

Consolidated Financial Statements

**Echo Energy Canada Inc.**

December 31, 2007 and 2006

NEAL, PALLETT & TOWNSEND LLP



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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, 2007 and 2006 and the consolidated statements of income (loss) and 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 audits.

We conducted our audits 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, 2007 and 2006 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

*Neal, Pallett & Townsend LLP*

London, Canada  
March 7, 2008

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,

	2007	2006
	\$	\$
<b>ASSETS</b>		
<b>Current assets</b>		
Cash and cash equivalents	1,971,638	455,677
Term deposits	213,000	213,000
Accounts receivable	123,163	275,557
Inventory [note 4]	47,396	82,937
Prepays	20,565	14,126
	<b>2,375,762</b>	<b>1,041,297</b>
<b>Non-current assets</b>		
Property and equipment, net [note 5]	6,176,631	6,271,727
Oil and gas leases [note 6]	44,457,213	44,245,578
Investment in Ontex Resources Limited [note 7]	368,120	617,946
	<b>53,377,726</b>	<b>52,176,548</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>Current liabilities</b>		
Accounts payable and accrued liabilities	172,297	316,066
Accrued royalties	50,649	69,793
Subscriptions returnable [note 9]	1,320,000	—
Current portion of long-term debt [note 10]	1,260,000	310,000
Advances from Ontex Resources Limited [note 7]	85,072	35,906
	<b>2,888,018</b>	<b>731,765</b>
Long-term debt [note 10]	4,940,000	5,890,000
Subscriptions received in advance [note 9]	450,000	—
Asset retirement obligation [note 11]	78,500	81,300
Future income taxes [note 12]	13,009,100	13,669,100
	<b>21,365,618</b>	<b>20,372,165</b>
Commitments [note 13]		
<b>Shareholders' equity</b>		
<b>Share capital [note 14]</b>		
<b>Authorized</b>		
Unlimited common shares		
<b>Issued</b>		
Common shares	35,417,100	35,417,100
Contributed Surplus [note 15]	15,340	—
Deficit	(3,420,332)	(3,612,717)
	<b>32,012,108</b>	<b>31,804,383</b>
	<b>53,377,726</b>	<b>52,176,548</b>

See accompanying notes to consolidated financial statements

On behalf of the Board

signed "Robert Moore"

Director

signed "Gary Conn"

Director

# Echo Energy Canada Inc.

Incorporated under the laws of Ontario

## CONSOLIDATED STATEMENTS OF INCOME (LOSS) AND DEFICIT

For the year ended December 31,

	2007	2006
	\$	\$
<b>REVENUE</b>		
Gross sales	2,318,432	2,639,381
Less: Royalties	138,944	161,401
Net sales	2,179,488	2,477,980
Interest	9,515	8,333
Total revenue	2,189,003	2,486,313
<b>EXPENSES</b>		
Transportation	205,212	235,374
Operations	403,891	405,501
Depreciation, depletion and amortization	671,554	621,211
Loss on settlement of asset retirement obligation	27,300	—
Management, legal and audit fees [notes 14 and 16]	694,361	521,449
General and administrative expenses	141,644	281,756
Interest on long-term debt	419,173	388,231
Interest and bank charges	11,535	7,416
	2,574,670	2,460,938
<b>Earnings (loss) before the undernoted</b>	(385,667)	25,375
Exchange loss on foreign currency	(118,522)	(33,292)
Gain on sale of shares of Ontex Resources Limited [note 7]	50,231	9,882
Equity loss from Ontex Resources Limited [note 7]	(13,657)	(36,452)
Equity loss from Echo Power Generation Inc. [note 8]	—	(530,982)
Write-down - Echo Power Generation Inc. [note 8]	—	(961,993)
<b>Net loss before income taxes</b>	(467,615)	(1,527,462)
Future income tax recovery [note 12]	660,000	177,200
<b>Net earnings (loss)</b>	192,385	(1,350,262)
Deficit, beginning of year	(3,612,717)	(2,262,455)
<b>Deficit, end of year</b>	(3,420,332)	(3,612,717)
Basic and diluted income (loss) per share [note 14[a]]	\$ 0.004	\$ (0.026)

