

*Unaudited Interim Consolidated Financial Statements of*

**Iteration Energy Ltd.**

*September 30, 2007*

# Iteration Energy Ltd.

## Consolidated Balance Sheets (unaudited)

As at

(in thousands of dollars)

	September 30, 2007	December 31, 2006
<b>ASSETS (Note 5)</b>		
Current		
Cash	\$31	\$5,222
Accounts receivable	12,983	13,230
Future income taxes (Note 9)	-	876
Prepays and other current assets	1,696	1,206
	<b>14,710</b>	20,534
Deferred share issue costs (Note 8(g))	1,030	-
Property, plant and equipment (Notes 3 and 4)	284,531	193,550
Goodwill (Note 3)	33,899	20,568
	<b>334,170</b>	\$234,652
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current		
Bank indebtedness (Note 5)	\$74,850	\$28,640
Accounts payable and accrued liabilities (Note 6)	22,798	21,977
Stock based compensation payable (Note 8(d))	7,830	4,108
	<b>105,478</b>	54,725
Future income taxes (Note 9)	11,259	-
Leasehold inducements	232	331
Asset retirement obligations (Note 7)	17,945	9,198
	<b>134,914</b>	64,254
Commitments and contingencies (Notes 10, 11, and 12)		
Shareholders' equity		
Share capital (Note 8)	210,404	175,195
Warrants outstanding (Note 8(e))	4,108	4,166
Deficit	(15,256)	(8,963)
	<b>199,256</b>	170,398
	<b>\$334,170</b>	\$234,652

See accompanying notes to unaudited interim consolidated financial statements.

# Iteration Energy Ltd.

## Consolidated Statements of Loss, Comprehensive Loss and Deficit (unaudited)

<i>(in thousands of dollars, except per share amounts)</i>	Three months ended September 30,		Nine months ended September 30,	
	2007	2006	2007	2006
<b>Revenue</b>				
Production revenue	\$22,161	\$16,888	\$72,711	\$46,600
Royalties, net of Alberta Royalty Tax Credit	(5,387)	(3,041)	(14,806)	(9,795)
	<b>16,774</b>	13,847	<b>57,905</b>	36,805
Other production revenue	107	46	102	187
Interest income	-	23	-	257
	<b>16,881</b>	13,916	<b>58,007</b>	37,249
<b>Expenses</b>				
Production	3,786	4,122	12,884	8,260
Transportation	747	337	2,324	883
General and administrative	1,269	1,270	3,720	2,692
Stock based compensation expense (recovery) (Note 8(d))	(1,486)	(183)	3,722	(1,865)
Interest on current debt	398	471	1,259	698
Accretion expense	253	210	544	415
Depletion and depreciation	14,864	11,352	42,565	28,471
	<b>19,831</b>	17,579	<b>67,018</b>	39,554
Loss before income taxes	(2,950)	(3,663)	(9,011)	(2,305)
<b>Income taxes (Note 9)</b>				
Current income tax expense (recovery)	-	3	197	(28)
Future income tax recovery	(965)	(1,296)	(2,915)	(1,084)
	<b>(965)</b>	(1,293)	<b>(2,718)</b>	(1,112)
Net loss and Comprehensive loss	(1,985)	(2,370)	(6,293)	(1,193)
Deficit, beginning of period	(13,271)	(3,370)	(8,963)	(4,547)
Deficit, end of period	<b>\$(15,256)</b>	\$(5,740)	<b>\$(15,256)</b>	\$(5,740)
<b>Basic and diluted loss per common share (Note 8(f))</b>	<b>\$(0.03)</b>	\$(0.04)	<b>\$(0.10)</b>	\$(0.02)

See accompanying notes to the unaudited interim consolidated financial statements

