

Consolidated Financial Statements of

Iteration Energy Ltd.

December 31, 2007 and 2006

AUDITORS' REPORT

To the Shareholders of
Iteration Energy Ltd.

We have audited the consolidated balance sheets of Iteration Energy Ltd. as at December 31, 2007 and 2006 and the consolidated statements of loss, comprehensive loss and deficit and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these 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 financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall 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.

Ernst + Young LLP

Calgary, Canada
March 19, 2008

Chartered Accountants

Iteration Energy Ltd.

Consolidated Balance Sheets

As at

(in thousands of dollars)

	December 31, 2007	December 31, 2006
ASSETS (Note 5)		
Current		
Cash	\$1,230	\$5,222
Accounts receivable	16,062	13,230
Future income taxes (Note 9)	-	876
Prepays and other current assets	2,640	1,206
	19,932	20,534
Property, plant and equipment (Notes 3 and 4)	285,354	193,550
Goodwill (Note 3)	33,899	20,568
	\$339,185	\$234,652
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current		
Bank indebtedness (Note 5)	\$50,370	\$28,640
Accounts payable and accrued liabilities (Note 6)	30,574	21,977
Stock based compensation payable (Note 8(d))	7,520	4,108
	88,464	54,725
Future income taxes (Note 9)	7,510	-
Leasehold inducements	199	331
Asset retirement obligations (Note 7)	18,897	9,198
	115,070	64,254
Commitments and contingencies (Notes 10, 11, and 12)		
Shareholders' equity		
Share capital (Note 8)	238,586	175,195
Warrants outstanding (Note 8(e))	3,934	4,166
Deficit	(18,405)	(8,963)
	224,115	170,398
	\$339,185	\$234,652

See accompanying notes to the consolidated financial statements.

On behalf of the Board:

Don Archibald, Chairman

Brian L. Illing, CEO & President

Iteration Energy Ltd.

Consolidated Statements of Loss, Comprehensive Loss and Deficit

<i>(in thousands of dollars, except per share amounts)</i>	Year Ended December 31,	
	2007	2006
Revenue		
Production revenue	\$101,976	\$64,539
Royalties, net of Alberta Royalty Tax Credit	(20,772)	(12,969)
	81,204	51,570
Other production revenue	339	223
Interest income	-	275
	81,543	52,068
Expenses		
Production	21,685	12,539
Transportation	3,128	1,299
General and administrative	5,460	4,084
Stock based compensation (Note 8(d))	3,412	25
Interest on current debt	2,264	1,225
Accretion (Note 7)	833	471
Depletion and depreciation	60,092	40,115
	96,874	59,758
Loss before the following	(15,331)	(7,690)
Recovery of investment tax credits (Note 9)	1,131	1,376
Loss before income taxes	(14,200)	(6,314)
Income taxes (Note 9)		
Current income tax (recovery)	197	(169)
Future income tax recovery	(4,955)	(1,729)
	(4,758)	(1,898)
Net loss and Comprehensive loss	(9,442)	(4,416)
Deficit, beginning of year	(8,963)	(4,547)
Deficit, end of year	\$(18,405)	\$(8,963)
Basic and diluted loss per common share (Note 8(f))	\$(0.15)	\$(0.08)

See accompanying notes to the consolidated financial statements

Iteration Energy Ltd.

