	**122,653**	2,277
	96,151	58	**97,908**	8,277
Investing activities				
Property, plant and equipment expenditures	**(28,056)**	(925)	**(38,876)**	1,294
Investment	**(18)**	-	**(18)**	-
Deferred costs	**-**	(330)	**-**	(5,699)
Restricted cash	**(960)**	1,138	**(960)**	414
	(29,034)	(117)	**(39,854)**	(3,991)
Effects of foreign exchange rate changes on cash and cash equivalents	**-**	-	**-**	-
Net increase in cash and cash equivalents	**75,129**	(2,870)	**61,883**	(1,279)
Cash and cash equivalents, beginning of period	**7,476**	11,907	**20,722**	10,316
Cash and cash equivalents, end of period	**82,605**	9,037	**82,605**	9,037

1. Nature of operations

The Company was incorporated under the Company Act of British Columbia on January 8, 1986. The Company is currently engaged in the acquisition of exploration and operation of oil and gas properties.

On May 24, 2006, the Company completed a share consolidation whereby 10 pre-consolidation shares were exchanged for 1 post-consolidation share. All information related to common shares for the current and prior period has been restated to give effect to the share consolidation.

These financial statements have been prepared under the assumption that the Company will be able to realize its assets and discharge its liabilities in the normal course of business rather than through a process of forced liquidation. Continued operations of the Company are dependent on the Company's ability to receive continued financial support, complete equity financings, and successfully acquire an interest in assets or a business and the ability to generate profitable operations in the future.

These financial statements have been reviewed by the Company's Audit Committee and approved by its Board of Directors.

2. Basis of presentation

These unaudited interim financial statements have been prepared in accordance with Canadian generally accepted accounting principles for interim financial statements. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, the accompanying financial information reflects all adjustments, consisting primarily of normal recurring adjustments, which are, in the opinion of management, necessary for a fair presentation of results for the interim periods. Operating results for the three and six month periods ended June 30, 2007 are not necessarily indicative of the results that may be expected for the year ending December 31, 2007. These interim consolidated financial statements follow the same accounting policies as the audited consolidated financial statements of the Company for the year ended December 31, 2006, except for the new policies disclosed below. Accordingly, these interim consolidated financial statements should be read in conjunction with the Company's 2006 annual audited consolidated financial statements and notes thereto.

Effective January 1, 2007, the Company adopted two new accounting standards related to financial instruments that were issued by the Canadian Institute of Chartered Accountants ("CICA"). These accounting policy changes were adopted on a prospective basis with no restatement of prior period financial statements. The new standards and accounting policy changes are as follows:

(a) Comprehensive income (CICA Handbook Section 1530)

Comprehensive income comprises the Company's net income and other comprehensive income. Other comprehensive income represents changes in shareholders' equity during a period arising from non-owner sources and, for the Company, includes currency translation adjustments on the net investment in self-sustaining operations and unrealized gains and losses on available-for-sale securities. The Company's comprehensive income, components of other comprehensive income, and accumulated other comprehensive income are presented in the statement of changes in shareholders' equity and comprehensive income. Prior financial statements retroactively reflect the classification of the currency translation adjustments on the Company's net investment in self-sustaining operations as components of other comprehensive income.

2. Basis of presentation (continued)

(b) *Financial instruments – recognition and measurement (CICA Handbook Section 3855) and disclosure and presentation (CICA Handbook Section 3861)*

In accordance with these new standards, the Company now classifies all financial instruments as either held-for-trading, available for sale, held-to-maturity, loans and receivables or other financial liabilities. Financial instruments classified as held-for-trading are measured at fair value with unrealized gains and losses recognized in operating results. Financial instruments classified as available for sale are measured at fair value with unrealized gains and losses recognized in other comprehensive income. Financial instruments classified as held-to-maturity, loans and receivables or other financial liabilities are measured at amortized cost.

Upon adoption of these new standards, the Company has designated its cash and cash equivalents as held-for-trading, which are measured at fair value. Accounts receivable and other are classified as loans and receivables, which are measured at amortized cost. Accounts payable and accrued liabilities and notes payable are classified as other liabilities, which are measured at amortized cost.

The Company adopted a policy, under Section 3855, to expense debt financing fees when they are incurred and as a result the Company recorded a non-cash adjustment to increase opening deficit by $1,156,000 to eliminate the opening balance of debt financing fees that were capitalized and amortized under the Company's previous accounting policy.

(c) *Foreign currency translation*

The Company has changed its reporting currency to United States dollars effective January 1, 2007. The change in reporting currency was made to improve investors' ability to compare the Company's results with those of most other publicly traded businesses in the industry. Historical results have been restated to the reporting currency using the current rate method. Under this method, the assets and liabilities were translated using the exchange rate in effect at the balance sheet date. The statements of operations and cash flows were translated at the average rate for the respective reporting periods. Any resulting foreign exchange gains and losses were recorded as a separate component of shareholders' equity and described as cumulative translation adjustments within accumulated comprehensive income.

3. Acquisition

Sociedad de Exploracion y Explotacion Petrolera S.A. ("SEEPSA")

On July 6, 2006, the Company acquired all of the issued and outstanding shares of SEEPSA, a Colombian oil and gas producer wholly owned by Empresa Nacional de Petroleos de Chile S.A., the national oil company of Chile, for $64,952,000. The results of operations of SEEPSA are included in the consolidated statement of operations since July 6, 2006.

SEEPSA has interests in several blocks and producing oil fields in central Colombia along with working interests in two significant oil pipelines. These include a 90.6% interest in the Dindal and Rio Seco Blocks, a 27.7% interest in the Caguan Block, and a 30% interest in the Acevedo Block. All properties are located in Colombia.

(Tabular amounts expressed in thousands of U.S. dollars, except share and per share amounts)

3. Acquisition (continued)

Sociedad de Exploracion y Explotacion Petrolera S.A. ("SEEPSA") (continued)

The business combination has been accounted for as a purchase transaction with the Company as the acquirer of SEEPSA. The allocation of the purchase price based on the consideration paid and the fair value of SEEPSA's net assets acquired is as follows:

Net assets acquired at fair values:

	$
Cash	1,022
Non-cash working capital	4,746
Property, plant and equipment	64,160
Investments	542
Asset retirement obligation	(2,333)
Net future income tax liability	(3,185)
Net assets acquired	64,952

Total consideration paid consists of the following:

	$
Cash	62,212
Acquisition costs	2,740
	64,952

4. Accounts receivable and other

	June 30, 2007	December 31, 2006
	$	$
Accounts receivable	**1,980**	-
Receivable from joint interest partners	**1,945**	1,817
VAT receivable	**298**	1,948
Prepaid expenses and other	**3,772**	1,157
	7,995	4,922

(Tabular amounts expressed in thousands of U.S. dollars, except share and per share amounts)

5. Property, plant and equipment

The following tables summarize the Company's property, plant and equipment as at June 30, 2007 and December 31, 2006:

			June 30, 2007
	Cost	**Accumulated depletion and depreciation**	**Net book value**
	$	**$**	**$**
Oil and gas properties	**141,804**	**15,179**	**126,625**
Equipment, furniture and fixtures	**485**	**66**	**419**
	142,289	**15,245**	**127,044**

			December 31, 2006
	Cost	Accumulated depletion and depreciation	Net book value
	$	$	$
Oil and gas properties	98,193	4,957	93,236
Equipment, furniture and fixtures	347	36	311
	98,540	4,993	93,547

a) On May 9, 2007 the Company was advised by ANH that the Company had secured a Technical Evaluation Agreement for Arauca Block located in the Llanos Basin of Colombia. The Company paid $5.8 million consisting of $400,000 in cash and issued 400,000 shares as an agency fee in relation to the granting of the block and is included in oil and gas properties.