# Iteration Energy Ltd.

## Consolidated Statements of Cash Flows (unaudited)

	Three months ended September 30,		Nine months ended September 30,	
<i>(in thousands of dollars)</i>	2007	2006	2007	2006
<b>OPERATING ACTIVITIES</b>				
Net loss	<b>\$(1,985)</b>	\$(2,370)	<b>\$(6,293)</b>	\$(1,193)
Add (deduct) non-cash items:				
Depletion and depreciation	<b>14,864</b>	11,352	<b>42,565</b>	28,471
Accretion expense	<b>253</b>	210	<b>544</b>	415
Future income tax recovery	<b>(965)</b>	(1,296)	<b>(2,915)</b>	(1,084)
Amortization of leasehold inducements	<b>(33)</b>	(37)	<b>(99)</b>	(107)
Stock-based compensation expense (recovery) (Note 8 (d))	<b>(1,486)</b>	(183)	<b>3,722</b>	(1,865)
Asset retirement expenditures	<b>(87)</b>	-	<b>(121)</b>	-
Funds from operations	<b>10,561</b>	7,676	<b>37,403</b>	24,637
Net change in non-cash operating working capital (Note 13)	<b>682</b>	4,182	<b>(5,326)</b>	(1,273)
	<b>11,243</b>	11,858	<b>32,077</b>	23,364
<b>INVESTING ACTIVITIES</b>				
Proceeds from sale of property, plant and equipment	-	-	<b>122</b>	679
Acquisition of oil and gas properties	<b>(52,695)</b>	46	<b>(55,068)</b>	(51,087)
Additions to oil and gas properties	<b>(18,621)</b>	(16,789)	<b>(71,572)</b>	(47,877)
Additions to other capital assets	<b>(44)</b>	(55)	<b>(44)</b>	(79)
Net change in non-cash investing working capital (Note 13)	<b>7,642</b>	1,737	<b>5,904</b>	(2,677)
	<b>(63,718)</b>	(15,061)	<b>(120,658)</b>	(101,041)
<b>FINANCING ACTIVITIES</b>				
Increase in bank indebtedness	<b>52,955</b>	439	<b>46,210</b>	30,585
Common shares issued for cash	-	-	<b>40,401</b>	25,210
Share issue costs	<b>(11)</b>	(42)	<b>(2,191)</b>	(1,567)
Deferred share issue costs	<b>(1,030)</b>	-	<b>(1,030)</b>	-
Principal payment – capital lease obligation	-	(112)	-	(338)
Net change in non-cash financing working capital (Note 13)	-	-	-	(278)
	<b>51,914</b>	285	<b>83,390</b>	53,612
Decrease in cash	<b>(561)</b>	(2,918)	<b>(5,191)</b>	(24,065)
Cash, beginning of period	<b>592</b>	3,987	<b>5,222</b>	25,134
Cash, end of period	<b>\$31</b>	\$1,069	<b>\$31</b>	\$1,069

See Note 13 for supplemental disclosure

See accompanying notes to the unaudited interim consolidated financial statements

# Iteration Energy Ltd.

## Notes to the Unaudited Interim Consolidated Financial Statements For the Three and Nine Months Ended September 30, 2007 and 2006

(Tabular amounts in thousands of dollars, unless otherwise noted)

### 1. NATURE OF OPERATIONS

Iteration Energy Ltd. (“Iteration” or the “Company”) is a public company that trades on the Toronto Stock Exchange and is incorporated under the Business Corporations Act (Alberta). Iteration is engaged in the exploration, development and production of petroleum and natural gas in Canada.

### 2. SIGNIFICANT ACCOUNTING POLICIES

The unaudited interim consolidated financial statements of Iteration have been prepared in accordance with Canadian generally accepted accounting principles and are consistent with those policies set out in the audited consolidated financial statements for the year ended December 31, 2006, except as disclosed below. These interim consolidated financial statements do not include all disclosures provided in the December 31 financial statements and should be read in conjunction with those financial statements.

#### Change in Accounting Policies

On January 1, 2007, the Company adopted four new accounting standards that were issued by the Canadian Institute of Chartered Accountants; Handbook Section 1530, *Comprehensive Income*, Handbook Section 3855, *Financial Instruments-Recognition and Measurement*, Handbook Section 3861, *Financial Instruments – Disclosure and Presentation* and Handbook Section 3865, *Hedges*. As required by the new standards, prior periods have not been restated. The adoption of these standards has had no material impact on the Company’s net earnings or cashflows. The other effects of the implementation of the new standards are discussed below.

#### Comprehensive Income

Section 1530 introduces Comprehensive Income, which consists of net income and other comprehensive income (“OCI”). This section requires companies to present a statement of comprehensive income, defined as a change in net assets arising from transactions and other events from non-owner sources. The statement presents net income and each component recognized in other comprehensive income. For the three and nine months ended September 30, 2007, the Company did not recognize any OCI. Should the Company recognize any OCI in the future, the cumulative changes in OCI would be recognized in Accumulated Other Comprehensive Income (“AOCI”), which would be presented as a new category within Shareholders’ Equity in the Consolidated Balance Sheet.

