

Consolidated Financial Statements

**Echo Energy Canada Inc.**

December 31, 2006 and 2005

NEAL, PALLETT & TOWNSEND LLP

**NP T**

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**AUDITORS' REPORT**

To the Shareholders of  
**Echo Energy Canada Inc.**

We have audited the consolidated balance sheets of **Echo Energy Canada Inc.** as at December 31, 2006 and 2005 and the consolidated statements of earnings (loss) and retained earnings (deficit) and cash flows for the years then ended. These consolidated financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the company as at December 31, 2006 and 2005 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

London, Canada  
March 2, 2007

*Neal, Pallett & Townsend LLP*

Chartered Accountants  
Licensed Public Accountants

# Echo Energy Canada Inc.

Incorporated under the laws of Ontario

## CONSOLIDATED BALANCE SHEETS

As at December 31

	2006	2005
	\$	\$
<b>ASSETS</b>		
<b>Current assets</b>		
Cash and cash equivalents	455,677	1,555,875
Term deposits	213,000	213,000
Accounts receivable	275,557	529,304
Inventory <i>[note 3]</i>	82,937	34,911
Advances to Ontex Resources Limited <i>[note 6]</i>	—	711,770
Advances to Echo Power Generation Inc. <i>[note 7]</i>	—	398,969
Prepays	14,126	1,735
	<b>1,041,297</b>	<b>3,445,564</b>
<b>Non-current assets</b>		
Property and equipment, net <i>[note 4]</i>	6,271,727	6,094,002
Oil and gas leases <i>[note 5]</i>	44,245,578	43,018,157
Investment in Ontex Resources Limited <i>[note 6]</i>	617,946	—
Investment in Echo Power Generation Inc. <i>[note 7]</i>	—	1,192,975
	<b>52,176,548</b>	<b>53,750,698</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>Current liabilities</b>		
Accounts payable and accrued liabilities	316,066	401,680
Accrued royalties	69,793	125,073
Current portion of long-term debt <i>[note 8]</i>	310,000	310,000
Advances from Ontex Resources Limited <i>[note 6]</i>	35,906	—
	<b>731,765</b>	<b>836,753</b>
Long-term debt <i>[note 8]</i>	5,890,000	5,890,000
Asset retirement obligation <i>[note 9]</i>	81,300	23,000
Future income taxes <i>[note 10]</i>	13,669,100	13,846,300
	<b>20,372,165</b>	<b>20,596,053</b>
Commitments <i>[note 12]</i>		
<b>Shareholders' equity</b>		
<b>Share capital <i>[note 11]</i></b>		
<b>Authorized</b>		
Unlimited common shares		
<b>Issued</b>		
Common shares	35,417,100	35,417,100
Deficit	(3,612,717)	(2,262,455)
	<b>31,804,383</b>	<b>33,154,645</b>
	<b>52,176,548</b>	<b>53,750,698</b>

See accompanying notes to consolidated financial statements

On behalf of the Board

"Salvatore Fuda"

"Gary Conn"

# Echo Energy Canada Inc.

Incorporated under the laws of Ontario

## CONSOLIDATED STATEMENTS OF EARNINGS (LOSS) AND RETAINED EARNINGS (DEFICIT)

For the year ended December 31,

	2006	2005
	\$	\$
<b>REVENUE</b>		
Gross sales	2,639,381	4,318,912
Less: Royalties	161,401	245,966
Net sales	2,477,980	4,072,946
Interest	8,333	6,372
Total revenue	2,486,313	4,079,318
<b>EXPENSES</b>		
Transportation	235,374	254,561
Operations	405,501	738,151
Depreciation, depletion and amortization	621,211	304,673
Management and professional fees	521,449	879,121
General and administrative expenses	281,756	370,828
Interest on long-term debt	388,231	320,262
Interest and bank charges	7,416	8,834
	2,460,938	2,876,430
<b>Earnings before the undernoted</b>	25,375	1,202,888
Exchange loss on foreign currency	(33,292)	(33,820)
Gain on sale of shares of Ontex Resources Limited [note 6]	9,882	—
Equity loss from Ontex Resources Limited [note 6]	(36,452)	—
Equity loss from Echo Power Generation Inc. [note 7]	(530,982)	(375,483)
Write-down - Echo Power Generation Inc. [note 7]	(961,993)	—
<b>Net earnings (loss) before income taxes</b>	(1,527,462)	793,585
Future income tax recovery (expense) [note 10]	177,200	(357,500)
<b>Net earnings (loss)</b>	(1,350,262)	436,085
Deficit, beginning of year	(2,262,455)	(2,698,540)
<b>Deficit, end of year</b>	(3,612,717)	(2,262,455)
Basic and diluted income (loss) per share [note 11[b]]	\$ (0.026)	\$ 0.008