6. Notes payable

On July 6, 2006, in conjunction with the SEEPSA acquisition, the Company issued 32,500 units at a price of Cdn$1,000 per unit for gross proceeds of Cdn$32.5 million. Each unit consisted of Cdn$1,000 principal amount 13% senior unsecured note due June 14, 2011 and 100 common share purchase warrants exercisable for a period of two years at an exercise price of Cdn$4.00 per common share.

The Company has allocated a fair value attributable to the warrants which formed part of the issuance of $4.4 million, net of issue costs of $0.3 million which was determined using the Black-Scholes pricing model assuming no dividends are to be paid, a weighted average volatility of 113%, an average annual risk free rate of 4.42% and an estimated life of 2 years.

The notes were accreted using the effective interest method over the life of the notes to bring the carrying value of the notes to their face value of $28.1 million (Cdn$32.5 million) at the maturity date. The notes were redeemed in full on May 9, 2007 and resulted in a loss of $4.1 million representing the difference between the face value and the carrying value of the note.

(Tabular amounts expressed in thousands of U.S. dollars, except share and per share amounts)

7. Share capital

(a) *Common shares*

Authorized:

An unlimited number of common shares without par value
An unlimited number of preferred shares without par value

(b) On April 19, 2007, the Company completed a financing by issuing 14.4 million common shares at a price of Cdn$10.00 per share for gross proceeds of Cdn$143.7 million. The gross proceeds include the exercise in full by the underwriters' option to purchase an additional 1.875 million common shares at $10.00 per share. A portion of the net proceeds of this financing was used to repay the company's 13% senior unsecured notes on May 9, 2007.

(c) *Warrants*

	June 30, 2007		December 31, 2006	
	Number of warrants	**Weighted average exercise price**	Number of warrants	Weighted average exercise price
		Cdn$		Cdn$
Balance outstanding, beginning of period	**5,243,487**	**3.63**	4,508,242	3.90
Issued on private placement	**-**	**-**	3,250,000	4.00
Issued on exercise of compensation options	**4,122**	**2.97**	89,935	3.97
Issued to bridge loan lenders	**-**	**-**	120,000	3.90
Exercised	**(694,409)**	**3.00**	(1,268,590)	3.48
Expired warrants	**-**	**-**	(1,456,100)	5.35
Balance outstanding, end of period	**4,553,200**	**3.92**	5,243,487	3.63

The following table summarizes information concerning outstanding and exercisable warrants at June 30, 2007:

Outstanding and exercisable	Exercise price	Expiry date
	Cdn$	
1,295,700	3.00	July 20, 2007
60,000	3.90	March 14, 2008
3,197,500	4.00	July 6, 2008
4,553,200		

(Tabular amounts expressed in thousands of U.S. dollars, except share and per share amounts)

7. Share capital (continued)

(d) Incentive stock option plan

A summary of the changes in the Company's incentive share option plan at June 30, 2007 and December 31, 2006 are as follows:

	June 30, 2007		December 31, 2006	
	Number of options	**Weighted average exercise price**	Number of options	Weighted average exercise price
		Cdn$		Cdn$
Balance outstanding, January 1	**2,903,000**	**3.65**	674,750	3.40
Granted	**1,943,000**	**10.60**	2,454,000	3.69
Exercised	**(416,000)**	**3.46**	(143,500)	3.41
Cancelled	**-**	**-**	(82,250)	3.20
Balance outstanding, March 31	**4,430,000**	**6.71**	2,903,000	3.65

The following table summarizes information concerning outstanding and exercisable options at June 30, 2007:

Outstanding and exercisable		
Number of options	Weighted average exercise price per share	Expiry dates
	Cdn$	
189,500	3.00	May 2, 2010
37,500	3.05	October 16, 2011
1,917,500	3.50	August 21, 2011
222,500	3.80	October 27, 2009
50,000	6.40	January 9, 2012
60,000	7.30	November 20, 2011
60,000	7.75	November 28, 2011
35,000	8.05	February 9, 2012
1,808,000	10.75	April 20, 2012
50,000	11.15	April 25, 2012
4,430,000	6.71	

(Tabular amounts expressed in thousands of U.S. dollars, except share and per share amounts)

7. Share capital (continued)

(d) Incentive stock option plan (continued)

The fair value of options granted by the Company in 2007 and 2006 was determined using the Black-Scholes option pricing model using the following weighted average assumptions:

	June 30, 2007	December 31, 2006
Weighted average risk-free rate	**4.0%**	4.3%
Dividend yield	**Nil**	Nil
Volatility factor of the expected market price of the Company's shares	**101%**	109%
Average expected option life (years)	**2.5**	2.5
Weighted average grant date fair value per share of options issued during the period	**Cdn$6.36**	Cdn$2.28

8. Segmented information

(a) Operating segment - The Company's operations are primarily directed towards the acquisition and exploration of oil and gas resource properties in Colombia.

(b) Geographic segments - The Company's assets (consisting of oil and gas properties and equipment), revenues and expenses by geographic areas are as follows:

	Three months ending June 30, 2007		
	Colombia	**Canada**	**Total**
	$	**$**	**$**
Property, plant and equipment	**127,072**	**2**	**127,074**
Revenues	**9,279**	**-**	**9,279**
Depletion, depreciation and accretion	**-** **3,703**	**-**	**3,703**
Stock-based compensation	**-**	**10,628**	**10,628**
General and administrative	**2,863**	**720**	**3,583**
Operating costs	**2,583**	**-**	**2,583**
	130	**(11,348)**	**(11,218)**
Interest expense	**9**	**4,790**	**4,799**
Interest income	**-**	**(691)**	**(691)**
Loss(gain) on foreign exchange	**199**	**64**	**263**
Other (income) expense	**(97)**	**79**	**(18)**
Income tax expense	**1,672**	**-**	**1,672**
Net loss	**(1,653)**	**(15,590)**	**(17,243)**

(Tabular amounts expressed in thousands of U.S. dollars, except share and per share amounts)

