



Interim Consolidated Financial Statements

Three Months ended March 31, 2009 and 2008

Unaudited – Prepared by Management

**NOTICE OF NO AUDITOR REVIEW OF
INTERIM FINANCIAL STATEMENTS**

In accordance with National Instrument 51-102 released by the Canadian Securities Administrators, the Company discloses that its auditors have not reviewed these interim financial statements as at and for the three months ended March 31, 2009 and 2008.

MAHALO ENERGY LTD.*Unaudited Interim Consolidated Financial Statements***CONSOLIDATED BALANCE SHEETS**

(See basis of presentation - note 1)

As at	March 31,	December 31,
	2009	2008
<i>(\$000'S)</i>		
Assets (note 6)		
Current		
Cash	1,288	2,073
Accounts receivable	14,275	11,644
Prepaid and deposits	1,066	999
Current portion of unrealized gain on derivative natural gas contracts (note 11)	13,347	6,593
	29,976	21,309
Deferred financing costs (note 6)	11,934	15,607
Unrealized gain on derivative natural gas contracts (note 11)	3,346	4,151
Property and equipment (notes 4 and 5)	137,868	139,321
Assets held for sale (note 4)	3,509	3,469
	186,633	183,857
Liabilities		
Current		
Accounts payable and accrued liabilities	36,947	38,118
Bank debt (note 6)	77,386	75,097
	114,333	113,215
Asset retirement obligations (note 7)	1,456	1,385
Asset retirement obligations related to assets held for sale (note 4)	1,880	1,848
Future income taxes	6,523	6,015
	124,192	122,463
Commitments (note 10)		
Shareholders' equity		
Share capital (note 8)	158,979	158,979
Warrants (note 8)	1,990	1,990
Contributed surplus (note 8)	10,148	9,848
Deficit	(122,174)	(121,198)
Accumulated other comprehensive income	13,498	11,775
	62,441	61,394
	186,633	183,857

See accompanying notes to the unaudited interim consolidated financial statements

MAHALO ENERGY LTD.*Unaudited Interim Consolidated Financial Statements***CONSOLIDATED STATEMENTS OF LOSS**

Three months ended March 31,	2009	2008
<i>(\$000's, except per share)</i>		<i>(restated - notes 2 & 4)</i>
Revenues		
Petroleum and natural gas revenue	9,614	7,780
Royalty expense	(2,422)	(1,960)
	7,192	5,820
Gain on derivative natural gas contracts	7,126	-
Salt water disposal income	464	-
	14,782	5,820
Expenses		
Operating	1,908	916
Transportation	816	459
General and administrative	1,732	791
Stock-based compensation	270	468
Foreign exchange loss	-	169
Interest and financing costs (note 6)	6,433	543
Depletion, depreciation and accretion	3,402	2,453
	14,561	5,799
Income from continuing operations, before income taxes	221	21
Current income tax expense	6	5
Future income tax expense	329	408
Loss from continuing operations	114	392
Loss from discontinued operations (note 4)	862	102
Net loss	976	494
Loss per share from continuing operations (note 8)		
Basic and diluted	0.00	0.01
Loss per share from discontinued operations (note 8)		
Basic and diluted	0.02	0.00
Net loss per share (note 8)		
Basic and diluted	0.02	0.01

See accompanying notes to the unaudited interim consolidated financial statements

MAHALO ENERGY LTD.*Unaudited Interim Consolidated Financial Statements***CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)**

Three months ended March 31,	2009	2008
<i>(\$000's)</i>		
Net loss	(976)	(494)
Translation of US dollar results to Canadian dollar reporting currency	1,723	-
Other comprehensive income	1,723	-
Comprehensive income (loss)	747	(494)

*See accompanying notes to the unaudited interim consolidated financial statements***MAHALO ENERGY LTD.***Unaudited Interim Consolidated Financial Statements***CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY**

Three months ended March 31,	2009	2008
<i>(\$000's)</i>		<i>(restated - notes 2 & 4)</i>
Share Capital		
Balance, beginning and end of period	158,979	158,979
Warrants		
Balance, beginning and end of period	1,990	1,990
Contributed Surplus		
Balance, beginning of period	9,848	8,117
Stock-based compensation costs	300	523
Balance, end of period	10,148	8,640
Deficit		
Balance, beginning of period	(121,198)	(53,837)
Net loss	(976)	(494)
Balance, end of period	(122,174)	(54,331)
Accumulated Other Comprehensive Income		
Balance, beginning of period	11,775	-
Foreign exchange	1,723	-
Balance, end of period	13,498	-

See accompanying notes to the unaudited interim consolidated financial statements

MAHALO ENERGY LTD.*Unaudited Interim Consolidated Financial Statements***CONSOLIDATED STATEMENTS OF CASH FLOWS**

Three months ended March 31,	2009	2008
<i>(\$000's)</i>		<i>(restated - notes 2 & 4)</i>
Operating activities		
Net loss from continuing operations	(114)	(392)
Non-cash items:		
Stock-based compensation	270	468
Depletion, depreciation and accretion	3,402	2,453
Unrealized financial derivative gain	(5,572)	-
Unrealized foreign exchange loss	-	178
Amortization of deferred financing costs	4,086	-
Future income tax expense	329	408
Cash flow from continuing operations	2,401	3,115
Change in non-cash working capital	(22)	(2,833)
Cash flow from discontinued operations	(817)	2,256
	1,562	2,538
Financing activities		
Long-term debt	18	6,275
	18	6,275
Investing activities		
Expenditure on property and equipment	(227)	(5,297)
Proceeds on sale of oil and gas properties	2,293	-
(Increase) decrease in assets held for sale	7	(3,210)
Change in non-cash working capital	(4,438)	(1,966)
	(2,365)	(10,473)
Increase (decrease) in cash	(785)	(1,660)
Cash, beginning of period	2,073	3,973
Cash, end of period	1,288	2,313

See accompanying notes to the unaudited interim consolidated financial statements

MAHALO ENERGY LTD.

NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

Three Months Ended March 31, 2009 and 2008

All amounts are expressed in Canadian dollars unless otherwise stated

1. BASIS OF PRESENTATION AND GOING CONCERN ISSUES

These unaudited interim consolidated financial statements have been prepared using generally accepted accounting principles (GAAP) on the basis that the Company will be able to discharge its obligations and realize its assets in the normal course of business at the values at which they are carried in these financial statements, and that the Company will be able to continue its business activities.

In accordance with Canadian GAAP appropriate for a going concern, property and equipment is carried at cost less accumulated amortization and any impairment losses. They are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable. There can be no assurance that expected future cash flows will be realized or will be sufficient to recover the carrying amount of property and equipment.

The future operation of the Company is dependant on its ability to successfully raise capital and receive the continued financial support from its lenders (see note 6). As at March 31, 2009, the Company had a working capital deficiency of \$84.4 million and an accumulated deficit of \$122.2 million. The Company requires additional funds to maintain operations and discharge liabilities as they become due, as further discussed below. These conditions raise substantial doubt about the Company's ability to continue as a going concern.

As of March 31, 2009, the Company was in breach of certain covenants under its bank credit agreement, including non-payment of a US \$5 million revolving loan advance and a US \$10 million loan fee, both of which were due on March 31, 2009. The Company continues to work with its lenders to rectify this issue. If an acceptable solution is not achieved and the debt is called, it is unlikely that the Company will be able to continue its activities and discharge its obligations. The outcome of these matters is dependant on factors outside of the Company's control and cannot be predicted at this time.

Management believes that the going concern assumption is appropriate for these financial statements. If this assumption is not appropriate, adjustments to the carrying amounts of the assets and liabilities, revenues and expenses and the balance sheet classifications used may be necessary.

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 the United States.

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, 2008, after giving effect to the adoption of new accounting standards discussed in note 3.

The unaudited interim consolidated financial statements should be read in conjunction with the Company's audited consolidated financial statements and notes thereto as at and for the year ended December 31, 2008.

The results of operations for the three months ended March 31, 2009 may not be indicative of the results for the 2009 fiscal year.

3. NEW ACCOUNTING STANDARDS AND PRONOUNCEMENTS

On January 1, 2009, the Company adopted CICA Handbook Section 3064 - Goodwill and Intangible Assets which establishes guidance for the recognition, measurement, presentation and disclosure of goodwill and intangible assets, including guidance on pre-production and start-up costs, requiring that these costs be expensed as incurred. The current goodwill standards are carried forward unchanged from that included in the previous section 3062. The adoption of this standard did not have an impact on the Company's consolidated financial statements.

