IVANHOE ENERGY INC
Form 10-Q
May 10, 2010

Table of Contents

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

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

For the quarterly period ended March 31, 2010

or

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

For the transition period from _____ to _____

Commission file number 000-30586

IVANHOE ENERGY INC.
(Exact name of registrant as specified in its charter)

Yukon, Canada	**98-0372413**
(State or other jurisdiction of incorporation or organization)	*(I.R.S. Employer Identification No.)*
Suite 654 999 Canada Place Vancouver, British Columbia, Canada	**V6C 3E1**
(Address of principal executive office)	*(zip code)*

(604) 688-8323
(registrant s telephone number, including area code)
No Changes
(Former name, former address and former fiscal year, if changed since last report)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). o Yes o No

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

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

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

The number of shares of the registrant s capital stock outstanding as of May 10, 2010 was 333,840,188 Common Shares, no par value.

TABLE OF CONTENTS

2

Table of Contents

Part I Financial Information

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

	March 31, 2010	December 31, 2009
Assets		
Current Assets:		
Cash and cash equivalents	$ 136,385	$ 21,512
Accounts receivable	4,802	5,021
Note receivable	261	225
Prepaid and other current assets	565	771
Restricted cash	2,850	2,850
	144,863	30,379
Oil and gas properties and development costs, net *(Note 2)*	182,219	158,392
Intangible assets HTL™ technology *(Note 3)*	92,153	92,153
Long term assets	1,183	839
	$ 420,418	$ 281,763
Liabilities and Shareholders Equity		
Current Liabilities:		
Accounts payable and accrued liabilities	$ 11,638	$ 10,779
Income tax payable *(Note 12)*	180	530
Asset retirement obligations *(Note 5)*	330	753
	12,148	12,062
Long term debt *(Note 4)*	38,449	36,934
Asset retirement obligations *(Note 5)*	349	195
Long term obligation *(Note 6)*	1,900	1,900
Future income tax liability *(Note 12)*	22,817	22,643
	75,663	73,734
Commitments and contingencies *(Note 6)*		
Going concern and basis of presentation *(Note 1)*		
Shareholders Equity:		
Share capital, issued 333,752,664 common shares December 31, 2009 282,558,593 common shares	549,075	422,322
Purchase warrants *(Note 7)*	33,423	19,427

Contributed surplus	18,573	20,029
Convertible note	2,086	2,086
Accumulated deficit	(258,402)	(255,835)
	344,755	208,029
	$ 420,418	$ 281,763

(See accompanying Notes to the Consolidated Financial Statements)

Table of Contents

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

	Three Months Ended March 31, 2010	2009 (Note 13)
Revenue		
Oil revenue	$ 5,330	$ 5,733
Gain on derivative instruments		82
Interest income	19	11
	5,349	5,826
Expenses		
Operating costs	2,275	2,701
General and administrative *(Note 2)*	4,977	5,879
Business and technology development	2,511	2,037
Depletion and depreciation	2,083	5,955
Foreign exchange gain	(4,187)	(993)
Interest expense and financing costs	4	177
	7,663	15,756
Loss from continuing operations before income taxes	(2,314)	(9,930)
Provision for income taxes		
Current	(79)	(1,645)
Future	(174)	
	(253)	(1,645)
Net loss from continuing operations	(2,567)	(11,575)
Net loss from discontinued operations *(Note 13)*		(698)
Net Loss and Comprehensive Loss	$ (2,567)	$ (12,273)
Accumulated deficit, beginning of period	(255,835)	(194,183)
Accumulated deficit, end of period	$ (258,402)	$ (206,456)

Net loss per share				
Net loss from continuing operations, basic and diluted	$	(0.01)	$	(0.04)
Net income (loss) from discontinued operations, basic and diluted				
Net loss per share, basic and diluted	$	(0.01)	$	(0.04)
Weighted average number of Shares (in thousands)				
Basic		307,233		279,381
Diluted		**307,233**		279,381

(See accompanying Notes to the Consolidated Financial Statements)

4

Table of Contents

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

	Three Months Ended March 31, 2010	Three Months Ended March 31, 2009
Operating Activities		
Net loss	$ (2,567)	$ (12,273)
Net loss from discontinued operations		698
Items not requiring use of cash:		
Depletion and depreciation	2,083	5,955
Stock based compensation	537	450
Unrealized loss on derivative instruments		455
Unrealized foreign exchange gain	(4,373)	(974)
Future income tax expense	174	
Other	192	91
Abandonment costs settled *(Note 5)*	(58)	
Changes in non-cash working capital items *(Note 11)*	18	613
Net cash provided by (used in) operating activities from continuing operations	(3,994)	(4,985)
Net cash provided by (used in) operating activities from discontinued operations		897
Net cash provided by (used in) operating activities	(3,994)	(4,088)
Investing Activities		
Capital investments	(25,337)	(5,209)
Other	(348)	28
Changes in non-cash working capital items *(Note 11)*	880	(611)
Net cash used in investing activities from continuing operations	(24,805)	(5,792)
Net cash provided by (used in) investing activities from discontinued operations		(476)
Net cash provided by (used in) investing activities	(24,805)	(6,268)
Financing Activities		
Shares issued on private placements, net of share issue costs	136,321	
Proceeds from exercise of options and warrants	1,636	
Payments of debt obligations		(416)
Other		479
Changes in non-cash working capital items *(Note 11)*		(23)
Net cash provided by (used in) financing activities from continuing operations	137,957	40
		(554)

