



Quarterly Report

For the Three Months ended March 31, 2008
(Unaudited)

Message to Shareholders

Summary of Results

	Three Months Ended	
	March 31	
	2008	2007
Financial (\$000's except per share)		
Petroleum and natural gas revenue	13,418	10,432
Operating netback (1)	7,426	6,081
Net income (loss)	(494)	(1,036)
Per share - basic & diluted	(0.01)	(0.02)
Funds from operations (1)	5,371	3,494
Per share - basic (1)	0.09	0.06
Capital expenditures	8,507	8,819
Proceeds from sale of oil and gas assets	-	14,183
Net debt, end of period (1)	56,545	43,023
Operational		
Average daily sales volumes (boe) (1)	3,403	2,624
Average selling price (\$/boe)	43.33	44.18
Operating netback (\$/boe)	23.98	25.75

(1) Refer to advisories regarding non-GAAP financial measures and barrel of oil equivalent ("boe") measures.

Q1 2008 Highlights

- **Increased sales revenues by 29 percent, funds from operations by 54 percent and average daily sales volume by 30 percent from a year earlier.**
- **Achieved a 25 percent reduction in current quarter operating expense to \$6.74 per boe from \$8.94 per boe in first quarter 2007 through operating efficiencies and rationalization of assets.**
- **Drilled 11 (5.5 net) wells, including 2 (2.0 net) in Canada and 9 (3.5 net) in the United States.**

Financial

Mahalo generated funds from operations of \$5.4 million on sales of \$13.4 million and recorded a net loss of \$0.5 million during the three months ended March 31, 2008. This compares with funds from operations of \$3.5 million, sales of \$10.4 million and a net loss of \$1.0 million in first quarter 2007. Additional information regarding our first quarter results is set out in our Management's Discussion and Analysis for the three months ended March 31, 2008.

Operational

In first quarter 2008, the Company spent \$8.5 million which included \$6.2 million on drilling and completions, facilities and infrastructure undertakings and \$1.7 million on land and seismic. During the quarter, 11 (5.5 net) wells were drilled and completed resulting in 10 (4.5 net) wells capable of immediate production and one horizontal well that will require remedial re-entry and testing to further assess its potential.

Sales of oil and gas averaged 3,403 boe per day during first quarter 2008 compared with 3,542 boe per day in fourth quarter 2007. The reduction was caused by a number of factors including gas gathering interruptions at our Poteau, Oklahoma field, weather-related issues and some operational difficulties. In addition, although 10 (4.5 net) producing wells were drilled and completed in first quarter 2008, four of the wells did not come on stream until late in the quarter. The remaining six wells began producing in second quarter 2008.

While the Company continues to pursue resource opportunities in both Canada and the United States, it remains committed to its Oklahoma Hartshorne CBM assets; this play area has demonstrated repeatable, long life reserves with low declines. We also continue to spend research capital to become even more effective with our CBM development and to gain a better understanding of Shale stimulation which we believe is imperative to economically unlocking this huge resource. In first quarter 2008, Mahalo drilled 9 (3.5 net) successful CBM wells at Lakeview.

In Canada, while continuing to pursue a better understanding of Mannville and Horseshoe CBM, Mahalo has drilled and completed a number of conventional natural gas wells, primarily at Tofield in Alberta. The wells have shown strong economics and high initial deliverability. While these wells come with different production and reserve replacement challenges, they offer an opportunity to be good production back-fillers and solid cash contributors, especially at current prices. During first quarter 2008, Mahalo drilled an additional gas well at Tofield which came on stream in April. A shallow oil well drilled at Kinsella in Alberta during the quarter will require re-entry and further testing to assess its productive potential.

Fiscal 2008 will again be an active year for Mahalo; however, such efforts will still represent a minor draw on a prospect inventory that currently includes 450+ United States locations, including 212 net Hartshorne CBM wells; the remaining inventory involves Shale prospects. With an ongoing opportunity of this magnitude, Mahalo will continue directing a significant portion of its capital spending towards its United States resource asset base. Mahalo is also committed to capture additional Hartshorne CBM acreage which will help grow production and reserves. As previously stated, the Company's shale resource is large and capital intensive to exploit. Mahalo will continue its shale development efforts in 2008, ideally through a suitable joint venture arrangement. Mahalo will also actively recruit staff for its US resource technical team in 2008.

Outlook

In March, Mahalo provided 2008 guidance to its shareholders. The guidance assumed a full year average projected production rate of 4,050 boe per day and funds from operations of approximately \$30 million, based on an average realized natural gas price of Cdn \$7.60 per Mcf. The recent strength in North American gas prices is highly encouraging; however, Mahalo knows that gas prices in the longer term will remain highly unpredictable. The Company is confident that it will meet its full year targets; it will also retain an appropriate level of flexibility in its 2008 and future spending plans.

A majority of projected capital spending of \$41 million for 2008 relates to properties in the United States. The Company plans to drill 15 net Hartshorne CBM wells in second quarter 2008, on the way to an estimated 42 net Hartshorne CBM wells for the full year. Our United States program also includes seismic to improve CBM and shale drilling co-ordinates. The 2008 capital spending program is based on expectations involving sales volumes, realized commodity prices, operating netbacks and other matters and is therefore subject to modification.

The Company's present bank credit facility expires in early 2009; negotiations are underway to extend or replace the facility. The Company is confident that it will accomplish this in a timely manner and under suitable terms and conditions.

Management announcement

I am pleased that Mr. James Burns, P.Geol, MBA, has joined Mahalo as Chief Operating Officer. Mr. Burns served most recently as the President and CEO of Essential Energy Services Trust and prior thereto, in senior positions with several energy companies including Dominion Exploration Canada Ltd. and Slade Energy Inc. He was also founder, President and CEO of Cedar Energy Inc. Mr. Burns received a B.Sc. (Honours in Geology) from Carleton University and a Masters in Business Administration (Specialization in Finance) from the University of Calgary. His strong management and technical strengths will be an asset to Mahalo's growth in both Shale and CBM.

On behalf of the Board of Directors
"Signed"

Duncan Chisholm
President and Chief Executive Officer

MANAGEMENT'S DISCUSSION AND ANALYSIS

PRIMARY BUSINESS

Mahalo Energy Ltd. ("Mahalo" or the "Company") is a publicly traded company (TSX: CBM) focused on acquisition, exploration, development and production of unconventional natural gas, principally coalbed methane ("CBM") in Western Canada and coalbed methane and shale gas in the Arkoma Basin in the state of Oklahoma, U.S.A. The Company also has some crude oil and conventional natural gas operations in Western Canada. The Company's head office is in Calgary, Alberta, Canada.

At March 31, 2008, Mahalo Energy Ltd. had one wholly-owned subsidiary, Mahalo Energy (USA) Inc., a company incorporated under the laws of Delaware. Unless the context otherwise requires, references herein to "Mahalo" or the "Company" include Mahalo Energy Ltd. and Mahalo Energy (USA) Inc.

READER GUIDANCE

This Management's Discussion and Analysis ("MD&A") is dated May 15, 2008 and should be read in conjunction with the unaudited consolidated financial statements and accompanying notes for the three months ended March 31, 2008 and the audited consolidated financial statements and accompanying notes and the MD&A for the year ended December 31, 2007.

The reporting and measurement currency is the Canadian dollar, unless otherwise specified. Unless otherwise noted, production and sales volumes reflect the Company's working interest before royalties. Certain columns in tables may not add due to rounding.

This MD&A contains forward-looking information and statements, refers to and discusses certain non-GAAP financial measures and aggregates certain oil and gas information in terms of barrels of oil equivalent. The reader is specifically referred to and encouraged to read the section entitled "Special Cautionary Advisories" at the end of this MD&A.

Readers should be aware that historical results are not necessarily indicative of future performance. Additional information relating to the Company, including the Company's 2007 Annual Information Form, is available on the System for Electronic Document Analysis and Retrieval ("SEDAR") at www.sedar.com or at the Company's website at www.mahaloenergy.com.

RESULTS OF OPERATIONS

The Company generated funds from operations of \$5.4 million on sales revenues of \$13.4 million and recorded a net loss of \$0.5 million in first quarter 2008. The following table provides a comparison of current period results with the immediately preceding quarter and the corresponding first quarter of 2007.

	Three Months Ended		
	Mar 31	Dec 31	Mar 31
	2008	2007	2007
<i>(\$000s, except per share)</i>			
Petroleum and natural gas revenue	\$ 13,418	\$ 11,453	\$ 10,432
Operating netback (1)	7,426	5,579	6,081
Net income (loss)	(494)	(696)	(1,036)
Per share: basic and diluted	(0.01)	(0.01)	(0.02)
Funds from operations (1)	5,371	3,164	3,494
Per share: basic	0.09	0.05	0.06

(1) Please refer to special advisories regarding use of non-GAAP financial measures.