Consolidated Statements of Cash Flows

<i>(in thousands of dollars)</i>	Year Ended December 31,	
	2007	2006
OPERATING ACTIVITIES		
Net loss	\$(9,442)	\$(4,416)
Add (deduct) non-cash items:		
Depletion and depreciation	60,092	40,115
Accretion (Note 7)	833	471
Recovery of investment tax credits	(1,131)	(1,376)
Future income tax recovery	(4,955)	(1,729)
Amortization of leasehold inducements	(132)	(140)
Stock based compensation (Note 8 (d))	3,412	25
Asset retirement expenditures	(171)	(23)
Funds from operations	48,506	32,927
Net change in non-cash operating working capital (Note 13)	(4,330)	(1,562)
	44,176	31,365
INVESTING ACTIVITIES		
Proceeds from sale of property, plant and equipment	122	693
Acquisition of oil and gas properties	(55,670)	(51,529)
Additions to oil and gas properties	(88,580)	(63,235)
Additions to other capital assets	(71)	(79)
Net change in non-cash investing working capital (Note 13)	8,661	213
	(135,538)	(113,937)
FINANCING ACTIVITIES		
Increase in bank indebtedness	21,730	28,640
Common shares issued for cash	69,697	37,285
Share issue costs	(4,057)	(2,257)
Principal payment – capital lease obligation	-	(730)
Net change in non-cash financing working capital (Note 13)	-	(278)
	87,370	62,660
Decrease in cash	(3,992)	(19,912)
Cash, beginning of year	5,222	25,134
Cash, end of year	\$1,230	\$5,222

See Note 13 for supplemental disclosure

See accompanying notes to the consolidated financial statements

Iteration Energy Ltd.

Notes to the Consolidated Financial Statements Year Ended December 31, 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 consolidated financial statements of Iteration have been prepared in accordance with Canadian generally accepted accounting principles. The timely preparation of financial statements requires that management make estimates and assumptions, and use judgment regarding assets, liabilities, revenues and expenses. Such estimates primarily relate to unsettled transactions and events as of the date of the financial statements. Accordingly, actual results may differ from estimated amounts. In the opinion of management, these consolidated financial statements have been properly prepared within reasonable limits of materiality and within the framework of the significant accounting policies summarized below.

a) Basis of Consolidation

These consolidated financial statements include the accounts of Iteration, its wholly owned subsidiary and its partnerships.

b) Cash

Cash consists of amounts in various accounts with financial institutions maintained by the Company.

c) Property, plant and equipment

Cost

The Company follows the full cost method of accounting whereby all costs relating to the acquisition of, exploration for and development of oil and gas reserves are capitalized in a single Canadian cost center. Such costs include lease acquisition, lease rentals on undeveloped properties, geological and geophysical, drilling both productive and non-productive wells, production equipment and overhead charges directly related to acquisition, exploration and development activities.

Proceeds from the sale of oil and gas properties and related equipment are applied against capitalized costs with no gain or loss recognized unless such a disposition would change the depletion rate by 20 percent or more. Gains and losses are recognized upon the disposition of other assets.

Other capital assets are recorded at cost.

Depletion and depreciation

All costs of acquisition, exploration and development of oil and gas reserves, associated tangible plant and equipment costs (net of salvage value), and estimated costs of future development of proven undeveloped reserves are depleted and depreciated by the unit of production method based on estimated gross proved reserves as determined by independent engineers.

Costs of unproved properties and seismic costs on undeveloped land are initially excluded from oil and gas properties for the purpose of calculating depletion. When proven reserves are assigned or the property is considered to be impaired, the cost of the property or the amount of the impairment is added to costs subject to depletion.

The relative volumes of oil and natural gas reserves and production are converted to equivalent barrels of oil based on the relative energy content of each product on a 1 barrel to 6 thousand cubic feet basis.

Depreciation of capital assets not related to oil and gas properties is provided using the declining balance method at rates between 20 and 30%. Leasehold improvements are amortized on a straight-line basis over the term of the lease.

Impairment

The Company calculates its ceiling test by comparing the carrying value of its oil and gas properties to the sum of undiscounted cash flows expected to result from the future production of proved reserves and the sale of unproved properties. Cash flows are based on third party quoted forward prices, adjusted for transportation and quality. Should the ceiling test result in an excess of carrying value, the Company would then measure the amount of impairment by comparing the carrying amounts of its oil and gas properties to an amount equal to the estimated net present value of expected future cash flows from proved plus probable reserves and the sale of unproved properties. A risk-free interest rate of 6.5% (2006: 6%) is used to arrive at the net present value of the future cash flows.