Net cash provided by (used in) financing activities from discontinued operations				
Net cash provided by (used in) financing activities		137,957		(514)
Foreign Exchange gain on Cash and Cash Equivalents Held in a Foreign Currency		5,715		(31)
Increase in Cash and Cash Equivalents, for the period		114,873		(10,901)
Cash and cash equivalents, beginning of period		21,512		39,265
Cash and Cash Equivalents, end of period	$	136,385	$	28,364
Cash and cash equivalents, end of period continuing operations	$	136,385	$	26,115
Cash and cash equivalents, end of period discontinued operations	$		$	2,249

(See accompanying Notes to the Consolidated Financial Statements)

Table of Contents

Notes to the Unaudited Condensed Consolidated Financial Statements
March 31, 2010

(all tabular amounts are expressed in thousands of U.S. dollars except per share amounts)

1. GOING CONCERN AND BASIS OF PRESENTATION

Ivanhoe Energy Inc. s (the **Company** or **Ivanhoe Energy**) accounting policies are in accordance with accounting principles generally accepted in Canada. These policies are consistent with accounting principles generally accepted in the United States (U.S.), except as outlined in Note 14. These interim condensed consolidated financial statements do not include all disclosures normally provided in annual consolidated financial statements and should be read in conjunction with the Company s most recent annual consolidated financial statements. In the opinion of management, all adjustments (which included normal recurring adjustments) necessary for the fair presentation for the interim periods have been made. The results of operations and cash flows are not necessarily indicative of the results for a full year.

The Company s financial statements as at and for the three-month period ended March 31, 2010 have been prepared in accordance with generally accepted accounting principles (GAAP) as applied in Canada for a going concern, which assumes that the Company will continue in operation for the foreseeable future and will be able to realize its assets and discharge its liabilities in the normal course of operations. The Company incurred a net loss of $2.6 million for the three-month period ended March 31, 2010, and as of March 31, 2010, had an accumulated deficit of $258.4 million. Cash flow consumed in operating activities for the first quarter of 2010 was $4 million. The Company currently anticipates incurring substantial expenditures to further its capital development programs, particularly those related to the development of exploration opportunities in China and Mongolia, the development of an oil sands project in Alberta and the development of a heavy oil field in Ecuador. The Company s cash flow from operating activities will not be sufficient to both satisfy its current obligations and meet the requirements of these capital investment programs. Completion of these projects by the Company is dependent upon its ability to obtain capital to fund further development of these projects and others in the portfolio and also to meet ongoing obligations. The Company intends to finance its future funding requirements primarily through a combination of strategic private investors and/or public equity markets. Given the expectation of rising interest rates and tighter credit markets, public and/or private debt issuance will be a secondary source of funds. Without access to financing, there is a chance that the Company may not be able to continue as a going concern. These consolidated financial statements do not include any adjustments to the amounts and classification of assets and liabilities that would be necessary should the Company be unable to continue as a going concern.

Table of Contents

2. OIL AND GAS PROPERTIES AND DEVELOPMENT COSTS

In July 2009, the Company sold its U.S. operating segment (see Note 13); consequently, the segment historical comparative information has been revised to reflect this sale. Capital assets categorized by segment are as follows:

	As at March 31, 2010					
	Oil and Gas				Business and Technology	
	Integrated		Conventional			
	Canada	Ecuador	Asia	Corporate	Development	Total
Oil and Gas Properties:						
Proved	$	$	$ 149,491	$	$	$ 149,491
Unproved	112,343	11,274	15,833			139,900
	112,343	11,274	165,324			289,391
Accumulated depletion			(102,002)			(102,002)
Accumulated provision for impairment			(16,550)			(16,550)
	112,343	11,274	46,772			170,839
Development Costs:						
Feasibility studies and other deferred costs:						
Iraq and Libya HTL™					834	834
Egypt GTL					5,054	5,054
Accumulated provision for impairment					(5,888)	(5,888)
Feedstock test facility					11,187	11,187
Accumulated depreciation and impairment					(526)	(526)
					10,661	10,661
Furniture and equipment	24	169	135	1,203	22	1,553
Accumulated depreciation	(8)	(53)	(92)	(670)	(11)	(834)
	16	116	43	533	11	719
	$ 112,359	$ 11,390	$ 46,815	$ 533	$ 10,672	$ 182,219

	As at December 31, 2009					
	Oil and Gas				Business and Technology	
	Integrated		Conventional			
	Canada	Ecuador	Asia	Corporate	Development	Total
Oil and Gas Properties:						
Proved	$	$	$ 148,110	$	$	$ 148,110
Unproved	94,431	6,755	14,411			115,597

	94,431	6,755	162,521			263,707
Accumulated depletion			(99,744)			(99,744)
Accumulated provision for impairment			(16,550)			(16,550)
	94,431	6,755	46,227			147,413
Development Costs:						
Feasibility studies and other deferred costs:						
Iraq and Libya HTL™					834	834
Egypt GTL					5,054	5,054
Accumulated provision for impairment					(5,888)	(5,888)
Feedstock test facility					10,868	10,868
Accumulated depreciation and impairment					(393)	(393)
					10,475	10,475
Furniture and equipment	24	169	135	968	22	1,318
Accumulated depreciation	(8)	(53)	(92)	(650)	(11)	(814)
	16	116	43	318	11	504
	$ 94,447	$ 6,871	$ 46,270	$ 318	$ 10,486	$ 158,392

