



Interim Consolidated Financial Statements

Three and Six Months ended June 30, 2009 and 2008

Unaudited – Prepared by Management

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

In accordance with National Instrument 51-102 released by the Canadian Securities Administrators, the Company discloses that its auditors have not reviewed the interim consolidated financial statements for the three and six months ended June 30, 2009 and 2008.

MAHALO ENERGY LTD.
CONSOLIDATED BALANCE SHEETS

(Under Creditor Protection Proceedings as of May 21 and 22, 2009 - Note 1)

(Unaudited, in thousands)

As at	June 30 2009	December 31 2008
Assets (note 6)		
Current		
Cash	3,641	2,073
Accounts receivable	10,033	11,644
Prepaid and deposits	1,317	999
Current portion of unrealized gain on derivative natural gas contracts (note 11)	11,999	6,593
	26,990	21,309
Deferred financing costs (note 6)	7,305	15,607
Unrealized gain on derivative natural gas contracts (note 11)	660	4,151
Property and equipment (notes 4 and 5)	125,207	139,321
Assets held for sale (note 4)	-	3,469
	160,162	183,857
Liabilities		
Current		
Accounts payable and accrued liabilities	21,240	38,118
Bank debt (note 6)	84,971	75,097
	106,211	113,215
Asset retirement obligations (note 7)	1,371	1,385
Asset retirement obligations related to assets held for sale (note 4)	-	1,848
Future income taxes	2,541	6,015
	110,123	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)	10,448	9,848
Deficit	(130,377)	(121,198)
Accumulated other comprehensive income	8,999	11,775
	50,039	61,394
	160,162	183,857

See accompanying notes to the unaudited consolidated financial statements

MAHALO ENERGY LTD.
CONSOLIDATED STATEMENTS OF LOSS

(Under Creditor Protection Proceedings as of May 21 and 22, 2009 - Note 1)

(Unaudited, in thousands except per share amounts)

For the Periods ended June 30	Three Months		Six Months	
	2009	2008	2009	2008
		<i>(restated - notes 2 & 4)</i>		<i>(restated - notes 2 & 4)</i>
Revenues				
Petroleum and natural gas revenue	7,276	9,213	16,890	16,993
Royalty expense	(1,965)	(2,373)	(4,387)	(4,333)
	5,311	6,840	12,503	12,660
Gain (loss) on derivative natural gas contracts	(1,045)	-	6,081	-
Other income	(15)	-	449	-
	4,251	6,840	19,033	12,660
Expenses				
Operating	1,420	1,480	3,328	2,396
Transportation	609	524	1,425	982
General and administrative	1,759	1,242	3,491	2,033
Stock-based compensation	270	510	540	978
Foreign exchange loss	-	319	-	489
Interest and financing costs (note 6)	7,421	697	13,854	1,238
Depletion, depreciation and accretion	3,072	2,661	6,474	5,114
	14,551	7,433	29,112	13,230
Loss from continuing operations, before income taxes	(10,300)	(593)	(10,079)	(570)
Current income tax expense	6	5	12	10
Future income tax expense (recovery)	(3,617)	290	(3,288)	698
Loss from continuing operations	(6,689)	(888)	(6,803)	(1,278)
Loss from discontinued operations (note 4)	(1,514)	(30,616)	(2,376)	(30,720)
Net loss	(8,203)	(31,504)	(9,179)	(31,998)
Loss per share from continuing operations (note 8)				
Basic and diluted	(0.11)	(0.01)	(0.11)	(0.02)
Loss per share from discontinued operations (note 8)				
Basic and diluted	(0.03)	(0.52)	(0.05)	(0.52)
Net loss per share (note 8)				
Basic and diluted	(0.14)	(0.53)	(0.16)	(0.54)

See accompanying notes to the unaudited consolidated financial statements

MAHALO ENERGY LTD.**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)**

(Under Creditor Protection Proceedings as of May 21 and 22, 2009 - Note 1)

(Unaudited, in thousands)

For the Periods ended June 30	Three Months		Six Months	
	2009	2008	2009	2008
		<i>(restated - notes 2 & 4)</i>		<i>(restated - notes 2 & 4)</i>
Net loss	(8,203)	(31,504)	(9,179)	(31,998)
Translation of US dollar results to Canadian dollar reporting currency	(4,499)	-	(2,776)	-
Other comprehensive income	(4,499)	-	(2,776)	-
Comprehensive income (loss)	(12,702)	(31,504)	(11,955)	(31,998)

*See accompanying notes to the unaudited consolidated financial statements***MAHALO ENERGY LTD.****CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY**

(Under Creditor Protection Proceedings as of May 21 and 22, 2009 - Note 1)

(Unaudited, in thousands)

For the Periods ended June 30	Three Months		Six Months	
	2009	2008	2009	2008
		<i>(restated - notes 2 & 4)</i>		<i>(restated - notes 2 & 4)</i>
Share Capital				
Balance, beginning and end of period	158,979	158,979	158,979	158,979
Warrants				
Balance, beginning and end of period	1,990	1,990	1,990	1,990
Contributed Surplus				
Balance, beginning of period	10,148	8,640	9,848	8,117
Stock-based compensation costs	300	564	600	1,087
Balance, end of period	10,448	9,204	10,448	9,204
Deficit				
Balance, beginning of period	(122,174)	(54,332)	(121,198)	(53,837)
Net loss	(8,203)	(31,503)	(9,179)	(31,998)
Balance, end of period	(130,377)	(85,835)	(130,377)	(85,835)
Accumulated Other Comprehensive Income				
Balance, beginning of period	13,498	-	11,775	-
Foreign exchange	(4,499)	-	(2,776)	-
Balance, end of period	8,999	-	8,999	-

See accompanying notes to the unaudited consolidated financial statements

MAHALO ENERGY LTD.**CONSOLIDATED STATEMENTS OF CASH FLOWS**

(Under Creditor Protection Proceedings as of May 21 and 22, 2009 - Note 1)

(Unaudited, in thousands)

For the Periods ended June 30	Three Months		Six Months	
	2009	2008	2009	2008
		<i>(restated - notes 2 & 4)</i>		<i>(restated - notes 2 & 4)</i>
Operating activities				
Net loss from continuing operations	(6,689)	(888)	(6,803)	(1,278)
Non-cash items:				
Stock-based compensation	270	510	540	978
Depletion, depreciation and accretion	3,072	2,661	6,474	5,114
Unrealized financial derivative loss (gain)	3,021	-	(2,551)	-
Unrealized foreign exchange loss	-	225	-	404
Amortization of deferred financing costs	3,707	-	7,793	-
Future income tax expense (recovery)	(3,617)	290	(3,288)	698
Cash flow from (used in) continuing operations	(236)	2,798	2,165	5,916
Change in non-cash working capital	(14,133)	50	(14,155)	(2,783)
Cash flow from (used in) discontinued operations	(316)	3,571	(1,133)	5,824
	(14,685)	6,419	(13,123)	8,957
Financing activities				
Bank debt	16,251	7,174	16,269	13,449
Deferred financing costs	-	(3,401)	-	(3,401)
	16,251	3,773	16,269	10,048
Investing activities				
Expenditure on property and equipment	(691)	(10,470)	(918)	(15,767)
Proceeds on sale of oil and gas properties	-	-	2,293	-
(Increase) decrease in assets held for sale	448	(3,167)	455	(6,377)
Change in non-cash working capital	1,030	1,081	(3,408)	(885)
	787	(12,556)	(1,578)	(23,029)
Increase (decrease) in cash	2,353	(2,364)	1,568	(4,024)
Cash, beginning of period	1,288	2,313	2,073	3,973
Cash (bank indebtedness), end of period	3,641	(51)	3,641	(51)

See accompanying notes to the unaudited consolidated financial statements

MAHALO ENERGY LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Three and Six Months Ended June 30, 2009 and 2008

(Unaudited, amounts in Canadian dollars unless otherwise stated)

1. CREDITOR PROTECTION AND GOING CONCERN ISSUES

(a) Nature of the Business

Mahalo Energy Ltd. (“Mahalo” or the “Company”) was incorporated under the *Business Corporations Act (Alberta)* on April 21, 2004. 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.

