

PROBE RESOURCES LTD.
(A Development Stage Company)

REPORT AND CONSOLIDATED FINANCIAL STATEMENTS

August 31, 2007 and 2006



BDO Dunwoody LLP
Chartered Accountants

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AUDITORS' REPORT

To the Shareholders,
Probe Resources Ltd.

We have audited the consolidated balance sheets of Probe Resources Ltd. as at August 31, 2007 and 2006 and the consolidated statements of 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 August 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.

(signed) "BDO Dunwoody LLP"

Chartered Accountants

Vancouver, Canada
February 12, 2008

PROBE RESOURCES LTD.
(A Development Stage Company)
CONSOLIDATED BALANCE SHEETS
August 31, 2007 and 2006

	<u>ASSETS</u>	<u>2007</u>	<u>2006</u>
Current			
Cash and cash equivalents		\$ 68,854	\$ 113,035
Marketable securities – Note 3		-	161,663
GST receivable		12,608	5,682
Prepaid expenses		<u>1,250</u>	<u>-</u>
		82,712	280,380
Equipment – Note 4		-	592
Mineral property – Note 5		-	1
Oil and gas property – Notes 6, 11 and 13		<u>8,112,625</u>	<u>-</u>
		<u>\$ 8,195,337</u>	<u>\$ 280,973</u>

LIABILITIES

Current			
Accounts payable and accrued liabilities – Note 11		\$ 742,691	\$ 37,289
Advances payable – Notes 7 and 11		<u>1,012,814</u>	<u>-</u>
		1,755,505	37,289
Asset retirement obligation – Note 8		<u>531,632</u>	<u>-</u>
		<u>2,287,137</u>	<u>37,289</u>

SHAREHOLDERS' EQUITY

Share capital – Notes 9 and 13		7,691,846	2,033,092
Contributed surplus – Note 9		1,090,364	-
Deficit		<u>(2,874,010)</u>	<u>(1,789,408)</u>
		<u>5,908,200</u>	<u>243,684</u>
		<u>\$ 8,195,337</u>	<u>\$ 280,973</u>

Nature of Operations and Ability to Continue as a Going Concern – Note 1
Subsequent Events – Notes 6 and 13

APPROVED BY THE DIRECTORS:

<u>“Bruce Ganer”</u> Bruce Ganer	Director	<u>“Desmond Balakrishnan”</u> Desmond Balakrishnan	Director
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SEE ACCOMPANYING NOTES

PROBE RESOURCES LTD.
(A Development Stage Company)
CONSOLIDATED STATEMENTS OF LOSS AND DEFICIT
for the years ended August 31, 2007 and 2006

	<u>2007</u>	<u>2006</u>
General and administrative expenses		
Accounting and audit	\$ 24,180	\$ 9,587
Administration and other fees – Note 11	72,300	42,325
Amortization	-	254
Bank charges and interest	542	456
Consulting fees	12,000	-
Directors' fees – Note 11	28,500	4,500
Filing fees	9,523	6,028
Foreign exchange	46,320	-
Furniture and telephone rental – Note 11	27,325	25,611
Legal fees	18,917	-
Office and miscellaneous– Note 11	33,278	30,928
Promotion and travel	12,865	2,567
Rent – Note 11	26,136	23,994
Stock-based compensation – Note 9	831,364	-
Transfer agent fees	6,543	3,605
Wages and benefits	3,867	3,004
Write-off of equipment	<u>592</u>	<u>-</u>
Loss before other items	(1,154,252)	(152,859)
Gain on sale of marketable securities – Note 3	66,577	26,996
Interest income – Note 11	6,427	13,429
Write-down of mineral property – Note 5	(3,354)	(92,451)
Write-down of marketable securities – Note 3	<u>-</u>	<u>(101,680)</u>
Net loss for the year	(1,084,602)	(306,565)
Deficit, beginning of the year	<u>(1,789,408)</u>	<u>(1,482,843)</u>
Deficit, end of the year	<u>\$ (2,874,010)</u>	<u>\$ (1,789,408)</u>
Basic and diluted loss per share	<u>\$ (0.08)</u>	<u>\$ (0.02)</u>
Weighted average number of shares outstanding	<u>13,396,158</u>	<u>12,807,976</u>