On January 20, 2009, the CICA issued EIC-173 Credit Risk and the Fair Value of Financial Assets and Financial Liabilities. Under this EIC, an entity's own credit risk and the credit risk of the counterparty should be taken into account in determining the fair value of financial assets and liabilities, including derivative instruments. The Company adopted the requirements of EIC-173 effective January 1, 2009. The adoption of this standard did not have an impact on the Company's consolidated financial statements.

Accounting Pronouncements

In February 2008, the Canadian Accounting Standards Board confirmed the use of International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board. The changeover date for Canadian publicly accountable enterprises is January 1, 2011 and will require restatement of comparative figures. IFRS will replace the current CICA Handbook as Canadian GAAP. Significantly increased disclosure will be required under IFRS, 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 Company has undertaken a preliminary review of its current accounting policies under Canadian GAAP in an effort to identify key differences and options with respect to acceptable accounting standards under IFRS.

On January 1, 2011, the Company will be required to adopt CICA Handbook Section 1582 – Business Combinations which establishes revised standards for accounting for business combinations, which in turn are aligned with International Financial reporting Standards ("IFRS") on business combinations. The Section applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after January 1, 2011. Earlier application is permitted. The effects on the Company's financial statements are currently being reviewed but are not expected to be significant.

4. ASSETS HELD FOR SALE AND DISCONTINUED OPERATIONS

During 2008, Mahalo committed to dispose of its Canadian resource assets with an agent being engaged to facilitate the process. A majority of the assets were sold by March 31, 2009. The Company has determined that there is a significant probability that the remaining assets held for sale will be sold within the next year.

Since the assets to be sold encompass the entire Canadian business segment or cost centre under full cost accounting, the cost center has been accounted for as a "discontinued operation" as required under Canadian GAAP. A value of \$3.5 million, representing the estimated fair value less costs to sell, has been assigned to the petroleum and natural gas assets remaining to be sold as at March 31, 2009 (December 31, 2008 - \$3.5 million). These assets have been reclassified from "property and equipment" to "assets held for sale" on the consolidated balance sheets. A liability of \$1.9 million (December 31, 2008 - \$1.8 million), being the asset retirement obligations associated with the assets held for sale, has also been set out separately on the consolidated balance sheets.

The results of operations related to the Canadian cost center are as follows:

Three months ended March 31, (\$000's)	2009	2008
Revenues		
Petroleum and natural gas revenue	266	5,638
Royalty expense	4	(1,393)
Other	4	13
	274	4,258
Expenses		
Operating and transportation	438	1,264
General & administrative	488	329
Interest	165	410
Depletion, depreciation and accretion	45	2,357
	1,136	4,360
Loss from discontinued operations	(862)	(102)

Interest expense was allocated to discontinued operations based on asset values.

The carrying value of the Company's petroleum and natural gas properties and related facilities is limited to the fair value less costs of sale, which in turn was based on the AECO Gas benchmark reference price adjusted for quality and price differentials, specific to the Company's assets, and discounted at an interest rate of 10 percent over the estimated reserve life.

The Company capitalized \$13,576 (2008 - \$35,421) of direct general and administrative costs related to petroleum and natural gas properties. The Company also capitalized \$30,000 (2008 - \$54,657) of stock based compensation costs. These costs relate to discontinued operations.

5. PROPERTY AND EQUIPMENT

	Cost	Accumulated Depletion and Depreciation	Net Book Value
<i>(\$000's)</i>			
March 31, 2009:			
Petroleum and natural gas properties and equipment	176,109	38,255	137,854
Other	542	528	14
	176,651	38,783	137,868
December 31, 2008:			
Petroleum and natural gas properties and equipment	174,198	34,930	139,268
Other	539	486	53
	174,737	35,415	139,321

Costs associated with unproven properties excluded from costs subject to depletion amounted to \$22,018,287 (December 31, 2008 - \$21,633,089). Future development costs of \$33,049,200 (December 31, 2008 - \$33,049,200) have been included in the costs subject to depletion.

6. BANK DEBT

The Company has a US \$105 million credit facility (the “Facility”) with Ableco Finance LLC (the “Lender”). All borrowings under the Facility are denominated in US dollars. On March 5, 2009, Mahalo announced that it had received a reservation of rights letter from Ableco (“the Lenders”) notifying the Company that it is in default under its loan agreement for failure to comply with certain covenants relating to obtaining a letter of intent (“LOI”) for the sale or recapitalization of the Company by March 1, 2009. As a result of the default, the Lenders advised Mahalo that until resolved, future loans would be made in the sole discretion of the Lenders.

As at March 31, 2009, US \$39.9 million (Cdn \$50.3 million) was drawn on the revolver loan and US \$21.5 million (Cdn \$27.1 million) was drawn on the term loan. Of the revolver loan, US \$5.0 million (Cdn \$6.3 million) was repayable on March 31, 2009. The weighted average effective interest rate on borrowings outstanding under the Facility at March 31, 2009 was 12.7 percent (December 31, 2008 – 9.53 percent).

At March 31, 2009, irrevocable standby letters of credit were issued for a total of Cdn \$20,000 and US \$20,000 (December 31, 2008 - Cdn \$145,000 and US \$20,000). These letters of credit reduce the amount available under the facility.

As of March 31, 2009, the Company was in breach of certain covenants under its bank credit agreement, including non-payment of a US \$5 million revolver advance which was due and payable on March 31, 2009 and a US \$10 million loan fee. The loan fee was levied under the terms of a November 28, 2008 credit facility amendment and became due when the Company failed to achieve certain restructuring and/or refinancing initiatives by March 31, 2009. The US \$10 million loan fee was included in the Company’s accounts payable and accrued liabilities as at March 31, 2009 and December 31, 2008.

Under the terms of the Facility, if any Event of Default occurs and is continuing, the administrative agent shall, at the request of, or may, with the consent of, the Lender, take any or all of the following actions:

- a) Terminate any commitment to make loans and any other credit extensions.
- b) Declare the unpaid principal amount of all outstanding loans, all interest accrued and unpaid thereon, and all other amounts owing or payable to be immediately due and payable.
- c) Require that the borrower cash collateralize any letters of credit.
- d) Exercise all rights and remedies available to the Lender under the loan documents.

The Lenders have not exercised their default-related rights or demanded repayment of amounts outstanding under the Facility. As long as the default continues, Management considers the credit facility to have the same characteristics as a demand loan; therefore, it has been classified as a current liability. Additionally, should the loan be called earlier than December 31, 2009, any unamortized balance of deferred financing costs would be expensed in its entirety at that time.

7. 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, 2009, the estimated total undiscounted amount required to settle the asset retirement obligations related to continuing operations, adjusted for inflation of 2 percent, is approximately \$4.5 million (December 31, 2008 - \$4.5 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 related to continuing operations is provided below:

Three months ended March 31, <i>(\$000's)</i>	2009	2008
Balance, beginning of period	1,385	871
Liabilities incurred	-	21
Revision to assumptions	41	-
Accretion expense	30	20
Balance, end of period	1,456	912

The asset retirement obligation related to assets held for sale and discontinued operations are discussed in note 4.

8. 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)
March 31, 2009 and December 31, 2008	59,298,035	158,979

(c) Share Purchase Warrants

At March 31, 2009, the Company had outstanding 144,000 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 basis. 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. 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. No value has been assigned to these warrants.

In addition at March 31, 2009, 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 Company has a stock option plan whereby options may be granted to the Company's directors, officers, employees and consultants for up to 10 percent of the Company's outstanding common shares. The exercise price of the options is determined by the five day weighted average price of the stock on the five trading days immediately preceding the relevant date. Each stock option granted permits the holder to purchase one common share of the Company at the stated exercise price. Options currently outstanding have a term of five years and vest equally over three years commencing one year after the date of grant of the option.