7

Table of Contents

Costs as at March 31, 2010 of $139.9 million ($93.4 million at March 31, 2009), related to unproved oil and gas properties, are excluded from costs subject to depletion and depreciation. For the three-month period ended March 31, 2010, general and administrative expenses related directly to oil and gas acquisition, exploration and development activities of $1.1 million ($0.9 million for the first quarter of 2009) were capitalized. For the three-month period, ended March 31, 2010, interest on debt related to oil and gas acquisition activities of $0.6 million ($0.5 million for the same period in 2009) was capitalized.

3. INTANGIBLE ASSETS HTL™ TECHNOLOGY

In the 2005 merger with the Ensyn Group, Inc. (**Ensyn**), the Company acquired an exclusive, irrevocable license to deploy, worldwide, the RTP™ Process for petroleum applications as well as the exclusive right to deploy the RTP™ Process in all applications other than biomass. The Company s carrying value of the HTL™ Technology as at March 31, 2010 is $92.2 million. Since the Company acquired the technology, it has continued to expand its patent coverage to protect innovations to the HTL™ Technology as they are developed and to significantly extend the Company s portfolio of HTL™ intellectual property. The Company is the assignee of three granted patents and currently has five patent applications pending in the U.S. The Company also has multiple patents in other countries. This intangible asset was not amortized and its carrying value was not impaired during the first quarter of 2010.

4. LONG TERM DEBT

Notes payable consisted of the following as at:

	March 31, 2010	December 31, 2009
Convertible note (4.25% at March 31, 2010) due July 2011	$ 39,386	$ 38,005
Less:		
Unamortized discount	(937)	(1,071)
	$ 38,449	$ 36,934

5. ASSET RETIREMENT OBLIGATIONS

The Company provides for the expected costs required to abandon its oil and gas assets. Historically, this provision has encompassed only the Commercial Demonstration Facility (CDF) and the Feedstock Test Facility (FTF). However, during the first quarter of 2010, these estimates were expanded to include costs attributed to the abandonment of eight delineation wells associated with the Tamarack project that were completed but not abandoned during the first quarter of 2010. The undiscounted value of expected future costs required to settle the Company s asset retirement obligation are $1.0 million at March 31, 2010. To calculate the present value of these obligations, the Company used inflation rates of 1 to 2% and discounted the expected future costs at credit-adjusted rates of 3.5% and 5.3%, respectively, for Tamarack and the FTF. Expected future costs were derived by estimating current costs and escalating based on expected inflation. Inflation rates applied for Tamarack were 1.8%, whereas future abandonment costs for the FTF are expected to be consistent with current day costs. A reconciliation of the beginning and ending aggregate carrying amount of the Company s various asset retirement obligations is as follows:

	As at March 31, 2010	As at December 31, 2009
Carrying balance, beginning of year	$ 948	$ 1,928
Liabilities incurred	150	185
Liabilities settled	(58)	(118)
Liabilities transferred		
Accretion expense	4	79

Revisions in estimated cash flows	(365)	(1,126)
Carrying balance, end of period	679	948
Less: current portion	330	753
Carrying balance, end of period	$ 349	$ 195

Table of Contents

6. COMMITMENTS AND CONTINGENCIES

Zitong Block Exploration Commitment

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

Under this production-sharing contract, the Company was obligated to conduct a minimum exploration program during the first three years ending December 1, 2005 (**Phase I**). The Company completed Phase I with a drilling shortfall of approximately 700 feet. In December 2007, the Company and Mitsubishi (the **Zitong Partners**) made a decision to enter into the next three-year exploration phase (**Phase II**). The shortfall in Phase I drilling was carried over into Phase II.

By electing to participate in Phase II the Zitong Partners had to relinquish 30%, plus or minus 5%, of the Zitong block acreage and complete a minimum work program involving the acquisition of approximately 200 miles of new seismic lines and approximately 23,700 feet of drilling (including the Phase I shortfall), with total gross remaining estimated minimum expenditures for this program of $ 27.5 million. The Zitong Partners have relinquished 25% of the Block to complete the Phase I relinquishment requirement. The Phase II seismic line acquisition commitment was fulfilled in the Phase I exploration program. Drilling at the first of two locations is planned to commence in the second quarter of 2010, with expected completed drilling, completion and evaluation of both prospects finalized in late 2010. The Zitong Partners must complete the minimum work program by the end of the Phase II period, December 31, 2010, or pay to CNPC the cash equivalent of the deficiency in the work program for that exploration phase. The cash equivalent of the deficiency in the drilling program is defined as the actual average unit cost of the last well drilled multiplied by the footage shortfall. Based on our historical drilling costs, we estimate this deficiency to be $12.5 million at March 31, 2010. Following the completion of Phase II, the Zitong Partners must relinquish all of the remaining property except any areas identified for development and future production.

