IVANHOE ENERGY INC
Form 10-Q
August 11, 2008

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended June 30, 2008

or

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from __________ to __________

Commission file number 000-30586

IVANHOE ENERGY INC.

(Exact name of registrant as specified in its charter)

Yukon, Canada	**98-0372413**
(State or other jurisdiction of incorporation or organization)	*(I.R.S. Employer Identification No.)*

Suite 654 999 Canada Place Vancouver, British Columbia, Canada	**V6C 3E1**
(Address of principal executive office)	*(zip code)*

(604) 688-8323

(registrant s telephone number, including area code)

No Changes

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. þ Yes o No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer o	Accelerated filer þ	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). o Yes þ No

The number of shares of the registrant s capital stock outstanding as of June 30, 2008 was 245,540,784 Common Shares, no par value.

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Part I Financial Information

Item 1 Financial Statements
IVANHOE ENERGY INC.
Unaudited Condensed Consolidated Balance Sheets
(stated in thousands of U.S. Dollars, except share amounts)

	June 30, 2008	December 31, 2007
Assets		
Current Assets:		
Cash and cash equivalents	**$ 10,214**	$ 11,356
Accounts receivable	**11,893**	9,376
Advance	**725**	825
Prepaid and other current assets	**461**	602
Future income tax assets	**2,286**	
	25,579	22,159
Oil and gas properties and development costs, net	**104,555**	111,853
Intangible assets technology	**102,153**	102,153
Long term assets	**2,870**	751
	$ 235,157	$ 236,916
Liabilities and Shareholders Equity		
Current Liabilities:		
Accounts payable and accrued liabilities	**$ 10,992**	$ 9,538
Debt current portion	**11,636**	6,729
Derivative instruments	**27,863**	9,432
	50,491	25,699
Long term debt	**9,484**	9,812
Asset retirement obligations	**3,673**	2,218
Long term obligation	**1,900**	1,900
	65,548	39,629
Commitments and contingencies		
Shareholders Equity:		
Share capital, issued 245,540,784 common shares; December 31, 2007 244,873,349 common shares	**325,168**	324,262
Purchase warrants	**18,805**	23,078
Contributed surplus	**15,901**	9,937
Accumulated deficit	**(190,265)**	(159,990)
	169,609	197,287

$	**235,157**	$	236,916

(See accompanying notes)

IVANHOE ENERGY INC.
Unaudited Condensed Consolidated Statements of Operations, Comprehensive Loss and Accumulated Deficit
(stated in thousands of U.S. Dollars, except per share amounts)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	**2008**	2007
Revenue				
Oil and gas revenue	**$ 17,979**	$ 9,789	**$ 33,022**	$ 19,385
Loss on derivative instruments	**(20,787)**	(316)	**(24,733)**	(775)
Interest income	**36**	116	**108**	236
	(2,772)	9,589	**8,397**	18,846
Expenses				
Operating costs	**6,614**	4,223	**12,006**	7,908
General and administrative	**4,084**	3,384	**7,749**	6,256
Business and technology development	**1,914**	2,348	**3,671**	4,510
Depletion and depreciation	**8,129**	6,024	**16,495**	12,916
Interest expense and financing costs	**504**	189	**1,037**	382
	21,245	16,168	**40,958**	31,972
Loss before Income Taxes	**(24,017)**	(6,579)	**(32,561)**	(13,126)
Future income tax recovery	**2,286**		**2,286**	
Net Loss and Comprehensive Loss	**(21,731)**	(6,579)	**(30,275)**	(13,126)
Accumulated Deficit, beginning of period	**(168,534)**	(127,330)	**(159,990)**	(120,783)
Accumulated Deficit, end of period	**$ (190,265)**	$ (133,909)	**$ (190,265)**	$ (133,909)
Net Loss per share Basic and Diluted	**$ (0.09)**	$ (0.03)	**$ (0.12)**	$ (0.05)
Weighted Average Number of Shares (in thousands)	**245,250**	241,443	**245,063**	241,338

(See accompanying notes)