SEE ACCOMPANYING NOTES

PROBE RESOURCES LTD.
(A Development Stage Company)
CONSOLIDATED STATEMENTS OF CASH FLOWS
for the years ended August 31, 2007 and 2006

	<u>2007</u>	<u>2006</u>
Operating Activities		
Net loss for the year	\$ (1,084,602)	\$ (306,565)
Add (deduct) items not affecting cash		
Amortization	-	254
Stock-based compensation	831,364	-
Gain on disposal of marketable securities	(66,577)	(26,996)
Write-off of equipment	592	-
Write-down of mineral property	3,354	92,451
Write-down of marketable securities	<u>-</u>	<u>101,680</u>
	(315,869)	(139,176)
Changes in non-cash working capital balances		
GST receivable	(6,926)	(3,202)
Prepaid expenses	(1,250)	-
Accounts payable and accrued liabilities	<u>79,471</u>	<u>20,859</u>
	<u>(244,574)</u>	<u>(121,519)</u>
Financing Activity		
Net proceeds from issuance of common shares	<u>5,917,754</u>	<u>-</u>
Investing Activities		
Proceeds from disposal of marketable securities	228,240	40,800
Increase in oil and gas property	(5,942,248)	-
Mineral property costs	(3,353)	(7,500)
Decrease in advances receivable	<u>-</u>	<u>1,149</u>
	<u>(5,717,361)</u>	<u>34,449</u>
Decrease in cash during the year	(44,181)	(87,070)
Cash and cash equivalents, beginning of the year	<u>113,035</u>	<u>200,105</u>
Cash and cash equivalents, end of the year	<u>\$ 68,854</u>	<u>\$ 113,035</u>
Cash and cash equivalents consists of:		
Cash	\$ 68,854	\$ 16,292
Short-term investments	<u>-</u>	<u>96,743</u>
	<u>\$ 68,854</u>	<u>\$ 113,035</u>

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SEE ACCOMPANYING NOTES

Continued

PROBE RESOURCES LTD.
(A Development Stage Company)
CONSOLIDATED STATEMENTS OF CASH FLOWS
for the years ended August 31, 2007 and 2006

	<u>2007</u>	<u>2006</u>
Supplemental disclosure of cash flow information:		
Cash paid for:		
Interest	\$ _____ -	\$ _____ -
Income taxes	\$ _____ -	\$ _____ -
Non-cash Transactions – Note 12		

SEE ACCOMPANYING NOTES

PROBE RESOURCES LTD.
(A Development Stage Company)
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
August 31, 2007 and 2006

Note 1 Nature of Operations and Ability to Continue as a Going Concern

Probe Resources Ltd. (the “Company”) is a public company listed on the TSX Venture Exchange, incorporated under the British Columbia Business Corporations Act on November 15, 1988. At August 31, 2007, the Company was in the development stage and owned an interest in an oil and gas property located in the Gulf of Mexico.

These consolidated financial statements have been prepared in accordance with generally accepted accounting principles applicable to a going concern, which assumes that the Company will be able to meet its obligations and continue its operations for its next fiscal year. Realization values may be substantially different from carrying values as shown and these financial statements do not give effect to adjustments that would be necessary to the carrying values and classification of assets and liabilities should the Company be unable to continue as a going concern. At August 31, 2007, the Company had a working capital deficiency of \$1,672,793, had not yet achieved profitable operations and expects to incur further losses in the development of its business, all of which casts substantial doubt about the Company’s ability to continue as a going concern. The Company’s ability to continue as a going concern is dependent upon its ability to generate future profitable operations and/or to obtain the necessary financing to meet its obligations and repay its liabilities arising from normal business operations when they come due.

Note 2 Significant Accounting Policies

These consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles in Canada. Because a precise determination of many assets and liabilities is dependent upon future events, the preparation of financial statements for a period necessarily involves the use of estimates, which have been made using careful judgement. Actual results may differ from these estimates.

The financial statements have, in management’s opinion, been properly prepared within the framework of the significant accounting policies summarized below:

a) Principles of Consolidation

These consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary, Probe Resources US Ltd., incorporated on July 13, 2007 in the State of Nevada, USA. All inter-company transactions and balances have been eliminated.