Nyalga Block Exploration Commitment

The exploration period for the Nyalga Block XVI in Mongolia is for five years in duration and consists of three phases of two years, one year and two years respectively, with the ability to nominate a two-year extension following the first or second phase. The minimum work obligations consist of $2.7 million for the first phase, with the majority of that commitment in the second year of the phase, $1.0 million for the second phase and $2.5 million for the third phase, with the majority of that commitment in the second year of that phase. If, in one year, more than the minimum is expended, the excess can be applied to reduce the minimum expenditure in the next year of that phase. During the initial seismic program, a portion of the block, representing approximately 16% of the total, was declared by the Mongolian government to be an historical site and operations on that portion of the block, the Delgerkhaan area, were suspended. A letter from the Mineral Resources and Petroleum Authority of Mongolia (the MRPAM) was received in May 2008 that stated that the obligations under year one of the first phase would be extended for one year from the time the Company is allowed access to the suspended area. To date, access has not been allowed and discussions with MRPAM are still ongoing as to the possibility of entering into this suspended area. As at March 31, 2010, the Company has spent in excess of the commitments for the first phase. The minimum work obligation as at March 31, 2010 is $ 1.9 million.

Long Term Obligation

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

Income Taxes

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

The Company has an uncertain tax position in China related to when its entitlement to take tax deductions associated with development costs commenced. In March 2007, the Company received a preliminary indication from local Chinese tax authorities as to a potential change in the rule under which development costs are deducted from taxable income effective for the 2006 tax year. The Company discussed this matter with Chinese tax authorities and subsequently filed its 2006 tax return for Sunwing s wholly-owned subsidiary Pan-China Resources Ltd. (**Pan-China**) taking a new filing position in which development costs are capitalized and amortized on a straight line basis over six years starting in the year the development costs are incurred rather than deducted in their entirety in the year incurred. This change resulted in a $50.3 million reduction in tax loss carry-forwards in 2007 with an equivalent increase in the tax basis of development costs available for application against future Chinese income. The Company has received no formal notification of this rule change; however, it will continue to file tax returns under this new approach. To the extent that there is a different interpretation in the timing of the deductibility of development costs, this could potentially result in an increase of $1.1 million to the current tax provision.

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

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

Other Commitments

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

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

Lease Commitments

For the period ended March 31, 2010 the Company expended $0.5 million ($1.2 million for all of 2009) on operating leases relating to the rental of office space, which expire between July 2010 and September 2013. Such leases frequently provide for renewal options and require the Company to pay for utilities, taxes, insurance and maintenance expenses.

As at March 31, 2010, future net minimum payments for operating leases (excluding oil and gas and other mineral leases) were the following:

	Payments Due by Year (stated in thousands of U.S. dollars)					
	Total	**2010**	**2011**	**2012**	**2013**	**After 2013**
Lease commitments	3,193	1,480	1,141	446	126	

Table of Contents

7. SHARE CAPITAL AND WARRANTS

Following is a summary of the changes in shareholder s equity (excluding accumulated deficit) and stock options outstanding for the three-month period ended March 31, 2010:

	Common Shares					Stock Options	
	Number (thousands)	Amount	Purchase Warrants	Contributed Surplus	Convertible Note	Number (thousands)	Wtd. Avg Exercise Price Cdn.$
Balance December 31, 2009	282,559	$ 422,322	$ 19,427	$ 20,029	$ 2,086	15,013	$ 2.27
Shares issued for:							
Private placement, net of share issue costs	50,000	122,322	13,999				
Services	280	799				(280)	$ 2.44
Exercise of options	912	3,623		(1,993)		(1,461)	$ 3.01
Exercise of purchase warrants	2	9	(3)				
Options:							
Granted						182	$ 3.16
Forfeited							
Cancelled							
Compensation calculated for stock option grants*				537			
Balance March 31, 2010	333,753	$ 549,075	$ 33,423	$ 18,573	$ 2,086	13,454	$ 2.23

* - includes stock based compensation charged to continuing operations as well as discontinued operations

As at March 31, 2010, the following purchase warrants were exercisable to purchase common shares of the Company until the expiry date at the price per share as indicated below:

		Purchase Warrants						
Year of Issue	Price per Special Warrant	Issued	Exercisable	Common Shares Issuable	Value	Expiry Date	Exercise Price per Share	Cash Value on Exercise
			(thousands)					

						($U.S. 000)				($U.S. 000)
2006	U.S. $	2.23	11,400	11,398	11,398	18,802	May 2011	Cdn. $	2.93(1)	32,883
2009		NA	735	735	735	622	February 2011	Cdn. $	4.05	2,931
2010	Cdn. $	3.00	10,417	10,417	10,417	11,419	February 2011	Cdn. $	3.16	32,411
2010	Cdn. $	3.00	2,083	2,083	2,083	2,580	March 2011	Cdn. $	3.16	6,482
			24,635	24,633	24,633	$ 33,423				$ 74,707

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

In January 2010, the Company s Asia subsidiary signed an agreement that granted a private investor an option to acquire 833,334 shares of the subsidiary for Cdn $25 million. The investors right to exercise the option is contingent upon the occurrence of specific trigger events that are specified in the contract, and the share purchase option does not become exercisable, if at all, until the first quarter of 2011. The exercise period runs for a period of one year. Given the specific terms and conditions contained in the contract, Management believes the option has no current value at March 31, 2010.