Sales revenues in first quarter 2008 increased by approximately \$2.0 million over the preceding quarter principally as a result of higher realized commodity prices. The benefit was reflected in higher operating netback and funds

from operations; a shift in the amount of future income tax expense, a non-cash item, resulted in net earnings remaining relatively unchanged during the two periods.

Petroleum and natural gas revenue

The following table provides financial and operational information contributing to the Company's petroleum and natural gas revenue during the periods under comparison.

	Three Months Ended		
	Mar 31 2008	Dec 31 2007	Mar 31 2007
Petroleum and natural gas revenue (\$000s)			
Natural gas			
Canada	\$ 5,221	\$ 4,423	\$ 2,581
United States	7,780	6,689	6,996
	\$ 13,001	\$ 11,112	\$ 9,577
Crude oil			
Canada	\$ 417	\$ 341	\$ 855
Natural gas and crude oil			
Canada	\$ 5,638	\$ 4,764	\$ 3,436
United States	7,780	6,689	6,996
	\$ 13,418	\$ 11,453	\$ 10,432
Total sales volume (boe) (1) (2)	309,631	325,872	236,128
Average daily sales volume (1)			
Natural gas (Mcf/day)			
Canada	7,769	7,917	4,125
United States	12,290	12,913	10,528
	20,059	20,830	14,653
Crude oil (bbls/day)			
Canada	59	71	182
Barrels of oil equivalent (boe/day) (2)			
Canada	1,354	1,390	869
United States	2,049	2,152	1,755
	3,403	3,542	2,624
Average realized selling price			
Natural gas (\$/Mcf)			
Canada	\$ 7.38	\$ 6.07	\$ 6.95
United States	6.96	5.63	7.38
Weighted average	7.12	5.80	7.26
Crude oil (\$/bbl)			
Canada	77.32	52.59	52.36
Barrel of oil equivalent (\$/boe) (2)	43.33	35.15	44.15

(1) Petroleum and natural gas revenue and volumes are before deduction of royalties.

(2) Natural gas volumes are converted to a barrel of oil equivalent ("boe") at six mcf of natural gas = one bbl of crude oil.

Virtually all of the Company's sales revenues are from natural gas. Sales of oil and gas averaged 3,403 boe per day during first quarter 2008 compared with 3,542 boe per day in fourth quarter 2007. The reduction was caused by a number of factors including gas gathering interruptions at our Poteau, Oklahoma field, weather-related issues and some operational difficulties. In addition, although ten producers were drilled and completed in first quarter 2008, four of the wells did not come on stream until late in the quarter. The remaining six wells began producing in second quarter 2008.

A higher average realized price of \$44.33 per boe in first quarter 2008 resulted in a 17 percent increase in sales revenue over the preceding quarter. When comparing the current quarter with the corresponding quarter of 2007, average daily sales volumes and total sales revenues were up 30 percent and 29 percent, respectively.

In first quarter 2008, North American natural gas prices began to steadily strengthen as a result of much colder weather which, in turn, created significant natural gas demand for heating and power generation. This resulted in a sharp reduction in natural gas storage levels which had been at a record high entering the North American winter heating season. The recent improvement in natural gas pricing appears to be holding, supported to an extent by crude oil prices that continue to reach for new highs. Although the current pricing outlook for natural gas remains strong, natural gas prices have potential to remain volatile and unpredictable as markets react rapidly to news events, weather forecasts and natural gas inventory reports. Mahalo attempts to protect its cash flow from commodity price volatility, principally by entering into fixed price physical sales contracts and hedging arrangements when considered prudent.

A majority of the Company's natural gas sales continue to be from properties in the United States. Such production is delivered for sale into the Oklahoma Gas Transmission and Centre Point East pipeline.

Royalty expense

Oil and gas royalties are paid to various government entities and other land and mineral rights owners. In Oklahoma, government royalty assessments are generally based on the price realized for the underlying petroleum product. In Canada, the rate of royalties payable to government entities depends on many factors such as prescribed reference prices, well productivity, geographical location and field discovery date, method of recovery and the type and quality of petroleum product produced. Although various factors impact the computation of royalty expense, realized price continues to be the predominate factor for oil and gas produced by Mahalo.

	Three Months Ended		
	Mar 31 2008	Dec 31 2007	Mar 31 2007
Royalty expense (\$000s)			
Canada	\$ 1,392	\$ 1,237	\$ 454
United States	1,960	1,674	1,517
	\$ 3,353	\$ 2,911	\$ 1,971
Royalty expense (\$/boe)			
Canada	\$ 11.30	\$ 9.68	\$ 5.81
United States	10.52	8.45	9.61
Weighted average	10.83	8.93	8.35

Royalty expense in Canada increased in total and on a per boe basis, when comparing the current and preceding quarter with first quarter 2007, due mainly to higher sales of conventional natural gas and the higher government royalty rate that it attracts.

Operating expense

Operating expense includes various costs, the most significant of which are contractor labour, compression, chemicals and treating supplies, water disposal, equipment rental, minor well workovers and operator overhead.

	Three Months Ended		
	Mar 31	Dec 31	Mar 31
	2008	2007	2007
Operating expense (\$000s)			
Canada	\$ 1,172	\$ 1,213	\$ 1,071
United States	916	1,210	1,040
	\$ 2,088	\$ 2,423	\$ 2,111
Operating expense (\$/boe)			
Canada	\$ 9.51	\$ 9.49	\$ 13.69
United States	4.91	6.11	6.59
Weighted average	6.74	7.44	8.94

Operating costs in Canada during the current quarter were relatively unchanged from the preceding quarter. Such costs showed significant improvement on a boe basis when compared with first quarter 2007 primarily as a result of having sold certain conventional oil and gas properties which were more expensive to operate. The Company has also been successful in reducing per unit operating costs in its United States operations.

Transportation expense

Transportation expense includes costs to move saleable oil and gas from the crude oil wellhead or natural gas plant outlet to its ultimate point of sale.

	Three Months Ended		
	Mar 31	Dec 31	Mar 31
	2008	2007	2007
Transportation expense (\$000s)			
Canada	\$ 92	\$ 78	\$ 111
United States	459	462	158
	\$ 551	\$ 540	\$ 269
Transportation expense (\$/boe)			
Canada	\$ 0.75	\$ 0.61	\$ 1.43
United States	2.46	2.33	1.00
Weighted average	1.78	1.66	1.14

Total transportation expense fluctuated between two and five percent of sales revenues during the periods under comparison.

Operating netback

Operating netback is a non-GAAP financial measure of net oil and gas revenue commonly used in the oil and gas industry. The Company uses this non-GAAP measure, in conjunction with a barrel of oil equivalent volumetric measure, to aggregate oil and gas volumes and to assess comparability of petroleum sales and related costs between geographic business segments and periods. The following tables reflect operating netback by geographic area for the respective quarterly periods under comparison.

Three months ended Mar 31	Canada		United States		Total	
	2008	\$/boe	2008	\$/boe	2008	\$/boe
<i>(\$000s, except per boe)</i>						
Petroleum and natural gas revenue	\$ 5,638	\$ 45.75	\$ 7,780	\$ 41.74	\$ 13,418	\$ 43.33
Royalties	1,392	11.30	1,960	10.52	3,353	10.83
Operating and transportation	1,265	10.26	1,374	7.37	2,639	8.52
Operating netback	\$ 2,981	\$ 24.19	\$ 4,446	\$ 23.85	\$ 7,426	\$ 23.98

Three months ended Dec 31	Canada		United States		Total	
	2007	\$/boe	2007	\$/boe	2007	\$/boe
<i>(\$000s, except per boe)</i>						
Petroleum and natural gas revenue	\$ 4,764	\$ 37.25	\$ 6,689	\$ 33.78	\$ 11,453	\$ 35.15
Royalties	1,237	9.68	1,674	8.45	2,911	8.93
Operating and transportation	1,292	10.10	1,672	8.44	2,964	9.10
Operating netback	\$ 2,234	\$ 17.47	\$ 3,344	\$ 16.89	\$ 5,578	\$ 17.12

During first quarter 2008, the Company realized an average operating netback of \$23.98 per boe as compared with \$17.12 per boe in fourth quarter 2007. Total sales volumes were down by approximately 5 percent during first quarter 2008 when compared with fourth quarter 2007. A majority of the improvement in per unit operating netback in the current quarter resulted from a higher average realized price.

In the three month period ended March 31, 2007, the average operating netback was \$25.75 per boe as reflected in the following table.