Note 2 Significant Accounting Policies – (cont'd)

b) Equipment and Amortization

Computer equipment is recorded at cost. Amortization is charged to operations on a declining balance basis at an annual rate of 30%:

c) Mineral Properties

The Company defers the cost of acquiring, maintaining its interest, exploring and developing mineral properties until such time as the properties are placed into production, abandoned, sold or considered to be impaired in value. Costs of producing properties will be amortized on a unit of production basis and costs of abandoned properties are written-off. Proceeds received on the sale of interests in mineral properties are credited to the carrying value of the mineral properties, with any excess included in operations. Write-downs due to impairment in value are charged to operations. Management reviews the carrying value of mineral properties on a periodic basis and will recognize impairment in value based upon current exploration results, the prospect of further work being carried out by the Company, the assessment of future probability of profitable revenues from the property or from the sale of the property.

d) Oil and Gas Properties

The Company follows the full cost method of accounting for oil and gas operations whereby all costs of exploring for and developing oil and gas reserves are initially capitalized on a country-by-country basis. Such costs include land acquisition costs, lease rentals, geological and geophysical expenses, carrying charges on non-producing properties, costs of drilling and overhead charges directly related to acquisition and exploration activities.

Costs capitalized, together with the costs of production equipment and pipeline, are depleted and amortized on the unit-of-production method based on the estimated gross proved reserves as determined by independent petroleum engineers. Petroleum products and reserves are converted to a common unit of measure, using 6 MCF of natural gas to one barrel of oil.

Costs of acquiring and evaluating unproved properties are initially excluded from depletion calculations. These unevaluated properties are assessed periodically to ascertain whether impairment has occurred. When proved 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 calculations.

Note 2 Significant Accounting Policies – (cont'd)

d) Oil and Gas Properties – (cont'd)

Proceeds from a sale of petroleum and natural gas properties are applied against capitalized costs, with no gain or loss recognized, unless such a sale would significantly alter the rate of depletion and amortization. Royalties paid net of any tax credits received are included in oil and gas sales cost of sales.

In applying the full cost method, the Company calculates a ceiling test whereby the carrying value of petroleum and natural gas properties is compared to the sum of the undiscounted cash flows expected to result from the proved reserves and the lower of cost or market of unproved properties. Cash flows used in the ceiling test are based on independent third party quoted forward prices, adjusted for contracted prices and quality differentials. 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 petroleum and natural gas properties to an amount equal to the estimated net present value of unproved properties. A risk-free interest rate is used to arrive at the net present value of future cash flows. Carrying values in excess of the estimated discounted future cash flows would be recorded as a permanent impairment.

The recoverability of amounts shown for unproven properties is dependent upon the discovery of economically recoverable reserves, the ability of the Company to obtain necessary financing to complete the development of the properties and upon future profitable production or proceeds from the disposition thereof.

e) Environmental Costs

Environmental expenditures that relate to current operations are expensed or capitalized as appropriate. Expenditures that relate to an existing condition caused by past operations and which do not contribute to current or future revenue generation are expensed. Liabilities are recorded when environmental assessments and/or remedial efforts are probable, and the costs can be reasonably estimated. Generally, the timing of these accruals coincides with the earlier of completion of a feasibility study or the Company's commitment to a plan of action based on the then known facts.

f) Asset Retirement Obligations

The fair value of obligations associated with the retirement of tangible long-lived assets are recorded in the period in which it is incurred and a reasonable estimate of the fair value can be made, with a corresponding increase to the carrying amount of the related asset. The obligations recognized are statutory, contractual or legal obligations. The liability is accreted over time for changes in the fair value of the liability through charges to accretion, which is included in depletion, depreciation and accretion expense. The costs capitalized to the related assets are amortized in a manner consistent with the depletion and depreciation of the related asset.

Note 2 Significant Accounting Policies – (cont'd)

g) Impairment of Long-Lived Assets

Canadian generally accepted accounting principles require that long-lived assets and intangibles to be held and used by the Company be reviewed for possible impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. If changes in circumstances indicate that the carrying amount of an asset that an entity expects to hold and use may not be recoverable, future cash flows expected to result from the use of the asset and its disposition must be estimated. If the undiscounted value of the future cash flows is less than the carrying amount of the asset, impairment is recognized. Management believes there has been no impairment of the Company's long-lived assets as at August 31, 2007.

h) Stock-based Compensation

The fair value of all share purchase options granted is expensed over their vesting period with a corresponding increase to contributed surplus. Upon exercise of share purchase options, the consideration paid by the option holder, together with the amount previously recognized in contributed surplus, is recorded as an increase to share capital.