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,

	2007	2006
	\$	\$
<b>Cash provided by (used in)</b>		
<b>OPERATING ACTIVITIES</b>		
Net earnings (loss)	192,385	(1,350,262)
Items not affecting cash		
Future income tax expense	(660,000)	(177,200)
Depreciation, depletion and amortization	654,646	654,986
Gain on sale of shares	(50,231)	(9,882)
Loss on settlement of asset retirement obligation	27,300	
Share compensation to consultants	15,340	—
Equity loss from Ontex Resources Limited	13,657	36,452
Equity loss from Echo Power Generation Inc.	—	530,982
Write-down - Echo Power Generation Inc.	—	961,993
Change in non-cash operating working capital [note 17]	18,583	52,435
	<b>211,680</b>	<b>699,504</b>
<b>FINANCING ACTIVITIES</b>		
Repayments from Echo Power Generation Inc.	—	398,969
Repayments and advances from Ontex Resources Limited	49,166	747,676
	<b>49,166</b>	<b>1,146,645</b>
<b>INVESTING ACTIVITIES</b>		
Purchase of property and equipment	(9,670)	(251,362)
Acquisition of oil and gas leases	(756,615)	(1,750,469)
Payments to settle asset retirement obligations	(35,000)	—
Investment in Echo Power Generation Inc.	—	(300,000)
Investment in Ontex Resources Limited	—	(924,516)
Subscriptions received in advance	1,770,000	—
Proceeds on sale of investment in Ontex Resources Limited	286,400	280,000
	<b>1,255,115</b>	<b>(2,946,347)</b>
<b>Increase (decrease) in cash and cash equivalents</b>	<b>1,515,961</b>	<b>(1,100,198)</b>
Cash and cash equivalents, beginning of year	455,677	1,555,875
<b>Cash and cash equivalents, end of year</b>	<b>1,971,638</b>	<b>455,677</b>

See accompanying notes to consolidated financial statements

## **Echo Energy Canada Inc.**

# **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

For the years ended December 31, 2007 and 2006

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

Echo Energy Canada Inc. (the "Company") was amalgamated on April 1, 2006 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. and Pecho Pipelines Inc. The company and Echo Energy Inc. ("EEI") were amalgamated on April 1, 2006 and continue as Echo Energy Canada Inc.

## **2. SIGNIFICANT ACCOUNTING POLICIES**

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] Cash and cash equivalents**

Cash and cash equivalents include bank deposits that are readily convertible to a known amount of cash and subject to an insignificant risk of changes in value.

### **[b] Investments**

Investments in companies over which the Company believes it exerts significant influence are accounted for on the equity basis. Under this method, the Company includes its share of the results of operations of the investee as earnings.

### **[c] 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

## **Echo Energy Canada Inc.**

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

For the years ended December 31, 2007 and 2006

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 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.

#### **[d] 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.

#### **[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. Trucks and tractor are depreciated on the declining balance method over their estimated useful lives at an annual rate of 20%. Costs of constructing the gas gathering

## Echo Energy Canada Inc.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the years ended December 31, 2007 and 2006

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, 2007, the Company's largest credit exposure to a single party was approximately \$120,242.

##### *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, 2007 and 2006

### *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 contributed surplus. 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 under an agreement of sale.

## **3. CHANGES IN ACCOUNTING POLICY**

Effective January 1, 2007, the Company has adopted CICA Handbook sections 1530 "Comprehensive Income", 3855 "Financial Instruments - Recognition and Measurement", 3861 - "Financial Instruments - Disclosure and Presentation" and 3865 "Hedges". These new standards are effective on a prospective basis with no restatement of comparative figures.

Section 1530 establishes standards for reporting and presenting comprehensive income, which is defined as the change in equity from transactions, events and circumstances from non-owner sources. Other comprehensive income refers to items recognized in comprehensive income that

## **Echo Energy Canada Inc.**

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

For the years ended December 31, 2007 and 2006

are excluded from net income calculated in accordance with generally accepted accounting principles.

Section 3855 requires financial instruments be classified into one of the following categories: held-to-maturity, held for trading, loans and receivables, available-for-sale financial assets or other financial liabilities. All financial instruments, including derivatives, are measured in the balance sheet at fair value, except for loans and receivables, held-to-maturity investments and other financial liabilities which are measured at amortized cost. The adoption of this section did not require any transitional adjustments to opening accumulated other comprehensive income.

