



formerly



**Consolidated Financial Statements  
(unaudited)**

**For the Three Months ended  
May 31, 2009**

(Expressed in Canadian dollars)

**HEMISPHERE ENERGY CORPORATION**  
(formerly Northern Hemisphere Development Corp.)  
**Consolidated Balance Sheets**  
**As at May 31, 2009**  
(Expressed in Canadian dollars)  
(Unaudited)

	May 31, 2009	February 28, 2009
<b>Assets</b>		
<b>Current</b>		
Cash and cash equivalents	\$ 260,424	\$ 310,394
Accounts receivable	26,212	44,093
Prepaid expenses and deposits	746	7,983
	287,382	362,470
<b>Reclamation Deposit</b>	56,441	56,441
<b>Property and Equipment</b> (note 3)	29,345	30,751
<b>Petroleum and Natural Gas Interests</b> (notes 4 and 5)	671,119	707,551
	\$ 1,044,286	\$ 1,157,214
<b>Liabilities</b>		
<b>Current</b>		
Accounts payable and accrued liabilities	\$ 210,679	\$ 196,643
	210,679	196,643
<b>Asset Retirement Obligation</b> (note 5)	6,320	6,077
	216,998	202,720
<b>Shareholders' Equity</b>		
<b>Capital Stock</b> (note 7)	21,199,903	21,199,903
<b>Contributed Surplus</b> (note 7(e))	4,543,065	4,543,065
<b>Deficit</b>	(24,915,680)	(24,788,474)
	827,288	954,494
	\$ 1,044,286	\$ 1,157,214
<b>Nature and Continuance of Operations</b> (note 1)		
<b>Contingency</b> (note 12)		

**On Behalf of the Board**

Signed:

"C.N. O'Sullivan" Director

"H.K. Maddison" Director

See accompanying notes to the consolidated financial statements

**HEMISPHERE ENERGY CORPORATION**  
(formerly Northern Hemisphere Development Corp.)  
**Consolidated Statements of Operations and Deficit**  
**For the Three Months ended May 31, 2009**  
(Expressed in Canadian dollars)  
(Unaudited)

	Three Months Ended May 31,	
	2009	2008
<b>Oil and Gas Operations</b>		
Gross revenue, Natural gas - British Columbia	\$ 32,496	\$ 111,679
Cost of production	(20,964)	(49,037)
Net revenue, Natural gas - British Columbia	11,532	62,642
Oil and gas revenue, net of cost - Oklahoma	300	2,156
Total Revenues - net	11,832	64,798
<b>Administrative Expenses</b>		
Depletion, depreciation and accretion	38,081	52,135
Management fees (note 8(a))	25,000	13,961
Wages and benefits	22,843	27,005
Professional fees	17,615	14,438
Transfer agent and filing fees	11,573	1,402
Bank charges and interest	5,943	279
Shareholder communication	4,903	1,821
Rent (note 8(b))	4,255	3,898
Office expenses	4,199	6,124
Foreign exchange loss (gain)	2,993	712
Telephone	1,711	1,488
Travel and accommodation	876	5,142
	139,992	128,407
<b>Loss Before Other Items</b>	<b>(128,160)</b>	<b>(63,609)</b>
<b>Other items:</b>		
Interest income	954	971
<b>Net Loss and Comprehensive Loss for the period</b>	<b>(127,206)</b>	<b>(62,638)</b>
<b>Deficit, beginning of period</b>	<b>(24,788,474)</b>	<b>(23,150,731)</b>
<b>Deficit, end of period</b>	<b>\$ (24,915,680)</b>	<b>\$ (23,213,369)</b>
<b>Loss per share</b>	<b>\$ (0.01)</b>	<b>\$ (0.01)</b>
<b>Weighted Average Number of Common Shares</b>		
<b>Outstanding</b>	<b>9,955,942</b>	<b>9,185,944</b>

See accompanying notes to the consolidated financial statements

**HEMISPHERE ENERGY CORPORATION**  
(formerly Northern Hemisphere Development Corp.)  
**Consolidated Statements of Cash Flow**  
**For the Three Months ended May 31, 2009**  
(Expressed in Canadian dollars)  
(Unaudited)

	Three Months Ended May 31,	
	2009	2008
Net loss	\$ (127,206)	\$ (62,638)
Items not involving cash		
Depletion, depreciation and accretion	38,081	52,135
	<b>(89,125)</b>	<b>(10,503)</b>
<b>Changes in Non-Cash Working Capital</b>		
Accounts receivable	17,882	50,005
Prepaid expenses	7,238	2,237
Accounts payable and accrued liabilities	14,036	(22,952)
	<b>39,155</b>	<b>29,290</b>
<b>Cash Used in Operating Activities</b>	<b>(49,970)</b>	<b>18,787</b>
<b>Investing Activities</b>		
Expenditures on petroleum and natural gas interests	0	(20,345)
<b>Cash Used in Investing Activities</b>	<b>-</b>	<b>(20,345)</b>
<b>Inflow (Outflow) of Cash</b>	<b>(49,970)</b>	<b>(1,558)</b>
<b>Cash, Beginning of Period</b>	<b>310,394</b>	<b>138,024</b>
<b>Cash, End of Period</b>	<b>\$ 260,424</b>	<b>\$ 136,466</b>
<b>Cash and Cash Equivalent Consists of the following:</b>		
Cash	\$ 80,424	\$ 86,466
Term deposits	180,000	50,000
<b>Cash and Cash Equivalent, End of Year</b>	<b>260,424</b>	<b>136,466</b>

See accompanying notes to the consolidated financial statements

**HEMISPHERE ENERGY CORPORATION**  
**(formerly Northern Hemisphere Development Corp.)**  
**Notes to Consolidated Financial Statements**  
**For the Three Months ended May 31, 2009**  
**(Expressed in Canadian dollars)**  
**(Unaudited)**

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**1. NATURE OF OPERATIONS AND GOING CONCERN**

Hemisphere Energy Corporation, formerly Northern Hemisphere Development Corp., (the "Company") was incorporated under the laws of British Columbia. The Company's principal business is the acquisition, exploration, development and production of petroleum and natural gas interests.

These consolidated financial statements have been prepared on the basis of accounting principles applicable to a going concern, which assumes that the Company will be able to continue in operation for the foreseeable future and will be able to realize its assets and discharge its liabilities and commitments in the normal course of business.

The Company has incurred an operating loss for the three months ended May 31, 2009 of \$127,206 (May 31, 2008 - \$62,638), has working capital of \$76,702 (February 28, 2009 - \$165,827), an accumulated deficit of \$24,915,680 (February 28, 2009 - \$24,788,474), limited resources, and no assurances that sufficient funding will be available to conduct further exploration and development of its resource interests. The Company will require additional equity financing to meet its administrative overhead costs, and to continue exploration and development work on its resource properties in 2010.

The application of the going concern concept is dependent upon the Company's ability to generate future profitable operations and receive continued financial support from its shareholders. Management is actively seeking to raise the necessary capital to meet its funding requirements and has undertaken available cost cutting measures. There can be no assurance that management's plan will be successful given the current difficult conditions.

These consolidated financial statements do not include any adjustments relating to the recoverability of assets and classification of assets and liabilities that might be necessary should the Company be unable to continue as a going concern.

**2. SIGNIFICANT ACCOUNTING POLICIES**

The consolidated financial statements of the Company have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP"). The Company's functional and reporting currency is the Canadian dollar.

(a) Principles of Consolidation

These consolidated financial statements include the accounts of the Company and its integrated, wholly-owned subsidiary, Hemisphere Development Corporation, a US corporation. All significant intercompany balances and transactions have been eliminated on consolidation.

(b) Cash and Cash Equivalent

Cash and cash equivalent include cash and short-term, highly liquid investments that are readily convertible into known amounts of cash. Included in cash equivalent at May 31, 2009 is a term deposit earning interest of 2.15% and maturing on December 11, 2009.