#### Financial Instruments – Recognition and Measurement

The Financial Instruments standard, Section 3855 establishes the recognition and measurement criteria for financial assets, financial liabilities and derivatives. All financial instruments are required to be measured at fair value on initial recognition of the instrument, except for certain related party transactions. Measurement in subsequent periods is dependent on whether the financial instrument has been classified as “held-for-trading”, “available-for-sale”, “held-to-maturity”, “loans and receivables”, or “other financial liabilities” as defined by the standard.

Financial assets and financial liabilities “held-for-trading” are measured at fair value with changes in those fair values recognized in net earnings. Financial assets “available-for-sale” are measured at fair value, with changes in those fair values measured in OCI. Financial assets “held-to-maturity”, “loans and receivables”, and “other financial liabilities” are measured at amortized cost using the effective interest method of amortization. The methods used by the Company in determining the fair value of financial instruments is unchanged as a result of implementing the new standard.

Cash is designated as “held-for-trading” and is measured at carrying value, which approximates fair value due to the short-term nature of this instrument. Accounts receivable are designated as “loans and receivables”. Bank indebtedness, accounts payable, and accrued liabilities are designated as “other liabilities”.

The Company considers the current fixed price contracts in place to be future sales contracts under the normal course of business at an agreed price with our current gas marketer, which will be satisfied by the future delivery of natural gas. As a result, the Company has not calculated a fair value for the instruments for purposes of recording the contracts on the balance sheet

The adoption of the Financial Instruments standard has resulted in no change in the previous accounting treatment or reporting by the Company.

In addition, the Company has assessed new and revised accounting pronouncements that have been issued that are not yet effective and determined that the following may have a significant impact on the Company.

#### Financial Instruments – Disclosures and Presentation

As of January 1, 2008, the Company will be required to adopt two new CICA standards. Handbook Section 3862, *Financial Instruments – Disclosures* and Handbook Section 3863, *Financial Instruments – Presentation*. These Handbook Sections will replace existing Handbook Section 3861, *Financial Instruments – Presentation and Disclosure*. The new disclosure standard increases the emphasis on the risks associated with both recognized and unrecognized financial instruments and how those risks are managed. The new presentation standard carries forward the former presentation requirements.

#### Capital Disclosures

Also as of January 1, 2008, the Company will be required to adopt Handbook Section 1535, *Capital Disclosures* which will require companies to disclose their objectives, policies and processes for managing capital. In addition, disclosures are to include whether companies have complied with externally imposed capital requirements.

Both new standards were issued in December 2006 and the Company is assessing the impact on its financial statements.

### **3. ACQUISITIONS AND DISPOSITIONS**

#### **Peace River Arch Partnership**

On September 28, 2007, with an effective date of June 1, 2007, the Company purchased 100% of the partnership interests of the Peace River Arch partnership from an arms length third party for a gross purchase price of \$52,375,000. After preliminary adjustments for interest, operating results and capital expenditures between the effective date and the date of close, the Company paid \$50,501,000. The partnership owns producing properties located in the Peace River Arch area of North West Alberta and the Manyberries area in South East Alberta. The purchase price was initially funded from the Company’s credit facility. The results of operations for the Peace River Arch partnership have been included in the consolidated financial statements from the September 28, 2007 acquisition date.

The acquisition was accounted for by the purchase method and the purchase price was allocated on a preliminary basis as follows:

<b>(\$000's)</b>	
Property, plant and Equipment	\$55,937
Goodwill	13,331
Future income tax liability	(11,992)
Asset retirement obligation	(6,775)
<b>Total purchase price</b>	<b>\$50,501</b>
Consideration was comprised of :	
Cash	\$50,501
<b>Total consideration</b>	<b>\$50,501</b>

#### **East Central Alberta Properties**

On June 27, 2006, with an effective date of April 1, 2006, the Company purchased five producing properties from an unrelated third party for a gross purchase price of \$42,325,000. After adjustments for operating results and capital expenditures between the effective date and the closing date, the Company paid \$41,426,000. The purchase price was initially funded from the Company's credit facility. The Company commenced reporting production from the acquisition on July 1, 2006

#### **4. PROPERTY PLANT AND EQUIPMENT**

	<b>September 30, 2007</b>	December 31, 2006
	(\$000's)	(\$000's)
Oil and gas properties	<b>\$448,957</b>	\$ 315,455
Other	<b>726</b>	683
	<b>449,683</b>	316,138
Less accumulated depletion and depreciation	<b>165,152</b>	122,588
	<b>\$284,531</b>	\$ 193,550

At September 30, 2007, unproved properties and seismic expenditures amounting to \$46,361,000 (September 30, 2006: \$26,254,000) have been excluded from the depletion calculation. Future development costs on proven undeveloped reserves of \$5,945,000 (September 30, 2006: \$1,021,000) are included in the depletion calculation.