The carrying value of undeveloped properties (land and seismic data) is reviewed periodically and written down to net realizable value if impairment is determined.

d) Goodwill

Goodwill is recorded at cost and not amortized. The Company tests for potential impairment of goodwill on an annual basis and, should it be determined that goodwill is impaired, the asset is written down at that time. For the years ended December 31, 2007 and 2006, no impairment write down of goodwill was required.

e) Leases

Leases that transfer substantially all the benefits and risks of ownership to the Company are recorded as capital leases. Assets under capital lease are included in property, plant and equipment with offsetting long-term capital lease obligations being recorded as liabilities. All other leases are classified as operating leases under which lease costs are expensed in the period incurred.

f) Asset Retirement Obligations

The Company recognizes the fair value of a liability for an asset retirement obligation in the period in which it is incurred and records a corresponding increase in the carrying value of the related long-lived asset. The fair value is determined through a review of engineering studies, industry guidelines, and management's estimate on a site by site basis. The liability is subsequently adjusted for the passage of time, and is recognized as an accretion expense in the statement of earnings (loss). The liability is also adjusted due to revisions in either the timing or the amount of the original estimated cash flows associated with the liability. The increase in the carrying value of the asset is amortized using the unit of production method based on estimated gross proven reserves as determined by independent engineers. Actual costs incurred upon the settlement of the obligations are charged against the liability.

g) Leasehold Inducements

The value of leasehold inducements received is deferred and amortized on a straight-line basis as a reduction of rental expense over the term of the related lease.

h) Revenue Recognition

Oil and natural gas sales are recognized as revenue when the commodities are delivered to purchasers.

i) Joint Operations

The Company conducts exploration, development and production activities jointly with others and, accordingly, these financial statements reflect only the Company's proportionate interest in such activities.

j) Stock Based Compensation

Under the Company's stock option plan, options to purchase common shares may be granted to directors, officers and employees at current market prices.

The Company's stock option plan as approved by the Company's shareholders, 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. The Company records a liability for the cash payment and a stock based compensation expense or recovery dependent on changes in the Company's share price and the number of options outstanding.

k) Future Income Taxes

The Company follows the liability method of accounting for income taxes. Under this method, future tax assets and liabilities are determined based on differences between financial reporting and tax bases of assets and liabilities and are measured using substantively enacted tax rates and laws that will be in effect when the differences are expected to reverse. Income tax expense for the year is the tax payable for the year and any change during the year in future income tax assets and liabilities. A valuation allowance is recorded to the extent that there is uncertainty regarding utilization of future tax assets.

l) Per Common Share Amounts

The Company uses the treasury stock method to determine the dilutive effect of stock options and warrants. This method assumes that proceeds from the exercise of stock options and warrants would be used to purchase common shares at the average market price during the year.

m) Measurement Uncertainty

The amount recorded for depletion and depreciation of oil and gas properties, the provision for asset retirement obligations and the ceiling test calculation are based on estimates of gross proven reserves, production rates, commodity prices, future costs and other relevant assumptions. Accruals for revenue and expenses are prepared based on estimates when actual amounts are not yet known. By their nature, these estimates are subject to measurement uncertainty and the effect on the financial statements of changes in such estimates in future years could be significant.

n) Flow-through Common Shares

Resource expenditure deductions for income tax purposes related to exploration and development activities funded by flow-through share arrangements are renounced to investors in accordance with income tax legislation. The estimated tax benefits transferred to shareholders are recorded as a future income tax liability with a corresponding reduction to share capital when the expenditures are renounced.

Changes in Accounting Policies

On January 1, 2007, the Company adopted six new accounting standards that were issued by the Canadian Institute of Chartered Accountants: Section 1506, *Accounting Changes*; Section 1530, *Comprehensive Income*; Section 3251, *Equity*; Section 3855, *Financial Instruments-Recognition and Measurement*; Section 3861, *Financial Instruments – Disclosure and Presentation*; and 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 equity, net loss or cash flows. The other effects of the implementation of the new standards are discussed below.

Accounting Changes

Section 1506 provides expanded disclosure for changes in accounting policies, accounting estimates and correction of errors. Under the standard, accounting changes should be applied on a retroactive basis unless otherwise permitted or where it is impractical to do so. Voluntary changes in accounting policy are made only when required by the primary source of GAAP, or the change results in more relevant and reliable information.

