Consolidated Financial Statements

Echo Energy Canada Inc.

September 30, 2008

Echo Energy Canada Inc.

Notice to Reader

The management of Echo Energy Canada Inc. is responsible for the preparation of the accompanying interim financial statements. The interim financial statements have been prepared in accordance with accounting principles generally accepted in Canada and are considered by management to present fairly the financial position, operating results and cash flows of the Company.

These interim financial statements have not been reviewed by an auditor. These interim financial statements are unaudited and include all adjustments, consisting of normal and recurring items, that management considers necessary for a fair presentation of the consolidated financial position, results of operations and cash flows.

(signed) "Gary Conn"

Gary Conn, President and Chief Executive Officer

(signed) "Peter Pistor"

Peter Pistor, Chief Financial Officer

November 13, 2008

Echo Energy Canada Inc.

Incorporated under the laws of Ontario

CONSOLIDATED BALANCE SHEETS

As at

	September 30, 2008	December 31, 2007
	$	$
	[unaudited]	[audited]
ASSETS		
Current assets		
Banks	**390,815**	1,971,638
Term deposits	**213,000**	213,000
Accounts receivable	**257,408**	123,163
Inventory *[note 4]*	**53,482**	47,396
Prepaids	**31,711**	20,565
	946,416	2,375,762
Non-current assets		
Property and equipment, net *[note 5]*	**6,486,627**	6,176,631
Oil and gas leases *[note 6]*	**44,405,222**	44,457,213
Investment in Ontex Resources Limited *[note 7]*	**316,925**	368,120
	52,155,190	53,377,726
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities		
Accounts payable and accrued liabilities	**150,091**	172,297
Accrued royalties	**72,728**	50,649
Subscriptions returnable *[note 9]*	**—**	1,320,000
Current portion of long-term debt *[note 10]*	**5,550,000**	1,260,000
Advances from Ontex Resources Limited *[note 7]*	**12,443**	85,072
	5,785,262	2,888,018
Long-term debt *[note 10]*	**—**	4,940,000
Subscriptions received in advance *[note 9]*	**—**	450,000
Asset retirement obligation *[note 11]*	**85,550**	78,500
Future income taxes *[note 12]*	**12,754,000**	13,009,100
	18,624,812	21,365,618
Commitments *[note 13]*		
Shareholders' equity		
Share capital *[note 14]*		
Authorized		
Unlimited common shares		
Issued		
Common shares	**37,417,100**	35,417,100
Contributed Surplus *[note 15]*	**15,340**	15,340
Deficit	**(3,902,062)**	(3,420,332)
	33,530,378	32,012,108
	52,155,190	53,377,726

See accompanying notes to consolidated financial statements

On behalf of the Board

signed "David Johnstone" — Director

signed "Gary Conn" — Director

Echo Energy Canada Inc.