8. SEGMENT INFORMATION

The Company has four reportable business segments: Oil and Gas Integrated, Oil and Gas Conventional, Business and Technology Development and Corporate. In July 2009, the Company sold its U.S. operating segment (see Note 13); consequently, reported segment information has been revised to reflect this sale.

Table of Contents

Oil and Gas

Integrated

Projects in this segment have two primary attributes. The first attribute consists of conventional exploration and production activities together with enhanced oil recovery techniques such as steam assisted gravity drainage. The second attribute consists of the deployment of our HTL™ Technology that will be used to upgrade heavy oil at facilities located in the field to produce lighter, more valuable crude. The Company currently has two such projects currently reported in this segment a heavy oil project in Alberta and a heavy oil project in Ecuador.

Conventional

The Company explores for, develops and produces crude oil and natural gas in China, and recently acquired an exploration block in Mongolia. In China, the Company s development and production activities are conducted at the Dagang oil field located in Hebei Province and its exploration activities are conducted on the Zitong block located in Sichuan Province. In Mongolia, the exploration activity is being conducted in Block XVI in the Nyalga Basin. Prior to July 2009, (see Note 13) the Company conducted U.S. exploration, development and production activities primarily in California and Texas.

Business and Technology Development

The Company incurs various costs in the pursuit of projects throughout the world. Such costs incurred prior to signing a memorandum of understanding (**MOU**) or similar agreement, are considered to be business and technology development and are expensed as incurred. Upon executing a MOU to determine the technical and commercial feasibility of a project, including studies for the marketability for the project s products, the Company assesses whether the feasibility and related costs incurred have potential future value, are likely to lead to a definitive agreement for the exploitation of proved reserves and therefore should be capitalized.

Additionally, the Company incurs costs to develop, enhance and identify improvements in the application of the technologies it owns or licenses. The cost of equipment and facilities acquired, or construction costs for such purposes, are capitalized as development costs and amortized over the expected economic life of the equipment or facilities, commencing with the start up of commercial operations for which the equipment or facilities are intended.

Corporate

The Company s corporate segment consists of costs associated with the board of directors, executive officers, corporate debt, financings and other corporate activities.

Table of Contents

The following tables present the Company s segment information for the three-month period ended March 31, 2010 and identifiable assets as at March 31, 2010 and December 31, 2009:

Segment Information

	Three Months Ended March 31, 2010						
	Oil and Gas				Business and Technology		
	Integrated		Conventional				
	Canada	Ecuador	Asia	U.S.	Development	Corporate	Total
Revenue							
Oil revenue	$	$	$ 5,330	$	$	$	$ 5,330
Interest income			2			17	19
			5,332			17	5,349
Expenses							
Operating costs			2,275				2,275
General and administrative	414	500	687			3,376	4,977
Business and technology development	23	2			2,486		2,511
Depletion and depreciation	2	7	2,258		(232)	48	2,083
Foreign exchange loss	(8)		9			(4,188)	(4,187)
Interest expense and financing costs	1				3		4
	432	509	5,229		2,257	(764)	7,663
Income (loss) from continuing operations before income taxes	(432)	(509)	103		(2,257)	781	(2,314)
(Provision for) recovery of income taxes							
Current			(78)			(1)	(79)
Future					(174)		(174)
			(78)		(174)	(1)	(253)
Net income (loss) from continuing operations	(432)	(509)	25		(2,431)	780	(2,567)

Net loss from discontinued operations							
Net income (loss) and comprehensive income (loss)	$ (432)	$ (509)	$ 25	$	$ (2,431)	$ 780	$ (2,567)
Capital Investments	$ 17,912	$ 4,175	$ 2,803	$	$ 225	$ 222	$ 25,337
Identifiable Assets:							
As at March 31, 2010	$ 112,638	$ 12,788	$ 57,536	$	$ 102,917	$ 134,539	$ 420,418
As at December 31, 2009	$ 94,594	$ 7,597	$ 57,528	$	$ 102,878	$ 19,166	$ 281,763

Segment Information

	Three Months Ended March 31, 2009						
	Oil and Gas				Business and Technology		
	Integrated		Conventional				
	Canada	Ecuador	Asia	U.S.	Development	Corporate	Total
Revenue							
Oil revenue	$	$	$ 5,733	$	$	$	$ 5,733
Gain on derivative instruments			82				82
Interest income			1			10	11
			5,816			10	5,826
Expenses							
Operating costs			2,701				2,701
General and administrative	138	518	396			4,827	5,879
Business and technology development	294				1,743		2,037
Depletion and depreciation	1	14	5,274		629	37	5,955
Foreign exchange loss	1		22			(1,016)	(993)
Interest expense and financing costs			148		25	4	177
	434	532	8,541		2,397	3,851	15,755
Loss from continuing operations before income taxes	(434)	(532)	(2,725)		(2,397)	(3,841)	(9,929)
(Provision for) recovery of income taxes							
Current			(1,636)			(9)	(1,645)
Future							
			(1,636)			(9)	(1,645)
Net loss from continuing operations	(434)	(532)	(4,361)		(2,397)	(3,851)	(11,575)
				(698)			(698)

Net loss from discontinued operations							
Net loss and comprehensive loss	$ (434)	$ (532)	$ (4,361)	$ (698)	$ (2,397)	$ (3,851)	$ (12,273)
Capital Investments	$ 2,068	$ 656	$ 1,156	$ 55	$ 1,274	$	$ 5,209

9. FINANCIAL INSTRUMENTS AND FINANCIAL RISK FACTORS

The accounting classification of each category of financial instruments, and their carrying amounts, are set out below. Carrying amounts approximate fair value except for long-term debt. After taking into account its own credit risk, the Company calculated the fair value of its long-term debt to be $37.3 million as at March 31, 2010.