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. These include unrealized gains and losses on available for sale investments and the effective portion of gains or losses on derivatives designated as cash flow hedges. For the year ended December 31, 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.

Equity

Section 3251 establishes standards for the presentation of equity and changes in equity for the reporting period. The adoption of this standard did not have a significant impact on the Company’s consolidated financial statements.

Financial Instruments – Recognition and Measurement

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 are 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”.

All derivative financial instruments are classified as held for trading financial instruments and are measured at fair value, even when they are part of a hedging relationship. Associated gains and losses are included in net earnings (loss) in the period in which they arise.

Section 3865 provides alternative treatments to Section 3855 for entities which choose to designate qualifying transactions as hedges for accounting purposes. It specifies how hedge accounting is applied and the disclosures required when it is applied. This section did not currently have an impact on the Company’s consolidated financial statements.

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 standards increase 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.

International Financial Reporting Standards (“IFRS”)

The Canadian Accounting Standards Board has now confirmed that the use of IFRS will be required in 2011 for publicly accountable, profit-oriented enterprises. IFRS will replace current Canadian GAAP followed by the Company. The Company will be required to begin reporting under IFRS effective January 1, 2011 and will be required to provide information following IFRS for the comparative period. The Company is currently evaluating the impact of adopting IFRS.

3. ACQUISITIONS

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 \$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 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:

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

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 from the June 27, 2006 acquisition date.

4. PROPERTY, PLANT AND EQUIPMENT

	December 31, 2007	December 31, 2006
	(\$000's)	(\$000's)
Oil and gas properties	\$467,281	\$ 315,455
Other	753	683
	468,034	316,138
Less accumulated depletion and depreciation	182,680	122,588
	\$285,354	\$ 193,550

At December 31, 2007, unproved properties and seismic expenditures amounting to \$46,748,000 (December 31, 2006: \$30,231,000) have been excluded from the depletion calculation. Future development costs on proven undeveloped reserves of \$24,744,000 (December 31, 2006: \$10,022,000) are included in the depletion calculation.

For the year ended December 31, 2007, the Company capitalized \$2,453,000 (year ended December 31, 2006: \$1,864,000) of overhead directly related to exploration and development activities.

Iteration performs a ceiling test at least annually in accordance with the Canadian Institute of Chartered Accountants' full cost accounting guideline. No write-down was required for the year ended December 31, 2007 based on the following expected future commodity prices.

	Edmonton Light Crude Oil \$/Barrel (Cdn)	Alberta AECO Spot Price \$/Gigajoule (Cdn)	British Columbia Westcoast Station 2 \$/MMBtu (Cdn)	Edmonton NGL Mix \$/bbl (Cdn)
2008	88.17	6.51	5.96	39.29
2009	84.54	7.22	6.67	39.13
2010	83.16	7.69	7.14	39.38
2011	81.26	7.70	7.15	38.76
2012	80.73	7.61	7.06	38.44
Thereafter		2% annual increase		

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 6.10% per annum (2006 – 6.0% per annum).

6. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

The accounts payable and accrued liabilities consist of the following:

	December 31, 2007 (\$000's)	December 31, 2006 (\$000's)
Trade accounts payable	\$22,143	\$16,278
Joint venture accounts payable	1,944	2,491
Royalties payable	6,487	3,208
Total	\$30,574	\$21,977

7. ASSET RETIREMENT OBLIGATIONS

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 2008 through 2036) will total approximately \$39,281,000 (December 31, 2006: \$18,490,000). The estimated fair value of the obligation at December 31, 2007 is \$18,897,000 (December 31, 2006: \$9,198,000) using a discount rate of six and one half percent (six per cent in 2006) and an inflation rate of two percent. As at December 31, 2007, no funds have been set aside to settle this obligation.