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, 2008	3,999,731	3.51
Granted	280,000	0.22
Forfeited	(174,999)	4.26
Outstanding, March 31, 2009	4,104,732	3.26
Exercisable, March 31, 2009	2,473,315	3.89

The following summarizes information about stock options outstanding at March 31, 2009:

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)
\$0.22 to \$3.95	2,633,932	2.52	3.2	1,002,516	2.88	2.2
\$4.19 to \$4.77	1,402,400	4.57	1.3	1,402,399	4.57	1.3
\$5.00 to \$7.40	68,400	5.00	0.4	68,400	5.00	0.4
	4,104,732	3.26	2.5	2,473,315	3.89	1.6

(e) Stock-Based Compensation

The Company accounts for its stock-based compensation using the fair value method. Under this method, the fair value of stock options granted is recognized as a charge to earnings with a corresponding increase to contributed surplus over the vesting period.

The fair value of stock options granted during the year was estimated using the Black-Scholes option-pricing model, using the following weighted average assumptions:

Three months ended March 31,	2009	2008
Risk free interest rate (%)	0.8	3.5
Expected life (years)	5.0	5.0
Expected volatility (%)	201	47
Weighted average fair value per share (\$)	0.07	1.77

During the three months ended March 31, 2009, stock-based compensation amounted to \$300,000 (2008 - \$523,381), of which \$270,000 (2008 - \$468,724) was recognized as an expense and \$30,000 (2008 - \$54,657) was capitalized to property and equipment.

(f) Contributed Surplus

The following table reconciles Mahalo's contributed surplus:

<i>(\$000's)</i>	
Balance, December 31, 2008	9,848
Stock-based compensation costs	300
Balance, March 31, 2009	10,148

(g) Per Share Amounts

The weighted average number of shares outstanding is as follows:

	Three Months Ended March 31	
	2009	2008
Weighted average basic and diluted	59,298,035	59,298,035

For the periods ended March 31, 2009 and 2008, share purchase warrants and stock options were anti-dilutive.

9. Management of Capital Structure

The Company considers its capital structure to include working capital, long-term debt and shareholders' equity. Mahalo may from time to time make adjustments to its capital expenditure program and sell assets or issue new debt or equity; however, there is no assurance that debt or equity financing will be available on terms acceptable to the Company.

The Company manages its capital structure and makes adjustments to it in 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 set forth in the following table.

	March 31 2009
<i>(\$000's)</i>	
Current assets	16,629
Accounts payable and accrued liabilities	(36,947)
Bank debt (note 6)	(77,386)
Working capital deficiency	(97,704)
Shareholders' equity	62,441

Working capital and long-term 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. In addition, the Company must comply with the following debt covenants under the bank credit facility; interest rate coverage ratio, consolidated leverage ratio, current ratio, minimum liquidity, asset coverage ratio, minimum production, minimum hedging positions and maximum capital expenditures.

As of March 31, 2009, the Company was in breach of certain covenants under its bank credit agreement, including non-payment of a US \$5 million revolver advance and a US \$10 million loan fee on March 31, 2009. The Company is currently working with its lenders to rectify this issue. If an acceptable solution is not achieved and the debt is called, the Company will require additional capital to continue its activities and discharge its obligations. The outcome of these matters is dependant on factors outside of the Company's control and cannot be predicted at this time.

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.

10. COMMITMENTS

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

	2009	2010	2011	2012	2013	Total
<i>(\$000's)</i>						
Office lease	361	671	532	109	46	1,719
Equipment usage	76	2,376	-	-	-	2,452
	437	3,047	532	-	-	4,171

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 (or 750 days in total), with the contract taking effect upon release of the rig 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.

11. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

Carrying Values and Estimated Fair Values of Financial Assets and Liabilities

The Company's financial instruments as at March 31, 2009 consist of cash, accounts receivable, unrealized gain on derivative natural gas contracts, accounts payable and accrued liabilities, and bank debt. The Company classifies its cash and unrealized gain on derivative natural gas contracts as held-for-trading, its accounts receivable as loans and receivables, and its accounts payable and bank debt as other financial liabilities. The carrying value of the Company's cash, accounts receivable and accounts payable and accrued liabilities approximates fair value due to their immediate or short-terms to maturity. The fair value of the derivative contracts is recognized on the balance sheet. The carrying value of bank debt approximates fair value as it bears interest at market rate.

Credit Risk

Credit risk is the risk of loss if customers or counterparties do not fulfill their contractual obligations. Cash is maintained at major financial institutions. Credit risk arises principally from the Company's accounts receivable. A substantial portion of the Company's accounts receivable are with petroleum and natural gas marketers and joint venture partners and are subject to normal energy industry credit risk. It is the Company's policy to establish marketing relationships with large customers to help mitigate credit risk. Mahalo generally grants unsecured credit but routinely assesses the financial strength of such parties.

The Company enters into physical fixed price forward sales contracts with its gas marketers and financial derivative contracts with large banking institutions.

Joint venture 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 risk by obtaining partner approval of significant capital expenditures prior to performance of the project. The Company does not typically obtain collateral from joint venture partners; however, in certain circumstances a cash call may be requested in advance of the start of a project. In some cases, the Company does have the ability to withhold production from joint venture partners in the event of non-payment. Joint venture receivables are typically collected within one to three months of the joint venture bills being issued to the partner.

The Company considers its accounts receivable to be aged as follow:

	March 31 2009
<i>(\$000's)</i>	
Not past due (90 days or less)	12,119
Past due (greater than 90 days)	2,156
	<u>14,275</u>

The carrying amount of accounts receivable generally represent 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. The Company does not believe that any of its accounts receivable are impaired and believes that the counterparties are of high credit quality.

Mahalo has not experienced collection issues with either petroleum and natural gas marketers or joint venture partners; however, given the size of balances outstanding from its petroleum and natural gas marketers and in light of current market conditions, the Company has obtained collateral of US \$3.0 million in the form of a letter of credit. The Company's derivative contracts are with Wells Fargo who is also a participant in the Company's credit facility.

Market Risk

Market risk is the risk or uncertainty arising from possible market price movements and their impact on the future performance of a business. The market price movements that the Company is exposed to include petroleum and natural gas prices (commodity price risk), foreign currency exchange rates and interest rates, all of which could adversely affect the value of the Company's financial assets, liabilities and its financial results.

(a) Commodity Price Risk

The Company's operational results and financial condition are impacted by the price it receives for its petroleum and natural gas production. Commodity prices have fluctuated significantly this year. The Company takes steps to minimize the impact of commodity price volatility by entering into physical fixed price sales contracts and financial derivative contracts as considered prudent. At present, the Company's credit facility agreement requires that at least 80 percent of expected daily gas sales volumes be pre sold. All such transactions are conducted in accordance with the risk management policy that has been approved by the Board of Directors.

The Company has sales contracts outstanding with respect to the physical delivery and sale of natural gas at a fixed price. The estimated fair value of the fixed price physical sales contracts was \$6.1 million at March 31, 2009. The following is a summary of the physical fixed forward sales commitments.

Daily Volume (Mmbtu)	Contract Price	Term
3000	US \$10.22/MMbtu	November 2008 - June 2009
2750	US \$10.35/MMbtu	November 2008 - June 2009
1000	US \$10.26/MMbtu	November 2008 - July 2009
2000	Pan Index + US \$0.01/MMbtu	January 2009 - June 2009
5000	Pan Index + US \$0.05/MMbtu	July 2009 - May 2010
3000	Pan Index + US \$0.01/MMbtu	January 2009 - December 2009
2000	Pan Index Flat	July 2009 - December 2009

Taking into account the physical fixed forward sales contracts in 2009, the impact of a Cdn \$1 change per MMBtu on remaining volumes results in an estimated \$0.2 million impact on pre-tax income for the three months ended March 31, 2009.

At March 31, 2009, the Company also had derivative natural gas contacts outstanding as follows:

Transaction Type	Daily Volume (Mmbtu)	Contract Price	Term	Mark to Market (\$000's)
NYMEX Financial Fixed	5000	US \$7.44/MMbtu	Jan 2009 - Dec 2009	5,444
NYMEX Financial Fixed	2500	US \$8.10/Mmbtu	Jan 2010 - Dec 2010	2,464
Financial Panhandle Basis	5000	HH minus US \$1.12/MMbtu	July 2009 - May 2010	(616)
Financial Panhandle Basis	5000	HH minus US \$1.27/MMbtu	Jan 2009 - Dec 2009	(616)
Financial Panhandle Basis	2500	HH minus US \$0.98/MMbtu	Jan 2010 - Dec 2010	(174)
Financial Panhandle Basis	2500	HH minus US \$1.00/MMbtu	Jan 2010 - Dec 2010	(197)

In addition to the above, the Company has entered into a participating natural gas financial derivative swap contract whereby the Company will receive a floor price of US \$10/MMbtu for 5,000 MMbtu/day and will participate for 31 percent of the price in excess of US\$10/MMbtu. The term is for the period July 2009 to May 2010. The March 31, 2009 mark-to-market of this derivative is an asset of \$10.4 million.