**HEMISPHERE ENERGY CORPORATION**  
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**Notes to Consolidated Financial Statements**  
**For the Three Months ended May 31, 2009**  
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**(Unaudited)**

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**2. SIGNIFICANT ACCOUNTING POLICIES (Continued)**

(c) Petroleum and Natural Gas Interests

*Change in accounting policy*

During the 2009 year-end, the Company changed its method of accounting for oil and gas exploration and development activities from the full cost to the successful efforts method. The change in accounting policy will allow the Company to allocate expenditures incurred on oil and gas exploration on a well-by-well basis. This change will result in improved matching of costs and management estimates associated with impairment of oil and gas interests. The retrospective application of the successful efforts method did not result in any significant change in operating results or financial position for prior periods.

Under the successful efforts method, costs are initially capitalized as unproven property costs. Once proved reserves are discovered, the costs are reclassified to proved property costs. Exploration drilling costs are capitalized as suspended exploration well costs pending evaluation as to whether sufficient quantities of reserves have been found to justify commercial production. If commercial quantities of reserves are not found, exploration drilling costs are expensed. All exploratory wells are evaluated for commercial viability on a regular basis following completion of drilling. Exploration drilling costs remain capitalized if a determination is made that a sufficient quantity of reserves have been found and sufficient progress is being made to assess the reserves and the economic and operating viability. All other exploration costs, including geological and geophysical and annual lease rentals, are expensed to operations as incurred. All development costs are capitalized as proved property costs. Costs that directly relate to acquisition, exploration and development activities are capitalized.

Costs associated with unproven reserves are reviewed by management to determine whether they have become impaired. If impairment occurs, the carrying value of the related interest will be reduced to reflect the estimated net realizable value. The estimate will be based on the then current conditions. It is possible that changes could occur that would adversely affect management's estimates resulting in further write-downs of the carrying value of the interest. Any revenues earned on unproven properties are booked as a recovery of costs on that property.

(d) Depletion

Depletion of petroleum and natural gas interests and depreciation of production equipment are calculated using the unit-of-production method based upon estimated proved reserves, before royalties, as determined by independent engineers. In determining its depletion base, the Company includes estimated future costs to be incurred in developing proved reserves and excludes the cost of undeveloped properties until it is determined that proved reserves are attributable to the property or impairment has occurred.

**HEMISPHERE ENERGY CORPORATION**  
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**Notes to Consolidated Financial Statements**  
**For the Three Months ended May 31, 2009**  
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**(Unaudited)**

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**2. SIGNIFICANT ACCOUNTING POLICIES (Continued)**

(e) Impairment of Long-Lived Assets

The costs associated with proved reserves are assessed to be recoverable if the sum of the undiscounted cash flows expected from the production of proved reserves less unproved properties, net of any impairment, exceed the carrying value of the oil and gas assets. If the carrying value of the oil and gas assets is not assessed to be recoverable, an impairment loss is recognized to the extent that the carrying value exceeds the sum of the discounted cash flows expected from proved and probable reserves less unproved properties, net of any impairment. Cash flows are calculated based on estimated future product prices and discounted using the credit adjusted risk-free interest rate. Oil and natural gas assets are evaluated on an annual basis to determine whether the costs are recoverable and do not exceed the fair value of the properties.

(f) Joint Interest Operations

The Company's petroleum and natural gas exploration and production activities are conducted jointly with others and, accordingly, the financial statements reflect only the Company's proportionate interest in such activities.

(g) Equipment

Equipment is recorded at cost. Once the assets are in use, amortization is provided over their estimated useful lives on a declining-balance basis at the following annual rates:

Computers	-	30%
Equipment	-	20%
Furniture	-	20%

In the year of acquisition, amortization is recorded using the half-year rule.

(h) Asset Retirement Obligations ("ARO")

The Company's operations are subject to various laws and regulations for federal and regional jurisdictions governing the protection of the environment. These laws are continually changing. The Company expects to make, in the future, expenditures that comply with such laws and regulations but cannot predict the full amount or timing of such future expenditures. Estimated future reclamation costs are based principally on legal and regulatory requirements. Reclamation and remediation obligations arise from the acquisition, development, construction, and normal operation of oil and gas properties, plant and equipment.

The Company recognizes an estimate of the liability associated with an ARO in the financial statements at the time the liability is incurred. The estimated fair value of the ARO is recorded as a long-term liability, with a corresponding increase in the carrying amount of the related asset. The liability amount is increased each reporting period due to the passage of time and the amount of accretion is charged to earnings in the period. The ARO can also increase or decrease due to changes in the estimates of timing of cash flows or changes in the original estimated undiscounted cost. Actual costs incurred upon settlement of the ARO are charged against the ARO to the extent of the liability recorded.

**HEMISPHERE ENERGY CORPORATION**  
**(formerly Northern Hemisphere Development Corp.)**  
**Notes to Consolidated Financial Statements**  
**For the Three Months ended May 31, 2009**  
**(Expressed in Canadian dollars)**  
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**2. SIGNIFICANT ACCOUNTING POLICIES (Continued)**

(i) Revenue Recognition

Revenue from the sale of petroleum and natural gas is recorded when title passes to an external party and is based on volumes delivered to customers at contractual delivery points and rates, and collectability is reasonably assured. The costs associated with delivery, including operating and maintenance costs, transportation and production-based royalty expenses, are recognized during the same period in which the related revenue is earned and recorded.

Interest income is recorded on an accrual basis at the stated rate of interest of term deposits over the term to maturity.

(j) Foreign Currency Translation

Amounts recorded in foreign currency are translated into Canadian dollars as follows:

- (i) Monetary assets and liabilities, at the rate of exchange in effect as at the balance sheet date;
- (ii) Non-monetary assets and liabilities, at the exchange rates prevailing at the time of the acquisition of the assets or assumption of the liabilities; and
- (iii) Revenues and expenses, at the rate of exchange prevailing at the time of the transaction.

Gains and losses arising from the translation of foreign currency are included in net loss for the year.

(k) Income Taxes

The Company uses the asset and liability method for accounting for income taxes. Under this method of tax allocation, future income tax assets and liabilities are recognized for future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis, and losses carried forward. Future income tax assets and liabilities are measured using substantively enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on future income tax assets and liabilities of a change in tax rates is included in operations in the period in which the change is enacted or substantially assured. The amount of future income tax assets recognized is limited to the amount of the benefit that is more likely than not to be realized.

(l) Flow-Through Shares

From time to time, the Company finances a portion of its exploration program with the issuance of flow-through common shares. The tax attributes of qualifying expenditures are renounced to the subscribers of flow-through shares. The tax impact to the Company of the renunciation is recorded on the date that the renunciation is filed with the taxation authorities, through a decrease in the capital stock and the recognition of a future tax liability.

**HEMISPHERE ENERGY CORPORATION**  
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**Notes to Consolidated Financial Statements**  
**For the Three Months ended May 31, 2009**  
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**2. SIGNIFICANT ACCOUNTING POLICIES (Continued)**

(m) Loss Per Share

Basic loss per share is computed using the weighted average number of common shares outstanding during the year. The Company uses the treasury stock method to compute the dilutive effect of options, warrants and similar instruments. Under this method the dilutive effect on loss per share is calculated presuming the exercise of outstanding options, warrants and similar instruments. The treasury stock method assumes that proceeds received from the exercise of stock options and warrants would be used to repurchase common shares at the average market price during the period. However, the calculation of diluted loss per share excludes the effects of various conversions and exercise of options and warrants that would be anti-dilutive.

Shares held in escrow other than where their release is subject to the passage of time, are excluded from the computation of loss per share until the conditions for their release are satisfied.