For the three and nine months ended September 30, 2007, the Company capitalized \$585,000 and \$1,673,000 respectively, (three and nine months ended September 30, 2006: \$525,000 and \$1,390,000 respectively) of overhead directly related to exploration and development activities.

#### **5. BANK INDEBTEDNESS**

The bank indebtedness represents the drawn portion of a \$95 million credit facility that the Company has established with a Canadian Chartered Bank. A general security agreement and a guarantee and postponement of claim have been provided as security. For \$75 million of the credit facility, the terms under which the Company may borrow are as follows;

- i) Prime based loans bearing interest at the lender's prime bank rate;

- ii) Bankers acceptances, bearing interest at the banker's acceptance rate plus an acceptance fee of 87.5 basis points per annum;
- iii) Libor based loans in US currency bearing interest at the Libor rate plus 87.5 basis points per annum; and
- iv) Letters of guarantee and letters of credit, bearing interest on the face amount at 87.5 basis points per annum, for financial guarantees, and 58.3 basis points per annum, for non-financial guarantees.

For the remaining \$20 million of the credit facility, the terms under which the Company may borrow are as follows:

- i) Prime based loans bearing interest at the lender's prime bank rate plus 50 basis points;
- ii) Bankers acceptances, bearing interest at the banker's acceptance rate plus an acceptance fee of 137.5 basis points per annum; and
- iii) Libor based loans in US currency bearing interest at the Libor rate plus 137.5 basis points per annum.

The facility requires monthly payments of interest only, calculated in arrears. In addition, there is a standby fee calculated at 10 basis points per annum on the undrawn balance. During 2007, the effective rate of interest on the indebtedness outstanding was 6.05% per annum.

## 6. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

The accounts payable and accrued liabilities consist of the following:

	<b>September 30, 2007 (\$000's)</b>	December 31, 2006 (\$000's)
Trade accounts payable	<b>\$15,445</b>	\$16,278
Joint venture accounts payable	<b>2,256</b>	2,491
Royalties payable	<b>5,097</b>	3,208
<b>Total</b>	<b>\$22,798</b>	\$21,977

## 7. ASSET RETIREMENT OBLIGATION

The total future asset retirement obligations were estimated by management based on the Company's net working interest in all wells and facilities, estimated costs to reclaim and abandon wells and facilities and the estimated timing of the costs to be incurred in future periods. The Company estimates that the undiscounted cash flows related to asset retirement obligations, adjusted for inflation, to be incurred over the estimated reserve life of the underlying assets (which is estimated to be from 2007 through 2036) will total approximately \$37,361,000 (December 31, 2006: \$18,490,000). The fair value at September 30, 2007 is \$17,945,000 (December 31, 2006: \$9,198,000) using a discount rate of six and one half percent and an inflation rate of two percent. As at September 30, 2007, no funds have been set aside to settle this obligation.

	September 30, 2007 (\$000's)	December 31, 2006 (\$000's)
Balance, beginning of period	\$9,198	\$4,492
Liabilities incurred on acquisition of properties (note 3)	6,775	2,837
Increase in liabilities from drilling activity	1,549	2,366
Decrease in liabilities from revision of estimates	-	(945)
Accretion expense	544	471
Settlement of liabilities	(121)	(23)
Balance, end of period	<b>\$17,945</b>	\$9,198

## 8. SHARE CAPITAL

### (a) Authorized

Unlimited number of voting common shares without par value.  
Unlimited number of preferred shares issuable in series