	As at March 31, 2010				
	Loans and receivables	Available-for-sale financial assets	Held-for-trading	Financial liabilities measured at amortized cost	Total carrying amount
Financial Assets:					
Cash and cash equivalents	$	$	$ 136,385	$	$ 136,385
Accounts receivable	4,802				4,802
Note receivable	261				261
Restricted cash			2,850		2,850
Financial Liabilities:					
Accounts payable and accrued liabilities				(11,638)	(11,638)
Long term debt				(38,449)	(38,449)
Long term obligation				(1,900)	(1,900)
	$ 5,063	$	$ 139,235	$ (51,987)	$ 92,311

Table of Contents

Financial Risk Factors

The Company is exposed to a number of different financial risks arising from its normal business operations. These risks include, but are not limited to, exposure to commodity prices, foreign currency exchange rates and interest rates, credit risk and liquidity risk. There have been no significant changes to the Company s exposure to risks or to management s objectives, policies and processes to manage risks from those stated in the Company s 2009 Form 10-K.

10. CAPITAL MANAGEMENT

The Company continues to manage its capital as a going concern by enabling its subsidiaries to capture, develop and operate opportunities from the project portfolio that maximize the value returned to shareholders. There have been no changes in management s objectives, policies and processes regarding capital management from prior periods.

Table of Contents

11. SUPPLEMENTAL CASH FLOW INFORMATION

Supplemental cash flow information for the three-month period ended March 31, 2010:

	Three Months Ended March 31, 2010	Three Months Ended March 31, 2009
Supplemental Cash Flow Information		
Cash paid during the period for		
Income taxes	$ 427	$
Interest	$ 805	$ 1,865
Shares issued for services and capitalized	$ 799	$
Changes in non-cash working capital items		
Operating Activities		
Accounts receivable	$ 244	$ (658)
Note receivable	(36)	
Prepaid and other current assets	123	(42)
Accounts payable and accrued liabilities	37	(323)
Income tax payable	(350)	1,636
	18	613
Investing Activities		
Accounts receivable	(25)	32
Prepaid and other current assets	83	69
Accounts payable and accrued liabilities	822	(710)
	880	(611)
Financing Activities		
Accounts payable and accrued liabilities		(23)
	$ 898	$ (19)

	2010	2009
Cash and cash equivalents		
Bank accounts	$ 7,397	$ 28,364
Term deposit	128,988	
	$ 136,385	$ 28,364

Cash and cash equivalents at March 31, 2010 and December 31, 2009, are composed of bank balances in checking accounts with excess cash in money market accounts which invest primarily in government securities with less than 90 day original maturities.

12. INCOME TAXES

Prior to the Company selling its U.S. operating segment in July 2009, as further described in Note 13, the Company had future tax assets arising from net operating losses carry-forwards generated by this business segment. These future income tax assets were partially offset by certain future income tax liabilities in the U.S. and by a valuation allowance. As at June 30, 2009, as a result of the sale of the business segment, the Company was no longer able to offset these tax assets and liabilities but was required to present these future income tax assets as assets from discontinued operations and a future income tax liability both in the amount of $29.6 million in the accompanying balance sheet. The future income tax assets classified as Assets from discontinued operations were ultimately included in the $23.4 million loss on disposition as described in Note 13. Since this time, revisions were made to the future income tax liability based on the Company s ongoing projections for taxable income and its ability to utilize net operating loss carryforwards to reduce associated future income tax liabilities. Based on these assessments at March 31, 2010, the Company s future income tax liability is $22.8 million in the accompanying balance sheet.

Table of Contents

13. DISCONTINUED OPERATIONS

In June of 2009, management commenced a process to sell all of the Company s United States oil and gas exploration and production operations. On July 17, 2009, the Company completed the sale of its wholly owned subsidiary Ivanhoe Energy (USA) Inc. for a purchase price of $39.2 million. The purchaser acquired all of the Company s oil and gas exploration and production operations in California and Texas and additional exploration acreage in California. An escrow deposit in the amount of $2.0 million, which has been set aside from the sales proceeds, will be available to the purchaser for a period of one year to satisfy any indemnification obligations of the Company. The Company used approximately $5.2 million of the sales proceeds to repay an outstanding loan to a third party financial institution holding a security interest in the subsidiary company s assets. The Company applied the balance of the sales proceeds in the ongoing development of its heavy oil projects in Canada and Ecuador and for general corporate purposes.

In conjunction with the disposition of the US assets and the Company s focus on heavy oil opportunities, the Company has decided to close its support office in Bakersfield, California and transfer its Accounting operations to Calgary, Alberta. This transition will be completed early in the third quarter of 2010. Total costs associated with this closure, including severance and retention payments, are expected to be $0.5 million.