(n) Use of Estimates

The preparation of consolidated financial statements in conformity with Canadian GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements, and the reported amounts of revenues and expenses during the reporting period. Areas requiring the use of management estimates include collectability of accounts receivable, recoverability of petroleum and natural gas interests, rates of depletion and depreciation, accrued liabilities, determination of asset retirement obligations and environmental obligations, assumptions used in the calculation of stock-based compensation, allocation of proceeds for units between common shares and warrants, and the determination of the valuation allowance for future tax assets. Management believes the estimates are reasonable; however, actual results could differ from those estimates and could impact future results of operations and cash flows.

(o) Stock-Based Compensation

The Company accounts for stock-based compensation expense using a fair value based method with respect to all stock-based payments to directors, employees and non-employees. For the directors and employees, the fair value of the options is measured at the date of grant. For non-employees the fair value of the options is measured on the earlier of the date at which the counterparty performance is completed or the date the performance commitment is reached or the date at which equity instruments are granted if they are fully vested and non-forfeitable. The fair value of the options is accrued and charged either to operations or petroleum and natural gas interests, with the offset to contributed surplus.

(p) Capital Stock

The Company uses the residual value method with respect to the measurement of common shares and share purchase warrants issued as private placement units. The proceeds from the issue of units is allocated between common shares and share purchase warrants on a residual value basis, wherein the fair value of the common shares is based on the market close on the date the units are issued; and the balance, if any, is allocated to the attached warrants.

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**Notes to Consolidated Financial Statements**  
**For the Three Months ended May 31, 2009**  
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**(Unaudited)**

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**2. SIGNIFICANT ACCOUNTING POLICIES (Continued)**

(p) Capital Stock (continued)

Share issue costs are netted against share proceeds.

(q) Financial Instruments

All financial instruments are classified as one of the following: held-for-trading, held-to-maturity, loans and receivables, available-for-sale or other financial liabilities. Financial assets and liabilities held-for-trading are measured at fair value with gains and losses recognized in net income. Financial assets held-to-maturity, loans and receivables, and other financial liabilities are measured at amortized cost using the effective interest method. Available-for-sale instruments are measured at fair value with unrealized gains and losses recognized in other comprehensive income (loss) and reported in shareholders' equity. Any financial instrument may be designated as held-for-trading upon initial recognition.

Transaction costs that are directly attributable to the acquisition or issue of financial instruments that are classified as other than held-for-trading, which are expensed as incurred, are included in the initial carrying value of such instruments.

(r) Comprehensive Income

Comprehensive income or loss is defined as the change in the net assets of the Company for a period, other than changes attributable to transactions with shareholders. It is made up of net income and other comprehensive income. Other comprehensive income or loss consists of gains or losses affecting shareholders' equity that under Canadian GAAP are excluded from net income (loss).

The Company has no items of other comprehensive income in any period presented. Therefore, net loss as presented in the Company's statements of operations equals comprehensive loss.

(s) Changes in Accounting Policies

Effective March 1, 2008, the Company adopted the following standards of the Canadian Institute of Chartered Accountants ("CICA"):

(i) Capital Disclosures

Section 1535 establishes standards for disclosing information about an entity's capital and how it is managed. The entity's disclosure should include information about its objectives, policies and procedures for managing capital and disclose whether it has complied with any capital requirements to which it is subject and the consequences of non-compliance.

As a result of the adoption of these standards, additional disclosures have been included in note 10.

**HEMISPHERE ENERGY CORPORATION**  
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**Notes to Consolidated Financial Statements**  
**For the Three Months ended May 31, 2009**  
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**(Unaudited)**

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**2. SIGNIFICANT ACCOUNTING POLICIES (Continued)**

(s) Changes in Accounting Policies (Continued)

(ii) Financial Instruments

Section 3862, "Financial Instruments – Disclosures", and Section 3863, "Financial Instruments – Presentation", replace Section 3861, "Financial Instruments – Disclosures and Presentation", revising its disclosure requirements, and carrying forward its presentation requirements. These new sections place increased emphasis on disclosures about the nature and extent of risks arising from financial instruments and how the entity manages those risks.

Section 3862 specifies disclosures that enable users to evaluate: (i) the significance of financial instruments for the entity's financial position and performance; and (ii) the nature and extent of risks arising from financial instruments to which the entity is exposed and how the entity manages those risks.

As a result of the adoption of these standards, additional disclosures on the risks of certain financial instruments have been included in note 9.

(t) Future Accounting Changes

(i) International Financial Reporting Standards ("IFRS")

In 2006, the Canadian Accounting Standards Board ("AcSB") published a new strategic plan that will significantly affect financial reporting requirements for Canadian companies. The AcSB strategic plan outlines the convergence of Canadian GAAP with IFRS over an expected five year transitional period. In February 2008, the AcSB announced that January 1, 2011 is the changeover date for publicly-listed companies to use IFRS, replacing Canada's own generally accepted accounting principles. The IFRS standards will be effective for the Company for interim and fiscal period reporting commencing March 1, 2011. The effective date will require the restatement for comparative purposes of amounts reported by the Company for the interim periods and for the year ended February 28, 2011. While the Company has begun assessing the adoption of IFRS for 2011, the financial reporting impact of the transition to IFRS cannot be reasonably estimated at this time.

(ii) Business Combination

In January 2009, the CICA issued Section 1582, "Business Combinations", Section 1601, "Consolidations", and Section 1602, "Non-Controlling Interests". These sections replace the former Section 1581, "Business Combinations", and Section 1600, "Consolidated Financial Statements", and establish a new section for a non-controlling interest in a subsidiary.

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**Notes to Consolidated Financial Statements**  
**For the Three Months ended May 31, 2009**  
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**2. SIGNIFICANT ACCOUNTING POLICIES (Continued)**

(t) Future Accounting Changes (Continued)

(ii) Business Combination (Continued)

Sections 1582 and 1602 will require net assets, non-controlling interests and goodwill acquired in a business combination to be recorded at fair value and non-controlling interests will be reported as a component of equity. In addition, the definition of a business is expanded and is described as an integrated set of activities and assets that are capable of being managed to provide a return to investors or economic benefits to owners. Acquisition costs are not part of the consideration and are to be expensed when incurred. Section 1601 establishes standards for the preparation of consolidated financial statements.

These new sections apply to interim and annual consolidated financial statements relating to fiscal years beginning on March 1, 2011. Earlier adoption of these sections is permitted as of the beginning of a fiscal year. All three sections must be adopted concurrently. The Company is currently evaluating the impact of the adoption of these sections.

(iii) Credit Risk and the Fair Value of Financial Assets and Financial Liabilities

In January 2009, the Emerging Issues Committee ("EIC") of the CICA issued EIC-173, "Credit Risk and the Fair Value of Financial Assets and Financial Liabilities", which clarifies that 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. EIC-173 is to be applied retrospectively without restatement of prior periods in interim and annual financial statements for periods ending on or after the date of issuance of EIC-173. The Company will adopt this recommendation in its fair value determinations commencing March 1, 2009 and is currently assessing the impact of this change on its consolidated financial statements.

(iv) Goodwill

In February 2008, the CICA issued Section 3064, "Goodwill and Intangible Assets", replacing Section 3062, "Goodwill and Other Intangible Assets", and Section 3450, "Research and Development Costs". This section establishes standards for the recognition, measurement, presentation and disclosure of goodwill subsequent to its initial recognition and of intangible assets by profit-oriented enterprises. Standards concerning goodwill are unchanged from the standards included in the previous Section 3062. This new section is effective for the Company on March 1, 2009. The Company is in the process of assessing the impact of this new section on its consolidated financial statements.

(u) Comparative Figures

Certain of the comparative figures have been reclassified to conform to the current year's presentation.