	December 31, 2007 (\$000's)	December 31, 2006 (\$000's)
Balance, beginning of year	\$9,198	\$4,492
Liabilities incurred on acquisition of properties (note 3)	6,775	2,837
Increase in liabilities from drilling activity	2,262	2,366
Decrease in liabilities from revision of estimates	-	(945)
Accretion expense	833	471
Settlement of liabilities	(171)	(23)
Balance, end of year	\$18,897	\$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

	Year ended December 31, 2007		Year ended December 31, 2006	
	Number of Shares	Amount (\$000's)	Number of Shares	Amount (\$000's)
Balance, beginning of year	57,429,847	\$175,195	48,895,347	\$139,467
Shares issued on public offerings	12,977,400	67,892	6,200,000	25,110
Flow through shares issued on public offering	-	-	2,300,000	12,075
Shares issued on exercise of warrants	278,333	1,039	-	-
Shares issued on exercise of stock options	344,200	998	34,500	100
Share issue costs, net of tax effect of \$1,262,000 (2006: \$700,000)	-	(2,795)	-	(1,557)
Tax benefits renounced on prior year flow through share offering	-	(3,743)	-	-
Balance, end of year	71,029,780	\$238,586	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). As at December 31, 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:

	Year ended December 31, 2007		Year ended December 31, 2006	
	Number of Options	Weighted average exercise price \$	Number of Options	Weighted average exercise price \$
Outstanding, beginning of year	5,884,222	3.22	4,798,122	2.98
Granted	1,079,500	4.76	1,234,600	4.38
Exercised for shares	(344,200)	(2.90)	(34,500)	(2.90)
Exercised for cash	(667)	(4.90)	-	-
Forfeited	(50,066)	(4.49)	(114,000)	(5.72)
Outstanding, end of year	6,568,789	3.49	5,884,222	3.22
Options exercisable, end of year	3,236,062	3.11	1,617,096	2.98

The following table summarizes information about the stock options outstanding at December 31, 2007:

Range of exercise prices	Number outstanding December 31, 2007	Weighted average remaining contractual life (years)	Weighted average exercise price \$	Number exercisable December 31, 2007	Weighted average exercise price \$
\$2.90 to \$4.00	4,327,298	2.25	2.92	2,868,475	2.95
\$4.01 to \$5.00	2,031,866	3.42	4.54	334,562	4.28
\$5.01 to \$9.00	209,625	3.32	5.17	33,025	5.27
	6,568,789	2.65	3.49	3,236,062	3.11

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 year ended December 31, 2007, stock based compensation expense of \$3,412,000 (2006- \$25,000), was recognized based on the change in value of the outstanding stock options. The current year amounts were determined using the December 31, 2007 closing share price, as compared to the closing share price at December 31, 2006. 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 December 31, 2007 share price of \$4.75, had all of the 6,568,789 (December 31, 2006: 5,884,222) stock options outstanding been vested, aggregate stock based compensation expense and a corresponding liability of \$8,424,300 (December 31, 2006: \$7,071,000) would have been recognized. Of this amount, \$7,520,000 has been recognized as a liability at December 31, 2007 (December 31, 2006: \$4,108,000).

(e) Warrants

On March 21, 2005, warrants to purchase 5,000,000 common shares at \$2.90 per share were issued to Iteration Energy Inc. shareholders. On May 7, 2005, all of the warrants vested. During 2007, a total of 278,333 warrants were exercised. The 4,721,667 remaining warrants expire on September 21, 2008.

(f) **Per Share Amounts**

	Year ended December 31,	
	2007	2006
Weighted average common shares outstanding	63,678,453	52,751,751
Weighted average diluted common shares outstanding	63,678,453	52,751,751

The options and warrants outstanding for the year ended December 31, 2007 have no dilutive effect as the Company realized a net loss during the period.