See accompanying notes to consolidated financial statements

# Echo Energy Canada Inc.

Incorporated under the laws of Ontario

## CONSOLIDATED STATEMENTS OF CASH FLOWS

For the year ended December 31,

	2006	2005
	\$	\$
<b>Cash provided by (used in)</b>		
<b>OPERATING ACTIVITIES</b>		
Net earnings (loss)	(1,350,262)	436,085
Items not affecting cash		
Future income tax expense	(177,200)	357,500
Depreciation, depletion and amortization	654,986	304,673
Equity loss from Ontex Resources Limited	36,452	—
Equity loss from Echo Power Generation Inc.	530,982	375,483
Write-down - Echo Power Generation Inc.	961,993	—
Change in non-cash operating working capital <i>[note 14]</i>	52,435	(31,320)
	<b>709,386</b>	<b>1,442,421</b>
<b>FINANCING ACTIVITIES</b>		
Bank indebtedness	—	1,200,000
Repayments from (advances to) Echo Power Generation Inc.	398,969	(389,500)
Repayments from (advances to) Ontex Resources Limited	747,676	(550,954)
Issuance of common shares	—	1,893,250
	<b>1,146,645</b>	<b>2,152,796</b>
<b>INVESTING ACTIVITIES</b>		
Purchase of property and equipment	(251,362)	(835,917)
Acquisition of oil and gas leases	(1,750,469)	(1,112,865)
Investment in Echo Power Generation Inc.	(300,000)	—
Investment in Ontex Resources Limited	(654,398)	—
	<b>(2,956,229)</b>	
<b>Increase (decrease) in cash and cash equivalents</b>	<b>(1,100,198)</b>	<b>1,646,435</b>
Cash and cash equivalents, beginning of year	1,555,875	(90,560)
<b>Cash and cash equivalents, end of year</b>	<b>455,677</b>	<b>1,555,875</b>

*See accompanying notes to consolidated financial statements*

**Echo Energy Canada Inc.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

For the years ended December 31, 2006 and 2005

**1. NATURE OF OPERATIONS AND BASIS OF PRESENTATION**

Echo Energy Canada Inc. (the "Company") was incorporated on October 17, 1997 under the Business Corporations Act (Ontario). The Company is a natural resource company focused on the development of natural resource projects. The Company currently operates in one geographic region, Canada, and in one industry segment, oil and gas.

The consolidated financial statements include the accounts of the company and its wholly owned subsidiaries, 1490564 Ontario Inc., Pecho Pipelines Inc. and Echo Energy Inc. ("EEI"). The company and EEI were amalgamated on April 1, 2006 and continue as Echo Energy Canada Inc.

**2. SIGNIFICANT ACCOUNTING POLICIES**

The consolidated financial statements have been prepared by management using Canadian generally accepted accounting principles.

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingencies at the date of the financial statements, and revenues and expenses during the reporting period. Actual results will differ from those estimated.

In particular, the amounts recorded for depletion, depreciation and amortization of natural gas leases and for asset retirement obligations are based on estimates of reserves and future costs. By their nature, these estimates, and those related to future cash flows used to assess impairment, are subject to measurement uncertainty.

**[a] Investments**

Investments in companies over which the Company has significant influence are accounted for on the equity basis.

**[b] Oil and gas leases**

The Company follows the full cost method of accounting for natural gas leases, whereby all costs associated with the acquisition of, exploration for and development of gas reserves are capitalized. Costs capitalized include lease acquisition costs, geological and geophysical expenditures, drilling of productive and non-productive wells and related plan and production equipment costs. General and administrative expenses are not capitalized other than to the extent of the Company's interest in Company operated capital expenditure programs to which operation's fees have been charged in accordance with standard industry operating agreements. While in the development stage, revenues derived from the sale of gas were presented as a reduction of capitalized cost. Proceeds from the sale of gas

**Echo Energy Canada Inc.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

For the years ended December 31, 2006 and 2005

properties would reduce capitalized costs with recognition of a gain or loss if such a sale would significantly alter the rate of depletion and depreciation.