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(formerly Northern Hemisphere Development Corp.)  
Notes to Consolidated Financial Statements  
For the Three Months ended May 31, 2009  
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**3. EQUIPMENT**

		<b>May 31, 2009</b>		
	Cost	Accumulated Amortization	Net	
Computers	\$ 53,312	\$ 28,605	\$ 24,707	
Equipment	8,560	6,283	2,277	
Furniture	4,526	2,166	2,360	
	<u>\$ 66,398</u>	<u>\$ 37,054</u>	<u>\$ 29,345</u>	

  

		<b>February 28, 2009</b>		
	Cost	Accumulated Amortization	Net	
Computers	\$ 53,312	\$ 27,443	\$ 25,869	
Equipment	8,560	6,162	2,398	
Furniture	4,526	2,043	2,483	
	<u>\$ 66,399</u>	<u>\$ 35,648</u>	<u>\$ 30,751</u>	

**4. PETROLEUM AND NATURAL GAS INTERESTS**

		<b>May 31, 2009</b>		
	Cost	Accumulated Depletion and Depreciation	Total	
Petroleum and natural gas properties	\$ 1,315,050	\$ 643,931	\$ 671,118	

  

		<b>February 28, 2009</b>		
	Cost	Accumulated Depletion and Depreciation (note 2(u))	Total	
Petroleum and natural gas properties	\$ 1,315,050	\$ 607,498	\$ 707,552	

During the three months ended May 31, 2009, the Company capitalized general and administrative costs of \$nil (May 31, 2008 - \$20,035) attributable to acquisition, exploration and development activities. The Company recorded depletion and depreciation of \$36,433 (May 31, 2008 - \$49,928). As at May 31, 2009, costs of \$362,552 (May 31, 2008 - \$1,315,138) related to unproved properties were included in petroleum and natural gas interests and were excluded from the costs subject to depletion and depreciation.

**HEMISPHERE ENERGY CORPORATION**  
**(formerly Northern Hemisphere Development Corp.)**  
**Notes to Consolidated Financial Statements**  
**For the Three Months ended May 31, 2009**  
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**(Unaudited)**

**4. PETROLEUM AND NATURAL GAS INTERESTS (Continued)**

In the fiscal year ended February 28, 2009, the Company performed a ceiling test on its petroleum and natural gas interests and an impairment charge of \$99,759 was recorded. The impairment test was calculated by the Company's independent engineering consultant using future prices for the years 2009 to 2013 as follows:

	2009	2010	2011	2012	2013
Natural Gas \$/Mcf	\$ 5.12	\$ 6.43	\$ 6.96	\$ 7.29	\$ 7.50
NGL's \$/bbl	\$41.19	\$43.41	\$46.05	\$53.94	\$57.30

Subsequent to 2013 prices are expected to increase by approximately 2% per year.

**5. ASSET RETIREMENT OBLIGATION**

The ARO was based on the Company's net ownership interest in all wells and facilities, estimated costs to reclaim and abandon the wells and facilities and the estimated timing of the costs to be incurred in future periods. These payments are expected to be made over the next 7 to 12 years. The estimated total undiscounted amount to settle the AROs is \$16,000. This amount has been discounted using a credit-adjusted interest rate of 10% and an inflation rate of 2.0%. The Company has \$56,441 in various reclamation bonds for its properties held by the Ministry of Energy and Mines.

	May 31, 2009	February 28, 2009
Asset retirement obligation, beginning of year	\$ 6,077	\$ 16,970
Decrease in estimated future obligations	-	(11,863)
Obligations incurred	-	-
Accretion expense	243	970
Asset retirement obligation, end of year	\$ 6,320	\$ 6,077

**6. SEGMENTED INFORMATION**

The Company's one reportable operating segment is the exploration and development of petroleum and natural gas properties. Geographical information is as follows:

	May 31, 2009	February 28, 2009
Assets		
Canada	\$ 1,026,091	\$ 1,136,251
United States	18,195	20,963
	\$ 1,044,286	\$ 1,157,214
Revenues		
Canada	\$ 32,496	\$ 341,064
United States	300	13,304
	\$ 32,796	\$ 354,368

**HEMISPHERE ENERGY CORPORATION**  
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**Notes to Consolidated Financial Statements**  
**For the Three Months ended May 31, 2009**  
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**7. CAPITAL STOCK**

- (a) Authorized  
 Unlimited number of common shares without par value
- (b) Issued and Outstanding

	Number of Shares	Amount	Amount
<b>Balance, February 29, 2008</b>	<b>9,185,944</b>	<b>\$20,947,796</b>	<b>\$4,403,221</b>
Shares issued during the period:			
Non-flow-through share issuance	340,000	170,000	-
Flow -through share issuance	430,000	215,000	-
Stock based compensation	-	-	84,344
Allocation of value of warrants to contributed surplus	-	(55,500)	55,500
Share issuance costs	-	(11,410)	-
Income tax effect of flow-through share renouncement	-	(65,984)	-
<b>Balance, February 28, 2009</b>	<b>9,955,944</b>	<b>\$21,199,903</b>	<b>\$4,543,065</b>
Shares issued during the period:			
Adjustment for fractional shares on the 5 to 1 consolidation	(2)	-	-
<b>Balance, May 31, 2009</b>	<b>9,955,942</b>	<b>\$21,199,903</b>	<b>\$4,543,065</b>

Effective April 27, 2009 the Company consolidated its issued capital stock on a 5 old for 1 new basis. The authorized capital stock remained unchanged. The share consolidation was reflected retroactively, which resulted in the Company's issued capital stock decreasing from 49,779,718 common shares to 9,955,944 common shares as at February 28, 2009. Further, the Companies transfer agent gave directive on April 27, 2009 for reduction by 2 shares for fractional adjustment on the share consolidation.

With share consolidation reflected retroactively to February 28, 2009, references to capital stock, options and warrants in these consolidated financial statements and all prior loss per share information were also retroactively restated to give effect to the share consolidation unless otherwise stated.

There were no share issuances during the three months ended May 31, 2009.

**HEMISPHERE ENERGY CORPORATION**  
**(formerly Northern Hemisphere Development Corp.)**  
**Notes to Consolidated Financial Statements**  
**For the Three Months ended May 31, 2009**  
**(Expressed in Canadian dollars)**  
**(Unaudited)**

**7. CAPITAL STOCK (Continued)**

(c) Stock Options

The Company has a stock option plan in place under which it is authorized to grant incentive stock options to officers, directors, employees and to persons in consideration for services. Stock options must be non-transferable and the aggregate number of shares that may be reserved for issuance may not exceed 10% of the issued shares at the time of grant and to each individual may not exceed 5% of the issued shares. The exercise price of stock options is determined by the board of directors of the Company at the time of grant and may not be less than the average closing price of the Company's shares on the ten trading days immediately preceding the day on which the option is granted and publicly announced, and may not be less than \$0.10 per share. Options have a maximum term of ten years and terminate not later than 30 days following the termination of the optionee's employment, except in the case of retirement, death or disability, in which case they terminate one year after the event. Vesting of the options is determined at the time of granting of the options at the discretion of the board of directors. Once approved and vested, options are exercisable at any time.

Details of the status of the Company's stock options for the three months ended May 31, 2009 are as follows:

Exercise Price	Expiry Date	Changes in the Period				Balance Outstanding & Exercisable May 31, 2009
		Balance Outstanding & Exercisable Feb 28, 2009	Granted	Exercised	Expired/ Cancelled	
\$1.50	30-Mar-09	135,000	-	-	(135,000)	0
\$1.75	17-Apr-09	23,515	-	-	(23,515)	0
\$1.50	13-Jul-10	40,000	-	-	-	40,000
\$0.75	7-Dec-10	40,000	-	-	-	40,000
\$0.75	9-Sep-11	568,000	-	-	(30,000)	538,000
		806,515	0	-	(188,515)	618,000
Weighted average exercise price		\$ 0.95	\$ -	\$ -	\$ 1.41	\$ 0.80

For the three months ended May 31, 2009, the Company has recognized \$nil (twelve months ended February 28, 2009 - \$84,344) in stock-based compensation.