Three months ended Mar 31	Canada		United States		Total	
	2007	\$/boe	2007	\$/boe	2007	\$/boe
<i>(\$000s, except per boe)</i>						
Petroleum and natural gas revenue	\$ 3,436	\$ 43.94	\$ 6,996	\$ 44.30	\$ 10,432	\$ 44.18
Royalties	454	5.81	1,517	9.61	1,971	8.35
Operating and transportation	1,182	15.12	1,198	7.59	2,380	10.08
Operating netback	\$ 1,800	\$ 23.01	\$ 4,281	\$ 27.10	\$ 6,081	\$ 25.75

General and administrative expense

General and administrative expense amounted to \$1.1 million in first quarter 2008, \$1.5 million in fourth quarter 2007 and \$1.5 million in first quarter 2007. Additional general and administrative expense in fourth quarter 2007 included costs associated with annual reserves evaluation and year-end audit. First quarter 2007 general and administrative expense included certain internal restructuring costs required to facilitate a greater operational emphasis in the United States.

Stock-based compensation expense

Stock-based compensation results from the amortization of the aggregate fair value of stock options over their related vesting period. The amount is primarily determined by the number of options granted, the vesting period and the estimated fair value of the options. Stock-based compensation expense remained relatively unchanged during the three quarterly periods under comparison, ranging from \$0.4 million to \$0.6 million per quarter.

Foreign exchange gains and losses

A portion of the Company's monetary assets and liabilities are denominated in United States dollars. Shifts in Canadian/United States currency rates result in foreign exchange gains and losses when account balances in a currency other than the reporting currency are settled or translated at the period end. During first quarter 2008, the Company incurred a small foreign exchange loss of \$0.2 million compared with gains of \$0.6 million and \$0.5 million in the fourth and first quarters of 2007, respectively. A majority of these foreign exchange gains and losses were unrealized at the end of the respective quarters.

Interest and financing expense

Interest and financing expense amounted to \$1.0 million in first quarter 2008, \$1.2 million in fourth quarter 2007 and \$1.0 million in first quarter 2007, respectively. The expense during each of these periods resulted from borrowings under a revolving credit facility with the Union Bank of California. A majority of the change in interest and financing expense resulted from the level of borrowings during the respective periods. Changes in the effective

cost of borrowing did not have a significant impact on interest expense. No interest and financing expense was capitalized during the periods under comparison.

Depletion, depreciation and accretion expense

Depletion and depreciation expense is computed on a unit of production basis. Such expense, on a boe basis, fluctuates from period to period primarily as a result of changes in the underlying proved reserves base and in the amount of costs subject to depletion and depreciation. Such costs are segregated and depleted on a county by country basis relative to the respective underlying proved reserves base within that country. Shifts in the proportion of oil and gas sold in Canada and the United States can impact the overall per unit depletion and depreciation rate for the Company from period to period.

	Three Months Ended		
	Mar 31	Dec 31	Mar 31
	2008	2007	2007
<i>(\$000s, except per boe)</i>			
Depletion and depreciation expense	\$ 4,722	\$ 4,969	\$ 4,160
Accretion expense	88	89	98
Depletion, depreciation and accretion expense	\$ 4,810	\$ 5,058	\$ 4,258
Depletion and depreciation expense (\$/boe)	\$ 15.25	\$ 15.25	\$ 17.62

The Company records an asset retirement obligation which reflects the present value of the estimated clean-up and restoration costs of wells, well sites, gathering lines and processing facilities at the time they are acquired or constructed and put into use. The liability is also adjusted when properties and related asset retirement obligations are disposed of. The asset retirement liability is increased each reporting period due to the passage of time and the related amount, referred to as "accretion", is charged to earnings in the period.

At March 31, 2008, the Company's asset retirement obligation amounted to \$4.3 million compared with \$4.1 million at December 31, 2007 and \$5.0 million at March 31, 2007. The sale of certain conventional oil and gas properties contributed to the \$0.9 million decrease between the 2007 periods.

Income tax expense

Future income taxes reflect the net tax effect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes (book value) and the amounts used for income tax purposes (tax basis). Future income tax assets, which result when the tax basis of assets exceed the book basis, are only recognized to the extent that their realization is considered more likely than not based upon projections of operating results and tax planning strategies available to the Company.

During first quarter 2008, the Company recorded future income tax expense of \$0.4 million compared with a future income tax recovery of \$1.3 million and future income tax expense of \$0.3 million in the fourth and first quarters of 2007, respectively. At the end of first quarter 2008, the Company had a future income tax liability of \$2.5 million which related solely to its United States operations. In Canada, the Company had an income tax asset at March 31, 2008 which fully offset by a valuation allowance.

LIQUIDITY AND CAPITAL RESOURCES

The Company's strategy is to focus on unconventional and selective conventional resource projects that offer the greatest opportunity to maximize funds flow generation and shareholder value. The Company's capital resources consist primarily of funds from operations, existing credit facilities and access to debt and capital markets. In addition, the Company has realized cash proceeds from the sale of non-core oil and gas assets and will continue to seek opportunities to prudently rationalize its resource asset base.

Funds from operations, which represent net earnings adjusted for non-cash items, is a non-GAAP measure used by Mahalo to assess its operating results and its ability to generate funds to finance future capital investment and service debt. The Company considers net income (loss) and cash provided by operating activities to be the most directly comparable GAAP measures to the non-GAAP measure, funds from operations. The following table illustrates the relationship between these measures. The table also reflects cash provided by (used in) operating, financing and investing activities and the aggregate change in cash during the respective periods.

	Three Months Ended		
	Mar 31	Dec 31	Mar 31
	2008	2007	2007
<i>(\$000s)</i>			
Net income (loss)	\$ (494)	\$ (696)	\$ (1,036)
Non-cash items	5,865	3,860	4,530
Funds from operations	5,371	3,164	3,494
Change in non-cash working capital related to operating activities	(2,833)	3,923	(531)
Cash provided by operating activities	2,538	7,087	2,963
Cash provided by (used in) financing activities	6,275	(7,125)	(6,050)
Cash provided by (used in) investing activities	(10,473)	2,968	10,143
Increase (decrease) in cash	\$ (1,660)	\$ 2,930	\$ 7,056

Cash provided by operating activities takes into account net earnings, adjusted for non-cash items, and includes a further adjustment for the change in operating-related, non-cash working capital that occurred during the respective periods. The majority of the change in non-cash working capital relating to operational activity involved shifts in accounts receivable and accounts payable balances and the timing of cash receipts and payments.

Operating activities

The major factors that accounted for the change in funds from operations during first quarter 2008, when compared with the immediately preceding quarter, were as follows:

<i>(\$000s)</i>			
Funds from operations generated in fourth quarter 2007		\$	3,164
Increase (decrease) in funds during first quarter 2008 as a result of:			
Higher operating netback			
Lower sales volumes	\$	(278)	
Higher realized sales prices		2,536	
Higher per unit royalties expense		(587)	
Lower per unit operating and transportation expense		175	1,846
Lower general and administrative expense			351
Lower interest and financing costs			235
Lower realized foreign exchange gain			(205)
Other			(20)
Funds from operations generated in first quarter 2008		\$	5,371

Financing activities

The Company has a revolving credit facility with the Union Bank of California. At March 31, 2008, the approved borrowing base was Cdn \$60.0 million and borrowings under the facility were equivalent to Cdn \$57.8 million. The facility is collateralized by a fixed charge on the Company's United States assets and a floating charge on its Canadian assets and requires the Company to maintain certain financial covenants and ratios. The credit facility expires in January 2009. The Company is currently in negotiations regarding the credit facility.

In first quarter 2007, the holder of 900,000 common share purchase warrants, issued in 2006 in conjunction with a purchase and farm-in agreement, exercised same upon payment to the Company of \$450,000.

Investing activities

The Company has since its inception expanded its oil and gas asset and production base through farm-ins, corporate and property acquisitions and exploration and development activity. The following table reflects property and equipment expenditures for which cash was utilized and the amount of cash realized from asset divestures during the periods under comparison.

	Three Months Ended		
	Mar 31 2008	Dec 31 2007	Mar 31 2007
<i>(\$000s)</i>			
Land and seismic	\$ 1,738	\$ 3,257	\$ 675
Drilling and completions	6,224	5,021	7,613
Facilities and equipment	545	288	531
	8,507	8,566	8,819
Property divestures	-	(14,189)	(14,183)
Cash expenditures on property and equipment, net	\$ 8,507	\$ (5,623)	\$ (5,364)
Canada	\$ 3,210	\$ (2,264)	\$ (11,237)
United States	5,297	(3,359)	5,873
Cash expenditures on property and equipment, net	\$ 8,507	\$ (5,623)	\$ (5,364)

In first quarter 2008, the Company spent \$8.5 million which included \$6.2 million on drilling and completions, facilities and infrastructure undertakings and \$1.7 million on land and seismic. During this period, 11 (5.5 net) wells were drilled and completed resulting in 10 (4.5 net) wells capable of immediate production and one horizontal well that will require remedial re-entry and testing to further assess its potential. In fiscal 2007, the Company participated in 54 (32.4 net) wells with a drilling success rate of 95 percent.