The mark-to-market of all derivative natural gas contracts was an asset of \$16.7 million at March 31, 2009. The fair value for these contracts was provided by the financial intermediary with whom the transactions were completed; they were tested by the Company for reasonableness based on comparing current market price and the fixed price of the contracts.

Taking into account the derivative natural gas contracts listed above, the impact of a Cdn \$1 change per MMbtu results in an estimated \$0.5 million impact on pre-tax income for the three months ended March 31, 2009.

(b) Interest Rate Risk

The Company is exposed to interest rate fluctuations on its bank debt which bears a floating rate of interest. The Company is sensitive to fluctuations in interest rate risk such that if interest rates on its bank debt changed by 1.0 percent, with all other variables held constant, net earnings for the three months ended March 31, 2009 would change by an estimated \$0.6 million. The Company has not deemed it necessary to enter into interest rate swaps or derivative financial instruments to reduce exposure to interest rate risk.

(c) Foreign Currency Exchange Risk

Foreign currency exchange risk is the risk that future cash flows will fluctuate as a result of changes in foreign exchange rates. The Company's foreign exchange translation exposure principally reflects the impact of fluctuations in the Canadian/United States exchange rate on monetary and non-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.

In 2008, the Company discontinued its resource operations in Canada; all continuing resource operations are located in the United States. As a result, a majority the Company's revenues and directly related expenses are now denominated in United States dollars. The Company's most significant liability, being amounts outstanding under its credit facility, are repayable in United States dollars. This results in a natural hedge which significantly reduces the Company's foreign currency risk. Certain cash expenses, primarily general and administrative costs incurred at head office, will continue to be incurred in Canadian dollars.

Since the Company reports in Canadian dollars, foreign exchange gains and losses will occur as Canadian/US dollar exchange rates shift. If foreign exchange rates had changed by \$0.01, with all other variables held constant, loss from continuing operations for the three months ended March 31, 2009 would change, but by an immaterial amount. The Company does not deem it necessary to utilize financial instruments to mitigate the risks arising from changes in foreign currency rates.

Liquidity Risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they become due. Liquidity is a reflection of a company's ability to access cash. Companies in the upstream oil and gas industry require sufficient cash in order to fund capital programs necessary to maintain and increase production and proved reserves, to acquire strategic oil and gas assets and to repay debt. The financial obligations on the balance sheet are as follows:

Financial liability at March 31, 2009	Less than one year	Total
<i>(\$000's)</i>		
Accounts payable and accrued liabilities	36,947	36,947
Bank debt	77,386	77,386
	114,333	114,333

As of March 31, 2009, the Company was in breach of certain covenants under its bank credit agreement, including non-payment of a US \$5 million revolver loan amount on March 31, 2009 and a US \$10 million loan fee as discussed in note 6.



Quarterly Report

Three Months ended March 31, 2009
(Unaudited)

Message to Shareholders

SUMMARY OF RESULTS

Three months ended	Mar 31 2009	Mar 31 2008
		<i>(Restated)</i>
Financial (\$000's except per share)		
Continuing operations:		
Petroleum and natural gas revenue	9,614	7,780
Operating netback	4,468	4,445
Loss from continuing operations	(114)	(392)
Per share - basic & diluted	0.00	(0.01)
Loss from discontinued operations	(862)	(102)
Per share - basic & diluted	(0.02)	0.00
Net loss	(976)	(494)
Per share - basic & diluted	(0.02)	(0.01)
Funds from continuing operations	2,401	3,115
Per share - basic	0.04	0.05
Funds from discontinued operations	(817)	2,256
Per share - basic	(0.01)	0.04
Funds from operations	1,584	5,371
Per share - basic	0.03	0.09
Operational		
Average daily sales volumes (<i>boe</i>):		
Continuing operations	2,214	2,048
Discontinued operations	76	1,355
Continuing operations:		
Average selling price (\$/ <i>boe</i>)	48.26	41.74
Operating netback (\$/ <i>boe</i>)	22.42	23.85

(1) Refer to special advisories regarding use of Non-GAAP financial measures and barrel of oil ("*boe*") equivalents.

(2) Restated to reflect "discontinued operations" accounting.

Financial

In 2008, Mahalo committed to dispose of its Canadian resource assets; only a small number of minor properties remain to be disposed of. Since the assets encompassed Mahalo's entire Canadian business segment or cost centre under full cost accounting, the Company has accounted for these assets as "discontinued operations". Comparative information has been restated to reflect this change.

Mahalo generated funds from continuing operations of \$2.4 million on related sales of \$9.6 million and recorded a net loss from continuing operations of \$0.1 million during the three months ended March 31, 2009. This compares with funds from continuing operations of \$3.1 million, related sales of \$7.8 million and a net loss from continuing operations of \$0.4 million in first quarter 2008.

Additional information regarding the Company's results of operations and financial condition is included in the Management's Discussion and Analysis attached hereto. The reader is also specifically referred to Note 1 accompanying the unaudited consolidated financial statements for the three months ended March 31, 2009 regarding "basis of presentation and going concern issues".

Operational

The first quarter of 2009 saw no activity on Mahalo's oil and gas properties. Expenditures were kept to an absolute minimum to conserve cash. Production from Mahalo's US operations averaged 2,214 boe per day representing a decrease of about 106 boe per day from fourth quarter 2008 due to a combination of natural decline and suspension of certain routine maintenance procedures. The Company has not drilled a well since October of 2008 and production is now stabilizing after relatively higher initial declines in the period following first production. The Company's Canadian production is lower than the prior quarter due to a combination of property sales in the fourth quarter of 2008 and natural declines.

Default status with lenders, strategic alternatives process and going concern issues

The Company continues to be in breach of certain covenants under its bank credit facility. As a result of the default, the Lenders have advised Mahalo that until resolved, future loans would be made in the sole discretion of the Lenders. To date, the Lenders have not exercised their default-related rights or demanded repayment of the loan.

The Company is continuing to work with GMP Securities L.P. in seeking strategic alternatives. Although several proposals have resulted from the process, no proposal received to date has been satisfactory to Mahalo or its lenders and there is no reasonable expectation that an acceptable proposal will be received. In the opinion of management, there can be no assurance that the process will result in any change in the Company's current operations, that the Company will pursue any particular transaction or that any transaction will be concluded.

At March 31, 2009, the Company had a working capital deficiency of \$84.4 million, an accumulated deficit of \$122.2 million. As anticipated in the Company's MD&A for the year ended December 31, 2008, the Company incurred further defaults as a result of being unable to repay a US \$5 million short-term advance which was due and payable on March 31, 2009 and pay a US \$10 million loan facility fee. The loan facility fee was levied under the terms of a November 28, 2008 credit facility amendment and resulted from the Company's failure to achieve certain restructuring and/or refinancing initiatives by March 31, 2009.

If the Lenders were to call the debt, the Company would require an alternate credit facility and/or additional capital to discharge its obligations and continue its activities. Under current conditions, there can be no assurance that the Company has sufficient assets or will be able to raise sufficient capital to make a full repayment to its Lenders if such an event were to occur. In addition, any financial restructuring plan ultimately agreed on by Mahalo and its Lenders may involve bankruptcy or similar filings by Mahalo and/or its subsidiary, Mahalo Energy (USA) Inc. The outcome of these matters is dependent on factors outside of the Company's control and cannot be predicted at this time. These conditions raise substantial doubt about the Company's ability to continue as a going concern.

Additional information regarding this matter is set forth under "basis of presentation and going concern issues" and elsewhere in the Company's MD&A for the three months ended March 31, 2009.

On behalf of the Board of Directors,
"Signed"

James Burns
President and Chief Executive Officer

MANAGEMENT'S DISCUSSION AND ANALYSIS

This Management's Discussion and Analysis ("MD&A") of the results of operations and changes in financial condition of Mahalo Energy Ltd. ("Mahalo" or the "Company") should be read in conjunction with the unaudited consolidated financial statements and accompanying notes for the three months ended March 31, 2009 (which were not reviewed by the Company's auditors) and the audited consolidated financial statements and accompanying notes and the MD&A for the year ended December 31, 2008. This MD&A has been prepared taking into consideration information available up to and including May 14, 2009.