IVANHOE ENERGY INC.
Unaudited Condensed Consolidated Statements of Cash Flows
(stated in thousands of U.S. Dollars)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	**2007**	**2008**	**2007**
Operating Activities				
Net loss and comprehensive loss	**$ (21,731)**	$ (6,579)	**$ (30,275)**	$ (13,126)
Items not requiring use of cash:				
Depletion and depreciation	**8,129**	6,024	**16,495**	12,916
Stock based compensation	**793**	1,053	**1,911**	1,855
Unrealized loss on derivative instruments	**16,433**	286	**18,431**	952
Future income tax recovery	**(2,286)**		**(2,286)**	
Other	**268**	161	**459**	330
Changes in non-cash working capital items	**1,020**	(746)	**908**	(127)
	2,626	199	**5,643**	2,800
Investing Activities				
Capital investments	**(2,593)**	(8,123)	**(7,916)**	(13,457)
Proceeds from sale of assets	**100**		**100**	1,000
Recovery of HTL™ investments		9,000		9,000
Advance repayments	**100**	200	**100**	400
Other	**(73)**		**(103)**	75
Changes in non-cash working capital items	**(1,402)**	(481)	**(2,532)**	(1,494)
	(3,868)	596	**(10,351)**	(4,476)
Financing Activities				
Proceeds from exercise of options	**686**	165	**686**	165
Proceeds from debt obligations, net of financing costs	**5,472**		**5,472**	
Payments of debt obligations	**(615)**	(615)	**(1,230)**	(1,230)
Payments of deferred financing costs	**(1,480)**	(62)	**(2,064)**	(62)
Changes in non-cash working capital items	**702**		**702**	
	4,765	(512)	**3,566**	(1,127)
Increase (decrease) in cash and cash equivalents, for the period	**3,523**	283	**(1,142)**	(2,803)
Cash and cash equivalents, beginning of period	**6,691**	10,793	**11,356**	13,879
Cash and cash equivalents, end of period	**$ 10,214**	$ 11,076	**$ 10,214**	$ 11,076

(See accompanying notes)

Notes to the Condensed Consolidated Financial Statements
June 30, 2008
(all tabular amounts are expressed in thousands of U.S. dollars except per share amounts)
(Unaudited)

1. BASIS OF PRESENTATION

Ivanhoe Energy Inc s (the **Company** or **Ivanhoe Energy**) accounting policies are in accordance with accounting principles generally accepted in Canada. These policies are consistent with accounting principles generally accepted in the U.S., except as outlined in Note 15. The unaudited condensed consolidated financial statements have been prepared on a basis consistent with the accounting principles and policies reflected in the December 31, 2007 consolidated financial statements except as discussed in Note 2. These interim condensed consolidated financial statements do not include all disclosures normally provided in annual consolidated financial statements and should be read in conjunction with the most recent annual consolidated financial statements. The December 31, 2007 condensed consolidated balance sheet was derived from the audited consolidated financial statements, but does not include all disclosures required by generally accepted accounting principles (**GAAP**) in Canada and the U.S. In the opinion of management, all adjustments (which included normal recurring adjustments) necessary for the fair presentation for the interim periods have been made. The results of operations and cash flows are not necessarily indicative of the results for a full year.

The Company currently anticipates incurring substantial expenditures to further its capital development programs, particularly those related to the recently completed acquisition of two oilsands leases in Alberta. The continued existence of the Company is dependent upon its ability to obtain capital to fund further development and to meet obligations to preserve its interests in its existing Alberta properties and to meet the obligations associated with other potential HTL and GTL projects. The Company intends to finance the future payments required under the Alberta oilsands acquisition and other capital projects from a combination of strategic investors and/or traditional debt and equity markets, either at a parent company level or at the project level. The Company believes that it has sufficient funds to reach final investment decisions on its projects, however significant amounts of new capital will be required. These interim condensed consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles applicable to a going concern, which assumes that the Company will continue in operation for the foreseeable future and will be able to realize its assets and discharge its liabilities in the normal course of operations. If the going concern assumption was not appropriate for these condensed consolidated financial statements, then adjustments would be necessary to the carrying values of assets and liabilities, the reported expenses and the balance sheet classifications used.