The fair value was determined using the Black-Scholes option pricing model with the following weighted average assumptions:

	May 31, 2009	February 28, 2009
Expected life (years)	n/a	3.00
Interest rate	n/a	2.76%
Volatility	n/a	78.93%
Dividend yield	n/a	0.00%

**HEMISPHERE ENERGY CORPORATION**  
**(formerly Northern Hemisphere Development Corp.)**  
**Notes to Consolidated Financial Statements**  
**For the Three Months ended May 31, 2009**  
**(Expressed in Canadian dollars)**  
**(Unaudited)**

**7. CAPITAL STOCK (Continued)**

(c) Stock Options (continued)

Option pricing models require the input of highly subjective assumptions including the expected price volatility. Changes in the subjective input assumptions can materially affect the fair value estimate.

(d) Share Purchase Warrants

Details of the status of the Company's share purchase warrants for the three months ended May 31, 2009, are as follows:

Exercise Price	Expiry Date	Balance	Issued	Exercised	Expired/ Canceled	Balance
		Outstanding & Exercisable Feb 28, 2009				Outstanding & Exercisable May 31, 2009
\$0.75	12-Dec-09	180,000				180,000
\$0.75	6-Jan-10	35,000				35,000
\$0.75	5-Sep-10	170,000				170,000
			-	-	-	385,000
Weighted average		\$ 0.75				\$ 0.75

**8. RELATED PARTY TRANSACTIONS**

These transactions are in the ordinary course of business and are measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties. The following represents transactions entered into for the three months ended May 31, 2009:

- (a) Management fees of \$25,000 (2008 - \$13,961) were charged by directors and officers of the Company; and
- (b) Included in rental expense is rental income of \$4,500 (2008 - \$4,500) received from a company with common directors for shared office facilities.

**9. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT**

Cash and cash equivalent, and reclamation deposit are designated as held-for-trading; accounts receivable is designated as loans and receivables; and accounts payable and accrued liabilities is designated as other financial liabilities.

(a) Fair Value

The carrying values of cash and cash equivalent, accounts receivable, reclamation deposit, and accounts payable and accrued liabilities approximate their fair values due to the short-term maturity of these financial instruments.

**HEMISPHERE ENERGY CORPORATION**  
**(formerly Northern Hemisphere Development Corp.)**  
**Notes to Consolidated Financial Statements**  
**For the Three Months ended May 31, 2009**  
**(Expressed in Canadian dollars)**  
**(Unaudited)**

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(b) Credit Risk

Credit risk is the risk of financial loss to the Company if a counterparty to a financial instrument fails to meet its contractual obligations. Credit risk for the Company is primarily associated with its cash and cash equivalent and accounts receivable.

Receivables from petroleum and natural gas marketers are normally collected on the 25th day of the month following production. The Company's policy to mitigate credit risk associated with receivables is to establish marketing relationships, in conjunction with its joint interest partner, with purchasers that sell to A+ credit worthy customers. The Company historically has not experienced any collection issues with respect to its receivables.

Cash and cash equivalent consists of cash and term deposit. The Company manages the credit exposure related to the term deposit by selecting low risk investments with major financial institutions with strong investment grade ratings by a primary ratings agency.

Concentration of credit risk exists with the Company's cash and cash equivalent and accounts receivable. The Company's concentration of credit risk and maximum exposure thereto is as follows relating to funds held in Canada:

	May 31, 2009	February 28, 2009
Bank accounts	\$ 80,424	\$ 130,394
Term deposits	180,000	180,000
Accounts receivable	26,212	44,093
	\$ 286,636	\$ 354,487

(c) Liquidity Risk

Liquidity risk is the risk that the Company will encounter difficulty in meeting obligations associated with financial liabilities that are settled by delivering cash or another financial asset. To manage its working capital and its liquidity risk the Company prepares annual budgets, which are updated as necessary depending on factors including current and forecast product prices, successful capital deployment and general industry conditions. The Company monitors its working capital with review of its working capital position reports prepared on a weekly basis.

The Company's accounts payable and accrued liabilities come due within the current operating cycle of less than one year.

**HEMISPHERE ENERGY CORPORATION**  
**(formerly Northern Hemisphere Development Corp.)**  
**Notes to Consolidated Financial Statements**  
**For the Three Months ended May 31, 2009**  
**(Expressed in Canadian dollars)**  
**(Unaudited)**

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**9. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (Continued)**

(d) Market Risk

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk comprises three types of risk: foreign currency exchange risk, interest rate risk, and other price risk, which includes commodity price risk. The objective of market risk management is to manage and control market risk exposures within acceptable limits, while maximizing returns.

(i) Foreign currency exchange rate risk

Foreign currency exchange rate risk is the risk that the fair value or future cash flows will fluctuate as a result of changes in foreign exchange rates. Although substantially all of the Company's petroleum and natural gas sales are denominated in Canadian dollars, the underlying market prices in Canada for oil and natural gas could be impacted by changes in the exchange rate between the Canadian and United States dollar. This indirect exposure to foreign currency exchange rate risk is minimal and cannot be accurately quantified.

(ii) Interest rate risk

Interest rate risk is the risk that future cash flows will fluctuate as a result of changes in market interest rates. The Company's cash and cash equivalent is held in bank accounts and, due to the short-term nature of these financial instruments, fluctuations in market rates do not have an impact on the fair value as at February 28, 2009.

The Company manages interest rate risk by maintaining an investment policy that focuses on preservation of capital and liquidity.

**10. CAPITAL MANAGEMENT**

The Company's policy is to maintain a strong capital base so as to maintain investor, creditor and market confidence and to sustain the future development of the business. The Company 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 considers its capital to be all components of shareholders' equity. In order to maintain or adjust the capital structure, the Company may from time to time issue shares. The overall objective and policy for managing capital remained unchanged in the three months ended May 31, 2009 from prior reporting periods. Although the Company has been successful at raising funds in the past through equity financing, it is uncertain whether it can continue this financing due to the current economic conditions.

The Board of Directors does not establish a quantitative return on capital criteria for management, but rather relies on the expertise of the Company's management to sustain future development of the business.

The Company's capital is not subject to external restrictions.

**HEMISPHERE ENERGY CORPORATION**  
**(formerly Northern Hemisphere Development Corp.)**  
**Notes to Consolidated Financial Statements**  
**For the Three Months ended May 31, 2009**  
**(Expressed in Canadian dollars)**  
**(Unaudited)**

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**11. CONTINGENCY**

In March 2005, the Company received a notice from the Operator of one of its petroleum and natural gas interests requesting additional funding in the amount of \$160,214. The Company believes this amount is in excess of the amounts authorized for expenditures for payment under the Company's agreement with the Operator. The amount of this contingency has not been accrued in these financial statements as it is the Company's position that the Operator's request is without merit.

**12. SUBSEQUENT EVENTS**

- (a) On May 4, 2009, the Company entered into an agreement to acquire a property in the Sylvan Lake area of central Alberta for a purchase price of \$325,000. The agreement is expected to close on or before July 31, 2009 and is subject to certain conditions including normal due diligence and financing.
- (b) On May 25, 2009, the Company announced, subject to regulatory acceptance, a non-brokered private placement to consist of the sale of up to 4,400,000 units (the "Unit") at a price of \$0.25 per Unit, each Unit to consist of one common share and one common share purchase warrant. Each warrant entitles the holder to purchase one additional common share at a price of \$0.35 for a period of one year from closing. The Company expects to close the first tranche of the financing on or before July 31, 2009.



formerly



## **Management Discussion and Analysis**

**For the Three Months ended May 31, 2009**

**HEMISPHERE ENERGY CORPORATION**  
**(formerly Northern Hemisphere Development Corp.)**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**For the Three Months ended May 31, 2009**

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The following discussion and analysis of the operations, results, and financial position of Hemisphere Energy Corporation ("Hemisphere Energy" or the "Company"), for the three months ended May 31, 2009 should be read in conjunction with the May 31, 2009 Consolidated Financial Statements and the related Notes. These documents are available at [www.sedar.com](http://www.sedar.com). The effective date of this report is July 24, 2009.