The operating results for this discontinued operation for the periods noted were as follows:

	Three Months Ended March 31,	
	2010	2009
Revenue		
Oil and gas revenue	**$**	$ 1,966
Gain (loss) on derivative instruments		186
Interest income		3
		2,155
Expenses		
Operating costs		1,026
General and administrative		68
Depletion and depreciation		1,677
Interest expense and financing costs		82
		2,853
Net Loss		(698)

Table of Contents

14. ADDITIONAL DISCLOSURE REQUIRED UNDER U.S. GAAP

The Company s consolidated financial statements have been prepared in accordance with GAAP as applied in Canada. In the case of the Company, Canadian GAAP conforms in all material respects with U.S. GAAP except for certain matters, the details of which are as follows:

Condensed Consolidated Balance Sheets

The application of U.S. GAAP has the following effects on consolidated balance sheet items as reported under Canadian GAAP:

	As at March 31, 2010				As at December 31, 2009			
	Canadian GAAP	Increase (Decrease)	Notes	U.S. GAAP	Canadian GAAP	Increase (Decrease)	Notes	U.S. GAAP
Assets								
Current Assets:								
Cash and cash equivalents	$ 136,385	$		$ 136,385	$ 21,512	$		$ 21,512
Accounts receivable	4,802			4,802	5,021			5,021
Note receivable	261			261	225			225
Prepaid and other current assets	565			565	771			771
Restricted cash	2,850			2,850	2,850			2,850
Total Current Assets	144,863			144,863	30,379			30,379
Oil and gas properties and development costs, net	182,219	(38,500)	(i)	164,098	158,392	(38,500)	(i)	139,346
		21,408	(ii)			20,315	(ii)	
		(1,029)	(iii)			(861)	(iii)	
Intangible assets technology	92,153			92,153	92,153			92,153
Long term assets	1,183			1,183	839			839
Total Assets	$ 420,418	$ (18,121)		$ 402,297	$ 281,763	$ (19,046)		$ 262,717
Liabilities and Shareholders Equity								
Current Liabilities:								
Accounts payable and accrued liabilities	$ 11,638	$		$ 11,638	$ 10,779	$		$ 10,779
Income tax payable	180			180	530			530
Derivative instruments		22,372	(vi)	22,372		8,249	(vi)	8,249
Asset retirement obligation	330			330	753			753
Total Current Liabilities	12,148	22,372		34,520	12,062	8,249		20,311
Long term debt	38,449	1,057	(iii)	39,472	36,934	1,225	(iii)	38,005
		(34)	(iii)			(154)	(iii)	
	349			349	195			195

Asset retirement obligations								
Long term obligation	1,900			1,900	1,900			1,900
Future income tax liability	22,817			22,817	22,643			22,643
Total Liabilities	75,663	23,395		99,058	73,734	9,320		83,054
Shareholders Equity:								
Share capital	549,075	74,455	(iv)	637,094	422,322	74,455	(iv)	510,784
		(994)	(v)			(551)	(v)	
		1,358	(vii)			1,358	(vii)	
		13,200	(vi)			13,200	(vi)	
Purchase warrants	33,423	(33,423)	(vi)		19,427	(19,427)	(vi)	
Contributed surplus	18,573	(2,754)	(v)	12,872	20,029	(3,197)	(v)	13,885
		(2,947)	(vi)			(2,947)	(vi)	
Convertible note	2,086	(2,086)	(iii)		2,086	(2,086)	(iii)	
Accumulated deficit	(258,402)	(88,325)		(346,727)	(255,835)	(89,171)		(345,006)
Total Shareholders Equity	344,755	(41,516)		303,239	208,029	(28,366)		179,663
Total Liabilities and Shareholders Equity	$ 420,418	$ (18,121)		$ 402,297	$ 281,763	$ (19,046)		$ 262,717

18

Oil and Gas Properties and Development Costs

(i) There are certain differences between the full cost method of accounting for oil and gas properties as applied in Canada and as applied in the U.S. The principal difference is in the method of performing ceiling test evaluations under the full cost method of accounting rules. In the ceiling test evaluation for U.S. GAAP purposes, the Company limits, on a country-by-country basis, the capitalized costs of oil and gas properties, net of accumulated depletion, depreciation and amortization and deferred income taxes, to (a) the present value of estimated future net revenues computed by applying current prices of oil and gas reserves to estimated future production of proved oil and gas reserves as of the date of the latest balance sheet presented, less estimated future expenditures (based on current costs) to be incurred in developing and producing the proved reserves computed using a discount factor of ten percent and assuming continuation of existing economic conditions; plus (b) the cost of properties not being amortized (e.g. major development projects) and (c) the lower of cost or fair value of unproved properties included in the costs being amortized less (d) income tax effects related to the difference between the book and tax basis of the properties referred to in (b) and (c) above. If capitalized costs exceed this limit, the excess is charged as a provision for impairment. Unproved properties and major development projects are assessed on a quarterly basis for possible impairments or reductions in value. If a reduction in value has occurred, the impairment is transferred to the carrying value of proved oil and gas properties. The Company performed the ceiling test in accordance with U.S. GAAP and determined that for the three-months ended March 31, 2010 no impairment provision was required, nor was an impairment provision required under Canadian GAAP. The cumulative differences in the amount of impairment provisions between U.S. and Canadian GAAP were $38.5 million at March 31, 2010 and December 31, 2009.