2. CHANGES IN ACCOUNTING POLICIES

2008 Accounting Changes

On January 1, 2008 the Company adopted three new accounting standards that were issued by the Canadian Institute of Chartered Accountants (**CICA**): Handbook Section 1535 Capital Disclosures (**S.1535**), Handbook Section 3862 Financial Instruments Disclosures (**S.3862**), and Handbook Section 3863 Financial Instruments Presentation (**S.3863**). S.1535 establishes standards for disclosing information about an entity s capital and how it is managed. The objective of S.3862 is to require entities to provide disclosures in their financial statements that enable users to evaluate both the significance of financial instruments for the entity s financial position and performance; and the nature and extent of risks arising from financial instruments to which the entity is exposed during the period and at the balance sheet date, and how the entity manages those risks. The purpose of S.3863 is to enhance financial statement users understanding of the significance of financial instruments to an entity s financial position, performance and cash flows. The latter two replaced S.3861. The Company has adopted the new standards on January 1, 2008 with additional disclosures included in these condensed consolidated financial statements. There was no transitional adjustment to the condensed consolidated financial statements as a result of having adopted these standards.

Impact of New and Pending Canadian GAAP Accounting Standards

In February 2008, the CICA issued Handbook Section 3064, Goodwill and Intangible assets, (**S.3064**) replacing Handbook Section 3062, Goodwill and Other Intangible Assets (**S.3062**) and Handbook Section 3450, Research and Development Costs . Various changes have been made to other sections of the CICA Handbook for consistency purposes. S.3064 will be applicable to financial statements relating to fiscal years beginning on or after October 1, 2008. Accordingly, the Company will adopt the new standards for its fiscal year beginning January 1, 2009. The new section establishes standards for the recognition, measurement, presentation and disclosure of goodwill subsequent to its initial recognition and of intangible assets by profit-oriented enterprises. Standards concerning goodwill are unchanged from the standards included in the previous S.3062. Management has concluded that the requirements of this new Section as they relate to goodwill will not have a material impact on its consolidated financial statements; however, management is still evaluating the impact of the requirements related to development costs.

Convergence of Canadian GAAP with International Financial Reporting Standards

In 2006, Canada s Accounting Standards Board (**AcSB**) ratified a strategic plan that will result in Canadian GAAP, as used by public companies, being converged with International Financial Reporting Standards (**IFRS**) over a transitional period. The AcSB has developed and published a detailed implementation plan, with a required changeover date for fiscal years beginning on or after January 1, 2011. This convergence initiative is in its early stages as of the date of these financial statements. Management has commenced a program of analyzing the Company s historical financial information in order to assess the impact of the convergence on its financial statements.

3. OIL AND GAS PROPERTIES AND DEVELOPMENT COSTS

Capital assets categorized by geographical location and business segment are as follows:

	As at June 30, 2008				
	Oil and Gas				
	U.S.	China	HTL™	GTL	Total
Oil and Gas Properties:					
Proved	$ 110,316	$ 137,698	$	$	$ 248,014
Unproved	4,394	4,019			8,413
	114,710	141,717			256,427
Accumulated depletion	(30,228)	(70,582)			(100,810)
Accumulated provision for impairment	(50,350)	(16,550)			(66,900)
	34,132	54,585			88,717
HTL™ and GTL Development Costs:					
Feasibility studies and other deferred costs			527	5,054	5,581
Feedstock test facility			5,505		5,505
Commercial demonstration facility			11,083		11,083
Accumulated depreciation			(6,476)		(6,476)
			10,639	5,054	15,693
Furniture and equipment	547	119	113		779
Accumulated depreciation	(468)	(79)	(87)		(634)
	79	40	26		145
	$ 34,211	$ 54,625	$ 10,665	$ 5,054	$ 104,555

	As at December 31, 2007				
	Oil and Gas				
	U.S.	China	HTL™	GTL	Total
Oil and Gas Properties:					
Proved	$ 107,040	$ 134,648	$	$	$ 241,688
Unproved	4,373	3,297			7,670
	111,413	137,945			249,358