Mahalo completed its initial public offering and was listed on the Toronto Stock Exchange (“TSX”) on July 29, 2005. On May 1, 2009, the Company agreed to a voluntary delisting from the TSX as a result of its inability to meet continuing listing requirements. On August 19, 2009, the Company obtained a listing of its common shares on the NEX Board of the TSX Venture Exchange under the symbol CBM.H.

(b) Background

The Company has been exploring strategic alternatives since the fall of 2008 and during this period, has had discussions with a number of interested parties. Unfortunately, no satisfactory offers or proposals were received; management concluded that no transaction was likely to take place in the immediate future. In March 2009, the Company breached certain conditions of its credit facility agreement when it failed to achieve certain restructuring and/or refinancing initiatives and was unable to pay amounts aggregating US \$15 million which were payable under the credit facility agreement on March 31, 2009. As a result, the Company, with the unanimous authorization of its Board of Directors, determined that a business and financial restructuring could best be achieved within the framework of creditor protection.

(c) Chapter 11 and CCAA Proceedings

On May 21, 2009, Mahalo Energy (USA) Inc. filed a voluntary petition for relief under Chapter 11 of the United States Bankruptcy Code. Under Chapter 11, the Company may seek an adjustment of debts, either by reducing the debt or by extending the time for repayment, or may seek a more comprehensive reorganization. There is no guarantee that Mahalo will be able to obtain court orders or approvals with respect to motions which it may file from time to time with the United States Court. The creditor protection will end as a result of dismissal of the Chapter 11 Case, reflecting a successful restructuring, or alternatively, the conversion of the Chapter 11 Case into a Chapter 7 Case under the United States Bankruptcy Code. A Chapter 7 Case provides for liquidation of the debtor’s assets and subsequent distribution of proceeds to creditors.

On May 22, 2009, Mahalo Energy Ltd. obtained an order from the Court of Queen’s Bench of Alberta for protection under the Companies’ Creditors Arrangement Act (Canada) (“CCAA”). The Initial Order granted a stay period of 30 day, which has subsequently been extended and currently expires on October 30, 2009. There is no guarantee that Mahalo will be able to obtain court orders or approvals with respect to motions, including motions to further extend the stay period, which it may file from time to time with the Canadian Court.

Alger & Associates Inc. (“Monitor”) was appointed by the Canadian Court to monitor Mahalo’s property and the conduct of its business. The Monitor has the prescribed rights and obligations as set out in the CCAA and is also empowered to, among other things, monitor the Company’s receipts and disbursements, report to the Court

with respect to matters relating to Mahalo's property and business and advise the Company in the development of any plan of compromise or arrangement with creditors.

The Court Orders providing creditor protection permit Mahalo to remain in possession and control of its property, carry on its business, retain employees and other service providers and continue with the process of evaluating strategic alternatives available to the Company, including a sale of Mahalo or its assets. Although the Company did enter into a financing commitment for approximately \$2 million of debtor in possession ("DIP") financing with its lender, Ableco Finance, LLC, such financing was not approved by the US Court and therefore was not realized.

If Mahalo is not able to develop and present a plan of compromise or arrangement with its creditors, or if the plan is not accepted by affected creditors, then the Company will lose the protection of the stay of proceedings and substantially all debt obligations of the Company will be due and payable, which, in turn, would in all likelihood lead to the liquidation or forfeiture of Mahalo's assets.

Mahalo has engaged Alvarez & Marsal North America, LLC, a United States firm, to act as advisors to the Company to assist with the business and financial restructuring, a process which may involve the sale of all or substantially all of the Company's assets.

(d) Basis of Presentation and Going Concern Issues

These unaudited interim consolidated financial statements have been prepared using the same Canadian generally accepted accounting principles (GAAP) as applied prior to filing for and being granted creditor protection under the Chapter 11 and CCAA proceedings. The financial statements continue to be prepared using the going concern concept that, in turn, assumes 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 for the foreseeable future.

The Chapter 11 and CCAA proceedings provide for a period of time for the Company to stabilize its operations and financial condition and develop a restructuring plan that is acceptable to the Courts and to creditors. The outcome of these proceedings including realization of assets and successful discharge of liabilities is impossible to predict. These conditions raise substantial doubt about the Company's ability to continue as a going concern. If the going concern basis of preparation is not appropriate, adjustments to the carrying amounts of the assets, liabilities, revenues and expenses and the balance sheet classifications used may be necessary.

The accompanying financial statements do not purport to reflect or provide for the consequences of the Insolvency Proceedings. In particular, such financial statements do not purport to show: (a) as to assets, their realizable value on a liquidation basis or their availability to satisfy liabilities; (b) as to pre-petition liabilities, the amounts that may be allowed for claims or contingencies, or the status and priority thereof; (c) as to shareholders accounts, the effect of any changes that may be made in the capitalization of the Company; or (d) as to operations, the effect of any changes that may be made in the business.

While the Company is under creditor protection, it will make adjustments to the financial statements to isolate assets, liabilities, revenues, and expenses related to the reorganization and restructuring activities so as to distinguish these events and transactions from those associated with the ongoing operation of the business. Further, claims allowed arising under the Insolvency Proceedings may be recorded as liabilities and presented separately on the consolidated balance sheets. If a restructuring occurs and there is substantial realignment of the equity and non-equity interests in the Company, the Company will be required under Canadian GAAP, to adopt "fresh start" reporting. Under fresh start reporting, the Company would undertake a comprehensive re-evaluation of its assets and liabilities based on the reorganization value as established and confirmed in the Plan. The financial statements do not present any adjustments that may be required during the period that the Company remains under creditor protection, or that may be required under fresh start reporting.

In accordance with Canadian GAAP appropriate for a going concern, property, plant and equipment is carried at cost less accumulated amortization, depletion, and any impairment losses and they are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of such assets may not be

recoverable. The series of events that led the Company to the Insolvency Proceedings and the events since then triggered impairment tests for its property, plant and equipment. The Company made assumptions, such as growth, commodity prices, production volumes and achieving cost reductions, about the future cash flows expected from the use of its assets. There can be no assurance that expected future cash flows will be realized or will be sufficient to recover the carrying amount of property, plant and equipment.

The preparation of financial statements in accordance with Canadian GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the dates of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting periods. The Insolvency Proceedings materially affect the degree of uncertainty associated with the measurement of many amounts in the financial statements. More specifically, it could impact the recoverability tests and the fair value assumptions used in the impairment test of property, plant and equipment.

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.

3. NEW ACCOUNTING STANDARDS AND PRONOUNCEMENTS

On January 1, 2009, the Company adopted Canadian Institute of Chartered Accountants ("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. At this time, the Company, due to the significant financial uncertainties, is unable to reasonably quantify the impact of adopting IFRS on its consolidated financial statements.

In June 2009, the CICA issued amendments to Handbook Section 3862 - Financial Instruments – Disclosures. The amendments enhance disclosures about fair value measurements, including the relative reliability of the inputs used in those measurements, and about the liquidity risk of financial instruments. Financial Instruments

will have to be classified into three classes based on the type of inputs used to determine the fair value of financial instruments. The amendments will be effective for the Company's financial statements as at December 31, 2009. The Company is currently evaluating the impact of these new requirements on its financial statements.