The Company uses the Black-Scholes option valuation model to calculate the fair value of share purchase options at the date of grant. Option pricing models require the input of highly subjective assumptions, including the expected price volatility. Changes in these assumptions can materially affect the fair value estimate.

i) Foreign Currency Translation

Monetary assets and liabilities denominated in foreign currencies are translated into Canadian dollars at rates of exchange in effect at the date of the balance sheet. Non-monetary assets, liabilities and other items recorded in income arising from transactions denominated in foreign currencies are translated at rates of exchange in effect at the date of the transaction. Resulting exchange gains or losses are included in operations when incurred.

j) Basic and Diluted Loss Per Share

Basic loss per share is calculated by dividing the net loss available to common shareholders by the weighted average number of shares outstanding during the year. Diluted earnings per share reflect the potential dilution of securities that could share in earnings of an entity. In a loss year, potentially dilutive common shares are excluded from the loss per share calculation as the effect would be antidilutive. Basic and diluted loss per share are the same for the years presented.

Note 2 Significant Accounting Policies – (cont'd)

j) Basic and Diluted Loss Per Share – (cont'd)

For the years ended August 31, 2007 and 2006, potentially dilutive common shares (relating to options and warrants outstanding at year-end) totaling 12,040,910 (2006: Nil) were not included in the computation of loss per share because their effect was antidilutive.

k) Financial Instruments

The carrying values of cash and cash equivalents, accounts payable and accrued liabilities and advances payable approximate their fair value. It is management's opinion that the Company is not exposed to significant interest, currency or credit risks arising from these financial instruments.

l) Income Taxes

The Company has adopted the asset and liability method of accounting for income taxes. Under this method, current income taxes are recognized for the estimated income taxes payable for the current period. Future income tax assets and liabilities are recognized for temporary differences between the tax and accounting basis of assets and liabilities as well as for the benefit of the losses available to be carried forward to future years for tax purposes only if it is more likely than not that they can be realized.

m) Marketable Securities

Marketable securities are carried at the lower of cost and market value.

n) Cash and Cash Equivalents

Cash and cash equivalents consist of all highly liquid investments that are readily convertible to cash and have maturities of one year or less when purchased.

Note 3 Marketable Securities

At August 31, 2006, the Company held 4,362 common shares of Sherritt International Inc. These shares were carried at a cost of \$59,983 (market value \$105,631). During the year ended August 31, 2007, the Company sold the shares for proceeds of \$143,235 and recorded a gain on sale of \$83,252.

Note 3 Marketable Securities – (cont'd)

At August 31, 2006, the Company held 4,067,186 common shares of Rose Marie Resources Ltd., a public company with directors in common with the Company. The Company acquired these shares as payment on advances and accrued interest receivable totalling \$203,360. The shares were carried at market value at August 31, 2006. During the year ended August 31, 2007, the shares were sold for proceeds of \$85,005 resulting in a loss on sale of \$16,674.

Note 4 Equipment

	<u>2007</u>		
	<u>Cost</u>	<u>Accumulated Amortization</u>	<u>Net</u>
Computer equipment	\$ -	\$ -	\$ -
	<u>2006</u>		
	<u>Cost</u>	<u>Accumulated Amortization</u>	<u>Net</u>
Computer equipment	\$ 2,625	\$ 2,033	\$ 592

Note 5 Mineral Property

	<u>2007</u>	<u>2006</u>
Larry Claim Group		
Balance, beginning of the year	\$ 1	\$ 84,952
Consulting fees	<u>3,353</u>	<u>7,500</u>
	3,354	92,452
Less: amount written off	<u>(3,354)</u>	<u>(92,451)</u>
Balance, end of the year	<u>\$ -</u>	<u>\$ 1</u>

The Company had a 100% undivided interest in the Larry Claim Group comprised of 24 claims located in the Greenwood Mining District, Province of British Columbia. Management does not intend to carry out additional work on this property and accordingly wrote off all costs relating to work done on the property.