Accumulated depletion	(27,091)	(58,583)			(85,674)
Accumulated provision for impairment	(50,350)	(16,550)			(66,900)
	33,972	62,812			96,784
HTL™ and GTL Development Costs:					
Feasibility studies and other deferred costs			389	5,054	5,443
Feedstock test facility			4,724		4,724
Commercial demonstration facility			9,903		9,903
Accumulated depreciation			(5,159)		(5,159)
			9,857	5,054	14,911
Furniture and equipment	529	119	107		755
Accumulated depreciation	(449)	(77)	(71)		(597)
	80	42	36		158
	$ 34,052	$ 62,854	$ 9,893	$ 5,054	$ 111,853

Costs as at June 30, 2008 of $8.4 million ($7.7 million at December 31, 2007), related to unproved oil and gas properties have been excluded from costs subject to depletion and depreciation. Included in that same depletion calculation were $15.1 million for future development costs associated with proven undeveloped reserves as at June 30, 2008 ($8.9 million at December 31, 2007).

For the three-month and six-month periods ended June 30, 2008, general and administrative expenses related directly to oil and gas acquisition, exploration and development activities of $0.6 million and $1.2 million ($0.9 million and $1.8 million for those same periods in 2007) were capitalized.

4. INTANGIBLE ASSETS TECHNOLOGY

The Company s intangible assets consist of the following:

HTL™ Technology

The Company owns an exclusive, irrevocable license to deploy, worldwide, the patented rapid thermal processing process (**RTP™ Process**) for petroleum applications as well as the exclusive right to deploy the RTP™ Process in all applications other than biomass. The Company s carrying value of the RTP™ Process for heavy oil upgrading (**HTL™ Technology** or **HTL™**) as at June 30, 2008 and December 31, 2007 was $92.2 million. Since the Company acquired the technology, it has continued to expand its patent coverage to protect innovations to the HTL Technology as they are developed and to significantly extend the Company s portfolio of HTL intellectual property. The Company is the assignee of three granted patents and currently has five patent applications pending in the U.S. The Company also has multiple patents pending in numerous other countries.

Syntroleum Master License

The Company owns a master license from Syntroleum Corporation (**Syntroleum**) permitting the Company to use Syntroleum s proprietary gas-to-liquids (**GTL Technology** or **GTL**) process in an unlimited number of projects around the world. The Company s master license expires on the later of April 2015 or five years from the effective date of the last site license issued to the Company by Syntroleum. In respect of GTL projects in which both the Company and Syntroleum participate no additional license fees or royalties will be payable by the Company and Syntroleum will contribute, to any such project, the right to manufacture specialty and lubricant products. Both companies have the right to pursue GTL projects independently, but the Company would be required to pay the normal license fees and royalties in such projects. The Company s carrying value of the Syntroleum GTL master license as at June 30, 2008 and December 31, 2007 was $10.0 million.

Recovery of capitalized costs related to potential HTL™ and GTL projects is dependent upon finalizing definitive agreements for, and successful completion of, the various projects. These intangible assets were not amortized and their carrying values were not impaired for the three-month and six-month periods ended June 30, 2008 and 2007.

5. LONG TERM DEBT

Notes payable consisted of the following as at:

	June 30, 2008	**December 31, 2007**
Variable rate bank note, (5.70% - 5.85% at June 30, 2008), due 2008	$ 5,200	$ 4,500
Variable rate bank note (6.29% at June 30, 2008) due 2010	10,000	10,000
Non-interest bearing promissory note, due 2006 through 2009	1,646	2,876
Demand loan at 8% due August 2008	4,936	
	21,782	17,376
Less:		
Unamortized discount	(48)	(139)
Unamortized deferred financing costs	(614)	(696)
Current maturities	(11,636)	(6,729)

	(12,298)	(7,564)
	$ 9,484	$ 9,812

Bank Loans

In October 2006 the Company arranged a Senior Secured Revolving/Term Credit Facility of up to $15 million with an initial borrowing base of $8 million. The facility is a revolving facility and is due in October 2008. Depending on the drawn amount, interest, at the Company s option, will be either at 1.75% to 2.25%, above the bank s base rate or 2.75% to 3.25% over the London Inter-Bank Offered Rate (**LIBOR**). The loan terms include the requirement for the Company to enter into two-year commodity derivative contracts (See Note 10) covering up to 14,700 Bbls of the Company s production from its South Midway property in California and its Spraberry property in West Texas. As part of reestablishing the borrowing base amount, the Company was required to enter into an additional commodity derivative contract (See Note 10). The facility is secured by a mortgage on both of these properties.