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. Since the assets held for sale encompassed the entire Canadian business segment or cost centre under full cost accounting, the cost center was accounted for as a “discontinued operation” as required under Canadian GAAP. The assets were reclassified from “property and equipment” to “assets held for sale” on the consolidated balance sheets. A liability representing the asset retirement obligations associated with the assets held for sale was set out separately on the consolidated balance sheets. The sales process was effectively complete at June 30, 2009.

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

For the Periods ended June 30	Three Months		Six Months	
	2009	2008	2009	2008
<i>(\$000's)</i>				
Revenues				
Petroleum and natural gas revenue	259	7,020	525	12,658
Royalty expense	41	(1,177)	45	(2,570)
Other	10	6	14	18
	310	5,849	584	10,106
Expenses				
Operating and transportation	163	1,218	601	2,483
General & administrative	273	536	761	865
Interest	190	525	355	935
Depletion, depreciation and accretion	58	1,886	103	4,243
Writedown of property and equipment	1,140	32,300	1,140	32,300
	1,824	36,465	2,960	40,826
Loss from discontinued operations	(1,514)	(30,616)	(2,376)	(30,720)

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

5. PROPERTY AND EQUIPMENT

	Cost	Accumulated Depletion and Depreciation	Net Book Value
<i>(\$000's)</i>			
June 30, 2009:			
Petroleum and natural gas properties and equipment	168,399	43,245	125,154
Other	1,141	1,088	53
	<u>169,540</u>	<u>44,333</u>	<u>125,207</u>
December 31, 2008:			
Petroleum and natural gas properties and equipment	174,198	34,930	139,268
Other	1,138	1,085	53
	<u>175,336</u>	<u>36,014</u>	<u>139,321</u>

Costs associated with unproven properties excluded from costs subject to depletion amounted to \$22,018,287 at June 30, 2009 (December 31, 2008 - \$21,633,089). Future development costs of \$33,049,200 have been included in the costs subject to depletion at June 30, 2009 (December 31, 2008 - \$33,049,200).

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. As at June 30, 2009, US \$73.1 million (equivalent of Cdn \$85.0 million) was outstanding under the facility (December 31, 2008 – US \$62.7 million; equivalent of Cdn \$75.1 million). Irrevocable standby letters of credit for a total of Cdn \$20,000 and US \$10,000 were issued and outstanding at June 30, 2009 (December 31, 2008 - Cdn \$145,000 and US \$20,000). The letters of credit reduce the amount available under the facility. The weighted average effective interest rate on outstanding borrowings at June 30, 2009 was 14.7 percent (December 31, 2008 – 9.53 percent).

The Company is in breach of certain covenants under the credit facility. On March 5, 2009, Mahalo announced that it had received a reservation of rights letter from the Lender notifying the Company that it was in default 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 of March 31, 2009, the Company committed a further breach of certain covenants as a result of non-repayment of a short-term US \$5 million revolver advance which was provided as a part of a November 28, 2008 credit facility amendment, and non-payment of a US \$10 million loan fee levied under the terms of that same amendment. The loan fee resulted from failure by the Company to achieve certain restructuring and/or refinancing initiatives by March 1, 2009. The amounts remain unpaid as at June 30, 2009. The loan fee was reflected in accounts payable and accrued liabilities at December 31, 2008 and in bank debt at June 30, 2009.

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 a result of the default situation, 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 June 30, 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:

Six months ended June 30	2009	2008
<i>(\$000's)</i>		
Balance, beginning of period	1,385	871
Liabilities incurred	-	86
Revision to assumptions	(72)	-
Accretion expense	58	38
Balance, end of period	1,371	995

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)
June 30, 2009 and December 31, 2008	59,298,035	158,979

(c) 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	(759,732)	4.24
Outstanding, June 30, 2009	3,519,999	3.10
Exercisable, June 30, 2009	2,384,988	3.63

The following summarizes information about stock options outstanding at June 30, 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)
\$.022 to \$3.95	2,487,199	2.47	3.0	1,352,189	2.87	2.2
\$4.19 to \$4.77	964,400	4.59	1.1	964,399	4.59	0.1
\$5.00 to \$7.40	68,400	5.00	0.1	68,400	5.00	0.1
	3,519,999	3.10	2.4	2,384,988	3.63	1.7

(d) 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:

Six months ended June 30	2009	2008
Risk free interest rate (%)	0.8	3.5
Expected life (years)	5.0	5.0
Expected volatility (%)	201	53
Weighted average fair value per share (\$)	0.07	1.74

During the three and six months ended June 30, 2009, stock-based compensation amounted to \$300,000 and \$600,000 (2008 - \$563,914 and \$1,087,295), of which \$270,000 and \$540,000 (2008 - \$509,840 and \$977,564) was recognized as an expense and \$30,000 and \$60,000 (2008 - \$55,074 and \$109,731) was capitalized to property and equipment.

(e) 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, June 30, 2009	10,148

(f) Per Share Amounts

The weighted average number of shares outstanding is as follows:

For the Periods ended June 30	Three Months		Six Months	
	2009	2008	2009	2008
Weighted average basic and diluted	59,298,035	59,298,035	59,298,035	59,298,035

For the periods ended June 30, 2009 and 2008, share purchase warrants and stock options were anti-dilutive.

9. Management of Capital Structure

The Company has obtained and is currently under creditor protection through Chapter 11 proceedings in the United States and CCAA proceedings in Canada (see Note 1) as it continues to evaluate strategic alternatives, including a sale of Mahalo or its assets. The Company is in breach of certain covenants under its bank credit agreement (see Note 6), including non-payment of amounts that became due and payable on March 31, 2009. The outcome of these matters is dependant on factors outside of the Company's control and cannot be predicted at this time.

The Chapter 11 and CCAA proceedings have a significantly restrictive impact on the Company's ability to manage its capital structure in the near term. The primary short-term objective and focus during these proceedings is to maintain a level of liquidity necessary to fund the ongoing business cycle and to ultimately attain a successful business and financial restructuring of the Company.

Notwithstanding the current situation, the Company's longer term capital management objectives remain unchanged. 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.

As at June 30	2009
<i>(\$000's)</i>	
Current assets	26,990
Accounts payable and accrued liabilities	(21,240)
Bank debt (note 6)	(84,971)
Working capital deficiency	(79,221)
Shareholders' equity	50,039

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 any capital requirements imposed by

any regulators; 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.

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	69	95	98	100	42	404
Equipment usage	76	2,376	-	-	-	2,452
	145	2,471	98	100	42	2,856

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 June 30, 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:

As at June 30	2009
<i>(\$000's)</i>	
Not past due (90 days or less)	7,725
Past due (greater than 90 days)	2,308
	10,033

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. 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 \$0.4 million at June 30, 2009. The following is a summary of the physical fixed forward sales commitments.

Daily Volume (Mmbtu)	Contract Price	Term
1000	US \$10.26/MMbtu	November 2008 - July 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 \$0.5 million impact on pre-tax income for the six months ended June 30, 2009.

At June 30, 2009, the Company also had derivative natural gas contracts 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	3,255
NYMEX Financial Fixed	2500	US \$8.10/MMbtu	Jan 2010 - Dec 2010	2,148
Financial Panhandle Basis	5000	HH minus US \$1.12/MMbtu	July 2009 - May 2010	(969)
Financial Panhandle Basis	5000	HH minus US \$1.27/MMbtu	Jan 2009 - Dec 2009	(637)
Financial Panhandle Basis	2500	HH minus US \$0.98/MMbtu	Jan 2010 - Dec 2010	(453)
Financial Panhandle Basis	2500	HH minus US \$1.00/MMbtu	Jan 2010 - Dec 2010	(375)

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 June 30, 2009 mark-to-market of this derivative is an asset of \$9.7 million.