8. Segmented information (continued)

	Six months ending June 30, 2007		
	Colombia	**Canada**	**Total**
	$	**$**	**$**
Revenues	**14,479**	**-**	**14,479**
Depletion, depreciation and accretion	**-** **10,221**	**1**	**10,222**
Stock-based compensation	**-**	**11,019**	**11,019**
General and administrative	**5,236**	**1,371**	**6,607**
Operating costs	**3,209**	**-**	**3,209**
	(4,187)	**(12,391)**	**(16,578)**
Interest expense	**9**	**5,701**	**5,710**
Interest income	**(1)**	**(711)**	**(712)**
Loss(gain) on foreign exchange	**306**	**102**	**408**
Other (income) expense	**(152)**	**45**	**(107)**
Income tax expense	**743**	**-**	**743**
Net loss	**(5,092)**	**(17,528)**	**(22,620)**

9. Contingency

a) On August 17, 2005, Gran Colombia and Hocol entered into a farm-out agreement in order to facilitate Hocol's assignment of rights Hocol had obtained under earlier agreements with Empresa Colombiana de Petroleos ("Ecopetrol"), a Colombian industrial and commercial state-owned company involved in the exploitation of hydrocarbons. One agreement related to exploration and exploitation of oil and gas in an area of Colombia known as the Doima Block. A second agreement concerned the incremental production of oil and gas in parts of the Doima Block referred to as the Ortega Area. The farm-out agreement between Gran Colombia and Hocol, which was originally entered into between Solaris and Hocol, allowed Hocol to share the risks and benefits of exploring and development the rights it has in the Doima Block. On December 23, 2005, the Company announced that Hocol had challenged the Company's right to continue testing the Don Pedro-1 well, alleging breaches to the farm-out agreement. The Company has commenced an arbitration process to enforce its rights under the farm-out agreement and the outcome is currently not determinable. The properties in dispute are included in unproved properties within property, plant and equipment. See note 10(b) below for developments in this matter that occurred subsequent to June 30, 2007.

b) On February 13, 2007, the Company issued a letter of credit in favour of Saxon Energy Services Inc. for $960,000 to secure availability of the Saxon 126 Rig and concludes upon the termination of that arrangement.

10. Subsequent events

a) On July 12, 2007 the Company was awarded 3 blocks offered by Perupetro in Peru. The commitments for the first exploration phase include regional studies and seismic acquisition. Upon successful completion of phase one, the company has the option to continue the exploration program with additional seismic acquisition and drilling one well for each block.

b) On August 14, 2007 The Company announced that it had reached a settlement with respect to this dispute with Hocol, the terms of which shall remain confidential. As a result, the Company currently does not hold any interest in the oil and gas fields of the Doima Contract or the Ortega Contract.

MANAGEMENT'S DISCUSSION AND ANALYSIS

The Company changed its reporting currency to United States dollars effective January 1, 2007. All amounts referred to in this management's discussion and analysis are in US dollars.

SUMMARY OF QUARTERLY RESULTS (ALL AMOUNTS IN $US)

	2007		2006				2005	
	Q2	Q1	Q4	Q3	Q2	Q1	Q4	Q3
Financial ($000s except where noted)								
Oil revenue[1]	9,279	5,199	9,608	5,292	-	-	-	-
Funds flow from operations[2]	2,801	(1,499)	2,688	4,265	(1,257)	(426)	(21)	(583)
Per share – basic and diluted ($)[3]	0.07	(0.04)	0.08	0.14	(0.07)	(0.03)	0.00	(0.05)
Net loss	(17,243)	(5,379)	(1,817)	(1,741)	(757)	(428)	78	(703)
Per share – basic and diluted ($)[3]	(0.45)	(0.17)	(0.06)	(0.06)	(0.04)	(0.03)	0.01	(0.06)
Capital expenditures	28,056	10,801	16,496	2,947	925	2,169	4083	4

(1) Expressed as Oil revenues less royalties
(2) Calculated based on cash flow from operations before non-cash operating working capital
(3) Based on the weighted average number of basic and diluted shares
(4) On May 19, 2006 the Company consolidated its share capital on a 10 old for 1 new basis. All information related to common shares for the current and prior period has been restated to give effect to the share consolidation.

The following MD&A is dated August 14, 2007 and should be read in conjunction with the consolidated financial statements and accompanying notes of Pacific Stratus Energy Ltd. ("Pacific Status" or the "Company") as at and for the three and six months ended June 30, 2007. Additional information for the Company can be found on SEDAR at www.sedar.com or at www.pacificstratus.com. In addition to historical information, the MD&A contains forward-looking statements that are generally identifiable as any statements that express, or involve discussions as to, expectations, beliefs, plans, objectives, assumptions or future events of performance (often, but not always, through the use of words or phrases such as "will likely result," "expected," "is anticipated," "believes," "estimated," "intends," "plans," "projection", and "outlook") are not historical facts and may be forward-looking and may involve estimates, assumptions and uncertainties which could cause actual results or outcomes to differ materially from those expressed in such forward-looking statements. Actual results achieved during the forecast period will vary from the information provided herein as a result of numerous known and unknown risks and uncertainties and other factors. Such factors include, but are not limited to: general economic, market and business conditions; fluctuations in oil and gas prices; the results of exploration and development of drilling and related activities; fluctuation in foreign currency exchange rates; the uncertainty of reserve estimates; changes in environmental and other regulations and other regulations; and risks associated with oil and gas operations and other factors, many of which are beyond the control of the Company. Accordingly, there is no representation by Pacific Stratus that actual results achieved during the forecast period will be the same in whole or in part as those forecasted. Further, any forward looking statement or statements to reflect events or circumstances after the date on which such statement is made or to reflect the occurrence of unanticipated events, except as required by applicable securities laws.

This report contains financial terms that are not considered measures under Canadian generally accepted accounting principles ("GAAP"), such as funds flow from operations and funds flow per share. These measures are commonly utilized in the oil and gas industry and are considered informative for management and shareholders. Specifically, funds flow from operations and funds flow per share reflect cash generated from operating activities before changes in other non-cash working capital. Funds flow from operations should not be considered an alternative to or more meaningful than cash flow from operating activities as determined under GAAP as an indicator of the Company's performance and demonstrate the Company's ability to generate sufficient cash to fund future growth opportunities. All amounts are in U.S. dollars.

Background

Pacific Stratus Ventures Ltd. was incorporated under the Company Act of British Columbia. From January 8, 1986 until 1997 the Company's principal business activity was cosmeceutical retail sales. From then until April 2004, the Company had no principal business activity. On June 14, 2005, the Company changed its name to Pacific Stratus Energy Ltd. During 2004, management of Pacific Stratus concentrated on finding new opportunities in oil and gas exploration and production and entered into several agreements to acquire companies with holding rights in the oil and gas industry, principally in Colombia. Presently, through its wholly owned subsidiaries, the Company holds oil and gas exploration rights to four onshore permits located in the Republic of Colombia and the Company has acquired a portfolio of producing assets, representing production of approximately 2,000 barrels per day.