Upon adoption of these new standards, the Company designated its cash and short-term investments as held-for-trading. Accounts receivable has been classified as loans and receivables. Accounts payable and accrued liabilities, accrued royalties and advances from Ontex have been classified as other financial liabilities.

Section 3861 establishes standards for presentation of financial instruments and identifies the information required for disclosure in the company's financial statements. The adoption of the new recommendations did not impact the consolidated financial statements.

Section 3865 specifies the criteria under which hedge accounting can be used and establishes the required disclosures. The Company is not currently engaged in any hedging activity. As a result, the adoption of section 3865 did not have any impact on the Company's consolidated financial statements.

The Canadian Accounting Standards Board (AcSB) issued two new Sections in relation to financial instruments: Section 3862, Financial Instruments – Disclosures, and Section 3863, Financial Instruments – Presentation. Both sections will become effective for the Company's 2008 disclosure and may require increased disclosure regarding financial instruments.

The AcSB issued Section 1535, Capital Disclosures. This standard requires disclosure regarding what the Company defines as capital and its objectives, policy and processes for managing capital. This standard will be effective for the Company's 2008 disclosure.

The AcSB issued Section 3031, Inventories. This standard prescribes the accounting treatment for inventories, and is not expected to impact the Company's 2008 disclosure.

**Echo Energy Canada Inc.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

For the years ended December 31, 2007 and 2006

**4. INVENTORY**

	<b>2007</b>	2006
	\$	\$
Natural gas in storage:		
22,034 mcf	—	82,937
11,471 mcf	47,396	—
	<u>47,396</u>	<u>82,937</u>

**5. PROPERTY AND EQUIPMENT**

	<b>2007</b>		
	<b>Cost</b>	<b>Accumulated</b>	<b>Net book</b>
	\$	amortization	value
	\$	\$	\$
Trucks and tractor	79,659	34,231	45,428
Gas gathering pipeline and compressor system	6,327,177	195,974	6,131,203
	<u>6,406,836</u>	<u>230,205</u>	<u>6,176,631</u>

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

## Echo Energy Canada Inc.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the years ended December 31, 2007 and 2006

#### 6. OIL AND GAS LEASES

	Acquisition \$	Exploration \$	Total \$
<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>
Deferred exploration costs	—	756,615	756,615
Revision to asset retirement obligation	—	4,900	4,900
Depreciation, depletion and amortization	—	(549,880)	(549,880)
<b>Balance, December 31, 2007</b>	<b>35,082,391</b>	<b>9,374,822</b>	<b>44,457,213</b>

[a] Pursuant to an agreement (the "Agreement") dated August 23, 2000, and purchased by Ontex on January 17, 2002, Echo acquired a 100% interest in certain oil and gas leases covering 2,000 acres in Bayham Township, Ontario. The Agreement reserves a gross overriding royalty to Ontex of 10%. 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 five Houghton leases.

## **Echo Energy Canada Inc.**

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

For the years ended December 31, 2007 and 2006

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.

#### **7. 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 resulting in a gain of \$9,882. In January 2007, the Company sold an additional 620,000 shares at a price of \$0.17 per share for \$105,400 resulting in a gain of \$9,384. In August 2007, the Company sold 905,000 shares at a price of \$0.20 per share for \$181,000 resulting in a gain of \$40,847.

## Echo Energy Canada Inc.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the years ended December 31, 2007 and 2006

As a result, the Company holds 2,465,233 shares representing a 2.89% interest in Ontex, a publicly traded company, as follows:

	2007 \$	2006 \$
Opening balance	617,946	—
Acquisition of common shares	—	924,516
Sale of common shares	(236,169)	(270,118)
Share of equity loss	(13,657)	(36,452)
	<u>368,120</u>	<u>617,946</u>

Ontex has two common directors with the Company, one of whom is Chief Executive Officer, a common Chief Financial Officer and owns 13.3% of the Company's outstanding shares at December 31, 2007 [2006 – 13.3%] giving rise to common significant influence. With the issuance by the Company of common shares described in Note 14, Ontex's ownership percentage decreased to 11.69%. Advances payable in the amount of \$85,072 (2006 –\$35,906) arising from royalty obligations and expenses paid on the Company's behalf are non-interest bearing and payable on demand.