The mark-to-market of all derivative natural gas contracts was an asset of \$12.7 million at June 30, 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 \$0.1 million impact on pre-tax income for the six months ended June 30, 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 six months ended June 30, 2009 would change by an estimated \$0.7 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 six months ended June 30, 2009 would change by an estimated

\$0.4 million. 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 June 30, 2009	Less than one year	Total
<i>(\$000's)</i>		
Accounts payable and accrued liabilities	21,240	21,240
Bank debt	84,971	84,971
	106,211	106,211

The Company has obtained and is currently under creditor protection through Chapter 11 proceedings in the United States and CCAA proceedings in Canada (see Note 1) as it continues to evaluate strategic alternatives, including a sale of Mahalo or its assets. The Company is in breach of certain covenants under its bank credit agreement (see Note 6), including non-payment of amounts that became due and payable on March 31, 2009. The outcome of these matters is dependant on factors outside of the Company's control and cannot be predicted at this time.



Quarterly Report

Three and Six Months ended June 30, 2009
(Unaudited)

Message to Shareholders

Mahalo Energy Ltd. ("Mahalo" or the "Company") announces its results for the three and six months ended June 30, 2009.

SUMMARY OF RESULTS	Three Months Ended		Six Months Ended	
	Jun 30 2009	Jun 30 2008	Jun 30 2009	Jun 30 2008
		<i>(Restated) (2)</i>		<i>(Restated) (2)</i>
Financial (\$000's except per share) (1)				
Continuing operations:				
Petroleum and natural gas revenue	7,276	9,213	16,890	16,993
Operating netback	3,282	4,836	7,750	9,282
Loss from continuing operations	(6,689)	(888)	(6,803)	(1,278)
Per share - basic & diluted	(0.11)	(0.01)	(0.11)	(0.02)
Loss from discontinued operations	(1,514)	(30,616)	(2,376)	(30,720)
Per share - basic & diluted	(0.03)	(0.52)	(0.05)	(0.52)
Net loss	(8,203)	(31,504)	(9,179)	(31,998)
Per share - basic & diluted	(0.14)	(0.53)	(0.16)	(0.54)
Funds from (used in) continuing operations	(236)	2,798	2,165	5,916
Per share - basic	0.00	0.05	0.04	0.10
Funds from (used in) discontinued operations	(316)	3,571	(1,133)	5,824
Per share - basic	(0.01)	0.06	(0.02)	0.10
Funds from (used in) operations	(552)	6,369	1,032	11,740
Per share - basic	(0.01)	0.11	0.02	0.20
Operational (1)				
Average daily sales volumes (boe):				
Continuing operations	1,802	2,029	2,007	2,039
Discontinued operations	64	1,254	70	1,304
Continuing operations:				
Average selling price (\$/boe)	44.37	48.26	46.50	45.80
Operating netback (\$/boe)	20.02	22.42	21.34	25.01

(1) Refer to special advisories set forth in the Company's MD&A regarding use of Non-GAAP financial measures and barrel of oil ("boe") equivalents.

(2) Restated to reflect "discontinued operations" accounting in respect of Canadian resource assets.

Financial

During second quarter 2009, the Company had petroleum and natural gas revenues from continuing operations of \$7.3 million, a net loss from continuing operations of \$6.7 million and a net use of funds from continuing operations of \$0.2 million. Lower operating netback and significantly higher interest and financing costs were contributing factors when comparing current quarter results from continuing operations with the same period in 2008.

In second quarter 2008, the Company recorded a \$32.3 million write-down of Canadian resource assets, which in turn, was primarily responsible for the loss from discontinued operations during that period.

Operational

In 2008, Mahalo committed to dispose of its Canadian resource assets; the process was effectively complete by quarter's end. The first and second quarters of 2009 saw virtually 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 1,802 boe per day, down 412 boe per day from the immediately preceding quarter due to natural decline and suspension of certain routine maintenance procedures. The Company has not drilled a well since October 2008.

Creditor Protection and Going Concern Issues

The Company has been exploring strategic alternatives since the fall of 2008 and during this period, has had discussions with a number of interested parties. Unfortunately, no satisfactory offers or proposals were received; management concluded that no transaction was likely to take place in the immediate future. In March 2009, the Company breached certain conditions of its credit facility agreement when it failed to achieve certain restructuring and/or refinancing initiatives and was unable to pay amounts aggregating US \$15 million which were payable under the credit facility agreement on March 31, 2009. As a result, the Company, with the unanimous authorization of its Board of Directors, determined that a business and financial restructuring could best be achieved within the framework of creditor protection.

On May 21, 2009, Mahalo Energy (USA) Inc. filed a voluntary petition for relief under Chapter 11 of the United States Bankruptcy Code. Under Chapter 11, the Company may seek an adjustment of debts, either by reducing the debt or by extending the time for repayment, or may seek a more comprehensive reorganization. The creditor protection will end as a result of dismissal of the Chapter 11 Case, which would in turn reflect a successful restructuring, or alternatively, the conversion of the Chapter 11 Case into a Chapter 7 Case under the United States Bankruptcy Code. A Chapter 7 Case provides for liquidation of the debtor's assets and subsequent distribution of proceeds to creditors.

On May 22, 2009, Mahalo Energy Ltd. obtained an order from the Court of Queen's Bench of Alberta for protection under the Companies' Creditors Arrangement Act (Canada) ("CCAA"). The Initial Order granted a stay period of 30 days, which has subsequently been extended and currently expires on October 30, 2009. There is no guarantee that Mahalo will be able to obtain court orders or approvals with respect to motions, including motions to further extend the stay period, which it may file from time to time with the Canadian Court. Alger & Associates Inc. ("Monitor") was appointed by the Canadian Court to monitor Mahalo's property and the conduct of its business.

The Court Orders providing creditor protection permit Mahalo to remain in possession and control of its property, carry on its business, retain employees and other service providers and continue with the process of evaluating strategic alternatives available to the Company, including a sale of Mahalo or its assets. Although the Company did enter into a financing commitment for approximately \$2 million of debtor in possession ("DIP") financing with its lender, Ableco Finance, LLC, such financing was not approved by the US Court and therefore was not realized.

Mahalo has engaged Alvarez & Marsal North America, LLC, a United States firm, to act as advisors to the Company to assist with the business and financial restructuring, a process which may involve the sale of all or substantially all of the Company's assets.

The outcome of these matters is dependent on factors outside of the Company's control, cannot be predicted at this time and raise substantial doubt about the Company's ability to continue as a going concern.

Additional information regarding this matter is set forth in the Company's MD&A for the three and six months ended June 30, 2009.

Management and Board Changes

During June 2009, Mr. James Burns, President and CEO and Director of Mahalo and Mr. Willie Dawidowski, Chief Financial Officer of Mahalo resigned their positions. Mr. David Burton has been appointed President and CEO and Director to replace Mr. Burns. Mr. Stuart King has assumed the duties of Chief Financial Officer. In July 2009, Mr. Kevin Wolfe and Mr. David Butler ceased to be directors of the Company. Mahalo wishes to thank James, Willie, Kevin and David for their valued contributions to the Company.

On behalf of the Board of Directors,
"Signed"

David Burton
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 and six months ended June 30, 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 August 31, 2009.