The Company currently has working interests in the following blocks:

Producing Blocks

Guadas	(90.6% interest acquired in the 2006 SEEPSA acquisition)
Rio Ceibas	(27.3% interest acquired in the 2006 SEEPSA acquisition)

Exploration Blocks

La Creciente	(100% interest with a significant gas discovery)
Moriche	(80% interest with an oil discovery)
Guama	(100% interest)

The Company also has a 50% interest in the Puli 7 well (acquired in the 2005 Sheridan acquisition).

Strategy

The Company strives to enhance shareholder value through the acquisition and development of highly prospective oil and gas exploration areas. While the competition for attractive development properties is intense, and the odds of advancing individual properties to production are long, the Company believes that its strategy is achievable and offers an attractive risk-reward ratio. Pacific Stratus focuses on areas where management has long-standing experience and above-average relationships. Additionally, the Company has taken a portfolio approach to mitigate risk, acquiring various properties in prolific areas to improve the odds of success and wherever possible, joint ventures its higher risk properties with partners who provide significant technical and financial resources.

Overview

The Company has concentrated on building its main operational and administrative infrastructure as well as acquiring oil and gas properties or rights of merit in accordance with the Company's long-term strategic objectives.

On February 7, 2007, the Company reached an agreement with Saxon Energy Inc. to secure 100% availability of the Saxon 126 Rig for a one-year period. The Company will use this rig to drill five wells over the year, beginning with La Creciente.

The Company announced the spudding of its Mauritia Norte-1 well located in the Moriche Block in the Llanos Basin of Colombia on February 12, 2007. The Mauritia Norte-1 well was drilled to a total measured depth of 10,000 feet and heavy and light oil was discovered in the Ubaque and Mirador reservoirs. The well produced 1,116 barrels of 36.5˚ API gravity oil per day by natural flow. On April 18, 2007, the Company announced the completion of the production tests. The tests performed at the Mirador Formation achieved natural flow of 36.8˚ API gravity oil with a 20.1% bottoms, sediment & water (BSW) content through a 24/64 inch choke. The pressure recorded at a depth of 8,965-8,967 feet was 3,755 psi. The Company has determined that the Mauritia Norte-1 well will be completed to produce from this interval. The Company originally had a 60% working interest, but now holds an 80% interest in the Moriche Block. Extended production tests and initial sales of Mauritia crude at the Mauritia Norte-1 discovery well have commenced.

On March 14, 2007, the Company announced that the Agencia Nacional de Hidrocarburos ("ANH") has awarded an interest in the Guama Block to SEEP S.A., its wholly owned subsidiary. The Company has a 100% interest in the area that spans 216,123 acres in the lower Magdalena Basin close to the Company's La Creciente Block. The Company paid $400,000 and 400,000 shares as an agency fee to an arm's length third-party in relation to the granting of the block. The Company is committed to reprocess 300 kilometres of existing seismic and to acquire 200 kilometres of new 2D seismic in the first 18 months.

On April 19, 2007, the Company announced that it had completed the financing of 14.375 million common shares at a price of Cdn$10.0 per share for aggregate gross proceeds of Cdn$143.75 million. The syndicate of underwriters for the offering was led by GMP Securities L.P. and was comprised of Cormark Securities Inc., Westwind Partners Inc., Orion Securities Inc., Wellington West Capital Markets Inc. and Fraser Mackenzie Limited. The gross proceeds include the exercise in full by the underwriters' option to purchase an additional 1.875 million common shares at Cdn$10.0 per share. A portion of the net proceeds of this financing was used to repay the Company's 13% senior unsecured notes, for which the redemption date was May 9, 2007. The company plans to use the remaining proceeds to complete the 2007 production program at La Creciente, construct the La Creciente production facilities and gas pipeline, development of its Moriche property including the construction of production facilities, evaluate its properties in the Llanos Basin, and for general corporate purposes.

On April 26, 2007, the Company announced the spudding of its La Creciente-2 exploratory well, which is being drilled by the Saxon 126 rig. The drilling target was the Cienaga de Oro Formation 3 kilometres northwest from the La Creciente-1 discovery well that encountered 590 feet of gas-bearing sandstones with an all open flow potential exceeding 200 million cubic feet per day. Ahead of schedule, the drilling of La Creciente-2 began phase 3 of the Company's commitment to the ANH under its contract. The Company had also acquired an additional 140 square kilometers of 3D and 70 kilometres of 2D seismic. On July 5, 2007 drilling at La Creciente-2 reached the stratigraphic top of the Cienaga de Oro Formation at the expected depth of 11,025 feet and encountered total gas readings of 22,980 parts per million at 10,930 feet and 25,436 ppm at 10,956 feet, similar to those recorded at LC-1. The Company has experienced operational delays during drilling that caused instability of the lower portion of the borehole within the shales of the Porquero formation. To safeguard the operation, it was decided to side track this portion of the well starting below the last casing point at 7,326 feet.

On July 31, 2007 the Company announced that it had reached total depth of 11,965 feet at the La Creciente-2 well. The top of the reservoir in the Cienaga de Oro Formation was encountered at 11,033 feet. The reservoir has a gross thickness of 810 feet, with the upper 300 feet consisting mostly of fine sandstones and siltstones with occasional shales, while the lower 510 feet consisted of fine to coarse quartz sandstones, interbeded with siltstones, claystones, and shales. The whole section showed significant counts of methane as high as 700 parts per million despite relatively high mud weights used during the drilling operation to control reservoir pressures.

On August 14, 2007 the company announced that at the La Creciente-2 well, located on Prospect A (LCA-2), three gas bearing intervals were defined totaling 156 feet of Net Reservoir, for a Net to Gross ratio of 32% and porosities of 15% to 18%. The Company is now preparing to do an open hole production test to jointly test the sandstones from 11,330 to 11,650 feet. Following the test, the well will be completed with a 5-inch liner to selectively test the three intervals at 11,327-11,368, 11,397-11,411 and 11,426-11,513 feet respectively.

A water-gas contact was encountered in the basal sandstone at 11,740 feet measured depth or 11,030 feet true vertical depth sub-sea level. This contact is located 33 feet below the bottom of the reservoir column at the previously-drilled La Creciente-1 well and it represents the lower limit of the reservoir at Prospect A. Using average parameters for the reserve calculation, this represents a potential increase of 25% of the existing reserves attributed to Prospect A.

Now that the Company has defined the lower limit of the reservoir at Prospect A, the Company is ready to fully develop this field and to actively explore the other prospects located at La Creciente, especially Prospect D whose structural closing area is 22% larger than Prospect A. Drilling will commence on this target after completing the production tests at LCA-2. Recently acquired seismic data has also produced three additional prospects and one lead.

At the La Creciente 3 well, also located on Prospect A (LCA-3), drilling has reached a depth of 8,000 feet. Given that the water-gas contact was found at a true vertical depth of 11,030 feet sub-sea level, the company has decided to deviate this well toward the crest of the structure to reach the Cienaga de Oro formation at a depth of 10,292 feet.