Incorporated under the laws of Ontario

CONSOLIDATED STATEMENTS OF INCOME (LOSS) AND DEFICIT

For the

	Three month period ended		Nine month period ended	
	September 30, 2008	September 30, 2007	**September 30, 2008**	September 30, 2007
	$	$	**$**	$
	[unaudited]	[unaudited]	**[unaudited]**	[unaudited]
REVENUE				
Gross sales	**803,346**	528,088	**2,276,120**	1,850,426
Less: Royalties	**53,013**	33,193	**145,569**	116,043
Net sales	**750,333**	494,895	**2,130,551**	1,734,383
Interest	**3,290**	2,026	**14,062**	7,472
Total revenue	**753,623**	496,921	**2,144,613**	1,741,855
EXPENSES				
Transportation	**52,424**	50,459	**157,807**	150,054
Operations	**127,415**	82,668	**339,714**	282,142
Depreciation, depletion and amortization	**184,297**	135,161	**510,919**	406,044
Accretion	**2,350**	—	**7,050**	—
Net change in inventory	**(36,276)**	19,051	**(6,086)**	50,043
Management fees *[notes 14 and 16]*	**106,058**	105,658	**403,988**	369,916
Legal and audit fees	**34,338**	19,330	**1,010,328**	89,836
General and administrative expenses	**7,435**	22,138	**161,554**	135,469
Interest on long-term debt	**83,916**	104,635	**260,360**	305,583
Interest and bank charges	**1,352**	2,571	**4,214**	6,847
	563,309	541,671	**2,849,848**	1,795,934
Earnings (loss) before the undernoted	**190,314**	(44,750)	**(705,235)**	**(54,079)**
Exchange gain (loss) on foreign currency	**2,126**	(44,143)	**10,070**	(105,966)
Gain on sale of shares of Ontex Resources Limited *[note 7]*	**—**	40,847	—	50,231
Gain on sale of property and equipment	**2,017**	—	**9,530**	
Equity loss from Ontex Resources Limited *[note 7]*	**(36,258)**	(2,351)	**(51,195)**	(10,524)
Share compensation expense *[note 12[c]]*	—	(9,730)	—	(9,730)
Net loss before income taxes	**158,199**	(60,127)	**(736,830)**	(130,068)
Future income tax recovery *[note 12]*	**(64,600)**	20,600	**255,100**	42,100
Net earnings (loss)	**93,599**	(39,527)	**(481,730)**	(87,968)
Deficit, beginning of period	**(3,995,661)**	(3,661,158)	**(3,420,332)**	(3,612,717)
Deficit, end of period	**(3,902,062)**	(3,700,685)	**(3,902,062)**	(3,700,685)
Basic and diluted income (loss) per share *[note 14[a]]*	**$ 0.002**	$ (0.001)	**$ (0.008)**	$ (0.002)

See accompanying notes to consolidated financial statements

Echo Energy Canada Inc.

Incorporated under the laws of Ontario

CONSOLIDATED STATEMENTS OF CASH FLOWS

For the

	Three month period ended		Nine month period ended	
	September 30, 2008	September 30, 2007	**September 30, 2008**	September 30, 2007
	$	$	**$**	$
	[unaudited]	[unaudited]	**[unaudited]**	[unaudited]
Cash provided by (used in)				
OPERATING ACTIVITIES				
Net earnings (loss)	**93,599**	(39,527)	**(481,730)**	(87,968)
Items not affecting cash				
Future income tax expense	**64,600**	(20,600)	**(255,100)**	(42,100)
Depreciation, depletion and amortization	**184,179**	136,616	**510,919**	411,249
Accretion	**2,350**	(50,231)	**7,050**	(50,231)
Gain on sale of assets	**(2,017)**	9,384	**(9,530)**	
Share compensation to consultants	**—**	2,630	**—**	9,730
Equity loss from Ontex Resources Limited	**36,258**	2,351	**51,195**	10,524
Change in non-cash operating working capital *[note 17]*	**(129,729)**	(25,980)	**(151,604)**	(41,945)
	249,240	25,167	**(328,800)**	209,259
FINANCING ACTIVITIES				
Bank indebtedness	**(150,000)**	—	**(650,000)**	
Repayments and advances from Ontex Resources Limited	**(2,611)**	12,259	**(72,629)**	42,215
Subscriptions received in advance	**—**	—	**(1,770,000)**	
Issuance of common shares	**—**	—	**2,000,000**	
	(152,611)	54,474	**(492,629)**	42,215
INVESTING ACTIVITIES				
Purchase of property and equipment	**7,127**	(3,100)	**(393,794)**	(6,679)
Acquisition of oil and gas leases	**(86,116)**	(169,122)	**(377,618)**	(573,864)
Proceeds on sale of property and equipment	**2,017**	—	**12,017**	
Proceeds on sale of investment in Ontex Resources Limited	**—**	181,000	**—**	286,400
	(76,972)	(466,365)	**(759,395)**	(294,143)
Increase (decrease) in cash in banks	**19,657**	(386,724)	**(1,580,824)**	(42,669)
Banks, beginning of period	**371,157**	377,328	**1,971,638**	455,677
Banks, end of period	**390,814**	(9,396)	**390,814**	413,008

See accompanying notes to consolidated financial statements

Echo Energy Canada Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the nine months ended September 30, 2008

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 interim consolidated financial statements have been prepared by management using Canadian generally accepted accounting principles and follow the same accounting principles and methods of computation as the audited annual consolidated financial statements for the year ended December 31, 2007 except for the changes described in paragraph (m) below. The interim consolidated financial statements should be read in conjunction with the audited annual consolidated financial statements and the notes thereto.

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 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 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

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. Risk management is described below.