Summarized information of the financial position and results of operations of Ontex are as follows:

	2007 \$	2006 \$
Assets	14,829,010	11,158,848
Liabilities	85,185	61,721
Shareholders' equity	14,743,825	11,097,127
Liabilities and shareholders' equity	<u>14,829,010</u>	<u>11,158,848</u>
Revenue	166,689	43,565
Expenses	(686,079)	(488,916)
Equity in earnings (loss) of Echo Energy Canada Inc.	25,652	(180,039)
Other items	37,619	(176,000)
Loss for the year	(456,119)	(801,390)
Other comprehensive income (loss)	(61,124)	—
Comprehensive loss for the year	<u>(517,243)</u>	<u>(801,390)</u>

For more detailed information, please refer to Ontex's public filings.

## Echo Energy Canada Inc.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the years ended December 31, 2007 and 2006

#### 8. INVESTMENT IN ECHO POWER GENERATION INC.

As at December 31, 2006, the company held 13,000,000 common shares of Echo Power Generation Inc. ("EPG"). EPG continued to record losses and requires additional funding to support future operations.

The Company reflected a write-down of its 37.78% interest in EPG on December 31, 2006 to record the investment at \$nil as follows:

	2007 \$	2006 \$
Opening balance	—	1,192,975
Acquisition of common shares	—	300,000
Share of equity loss	—	(530,982)
Write-down of investment	—	(961,993)
	—	—

#### 9. SUBSCRIPTIONS RECEIVED IN ADVANCE

On November 23, 2007, the Company received \$1,770,000 in subscriptions for common shares. The purpose of the proposed \$2,000,000 private placement was to raise funds to capitalize the Company and to finance the development of its gas reserves. In January and February 2008, \$1,320,000 was returned to subscribers.

Completion of the private placement was delayed by an application for an injunction filed by three shareholders of Echo Energy, namely Salvatore Fuda, Challenge Gas Holding AB ("Challenge"), and Exclusive Asset Management Inc. ("Exclusive") against Echo Energy and five of its directors, namely Gary Conn, Michael Hunter, Robert Moore, David Johnstone, and Salvatore Pacifico (the "Fuda Action"). The court did not enjoin the Company from proceeding with a private placement that allowed Mr Fuda to buy all or 52% of the \$2,000,000 private placement. In March 2008, the private placement was completed pursuant to the order with the issuance of 6,000,000 common shares, at an issue price of \$0.25 per common share, and 1,428,571 flow-through common shares, at an issue price of \$0.35 per flow-through common share. 5,000,000 common shares and 857,143 flow-through common shares were issued to the Chairman of the Company, with the balance issued to private investors.

#### 10. LONG-TERM DEBT

In February 2008, the Company's approved revolving credit facility was decreased from \$6,200,000 to \$5,200,000 based on the bank's assessment of its borrowing base. The remaining principal requires interest only payments for the balance of the revolving period to July 30, 2008 at which time the facility will be extended for a further 364 day period, or converted to a one year

## Echo Energy Canada Inc.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the years ended December 31, 2007 and 2006

term with quarterly principal payments of one twentieth of the advanced amount, if necessary, commencing October 30, 2008.

	2007 \$	2006 \$
Prime plus 0.5% revolving credit facility	<b>6,200,000</b>	6,200,000
Less amounts expected to be due within one year	<b>1,260,000</b>	310,000
Amounts due in 2009 if converted to a one year term	<b>4,940,000</b>	5,890,000

Interest is 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.

#### 11. ASSET RETIREMENT OBLIGATION

During the year ended December 31, 2006, the Company adjusted its estimated total undiscounted asset retirement obligation based on a gross liability of \$370,000 discounted at the Company's then current cost of financing of 6.25% to a present value of \$81,300 over a 25 year life in accordance with estimates prepared by an independent consulting engineer. During the year ended December 31, 2007 the company settled its liabilities on 7 wells and recorded obligations on 5 wells completed in the year as follows:

	2007 \$	2006 \$
Balance – beginning of year	<b>81,300</b>	23,000
Revisions in timing of estimated cash flows	—	58,300
Liabilities settled in year	<b>(7,700)</b>	—
Liabilities incurred for completed wells	<b>4,900</b>	—
Balance – end of year	<b>78,500</b>	81,300

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.