BASIS OF PRESENTATION AND GOING CONCERN ISSUES

The unaudited consolidated financial statements as at and for the three months ended March 31, 2009 have been prepared by management using generally accepted accounting principles (GAAP) on the basis that the Company will be able to discharge its obligations and realize its assets in the normal course of business at the values at which they are carried in the financial statements, and that the Company will be able to continue its business activities. If this assumption is not appropriate, adjustments to the carrying amounts of the assets and liabilities, revenues and expenses and the balance sheet classifications used may be necessary.

In accordance with Canadian GAAP appropriate for a going concern, property and equipment is carried at cost less accumulated amortization and any impairment losses; they are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable. There can be no assurance that expected future cash flows will be realized or will be sufficient to recover the carrying amount of property and equipment. The Company's ability to continue as a going concern is dependent upon its ability to achieve profitable operations, obtain waivers or amendments relative to defaults under its bank credit facility, obtain the necessary financing to meet its obligations, repay its liabilities arising from normal business operations when they become due, successfully raise capital and receive the continued financial support of its Lenders. Significant conditions and events, however, exist that cast doubt on the validity of this assumption.

At March 31, 2009, the Company had a working capital deficiency of \$84.4 million, an accumulated deficit of \$122.2 million and was in default under its bank credit facility. As anticipated in the Company's MD&A for the year ended December 31, 2008, the Company incurred further defaults as a result of being unable to repay a US \$5 million short-term advance which was due and payable on March 31, 2009 and pay a US \$10 million loan facility fee. The loan facility fee was levied under the terms of a November 28, 2008 credit facility amendment and resulted from the Company's failure to achieve certain restructuring and/or refinancing initiatives by March 31, 2009.

The Lender has advised Mahalo that until resolved, future loans would be made in the sole discretion of the Lender. To date, the Lender has not exercised its default-related rights or demanded repayment of the loan. Under current conditions, there can be no assurance that the Company has sufficient assets or will be able to raise sufficient capital to make a full repayment to its Lender if such an event were to occur. In addition, any financial restructuring plan ultimately agreed to by Mahalo and its Lender may involve bankruptcy or similar filings by Mahalo and/or its subsidiary, Mahalo Energy (USA) Inc. The outcome of these matters is dependent on factors outside of the Company's control. These conditions raise substantial doubt about the Company's ability to continue as a going concern.

The Company continues to work with GMP Securities L.P. ("GMP") in seeking strategic alternatives. Although several proposals have resulted from the GMP led process, no proposal has been satisfactory to Mahalo or its Lender and there is no reasonable expectation that an acceptable proposal will be received.

READER GUIDANCE

The reader is advised that 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" concerning "Forward-looking statements", "Non-GAAP financial measures" and "Barrel of oil equivalent volumetric measures" at the end of this MD&A.

The financial data presented in this MD&A has been prepared in accordance with Canadian GAAP, unless otherwise indicated. Production, sales and reserves volumes referred to in this MD&A reflect the Company's working interest before deduction of royalties paid to others, unless otherwise noted. The reporting and measurement currency is the Canadian dollar, unless otherwise specified. References to "US\$" are to United States dollars. Certain columns in tables may not add due to rounding.

Readers should be aware that historical results are not necessarily indicative of future performance. Additional information relating to the Company is available on the System for Electronic Document Analysis and Retrieval ("SEDAR") at www.sedar.com or from the Company's web-site at www.mahaloenergy.com.

PRIMARY BUSINESS

Mahalo Energy Ltd. was incorporated on April 21, 2004 under the *Business Corporations Act (Alberta)*. Its common shares trade through the facilities of The Toronto Stock Exchange (TSX) under the trading symbol "CBM". Unless the context otherwise requires, references herein to "Mahalo" or the "Company" include Mahalo Energy Ltd. and its wholly-owned subsidiary, Mahalo Energy (USA) Inc. The Company is focused on acquisition, exploration, development and production of unconventional natural gas, principally coalbed methane ("CBM") and shale gas in the Arkoma Basin in the state of Oklahoma, U.S.A.

In 2008, Mahalo committed to dispose of its Canadian resource assets; only a small number of minor properties remain to be disposed of. Since the Canadian resource assets encompassed the entire Canadian business segment or cost centre under full cost accounting, the Company accounted for these assets as "discontinued operations" effective third quarter 2008. Results for prior periods have been "restated" to conform to this presentation; any reference within this MD&A to amounts being "restated" refers to "discontinued operations" accounting.

SUMMARY OF RESULTS

Three months ended	Mar 31 2009	Dec 31 2008	Mar 31 2008
Financial (\$ 000's except per share) (1)			<i>(Restated)</i> (2)
Net loss from continuing operations	(114)	(9,671)	(392)
Per share - basic & diluted	0.00	(0.16)	(0.01)
Net loss from discontinued operations	(862)	(7,390)	(102)
Per share - basic & diluted	(0.01)	(0.12)	0.00
Net loss	(976)	(17,061)	(494)
Per share - basic & diluted	(0.02)	(0.29)	(0.01)
Funds from continuing operations	2,063	2,640	3,115
Per share - basic	0.03	0.04	0.05
Funds from discontinued operations	(817)	(1,265)	2,256
Per share - basic	(0.01)	(0.02)	0.04
Funds from operations	1,246	1,375	5,371
Per share - basic	0.02	0.02	0.09

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

(2) Comparative periods have been restated to reflect "discontinued operations" accounting.

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 2009	Dec 31 2008	Mar 31 2008
			<i>(Restated)</i>
Average daily sales volumes (boe)			
Continuing operations	2,214	2,320	2,048
Discontinued operations	76	200	1,355
	2,290	2,520	3,403
Continuing operations:			
Petroleum and natural gas revenue (\$000s)	9,614	11,081	7,780
Average realized selling price (\$/Mcf)	8.04	8.65	6.96
Average realized selling price (\$/boe)	48.26	51.92	41.74

(1) Refer to special advisories regarding use of barrel of oil ("boe") equivalent measures.

The Company's petroleum and natural gas sales volumes and revenues from continuing operations consist solely of natural gas produced and sold from properties in Oklahoma; the gas is delivered for sale into the Oklahoma Gas Transmission and Centre Point East pipeline system.

Production from continuing operations averaged 2,214 boe per day representing a decrease of about 106 boe per day from fourth quarter 2008 due to a combination of natural decline and suspension of certain routine maintenance procedures. The Company has not drilled a well since October 2008 and production is now stabilizing after relatively higher initial declines in the period following first production. Production from the Company's discontinued operations in first quarter 2009 was lower than the prior quarter due to a combination of property sales in fourth quarter 2008 and natural declines.

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. In compliance with its credit facility, Mahalo has since mid 2008, sold a substantial portion of its natural gas under fixed price physical forward contracts; this helped to reduce the impact of market volatility, resulting in an average realized natural gas sales price of \$8.04 per Mcf in first quarter 2009 and \$8.65 per Mcf in fourth quarter 2008 compared with an average Henry Hub spot price of approximately \$5.50 per Mcf and \$7.60 per Mcf (all expressed in Canadian funds) in the same periods respectively.

Although the Company also utilizes financial derivative instruments from time to time to protect its cash flow, related gains or losses do not impact the reported average sales price; gains and losses from financial instruments are reflected separately on the consolidated statement of operations.

Royalty expense

Royalties are paid to government entities and other land and mineral rights owners. Oklahoma government royalty assessments are generally based on the price realized for the underlying petroleum product.

Three months ended	Mar 31 2009	Dec 31 2008	Mar 31 2008
			<i>(Restated)</i>
Continuing operations:			
Royalty expense (\$000s)	2,422	2,797	1,960
Royalty expense (\$/boe)	12.18	13.11	10.52
Royalty expense (% of revenue)	25%	25%	25%

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 2009	Dec 31 2008	Mar 31 2008
			<i>(Restated)</i>
Continuing operations:			
Operating expense (\$000s)	1,908	2,031	916
Operating expense (\$/boe)	9.56	9.51	4.91

Transportation expense

Transportation expense from continuing operations 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 2009	Dec 31 2008	Mar 31 2008
			<i>(Restated)</i>
Continuing operations:			
Transportation expense (\$000s)	816	663	459
Transportation expense (\$/boe)	4.09	3.10	2.46

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 assess comparability of sales and related costs. The following table reflects natural gas sales volumes and the components of operating netback from continuing operations for the respective quarterly periods under comparison.