CREDITOR PROTECTION

The Company has been exploring strategic alternatives since the fall of 2008 and during this period, has had discussions with a number of interested parties. Unfortunately, no satisfactory offers or proposals were received; management concluded that no transaction was likely to take place in the immediate future. In March 2009, the Company breached certain conditions of its credit facility agreement when it failed to achieve certain restructuring and/or refinancing initiatives and was unable to pay amounts aggregating US \$15 million which were payable under the credit facility agreement on March 31, 2009. As a result, the Company, with the unanimous authorization of its Board of Directors, determined that a business and financial restructuring could best be achieved within the framework of creditor protection.

On May 21, 2009, Mahalo Energy (USA) Inc. filed a voluntary petition for relief under Chapter 11 of the United States Bankruptcy Code. Related pleadings and court orders are available on the Company's website, at www.mahaloenergy.com. Under Chapter 11, the Company may seek an adjustment of debts, either by reducing the debt or by extending the time for repayment, or may seek a more comprehensive reorganization. There is no guarantee that Mahalo will be able to obtain court orders or approvals with respect to motions which it may file from time to time with the United States Court. The creditor protection will end as a result of dismissal of the Chapter 11 Case, reflecting a successful restructuring, or alternatively, the conversion of the Chapter 11 Case into a Chapter 7 Case under the United States Bankruptcy Code. A Chapter 7 Case provides for liquidation of the debtor's assets and subsequent distribution of proceeds to creditors.

On May 22, 2009, Mahalo Energy Ltd. obtained an order from the Court of Queen's Bench of Alberta for protection under the Companies' Creditors Arrangement Act (Canada) ("CCAA"). The Initial Order granted a stay period of 30 days, which has subsequently been extended and currently expires on October 30, 2009. There is no guarantee that Mahalo will be able to obtain court orders or approvals with respect to motions, including motions to further extend the stay period, which it may file from time to time with the Canadian Court. Alger & Associates Inc. ("Monitor") was appointed by the Canadian Court to monitor Mahalo's property and the conduct of its business.

Alger & Associates Inc. ("Monitor") was appointed by the Canadian Court to monitor Mahalo's property and the conduct of its business. The Monitor has the prescribed rights and obligations as set out in the CCAA and is also empowered to, among other things, monitor the Company's receipts and disbursements, report to the Court with respect to matters relating to Mahalo's property and business and advise the Company in the development of any plan of compromise or arrangement with creditors. The Initial Order and related CCAA court filings are available on the Monitor's website, at www.alger.ca.

The Court Orders providing creditor protection permit Mahalo to remain in possession and control of its property, carry on its business, retain employees and other service providers and continue with the process of evaluating strategic alternatives available to the Company, including a sale of Mahalo or its assets. Although the Company did enter into a financing commitment for approximately \$2 million of debtor in possession ("DIP") financing with its lender, Ableco Finance, LLC, such financing was not approved by the US Court and therefore was not realized.

If Mahalo is not able to develop and present a plan of compromise or arrangement with its creditors, or if the plan is not accepted by affected creditors, then the Company will lose the protection of the stay of proceedings and substantially all debt obligations of the Company will be due and payable, which, in turn, would in all likelihood lead to the liquidation or forfeiture of Mahalo's assets.

Mahalo has engaged Alvarez & Marsal North America, LLC, a United States firm, to act as advisors to the Company to assist with the business and financial restructuring, a process which may involve the sale of all or substantially all of the Company's assets.

BASIS OF PRESENTATION AND GOING CONCERN ISSUES

The unaudited interim consolidated financial statements have been prepared using the same Canadian generally accepted accounting principles (GAAP) as applied prior to filing for and being granted creditor protection under the Chapter 11 and CCAA proceedings. The financial statements continue to be prepared using the going concern concept that, in turn, assumes 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 for the foreseeable future.

The Chapter 11 and CCAA proceedings provide for a period of time for the Company to stabilize its operations and financial condition and develop a restructuring plan that is acceptable to the Courts and to creditors. The outcome of these proceedings including realization of assets and successful discharge of liabilities is impossible to predict. These conditions raise substantial doubt about the Company's ability to continue as a going concern. If the going concern basis of preparation is not appropriate, adjustments to the carrying amounts of the assets, liabilities, revenues and expenses and the balance sheet classifications used may be necessary.

The interim consolidated financial statements do not purport to reflect or provide for the consequences of the Insolvency Proceedings. In particular, such financial statements do not purport to show: (a) as to assets, their realizable value on a liquidation basis or their availability to satisfy liabilities; (b) as to pre-petition liabilities, the amounts that may be allowed for claims or contingencies, or the status and priority thereof; (c) as to shareholders accounts, the effect of any changes that may be made in the capitalization of the Company; or (d) as to operations, the effect of any changes that may be made in the business.

While the Company is under creditor protection, it will make adjustments to the financial statements to isolate assets, liabilities, revenues, and expenses related to the reorganization and restructuring activities so as to distinguish these events and transactions from those associated with the ongoing operation of the business. Further, claims allowed arising under the Insolvency Proceedings may be recorded as liabilities and presented separately on the consolidated balance sheets. If a restructuring occurs and there is substantial realignment of the equity and non-equity interests in the Company, the Company will be required under Canadian GAAP, to adopt "fresh start" reporting. Under fresh start reporting, the Company would undertake a comprehensive re-evaluation of its assets and liabilities based on the reorganization value as established and confirmed in the Plan. The interim consolidated financial statements do not present any adjustments that may be required during the period that the Company remains under creditor protection, or that may be required under fresh start reporting.

In accordance with Canadian GAAP appropriate for a going concern, property, plant and equipment is carried at cost less accumulated amortization, depletion, and any impairment losses and they are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable. The series of events that led the Company to the Insolvency Proceedings and the events since then triggered impairment tests for its property, plant and equipment. The Company made assumptions, such as growth, commodity prices, production volumes and achieving cost reductions, about the future cash flows expected from the use of its assets. There can be no assurance that expected future cash flows will be realized or will be sufficient to recover the carrying amount of property, plant and equipment.

The preparation of financial statements in accordance with Canadian GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the dates of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting periods. The Insolvency Proceedings materially affect the degree of uncertainty associated with the measurement of many amounts in the financial statements. More specifically, it could impact the recoverability tests and the fair value assumptions used in the impairment test of property, plant and equipment.

Due to the Chapter 11 and CCAA proceedings and the significant uncertainties associated therewith, our past operating results and financial condition are not likely to be indicative of our future operating results and financial condition.

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. ("Mahalo" or the "Company") was incorporated under the Business Corporations Act (Alberta) on April 21, 2004. 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.

Mahalo completed its initial public offering and was listed on the Toronto Stock Exchange ("TSX") on July 29, 2005. On May 1, 2009, the Company agreed to a voluntary delisting from the TSX as a result of its inability to meet continuing listing requirements. On August 19, 2009, the Company obtained a listing of its common shares on the NEX Board of the TSX Venture Exchange under the symbol CBM.H.

In 2008, Mahalo committed to dispose of its Canadian resource assets; the process was effectively complete by quarter's end. 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 in respect of Canadian resource assets.