[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.

[m] Changes in accounting policies

Effective January 1, 2008 the Company adopted the following new CICA accounting standards: Section 3862, Financial Instruments – Disclosures; Section 3863, Financial Instruments – Presentation; Section 3031, Inventories; and Section 1535, Capital Disclosures.

CICA Section 3862, Financial Instruments - Disclosures, establishes standards for the disclosure of financial instruments including disclosing the significance of financial instruments and the nature and extent of risks arising from financial instruments.

The adoption of CICA Section 3863 had no impact on the Company's presentation since the new standard carries forward the existing presentation requirements.

Effective January 1, 2008, the Company adopted retrospectively the new CICA recommendations relating to Inventories (section 3031). The new standard provides additional guidance concerning measurement, classification and disclosure and allows the reversal of write-downs to net realizable value when there is a change in the circumstances giving rise to the impairment. On adopting these recommendations, the Company reclassified expenses to disclose the net change in inventory recognized as an expense during the period with comparative figures reclassified accordingly. The change had no impact on the Company's prior period inventory or retained earnings balances.

CICA Section 1535, Capital Disclosures, establishes standards for disclosing aspects of the entity's capital management strategy. This standard requires disclosure of both quantitative and qualitative disclosures around the entity's objectives, policies and processes for managing capital. Disclosure of any externally imposed capital requirements is required when applicable along with information regarding the consequences of non-compliance with such restrictions.

The adoption of these new standards had no impact on the Company's financial position or results of operations.

The Accounting Standards Board confirmed recently that public companies will be required to report under International Financial Reporting Standards (“IFRS”) effective January 1, 2011. The Company is currently assessing the impact of adopting IFRS, including an examination of recognition, measurement and disclosure differences.

3. RISK MANAGEMENT

Financial risk management

In the normal course of business, the Company is exposed to a number of financial risks that can affect its operating performance. These risks are; credit risk, liquidity risk and market risk. The Company's overall risk management program and prudent business practices seek to minimize any potential adverse affects on the Company's financial performance.

(i) Credit risk

Banks and term deposits – the Company places its cash with Canadian Schedule I banks.

Amounts receivable – 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 September 30, 2008, the Company’s largest credit exposure to a single party was approximately $233,000.

There have been no events of default for such amounts in the past. As of September 30, 2008, no amounts receivable were considered impaired or past due.

(ii) Liquidity risk

The Company is exposed to liquidity risk, which is the risk that the Company may be unable to generate or obtain sufficient cash to meet its commitments as they come due. The Company relies on generating funds from operations and on issuing new common shares to meet liquidity requirements and does not have sufficient capacity in revolving credit facilities to meet short-term fluctuations from forecasted results. Credit facilities are subject to the bank’s assessment of a prescribed borrowing base and can be accelerated or converted to a one-year term based on that assessment.

Accounts payable and accrued liabilities are settled in the regular course of business, based on negotiated terms with trade suppliers. All components of the September 30, 2008 balance will be settled in less than one year.

(iii) Market risk

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.

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

Capital risk management

Shareholders' equity is managed as the capital of the Company. The Company's objective when managing capital is to maintain an optimal capital structure to minimize the cost of capital and to safeguard the Company's ability to continue as a going concern in order to continue the process of exploring for, developing and operating natural gas and hydro-carbon properties to, ultimately, provide returns for common shareholders. In order to maintain or adjust the capital structure, the Company may issue new common shares from time to time subject to the possible temporary restriction discussed in Note 14.

4. INVENTORY

	September 30, 2008 $	December 31, 2007 $
Natural gas in storage:		
11,471 mcf	—	47,396
12,955 mcf	53,482	—
	53,482	47,396

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the nine months ended September 30, 2008

5. PROPERTY AND EQUIPMENT

	September 30, 2008		
	Cost $	**Accumulated amortization** $	**Net book value** $
Trucks and tractor	88,143	38,205	49,938
Gas gathering pipeline and compressor system	6,706,177	269,488	6,436,689
	6,794,320	307,693	6,486,627

	December 31, 2007		
	Cost $	Accumulated amortization $	Net book value $
Trucks and tractor	79,659	34,231	45,428
Gas gathering pipeline and compressor system	6,327,177	195,974	6,131,203
	6,406,836	230,205	6,176,631