Capitalized costs plus estimated future development costs of proven reserves are depleted and depreciated using the unit-of-production method based upon estimated proven developed and undeveloped gas reserves before royalties as determined by independent consulting engineers.

In applying the full cost method, the Company performs an impairment test, which restricts the net capitalized costs from exceeding an amount equal to the estimated undiscounted value of future net revenues from proven oil and gas reserves based on current prices and costs, after deducting estimated future general and administrative expenses, financing costs, income taxes and site restoration costs.

**[c] Asset Retirement Obligation**

The fair value of the estimated obligation associated with the retirement and reclamation of tangible long-lived assets is recorded when the related assets are put into use with a corresponding increase to the carrying amount of the related assets. This increase in capitalized costs is amortized to earnings on a basis consistent with depreciation, depletion and amortization of the underlying assets. Subsequent changes in the estimated fair value of the asset retirement obligations are capitalized and amortized over the remaining useful life of the underlying asset.

The asset retirement obligation liabilities are carried on the consolidated balance sheet at their discounted present value and are accreted over time for the change in their present value, with this accretion charge included in depreciation, depletion and amortization.

**[d] Cash and cash equivalents**

Cash and cash equivalents consist of cash and short-term deposits with original maturities of less than three months at the date of purchase.

**[e] Inventory**

Inventory of gas held in a third party storage facility is valued at the lower of cost, determined under the full cost method, and market value.

**[f] Property and equipment**

The Company records property and equipment at cost, net of any grants or incentives received. Automobiles are depreciated on the declining balance method over their

**Echo Energy Canada Inc.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

For the years ended December 31, 2006 and 2005

estimated useful lives at an annual rate of 20%. Costs of constructing the gas gathering pipeline and compressor system, plus estimated cost to complete, are depreciated based on the unit-of-production method.

An impairment loss is recognized when the carrying value of property and equipment will not be recovered through use.

**[g] Income taxes**

The Company accounts for income taxes under the liability method. Under this method of tax allocation, future income tax assets and liabilities are determined based on differences between the financial statement carrying values and their respective income tax basis (temporary differences). Future income tax assets and liabilities are measured using the enacted tax rates expected to be in effect when the temporary differences are likely to reverse. The effect on future income tax assets and liabilities of a change in tax rates is included in income in the period in which the change is enacted or substantively enacted. The amount of future income tax assets recognized is limited to the amount that is more likely than not to be realized.

**[h] Financial instruments**

*Credit Risk*

The Company's accounts receivable are due from entities in the oil and gas industry. Concentration of credit risk is mitigated by ensuring strict compliance with agreed credit terms and routine assessment of the financial strength of its customers, all of which are publicly reporting entities. At December 31, 2006, the Company's largest credit exposure to a single party was approximately \$272,500.

*Fair Value*

The carrying values of cash and cash equivalents, term deposits, accounts receivable, accounts payable and accrued liabilities, long-term debt and advances to related parties reflected in the consolidated balance sheets approximate their respective fair values.

*Currency Risk*

Currency risk is the risk to the Company's earnings that arise from fluctuations of foreign exchange rates and the degree of volatility of these rates. The Company is exposed to foreign currency exchange risk on cash, accounts receivable and accounts payable held in U. S. dollars. The Company does not use derivative instruments to reduce its exposure to foreign currency risk.

**Echo Energy Canada Inc.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

For the years ended December 31, 2006 and 2005

*Interest Rate Risk*

The Company is exposed to interest rate risk arising from fluctuations in interest rates on its long-term debt.

**[i] Flow-through shares**

Share capital includes flow-through shares issued pursuant to certain provision of the Income Tax Act (Canada). The Act provides that, where the share issuance proceeds are used for exploration and development expenditures, the related income tax deductions may be renounced to subscribers. Accordingly, these expenditures provide no income tax deduction to the Company.

**[j] Earnings (loss) per common share**

Basic earnings (loss) per share is computed by dividing net income (loss) for the period by the weighted average number of common shares outstanding in each respective period. Diluted earnings (loss) per share reflects the potential dilution of securities by adding other common stock equivalents in the weighted average number of common shares outstanding during the period, if dilutive, and calculated using the treasury stock method.