In order to accelerate the development of “Prospect A” and the exploration of the other prospects at La Creciente, the Company has contracted a second rig, the Saxon 133, for a period of one year. This rig is used at the LC-3 location and was spudded on July 27 2007 and expects to reach final depth of 12,800 feet within 50 days. This well is being drilled from the same location of La Creciente-1, but will be deviated towards the southwest to reach the deepest zone of the Cienaga de Oro Formation at Prospect A. Upon completion of La Creciente-2, the Saxon 126 rig will be moved to drill the exploratory well at prospect “D”, 5.5 kilometers north of La Creciente-1.

Construction of the pipeline to connect La Creciente-1 to the existing Guepaje-Corozal gas pipe will be completed by September 2007, with commercial gas production and sales expected to commence in October 2007.

The Company announced on May 9, 2007 that it has been advised by the ANH that the Company’s subsidiary, SEEP S.A. has secured a Technical Evaluation Agreement for the Arauca Block located in the Llanos Basin of Colombia. The Company expects this agreement to be finalized and executed shortly. In connection with the exploration and development of the Arauca Block, the company has arranged with Petro Rubiales Energy Corp. (formerly Consolidated AGX Resources Corp.)(“Peg”), a TSX Venture Exchange-listed company, to finance the planned work program and to jointly apply for the ANH Exploration and Production Contract for this property.

On May 31 the Company announced that it has entered into a memorandum of understanding to acquire a 26.25% interest in the Quifa Association Contract with PEG. The Quifa Association contract is located in the Llanos Basin of Colombia and consists of an area of 234 km(2). This block surrounds the Rubiales and Piriri fields, which are currently producing approximately 18,500 barrels of heavy crude oil per day, with previously assessed proven and probable reserves of over 375 million barrels of heavy crude oil (12.5 degrees API). The Company has agreed to solely fund all of PEG’s share of costs and expenses associated with the remaining exploration phases under the Quifa Agreement, which are estimated to be US$5.3 million and include seismic acquisition/processing and the drilling of three exploratory wells. The memorandum also provides that PEG will transport a portion of its Rubiales production to the Company’s production facilities at Guaduas in order to produce a blend suitable for pipeline transport and sale, and further provides that the parties shall act jointly in future bidding rounds in Colombia for heavy crude projects in the Llanos Basin. The memorandum is subject to Colombian regulatory approval.

Subsequent Events

On July 5, 2007 the Company obtained the Global Environmental Production Licence at the La Creciente Block in the Lower Magdalena Valley of Colombia. This licence covers all future drilling locations and infrastructure to bring the block into full production. The Company was also awarded a contract for the environmental studies necessary to build an additional pipeline to transport the full block production to the Carribean ports of Cartagena and Covenas. These studies will be completed within 90 days, permits should be obtained by year end and the pipeline could be ready to transport full block production in the second half of 2008.

On July 12 the Company announced that it has been awarded blocks 135, 137 and 138 offered by Perupetro in the 2007 Bidding Program. These blocks total 1,883,553 hectares and are located in the prolific Maranon Basin, to the south of the producing Ecuadorian Napo and Colombian Putumayo Basins. The Company evaluated 18 blocks offered by Perupetro in this bidding round but only made economic offers for four blocks. The main criteria used for the selection of these blocks were the size of the potential resources, the proximity to existing transport infrastructure and economics of the projects. The commitments for the first exploration phase include regional studies and seimic acquisition. Upon the successful completion of phase one, the Company has the option to continue the exploration program with additional seismic acquisition and drilling one well for each block. The Maranon Basin is a well known prolific hydrocarbon bearing area with very attractive geological prospects and access to the Pacific Ocean and the growing Asian markets.

The Company has also just announced that it has renegotiated its rights to the Puli-B block in Colombia and that its sole interest in Puli-B is in the Puli-7 well, which produces 70 bopd (net).

Oil and Gas Revenue

Oil and gas revenues were approximately $9.3 million in the second quarter compared to nil in the previous year and $14.5 million for the six months ending June 30, 2007 compared to nil in the same quarter in 2006. The increase is primarily due to the oil producing Guaduas and Rio Ceibas fields in Colombia purchased in the SEEP SA acquisition in the third quarter of 2006.

Average Daily Oil Production

	2007		2006			
	Q2	**Q1**	**Q4**	**Q3**	**Q2**	**Q1**
Average Daily Oil Production (bbl/day)	1,860	1,954	2,055	2,105	54	46

The significant increase in the third quarter of 2006 is the result of the acquisition of SEEPSA and its producing oil fields.

Average Benchmark Oil Price

Quarter ended	**2007 Q2**	**2006 Q2**
WTI ($/bbl)	64.94	58.07
Henry Hub Natural Gas ($/bbl)	7.55	6.77

Realized Prices

Oil and gas revenues averaged $60.30 per barrel in the three-month period ending June 30, 2007 compared to nil in the comparable 2006 quarter. The discount from average WTI is due primarily to the adjustment to the comparative oil quality produced.

Operating expenses

Operating costs were $2.6 million in the three-month period ending June 30, 2007 and $3.2 million for the six months ended June 30, 2007, compared to nil in the first two quarters of fiscal 2006. The increase was primarily due to acquisition of SEEP SA's oil producing fields in Colombia.

General and Administrative Expenses

General and administrative costs were approximately $3.6 million compared to $0.4 million in the second quarter of fiscal 2006 and $6.7 million for the six months ended June 30, 2007 compared to $0.6 million for the same period in the previous year. The increase is primarily due to the acquisition of SEEP SA's oil producing fields in Colombia and the company's focus on building its administrative infrastructure to support the company growth.

Stock-Based Compensation Expenses

Stock-based compensation was $10.6 million in the second quarter of fiscal 2007 compared to nil in the previous year and $11.0 million for the six months ended June 30, 2007 compared to nil for the same period in the previous year. The Company granted 1,858,000 options in the second quarter of 2007 compared to nil in the same quarter in 2006 and 1,943,000 for the six months ended June 30, 2007 compared to nil in the previous year.

Depletion, Depreciation and Accretion

Depletion, depreciation and accretion was approximately $3.7 million in the second quarter of fiscal 2007 compared to nil in the second quarter of fiscal 2006 and $10.2 million for the six months ended June 30, 2007 compared to nil in the previous year. The increase is primarily due to the reserve depletion of the oil producing fields in Colombia purchased in the SEEP SA acquisition.

Interest expense

Interest expense was $4.8 million compared to nil in the same quarter last year. The increase is primarily due to the interest costs on the Senior Unsecured Notes. Included in interest expense is $4.1 million non-cash loss related to the repayment of the Senior Unsecured notes. The loss was a result of the early repayment of the Cdn$32.5 million face value notes compared to its carrying value. The carrying value of the notes were being accreted using the effective interest method over the life of the notes to bring the carrying value to the their face value at the maturity date.

Income Taxes

Income tax provision was $1.7 million in the second quarter of 2007 compared to nil for the same period in the previous year and $0.7 million for the six months ended June 30, 2007 compared to nil for the same period in the previous year.