Hemisphere Energy is engaged in the exploration, development and production of oil and natural gas. The Company currently has natural gas production from four Triassic Halfway wells in the Trutch area of northeastern British Columbia. The Company is traded on the TSX Venture Exchange under the symbol HME.

### **FORWARD LOOKING STATEMENTS**

This document contains forward-looking statements. Certain information regarding the Company presented in this document, including estimates, future plans, expectations, opinions, forecasts and projections may constitute forward-looking statements under applicable securities law and necessarily involve risk associated with oil & gas exploration and development. Events or circumstances may cause actual results to differ materially from those predicted as a result of numerous known and unknown risks, uncertainties, and other factors, many of which are beyond the control of the Company. The reader is cautioned not to place undue reliance on this forward-looking information. Use of the term boe may be misleading, particularly if used in isolation. Petroleum and natural gas volumes and reserves are converted to a common unit of measure, referred to as a barrel of oil equivalent (boe), using a ratio of 6,000 cubic feet of natural gas to one barrel of oil. This conversion ratio is based on the energy equivalency at the burner tip and does not necessarily represent a value equivalency at the wellhead.

### **OVERVIEW**

#### **Trutch (Northeast British Columbia)**

Hemisphere Energy has a working interest varying from 10.5% - 35% in approximately 13,600 gross acres (~5,500 ha) of the Trutch Property which is located approximately 200 kilometres northwest of Fort St. John in British Columbia. Competitors to the east and south of the Trutch area have been actively exploring and developing the prolific Tommy Lakes Halfway gas field for a number of years. Hemisphere Energy currently has an interest in four Halfway gas wells in Trutch and recognizes multi-zone potential in the area.

The Company is in full production with four natural gas wells and has received natural gas production revenue for its working interest in the Trutch property since February 2007.

#### **Oklahoma**

The Company also has a small minority interest in certain oil and gas producing wells situated in the State of Oklahoma, USA. The interest in these properties was written down to nil in 1990 and the Company will not carryout any further expenditures on these wells.

**HEMISPHERE ENERGY CORPORATION**  
**(formerly Northern Hemisphere Development Corp.)**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**For the Three Months ended May 31, 2009**

**RESULTS OF OPERATIONS**

***Comparison of the Three months ended May 31, 2009 and May 31, 2008***

The Company reported a net loss for the three months ended May 31, 2009 of \$122,995 or \$0.01 per share compared to \$62,638 or \$0.01 per share for the previous year. A synopsis of the revenues and related expenses incurred in the year are discussed below.

**Revenues**

The Company generated total gross revenues of \$32,796 for the three months ended May 31, 2009 (May 2008 - \$113,835). This is a decrease in gross revenues of \$81,039, which is due to the combination of reduced natural gas commodity prices during the year and the natural decline in production rates of the gas wells. The production revenue for the northeastern British Columbia wells was \$32,496 for the period, consisting of \$28,689 in natural gas and \$3,808 in natural gas liquids.

The net revenue for the BC wells, after production, processing, transportation, marketing and royalty costs, was \$11,532 (May 2008 - \$62,642). In addition the Company continues to receive oil and gas revenues from its minority interest wells in Oklahoma, USA which were \$300 net of costs for the three months ended May 31, 2009 (May 2008 - \$2,156). Total net revenues reported for the year were \$11,832 (May 2008 - \$64,798).

Revenues	Three Months ended Feb 28/09				Revenue Years Ended	
	Q1	Units Q1	\$/unit Q1	boe/d Q1	28-Feb-09	29-Feb-08
BC - NGL's (bbl)	\$ 3,808	106.47	\$ 35.76	1.2	\$ 35,548	\$ 53,626
BC - Natural gas (mcf)	28,689	8,550	\$ 3.36	15.8	305,516	371,545
Oklahoma - minority int.	300	n/a	n/a	n/a	13,304	13,790
<b>Production revenue</b>	<b>\$ 32,796</b>	<b>1,532</b>	<b>\$ 21.41</b>	<b>17.0</b>	<b>\$ 354,368</b>	<b>\$ 438,961</b>

**Production Costs**

With four Halfway wells onstream in the Trutch area, Hemisphere Energy's average production rate for the three months ended May 31, 2009 was 17.0 boe per day (2008 - 21.7). Total production costs for the three months ended May 31, 2009 were \$20,964 (May 2008 - \$49,037) or \$13.69 per boe (2008 - \$24.54).

The Company's production costs are categorized in three main areas of royalties, operating costs and transportation costs.

Royalties for the three months ended May 31, 2009 were \$8,268 or \$5.40 per boe, which represents 25.2% of revenues (May 2008 - \$25,904). This results in a decrease in royalties in the amount of \$17,636 or 68%, which is due primarily to reduced commodity prices and production decline as well as royalty rate reductions as delineated below. The Company incurred crown royalties with the Province of British Columbia at a rate of 20% on NGLs and an average of 13.2% on natural gas. Gross over-riding royalties are also included in the royalty expenses at an average of 11.3% of all BC production revenue. The crown royalties for the three initial Trutch wells were reclassified under the marginal royalty incentive on completion of one year's production which occurred in March

**HEMISPHERE ENERGY CORPORATION**  
**(formerly Northern Hemisphere Development Corp.)**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**For the Three Months ended May 31, 2009**

2008. In February 2009 the A-38 well was also reclassified under the marginal royalty incentive, which resulted in additional royalty reductions when compared to the same period in the prior year.

Operating costs were \$11,214 for the quarter, which equates to \$7.32 per boe on a unit of production basis. These include all costs for gathering, processing, dehydration and compression of the gas, as well as marketing fees. Additional costs are also incurred periodically for maintenance and repairs.

Transportation expenses are expenses incurred by the Company to transport production volumes to the market in coordination with the Company's operator. Transportation costs were \$1,482 for the quarter, representing \$0.97 per boe.

Operating netback	Dollars	% of	\$/boe	Dollars	% of	\$/boe
	Q1	Revenue	Q1		Revenue	
	Three Months ended Feb 28/09			Year Ended 28-Feb-09		
Revenue	\$ 32,796	100%	\$ 21.41	\$ 354,368	100%	\$ 54.28
Royalties	8,268	25.2%	\$ 5.40	72,684	20.5%	\$ 11.13
Operating costs	11,214	34.2%	\$ 7.32	64,648	18.2%	\$ 9.90
Transportation	1,482	4.5%	\$ 0.97	6,229	1.8%	\$ 0.95
Production costs	20,964	63.9%	\$ 13.69	143,561	40.5%	\$ 21.99
<b>Total Netback</b>	<b>\$ 11,832</b>	<b>36.1%</b>	<b>\$ 7.73</b>	<b>\$ 210,807</b>	<b>59.5%</b>	<b>\$ 32.29</b>

**General and Administrative**

Total administrative expenses, before other items, increased by \$7,374 to \$135,781 for the three months ended May 31, 2009 from \$128,407 at May 31, 2008. This is due primarily to changes in the following expenses:

Management fees increased by \$11,039 to \$25,000 for the three months ended May 31, 2009 from \$13,961 in May 2008, which is due primarily to the reinstatement of management fees paid to a director. Wages and benefits decreased by \$4,162 to \$22,843 for the three months ended May 31, 2009 from \$27,005 in May 2008 due to reduced administrative staff.