Three months ended	Mar 31		Dec 31		Mar 31	
	2009	\$/boe	2008	\$/boe	2008	\$/boe
<i>(\$000s, except boe and \$/boe) (1)</i>					<i>(Restated)</i>	<i>(Restated)</i>
Continuing operations:						
Average daily sales volume (boe)	2,214		2,320		2,048	
Petroleum and natural gas revenue	9,614	48.26	11,081	51.92	7,780	41.74
Royalties	2,422	12.18	2,797	13.11	1,960	10.52
Operating and transportation	2,724	13.65	2,694	12.61	1,375	7.37
Operating netback	4,468	22.42	5,590	26.20	4,445	23.85

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

Operating netback from continuing operations during the three months ended March 31, 2009 decreased by \$1.1 million or \$3.78 per boe when compared with the immediately preceding quarter. The decrease in operating netback of \$1.1 million included negative variances of \$0.4 million due to lower sales volumes and \$0.7 million due to a lower average realized sales price. The benefit of a lower per unit royalty rate in the current quarter was offset by somewhat higher per unit operating and transportation costs.

Although the various components of operating netback from continuing operations fluctuated on a per unit basis when comparing the current quarter with first quarter 2008, overall operating netback remained unchanged at approximately \$4.4 million. The current quarter variances included a positive volume variance of \$0.3 million, positive price variance of \$1.3 million, negative per unit royalty rate variance of \$0.3 million and negative per unit operating and transportation cost variance of \$1.3 million.

Gain on derivative natural gas contracts

In the prior year, Mahalo entered into a participating natural gas swap contract covering the period July 1, 2009 to May 31, 2010. Under this swap arrangement, the Company will receive a floor price of US \$10 per Mmbtu for 5,000 Mmbtu of natural gas per day and 31 per cent of the price in excess of US \$10 per Mmbtu. The mark-to-market value of this arrangement at March 31, 2009 was an asset of \$10.4 million, an increase of \$3.6 million from that

recorded at December 31, 2008. During the current quarter, the Company also recorded a gain of \$3.5 million on other derivative natural gas contracts. Of the total gain of \$7.1 million in first quarter 2009, \$5.6 million was unrealized at March 31, 2009.

General and administrative expense

General and administrative expense from continuing operations amounted to \$1.7 million in first quarter 2009, \$1.8 million in fourth quarter 2008 and \$0.8 million in first quarter 2008. Such costs were higher when compared with first quarter 2008 for a number of reasons. In second quarter 2008, the Company added certain U.S. management and support staff to its Tulsa office. During the latter quarters, the Company incurred additional legal, audit and other professional costs associated with its current financial difficulties.

Stock-based compensation expense

Stock-based compensation from continuing operations 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.

Foreign exchange gains and losses

On December 1, 2008 the Company evaluated its changed economic circumstances, in particular its disposal of substantially all of its Canadian operations and its use of exclusively US dollar debt financing, and concluded that the US dollar is the most appropriate functional currency for all of its operations. Prior to December 1, 2008, the Company's functional currency was the Canadian dollar. The Company has retained the Canadian dollar as its reporting currency.

At December 1, 2008, the Company's non-monetary assets and liabilities were re-measured at the spot US dollar to Canadian dollar exchange rate. The change in functional currency increased comprehensive income by \$11.8 million; the amount resulted mainly from translation of property and equipment balances. During the three months ended March 31, 2009, comprehensive income increased by \$1.7 million due to translation of United States results to Canadian dollar reporting currency.

Interest and financing expense

Interest and financing expense related to continuing operations amounted to \$6.4 million in first quarter 2009, \$2.5 million in fourth quarter 2008 and \$0.5 million in first quarter 2008, respectively. Such expense included amortization of deferred financing fees of \$4.1 million and \$1.5 million during first quarter 2009 and fourth quarter 2008, respectively.

Under the terms of a renegotiated credit facility agreement dated November 28, 2008 and as a result of the Company's failure to achieve certain specific restructuring and/or refinancing initiatives by March 31, 2009, a loan facility fee of US \$10 million was levied by the Lender. The loan facility fee was included in accounts payable and accrued liabilities at March 31, 2009.

Loan fees are recorded as a deferred cost and subsequently amortized to expense over the remaining term of the credit facility; the Company has elected to more rapidly amortize such costs in light of reclassifying its bank debt as a current liability at March 31, 2009 and December 31, 2008. Interest and financing expense during the current and preceding quarter was also impacted, but to a lesser extent, by higher levels of borrowing and higher effective interest rates when compared with first quarter 2008.

Depletion, depreciation and accretion expense

Depletion, depreciation and accretion expense from continuing operations is reflected in the following table.

Three months ended	Mar 31	Dec 31	Mar 31
	2009	2008	2008
<i>(\$000s, except per boe)</i>			<i>(Restated)</i>
Continuing operations :			
Depletion and depreciation expense	3,372	3,870	2,434
Accretion expense	30	22	19
Depletion, depreciation and accretion expense	3,402	3,892	2,453
Depletion and depreciation <i>(\$/boe)</i>	16.92	18.13	13.06

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.

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. The Company's asset retirement obligation related to continuing operations amounted to \$1.5 million and \$1.4 million at March 31, 2009 and December 31, 2008, respectively. Asset retirement obligations related to assets held for sale amounted to \$1.9 million and \$1.8 million at March 31, 2009 and December 31, 2008, respectively.

Future income taxes

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 2009, the Company recorded future income tax expense related to continuing operations of \$0.3 million compared with a future income tax expense of \$1.9 million and \$0.4 million in the fourth and first quarters of 2008, respectively. At the end of first quarter 2009, the Company had a future income tax liability of \$6.5 million which related solely to its United States operations. In Canada, the Company had an income tax asset at March 31, 2009 which fully offset by a valuation allowance.

LIQUIDITY AND CAPITAL RESOURCES

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 certain non-core oil and gas assets in its on-going rationalization of its resource asset base and more recently, as a result of its decision to dispose of its Canadian resource assets.

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 2009	Dec 31 2008	Mar 31 2008
<i>(\$ 000s) (1)</i>			<i>(Restated)</i>
Net loss from continuing operations	(114)	(9,671)	(392)
Net loss from discontinued operations	(862)	(7,390)	(102)
Net income (loss)	(976)	(17,061)	(494)
Non-cash items	2,560	18,436	5,865
Funds from operations	1,584	1,375	5,371
Change in non-cash working capital related to operating activities	(22)	6,887	(2,833)
Cash provided by operating activities	1,562	8,262	2,538
Cash provided by (used in) financing activities	18	(212)	6,275
Cash provided by (used in) investing activities	(2,365)	(5,735)	(10,473)
Increase (decrease) in cash	(785)	2,315	(1,660)

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

Cash provided by operating activities takes into account 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 operating activities involved shifts in accounts receivable and accounts payable and the timing of cash receipts and payments.

Operating activities

The major factors that accounted for the change in funds from continuing operations during first quarter 2009, when compared with the immediately preceding quarter, were as follows:

<i>(\$ 000s) (1)</i>		
Funds from continuing operations in fourth quarter 2008		2,644
Increase (decrease) as a result of:		
Higher operating netback		
Lower sales volumes	(367)	
Lower realized sales prices	(739)	
Lower per unit royalties expense	191	
Higher per unit operating and transportation expense	(207)	(1,122)
Higher realized gain on derivative natural gas contracts		1,442
Higher interest and other income		312
Lower general and administrative expense		39
Higher cash interest and financing costs		(1,332)
Lower realized foreign exchange losses		420
Other		(2)
Funds from continuing operations in first quarter 2009		2,401

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

Financing activities

The Company has a US \$105 million credit facility (the "Facility") with Ableco Finance LLC (the "Lender"). All borrowings under the Facility are denominated in US dollars. On March 5, 2009, Mahalo announced that it had received a reservation of rights letter from Ableco ("the Lenders") notifying the Company that it is in default under its loan agreement for failure to comply with certain covenants relating to obtaining a letter of intent ("LOI") for the sale or recapitalization of the Company by March 1, 2009. As a result of the default, the Lenders advised Mahalo that until resolved, future loans would be made in the sole discretion of the Lenders.