### (b) Common Shares Issued

	Nine months ended September 30, 2007		Year ended December 31, 2006	
	Number of Shares	Amount (\$000's)	Number of Shares	Amount (\$000's)
Balance, beginning of period	57,429,847	\$175,195	48,895,347	\$139,467
Shares issued on public offering	7,000,000	39,200	6,200,000	25,110
Flow through shares issued on public offering	-	-	2,300,000	12,075
Shares issued on exercise of warrants	70,000	261	-	-
Shares issued on exercise of stock options	344,200	998	34,500	100
Share issue costs, net of tax effect of \$684,000 (2006: \$473,000)	-	(1,507)	-	(1,557)
Tax benefits renounced on prior year flow through share offering	-	(3,743)	-	-
Balance, end of period	<b>64,844,047</b>	<b>\$210,404</b>	57,429,847	\$ 175,195

### (c) Flow Through Shares

During 2006, the Company issued common shares on a flow-through basis for gross proceeds of \$12,075,000 to finance certain oil and gas expenditures to be incurred in 2007. The renouncement of these expenditures was made to the purchasers of these shares in 2007 and accordingly, share capital was reduced by the amount of the tax benefits associated with these expenditures (\$3,743,000). Under the look back provision governing flow-through shares, the Company is required to incur these eligible expenditures prior to December 31, 2007. As at September 30, 2007, the Company has incurred sufficient eligible expenditures to satisfy the requirements of the flow-through share offering.

**(d) Stock Options**

The Company has a stock option plan that provides for the issuance of options to its directors, officers, employees and non-employees to acquire up to 10% of the issued and outstanding common shares. The dates on which options vest are set by the Board of Directors at the time of grant. The exercise price of an option granted is the closing price of the Company's stock on the last trading date prior to the grant date. The dates on which options expire are also set by the Board of Directors at the time of grant and cannot exceed ten years.

Outstanding stock options to acquire common shares through the stock option plan are as follows:

	Nine months ended September 30, 2007		Year ended December 31, 2006	
	Number of Options	Weighted average exercise price \$	Number of Options	Weighted average exercise price \$
Outstanding, beginning of period	5,884,222	3.22	4,798,122	2.98
Granted	322,500	4.83	1,234,600	4.38
Exercised for shares	(344,200)	(2.90)	(34,500)	(2.90)
Exercised for cash	(667)	(4.90)	-	-
Forfeited	(43,933)	(4.49)	(114,000)	(5.72)
Outstanding, end of period	5,817,922	3.32	5,884,222	3.22
Options exercisable, end of period	3,200,900	3.10	1,617,096	2.98

The following table summarizes information about the stock options outstanding at September 30, 2007:

Range of exercise prices	Number outstanding September 30, 2007	Weighted average remaining contractual life (years)	Weighted average exercise price \$	Number exercisable September 30, 2007	Weighted average exercise price \$
\$2.90 to \$4.00	4,327,298	2.42	2.92	2,843,475	2.94
\$4.01 to \$5.00	1,325,999	3.31	4.39	324,400	4.27
\$5.01 to \$9.00	164,625	3.28	5.20	33,025	5.27
	5,817,922	2.65	3.32	3,200,900	3.10

The Company's stock option plan provides stock option holders the choice, upon exercise, to receive a cash payment in exchange for surrendering the option. The cash payment is equal to the appreciated value of the stock option as determined based on the difference between the option's exercise price and the Company's share price at the time of exercise. For the three and nine month period ended September 30, 2007, stock based compensation expense (recovery) of \$(1,486,000) and \$3,722,000 respectively (2006 recovery of \$183,000 and \$1,865,000 respectively), was recognized based on the change in value of the outstanding stock options. The current year amounts were determined using the September 30, 2007 closing share price, as compared to the closing share price at June 30, 2007 and December 31, 2006 respectively. Future fluctuations in the stock based compensation expense or recoveries are dependent on the movement of the Company's share price and the number of options outstanding. Based on the September 30, 2007 share price of \$5.00, had all of the 5,817,922 stock options outstanding been vested, aggregate stock based compensation expense and a corresponding liability of \$9,812,520 would have been recognized. Of this amount, \$7,829,589 has been recognized as a liability at September 30, 2007.

(e) **Warrants**

On March 21, 2005, warrants to purchase 5,000,000 common shares at \$2.90 were issued to Iteration Energy Inc. shareholders. On May 7, 2005, all of the warrants vested. During the quarter, no warrants were exercised (70,000 warrants were exercised in the nine months ended September 30, 2007). The 4,930,000 remaining warrants expire on September 21, 2008.