**[k] Stock-based compensation**

The Company recognizes stock based compensation expense when stock options are vested using the fair value method. The recognized stock based compensation is credited to capital stock. Any consideration paid upon the exercise of stock options or purchase of shares is credited to share capital.

**[l] Revenue**

Revenue from the sale of gas and associated hydrocarbons is recognized when the product is delivered.

**Echo Energy Canada Inc.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

For the years ended December 31, 2006 and 2005

**3. INVENTORY**

	2006 \$	2005 \$
Natural gas in storage:		
12,942 mcf	—	34,911
22,034 mcf	82,937	—
	82,937	34,911

**4. PROPERTY AND EQUIPMENT**

	2006		
	Cost \$	Accumulated amortization \$	Net book value \$
Automobile	72,385	23,512	48,873
Gas gathering pipeline and compressor system	6,326,077	103,223	6,222,854
	6,398,462	126,735	6,271,727

	2005		
	Cost \$	Accumulated amortization \$	Net book value \$
Automobile	70,775	11,496	59,279
Gas gathering pipeline and compressor system	6,076,324	41,601	6,034,723
	6,147,099	53,097	6,094,002

## Echo Energy Canada Inc.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the years ended December 31, 2006 and 2005

#### 5. OIL AND GAS LEASES

	Acquisition \$	Exploration \$	Total \$
<b>Balance, December 31, 2004</b>	<b>35,082,391</b>	<b>7,091,416</b>	<b>42,173,807</b>
Deferred exploration costs	—	1,100,138	1,100,138
Depreciation, depletion and amortization	—	(255,788)	(255,788)
<b>Balance, December 31, 2005</b>	<b>35,082,391</b>	<b>7,935,766</b>	<b>43,018,157</b>
Deferred exploration costs	—	1,750,469	1,750,469
Revision to asset retirement obligation	—	58,300	58,300
Depreciation, depletion and amortization	—	(581,348)	(581,348)
<b>Balance, December 31, 2006</b>	<b>35,082,391</b>	<b>9,163,187</b>	<b>44,245,578</b>

- [a] Pursuant to an agreement (the "Agreement") dated August 23, 2000 and amended October 20, 2000 among the Company, Ontex Resources Limited ("Ontex"), Southern Ontario National Gas Limited ("SONG") and EEI, all of which were related parties at the date of the transaction [note 12], EEI acquired a 100% interest in certain oil and gas leases owned by SONG and covering 2,000 acres in Bayham Township, Ontario. The consideration given in respect of the acquisition was \$100,000 in cash and 100,000 common shares of the Company.

The Agreement reserved a gross overriding royalty to SONG of 5% to be subsequently increased to 10%. On January 17, 2002, this royalty was bought by Ontex from SONG for consideration of 200,000 issued and outstanding common shares of the Company. The lessors have reserved a royalty of 5% of the net revenue from all gas and associated hydrocarbons produced from each well drilled on the lands under lease and a royalty of 12.5% of the net revenue from all oil and minerals recovered from the lands under lease.

- [b] On July 11, 2001, the Company entered into an agreement with SONG, to acquire five leases ("Houghton leases") in the Municipality of Houghton, County of Norfolk, Ontario. The consideration given in respect of the acquisition was \$50,000 in cash and 50,000 common shares of the Company.

SONG retained a 5% gross royalty until July 11, 2006 and a 10% gross royalty thereafter. The royalty applies to the properties in Concessions West, East and Concession I in Houghton Township affected by the Houghton leases.

## **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

For the years ended December 31, 2006 and 2005

The Company has also entered into additional leases with private land owners whereby:

- [c] The Company has acquired an exclusive right to carry on geological research and to drill for, produce, remove all oil, gas and associated hydrocarbons and minerals within the leased lands together with the right to use water resources and the right to locate and install gas metering facilities and the right to locate and construct and perpetually operate and maintain pipelines for transporting said products for a primary term of 5 years and for so long thereafter as any of the said products can be recovered or transported in useful or profitable quantities.