As at March 31, 2009, US \$39.9 million (Cdn \$50.3 million) was drawn on the revolver loan and US \$21.5 million (Cdn \$27.1 million) was drawn on the term loan. Of the revolver loan, US \$5.0 million (Cdn \$6.3 million) was repayable on March 31, 2009. At March 31, 2009, irrevocable standby letters of credit were issued for a total of Cdn

\$20,000 and US \$20,000 (December 31, 2008 - Cdn \$145,000 and US \$20,000). These letters of credit reduce the amount available under the facility.

The Company incurred further defaults when it failed to repay the US \$5 million revolver loan on March 31, 2009 and pay a US \$10 million loan facility fee. The loan facility fee was levied under the terms of a November 28, 2008 credit facility amendment and became due when the Company failed to achieve certain restructuring and/or refinancing initiatives by March 31, 2009. The US \$10 million fee was included in the Company's accounts payable and accrued liabilities as at March 31, 2009 and December 31, 2008.

To date, the Lenders have not exercised their default-related rights or demanded repayment of amounts outstanding under the Facility.

At March 31, 2009 and as at the date of this MD&A, the Company had 59,298,035 common shares, 1,440,000 common share purchase warrants and 144,000 performance warrants issued and outstanding. Contributed surplus at March 31, 2009 amounted to \$10.1 million, reflective of aggregate stock-based compensation costs incurred since inception of the Company in 2004.

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.

Investing activities

The following table reflects cash expenditures on property and equipment (net of proceeds from dispositions) for discontinued and continuing operations during the periods under comparison.

Three months ended	Mar 31 2009	Dec 31 2008	Mar 31 2008
<i>(\$000s)</i>			<i>(Restated)</i>
Discontinued operations	(7)	(1,488)	3,210
Land and seismic	47	535	1,180
Drilling and completions	180	1,723	3,946
Facilities and equipment	-	5,362	171
Divestures	(2,293)	-	-
Continuing operations	(2,066)	7,620	5,297
Cash expenditures, net	(2,073)	6,132	8,507

The first quarter of 2009 saw no activity on Mahalo's oil and gas properties. Expenditures were kept to an absolute minimum to conserve cash. As discussed earlier herein, the Company is in default under its bank credit facility; consequently, capital spending is being curtailed in an effort to improve the Company's financial position. During first quarter 2009, a salt water disposal facility was sold in the United States for net proceeds of \$2.3 million.

Contractual obligations

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

Year ended December 31,	2009	2010	2011	2012	2013	Total
<i>(\$000s)</i>						
Office lease	361	671	532	109	46	1,719
Equipment usage	76	2,376	-	-	-	2,452
	437	3,047	532	109	46	4,171

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 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 attempts to minimize the impact of natural gas price volatility by entering into physical fixed price sales contracts and derivative natural gas contracts for at least 80 per cent of expected daily sales volumes, as required by the Company's credit facility agreement.

The following is a summary of the commodity physical fixed price sale commitments outstanding at March 31, 2009 and at the date of this MD&A.

Transaction	Daily Volume <i>(MMBtu)</i>	Contract Price	Term
Sell	3,000	US \$10.22/MMbtu	November 2008 - June 2009
Sell	2,750	US \$10.35/MMbtu	November 2008 - June 2009
Sell	1,000	US \$10.26/MMbtu	November 2008 - July 2009
Sell	2,000	Pan Index + US \$0.01/MMbtu	January 2009 - June 2009
Sell	5,000	Pan Index + US \$0.05/MMbtu	July 2009 - May 2010
Sell	3,000	Pan Index + US \$0.01/MMbtu	January 2009 - December 2009
Sell	2,000	Pan Index Flat	July 2009 - December 2009

The physical fixed price sales contracts had an estimated fair value of \$6.1 million at March 31, 2009. The fair value for these contracts was provided by the financial intermediary with whom the transactions were completed; they were tested by the Company for reasonableness based on comparing current market price and the fixed price of the contracts. Because of the nature of the sales contracts, the related fair value is not reflected in the accounts of the Company at March 31, 2009 in accordance with GAAP.

At March 31, 2009 and at the date of this MD&A, the Company had the following derivative natural gas contracts outstanding.

Transaction	Daily Volume <i>(MMBtu)</i>	Contract Price	Term	Mark to Market <i>(\$000's)</i>
Sell - NYMEX Financial Fixed	5,000	US \$7.44/MMbtu	January 2009 - December 2009	5,444
Sell - NYMEX Financial Fixed	2,500	US \$8.10/MMbtu	January 2010 - December 2010	2,464
Sell - Financial Panhandle Basis	5,000	HH minus US \$1.12/MMBtu	July 2009 - May 2010	(616)
Sell - Financial Panhandle Basis	5,000	HH minus US \$1.27/MMBtu	January 2009 - December 2009	(616)
Sell - Financial Panhandle Basis	2,500	HH minus US \$0.98/MMBtu	January 2010 - December 2010	(174)
Sell - Financial Panhandle Basis	2,500	HH minus US \$1.00/MMBtu	January 2010 - December 2010	(197)

In addition to the contracts reflected above, the Company has entered into a participating natural gas financial derivative natural gas swap contract whereby the Company will receive a floor price of US \$10 per MMBtu for 5,000 Mmbtu per day and will participate for 31 per cent of the price in excess of US \$10 per MMBtu. The term is July 2009 to May 2010. The March 31, 2009 mark-to-market of this derivative was \$10.4 million.

The combined mark-to-market value of the above-noted derivative natural gas contracts was \$16.7 million at March 31, 2009 and is reflected in the Company's accounts as an asset as at that date. The fair value for these contracts was provided by the financial intermediary with whom the transactions were completed; they were tested by the Company for reasonableness based on comparing current market price and the fixed price of the contracts.

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 the Company's working capital deficiency, net debt and shareholders' equity balances as at March 31, 2009 and December 31, 2008.

As at	Mar 31	Dec 31
	2009	2008
<i>(\$ 000s)</i>		
Current assets	29,976	21,309
Accounts payable and accrued liabilities	(36,947)	(38,118)
Bank debt	(77,386)	(75,097)
Working capital (deficiency)	(84,357)	(91,906)
Adjust for unrealized financial derivative (gains) losses included above	(13,347)	(6,593)
Net debt	(97,704)	(98,499)
Shareholders' equity	62,441	61,394

As of March 1, 2009, the Company was in breach of certain covenants under its bank credit agreement and does not expect to have the default remedied or waived. Under the terms of the bank credit agreement, if any Event of Default occurs and is continuing, the administrative agent shall, at the request of, or may, with the consent of, the Lender, take any or all of the following actions:

- Terminate any commitment to make loans and any other credit extensions.
- Declare the unpaid principal amount of all outstanding loans, all interest accrued and unpaid thereon, and all other amounts owing or payable to be immediately due and payable.
- Require that the borrower cash collateralize any letters of credit.
- Exercise all rights and remedies available to the Lender under the loan documents.

Consequently, and as long as the default continues, Management considers the credit facility to have the same characteristics as a demand loan; therefore, it has been classified its bank debt as a current liability at March 31, 2009 and December 31, 2008. Should the bank debt be called earlier than December 31, 2009, any unamortized balance of deferred financing costs, which at March 31, 2009 amounted to \$11.9 million, would be expensed in its entirety at that time.

At the date of this MD&A, the Company had approximately US \$10.5 million of mechanics liens filed against several of its properties.

The Company, as at the date of this MD&A, is not in a position to pay the US \$5 million revolver loan amount that was due on March 31, 2009 or the US \$10 million loan facility fee levied when the Company failed to achieve certain restructuring and/or refinancing initiatives by March 31, 2009.

The Company continues to work with its Lenders on this and other matters related to the Facility. If an acceptable solution is not achieved and the debt is called, the Company will require additional capital to continue its activities and discharge its obligations. The outcome of these matters is dependant on factors outside of the Company's control and cannot be predicted at this time.

As a result of the weakened global economic situation, the Company is experiencing restricted access to debt and equity markets and increased borrowing costs. The lending capacity of all financial institutions is reported to have diminished and risk premiums have increased independent of the Company's business and asset base. Future capital expenditures must be financed with cash from operations, debt and/or equity. The Company's ability to obtain

further debt/equity funding is dependent upon, among other factors, the overall state of debt markets and investor appetite for equity investments in the energy industry and the Company's securities in particular.