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:

(\$000's)	Year ended December 31,	
	2007	2006
Loss before income taxes	\$(14,200)	\$(6,314)
Statutory Canadian corporate tax rate	32.12 %	34.50%
Anticipated tax recovery	\$(4,561)	\$(2,178)
Non-deductible Crown payments	-	1,505
Alberta Royalty Tax Credit	-	(37)
Resource allowance	-	(1,410)
Rate adjustment	(286)	190
Other	(108)	201
Future income tax recovery	\$(4,955)	\$(1,729)

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

(\$000's)	December 31, 2007	December 31, 2006
Income tax rate (%)	29.50	31.00
Property, plant and equipment, having different income tax and accounting basis	\$10,228	\$7,032
Deferred partnership income	13,082	9,088
Scientific research pools	(5,301)	(5,922)
Non capital loss carry forwards	(730)	(5,440)
Share issue costs	(1,568)	(1,057)
Accrued stock based compensation	(2,218)	(1,273)
Asset retirement obligation	(5,575)	(2,851)
Unamortized leasehold inducements	(59)	(103)
Other	(349)	(350)
Future income tax liability (asset)	\$7,510	\$(876)

The current income tax expense of \$197,000 for the year ended December 31, 2007 (2006: recovery of \$169,000) consists of the following:

	2007	2006
	(\$'000's)	(\$'000's)
Part 1 tax reassessment	-	(29)
Provincial income tax assessment for prior year	197	-
Part 1 tax reassessment – predecessor corporations	-	(140)
Current tax expense (recovery)	197	(169)

The Company has approximately \$1,820,000 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:

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);

2008	772
2009	386

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) Forward Contracts

As a means of managing commodity price volatility, the Company has entered into one forward contract for the future physical delivery of crude oil as follows:

Term	Volume (bbl/d)	Contract Price (USD /bbl)	Price Basis
Dec 1, 2007 – Nov 30, 2008	200	\$75.00 floor, \$90.20 ceiling	WTI

The Company considers the contract to be a future sales contract in the normal course of business at prices within a predetermined range with our current oil marketer, which will be satisfied by the future delivery of crude oil. As at December 31, 2007, the value of the remaining contract was an expense of \$460,000.

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 December 31, 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)	Year ended December 31,	
	2007	2006
Accounts receivable	\$(3,660)	\$7,019
Prepays and other current assets	(1,434)	135
Accounts payable and accrued liabilities	9,425	(8,521)
Income taxes payable	-	(260)
Net change	\$4,331	\$(1,627)

(\$000's)	Year ended December 31,	
	2007	2006
Net change by activity:		
Operating	\$ (4,330)	\$ (1,562)
Investing	8,661	213
Financing	-	(278)
Net change	\$ 4,331	\$ (1,627)

Additional information:

(\$000's)	Year ended December 31,	
	2007	2006
Cash interest paid	\$ 2,162	\$ 1,225
Cash taxes paid	197	15

14. SUBSEQUENT EVENTS

Acquisition of Cyries Energy Inc.

On January 21, 2008, Iteration announced an Arrangement Agreement (the "Agreement") with Cyries Energy Inc. ("Cyries") whereby each Cyries shareholder would receive 1.475 Iteration common shares for each Cyries share held. On March 3, 2008 the exchange ratio was increased to 1.62 Iteration common shares for each Cyries share held. Upon completion of the Arrangement, Cyries would become a wholly owned subsidiary of Iteration and current Iteration shareholders, option holders and warrant holders would hold approximately 47% of the combined entity.

On March 7, 2008, Cyries held a Shareholder Meeting at which the Arrangement was approved by the shareholders. Court approval of the Arrangement was also obtained on March 7, 2008. Pursuant with the terms of the arrangement, Iteration issued 93,990,604 Iteration common shares to complete the transaction. The acquisition will be accounted for using the purchase method and the purchase equation will be based on management's estimate of the fair values of the assets and liabilities of Cyries as at January 21, 2008.

In association with this transaction, the Company has entered into an Intercreditor Agreement with the Company's lenders and Cyries' lenders. Under the terms of the Intercreditor Agreement, the respective credit facilities will remain in place for a period of 60 days following completion of the transaction, at which time the two credit facilities will be combined into one.

Issue of Stock Options

In association with the acquisition of Cyries, the majority of Cyries' employees were offered employment with the Company. As part of their employment offers, 1,415,000 stock options were approved to be granted when the Company is out of blackout. The exercise price will be market price determined at the time the options are granted.

15. COMPARATIVE FIGURES

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