In September 2007 the Company arranged an additional Revolving/Term Credit Facility of up to $30 million with an initial borrowing base of $10 million. The facility is a revolving facility with a three-year term with interest payable only during the term. Interest will be three-month LIBOR plus 3.75%. The loan terms include the requirement for the Company to enter into three-year commodity derivative contracts (See Note 10) covering up to 18,000 Bbls per month of the Company s production from its Dagang field in China. The facility is secured by a security interest in the revenue from the Company s monthly oil sales in China and by a pledge of shares of the Company s Chinese subsidiaries.

Promissory Notes

In February 2006, the Company re-acquired the 40% working interest in the Dagang oil project not already owned by the Company. Part of the consideration was the issuance by the Company of a non-interest bearing, unsecured promissory note in the principal amount of approximately $7.4 million ($6.5 million after being discounted to net present value). The note is payable in 36 equal monthly installments commencing March 31, 2006. The Company has the right, during the three-year loan repayment period, to require the holder of the promissory note, Richfirst Holdings Limited (**Richfirst**), to convert the remaining unpaid balance of the promissory note into common shares of the Company s wholly-owned subsidiary, Sunwing Energy Ltd (**Sunwing**), or another company owning all of the outstanding shares of Sunwing, subject to Sunwing or the other company having obtained a listing of its common shares on a prescribed stock exchange. The number of shares issued would be determined by dividing the then outstanding principal balance under the promissory note by the issue price of shares of the newly listed company issued in the transaction that results in the listing, less a 10% discount.

Demand Loan

In April 2008, the Company obtained a loan from a third party finance company in the amount of Cdn. $5.0 million bearing interest at 8% per annum. The principal and accrued and unpaid interest matures and is repayable in August 2008. The lender has the option to convert the outstanding balance, in whole or in part, into the Company s common shares at a conversion price of Cdn.$2.24 per share.

The scheduled maturities of the Company s long term debt, excluding unamortized discount and unamortized deferred financing costs, as at June 30, 2008 were as follows:

2008	11,366
2009	416
2010	10,000
	$ 21,782

6. ASSET RETIREMENT OBLIGATIONS

The Company provides for the expected costs required to abandon its producing U.S. oil and gas properties and the HTL^{TM} commercial demonstration facility (**CDF**). The undiscounted amount of expected future cash flows required to settle the Company s asset retirement obligations for these assets as at June 30, 2008 was estimated at $6.3 million. These payments are expected to be made over the next 30 years; with over half of the payments between 2010 and 2025. To calculate the present value of these obligations, the Company used an inflation rate of 3% and the expected future cash flows have been discounted using a credit-adjusted risk-free rate of 6%. The changes in the Company s liability for the six-month period ended June 30, 2008 were as follows:

	2008

Carrying balance as of January 1, 2008	$ 2,218
Liabilities incurred	218
Accretion expense	78
Revisions in estimated cash flows	1,159
Carrying balance as of June 30, 2008	$ 3,673

7. COMMITMENTS AND CONTINGENCIES

Zitong Block Exploration Commitment

At December 31, 2005, the Company held a 100% working interest in a thirty-year production-sharing contract with China National Petroleum Corporation (**CNPC**) in a contract area, known as the Zitong Block, located in the northwestern portion of the Sichuan Basin. In January 2006, the Company farmed-out 10% of its working interest in the Zitong block to Mitsubishi Gas Chemical Company Inc. of Japan (**Mitsubishi**) for $4.0 million.