Property divestures in first quarter 2007 involved non-core conventional resource assets in Canada. During fourth quarter 2007, Mahalo sold its interest in the Corbett Creek CBM gas processing facility and gathering lines for Cdn \$4.7 million. The Company also sold approximately 6,700 net acres of oil, gas and mineral deep rights below the base of the Hartshorne formation at Island, Oklahoma for US \$8.4 million, retaining an overriding royalty interest.

Contractual obligations

As at the date of this MD&A, the Company has committed to certain payments as follows:

Years ended December 31	2008	2009	2010	2011	2012	Total
<i>(\$000s)</i>						
Office lease	\$ 425	\$ 542	\$ 568	\$ 426	\$ -	\$ 1,961
Office lease (US\$)	34	45	15	-	-	94
Equipment usage	1,014	2,376	2,376	-	-	5,766

The equipment usage obligation results from a drilling rig lease contract with a drilling company entered into on January 27, 2006. The terms of the contract include a commitment to utilize a specific drilling rig for a minimum of 250 days per year for three years, with the contract taking effect upon release of the rig to Mahalo. The rig was released to Mahalo in 2007. The terms of the agreement specify that the Company is obligated to pay a minimum standby rate of \$9,504 per day.

The Company has contracts with respect to the physical delivery of natural gas at a fixed price. The following is a summary of the commodity fixed price, forward sale commitments entered into by the Company and outstanding as of the date of this MD&A.

Transaction Type	Volume	Contract Price	Term
Sell	3,000 Mmbtu/day	US \$7.40 per MMbtu	November 2007 - October 2008
Sell	2,000 GJs/day	Cdn \$7.43 per GJ	January 2008 - December 2008
Sell	1,000 Mmbtu/day	US \$7.00 per MMbtu	April 2008 - October 2008
Sell	1,500 Mmbtu/day	US \$7.185 per MMbtu	February 2008 - January 2009
Sell	1,000 Mmbtu/day	US \$7.10 per MMbtu	April 2008 - October 2008
Sell	1,000 Mmbtu/day	US \$7.97 per MMbtu	April 2008 - June 2008
Sell	2,000 Mmbtu/day	US \$9.06 per MMbtu	May 2008
Sell	2,000 Mmbtu/day	US \$9.65 per MMbtu	June 2008 - October 2008
Sell	2,000 Mmbtu/day	US \$9.30 per MMbtu	May 2008

The Company indemnifies its directors and officers against all claims and losses reasonably incurred in the performance of their duties to the extent permitted by law. The Company maintains Directors and Officers insurance in amounts deemed adequate.

Liquidity

The following table illustrates working capital (deficiency), net debt and shareholders' equity at March 31, 2008 and December 31, 2007. The table also reflects certain measures and ratios which the Company considers useful in assessing liquidity. These measures and ratios are computed using non-GAAP financial measures; the reader is referred to the section entitled "Special Cautionary Advisories" at the end of this MD&A.

As at	Mar 31 2008	Dec 31 2007
<i>(\$000s)</i>		
Current assets	\$ 18,150	\$ 18,945
Accounts payable and accrued liabilities	16,934	20,924
Working capital (deficiency), before inclusion of debt due within one year	1,216	(1,979)
Current portion of long term debt	57,761	-
Working capital (deficiency)	(56,545)	(1,979)
Long term debt	-	51,334
Net debt (1)	\$ 56,545	\$ 53,313
Shareholders' equity	\$ 115,277	\$ 115,249
Funds from operations (twelve months trailing) (\$000s) (1)	\$ 15,414	\$ 13,537
Net debt to trailing funds from operations ratio (1)	3.67	3.94
Net debt as a % of shareholders' equity (1)	49%	46%
Net debt as a % of net debt plus shareholders' equity (1)	33%	32%

(1) Please refer to special advisories regarding use of non-GAAP financial measures.

Working capital is an aggregation of current assets and current liabilities. Operating, financing and investing activities generate and consume components of working capital of both a cash and non-cash nature. At March 31, 2008, the working capital deficiency included amounts outstanding under the Company's three year revolving credit facility; the facility expires in January 2009. The Company is confident that it will extend or replace the credit facility on acceptable terms and conditions. The working capital deficiency of \$2.0 million at December 31, 2007 could have been eliminated through additional borrowings under the Company's long-term credit facility.

The Company had 59,298,035 common shares, 1,440,000 common share purchase warrants and 535,200 performance warrants issued and outstanding at March 31, 2008. Since that date, 242,200 performance warrants have been cancelled. Contributed surplus amounted to \$8.6 million at March 31, 2008, reflective of aggregate stock-based compensation incurred since inception of the Company in April 2004.

Management anticipates that the Company will have adequate financial resources to fund operations, contractual obligations and discretionary capital expenditures through a combination of funds from operations, proceeds from the disposition of non-core resource properties and debt and/or equity financing. There is no assurance that debt or equity financing will be available on terms acceptable to the Company to meet its funding requirements.

Dividends

The Company has not declared or paid any dividends on its outstanding common shares. Any decision to pay dividends will be made by the Board of Directors on the basis of the Company's earnings, financial requirements and other conditions existing at the time. At present, the Company does not anticipate declaring and paying dividends in the near future.

OFF-BALANCE SHEET ARRANGEMENTS

The Company does not have any material off-balance sheet arrangements outstanding, except for certain office leases and equipment usage contracts as discussed under "contractual obligations".

RELATED PARTY TRANSACTIONS

The Company did not have any material transactions with related parties during the three months ended March 31, 2008.

COMPARATIVE AMOUNTS

Certain comparative amounts have been restated to conform to the presentation in the current period.

SUMMARY OF QUARTERLY FINANCIAL RESULTS (unaudited)

The following table presents a summary of consolidated quarterly operating results for the quarters ended June 30, 2006 through March 31, 2008.

	Q1	Q4	Q3	Q2	Q1	Q4	Q3	Q2
Selected quarterly information	2008	2007	2007	2007	2007	2006	2006	2006
Financial (\$000s, except per share)								
Petroleum and natural gas revenue	13,418	11,453	11,390	10,871	10,432	10,867	11,578	8,714
Operating netback	7,426	5,579	5,693	5,378	6,081	5,169	5,612	4,532
General and administrative	1,120	1,471	1,320	2,225	1,518	1,735	1,088	1,040
Stock-based compensation	468	577	514	324	445	457	260	369
Foreign exchange loss (gain)	169	(613)	(450)	(1,877)	(476)	2,048	11	(902)
Interest and financing expense	953	1,187	1,058	771	1,008	1,089	1,027	645
Write-down of property and equipment	-	-	-	-	-	36,322	-	-
Write-down of goodwill	-	-	-	-	-	12,743	-	-
Depletion, depreciation and accretion	4,810	5,057	4,822	4,316	4,258	8,400	4,742	3,734
Future income taxes (recovery)	408	(1,293)	271	(31)	294	(10,033)	(552)	444
Net income (loss)	(494)	(696)	(1,813)	(171)	(1,036)	(47,511)	(798)	(802)
Per share: basic and diluted	(0.01)	(0.01)	(0.03)	0.00	(0.02)	(0.81)	(0.01)	(0.02)
Funds from operations (1)	5,371	3,164	3,334	3,545	3,494	1,488	3,434	3,955
Per share: basic (1)	0.09	0.05	0.06	0.06	0.06	0.03	0.06	0.08
Reconciliation:								
Funds from operations (1)	5,371	3,164	3,334	3,545	3,494	1,488	3,434	3,955
Changes in non-cash working capital related to operating activities	(2,833)	3,923	258	(3,314)	(531)	(4,557)	7,218	4,974
Cash provided by (used in) operating activities	2,538	7,087	3,592	231	2,963	(3,069)	10,652	8,929
Operational								
Average daily sales (2)								
Natural gas (Mcf/day)	20,059	20,829	20,088	16,553	14,653	16,130	14,861	12,799
Crude oil (bbls/day)	59	71	59	47	182	284	463	161
Barrels of oil equivalent (boe/day)	3,403	3,542	3,407	2,805	2,624	2,972	2,939	2,294
Average realized selling prices								
Natural gas (\$/Mcf)	7.12	5.80	5.98	7.04	7.26	6.44	6.35	6.63
Crude oil (\$/bbl)	77.32	52.59	62.32	63.12	52.36	50.53	68.18	67.68
Barrel of oil equivalent (\$/boe)	43.33	35.15	36.34	42.58	44.15	39.75	42.82	41.74
Average operating netback (\$/boe)	23.98	17.12	18.16	21.06	25.75	18.91	20.76	21.71
Exchange rate								
Cdn\$/US\$ - average for period	0.998	1.019	0.957	0.911	0.854	0.878	0.892	0.891
Cdn\$/US\$ - at end of period	0.974	1.009	0.995	0.940	0.867	0.858	0.897	0.897

(1) Please refer to special advisories regarding use of non-GAAP financial measures.