SUMMARY OF RESULTS

	Three Months Ended			Six Months Ended	
	Jun 30 2009	Mar 31 2009	Jun 30 2008	Jun 30 2009	Jun 30 2008
Financial (\$000's except per share) (1)			(Restated) (2)		(Restated) (2)
Net loss from continuing operations	(6,689)	(114)	(888)	(6,803)	(1,278)
Per share - basic & diluted	(0.11)	0.00	(0.01)	(0.11)	(0.02)
Net loss from discontinued operations	(1,514)	(862)	(30,616)	(2,376)	(30,720)
Per share - basic & diluted	(0.03)	(0.01)	(0.52)	(0.05)	(0.52)
Net loss	(8,203)	(976)	(31,504)	(9,179)	(31,998)
Per share - basic & diluted	(0.14)	(0.02)	(0.53)	(0.16)	(0.54)
Funds from (used in) continuing operations	(236)	2,063	2,798	2,165	5,916
Per share - basic	0.00	0.03	0.05	0.04	0.10
Funds from (used in) discontinued operations	(316)	(817)	3,571	(1,133)	5,824
Per share - basic	(0.01)	(0.01)	0.06	(0.02)	0.10
Funds from (used in) operations	(552)	1,246	6,369	1,032	11,740
Per share - basic	(0.01)	0.02	0.11	0.02	0.20

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

(2) Restated to reflect "discontinued operations" accounting in respect of Canadian resource assets.

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			Six Months Ended	
	Jun 30 2009	Mar 31 2009	Jun 30 2008	Jun 30 2009	Jun 30 2008
Average daily sales volumes (boe)			(Restated)		(Restated)
Continuing operations	1,802	2,214	2,029	2,007	2,039
Discontinued operations	64	76	1,254	70	1,304
	1,866	2,290	3,283	2,077	3,343
Continuing operations:					
Petroleum and natural gas revenue (\$000s)	7,276	9,614	9,213	16,893	16,993
Average realized selling price (\$/Mcf)	7.40	8.04	8.32	7.75	7.63
Average realized selling price (\$/boe)	44.37	48.26	49.90	46.50	45.80

(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 1,802 boe per day representing a decrease of 412 boe per day from first quarter 2009 due to a combination of natural decline and suspension of certain routine maintenance procedures. In addition, the Company has not drilled a well since October 2008.

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 \$7.40 per Mcf in second quarter 2009 and \$8.04 per Mcf in first quarter 2009 compared with an average Henry Hub spot price of approximately \$4.20 per Mcf and \$5.50 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			Six Months Ended	
	Jun 30 2009	Mar 31 2009	Jun 30 2008	Jun 30 2009	Jun 30 2008
			<i>(Restated)</i>		<i>(Restated)</i>
Continuing operations:					
Royalty expense (\$000s)	1,965	2,422	2,373	4,393	4,333
Royalty expense (\$/boe)	11.98	12.18	12.85	12.09	11.68
Royalty expense (% of revenue)	27%	25%	26%	26%	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			Six Months Ended	
	Jun 30 2009	Mar 31 2009	Jun 30 2008	Jun 30 2009	Jun 30 2008
			<i>(Restated)</i>		<i>(Restated)</i>
Continuing operations:					
Operating expense (\$000s)	1,420	1,908	1,481	3,325	2,396
Operating expense (\$/boe)	8.66	9.56	8.02	9.15	6.46

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			Six Months Ended	
	Jun 30 2009	Mar 31 2009	Jun 30 2008	Jun 30 2009	Jun 30 2008
			<i>(Restated)</i>		<i>(Restated)</i>
Continuing operations:					
Transportation expense (\$000s)	609	816	523	1,425	982
Transportation expense (\$/boe)	3.71	4.09	2.84	3.92	1.90

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 Jun 30		Three Months Ended Mar 31		Three Months Ended Jun 30	
	2009	\$/boe	2009	\$/boe	2008	\$/boe
<i>(\$000s, except boe and \$/boe) (1)</i>					<i>(Restated)</i>	
Continuing operations:						
Average daily sales volume (boe)	1,802		2,214		2,029	
Petroleum and natural gas revenue	7,276	44.37	9,614	48.26	9,213	49.90
Royalties	1,965	11.98	2,422	12.18	2,373	12.85
Operating and transportation	2,029	12.37	2,724	13.65	2,004	10.86
Operating netback	3,282	20.02	4,468	22.42	4,836	26.19

(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 June 30, 2009 decreased by \$1.2 million or \$2.40 per boe when compared with the immediately preceding quarter. The decrease in operating netback of \$1.2 million included negative variances of \$0.8 million due to lower sales volumes and \$0.6 million due to a lower average realized sales price. A somewhat lower per unit royalty rate and lower per unit operating and transportation costs in the current quarter benefited operating netback by approximately \$0.2 million.

Operating netback from continuing operations during the current quarter decreased by \$1.6 million when compared with second quarter 2008. The decrease in operating netback resulted primarily from a negative volume variance of \$0.5 million and a negative sales price variance of \$0.9 million.

	Six Months Ended Jun 30		Six Months Ended Jun 30	
	2009	\$/boe	2008	\$/boe
<i>(\$000s, except boe and \$/boe) (1)</i>				
Continuing operations:				
Average daily sales volume (boe)	2,007		2,039	
Petroleum and natural gas revenue	16,890	46.50	16,993	45.80
Royalties	4,387	12.09	4,333	11.68
Operating and transportation	4,753	13.07	3,378	9.11
Operating netback	7,750	21.34	9,282	25.01

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

Operating netback for the six months ended June 30, 2009 declined principally due to higher per unit operating and transportation expense when compared with the same period in 2008.

Gain (loss) 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 June 30, 2009 was an asset of \$9.7 million. During the six months ended June 30, 2009, the Company also recorded net gains of \$3.2 million on other derivative natural gas contracts. Of the total gain of \$6.1 million recorded in first half 2009, \$2.6 million was unrealized at June 30, 2009

General and administrative expense

General and administrative expense from continuing operations amounted to \$1.8 million in second quarter 2009, \$1.7 million in first quarter 2009 and \$1.2 million in second quarter 2008. Such costs were higher in the 2009 periods and included additional legal and other professional costs associated with the Company's 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 the disposal of substantially all of its Canadian assets and operations and its use of exclusively US dollar debt financing. The Company 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 resulted in comprehensive income of \$12.4 million; the amount was one-time in nature and resulted mainly from translation of property and equipment balances at December 1, 2008.

Interest and financing expense

Interest and financing expense related to continuing operations amounted to \$7.4 million in second quarter 2009, \$6.4 million in first quarter 2009 and \$0.7 million in second quarter 2008, respectively. Such expense included amortization of deferred financing fees of \$3.7 million and \$4.1 million during the second and first quarters of 2009, 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 1, 2009, a loan facility fee of US \$10 million was levied by the Lender. The loan fee liability was included in accounts payable and accrued liabilities at December 31, 2008 and subsequently reclassified as bank debt effective April 1, 2009.

Costs associated with loan fees are recorded as deferred financing costs on the balance sheet and 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 effective December 31, 2008. At June 30, 2009, deferred loan fees remaining to be amortized amounted to \$7.3 million.

Depletion, depreciation and accretion expense

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

	Three Months Ended			Six Months Ended	
	Jun 30	Mar 31	Jun 30	Jun 30	Jun 30
	2009	2009	2008	2009	2008
<i>(\$000's, except per boe)</i>			<i>(Restated)</i>		<i>(Restated)</i>
Continuing operations:					
Depletion and depreciation expense	3,043	3,372	2,642	6,416	5,076
Accretion expense	29	30	19	58	38
Depletion, depreciation and accretion expense	3,072	3,402	2,661	6,474	5,114
Depletion and depreciation (<i>\$/boe</i>)	18.56	16.92	14.32	17.66	13.69

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 \$1.4 million at both June 30, 2009 and December 31, 2008. Asset retirement obligations related to assets held for sale amounted to \$1.9 million at December 31, 2008.

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 second quarter 2009, the Company recorded a future income tax recovery of \$3.6 million from continuing operations. At the end of second quarter 2009, 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 June 30, 2009 which was fully offset by a valuation allowance.