The Company continues to work with GMP Securities L.P. in seeking strategic alternatives. No decision on any particular alternative has been reached at this time and there can be no assurance that the process will result in any change in the Company's current operations, that the Company will pursue any particular transaction or that any transaction will be concluded.

The Company's ability to continue as a going concern is dependent upon its ability to achieve profitable operations, obtain waivers or amendments relative to defaults under its credit facility, obtain the necessary financing to meet its obligations, repay its liabilities arising from normal business operations when they become due, successfully raise capital and receive the continued financial support from its Lenders.

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, 2009.

FINANCIAL INSTRUMENT RISK

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, 2009.

BUSINESS RISKS AND UNCERTAINTIES

The information presented on business risks and uncertainties under the heading "Risk Factors" in the Company's Annual Information Form dated March 31, 2009 (which can be found at www.sedar.com) has not changed materially.

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, 2008.

COMPARATIVE AMOUNTS

The Company is in the process of disposing of its Canadian assets and operations. As a result, the Company is considered to have only one geographical reporting unit; the United States. Prior period amounts have been restated to reflect the discontinued operations. Certain other prior period amounts have been reclassified to conform to the presentation adopted in the current period.

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, 2009.

SUMMARY OF QUARTERLY FINANCIAL RESULTS (unaudited)

The following table presents a summary of consolidated quarterly operating results for the quarters ended June 30, 2007 through March 31, 2009.

Selected quarterly information	Q1 2009	Q4 2008	Q3 2008	Q2 2008	Q1 2008	Q4 2007	Q3 2007	Q2 2007
				(/)	(/)	(/)	(/)	(/)
Financial (\$ 000s, except per share)								
Continuing operations:								
Petroleum and natural gas revenue	9,614	11,081	9,477	9,213	7,780	6,689	7,410	7,474
Operating netback	4,468	5,590	4,527	4,836	4,445	3,343	3,870	3,874
Gain on derivative contracts	7,126	7,913	2,943	-	-	-	-	-
General and administrative	1,732	1,771	1,390	1,242	791	1,031	975	1,523
Stock-based compensation	270	73	445	510	468	577	514	324
Foreign exchange loss (gain)	-	13,172	3,284	319	169	(612)	(450)	(1,877)
Interest and financing expense	6,433	2,491	1,011	697	543	677	603	439
Depletion, depreciation, accretion	3,402	3,892	3,219	2,661	2,453	2,476	2,879	3,088
Future income taxes (recovery)	329	1,922	617	290	408	(1,293)	271	(31)
Net income (loss):								
Continuing operations	(114)	(9,671)	(2,501)	(887)	(392)	485	(929)	402
Per share: basic and diluted	0.00	(0.16)	(0.04)	(0.01)	(0.01)	0.01	(0.02)	0.01
Discontinued operations	(862)	(7,390)	(15,802)	(30,616)	(102)	(1,182)	(884)	(573)
Per share: basic and diluted	(0.02)	(0.13)	(0.27)	(0.52)	0.00	(0.02)	(0.01)	(0.01)
Net income (loss)	(976)	(17,061)	(18,303)	(31,503)	(494)	(697)	(1,813)	(171)
Per share: basic and diluted	(0.02)	(0.29)	(0.31)	(0.53)	(0.01)	(0.01)	(0.03)	0.00
Funds from continuing operations	2,401	2,644	2,539	2,798	3,115	1,850	2,332	3,112
Per share: basic	0.04	0.04	0.04	0.05	0.05	0.03	0.04	0.05
Funds from discontinued operations	(817)	(1,262)	881	3,570	2,256	1,316	1,001	433
Per share: basic	(0.01)	(0.02)	0.01	0.06	0.04	0.02	0.02	0.01
Funds from operations	1,584	1,382	3,420	6,368	5,371	3,166	3,333	3,545
Per share: basic	0.03	0.02	0.06	0.11	0.09	0.05	0.06	0.06
Reconciliation:								
Funds from operations	1,584	1,382	3,420	6,368	5,371	3,166	3,333	3,545
Changes in non-cash working capital related to operating activities	(22)	6,881	(550)	50	(2,833)	3,923	482	(3,314)
Cash provided by (used in) operating activities	1,562	8,263	2,870	6,418	2,538	7,089	3,815	231
Operational								
Average daily sales volume (boe/day)								
Continuing operations	2,214	2,320	2,191	2,029	2,048	2,152	2,107	1,952
Discontinued operations	76	200	870	1,254	1,354	1,390	1,300	853
	2,290	2,520	3,061	3,283	3,402	3,542	3,407	2,805
Continuing operations:								
Average realized selling prices								
Natural gas (\$/Mcf)	8.04	8.65	7.83	8.32	6.96	5.63	6.37	7.01
Barrel of oil equivalent (\$/boe)	48.26	51.92	47.01	49.90	41.74	33.78	38.23	42.07
Average operating netback (\$/boe)	22.42	26.20	22.46	26.19	23.85	16.89	19.97	21.80
Cdn\$/US\$ exchange rate								
Average for period	0.803	0.820	0.960	0.990	0.998	1.019	0.957	0.911
End of period	0.794	0.817	0.944	0.981	0.974	1.009	0.995	0.940

(1) Restated to reflect "discontinued operations" accounting.

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.

DISCLOSURE AND INTERNAL CONTROLS

There have been no changes in disclosure controls and procedures and internal control over financial reporting during the three months ended March 31, 2009 that have materially affected, or are reasonable likely to materially affect, the Company's internal control over financial reporting.

OUTLOOK

Default status with lenders, strategic alternatives process and going concern issues

The Company continues to be in breach of certain covenants under its bank credit facility. As a result of the default, the Lenders have advised Mahalo that until resolved, future loans would be made in the sole discretion of the Lenders. To date, the Lenders have not exercised their default-related rights or demanded repayment of the loan.

The Company is continuing to work with GMP Securities L.P. in seeking strategic alternatives. Although several proposals have resulted from the process, no proposal received to date has been satisfactory to Mahalo or its lenders and there is no reasonable expectation that an acceptable proposal will be received. In the opinion of management, there can be no assurance that the process will result in any change in the Company's current operations, that the Company will pursue any particular transaction or that any transaction will be concluded.

At March 31, 2009, the Company had a working capital deficiency of \$84.4 million, an accumulated deficit of \$122.2 million. As anticipated in the Company's MD&A for the year ended December 31, 2008, the Company incurred further defaults as a result of being unable to repay a US \$5 million short-term advance which was due and payable on March 31, 2009 and pay a US \$10 million loan facility fee. The loan facility fee was levied under the terms of a November 28, 2008 credit facility amendment and resulted from the Company's failure to achieve certain restructuring and/or refinancing initiatives by March 31, 2009.

If the Lenders were to call the debt, the Company would require an alternate credit facility and/or additional capital to discharge its obligations and continue its activities. Under current conditions, there can be no assurance that the Company has sufficient assets or will be able to raise sufficient capital to make a full repayment to its Lenders if such an event were to occur. In addition, any financial restructuring plan ultimately agreed on by Mahalo and its Lenders may involve bankruptcy or similar filings by Mahalo and/or its subsidiary, Mahalo Energy (USA) Inc. The outcome of these matters is dependent on factors outside of the Company's control and cannot be predicted at this time. These conditions raise substantial doubt about the Company's ability to continue as a going concern.

CORPORATE GOVERNANCE

This MD&A has been prepared by the management of Mahalo Energy Ltd. It has been reviewed and approved by the Audit Committee and the Board of Directors of the Company. Additional information related to the Company's Corporate Governance can be found in the Company's Annual Information Form ("AIF") and Information Circular, both of which are filed on SEDAR at www.sedar.com.

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 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 certain performance measures throughout this MD&A that do not have any standardized meaning and are not defined under Canadian Generally Accepted Accounting Principles ("GAAP"); they are therefore referred to as non-GAAP financial measures. These performance measures include "funds from operations", "funds from operations per share", "operating netback" and "net debt". The non-GAAP financial measures, as calculated and used by the Company, may not be comparable to similarly titled measures reported by other companies.

Management considers these non-GAAP 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 research analysts to value and compare oil and gas exploration and production companies, and are frequently included in published research when providing investment recommendations.

Funds from operations and funds from operations per share 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. 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 to service debt.

Operating netback should not be considered an alternative to, or more meaningful than, net earnings or other measures of performance or liquidity calculated in accordance with Canadian GAAP. 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.

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.

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.