The Company has completed the first phase of this project and in December 2007, the Company and Mitsubishi (the **Zitong Partners**) made a decision to enter into the next three-year exploration phase (**Phase 2**) of the project. By electing to participate in Phase 2 the Zitong Partners must relinquish 30%, plus or minus 5%, of the Zitong block acreage and complete a minimum work program involving the acquisition of approximately 200 miles of new seismic lines and the drilling of approximately 23,700 feet of new wellbore, (including a 700 foot shortfall from the first phase), with total estimated minimum expenditures for this program of $25.0 million. The Phase 2 seismic line acquisition commitment was fulfilled in the first phase exploration program and no further seismic acquisition is required by the contract. The Zitong Partners must complete the minimum work program by December 31, 2010, or will be obligated to pay to CNPC the cash equivalent of the deficiency in the work program for that exploration phase. The recent earthquake in China s Sichuan Province has resulted in some delays in analyzing and reviewing geophysical data. The Company will be evaluating whether these delays will prohibit it from completing the work program within the required time frame and address whether or not an extension of that time frame is needed in the near future. Following the completion of Phase 2, the Zitong Partners must relinquish all of the remaining property except any areas identified for development and production.

Long Term Obligation

As part of its 2005 merger with Ensyn Group, Inc., the Company assumed an obligation to pay $1.9 million in the event, and at such time that, the sale of units incorporating the HTL™ Technology for petroleum applications reach a total of $100.0 million. This obligation is recorded in the Company s consolidated balance sheet.

Income Taxes

The Company s income tax filings are subject to audit by taxation authorities, which may result in the payment of income taxes and/or a decrease its net operating losses available for carry-forward in the various jurisdictions in which the Company operates. While the Company believes its tax filings do not include uncertain tax positions, except as noted below, the results of potential audits or the effect of changes in tax law cannot be ascertained at this time.

The Company has an uncertain tax position related to the commencement of when tax deductions associated with development costs are taken. In March 2007, the Company received a preliminary indication from local Chinese tax authorities as to a potential change in the rule under which development costs are deducted from taxable income effective for the 2006 tax year. The Company discussed this matter with Chinese tax authorities and subsequently filed its 2006 tax return for Sunwing s wholly-owned subsidiary Pan-China Resources Ltd. (**Pan-China**) taking a new filing position in which development costs are capitalized and amortized on a straight line basis over six years starting in the year the development costs are incurred rather than deducted in their entirety in the year incurred. This change resulted in a $50.3 million reduction in tax loss carry-forwards in 2007 with an equivalent increase in the tax basis of development costs available for application against future Chinese income. The Company has received no formal notification of this rule change, however it will continue to file tax returns under this new approach. To the extent that there is a different interpretation in the timing of the deductibility of developmental costs this could potentially result in a reduction in the net operating losses of Pan-China and a current tax provision of $0.6 million.

The Company has an uncertain tax position related to calculation of a gain on the consideration received from two farm-out transactions (Richfirst January 2004 See Note 5 and Mitsubishi January 2006 See under Zitong Block Exploration Commitment in this Note 7) and the designation of whether the taxable gains may be subject to a withholding tax of 10% pursuant to Chinese tax law for income derived by a foreign entity. The Company is waiting for the Chinese tax authorities to reply to its request to validate in writing that its current treatment of such tax position is appropriate. To the extent that the calculation of a gain is interpreted differently and the amounts are subject to withholding tax there would be an additional current tax provision of approximately $0.7 million.

No amounts have been recorded in the financial statements related to the above mentioned uncertain tax positions as management has determined the likelihood of an unfavorable outcome to the Company to be low.

Other Commitments

The Company has contracted with Zeton Inc. (**Zeton**) to construct a Feedstock Test Facility (**FTF**) that has been designed to process small quantities of heavy oil. The FTF is a small (15-20 Bbls/d), highly flexible state-of-the-art HTL™ facility which will permit more cost-effective screening of feedstock crudes for current and potential partners in smaller volumes and at lower costs than required at the CDF. The contract is considered a lump-sum turn-key contract with scheduled payments tied to milestones. Should Zeton meet all of the remaining milestones, the Company will be obligated to pay $1.9 million in addition to what has been paid to date.

From time to time the Company enters into consulting agreements whereby a success fee may be payable if and when either a definitive agreement is signed or certain other contractual milestones are met. Under the agreements, the consultant may receive cash, Company shares, stock options or some combination thereof. These fees are not considered to be material in relation to the overall capital costs and funding requirements of the future individual projects.