LIQUIDITY AND CAPITAL RESOURCES

The Company has obtained and is currently under creditor protection through Chapter 11 proceedings in the United States and CCAA proceedings in Canada as it continues to evaluate strategic alternatives, including a sale of Mahalo or its assets. The Company is in breach of certain covenants under its bank credit agreement, including non-payment of amounts that became due and payable on March 31, 2009. The outcome of these matters is dependant on factors outside of the Company's control and cannot be predicted at this time.

The Chapter 11 and CCAA proceedings have a significantly restrictive impact on the Company's ability to manage its capital structure in the near term. The primary short-term objective and focus during these proceedings is to maintain a level of liquidity necessary to fund the ongoing business cycle and to ultimately attain a successful business and financial restructuring of the Company.

Notwithstanding the current situation, the Company's longer term capital management objectives remain unchanged. 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		Six Months Ended		
	Jun 30 2009	Mar 31 2009	Jun 30 2008	Jun 30 2009	Jun 30 2008
<i>(\$000s) (1)</i>			<i>(Restated)</i>		<i>(Restated)</i>
Net loss from continuing operations	(6,689)	(114)	(888)	(6,803)	(1,278)
Net loss from discontinued operations	(1,514)	(862)	(30,616)	(2,376)	(30,720)
Net loss	(8,203)	(976)	(31,504)	(9,179)	(31,998)
Non-cash items	7,651	2,560	37,873	10,211	43,738
Funds from (used in) operations	(552)	1,584	6,369	1,032	11,740
Change in non-cash working capital related to operating activities	(14,133)	(22)	50	(14,155)	(2,783)
Cash provided by (used in) operating activities	(14,685)	1,562	6,419	(13,123)	8,957
Cash provided by (used in) financing activities	16,251	18	3,773	16,269	10,048
Cash provided by (used in) investing activities	787	(2,365)	(12,556)	(1,578)	(23,029)
Increase (decrease) in cash	2,353	(785)	(2,364)	1,568	(4,024)

(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 second quarter 2009, when compared with the immediately preceding quarter, were as follows:

<i>(\$000s) (1)</i>		
Funds from continuing operations in first quarter 2009		2,401
Increase (decrease) as a result of:		
Lower operating netback		
Lower sales volumes		(792)
Lower realized sales prices		(631)
Lower per unit royalties expense		22
Lower per unit operating and transportation expense		<u>216</u>
Higher realized gain on derivative natural gas contracts		422
Lower other income		(480)
Higher general and administrative expense		(27)
Higher cash interest and financing costs		<u>(1,367)</u>
Funds from (used in) continuing operations in second quarter 2009		(236)

(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. As at June 30, 2009, US \$ 73.1 million (equivalent of Cdn \$ 85.0 million) was outstanding under the facility (December 31, 2008 – US \$ 62.7 million; equivalent of Cdn \$75.1 million). Irrevocable standby letters of credit for a total of Cdn \$ 20,000 and US \$ 10,000 were issued and outstanding at June 30, 2009 (December 31, 2008 - Cdn \$145,000 and US \$20,000). The letters of credit reduce the amount available under the facility.

On March 5, 2009, Mahalo announced that it had received a reservation of rights letter from the Lender 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 Lender advised Mahalo that until resolved, future loans would be made in the sole discretion of the Lender.

The Company incurred further defaults when it failed to repay the US \$5 million revolver loan on March 31, 2009 and failed to pay a US \$10 million loan facility fee on that same date. The loan fee resulted from failure by the Company to achieve certain restructuring and/or refinancing initiatives by March 1, 2009. The two amounts remain unpaid as at June 30, 2009. The loan fee was reflected in accounts payable and accrued liabilities on the balance sheet at December 31, 2008 and in bank debt at June 30, 2009. To date, the Lenders have not exercised their default-related rights or demanded repayment of amounts outstanding under the Facility.

At June 30, 2009 and as at the date of this MD&A, the Company had 59,298,035 common shares and 1,440,000 warrants to purchase common shares issued and outstanding. Contributed surplus at June 30, 2009 amounted to \$10.4 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		Six Months Ended		
	Jun 30 2009	Mar 31 2009	Jun 30 2008	Jun 30 2009	Jun 30 2008
<i>(\$000's)</i>			<i>(Restated)</i>		<i>(Restated)</i>
Discontinued operations	(448)	(7)	3,167	(455)	6,377
Land and seismic	-	47	2,107	47	3,287
Drilling and completions	691	180	7,513	871	11,449
Facilities and equipment	-	-	850	-	1,031
Divestures	-	(2,293)	-	(2,293)	-
Continuing operations	691	(2,066)	10,470	(1,375)	15,767
Cash expenditures, net	243	(2,073)	13,637	(1,830)	22,144

The first half of 2009 saw virtually no activity on Mahalo's oil and gas properties. During first quarter 2009, a salt water disposal facility was sold in the United States for net proceeds of \$2.3 million. As discussed earlier herein, the Company is in default under its bank credit facility and is under creditor protection in both Canada and the United States.

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	69	95	98	100	42	404
Equipment usage	76	2,376	-	-	-	2,452
	145	2,471	98	100	42	2,856

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 June 30, 2009.

Transaction	Daily Volume (MMBtu)	Contract Price	Term
Sell	1,000	US \$10.26/MMbtu	November 2008 - July 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 \$0.4 million at June 30, 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 June 30, 2009 in accordance with GAAP.

The Company had the following derivative natural gas contracts outstanding at June 30, 2009.

Transaction	Daily Volume (MMBtu)	Contract Price	Term	Mark to Market (\$000's)
Sell - NYMEX Financial Fixed	5,000	US \$7.44/MMbtu	January 2009 - December 2009	3,255
Sell - NYMEX Financial Fixed	2,500	US \$8.10/MMbtu	January 2010 - December 2010	2,148
Sell - Financial Panhandle Basis	5,000	HH minus US \$1.12/MMBtu	July 2009 - May 2010	(969)
Sell - Financial Panhandle Basis	5,000	HH minus US \$1.27/MMBtu	January 2009 - December 2009	(637)
Sell - Financial Panhandle Basis	2,500	HH minus US \$0.98/MMBtu	January 2010 - December 2010	(453)
Sell - Financial Panhandle Basis	2,500	HH minus US \$1.00/MMBtu	January 2010 - December 2010	(375)

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 June 30, 2009 mark-to-market of this derivative was \$9.7 million.

The combined mark-to-market value of the above-noted derivative natural gas contracts was \$12.7 million at June 30, 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 Company has obtained and is currently under creditor protection through Chapter 11 proceedings in the United States and CCAA proceedings in Canada (see Note 1) as it continues to evaluate strategic alternatives, including a sale of Mahalo or its assets. The Company is in breach of certain covenants under its bank credit agreement (see

Note 6), including non-payment of amounts that became due and payable on March 31, 2009. The outcome of these matters is dependant on factors outside of the Company's control and cannot be predicted at this time.

The Chapter 11 and CCAA proceedings have a significantly restrictive impact on the Company's ability to manage its financial affairs in the near term. The primary short-term objective and focus during these proceedings is to maintain a level of liquidity necessary to fund the ongoing business cycle and to ultimately attain a successful business and financial restructuring of the Company.

The following table illustrates the Company's working capital deficiency, net debt and shareholders' equity balances as at June 30, 2009 and December 31, 2008.