(2) Petroleum and natural gas revenue and volumes are before deduction of royalties.

Further details in respect of historical quarterly results can be found in the Company's quarterly and annual reports filed on SEDAR at www.sedar.com or on the Company's web-site at www.mahaloenergy.com.

OUTLOOK

In March, Mahalo provided 2008 guidance to its shareholders. The guidance assumed a full year average projected production rate of 4,050 boe per day and funds from operations of approximately \$30 million, based on an average realized natural gas price of Cdn \$7.60 per Mcf. The recent strength in North American gas prices is highly encouraging; however, Mahalo knows that gas prices in the longer term will remain highly unpredictable. The Company is confident that it will meet its full year targets; it will also retain an appropriate level of flexibility in its 2008 and future spending plans.

A majority of projected capital spending of \$41 million for 2008 relates to properties in the United States. The Company plans to drill 15 net Hartshorne CBM wells in second quarter 2008, on the way to an estimated 42 net Hartshorne CBM wells for the full year. Our United States program also includes seismic to improve CBM and shale drilling co-ordinates. The 2008 capital spending program is based on expectations involving sales volumes, realized commodity prices, operating netbacks and other matters and is therefore subject to modification.

The Company's present bank credit facility expires in early 2009; negotiations are underway to extend or replace the facility. The Company is confident that it will accomplish this in a timely manner and under suitable terms and conditions.

CONTROLS AND PROCEDURES

Disclosure controls and procedures

Disclosure controls and procedures are designed to ensure that information required to be disclosed by the Company is accumulated and communicated to management, including the Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO"), to allow timely decisions regarding required disclosure. The Company's CEO and CFO have concluded, based on their evaluation as of the end of the period covered by the interim filing that the Company's disclosure controls and procedures are effective to provide reasonable assurance that material information related to the issuer is made known to them by others within the Company. It should be noted that while the Company's CEO and CFO believe that the Company's disclosure controls and procedures provide a reasonable level of assurance and that they are effective, they do not expect that the disclosure controls and procedures or internal control over financial reporting will prevent all errors and fraud. A control system, no matter how well conceived or operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met.

Internal controls over financial reporting

Internal controls over financial reporting are designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with Canadian GAAP as at December 31, 2007. Management had evaluated the design effectiveness of internal controls over financial reporting and had concluded that such internal controls over financial reporting are properly designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with Canadian GAAP. There have been no events in the subsequent period that would cause management to alter this opinion as of the date of this MD&A.

Management is aware that given the Company's smaller size, adequate segregation of duties may not always be achievable in which case the Company relies on compensating controls. Management is also aware that in-house expertise to deal with complex accounting, taxation and reporting matters may not be sufficient, which is common with companies of a similar size. The Company must periodically rely upon outside assistance and advice to effectively deal with such matters. The Company's internal controls over financial reporting may not prevent or detect all errors, misstatements and fraud. The design of internal controls must also take into account resource constraints. A control system, including the Company's internal controls over financial reporting, no matter how well conceived or operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met.

CRITICAL ACCOUNTING ESTIMATES

The preparation of financial statements in conformity with generally accepted accounting principles requires the Company to make assumptions, judgments and estimates that may have a significant impact on the financial statements. Estimates are reviewed periodically and as adjustments become necessary, they are reported in earnings in the periods in which they become known. A summary of the Company's significant accounting policies can be found in Note 2 of the Audited Consolidated Financial Statements for the year ended December 31, 2007.

CHANGES IN ACCOUNTING POLICIES AND CANADIAN ACCOUNTING PRONOUNCEMENTS

Information regarding changes in accounting policies and Canadian accounting pronouncements is set forth in note 3 to the Company's Unaudited Consolidated Financial Statements for the three months ended March 31, 2008.

RISKS AND UNCERTAINTIES

The business of exploring for, developing and producing oil and gas reserves is inherently risky. There is a risk that the sale of the Company's reserves may be delayed indefinitely due to process constraints, lack of pipeline capacity or lack of markets. The price the Company receives for its crude oil and natural gas fluctuates continuously and for the most part is beyond its control. The Company is also subject to the risks associated with oil and gas properties, including exploration, development and production risks, and environmental risks such as the pollution of air, land and water. In all areas of the Company's business, it competes against entities that have greater technical and financial resources. The Company's growth is dependent upon external sources of financing which may not be available on acceptable terms. Additional information regarding business risks and uncertainties can be found under the heading "Risk Factors" in the Company's Annual Information Form dated March 27, 2008 at www.sedar.com. The risks discussed should not be construed as exhaustive. Information regarding risks associated with financial instruments is set forth in note 11 to the Company's Unaudited Consolidated Financial Statements for the three months ended March 31, 2008.

SPECIAL CAUTIONARY ADVISORIES

Forward-looking statements

Except for historical financial information contained herein, the matters discussed in this document may be considered forward-looking statements. Such statements include declarations regarding management's intent, belief or current expectations. Prospective investors are cautioned that any such forward-looking statements are not guarantees of future performance and involve a number of risks and uncertainties; actual results could differ materially from those indicated by such forward-looking statements. Among the important factors that could cause actual results to differ materially from those indicated by such forward-looking statements are: (i) that the information is of a preliminary nature and may be subject to further adjustment, (ii) the possible unavailability of financing, (iii) risks related to the exploration and development of oil and gas properties, (iv) the impact of price fluctuations and the demand and pricing for oil and natural gas, (v) the seasonal nature of the business, (vi) start-up risks, (vii) general operating risks, (viii) dependence on third parties, (ix) changes in government regulation, (x) the effects of competition, (xi) dependence on senior management, (xii) impact of economic conditions, and (xiii) fluctuations in currency exchange rates and interest rates. The forward-looking statements contained in this document are made as of the date hereof and are expressly qualified by this cautionary statement. Mahalo undertakes no obligation to update publicly or revise any forward-looking statements, whether as a result of new information, future events or otherwise, unless so required by law.

Non-GAAP financial measures

The Company uses and makes reference to "funds from operations", "funds from operations per share", "operating netback" and "net debt" in this MD&A. These terms do not have any standardized meaning, are not defined under Canadian Generally Accepted Accounting Principles ("GAAP") and are therefore referred to as non-GAAP financial measures. These non-GAAP measures should not be considered as an alternative to, or more meaningful than net earnings, cash provided by operating, financing and investing activities or other measures of financial performance or liquidity calculated in accordance with Canadian GAAP. The non-GAAP financial measures, as calculated and used by the Company, may not be comparable to similarly titled measures reported by other companies.

Funds from operations represent cash from operating activities before change in related non-cash working capital. Funds from operations per share are calculated using the weighted average shares outstanding, consistent with the calculation of earnings per share. These measures are used by Mahalo to assess its operating results and its ability to generate funds to finance future capital investments and service debt.

Operating netback presents a measure of net oil and gas revenue relative to realized commodity prices by deducting royalties and operating and transportation costs from oil and gas sales revenues. This non-GAAP measure is also used by the Company to assess comparability of petroleum sales and directly related costs

between periods. There is no GAAP measure that is reasonably comparable to operating netback as calculated by the Company.

Net debt as calculated by the Company represents long-term debt, less working capital (excluding unrealized gain or loss on financial instruments) and is used by the Company to assess financial strength. There is no GAAP measure that is reasonable comparable to net debt as calculated by the Company.

Management considers these non-GAAP financial measures as useful supplemental measures to analyze operations, compare performance between periods and provide shareholders and potential investors with additional information. These non-GAAP measures are also used by certain research analysts to value and compare oil and gas exploration and production companies, and are frequently included in published research when providing investment recommendations.

Barrel of oil equivalent ("boe") volumetric measures

The oil and gas industry commonly expresses production, sales and reserves volumes on a barrel of oil equivalent ("boe") basis whereby natural gas volumes are converted at a ratio of six thousand cubic feet ("Mcf") to one barrel ("bbl") of crude oil. The boe measure is used by the Company to aggregate oil and gas volumes. The measure is also considered to be useful for comparisons with other industry participants. The conversion ratio is based on an approximate energy equivalency of these commodities at the burner tip and does not represent a value equivalency at the well head. This conversion may therefore be misleading, particularly if used in isolation.

ADDITIONAL INFORMATION

Additional information relating to the Company and its business and operations is available on the System for Electronic Document Analysis and Retrieval ("SEDAR") at www.sedar.com or at the Company's web-site at www.mahaloenergy.com.