(f) **Per Share Amounts**

	Three months ended September 30,		Nine months ended September 30,	
	2007	2006	2007	2006
Weighted average common shares outstanding	<b>64,844,047</b>	<b>55,129,847</b>	<b>61,654,018</b>	51,689,169
Effect of dilutive warrants	-	-	-	-
Effect of dilutive options	-	-	-	-
Weighted average diluted common shares outstanding	<b>64,844,047</b>	<b>55,129,847</b>	<b>61,654,018</b>	51,689,169

The options and warrants outstanding for the quarter and nine months ended September 30, 2007 have no dilutive effect as the Company realized a net loss during these periods.

(g) **Deferred Share Issue Costs**

At September 30, 2007, the Company had incurred share issue costs in the amount of \$1,030,000 in respect of an issuance of 5,210,000 common shares at a price of \$4.80 per share for gross proceeds of \$25 million which closed subsequent to quarter end (Note 14).

**9. INCOME TAXES**

The provision for future income taxes recorded in the financial statements differs from the amount that would be obtained by applying the statutory income tax rate to the loss before tax as follows:

	Three months ended September 30,		Nine months ended September 30,	
(\$000's)	2007	2006	2007	2006
Loss before income taxes	<b>\$(2,950)</b>	\$(3,663)	<b>\$(9,011)</b>	\$(2,305)
Statutory Canadian corporate tax rate	<b>32.12%</b>	34.50%	<b>32.12%</b>	34.50%
Anticipated tax recovery	<b>\$(948)</b>	\$(1,263)	<b>\$(2,894)</b>	\$(795)
Non-deductible Crown payments	-	372	-	1,133
Alberta Royalty Tax Credit	-	(15)	-	(37)
Resource allowance	-	(358)	-	(1,059)
Rate adjustment	<b>33</b>	(125)	<b>101</b>	(126)
Other	<b>(50)</b>	93	<b>(122)</b>	(200)
Future income tax recovery	<b>\$(965)</b>	\$(1,296)	<b>\$(2,915)</b>	\$(1,084)

The Company's future income tax liability at September 30, 2007 and December 31, 2006 is comprised of the following:

(\$000's)	September 30, 2007	December 31, 2006
Income tax rate (%)	31.00	31.00
Property plant and equipment, having different income tax and accounting basis	\$16,652	\$7,032
Deferred partnership income	9,848	9,088
Scientific research pools	(5,922)	(5,922)
Non capital loss carry forwards	-	(5,440)
Share issue costs	(1,057)	(1,057)
Accrued stock based compensation	(2,427)	(1,273)
Asset retirement obligation	(5,563)	(2,851)
Unamortized leasehold inducements	(72)	(103)
Other	(200)	(350)
Future income tax liability (asset)	<b>\$11,259</b>	\$(876)

The Company also has approximately \$2,951,000 of unclaimed investment tax credits available to reduce future years' income taxes payable, the benefit of which has not been reflected in these financial statements. The investment tax credits (\$000's) expire as follows:

2007	1,131
2008	964
2009	856

## 10. OPERATING LEASES

The Company has entered into various operating leases with respect to its premises. The leases expire June 30, 2009 and require the following future minimum lease payments, by calendar year (\$000's);

2007	171
2008	687
2009	344

## 11. FINANCIAL INSTRUMENTS

### a) Fair Value

Financial instruments consist of cash, accounts receivable, accounts payable, and bank indebtedness. The carrying value of these instruments approximates fair value unless otherwise stated.

**b) Fixed Price Contracts**

As a means of managing commodity price volatility, the Company has entered into three fixed price contracts for the future physical delivery of natural gas as follows:

<b>Term</b>	<b>Volume (mcf/d)</b>	<b>Contract Price (mcf)</b>	<b>Price Basis</b>
April 1, 2007 – October 31, 2007	5,270	\$7.91 floor, \$8.54 ceiling	AECO monthly
April 1, 2007 – October 31, 2007	5,270	\$7.44	Station 2
April 1, 2007 – October 31, 2007	2,630	\$7.44	Station 2

As previously discussed, effective January 1, 2007, new accounting standards issued by the Canadian Institute of Chartered Accountants became effective, and were implemented by the Company. One of the new standards deals with hedges and the criteria needed to qualify for hedge accounting, as well as the timing for recognition of applicable hedge gains and losses. As the Company had no material fixed price contracts in place at December 31, 2006, there was no effect on the financial reporting of the Company as a result of the implementation of the new standard. With respect to the current fixed price contracts in place, the Company considers them to be future sales contracts under the normal course of business at an agreed price with our current gas marketer, which will be satisfied by the future delivery of natural gas. As a result, the Company has not calculated a fair value for the instruments for purposes of recording the contracts on the balance sheet.