6. OIL AND GAS LEASES

	Acquisition $	**Exploration** $	**Total** $
Balance, December 31, 2006	**35,082,391**	**9,163,187**	**44,245,578**
Deferred exploration costs	—	756,615	756,615
Revision to asset retirement obligation	—	4,900	4,900
Depreciation, depletion and amortization	—	(549,880)	(549,880)
Balance, December 31, 2007	**35,082,391**	**9,374,822**	**44,457,213**
Deferred exploration costs	—	377,618	377,618
Depreciation, depletion and amortization	—	(429,609)	(429,609)
Balance, September 30, 2008	**35,082,391**	**9,322,831**	**44,405,222**

[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.

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.

As a result, the Company holds 2,465,233 shares representing a 2.70% interest in Ontex, a publicly traded company, as follows:

	September 30, 2008 $	December 31, 2007 $
Opening balance	368,120	617,946
Sale of common shares	—	(236,169)
Share of equity loss	(51,195)	(13,657)
	316,925	368,120

Until September 30, 2008, Ontex had two common directors with the Company, one of whom is Chief Executive Officer, a common Chief Financial Officer and owns 11.69% of the Company's outstanding shares at September 30, 2008 [2007 – 13.3%] giving rise to common significant influence. Advances payable in the amount of $12,443 (2007 –$85,072) 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:

	September 30, 2008 $	December 31, 2007 $
Assets	15,540,853	14,829,010
Liabilities	410,194	85,185
Shareholders' equity	15,130,659	14,743,825
Liabilities and shareholders' equity	15,540,853	14,829,010

	September 30, 2008 $	September 30, 2007 $
Revenue	119,831	161,842
Expenses	(1,906,803)	(520,499)
Equity in earnings (loss) of Echo Energy Canada Inc.	(56,307)	(11,379)
Loss for the year	(1,843,279)	(370,036)
Other comprehensive income (loss)	(1,517)	(60,737)
Comprehensive loss for the year	(1,844,796)	(430,773)

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

8. INVESTMENT IN ECHO POWER GENERATION INC.

As at September 30, 2008, 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 and continues to account for the investment on the cost basis.

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. During the three months ended March 31, 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. In June 2008 the principal reduction was limited to $500,000 by the bank pending further analysis and negotiation. In September 2008, a new credit facility agreement was established. This is a demand loan that requires monthly principal payments of $50,000. Principal payments totaling $150,000 were made in the third quarter of 2008.

	September 30, 2008	December 31, 2007
	$	$
Prime plus .5% demand credit facility	**5,550,000**	6,200,000
Less current portion	**5,550,000**	1,260,000
Amounts due after one year	**-**	4,940,000

Although the banking agreement only calls for principal payments of $600,000 in the next year, it is a demand facility and therefore the entire amount has been classified as current debt. Interest is paid monthly. 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

As at December 31, 2007, the Company recorded its estimated total undiscounted asset retirement obligation based on a gross liability of $360,000 discounted at the Company's then cost of financing of 6.75% to a present value of $78,500 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. During the nine month period ended September 30, 2008, the Company recorded $7,050 of accretion expense as follows:

	September 30, 2008	December 31, 2007
	$	$
Balance – beginning of year	**78,500**	81,300
Accretion expense	**7,050**	
Liabilities settled in year	—	(7,700)
Liabilities incurred for completed wells	—	4,900
Balance – end of year	**85,550**	78,500

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.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the nine months ended September 30, 2008

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:

	September 30, 2008	September 30, 2007
	$	$
Expected income tax recovery (expense) using statutory income tax rates	**266,100**	48,600
Equity in income (loss) of affiliate not subject to income tax	**(10,300)**	(2,100)
Reduction of substantively enacted rates	—	2,400
Non-deductible expenses	**(700)**	(6,800)
Future income tax recovery	**255,100**	42,100

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

	September 30, 2008	December 31, 2007
	$	$
Property and equipment	**(313,700)**	(243,300)
Non-capital losses	**670,000**	475,400
Deferred exploration expenditures	**(1,675,900)**	(1,797,300)
Investment in EPG and Ontex	**15,800**	6,300
Tax effect pursuant to the business combination	**(11,450,200)**	(11,450,200)
	(12,754,000)	(13,009,100)

The Company has approximately $1,665,000 of Federal and $2,150,000 of Ontario non-capital losses that expire between 2009 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.