Effective January 1, 2007 the following Colombian tax reforms were introduced:

- Tax losses may be carried forward without limitations to offset to taxable income.
- The presumptive income tax rate was reduced from six percent to three percent on the prior tax year's net tax equity.
- The seven percent remittance tax was eliminated.
- A 1.2 percent equity tax was introduced.
- The income tax rate was reduced from 38.5 percent to 34 percent in 2007, and to 33 percent for subsequent years.

Net Loss

Net loss in the second quarter of 2007 was $17.2 million or $0.45 per share compared to net loss of $0.6 million or $0.04 per share in the same quarter last year. The increase in net revenues of $9.3 million for the producing properties acquired net of associated operating costs of $2.6 million and depletion, depreciation and accretion of $3.7 million is offset by an increase in non-cash stock compensation costs of $10.6 million, an increase in general and administrative costs of $3.1 million and increased interest expense of $4.8 million.

Funds Flow From Operations

The Company's funds flow from operations in the second quarter of 2007 generated $2.8 million compared to a use of $0.6 million in the previous year and generated $1.3 million of funds for the six months ended June 30, 2007 compared to a use of $1.0 million. The increase in the funds generated is primarily the increased revenues offset by Company's planned increase in general and administrative costs to support operations and exploration activities. Funds flow from operations is calculated based on cash flow from operations before non-cash operating working capital.

Capital Expenditures

Capital expenditures totaled $28.1 million in the second quarter of 2007 as compared to $0.9 million in the same period for previous year and $38.9 million for the six months ended June 30, 2007. The expenditures in 2007 related to the initial work commitments on the Company's exploration blocks in the La Creciente field and Moriche Block and development costs in the Guaduas field, Rio Ceibas field and the Puli field.

Commitments and Contingency

On August 17, 2005, the Company's subsidiary, Gran Colombia and Hocol S.A. ("Hocol") entered into a farm-out agreement in order to facilitate Hocol's assignment of rights Hocol had obtained under earlier agreements with Empresa Colombiana de Petroleos ("Ecopetrol"), a Colombian industrial and commercial state-owned company involved in the exploitation of hydrocarbons. One agreement related to exploration and exploitation of oil and gas in an area of Colombia known as the Doima Block. A second agreement concerned the incremental production of oil and gas in parts of the Doima Block referred to as the Ortega Area. The farm-out agreement between Gran Colombia and Hocol allowed Hocol to share the risks and benefits of exploring and development the rights it has in the Doima Block. On December 23, 2005, the Company announced that Hocol had challenged the Company's right to continue testing the Don Pedro-1 well, alleging breaches to the farm-out agreement. The disputed properties are included in unproved properties within the Property, Plant and Equipment category of the Company's financial statements.

On August 14, 2007 the Company announced that it has reached a settlement , the terms of which shall remain confidential, with respect to this dispute with Hocol. As a result, the Company now holds no interest in the oil and gas fields of the Doima Contract or the Ortega Contract.

On February 13, 2007, the Company issued a guarantee in favour of Saxon Energy Services Inc. in the form of a one-year letter of credit for US$960,000; the letter of credit pertains to the Company's agreement with Saxon Energy Services Inc. to secure availability of the Saxon 126 Rig and concludes upon the termination of that arrangement.

Liquidity and Capital Resources

At June 30, 2007 the Company had $75.2 million net working capital, including cash and cash equivalents of $82.6 million.

The Company had issued Senior Unsecured Notes in the amount of $28.1 million (Cdn$32.5 million) due June 14, 2011. The Company has repaid these notes using a portion of net proceeds from its April 19, 2007 financing where the aggregate gross proceeds were Cdn$143.75 million.

Risks and Uncertainties

Exploration and Development

The exploration and development of oil and gas deposits involve a number of uncertainties that even thorough evaluation, experience and knowledge of the industry cannot eliminate. It is impossible to guarantee that the exploration programs on the Company's properties will generate economically recoverable reserves. The commercial viability of a new hydrocarbon pool is dependent upon a number of factors which are inherent to reserves, such as the content and the proximity of infrastructure, as well as oil and gas prices which are subject to considerable volatility, regulatory issues such as price regulation, taxes, royalties, land tax, import and export of oil and gas, and environmental protection issues. The individual impact generated by these factors cannot be predicted with any certainty but, once combined, may result in non-economical reserves. The Company remains subject to normal risks inherent to the oil and gas industry such as unusual and unexpected geological changes in the parameters and variables of the petroleum system and operations.

Operating Hazards and Risks

Exploration for natural resources involves many risks, which even a combination of experience, knowledge and careful evaluation may not be able to overcome. Operations in which the Company has a direct or indirect interest will be subject to all the hazards and risks normally incidental to exploration, development and production of resources, any of which could result in work stoppages, damage to persons or property and possible environmental damage. Although the Company has obtained liability insurance in an amount which it considers adequate, the nature of these risks is such that liabilities might exceed policy limits, the liabilities and hazards might not be insurable, or the Company might not elect to insure itself against such liabilities due to high premium costs or other reasons, in which event the Company could incur significant costs that could have a material adverse effect upon its financial condition.

Reserve Estimates

Despite the fact that the Company has reviewed the estimated figures related to the potential reserve evaluation and probabilities attached thereto and it is of the opinion that the methods used to appraise these estimates are adequate, these figures remain estimates, even though they have been calculated or validated by independent appraisers. The reserves disclosed by the Company should not be interpreted as assurances of property life or of the profitability of current or future operations given that there are numerous uncertainties inherent in the estimation of economically recoverable gas/oil reserves.

Fluctuating Prices

Revenues from oil sales vary according to the existence of cost recovery pool balances. As of June 30, 2007 the Company had approximately $• million in unrecovered historical costs, to which must be added the capital expenditures and operating expenses of future years. The Company's revenues, if any, are expected to be in large part derived from the extraction and sale of oil and gas. The price of oil has fluctuated widely, particularly in recent years, and is affected by numerous factors beyond the Company's control, including international economic and political trends, expectations of inflation, war, currency exchange fluctuations, interest rates, global or regional consumptive patterns, speculative activities and increased production due to new extraction developments and improved extraction and production methods. The effect of these factors on the price of oil, and therefore the economic viability of any of the Company's exploration projects, cannot accurately be predicted.

Environmental Factors

All phases of the Company's operations are subject to environmental regulation in Colombia. 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. In addition, certain types of operations require the submission and approval of environmental impact assessments. Environmental legislation is evolving in a manner which means stricter standards, and enforcement, fines and penalties for non-compliance are more stringent. Environmental assessments of proposed projects carry a heightened degree of responsibility for companies and directors, officers and employees. The cost of compliance with changes in governmental regulations has a potential to reduce the profitability of operations. The current exploration, development and production activities of the Company require certain permits and licenses from various governmental authorities and such operations are and will be governed by laws and regulations governing exploration, development and production, labour standards, occupational health, waste disposal, toxic substances, land use, environmental protection, safety and other matters. Companies engaged in exploration activities generally experience increased costs and delays as a result of the need to comply with applicable laws, regulations and permits. There can be no assurance that all licenses and permits which the Company may require to carry out exploration and development of its projects will be obtainable on reasonable terms or on a timely basis, or that such laws and regulations would not have an adverse effect on any project that the Company may undertake.