In consideration for the exclusive rights, the Company has agreed to the following:

- i. Commence a well on the said leased lands within 12 months of the date of the lease or pay an annual rental of \$5.00 per acre until a well is drilled or until the primary term of the lease is expired;
- ii. Pay \$200 in advance for access to any wellsite on the leased lands to compensate for property damage and growing crops;
- iii. Pay a royalty ranging from 5% to 6.5% on the net revenue from all gas and associated hydrocarbons produced from each well drilled on the said leased lands once annually; or, pay a minimum of \$600 for each well for each year that yields a minimum of 300,000 cubic feet per day and a shut-in pressure of 300 pounds in 30 days; and
- iv. Pay a 12.5% royalty on net revenue from all oil and minerals recovered from the said leased lands.

### **6. INVESTMENT IN ONTEX RESOURCES LIMITED**

On March 16, 2006, the Company acquired 4,509,833 common shares of Ontex Resources Limited ("Ontex") at a price of \$0.18 per share pursuant to a debt to shares conversion agreement under which Ontex settled a \$811,770 debt owed to the Company. The debt comprised a number of cash advances made by the Company to Ontex. In October 2006, the Company participated in a rights offering to acquire a further 1,127,458 shares at a price of \$0.10 per share for \$112,746 to maintain its proportionate interest. In December 2006, the Company sold 1,647,058 shares at a price of \$0.17 per share for \$280,000 to an arms length purchaser resulting in a gain of \$9,882.

**Echo Energy Canada Inc.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

For the years ended December 31, 2006 and 2005

As a result, the Company holds an 5.87% interest in Ontex as follows:

	2006	2005
	\$	\$
Opening balance	—	—
Acquisition of common shares	924,516	—
Sale of common shares	(270,118)	—
Share of equity loss	(36,452)	—
	<u>617,946</u>	<u>—</u>

In January 2007, the Company sold an additional 620,000 shares at a price of \$0.17 per share for \$105,400.

Ontex has two common directors with the Company, and owns 13.3% of the Company's outstanding shares at December 31, 2006 [2005 – 13.3%]. Advances payable in the amount of \$35,906 (2005 – receivable of \$711,770) are non-interest bearing and payable on demand.

**7. INVESTMENT IN ECHO POWER GENERATION INC.**

As at December 31, 2004, the company held 10,000,000 common shares of EPG being 43.86% of the 22,797,270 common shares issued and outstanding at that time.

During the year ended December 31, 2005, EPG issued 96,428 additional flow-through special warrants at \$1.40 per special warrant through a private placement for proceeds of \$135,000.

In April 2006, the Company participated in a rights offering by EPG, acquiring rights to an additional 3,000,000 shares for \$300,000. On May 1, 2006, EPG notified the Company that the offering was fully subscribed and that 34,409,295 common shares were issued and outstanding.

As a result, the Company holds a 37.78% interest in EPG as follows:

	2006	2005
	\$	\$
Opening balance	1,192,975	1,568,458
Acquisition of common shares	300,000	—
Share of equity loss	(530,982)	(375,483)
Write-down of investment	(961,993)	—
	<u>—</u>	<u>1,192,975</u>

## **Echo Energy Canada Inc.**

### **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

For the years ended December 31, 2006 and 2005

As previously reported, the Company increased the amount of its investment in EPG on August 27, 2004 by \$1,830,608 to record its acquisition of Echo Energy Inc.'s 25% interest in EPG. The increase was based on a net asset valuation derived by Dundee Securities Corporation from a discounted cash flow analysis based on operating models and long-term business plans provided by management of EPG. EPG has continued to record losses since the valuation date, has expended the funds raised in the April 2006 rights offering and must raise additional funding to support future operations. The timing of long-term plans remains uncertain. As a result, the Company has recorded a write-down of its investment in EPG of \$961,993 to record the investment at nil as at December 31, 2006.

Advances due from EPG in the amount of \$398,969 at December 31, 2005 were repaid in the second quarter of 2006.

#### **8. LONG-TERM DEBT**

In January 2005, the Company secured a \$6,000,000 revolving production facility. \$5,000,000 of the facility was used to repay an interim loan which financed construction of the gas gathering pipeline and compressor system.

In October 2005, the facility credit limit was increased to \$6,500,000 and in August 2006 the revolving period was extended from July 31, 2006 to July 30, 2007 at which time the facility will be extended for a further 364 day period or converted to a one year term with quarterly principal payments of one twentieth of the advanced amount, if necessary, commencing October 30, 2007.