Unaudited Interim Consolidated Financial Statements

For the Three Months Ended March 31, 2008 and 2007

MAHALO ENERGY LTD.*Unaudited Interim Consolidated Financial Statements***Consolidated Balance Sheets**

(\$000's)

As at	March 31 2008	December 31 2007
ASSETS (note 5)		
Current		
Cash	\$ 2,313	\$ 3,973
Accounts receivable	14,706	13,995
Prepaid and deposits	1,131	977
	18,150	18,945
Property and equipment (note 4)	178,626	174,702
	\$ 196,776	\$ 193,647
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current		
Accounts payable and accrued liabilities	\$ 16,934	\$ 20,924
Current debt (note 5)	57,761	-
	74,695	20,924
Long-term debt (note 5)	-	51,334
Asset retirement obligations (note 6)	4,263	4,090
Future income taxes	2,541	2,050
	81,499	78,398
Shareholders' equity		
Share capital (note 7)	158,979	158,979
Warrants (note 7)	1,990	1,990
Contributed surplus (note 7)	8,640	8,117
Deficit	(54,332)	(53,837)
	115,277	115,249
	\$ 196,776	\$ 193,647
Commitments (note 12)		

See accompanying notes to the unaudited interim consolidated financial statements

For the three months ended March 31	2008	2007
REVENUES		
Petroleum and natural gas revenue	\$ 13,418	\$ 10,432
Royalty expense	(3,353)	(1,971)
	10,065	8,461
Gain (loss) on financial instruments	-	(74)
Interest and other income	13	10
	10,078	8,397
EXPENSES		
Operating	2,088	2,111
Transportation	551	269
General and administrative (note 4)	1,120	1,518
Stock-based compensation (note 7)	468	445
Foreign exchange (gain) loss (note 9)	169	(476)
Interest and financing costs (note 5)	953	1,008
Depletion, depreciation and accretion	4,810	4,258
	10,159	9,133
Loss before income tax	81	736
Current income taxes	5	7
Future income taxes	408	293
NET LOSS AND COMPREHENSIVE LOSS	494	1,036
DEFICIT, BEGINNING OF PERIOD	53,838	49,749
Adoption of accounting policy	-	371
DEFICIT, END OF PERIOD	\$ 54,332	\$ 51,156
Net loss per share (note 7)		
Basic and diluted	\$ (0.01)	\$ (0.02)

See accompanying notes to the unaudited interim consolidated financial statements

MAHALO ENERGY LTD.*Unaudited Interim Consolidated Financial Statements***Consolidated Statements of Cash Flows**

(\$000's)

For the three months ended March 31	2008	2007
OPERATING ACTIVITIES		
Net loss	\$ 494	\$ 1,036
Non-cash items:		
Stock-based compensation	468	445
Depletion, depreciation and accretion	4,810	4,258
Unrealized financial derivative loss	-	12
Unrealized foreign exchange (gain) loss (note 9)	179	(478)
Future income tax expense	408	293
	5,371	3,494
Change in non-cash working capital (note 10)	(2,833)	(531)
	2,538	2,963
FINANCING ACTIVITIES		
Issue of common shares	-	450
Increase (decrease) bank debt	6,275	(6,500)
	6,275	(6,050)
INVESTING ACTIVITIES		
Expenditure on property and equipment	(8,507)	(8,819)
Proceeds on sale of oil and gas properties	-	14,183
Change in non-cash working capital (note 10)	(1,966)	4,779
	(10,473)	10,143
INCREASE (DECREASE) IN CASH	(1,660)	7,056
CASH, BEGINNING OF PERIOD	3,973	1,287
CASH, END OF PERIOD	\$ 2,313	\$ 8,343

See accompanying notes to the unaudited interim consolidated financial statements

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE THREE MONTHS ENDED MARCH 31, 2008 and 2007

All amounts are expressed in Canadian dollars unless otherwise stated

1. NATURE OF OPERATIONS

Mahalo Energy Ltd. (“Mahalo” or the “Company”) was incorporated under the *Business Corporations Act (Alberta)* on April 21, 2004. Mahalo completed its initial public offering and was listed on the Toronto Stock Exchange on July 29, 2005. Mahalo has one wholly-owned subsidiary, Mahalo Energy (USA) Inc.

The Company’s primary business is the acquisition of, exploration for and development and production of coal bed methane and shale gas in Canada and the United States. The Company also has some conventional oil and gas operations in Canada.

2. SIGNIFICANT ACCOUNTING POLICIES

The interim consolidated financial statements of the Company have been prepared by management in accordance with Canadian generally accepted accounting principles, except that certain information and disclosures normally required in the notes to the financial statements have been condensed or omitted. The interim consolidated financial statements have been prepared following the same accounting policies and methods of computation as the consolidated financial statements for the fiscal year ended December 31, 2007, after giving effect to the adoption of new accounting standards discussed in note 3.

The interim consolidated financial statements should be read in conjunction with the Company’s consolidated financial statements and notes thereto as at and for the year ended December 31, 2007.

The results of operations for the three months ended March 31, 2008 may not be indicative of the results for the 2008 fiscal year.

3. ADOPTION OF NEW ACCOUNTING POLICIES

The CICA issued several new accounting standards, Section 1400 "General Standards of Financial Statement Presentation", Section 1535 "Capital Disclosures", Section 3031 "Inventories", Section 3862 "Financial Instruments – Disclosures", Section 3863 "Financial Instruments – Presentation". These standards become effective January 1, 2008.

CICA 1400, General Standards of Financial Statement Presentation, was amended to include requirements to assess and disclose an entity’s ability to continue as a going concern. The new requirements are effective for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2008. The adoption of this standard did not have an impact on The Company's financial statements.

Section 1535 establishes standards for disclosing information regarding an entity’s capital and how it is managed. The section specifies the disclosure of i) an objectives, policies, and processes for managing capital; ii) quantitative data about what the entity regards as capital; iii) whether the entity has complied with any capital requirements; and iv) if it has not complied, the consequences of such non-compliance. The adoption of the new standard did not impact the Company’s financial results, however required additional disclosure which can be found in note 8 to the unaudited consolidated financial statements.

Section 3863 specifies enhanced guidance for the measurement, costing, and disclosures of inventories. The standard provides that inventories be measured at the lower of costs and net realizable value, permits write-ups of subsequent increases in net realizable value of previously impaired inventories and prohibits the use of LIFO costing method. Upon adoption of the standard there was no material impact to the consolidated unaudited financial statements.

Sections 3862 and 3863 replace section 3861 “Financial Instruments – Disclosure and Presentation” which revises and enhances financial instruments disclosure requirements and leaves unchanged the presentation requirements. The objective of section 3862 is to provide financial statement disclosure to enable users to evaluate the significance of financial instruments for the Company's financial position and performance. The section also requires increased disclosure on the nature and extent of risks arising from financial instruments that the Company is exposed to during the reporting period and the balance sheet date and how the company is managing those risks. The purpose of section 3863 is to enhance the financial statement users' understanding of the significance of financial instruments to the Company's financial position, performance and cash flows. The implementation of this new standard did not impact the Company's financial results, however did result in additional disclosures – refer to note 11.

Recent Accounting Pronouncements

On February 13, 2008, the Canadian Accounting Standards Board (“AcSB”) confirmed the use of International Financial Reporting Standards (“IFRS”) for publicly accountable profit-oriented enterprises, including the Company, beginning on January 1, 2011 with appropriate comparative data from the prior year. IFRS will replace the current CICA Handbook as Canadian GAAP. Under IFRS significantly increased disclosure is required, especially for interim reporting. While IFRS uses a conceptual framework similar to Canadian GAAP, there are significant differences in accounting policies which must be addressed. The effects of these new standards on the Company's financial statements are currently being assessed.

Effective January 1, 2009, the Company will be required to adopt CICA Handbook Section 3064 “Goodwill and Intangible Assets”, which establishes the guidance for the recognition, measurement, presentation and disclosure of goodwill and intangible assets.

4. PROPERTY AND EQUIPMENT

(\$000's)	Cost	Accumulated Depletion and Depreciation	Net Book Value
March 31, 2008			
Canada:			
Petroleum and natural gas properties and equipment	\$ 116,574	\$ 39,776	\$ 76,798
Other	507	268	239
	117,081	40,044	77,037
USA:			
Petroleum and natural gas properties and equipment	127,069	25,683	101,386
Other	233	30	203
	127,302	25,713	101,589
	\$ 244,383	\$ 65,757	\$ 178,626
December 31, 2007:			
Canada:			
Petroleum and natural gas properties and equipment	\$ 113,287	\$ 37,509	\$ 75,778
Other	497	247	250
	113,784	37,756	76,028
USA:			
Petroleum and natural gas properties and equipment	121,888	23,259	98,629
Other	65	20	45
	121,953	23,279	98,674
	\$ 235,737	\$ 61,035	\$ 174,702

Costs associated with unproven properties excluded from costs subject to depletion amounted to \$65,019,884 (December 31, 2007 - \$68,195,657). Of the total excluded costs, \$44,524,197 (December 31, 2007 - \$45,717,934) related to Canada and \$20,495,687 (December 31, 2007 - \$22,477,723) to the United States.