The Company may provide indemnities to third parties, in the ordinary course of business, that are customary in certain commercial transactions such as purchase and sale agreements. The terms of these indemnities will vary based upon the contract, the nature of which prevents the Company from making a reasonable estimate of the maximum potential amounts that may be required to be paid. The Company s management is of the opinion that any resulting settlements relating to potential litigation matters or indemnities would not materially affect the financial position of the Company.

8. SHARE CAPITAL AND WARRANTS

Following is a summary of the changes in share capital and stock options outstanding for the six-month period ended June 30, 2008:

	Common Shares			**Stock Options**	
	Number (thousands)	**Amount**	**Contributed Surplus**	**Number (thousands)**	**Weighted Average Exercise Price Cdn.$**
Balance December 31, 2007	244,873	$ 324,262	$ 9,937	12,945	$ 2.37
Shares issued for:					
Exercise of options	668	906	(220)	(781)	$ 1.35
Options:					
Granted			1,911	3,782	$ 1.77
Expired				(139)	$ 2.04
Purchase warrants expired			4,273		
Balance June 30, 2008	245,541	$ 325,168	$ 15,901	15,807	$ 2.28

Purchase Warrants

The only changes to the number of the Company s purchase warrants and common shares issuable upon the exercise of the purchase warrants for the six-month period ended June 30, 2008 were the expiration of 4.1 million, and 11.0 million, purchase warrants in April and May 2008. The combined value of $4.3 million associated with these warrants was reclassified from Purchase Warrants to Contributed Surplus at the time of expiration.

As at June 30, 2008, the following purchase warrants were exercisable to purchase common shares of the Company until the expiry date at the price per share as indicated below:

Price per Special	**Purchase Warrants Common Shares**	**Exercise Price per**	**Value on Exercise**

Warrant	Issued	Exercisable (thousands)	Issuable	Value ($U.S. 000)	Expiry Date	Share	($U.S. 000)
U.S.$2.23	11,400	11,400	11,400	18,805	May 2011	Cdn. $2.93 (1)	32,973

(1) Each common share purchase warrant originally entitled the holder to purchase one common share at a price of $2.63 per share until the fifth anniversary date of the closing of the transaction. In September 2006, these warrants were listed on the Toronto Stock Exchange and the exercise price was changed to Cdn. $2.93.

Also see Note 14 Subsequent Events .

9. SEGMENT INFORMATION

The Company has three reportable business segments: Oil and Gas, HTL™ and GTL.

Oil and Gas

The Company explores for, develops and produces crude oil and natural gas in China and in the U.S. The Company seeks projects to which it can apply innovative technology and enhanced recovery techniques in developing them. In China, the Company s development and production activities are conducted at the Dagang oil field located in Hebei Province and its exploration activities are conducted on the Zitong block located in Sichuan Province. In the U.S., the Company s exploration, development and production activities are primarily conducted in California and Texas.

HTL™

The Company seeks to increase its oil reserves through the deployment of our HTL™ Technology. The technology is intended to be used to upgrade heavy oil at facilities located in the field to produce lighter, more valuable crude. In addition, an HTL™ facility can yield surplus energy for producing steam and electricity used in heavy-oil production. The thermal energy from the RTP™ Process provides heavy-oil producers with an alternative to natural gas that now is widely used to generate steam.

GTL

The Company holds a master license from Syntroleum to use its proprietary GTL Technology to convert natural gas into synthetic fuels. The master license allows the Company to use Syntroleum s proprietary process in GTL projects throughout the world to convert natural gas into ultra clean transportation fuels and other synthetic petroleum products.