Interest is charged at a rate of prime plus 0.5% and paid monthly during the revolving period. The facility is secured by an \$8,000,000 debenture representing a first floating charge on all assets and undertakings of the Company and a fixed charge on gas properties.

#### **9. ASSET RETIREMENT OBLIGATION**

During the year ended December 31, 2004, the Company accrued for an estimated total undiscounted asset retirement obligation of \$355,000 discounted at the Company's then current cost of financing to a present value of \$21,900 based on a 60 year life in accordance with estimates prepared by an independent consulting engineer. The estimate was increased to \$23,000 as at December 31, 2005 with the passage of time.

The engineer's evaluation of the reserves as of December 31, 2006 indicated that the flow rates of producing wells during the year were less than the forecasts used in prior evaluations and, as a result, forecasts were truncated to a 25 year life. The estimated obligation was increased by \$58,300 to reflect an undiscounted asset retirement obligation of \$370,000 discounted to a present value of \$81,300 based on a 25 year life.

## Echo Energy Canada Inc.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the years ended December 31, 2006 and 2005

Estimated future retirement costs such as dismantlement, site restoration and abandonment costs are subject to uncertainty associated with the method, timing and extent of future dismantlement, site restoration and abandonment. For example, changes in legislation or technology may result in actual future costs that differ materially from those estimated. The Company provided letters of credit in 2004 in the amount of \$140,000 as security for its asset retirement obligation.

#### 10. FUTURE INCOME TAXES

Income taxes vary from the amounts that would be computed by applying the Canadian federal and provincial statutory rates in 2006 of approximately 38% and 2005 of approximately 40% to earnings (loss) before income taxes as follows:

	2006	2005
	\$	\$
Expected income tax recovery (expense) using statutory income tax rates	582,300	(318,400)
Resource allowance	41,000	168,800
Loss not subject to income taxes	(396,000)	(150,600)
Reduction of substantively enacted rates	(400)	38,700
Non-deductible expenses	(49,700)	(96,000)
<b>Future income tax expense</b>	<b>177,200</b>	<b>(357,500)</b>

The tax effects of temporary differences that give rise to significant portions of the future tax liabilities are as follows:

	2006	2005
	\$	\$
Property and equipment	(144,800)	(27,800)
Non-capital losses	489,600	561,200
Deferred exploration expenditures	(2,169,800)	(2,349,200)
Investment in EPG and Ontex	17,100	(169,300)
Tax effect pursuant to the business combination	(11,861,200)	(11,861,200)
	<b>(13,669,100)</b>	<b>(13,846,300)</b>

The Company has approximately \$1,289,000 of operating losses that expire between 2007 and 2013.

## Echo Energy Canada Inc.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the years ended December 31, 2006 and 2005

#### 11. SHARE CAPITAL

The Company has issued common shares as follows:

	Number of shares #	Share capital \$
<b>Balance, December 31, 2004</b>	<b>51,201,915</b>	<b>34,236,150</b>
Shares issued pursuant to private placements	1,577,600	1,972,000
Costs of share issuance		(78,750)
Future tax impact of renunciation of development costs expended	—	(712,300)
<b>Balance, December 31, 2005</b>	<b>52,779,515</b>	<b>35,417,100</b>
Changes during the period	—	—
<b>Balance, December 31, 2006</b>	<b>52,779,515</b>	<b>35,417,100</b>

#### [a] Escrow shares

Pursuant to an escrow agreement dated October 14, 1998, between the Company and Ontex, 1,226,838 pre-split common shares of the Company held by Ontex were originally deposited in escrow. Under the terms of the escrow agreement, 368,051 shares were automatically releasable to Ontex, through to October 15, 2001, based upon the passage of time. Under the agreement, the remaining 858,786 pre-split shares (or 2,576,358 post-split shares) were releasable upon approval from the Ontario Securities Commission based upon certain expenditures on mineral exploration properties, the achievement of a specific five-year cumulative cash flow and the attainment of commercial production. Ontex made application for release of the shares in 2005 and received consent for release in December 2005.