Note 6 Oil and Gas Property

	<u>2007</u>	<u>2006</u>
Acquisition costs	\$ 647,379	\$ -
Drilling, completion and other costs – Note 11	6,180,278	-
Flowline	<u>1,284,968</u>	<u>-</u>
	<u>\$ 8,112,625</u>	<u>\$ -</u>

Gulf of Mexico – High Island

By a Farmout Agreement dated June 1, 2007 and amended July 16, 2007, the Company acquired a 33.574% working interest (25.1875% net revenue interest) in an oil and gas lease and well located in the High Island area of the Gulf of Mexico. Consideration for the acquisition is cash of \$583,495 (US\$550,000) payable the earlier of July 15, 2008 or the date by which sufficient funds have been received from the net revenue interest to pay the fee and 33.574% of all costs except for certain well costs of which the Company's share to be paid is 46.30896%. The Company has also agreed to a 72.5% share of the flowline costs. Legal fees of \$63,884 were incurred in connection with the acquisition. Subsequent to August 31, 2007, the Company purchased an additional 13.4291% working interest (10.075% net revenue interest) in the lease and a 7.97087% working interest (5.73113% net revenue interest) in the well. Consideration for the additional interest is the issue of 3,000,000 common shares (issued subsequently).

As at August 31, 2007, the well had been completed, however, production did not commence until subsequent to August 31, 2007. Accordingly, no depletion has been recorded as at August 31, 2007. Management has evaluated the carrying value and has determined that no impairment provision is required at August 31, 2007. The future prices used in the impairment test evaluation of the Company's oil and gas properties were as follows:

	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>
Oil - \$/Barrel	<u>\$69.88</u>	<u>\$69.94</u>	<u>\$67.94</u>	<u>\$67.68</u>	<u>\$67.64</u>
Natural gas - \$/MBTU	<u>\$7.78</u>	<u>\$8.22</u>	<u>\$8.06</u>	<u>\$7.83</u>	<u>\$8.11</u>

Other

During the year ended August 31, 2007, the Company obtained access to seismic data related to certain properties located in West Texas, U.S.A. for consideration of \$233,644 (US\$200,000). The Company also engaged another company to review and evaluate the data for a fee of US\$40,000 per month. Total costs incurred to August 31, 2007 are \$487,893 (US\$440,000). Subsequent to the consulting arrangement, a director of the other company became a director of the Company.

Note 7 Advances Payable

During the year ended August 31, 2007 payments on oil and gas expenditures were made directly to the operator on behalf of the Company. These advances payable do not bear interest, are unsecured and have no fixed terms of repayment.

Note 8 Asset Retirement Obligation

The Company has estimated the total future asset retirement obligation based on the Company's net ownership interest in oil and gas wells and facilities. This includes all estimated costs to dismantle, remove, reclaim and abandon the wells and facilities and the estimated time period during which these costs will be incurred in the future. The Company has estimated the total undiscounted cash flows required to settle the asset retirement obligations to be \$1,036,000 (2006: \$Nil). A credit-adjusted risk free rate of 10% was used to calculate the fair value of the asset retirement obligations.

The following table reconciles the asset retirement obligations associated with the retirement of oil and gas properties.

	Years ended August 31,	
	<u>2007</u>	<u>2006</u>
Balance, beginning of year	\$ -	\$ -
Liabilities incurred	531,632	-
Accretion expense	-	-
Balance, end of year	<u>\$ 531,632</u>	<u>\$ -</u>

Note 9 Share Capital

Authorized:

Unlimited common shares without par value

Issued:

	<u>Share Capital</u>		<u>Contributed</u>
	<u>Number of</u>		<u>Surplus</u>
	<u>Shares</u>	<u>Amount</u>	<u>Amount</u>
Balance, August 31, 2005 and 2006	13,409,101	\$ 2,033,092	\$ -
Issued for cash pursuant to private placement agreements - at \$0.60	10,000,000	6,000,000	-
Issued for finder's fees - at \$0.60	700,000	420,000	-
Less: share issue costs		(761,246)	259,000
Share purchase options	-	-	<u>831,364</u>
Balance, August 31, 2007	<u>24,109,101</u>	<u>\$ 7,691,846</u>	<u>\$ 1,090,364</u>

Note 9 Share Capital – (cont'd)

Issued: – (cont'd)

During the year ended August 31, 2007, the Company issued 10,000,000 units at \$0.60 per unit pursuant to a private placement for gross proceeds of \$6,000,000. Each unit consisted of one common share and one share purchase warrant entitling the holder thereof the right to purchase an additional common share for each warrant held at \$0.75 per share for one year. The Company incurred legal and filing fees of \$82,246 and issued 700,000 units as finders' fees with the same terms as the private placement units. All proceeds on the issue of units have been allocated to share capital and none to warrants.