## Echo Energy Canada Inc.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the years ended December 31, 2007 and 2006

#### 12. FUTURE INCOME TAXES

Income taxes vary from the amounts that would be computed by applying the Canadian federal and provincial statutory rates of approximately 36% to earnings (loss) before income taxes as follows:

	2007	2006
	\$	\$
Expected income tax recovery (expense) using statutory income tax rates	<b>168,900</b>	582,300
Resource allowance	<b>26,200</b>	41,000
Loss not subject to income taxes	—	(382,100)
Equity in income (loss) of affiliate not subject to income tax	<b>(4,900)</b>	(13,900)
Non-taxable portion of capital gain	<b>6,600</b>	—
Reduction of substantively enacted rates	<b>468,800</b>	(400)
Non-deductible expenses	<b>(5,600)</b>	(49,700)
<b>Future income tax recovery</b>	<b>660,000</b>	177,200

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

	2007	2006
	\$	\$
Property and equipment	<b>(243,300)</b>	(144,800)
Non-capital losses	<b>475,400</b>	489,600
Deferred exploration expenditures	<b>(1,797,300)</b>	(2,169,800)
Investment in EPG and Ontex	<b>6,300</b>	17,100
Tax effect pursuant to the business combination	<b>(11,450,200)</b>	(11,861,200)
	<b>(13,009,100)</b>	(13,669,100)

The Company has approximately \$1,180,000 of Federal and \$1,667,000 of Ontario non-capital losses that expire between 2008 and 2027.

#### 13. CONTINGENCIES AND COMMITMENTS

From time to time, the Company is the subject of litigation arising out of the Company's operations. Damages claimed under such litigation may be material or may be indeterminate and the outcome of such litigation may materially impact the Company's financial condition or results of operations. While the Company assesses the merits of each lawsuit and defends itself accordingly, the Company may be required to incur significant expenses or devote significant resources to defending itself against such litigation. These claims are not currently expected to have a material impact on the Company's financial position.

## Echo Energy Canada Inc.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the years ended December 31, 2007 and 2006

The Company is a party, as applicant and as respondent, to court applications alleging oppressive actions. The Company has assessed that the outcome of the actions is not determinable and, further, that the amount of contingent recovery or loss, if any, cannot be reasonably estimated.

The Company has contractual obligations under management consulting agreements, expiring between September 15, 2011 and September 15, 2013, to compensate its Chairman and President for management services provided by them in the aggregate amount of approximately \$465,000 for 2008, escalating at the rate of ten percent per annum.

A company influenced by a director is constructing gas gathering pipelines which are expected to be completed for an amount of approximately \$375,000 to \$400,000.

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 approximately \$220,000 are expected to be paid under existing leases during 2008.

#### 14. SHARE CAPITAL

The Company has issued common shares as follows:

	Number of shares #	Share capital \$
<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>
Changes during the period	—	—
<b>Balance, December 31, 2007</b>	<b>52,779,515</b>	<b>35,417,100</b>

## Echo Energy Canada Inc.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the years ended December 31, 2007 and 2006

#### [a] Earnings per share

	2007	2006
	\$	\$
<b>Basic and diluted earnings (loss) per share computation</b>		
Numerator:		
Net earnings (loss)	192,385	(1,350,262)
Denominator:		
Weighted average common shares outstanding	52,779,515	52,779,515
<b>Basic and diluted earnings (loss) per share</b>	<b>0.004</b>	<b>(0.026)</b>

#### [b] 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 preceding 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.

4,700,000 options granted on October 28, 2004 were exercisable in whole or in part at any time prior to October 28, 2007 at the exercise price of \$2.00 per common share. None of the options were exercised and have now expired.

On December 1, 2006, 265,000 options, exercisable at any time from November 30, 2007 to the expiry date of November 30, 2008 at a price of \$0.50, were granted to the Company's investor relations firm 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 values of the option compensation vested during the year were estimated at \$15,340, as discussed below, and recognized as an expense with offsetting credit to Contributed Surplus. A total of 7,785,000 shares remain available for issuance under the stock option plan.