Future development costs of \$37,284,900 (December 31, 2007 - \$38,361,700) have been included in the costs subject to depletion, of which \$7,244,700 related to Canada (2007 - \$7,588,300) and \$30,040,200 (2007 - \$30,773,400) to the United States.

The Company capitalized \$35,421 of direct general and administrative costs related to petroleum and natural gas properties in the three month period ended March 31, 2008 (2007 - \$54,804). In addition, the Company capitalized \$54,657 (2007 - \$61,174) of stock based compensation during the same period.

5. BANK DEBT

As at March 31, 2008, Mahalo has a CDN \$75.0 million revolving credit facility with a United States bank with an approved borrowing base of CDN \$60.0 million. The facility expires in January 2009. At the date of expiry, the borrowings under the facility become due and payable. The Company will be renegotiated a credit facility during 2008. At March 31, 2008, CDN \$57,761,434 (December 31, 2007 - \$51,334,315) was drawn on the facility. The revolving credit facility bears interest at the lender's base, US and CDN prime rate or Libor plus 0.0 to 1.5 percent depending on the level of facility utilization. The credit facility, which is collateralized by a fixed charge on the Company's United States assets and a floating charge on its Canadian assets, requires the Company to maintain

certain financial covenants and ratios. The Company is in compliance with all financial covenants and ratios.

The effective interest rate on amounts outstanding under the credit facility at March 31, 2008 was 6.96 percent (December 31, 2007 – 7.40 percent).

6. ASSET RETIREMENT OBLIGATIONS

The Company's asset retirement obligations result from net ownership interests in petroleum and natural gas properties and equipment including well sites, gathering systems and processing facilities.

At March 31, 2008, the estimated total undiscounted amount required to settle the asset retirement obligations, adjusted for inflation, is approximately \$12.1 million (December 31, 2007 - \$12.2 million). This amount has been discounted using a credit adjusted risk free interest rate of 8.5 percent. The expected period until settlement is dependent upon the useful lives of the underlying assets, which currently extend up to 50 years.

A reconciliation of the asset retirement obligation is provided below:

(\$000's)	
Balance, December 31, 2007	\$ 4,090
Liabilities incurred	81
Liabilities incurred on Corbett acquisition	-
Liabilities disposed	-
Revision to assumptions	4
Accretion expense	88
Balance, March 31, 2008	\$ 4,263

7. SHARE CAPITAL

(a) Authorized

Unlimited number of voting common shares with no par value.
Unlimited number of non-preferred shares issuable in series.

(b) Issued

Common shares	Number of Shares	Amount (\$000's)
Balance, March 31, 2008 and December 31, 2007	59,298,035	\$ 158,979

The weighted average number of shares outstanding is as follows:

	Three Month Ended March 31,	
	2008	2007
Weighted average basic and diluted	59,298,035	59,086,035

For the three month periods ended March 31, 2008 and 2007, share purchase warrants and stock options were anti-dilutive.

(c) Share Purchase Warrants

At March 31, 2008, the Company had outstanding 535,200 performance warrants at a strike price of \$4.92 per share. The warrants will become 100 percent vested when the Company's stock price is \$8.33 per share on a 45 day weighted average trading price. The warrants expire July 29, 2010. The warrants carry a "Put Right" whereby the warrant holders, at their option, may receive cash in an amount equal to the excess of the market price at the time of exercise over the strike price. No value has been assigned to these warrants. The warrants will be valued by the changes in the market price of the common shares at the end of each accounting period and will be amortized into earnings over their expected life once the performance condition becomes likely.

In addition at March 31, 2008, the Company had warrants which enable the warrant holder to acquire 1,440,000 common shares at \$4.17 per share. The value assigned to these warrants was \$1,990,412 using the Black-Scholes option-pricing model. These warrants expire November 30, 2009.

(d) Stock Options

The following table provides a continuity of stock options outstanding and the weighted average share prices for which shares have been reserved.

	Number of Options	Weighted Average Exercise Price (\$)
Outstanding, December 31, 2007	4,722,033	4.15
Granted	137,000	2.48
Forfeited	403,133	3.73
Outstanding, March 31, 2008	4,455,900	4.13
Exercisable, March 31, 2008	2,453,592	4.41

The following summarizes information about stock options outstanding at March 31, 2008:

Range of Exercise Price	Options Outstanding	Weighted Average Exercise Price (\$)	Weighted Average Remaining Term (Years)	Options Exercisable	Weighted Average Exercise Price (\$)	Weighted Average Remaining Term (Years)
\$2.30 to \$3.95	1,805,600	3.33	3.7	455,794	3.19	3.6
\$4.19 to \$4.77	2,241,900	4.57	2.4	1,702,733	4.59	2.3
\$5.00 to \$5.25	388,400	5.17	2.6	281,733	5.15	2.5
\$7.38 to \$7.40	20,000	7.39	2.8	13,332	7.39	2.8
	4,455,900	4.13	2.9	2,453,592	4.41	2.6

(e) Stock-Based Compensation

The fair value of stock options granted was estimated using the Black-Scholes option-pricing model. Weighted average assumptions and resulting fair value for stock options granted during the three months ended March 31, 2008 are as follows:

	2008
Risk free interest rate (%)	3.5
Expected life (years)	5.0
Expected volatility (%)	47
Weighted average fair value per share (\$)	1.77

During the three months ended March 31, 2008, the Company recorded stock-based compensation of \$523,381 (2007 - \$506,405) related to options granted under the formal stock option plan, of which

\$468,724 (2007 - \$445,231) was recognized as an expense and \$54,657 (2007 - \$61,174) was capitalized to property and equipment.

(f) Contributed Surplus

The following table reconciles Mahalo’s contributed surplus:

(\$000's)	
Balance, December 31, 2007	\$ 8,117
Stock-based compensation costs	523
Balance, March 31, 2008	\$ 8,640

8. Management of Capital Structure

The Company’s policy is to maintain a strong capital base so as to maintain investor, creditor and market confidence and to sustain the future development of the business.

The Company considers its capital structure to include shareholders’ equity, bank debt and working capital. Mahalo has the ability to adjust its capital structure and may from time to time issue new equity or debt, make adjustments to its capital expenditure program and sell assets..

The Company manages its capital structure and makes adjustments to it in the light of changes in economic conditions and the risk characteristics of the underlying petroleum and natural gas assets. The Company prepares annual capital expenditure budgets, which are updated at least quarterly to reflect results of operations and capital deployment, changes to forecasted prices and costs, general industry conditions and other factors. The annual and updated budgets are approved by the Board of Directors.

Mahalo’s capital structure is outlined below in the following table.

(\$000's)	March 31, 2008	
Current assets	\$	18,150
Accounts payable and accrued liabilities		16,934
Working capital, before inclusion of bank debt (1)		1,216
Bank debt		57,761
Working capital deficiency, including bank debt	\$	56,545
Shareholders' equity	\$	115,277

(1) The bank credit facility expires in January 2009.

Mahalo’s three year bank credit facility expires within twelve months and as a result, is included as a part of working capital at March 31, 2008. The Company is confident that it will extend or replace the credit facility on acceptable terms and conditions.

Working capital and bank debt fluctuate primarily as a result of normal operational activity and the timing and level of capital expenditures. Mahalo’s share capital is not subject to external restrictions; the approved borrowing base under the revolving bank credit facility is, however, based to a significant extent on the estimated value of the Company’s petroleum and natural gas reserves.

The Company has not declared or paid any dividends on its outstanding common shares. Any decision to pay dividends will be made by the Board of Directors on the basis of the Company’s earnings, financial requirements and other conditions existing at the time.

9. FOREIGN EXCHANGE

During the three months ended March 31, 2008, the Company recorded a net foreign exchange loss of \$169,931 (2007 – gain of \$476,427) of which a foreign exchange loss of \$179,222 (2007 – gain of \$478,378) was unrealized at the period end. The amounts reflect the impact of fluctuations in the Canadian/United States exchange rate on monetary assets and liabilities and revenues and expenses of the Company that are denominated in United States dollars.

10. SUPPLEMENTAL CASH FLOW INFORMATION

Changes in non-cash working capital were as follows:

(\$000's)	2008	2007
Increase (decrease) in non-cash working capital		
Accounts receivable	\$ 1,092	\$ 2,840
Prepaid and deposits	236	207
Accounts payable and accrued liabilities	(6,127)	1,201
Net change in non-cash working capital	\$ (4,799)	\$ 4,248
Relating to:		
Operating activities	\$ (2,833)	\$ (531)
Investing activities	(1,966)	4,779
Net change in non-cash working capital	\$ (4,799)	\$ 4,248

11. FINANCIAL INSTRUMENTS

(a) Fair value of financial instruments

The Company's financial instruments as at March 31, 2008 include cash and cash equivalents, accounts receivable, derivative contracts, accounts payable and accrued liabilities and bank debt. The fair value of cash and cash equivalents, accounts receivable, bank debt, accounts payable and accrued liabilities approximate their carrying amounts due to their short terms to maturity or the indexed rate of interest on the bank debt.