Corporate

The Company s corporate office is in Canada with its operational office in the U.S. For this note, any amounts for the corporate office in Canada are included in Corporate**.**

The following tables present the Company s interim segment information for the three-month and six-month periods ended June 30, 2008 and 2007 and identifiable assets as at June 30, 2008 and December 31, 2007:

	Three-Month Period Ended June 30, 2008					
	Oil and Gas					
	China	**U.S.**	**HTL™**	**GTL**	**Corporate**	**Total**
Oil and gas revenue	$ 11,747	$ 6,232	$	$	$	$ 17,979
Loss on derivative instruments	(15,009)	(5,778)				(20,787)
Interest income	11	22			3	36
	(3,251)	476			3	(2,772)
Operating costs	5,303	1,311				6,614
General and administrative	697	520			2,867	4,084
Business and technology development			1,885	29		1,914
Depletion and depreciation	5,794	1,698	634		3	8,129
Interest expense and financing costs	149	132	22		201	504
	11,943	3,661	2,541	29	3,071	21,245
Loss before Income Taxes	(15,194)	(3,185)	(2,541)	(29)	(3,068)	(24,017)

Future income tax recovery	2,286					2,286
Net Loss and Comprehensive Loss	$ (12,908)	$ (3,185)	$ (2,541)	$ (29)	$ (3,068)	$ (21,731)
Capital Investments	$ 1,646	$ 713	$ 231	$	$ 3	$ 2,593

	Six-Month Period Ended June 30, 2008					
	Oil and Gas					
	China	U.S.	HTL™	GTL	Corporate	Total
Oil and gas revenue	$ 22,635	$ 10,387	$	$	$	$ 33,022
Loss on derivative instruments	(17,691)	(7,042)				(24,733)
Interest income	25	66			17	108
	4,969	3,411			17	8,397
Operating costs	9,613	2,393				12,006
General and administrative	1,263	882			5,604	7,749
Business and technology development			3,605	66		3,671
Depletion and depreciation	12,000	3,154	1,334	3	4	16,495
Interest expense and financing costs	473	280	32		252	1,037
	23,349	6,709	4,971	69	5,860	40,958
Loss before Income Taxes	(18,380)	(3,298)	(4,971)	(69)	(5,843)	(32,561)
Future income tax recovery	2,286					2,286
Net Loss and Comprehensive Loss	$ (16,094)	$ (3,298)	$ (4,971)	$ (69)	$ (5,843)	$ (30,275)
Capital Investments	$ 3,771	$ 3,196	$ 946	$	$ 3	$ 7,916
Identifiable Assets (As at June 30, 2008)	$ 72,530	$ 41,001	$ 103,066	$ 15,088	$ 3,472	$ 235,157
Identifiable Assets (As at December 31, 2007)	$ 73,298	$ 40,726	$ 102,456	$ 15,073	$ 5,363	$ 236,916

	Three-Month Period Ended June 30, 2007					
	Oil and Gas					
	China	U.S.	HTL	GTL	Corporate	Total
Oil and gas revenue	$ 6,990	$ 2,799	$	$	$	$ 9,789
Loss on derivative instruments		(316)				(316)
Interest income	8	39			69	116

	6,998	2,522			69	9,589
Operating costs	3,288	935				4,223
General and administrative	623	795			1,966	3,384
Business and technology development			2,135	213		2,348
Depletion and depreciation	4,328	1,482	211	2	1	6,024
Interest expense and financing costs		98	6		85	189
	8,239	3,310	2,352	215	2,052	16,168
Net Loss and Comprehensive Loss	$ (1,241)	$ (788)	$ (2,352)	$ (215)	$ (1,983)	$ (6,579)
Capital Investments	$ 6,516	$ 981	$ 626	$	$	$ 8,123

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	Six-Month Period Ended June 30, 2007					
	Oil and Gas					
	China	U.S.	HTL	GTL	Corporate	Total
Oil and gas revenue	$ 13,875	$ 5,510	$	$	$	$ 19,385
Loss on derivative instruments		(775)				(775)
Interest income	19	61			156	236
	13,894	4,796			156	18,846
Operating costs	5,771	2,137				7,908
General and administrative	1,030	1,183			4,043	6,256
Business and technology development			4,152	358		4,510
Depletion and depreciation	9,054	3,096	759	5	2	12,916
Interest expense and financing costs	5	185	13		179	382
	15,860	6,601	4,924	363	4,224	31,972
Net Loss and Comprehensive Loss	$ (1,966)	$ (1,805)	$ (4,924)	$ (363)	$ (4,068)	$ (13,126)
Capital Investments	$ 10,318	$ 1,793	$ 1,346	$	$	$ 13,457

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