Retention of Key Personnel

The Company is dependent on retaining the services of a small number of key personnel of the appropriate calibre as its business develops. The success of the Company is, and will continue to be to a significant extent, dependent on the expertise and experience of the directors and senior management and the loss of one or more could have a materially adverse effect on the Company.

Political Risk

The Company's projects are located in Colombia and consequently the Company is subject to certain risks, including currency fluctuations and possible political or economic instability which may result in the impairment or loss of concessions or other rights, and exploration and production activities may be affected in varying degrees by political stability and government regulations relating to the industry. Colombia is home to South America's largest and longest running insurgency, and over the past two decades has experienced significant social upheaval and criminal activity relating to drug trafficking. While the situation has improved dramatically in recent years, there can be no guarantee that the situation will not again deteriorate. Additionally, the continued perception that matters have not improved in Colombia may hinder the Company's ability to access capital in a timely or cost effective manner. Any changes in regulations or shifts in political attitudes are beyond the control of the Company and may adversely affect its business. Exploration may be affected in varying degrees by government regulations with respect to restrictions on future exploitation and production, price controls, export controls, foreign exchange controls, income taxes, expropriation of property, environmental legislation and site safety.

Exchange Rate Volatility

To the extent revenues and expenditures denominated in or strongly linked to the U.S. dollar are not equivalent, the Company is exposed to exchange rate risk. In Colombia, the Company is exposed to the extent U.S. dollar revenues do not equal U.S. dollar expenditures. In addition, a portion of expenditures in Colombia are denominated in Colombian pesos, which are difficult to hedge. The Company is not currently using exchange rate derivatives to manage exchange rate risks.

Financial Resources

The Company's cash flow from operations may not be sufficient to fund its ongoing activities and implement its business plans. From time to time the Company may enter into transactions to acquire assets or the shares of other companies. Depending on the future exploration and development plans, the Company may require additional financing, which may not be available or, if available, may not be available on favourable terms. Failure to obtain such financing on a timely basis could cause the Company to forfeit or forego various opportunities.

Competition

The oil and gas industry is competitive in all its phases. The Company competes with many companies and individuals that have substantially greater financial and technical resources than the Company in the search for, and the acquisition of, properties as well as for the recruitment and retention of qualified employees. The Company's ability to increase its interests in the future will depend not only on its ability to explore and develop its present properties, but also on its ability to select, acquire and develop suitable properties or prospects.

Dividends

The future payments of dividends on the common shares of the Company will be dependent upon the financial requirements of the Company to finance future growth, the financial condition of the Company and other factors which the board of directors may consider appropriate in the circumstance. The Company has not paid any dividends and is unlikely to pay dividends in the immediate or foreseeable future.

Changes in Legislation

The oil and gas industry in Colombia is subject to extensive controls and regulations imposed by various levels of government. All current legislation is a matter of public record and the Company is unable to predict what additional legislation or amendments may be enacted. Amendments to current laws, regulations and permits governing operations and activities of oil and gas companies, including environmental laws and regulations which are evolving in Colombia, or more stringent implementation thereof, could have a material adverse impact on the Company and cause increases in expenditures and costs, affect the Company's ability to expand or transfer existing operations or require the Company to abandon or delay the development of new oil and gas properties.

Title Matters

The acquisition of title to oil and gas properties in Colombia is a detailed and time consuming process. The Company's properties may be subject to unforeseen title claims. While the Company has diligently investigated title to all property and has followed usual industry practice in obtaining satisfactory title opinions and, to the best of its knowledge, title to all of its properties is in good standing, this should not be construed as a guarantee of title. Title to the properties may be affected by undisclosed and undetected defects.

Repatriation of Earnings

Currently there are no restrictions on the repatriation from Colombia of earnings to foreign entities. However, there can be no assurance that restrictions on repatriation of earnings from Colombia will not be imposed in the future.

Transportation Costs

Disruption in or increased costs of transportation services could make oil and gas a less competitive source of energy or could make the Company's oil and gas less competitive than other sources. The industry depends on rail, trucking, ocean-going vessel, pipeline facilities, and barge transportation to deliver shipments, and transportation costs are a significant component of the total cost of supplying oil and gas. Disruptions of these transportation services because of weather-related problems, strikes, lockouts, delays or other events could temporarily impair ability to supply oil and gas to customers and may result in lost sales. In addition, increases in transportation costs, or changes in transportation costs for oil and gas produced by competitors, could adversely affect profitability. To the extent such increases are sustained, the Company could experience losses and may decide to discontinue certain operations forcing the Company to incur closure and/or care and maintenance costs, as the case may be. Additionally, lack of access to transportation may hinder the expansion of production at some of the Company's properties and the Company may be required to use more expensive transportation alternatives.

Disruptions in Production

Other factors affecting the production and sale of oil and gas that could result in decreases in profitability include: (i) expiration or termination of leases, permits or licences, or sales price re-determinations or suspension of deliveries; (ii) future litigation; (iii) the timing and amount of insurance recoveries; (iv) work stoppages or other labour difficulties; (v) worker vacation schedules and related maintenance activities; and (vi) changes in the market and general economic conditions. Weather conditions, equipment replacement or repair, fires, amounts of rock and other natural materials and other geological conditions can have a significant impact on operating results.

Enforcement of Civil Liabilities

Substantially all of the assets of the Company are located outside of Canada and certain of the directors and officers of the Company are resident outside of Canada. As a result, it may be difficult or impossible to enforce judgments granted by a court in Canada against the assets of the Company or the directors and officers of the Company residing outside of Canada.

Critical Accounting Policies and Estimates

The Company's financial statements are prepared in accordance with Canadian GAAP, which require management to make judgments, estimates and assumptions, which may have significant impact on the financial statements. A summary of the Company's significant accounting policies can be found in Note 2 to the Company's interim financial statements for the period ending June 30, 2007. The following is a discussion of those accounting policies and estimates that are considered critical in the determination of the Company's financial results.

Property and Equipment – Full Cost Accounting

The Company follows the full cost method of accounting and alternatively, could follow the successful efforts method of accounting whereby all costs related to non-producing wells are expensed in the period in which they are incurred.

Under the full cost method of accounting, capitalized costs are subject to a country-by-country cost centre impairment test. Under the successful efforts method of accounting, the costs are aggregated on a property-by-property basis and the carrying value of each property is subject to an impairment test. These policies may result in a different carrying value for property and equipment and a different net income. The full cost method is the method most commonly followed by Pacific Stratus Energy's comparable peer group of companies.