**c) Credit Risk**

Substantial portions of the Company's accounts receivable are with entities in the oil and gas industry. The Company generally extends unsecured credit to these companies, and therefore, the collection of accounts receivable may be affected by changes in economic or other conditions and may accordingly impact the Company's overall credit risk. Management believes the risk is mitigated by the size, reputation and diversified nature of the companies to which they extend credit. The Company has not previously experienced any material credit losses on the collection of receivables.

**d) Interest Rate Risk**

The Company is exposed to changes in the prime interest rate on its bank debt.

**12. CONTINGENCIES**

The Company is party to various lawsuits as at September 30, 2007. It is management's opinion that, based on the best currently available information, the amount of any potential exposure and the outcome of these lawsuits is not determinable at this time. As a result, no provisions for these items have been recorded in these financial statements.

Pursuant to a purchase and sale agreement, the Company has indemnified the purchaser of a former subsidiary company for up to \$1,000,000 of income tax and legal expenses incurred with respect to specifically identified income tax returns. Any obligation pursuant to the terms of this indemnification will be recorded in the period in which the obligation is incurred.

The Company indemnifies its directors and officers against any and all claims or losses reasonably incurred in the performance of their service to the Company to the extent permitted by law. The Company has acquired and maintains liability insurance for its directors and officers.

### 13. SUPPLEMENTAL DISCLOSURE ON CONSOLIDATED STATEMENTS OF CASH FLOWS

Changes in non-cash working capital were comprised of the following:

(\$000's)	Three months ended		Nine months ended	
	September 30, 2007	2006	September 30, 2007	2006
Accounts receivable	\$1,834	\$447	\$247	\$8,242
Prepays and other current assets	(41)	(259)	(490)	34
Accounts payable and accrued liabilities	6,531	5,731	821	(12,504)
Net change	\$8,324	\$5,919	\$578	\$(4,228)

(\$000's)	Three months ended		Nine months ended	
	September 30, 2007	2006	September 30, 2007	2006
Net change by activity:				
Operating	\$682	\$4,182	\$(5,326)	\$(1,273)
Investing	7,642	1,737	5,904	(2,677)
Financing	-	-	-	(278)
Net change	\$8,324	\$5,919	\$578	\$(4,228)

Additional information:

(\$000's)	Three months ended		Nine months ended	
	September 30, 2007	2006	September 30, 2007	2006
Cash interest paid	\$398	\$471	\$1,259	\$698
Cash taxes paid (recovered)	-	3	197	(28)

### 14. SUBSEQUENT EVENTS

#### Equity Issue

On October 17, 2007, the Company closed the issuance through a bought deal equity financing of 5,210,000 Subscription Receipts at \$4.80 per Subscription Receipt for gross proceeds of \$25 million (net proceeds of approximately \$23.4 million). Each Subscription Receipt can be and was converted by the holder into one Common Share of the Company for no additional consideration. The underwriters were also granted an over-allotment option for an additional 781,500 Subscription Receipts at a price of \$4.80 per Subscription Receipt. On November 13, 2007 the underwriters exercised their option with respect to 767,400 Subscription Receipts, which were immediately converted into Common Shares, and resulted in additional gross proceeds of \$3.7 million (net proceeds of \$3.5 million) which were applied to reduce drawings on the Company's credit facility.

#### Exercise of Warrants

Subsequent to September 30, 2007, 208,333 warrants were exercised for common shares of the Company resulting in gross proceeds of \$604,000.

**Granting of Options**

Subsequent to September 30, 2007, 127,000 options were granted to new hires of the Company at an average exercise price of \$4.91 per option and 545,000 options were granted to existing employees of the Company at an exercise price of \$4.80 per option.

**Fixed price Contract**

On October 26, 2007, the Company entered into the following costless collar:

			Collar parameters			
Commodity	Volume (bbls/day)	Term	Floor	Ceiling	Currency	Benchmark
Oil	200	Dec 1, 2007 – Nov 30, 2008	\$75.00	\$90.20	US	WTI

**15. COMPARATIVE FIGURES**

Certain figures provided for 2006 have been reclassified to conform to the presentation adopted in 2007.