As at	Jun 30 2009	Dec 31 2008
<i>(\$000s)</i>		
Current assets	26,990	21,309
Accounts payable and accrued liabilities	(21,240)	(38,118)
Bank debt	(84,971)	(75,097)
Working capital (deficiency)	(79,221)	(91,906)
Adjust for unrealized financial derivative (gains) losses included above	(11,999)	(6,593)
Net debt	(91,220)	(98,499)
Shareholders' equity	50,039	61,394

At the date of this MD&A, the Company had approximately US \$10.6 million of mechanics liens filed against several of its properties.

As noted earlier herein, the Company continues to be 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.

The Lenders have not exercised their default-related rights or demanded repayment of amounts outstanding under the Facility. As a result of the default situation, Management considers the credit facility to have the same characteristics as a demand loan; therefore, it has been classified as a current liability.

As a result of the weakened global economic situation, many companies are 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. A company's ability to obtain further debt/equity funding in this environment 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.

Mahalo's ability to continue as a going concern is dependent upon its ability to successfully emerge from creditor protection proceedings with an adequately restructured business and financial position, 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.

SUMMARY OF QUARTERLY FINANCIAL RESULTS (unaudited)

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

Selected quarterly information	Q2 2009	Q1 2009	Q4 2008	Q3 2008	Q2 2008	Q1 2008	Q4 2007	Q3 2007
					(1)	(1)	(1)	(1)
Financial (\$000s, except per share)								
Continuing operations:								
Petroleum and natural gas revenue	7,276	9,614	11,081	9,477	9,213	7,780	6,689	7,410
Operating netback	3,282	4,468	5,590	4,527	4,836	4,445	3,343	3,870
Gain (loss) on derivative contracts	(1,045)	7,126	7,913	2,943	-	-	-	-
General and administrative	1,759	1,732	1,771	1,390	1,242	791	1,031	975
Stock-based compensation	270	270	73	445	510	468	577	514
Foreign exchange loss (gain)	-	-	13,172	3,284	319	169	(612)	(450)
Interest and financing expense	7,421	6,433	2,491	1,011	697	543	677	603
Depletion, depreciation, accretion	3,072	3,402	3,892	3,219	2,661	2,453	2,476	2,879
Future income taxes (recovery)	(3,617)	329	1,922	617	290	408	(1,293)	271
Net income (loss):								
Continuing operations	(6,689)	(114)	(9,671)	(2,501)	(887)	(392)	485	(929)
Per share: basic and diluted	(0.11)	0.00	(0.16)	(0.04)	(0.01)	(0.01)	0.01	(0.02)
Discontinued operations	(1,514)	(862)	(7,390)	(15,802)	(30,616)	(102)	(1,182)	(884)
Per share: basic and diluted	(0.03)	(0.02)	(0.13)	(0.27)	(0.52)	0.00	(0.02)	(0.01)
Net income (loss)	(8,203)	(976)	(17,061)	(18,303)	(31,503)	(494)	(697)	(1,813)
Per share: basic and diluted	(0.14)	(0.02)	(0.29)	(0.31)	(0.53)	(0.01)	(0.01)	(0.03)
Funds from (used in) continuing operations	(236)	2,401	2,644	2,539	2,798	3,115	1,850	2,332
Per share: basic	0.00	0.04	0.04	0.04	0.05	0.05	0.03	0.04
Funds from (used in) discontinued operations	(316)	(817)	(1,262)	881	3,570	2,256	1,316	1,001
Per share: basic	(0.01)	(0.01)	(0.02)	0.01	0.06	0.04	0.02	0.02
Funds from (used in) operations	(552)	1,584	1,382	3,420	6,368	5,371	3,166	3,333
Per share: basic	(0.01)	0.03	0.02	0.06	0.11	0.09	0.05	0.06
Reconciliation:								
Funds from operations	(552)	1,584	1,382	3,420	6,368	5,371	3,166	3,333
Changes in non-cash working capital related to operating activities	(14,133)	(22)	6,881	(550)	50	(2,833)	3,923	482
Cash provided by (used in) operating activities	(14,685)	1,562	8,263	2,870	6,418	2,538	7,089	3,815
Operational								
Average daily sales volume (boe/day)								
Continuing operations	1,802	2,214	2,320	2,191	2,029	2,048	2,152	2,107
Discontinued operations	64	76	200	870	1,254	1,354	1,390	1,300
	1,866	2,290	2,520	3,061	3,283	3,402	3,542	3,407
Continuing operations:								
Average realized selling prices								
Natural gas (\$/Mcf)	7.40	8.04	8.65	7.83	8.32	6.96	5.63	6.37
Barrel of oil equivalent (\$/boe)	44.37	48.26	51.92	47.01	49.90	41.74	33.78	38.23
Average operating netback (\$/boe)	20.02	22.42	26.20	22.46	26.19	23.85	16.89	19.97
Cdn\$/US\$ exchange rate								
Average for period	0.859	0.803	0.820	0.960	0.990	0.998	1.019	0.957
End of period	0.860	0.794	0.817	0.944	0.981	0.974	1.009	0.995

(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.

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 six months ended June 30, 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 and six months ended June 30, 2009.

BUSINESS RISKS AND UNCERTAINTIES

The reader is referred to information regarding 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). Since that filing, the Company has:

- Obtained creditor protection through Chapter 11 proceedings in the United States and CCAA proceedings in Canada as it continues to evaluate strategic alternatives, including a sale of Mahalo or its assets.
- Agreed to a voluntary delisting of its common shares from the TSX as a result of its inability to meet continuing listing requirements.

Management believes that these events result in increased risk and uncertainty and should be considered as additional "Risk Factors" in an assessment of the Company.

CRITICAL ACCOUNTING ESTIMATES

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.

The preparation of financial statements in accordance with Canadian GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the dates of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting periods. Estimates are reviewed periodically and as adjustments become necessary, they are reported in earnings in the periods in which they become known.

The current Insolvency Proceedings materially affect the degree of uncertainty associated with the measurement of many amounts in the financial statements. More specifically, it could impact the recoverability tests and the fair value assumptions used in the impairment test of property, plant and equipment.

COMPARATIVE AMOUNTS

In 2008, the Company began the process of disposing of its Canadian assets and operations; the process has since been completed. 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 and six months ended June 30, 2009.

DISCLOSURE AND INTERNAL CONTROLS

There have been no changes in disclosure controls and procedures and internal control over financial reporting during the six months ended June 30, 2009 that have materially affected, or are reasonable likely to materially affect, the Company's internal control over financial reporting.

OUTLOOK

On May 21, 2009, Mahalo Energy (USA) Inc. filed a voluntary petition for relief under Chapter 11 of the United States Bankruptcy Code. On May 22, 2009, Mahalo Energy Ltd. obtained an order from the Court of Queen's Bench of Alberta for protection under the Companies' Creditors Arrangement Act (Canada) ("CCAA").

The Court Orders providing creditor protection permit Mahalo to remain in possession and control of its property, carry on its business, retain employees and other service providers and continue with the process of evaluating strategic alternatives available to the Company, including a sale of Mahalo or its assets. Although the Company did enter into a financing commitment for approximately \$2 million of debtor in possession ("DIP") financing with its lender, Ableco Finance, LLC, , such financing was not approved by the US Court and therefore was not realized.

Mahalo has engaged Alvarez & Marsal North America, LLC, a United States firm, to act as advisors to the Company to assist with the business and financial restructuring, a process which may involve the sale of all or substantially all of the Company's assets.

The outcome of these matters is dependent on factors outside of the Company's control, cannot be predicted at this time and 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 inability to meet minimum listing requirements on an alternate exchange, (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, (xiii) fluctuations in currency exchange rates and interest

rates, (xiii) the possible unavailability of financing, and (xiv) the outcome of proceedings under the Chapter 11 filing and the Companies' Creditors Arrangement Act (Canada) filing.

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.