Under full cost accounting, a limit is placed on the carrying value of the net capitalized costs in each cost centre in order to test impairment. Impairment exists when the carrying value of developed properties of a cost centre exceeds the estimated undiscounted future net cash flows associated with the cost centre's proved reserves. Costs relating to undeveloped properties are subject to individual impairment assessments until it can be determined whether or not proved reserves exist. If impairment is determined to exist, the costs carried on the balance sheet in excess of the discounted future net cash flows associated with the cost centre's proved plus probable reserves are charged to income.

Reserve Estimates

Reserve estimates can have a significant impact on net income and the carrying value of capital assets. The process of estimating reserves requires significant judgment based on available geological, geophysical, engineering, and economic data, projected rates of production, estimated commodity price forecasts and the timing of future expenditures, all of which are subject to interpreting and uncertainty. Reserve estimates impact net income through depletion expense and the application of impairment tests. Revisions or changes in reserve estimates can have either a positive or a negative impact on the net income and can impact the carrying amount of capital assets.

Creditors may also use reserve estimates to assess the allowable borrowing base under secured credit facilities. Changes to the reserve estimates can result in borrowing base increases or decreases, which could impact the Company's financial position.

Asset Retirement Obligations

The Company recognizes the estimated fair value of future retirement obligations associated with capital assets as a liability. The Company estimates the liability based on the estimated costs to abandon and reclaim its net ownership in tangible long-lived assets such as wells and facilities and the estimated timing of the costs to be incurred in future periods. Actual payments to settle the obligations may differ from estimated amounts.

Stock-Based Compensation

The Company uses the fair value method for valuing stock option grants. Under this method, compensation cost attributable to all stock options granted is measured at fair value at the grant date, using the Black-Scholes valuation model, and expensed over the vesting period with a corresponding increase to contributed surplus. Upon exercise of options, consideration received together with the amount previously recognized in contributed surplus is recorded as an increase to share capital.

Income Tax Accounting

The determination of the Company's income and other tax liabilities requires interpretation of complex laws and regulations often involving multiple jurisdictions. All tax filings are subject to audit and potential reassessment after the lapse of considerable time. Accordingly, the actual income tax liability may differ significantly from that estimated and recorded by management.

New Accounting Pronouncements

Effective January 1, 2007, the Company adopted three new accounting standards, who of which are related to financial instruments that were issued by the Canadian Institute of Chartered Accountants ("CICA"). These accounting policy changes were adopted on a prospective basis with no restatement required for the prior period financial statements. The new standards and accounting policy changes are as follows:

(a) Comprehensive income (CICA Handbook Section 1530)

Comprehensive income comprises the Company's net income and other comprehensive income. Other comprehensive income represents changes in shareholders' equity during a period arising from non-owner sources and, for the Company, includes currency translation adjustments on the net investment in self-sustaining operations and unrealized gains and losses on available-for-sale securities. The Company's comprehensive income, components of other comprehensive income, and accumulated other comprehensive income are presented in the statement of changes in shareholders' equity and comprehensive income. Prior financial statements retroactively reflect the classification of the currency translation adjustments on the Company's net investment in self-sustaining operations as components of other comprehensive income.

(b) Financial instruments – recognition and measurement (CICA Handbook Section 3855) and disclosure and presentation (CICA Handbook Section 3861)

In accordance with these new standards, the Company now classifies all financial instruments as either held-for-trading, available for sale, held-to-maturity, loans and receivables or other financial liabilities. Financial instruments classified as held-for-trading are measured at fair value with unrealized gains and losses recognized in operating results. Financial instruments classified as available for sale are measured at fair value with unrealized gains and losses recognized in other comprehensive income. Financial instruments classified as held-to-maturity, loans and receivables or other financial liabilities are measured at amortized cost.

Upon adoption of these new standards, the Company has designated its cash and cash equivalents as held-for-trading, which are measured at fair value. Accounts receivable and other are classified as loans and receivables, which are measured at amortized cost. Accounts payable and accrued liabilities and notes payable are classified as other liabilities, which are measured at amortized cost.

The Company adopted a policy, under Section 3855, to expense debt financing fees when they are incurred and as a result the Company recorded a non-cash adjustment to increase opening deficit by $1,156,000 to eliminate the opening balance of debt financing fees that were capitalized and amortized under the Company's previous accounting policy.

(c) Foreign currency translation

The Company has changed its reporting currency to United States dollars effective January 1, 2007. The change in reporting currency was made to improve investors' ability to compare the Company's results with those of most other publicly traded businesses in the industry. Historical results have been restated to the reporting currency using the current rate method. Under this method, the assets and liabilities were translated using the exchange rate in effect at the balance sheet date. The statements of operations and cash flows were translated at the average rate for the respective reporting periods. Any resulting foreign exchange gains and losses were recorded as a separate component of shareholders' equity and described as cumulative translation adjustments within accumulated comprehensive income.

Regulatory Policies

Certification of Disclosures in Annual and Interim Filings

In accordance with Multilateral Instrument 52-109 of the Canadian Securities Administrators, the Company annually issues a "Certification of Annual Filings" ("Certification"). The Certification requires certifying officers to state that they are responsible for establishing and maintaining disclosure controls and procedures, have designed such procedures and evaluated their effectiveness as of the end of the period covered by these annual filings.

The certifying officers have evaluated the effectiveness of the Company's disclosure controls and procedures and, based on such evaluation, believe that the disclosure controls and procedures provide a reasonable assurance that information required to be disclosed by the Company in these annual filings is recorded, processed, summarized and reported within the time periods specified and the controls and procedures ensure that the information required to be disclosed by the Company is accumulated and communicated to management, including its Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

In addition, the certifying officers of the Company are responsible for designing internal controls over financial reporting or causing them to be designed 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. Following the acquisition of SEEPSA, work is ongoing to improve and modernize these controls and to ensure that they remain consistently applied. The Company realized that with the increasing complexity of the business and more demanding filing requirements of the TSX that additional financial personnel were needed. As a result, the Company has implemented plans for the availability of dedicated resources. Management and the Board of Directors are working to mitigate the risk of a material misstatement in financial reporting, however, there can be no assurance that this risk can be reduced to less than a remote likelihood of a material misstatement. The Company has continually had in place systems relating to internal control over financial reporting and will continue to monitor internal controls as the Company's business evolves.

The certifying officers have evaluated the design of the Company's internal control over financial reporting. Based on this evaluation as of June 30, 2007, the certifying officers have concluded that the Company's internal control over financial reporting, as defined in 52-109, is designed to provide reasonable assurance regarding the reliability of financial reporting and preparation of the financial statements for the quarter ended June 30, 2006, in accordance with Canadian GAAP. There has been no change in the Company's internal control over financial reporting that occurred during the most recently completed quarter that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

Outlook

The Company will continue to invest in capital expenditures to commercialize the gas discoveries at La Creciente and oil discoveries in the Moriche block. Capital expenditures will focus on the 2007 production program at La Creciente, construction of the La Creciente production facilities and gas pipeline, development of its Moriche property, including the construction of production facilities, and on evaluating its properties in the Llanos Basin.