#### [b] Earnings per share

	2006 \$	2005 \$
<b>Basic and diluted earnings (loss) per share computation</b>		
Numerator:		
Net earnings (loss)	(1,350,262)	436,085
Denominator:		
Weighted average common shares outstanding	52,779,515	51,393,111
<b>Basic and diluted earnings (loss) per share</b>	<b>(0.026)</b>	<b>0.008</b>

## **Echo Energy Canada Inc.**

### **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

For the years ended December 31, 2006 and 2005

#### **[c] Issuance of Shares**

During the year ended December 31, 2005, the Company completed private placements that resulted in the issuance of 1,577,600 flow through common shares at a price of \$1.25.

#### **[d] Stock options**

Under the stock option plan, eligible directors, officers and employees may be granted options to acquire common shares at a price which is not less than the closing price of the Company's common shares on the TSX Venture Exchange on the trading day immediately preceeding the date of grant less any discounts permitted by the rules of the Exchange. The options are not transferable, shall vest immediately and may be subject to any vesting the Board of Directors determines not to exceed a term of 10 years.

The 4,700,000 options granted on October 28, 2004 are exercisable in whole or in part at any time prior to October 28, 2007 at the exercise price of \$2.00 per common share. As at December 31, 2006 none of the options have been exercised and none have expired.

On December 1, 2006, 265,000 options, exercisable at a price of \$0.50, were granted to Agoracom Investor Relations Corp under an investor relations agreement with vesting of one-quarter of the options on each of February 28, 2007, May 31, 2007, August 31, 2007 and November 30, 2007. The fair value of the option compensation will be recognized on the vesting dates. A total of 155,000 shares remain available for issuance under the stock option plan.

## **12. COMMITMENTS**

The Company has contractual obligations under management consulting agreements, expiring between September 15, 2011 and September 15, 2013, to compensate its Chairman, President and Vice-President for management services provided by them in the aggregate amount of \$608,533 for 2007, escalating at the rate of ten percent per annum.

In September 2001, the Company's subsidiary, 1490564 Ontario Inc., entered into an agreement for the purchase of certain oil and gas leases for \$90,000 subject to regulatory approval. At December 31, 2006, no payments in respect of this agreement have been made.

The Company has also entered into a number of exclusive lease rights with land owners. These leases contemplate a minimum or maximum amount payable in the form of rent per acre of land under lease and royalties on revenues generated on gas, oil and minerals extracted from the land. While the leases grant rights to the Company over a specified term, the Company may at any time release all or part of its interest and thereby terminate its obligations. Payments totaling \$224,891 are expected to be paid under existing leases during 2007.

## Echo Energy Canada Inc.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the years ended December 31, 2006 and 2005

In addition, the Company entered into an agreement to lease compressor equipment with a remaining minimum lease commitment for 2007 of \$88,846.

#### 13. RELATED PARTY TRANSACTIONS

All related party transactions have been recorded at the exchange amount which represented the amount of consideration established and agreed to by the related parties.

During the year ended December 31, 2006, the Company paid certain of its directors and executive officers \$749,293 [2005 - \$557,400] in consulting fees. The Company also paid \$55,769 [2005 - \$89,507] in respect of rent and office services to a company influenced by the Chairman.

On March 16, 2006, the Company acquired 4,509,833 common shares of Ontex Resources Limited ("Ontex") at a price of \$0.18 per share pursuant to a debt to shares conversion agreement under which Ontex settled a \$811,770 debt owed to the Company as discussed in Note 6. In October 2006, the Company acquired a further 1,127,458 shares at a price of \$0.10 per share and, in December 2006, sold 1,647,058 shares at a price of \$0.17 per share to an arms length purchaser. Ontex has two common directors with the Company and, as a result of the above transactions, owns 5.87% of the Company's outstanding shares at December 31, 2006

#### 14. STATEMENT OF CASH FLOWS

[a] Changes in non-cash working capital consist of the following:

	2006	2005
	\$	\$
Accounts receivable	253,747	(305,320)
Inventory	(48,026)	87,478
Prepaid expenses	(12,391)	1,820
Accounts payable and accrued liabilities	(85,614)	75,405
Accrued royalties	(55,280)	109,297
	<u>52,435</u>	<u>(31,320)</u>

[b] Supplemental cash flow information

	2006	2005
	\$	\$
Interest received	7,543	6,372
Interest paid	395,647	320,262

**Echo Energy Canada Inc.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

For the years ended December 31, 2006 and 2005

**15. COMPARATIVE AMOUNTS**

Certain comparative amounts have been reclassified to reflect the presentation adopted in the current period.