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 in 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.

The Company is committed to spending a further $247,298 on exploration costs during 2008 and 2009 as part of the flow-through funding agreements that were completed during calendar 2008.

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 $**
Balance, December 31, 2006	**52,779,515**	**35,417,100**
Changes during the period	—	—
Balance, December 31, 2007	**52,779,515**	**35,417,100**
Private placement completed during the period	**7,428,571**	**2,000,000**
Balance, September 30, 2008	**60,208,086**	**37,417,100**

During 2008, the Company may be required to expand the existing capital structure to fund a reduction in its long-term debt, if any. The Company may also be required to fund a capital program, as recommended by its independent engineer, to commence production on five non-producing wells and to drill additional wells at a cost of up to $5,240,000. On April 18, 2008, the Court ordered the Company to carry on business in the normal course and to not incur new financial obligations until the disposition of a Court application by the Company. This temporary restriction on capital arises from a court application in which the Company has alleged that certain shareholders have breached the Securities Act, among other things. The application is expected to be resolved in the fourth quarter. The Company does not expect to pay dividends during 2008.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the nine months ended September 30, 2008

[a] Earnings per share

	September 30, 2008 $	September 30, 2007 $
Basic and diluted earnings (loss) per share computation		
Numerator:		
Net earnings (loss)	**(481,730)**	(87,968)
Denominator:		
Weighted average common shares outstanding	**57,012,783**	**52,779,515**
Basic and diluted earnings (loss) per share	**(0.008)**	(0.002)

[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.

[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
February 28, 2007					
66,250	**6.5%**	**5.4%**	**21 months**	**$0.05**	**$3,610**
May 31, 2007					
66,250	**6.5%**	**9.5%**	**18 months**	**$0.05**	**$3,490**
August 31, 2007					
66,250	**6.5%**	**9.5%**	**15 months**	**$0.04**	**$2,630**
November 30, 2007					
66,250	**6.5%**	**35.3%**	**12 months**	**$0.08**	**$5,610**

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

	September 30, 2008 $	December 31, 2007 $
Balance – beginning of period	**15,340**	—
Share compensation to consultants	—	15,340
Balance – end of period	**15,340**	15,340

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 Chairman and CEO of Ontex. During the nine month period ended September 30, 2008, the Company paid a company influenced by the President and Treasurer $225,292 [2007 - $150,136] in management and consulting fees. $60,142 of the amount paid in 2008 related to a retroactive adjustment for the years 2001 to 2006.

[b] The Company's Chairman, under temporary suspension, is a director. During the nine month period ended September 30, 2008, the Company paid a company influenced by the Chairman $158,122 [2007 - $150,136] in management and consulting fees.

[c] During the nine month period ended September 30, 2008, the Company paid $86,120 [2007 - $84,975] in respect of financial services provided by the former Chief Financial Officer of the Company.

[d] The Company’s Vice-President is a director of the Company. During the nine month period ended September 30, 2008, the Company paid the Vice-President $nil [2007 - $106,863] in respect of management and consulting services.

[e] During the nine month period ended September 30, 2008, the Company paid $2,158 [2007 - $3,171] in respect of field services and expenses to a company influenced by a director of the Company.

[f] During the nine month period ended September 30, 2008, the Company paid $402,244 to a company influenced by a director for construction of gas gathering pipelines.

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

During the nine month period ended September 30, 2008, 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 $43,100 and paid $115,728 on account of net advances for similar items owing as at December 31, 2007 or advanced subsequently.

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 2.70% of the Company's outstanding shares at September 30, 2008.

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:

	September 30, 2008 $	September 30, 2007 $
Accounts receivable	**(134,245)**	101,121
Inventory	**(6,086)**	50,043
Prepaid expenses	**(11,146)**	(12,306)
Accounts payable and accrued liabilities	**(22,205)**	(168,079)
Accrued royalties	**22,079**	(12,724)
	(151,603)	(41,945)

[b] Supplemental cash flow information

	September 30, 2008 $	September 30, 2007 $
Interest received	**12,940**	7,472
Interest paid	**272,116**	305,583

18. COMPARATIVE AMOUNTS

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