Depletion, depreciation and accretion was recorded at \$38,081 for the three months ended May 31, 2009 (May 2008 – \$52,135). Of this amount, \$36,433 is for depletion of the Company's four producing wells. These non cash expenses were computed in coordination with the independent evaluation report from Sproule Associates issued in April 2009, less an allowance for production decline. Depreciation was recorded on the Company's equipment in the amount of \$1,406 for the quarter and \$243 was also recorded for accretion expense on the Company's asset retirement obligation for its producing wells.

Professional fees increased by \$3,177 to \$17,615 for the three months ended May 31, 2009 from \$14,438 in 2008. This is primarily for additional fees for orchestrating the special shareholders' meeting regarding the corporate name change and share consolidation.

Transfer agent and filing fees and shareholder communication expenses also increased by \$13,253 to \$16,476 for the three months ended May 31, 2009 from \$3,223 in May 2008. This is primarily for additional fees for orchestrating the special shareholders' meeting regarding the corporate name change and share consolidation.

**HEMISPHERE ENERGY CORPORATION**  
**(formerly Northern Hemisphere Development Corp.)**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**For the Three Months ended May 31, 2009**

Bank interest and charges increased by \$5,664 to \$5,943 for the three months ended May 31, 2009 from \$279 in May 2008. This is due to interest recorded on the Part 12.6 tax assessment for the three months ending May 31, 2009, as well as an adjustment by Canada Revenue Agency on the total amount assessed.

**Other Items**

Under other items, the Company recorded interest income in the amount of \$954 during the three months ended May 31, 2009, which decreased by \$17 compared to the \$971 in the three months ended May 31, 2008.

**SELECTED ANNUAL INFORMATION**

The following are highlights of financial data on the Company for the most recently completed three financial years:

	<b>Fiscal Year Ended February 28,</b>		
	<b>2009</b>	<b>2008</b>	<b>2007</b>
(Loss) Income before Income Tax	\$ (1,703,726)	\$ (1,627,193)	\$ (2,545,928)
Net Loss	(1,637,743)	(1,627,193)	(2,545,928)
Loss Per Share	(0.17)	(0.18)	(0.06)
Total Assets	1,157,214	2,306,995	3,780,582
Total Liabilities	202,720	106,709	96,372
Working Capital	165,827	131,735	1,092,724

**SUMMARY OF QUARTERLY RESULTS**

	<b>2009</b>	<b>2009</b>	<b>2008</b>	<b>2008</b>	<b>2008</b>	<b>2008</b>	<b>2007</b>	<b>2007</b>
	<b>31-May Q1</b>	<b>28-Feb Q4</b>	<b>30-Nov Q3</b>	<b>31-Aug Q2</b>	<b>31-May Q1</b>	<b>29-Feb Q4</b>	<b>30-Nov Q3</b>	<b>31-Aug Q2</b>
Total revenue	32,796	61,476	73,441	105,616	113,835	119,481	81,753	81,455
Income (loss) before extraordinary items	-128,160	-229,844	-191,153	-96,386	-63,609	-445,641	-43,055	-97,983
Basic loss per share	-0.01	-0.02	0.00	0.00	0.00	-0.01	0.00	0.00
Diluted per share	-0.01	-0.02	0.00	0.00	0.00	-0.01	0.00	0.00
Net income (loss)	-127,206	-1,288,765	-190,969	-95,375	-62,638	-1,427,280	-26,455	-88,654
Basic per share	-0.01	-0.14	0.00	0.00	0.00	-0.03	0.00	0.00
Diluted per share	-0.01	-0.14	0.00	0.00	0.00	-0.03	0.00	0.00

**HEMISPHERE ENERGY CORPORATION**  
**(formerly Northern Hemisphere Development Corp.)**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**For the Three Months ended May 31, 2009**

**SHARE CAPITAL AND FINANCING ACTIVITIES**

Effective April 27, 2009 the Company consolidated its issued capital stock on a 5 old for 1 new basis. The authorized capital stock remained unchanged. The share consolidation was reflected retroactively, which resulted in the Company's issued capital stock decreasing from 49,779,718 common shares to 9,955,944 common shares as at February 28, 2009. Further, the Companies transfer agent gave directive on April 27, 2009 for reduction by 2 shares for fractional adjustment on the share consolidation.

With share consolidation reflected retroactively to February 28, 2009, references to capital stock, options and warrants in these consolidated financial statements and all prior loss per share information were also retroactively restated to give effect to the share consolidation unless otherwise stated.

There were no share issuances during the three months ended May 31, 2009.

At July 24, 2009, the Company had 9,955,942 common shares outstanding.

**LIQUIDITY AND CAPITAL RESOURCES**

Historically, the Company has funded its operations through equity financing and the exercise of options and warrants. The Company maintained a working capital position of \$76,702 at the period ended May 31, 2009. Management believes it will have to raise further funds by way of brokered/non-brokered private placements in order to finance corporate expenses and ongoing development of the Trutch property, as well as future growth opportunities. The Company announced a non-brokered private placement on May 25, 2009 under which it plans to raise \$1.1 million for financing acquisitions, including the Sylvan Lake property acquisition announced on May 4, 2009, and general working capital purposes. The Company expects to close the first tranche of the financing on or before July 31, 2009.

**RELATED PARTY TRANSACTIONS**

These transactions are in the ordinary course of business and are measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties. The following represents transactions entered into for the three months ended May 31, 2009:

- (a) Management fees of \$25,000 (May 2008 - \$13,961) were charged by directors and officers of the Company; and
- (b) Included in rental expense is rental income of \$4,500 (May 2008 - \$4,500) received from a company with common directors for shared office facilities.

**HEMISPHERE ENERGY CORPORATION**  
**(formerly Northern Hemisphere Development Corp.)**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**For the Three Months ended May 31, 2009**

**CORPORATE INTERNAL CONTROLS**

Management has evaluated the effectiveness of the Company's disclosure controls and procedures as at May 31, 2009 and has concluded, based on its evaluation, that these controls and procedures provide reasonable assurance that material information relating to the Company is made known to management and reported as required. Management is also responsible for the design of internal controls over financial reporting in order to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with Canadian generally accepted accounting principles. Management believes the design to be sufficient and appropriate to provide such reasonable assurance.

**OFF-BALANCE SHEET ARRANGEMENTS**

The Company has not entered into any off-balance sheet transactions.

**PROPOSED TRANSACTIONS**

On May 4, 2009, the Company entered into an agreement to acquire a property in the Sylvan Lake area of central Alberta for a purchase price of \$325,000. The agreement is expected to close on or before July 31, 2009 and is subject to certain conditions including normal due diligence and financing.

**CRITICAL ACCOUNTING ESTIMATES**

The Company's significant accounting policies are set out in Note 2 to the audited financial statements for the three months ended May 31, 2009, and have been consistently followed in the preparation of the interim financial statements.

Estimates where significant management judgments are involved, relate to its petroleum and natural gas interests and other critical items as listed below:

- (a) Petroleum and Natural Gas Interests

*Change in accounting policy*

During the 2009 year-end, the Company changed its method of accounting for oil and gas exploration and development activities from the full cost to the successful efforts method. The change in accounting policy will allow the Company to allocate expenditures incurred on oil and gas exploration on a well-by-well basis. This change will result in improved matching of costs and management estimates associated with impairment of oil and gas interests. The retrospective application of the successful efforts method did not result in any significant change in operating results or financial position for prior periods.