The Company is exposed to financial risks arising from its financial assets and liabilities. The financial risks include credit risk, market risk on commodity and foreign exchange risk, interest rate risk and liquidity risk. These risks are outlined more fully below.

Financial Instrument	Category
Cash and cash equivalents	Held for trading
Accounts receivable	Loans and receivables
Accounts payable and accrued liabilities	Other liabilities
Bank debt	Other liabilities

(b) Credit risk

Credit risk is the risk of financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its contractual obligations and arises principally from the Company's receivables from joint venture partners and petroleum and natural gas marketers. A substantial portion of the Company's accounts receivable are with customers in the energy industry and are subject to normal industry credit risk. Mahalo generally grants unsecured credit but routinely assesses the financial strength of its customers.

As is common in the petroleum and natural gas industry in Western Canada, receivables relating to the sale of petroleum and natural gas are received on or about the 25th day of the following month. In United States, the receivables are received on or about the 1st day of the second following month. The Company's policy to mitigate credit risk associated with these balances is to establish marketing relationships with large purchasers. Mahalo historically has not experienced any collection issues with its petroleum and natural gas marketers. Joint venture receivables are typically collected within one to three months of the joint venture bills being issued to the partner. However, the receivables are typically from participants in the petroleum and natural gas sector and collection of the outstanding balances is dependent on industry factors such as commodity price fluctuations, escalating costs, the risk of unsuccessful drilling and occasional disagreement between parties. The Company attempts to mitigate this risk by obtaining partner approval of significant capital expenditures prior to performance of the project. The Company does not typically obtain collateral from petroleum and natural gas marketers or joint venture partners; however in certain circumstances a cash call may be requested in advance of the start of the project. In some cases, the Company does have the ability to withhold production from joint venture partners in the event of non-payment.

The carrying amount of accounts receivable generally represents the maximum credit exposure faced by the Company. The Company does not have an allowance for doubtful accounts, and has not written off any receivables during the three months ended March 31, 2008.

As at March 31, 2008, the Company considers its receivables to be aged as follows:

Aging	March 31, 2008	
(\$000's)		
Not past due (less than 90 days)	\$	12,776
Past due (greater than 90 days)		1,930
	\$	14,706

(c) Liquidity risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they are due. The Company's approach to managing liquidity is to ensure, as far as possible, that it will have sufficient liquidity to meet its liabilities when due, under normal and stressed conditions without incurring unacceptable losses or risking harm to the Company's reputation.

The Company prepares annual capital expenditure budgets, which are regularly monitored and updated as considered necessary. In addition, Mahalo utilizes authorizations for expenditures on both operated and non-operated projects to further manage capital expenditures. To facilitate the capital expenditure program, the Company has a revolving credit facility (note 5), that is reviewed at least semi-annually by the lender.

The contractual maturities of financial liabilities; accounts payable and accrued liabilities of \$16,934,275, bank debt of \$57,761,435 and associated interest payments are due and payable within less than one year.

(d) Market risk

Market risk is the risk that changes in market prices, such as foreign exchange rates, commodity prices and interest rates will affect the Company's net earnings or the value of the financial instruments. The object of market risk management is to manage and control market risk exposures within acceptable limits, while maximizing returns. The Company utilizes commodity price contracts to manage market risks relevant to commodity prices when considered prudent. The Company attempts to minimize the impact of commodity price volatility by entering into physical fixed price sales contracts and financial derivative contracts for up to 50 percent of expected daily gas sales volumes after royalties, when considered prudent. All such transactions are conducted in accordance with the risk management policy that has been approved by the Board of Directors.

(e) Foreign currency exchange risk

Foreign currency exchange rate risk is the risk that the fair value or future cash flows will fluctuate as a result of changes in foreign exchange rates. The Company's operations in Canada and the United States are integrated, which results in the economic exposure of the United States entity to be tied to the reporting currency. Currently, the Company's foreign exchange translation exposure principally reflects the impact of fluctuations in the Canadian/United States exchange rate on monetary assets and liabilities and revenues and expenses of the Company. In addition, the underlying market prices for petroleum and natural gas are impacted by changes in the exchange rate between the Canadian and United States dollar. If foreign exchange rates had changed by \$0.01, with all other variables held constant, net earnings for the three months ended March 31, 2008 would change by an estimated \$48,188. The Company had no forward exchange rate contracts in place as at or during the three months ended March 31, 2008.

(f) Commodity price risk

Commodity price risk is the risk that the fair value or future cash flows will fluctuate as a result of changes in commodity prices. Commodity prices for petroleum and natural gas are impacted by not only the relationship between the Canadian and United States dollar, as outlined above, but also world economic events that dictate the levels of supply and demand. The Company attempts to minimize the impact of commodity price volatility by entering into physical fixed price sales contracts and financial derivative contracts for up to 50 percent of expected daily gas sales volumes after royalties, when considered prudent.

The Company has sales contracts outstanding with respect to the physical delivery of natural gas at a fixed price. The following is a summary of the physical fixed price forward sales commitments as at March 31, 2008.

Daily Volume	Contract Price	Term
3,000 MMbtu	US \$7.40/MMbtu	November 2007 - October 2008
2,000 GJ	CDN \$7.43/GJ	January 2008 - December 2008
1,000 MMbtu	US \$7.00/MMbtu	April 2008 - October 2008
1,500 MMbtu	US \$7.185/MMbtu	February 2008 - January 2009
1,000 MMbtu	US \$7.10/MMbtu	April 2008 - October 2008
1,000 MMbtu	US \$7.97/MMbtu	April 2008 - June 2008

As at March 31, 2008, a \$1.00 change per MMbtu and per GJ on the fixed price forward contracts listed above, results in an estimated \$0.6 million impact on net income.

(g) Interest rate risk

Interest rate risk is the risk that future cash flows will fluctuate as a result of changes in market interest rates. The Company is exposed to interest rate fluctuations on its bank debt which bears a floating rate of interest. If interest rates had changed by 1.0%, with all other variables held constant, net earnings for the three months ended March 31, 2008 would change by an estimated \$0.1 million. The Company had no interest rate swap or financial contracts in place as at or during the three months ended March 31, 2008.

12. COMMITMENTS

The Company has committed to certain payments over the next five years as follows:

	2008	2009	2010	2011	2012	Total
Canada: (\$000's)						
Office lease	\$ 425	\$ 542	\$ 568	\$ 426	\$ -	\$ 1,961
Equipment usage	1,014	2,376	2,376	-	-	5,766
	\$ 1,439	\$ 2,918	\$ 2,944	\$ 426	\$ -	\$ 7,727
USA (US\$000's):						
Office lease	\$ 34	\$ 45	\$ 15	\$ -	\$ -	\$ 94

Subsequent to March 31, 2008, the Company entered into the following physical fixed price forward sales contract commitments to sell:

Daily Volume	Contract Price	Term
2,000 MMbtu	US \$9.06/MMbtu	May 2008
2,000 MMbtu	US \$9.65/MMbtu	June 2008 - October 2008
2,000 MMbtu	US \$9.30/MMbtu	May 2008
1,500 MMbtu	US \$8.80/MMbtu	April 2008

13. SEGMENTED INFORMATION

The Company's petroleum and natural gas exploration, development and production operations are conducted in two geographic segments: Canada and the United States. The following table reflects segmented information as at and for the three months ended March 31, 2008.

(\$000's)	Canada	United States	Total
2008:			
Net revenue	\$ 4,258	\$ 5,820	\$ 10,078
Net income (loss)	(960)	466	(494)
Capital expenditures, net	3,210	5,297	8,507
Property and equipment	77,037	101,589	178,626
Total assets	84,866	111,910	196,776
2007:			
Net revenue	\$ 2,918	\$ 5,479	\$ 8,397
Net income (loss)	(1,964)	928	(1,036)
Capital expenditures, net	(11,237)	5,874	(5,363)
Property and equipment	75,046	93,309	168,355
Total assets	91,974	101,000	192,974

14. RELATED PARTY TRANSACTIONS

The Company is related to Avenir Capital Corporation and Avenir Operating Corp. by virtue of certain directors in common. The Company conducts joint operating activities with these companies in the normal course of business.

During the three months ended March 31, 2007, the Company sold certain non-core properties to Avenir Operating Corp., a related company by virtue of certain directors in common for \$7.2 million. The measurement basis used for the transaction was an independent reserves valuation as at December 31, 2006. The transaction value was also compared with current market sales metrics from an independent public source. The asset sale transaction was a cash transaction and did not include any ongoing contractual or other commitments.