(ii) The cumulative differences in the amount of impairment provisions between U.S. and Canadian GAAP resulted in a reduction in accumulated depletion.

(iii) As more fully described in Note 5 of our financial statements and in Item 8 of our 2009 Annual Report filed on Form 10-K, we were required, under Canadian GAAP, to bifurcate the value of a convertible note, allocating a portion to long-term debt and a portion to equity. Under U.S. GAAP, the convertible debt securities are classified in their entirety as debt. Under Canadian GAAP this discount accretion was capitalized. To reconcile to U.S. GAAP the entire $2.1 million recorded in equity is reversed as well as the unamortized discount of $1.1 million and the accreted discount that was capitalized in the amount of $1.0 million. In addition, because the convertible note is not denominated in U.S. currency the remeasurement of the different carrying value for U.S. GAAP results in an increase to net income. The foreign exchange loss of $0.1 million is shown as a separate amount in the U.S. GAAP reconciliation of the Company s balance sheet shown above and is adjusted to the Foreign Exchange Loss line item in the U.S. GAAP reconciliation of the statement of operations below.

Shareholders Equity

(iv) In June 1999, the shareholders approved a reduction of stated capital in respect of the common shares by an amount of $74.5 million being equal to the accumulated deficit as at December 31, 1998. Under U.S. GAAP, a reduction of the accumulated deficit such as this is not recognized except in the case of a quasi reorganization.

(v) Under Canadian GAAP, the Company accounts for all stock options granted to employees and directors since January 1, 2002 using the fair value based method of accounting. Under this method, compensation costs are recognized in the financial statements over the stock options vesting period using an option-pricing model for determining the fair value of the stock options at the grant date. Under U.S. GAAP, prior to January 1, 2006 the Company applied Accounting Principles Board (**APB**) Opinion No. 25, as interpreted by the Financial Accounting Standards Board (**FASB**) Interpretation No. 44, in accounting for its stock option plan and did not recognize compensation costs in its financial statements for stock options issued to employees and directors. Beginning January 1, 2006 the Company applied the revision to FASB s Accounting Standards Codification (**ASC**) Topic 718 Stock Compensation (formerly SFAS 123R) which supersedes APB No. 25, Accounting for Stock Issued to Employees . The Company elected to implement this statement on a modified prospective basis starting in the first quarter of 2006 whereby the Company began recognizing stock based compensation in its U.S. GAAP results of operations for the unvested portion of awards outstanding as at January 1, 2006 and for all awards granted after January 1, 2006. There are no significant differences between the accounting for stock options under Canadian GAAP and U.S. GAAP subsequent to January 1, 2006.

(vi) The Company accounts for purchase warrants as equity under Canadian GAAP. As more fully described in our financial statements in Item 8 of our 2009 Annual Report filed on Form 10-K, the accounting treatment of warrants under U.S. GAAP reflects the application of ASC Topic 815 Derivatives and Hedging (formerly SFAS 133). Under Topic 815, share purchase warrants with an exercise price denominated in a currency other than a company s functional currency are accounted for as derivative liabilities. Changes in the fair value of the warrants are required to be recognized in the statement of operations each reporting period for U.S. GAAP purposes. At the time that the Company s share purchase warrants are exercised, the value of the warrants will be reclassified to shareholders equity for U.S. GAAP purposes. Under Canadian GAAP, the fair value of the warrants on the issue date is recorded as a reduction to the proceeds from the issuance of common shares, with the offset to the warrant component of equity. The warrants are not revalued to fair value under Canadian GAAP.

(vii) Under U.S. GAAP, the aggregate value attributed to the acquisition of royalty rights during 1999 and 2000 was $1.4 million higher, due to the difference between Canadian and U.S. GAAP in the value ascribed to the shares issued, primarily resulting from differences in the recognition of effective dates of the transactions.

Condensed Consolidated Statements of Operations

The application of U.S. GAAP had the following effects on net income (loss) and net income (loss) per share as reported under Canadian GAAP:

	Three Months Ended March 31, 2010				**Three Months Ended March 31, 2009**			
	Canadian GAAP	Increase (Decrease)	Notes	U.S. GAAP	Canadian GAAP	Increase (Decrease)	Notes	U.S. GAAP
Revenue								
Oil revenue	$ 5,330	$		$ 5,330	$ 5,733	$		$ 5,733
Gain (loss) on derivative instruments		(127)	(vi)	(127)	82	(2,041)	(vi)	(1,959)
Interest income	19			19	11			11
Total Revenue	5,349	(127)		5,222	5,826	(2,041)		3,785
Expenses								
Operating costs	2,275			2,275	2,701			2,701
General and administrative	4,977			4,977	5,879			5,879
Business and technology development	2,511			2,511	2,037			2,037
Depletion and depreciation	2,083	(1,093)	(ix)	990	5,955	(3,213)	(ix)	2,742
Foreign exchange (gain) loss	(4,187)	120	(iii)	(4,067)	(993)	(392)	(iii)	(1,385)
Interest expense and financing costs	4			4	177			177
Provision for impairment of intangible asset and development						146	(viii)	146