**HEMISPHERE ENERGY CORPORATION**  
**(formerly Northern Hemisphere Development Corp.)**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**For the Three Months ended May 31, 2009**

Under the successful efforts method, costs are initially capitalized as unproven property costs. Once proved reserves are discovered, the costs are reclassified to proved property costs. Exploration drilling costs are capitalized as suspended exploration well costs pending evaluation as to whether sufficient quantities of reserves have been found to justify commercial production. If commercial quantities of reserves are not found, exploration drilling costs are expensed. All exploratory wells are evaluated for commercial viability on a regular basis following completion of drilling. Exploration drilling costs remain capitalized if a determination is made that a sufficient quantity of reserves have been found and sufficient progress is being made to assess the reserves and the economic and operating viability. All other exploration costs, including geological and geophysical and annual lease rentals, are expensed to operations as incurred. All development costs are capitalized as proved property costs. Costs that directly relate to acquisition, exploration and development activities are capitalized.

Costs associated with unproven reserves are reviewed by management to determine whether they have become impaired. If impairment occurs, the carrying value of the related interest will be reduced to reflect the estimated net realizable value. The estimate will be based on the then current conditions. It is possible that changes could occur that would adversely affect management's estimates resulting in further write-downs of the carrying value of the interest. Any revenues earned on unproven properties are booked as a recovery of costs on that property.

(b) Depletion

Depletion of petroleum and natural gas interests and depreciation of production equipment are calculated using the unit-of-production method based upon estimated proved reserves, before royalties, as determined by independent engineers. In determining its depletion base, the Company includes estimated future costs to be incurred in developing proved reserves and excludes the cost of undeveloped properties until it is determined that proved reserves are attributable to the property or impairment has occurred.

(c) Impairment of Long-Lived Assets

The costs associated with proved reserves are assessed to be recoverable if the sum of the undiscounted cash flows expected from the production of proved reserves less unproved properties, net of any impairment, exceed the carrying value of the oil and gas assets. If the carrying value of the oil and gas assets is not assessed to be recoverable, an impairment loss is recognized to the extent that the carrying value exceeds the sum of the discounted cash flows expected from proved and probable reserves less unproved properties, net of any impairment. Cash flows are calculated based on estimated future product prices and discounted using the credit adjusted risk-free interest rate. Oil and natural gas assets are evaluated on an annual basis to determine whether the costs are recoverable and do not exceed the fair value of the properties.

(d) Joint Interest Operations

**HEMISPHERE ENERGY CORPORATION**  
**(formerly Northern Hemisphere Development Corp.)**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**For the Three Months ended May 31, 2009**

The Company's petroleum and natural gas exploration and production activities are conducted jointly with others and, accordingly, the financial statements reflect only the Company's proportionate interest in such activities.

(e) Equipment

Equipment is recorded at cost. Once the assets are in use, amortization is provided over their estimated useful lives on a declining-balance basis at the following annual rates:

Computers	-	30
Equipment	-	20
Furniture	-	20

In the year of acquisition, amortization is recorded using the half-year rule.

(f) Asset Retirement Obligations ("ARO")

The Company's operations are subject to various laws and regulations for federal and regional jurisdictions governing the protection of the environment. These laws are continually changing. The Company expects to make, in the future, expenditures that comply with such laws and regulations but cannot predict the full amount or timing of such future expenditures. Estimated future reclamation costs are based principally on legal and regulatory requirements. Reclamation and remediation obligations arise from the acquisition, development, construction, and normal operation of oil and gas properties, plant and equipment.

The Company recognizes an estimate of the liability associated with an ARO in the financial statements at the time the liability is incurred. The estimated fair value of the ARO is recorded as a long-term liability, with a corresponding increase in the carrying amount of the related asset. The liability amount is increased each reporting period due to the passage of time and the amount of accretion is charged to earnings in the period. The ARO can also increase or decrease due to changes in the estimates of timing of cash flows or changes in the original estimated undiscounted cost. Actual costs incurred upon settlement of the ARO are charged against the ARO to the extent of the liability recorded.

(g) Revenue Recognition

Revenue from the sale of petroleum and natural gas is recorded when title passes to an external party and is based on volumes delivered to customers at contractual delivery points and rates, and collectability is reasonably assured. The costs associated with delivery, including operating and maintenance costs, transportation and production-based royalty expenses, are recognized during the same period in which the related revenue is earned and recorded. Interest income is recorded on an accrual basis at the stated rate of interest of term deposits over the term to maturity.

**HEMISPHERE ENERGY CORPORATION**  
**(formerly Northern Hemisphere Development Corp.)**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**For the Three Months ended May 31, 2009**

**FINANCIAL INSTRUMENTS**

The Company's financial instruments consist of cash, accounts receivable, accounts payable and accrued liabilities and amounts owing to related parties. Terms of the financial instruments are fully disclosed in the Company's consolidated financial statements. Management's opinion is that the Company is not exposed to significant interest, currency, or credit risks arising from its financial instruments and that, unless otherwise noted, their fair values approximate their carrying values.

**RISKS**

Oil and gas exploration and development involves a high degree of risk and many properties are ultimately not developed to a producing stage. There can be no assurance that the Company's future exploration and development activities will result in discoveries of commercial bodies of oil and gas. Whether an oil and gas property will be commercially viable depends on a number of factors including the particular attributes of the reserve and its proximity to infrastructure, as well as commodity prices and government regulations, including regulations relating to prices, taxes, royalties, land tenure, land use, and environmental protection. The exact effect of these factors cannot be accurately predicted, and the combination of these factors may result in an oil and gas property not being profitable.

**DISCLOSURE FOR VENTURE ISSUERS WITHOUT SIGNIFICANT REVENUE**

The following table is a breakdown of the material components listed for the three most recently completed financial years:

	<b>Fiscal Year Ended February 28,</b>		
	<b>2009</b>	<b>2008</b>	<b>2007</b>
Capitalized acquisition, exploration and development costs	\$68,680	\$794,955	\$1,559,142
Stock-based compensation	84,344	143,269	36,487
Shares issued for cash, net of issue costs	373,590	0	121,650
General and administration costs	707,454	767,765	350,483

**CONTINGENCY**

In March 2005, the Company received a notice from the operator of the deep test well at the Bougie Trutch property requesting additional funding in the amount of \$160,214 for payment of expenditures. In 2007, the Company requested an external audit of this well from the operator as it is the Company's position that the operator's request is without merit. The Company believes it has not received sufficient documentation from the operator to justify payment of the expenditures on the premise.

**HEMISPHERE ENERGY CORPORATION**  
**(formerly Northern Hemisphere Development Corp.)**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**For the Three Months ended May 31, 2009**

**SUBSEQUENT EVENTS**

- (a) On May 4, 2009, the Company entered into an agreement to acquire a property in the Sylvan Lake area of central Alberta for a purchase price of \$325,000. The agreement is expected to close on or before July 31, 2009 and is subject to certain conditions including normal due diligence and financing.
  
- (b) On May 25, 2009, the Company announced, subject to regulatory acceptance, a non-brokered private placement to consist of the sale of up to 4,400,000 units (the "Unit") at a price of \$0.25 per Unit, each Unit to consist of one common share and one common share purchase warrant. Each warrant entitles the holder to purchase one additional common share at a price of \$0.35 for a period of one year from closing. The Company expects to close the first tranche of the financing on or before July 31, 2009.

**LIST OF DIRECTORS AND OFFICERS**

Charles O'Sullivan, B.Sc., Director and Chairman  
Don Simmons, B.Sc., P.Geol, Director, President and CEO  
Dorlyn Evancic, CGA, Chief Financial Officer  
Alan Crawford, MBA, Director  
Frank Borowicz, QC, CA (Hon), Director  
Ken Maddison, FCA, Director  
Gregg Vernon, B.Sc., P.Eng, Director  
Greg Sadler, P.Eng., Director  
Bruce McIntyre, P.Geol., Director

**ADDITIONAL INFORMATION**

Additional information relating to the Company is available on SEDAR at [www.sedar.com](http://www.sedar.com).