## Echo Energy Canada Inc.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the years ended December 31, 2007 and 2006

#### [c] Share compensation expense

The fair value of \$15,340 for the options granted and vested in 2007 were estimated at the date of vesting using the Black-Scholes option pricing model with no expected dividend yield and the following weighted average assumptions and fair values:

Number of Options	Risk free rate	Expected Volatility	Option Life	Fair value per option	Total Fair value
<i>February 28, 2007</i>					
<b>66,250</b>	<b>6.5%</b>	<b>5.4%</b>	<b>21 months</b>	<b>\$0.05</b>	<b>\$3,610</b>
<i>May 31, 2007</i>					
<b>66,250</b>	<b>6.5%</b>	<b>9.5%</b>	<b>18 months</b>	<b>\$0.05</b>	<b>\$3,490</b>
<i>August 31, 2007</i>					
<b>66,250</b>	<b>6.5%</b>	<b>9.5%</b>	<b>15 months</b>	<b>\$0.04</b>	<b>\$2,630</b>
<i>November 30, 2007</i>					
<b>66,250</b>	<b>6.5%</b>	<b>35.3%</b>	<b>12 months</b>	<b>\$0.08</b>	<b>\$5,610</b>

The Black-Scholes model, used by the Company to calculate option values, as well as other accepted option valuation models, were developed to estimate fair value of freely tradable, fully transferable options without vesting restrictions. These models also require four highly subjective assumptions, including future stock price volatility and expected time until exercise, which greatly affect the calculated values.

#### [d] Issuance of Shares

In November 2007, the Company approved a \$2,000,000 private placement which was completed in March 2008 with the issuance of 6,000,000 common shares, at an issue price of \$0.25 per common share, and 1,428,571 flow-through common shares, at an issue price of \$0.35 per flow-through common share. 5,000,000 common shares and 857,143 flow-through common shares were issued to the Chairman of the Company, with the balance issued to private investors.

#### 15. CONTRIBUTED SURPLUS

	2007	2006
	\$	\$
Balance – beginning of year	—	—
Share compensation to consultants	<b>15,340</b>	—
Balance – end of year	<b>15,340</b>	—

## Echo Energy Canada Inc.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the years ended December 31, 2007 and 2006

#### 16. 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.

- [a] The Company's President and Treasurer is a director and is also President and Treasurer and a director of Ontex. During the year ended December 31, 2007, the Company paid a company influenced by the President and Treasurer \$202,844 [2006 - \$232,341] in management and consulting fees.
- [b] The Company's Chairman is a director and is also Chairman and a director of Ontex. During the year ended December 31, 2007, the Company paid a company influenced by the Chairman \$202,844 [2006 - \$184,404] in management and consulting fees. The Company also paid \$nil [2006 - \$55,769] in respect of rent and office services to a company influenced by the Chairman.
- [c] During the year ended December 31, 2007, the Company paid \$116,220 [2006 - \$93,075] in respect of financial services provided by the Chief Financial Officer of the Company.
- [d] The Company's Vice-President is a director of the Company. During the year ended December 31, 2007, the Company paid the Vice-President \$106,863 [2006 - \$208,604] in respect of management and consulting services.
- [e] During the year ended December 31, 2007, the Company paid \$6,870 [2006 - \$22,644] in respect of field services and expenses to a director of the Company.

The Company has ongoing contractual obligations under management consulting agreements as discussed in Note 13.

During the year ended December 31, 2007, the Company received net advances from Ontex Resources Limited ("Ontex") on account of royalty obligations and expenses paid on the Company's behalf in the amount of \$49,166 in addition to \$35,906 of net advances for similar items received in 2006 subsequent to the debt for shares conversion discussed below.

On March 16, 2006, the Company acquired 4,509,833 common shares of 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. In January 2007, the Company sold an additional 620,000 shares at a price of \$0.17 and, in August 2007, sold 905,000 shares at a price of \$0.20. All of the sales were made to arm's length purchasers. Ontex has two common directors with the Company and, as a result of the above transactions, owns 2.89% of the Company's outstanding shares at December 31, 2007.

## Echo Energy Canada Inc.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the years ended December 31, 2007 and 2006

In March 2008, company completed a private placement which included the issuance of 5,000,000 common shares and 857,143 flow-through common shares to the Chairman of the Company.

#### 17. STATEMENT OF CASH FLOWS

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

	2007	2006
	\$	\$
Accounts receivable	152,394	253,747
Inventory	35,541	(48,026)
Prepaid expenses	(6,439)	(12,391)
Accounts payable and accrued liabilities	(143,769)	(85,614)
Accrued royalties	(19,144)	(55,280)
	<u>18,583</u>	<u>52,435</u>

[b] Supplemental cash flow information

	2007	2006
	\$	\$
Interest received	9,545	7,543
Interest paid	418,992	395,647

#### 18. COMPARATIVE AMOUNTS

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