Escrow:

At August 31, 2007 and 2006, 601,125 common shares were held in escrow by the Company's transfer agent. The release of these shares is subject regulatory approval.

Commitments:

Stock-Based Compensation Plan

The Company has a stock option plan whereby the maximum number of shares reserved for issue under the plan shall not exceed 10% of the outstanding common shares of the Company, as at the date of the grant. The maximum number of common shares reserved for issue to any one person under the plan cannot exceed 5% of the issued and outstanding number of common shares at the date of the grant and the maximum number of common shares reserved for issue to a consultant or a person engaged in investor relations activities cannot exceed 2% of the issued and outstanding number of common shares at the date of the grant. The exercise price of each option granted under the plan may not be less than the Discounted Market Price (as that term is defined in the policies of the TSX). Options may be granted for a maximum term of five years from the date of the grant, are non-transferable and expire within 90 days of termination of employment or holding office as director or officer of the Company. Unless otherwise stated, share purchase options vest when granted.

Information regarding the Company's outstanding share purchase options is summarized as follows:

Note 9 Share Capital – (cont'd)

Commitments: – (cont'd)

Stock-Based Compensation Plan – (cont'd)

	Years ended August 31,			
	<u>2007</u>		<u>2006</u>	
	<u>Number</u>	<u>Weighted Average Exercise Price</u>	<u>Number</u>	<u>Weighted Average Exercise Price</u>
Outstanding, beginning of the year	-	\$0.00	-	\$0.00
Granted	<u>1,340,910</u>	<u>\$0.67</u>	<u>-</u>	<u>\$0.00</u>
Outstanding and exercisable, end of the year	<u>1,340,910</u>	<u>\$0.67</u>	<u>-</u>	<u>\$0.00</u>

Share purchase options outstanding at August 31, 2007 are as follows:

<u>Number of Options</u>	<u>Exercise Price</u>	<u>Expiry Date</u>
<u>1,340,910</u>	\$0.67	July 26, 2012

The fair value of the share purchase options granted during the year ended August 31, 2007 of \$831,364 (2006: \$Nil) was estimated using the Black-Scholes option pricing model using the following assumptions:

	<u>2007</u>	<u>2006</u>
Risk-free interest rate	4.13%	-
Dividend yield	0%	-
Expected stock price volatility	104.4%	-
Weighted average expected stock option life	5 years	-

Note 9 Share Capital – (cont'd)

Commitments: – (cont'd)

Share Purchase Warrants

Information regarding the Company's outstanding share purchase warrants is summarized below:

	Years ended August 31,		Years ended August 31,	
	2007		2006	
	<u>Number</u>	<u>Weighted Average Exercise Price</u>	<u>Number</u>	<u>Weighted Average Exercise Price</u>
Beginning of the year	-	-	-	-
Issued	<u>10,700,000</u>	<u>\$0.75</u>	<u>-</u>	<u>-</u>
End of the year	<u>10,700,000</u>	<u>\$0.75</u>	<u>-</u>	<u>-</u>

Share purchase warrants outstanding at August 31, 2007 are as follows:

<u>Number of Warrants</u>	<u>Exercise Price</u>	<u>Expiry Date</u>
<u>10,700,000</u>	\$0.75	August 9, 2008

These warrants are subject to an acceleration provision whereby, if the Company's shares trade above \$0.75 for 20 consecutive trading days after the expiration of their hold period, the Company may give notice that the warrants will expire in 30 days if unexercised.

Brokers Warrants

Share issue costs of \$259,000 with respect to 700,000 share purchase warrants issued for finders' fees during the year ended August 31, 2007 and included in the share purchase warrants outstanding above, were estimated using the Black-Scholes option pricing model with the following assumptions:

	<u>2007</u>
Risk-free interest rate	3.28%
Dividend yield	0%
Expected stock price volatility	87.8%
Weighted average expected stock option life	1 year

Note 10 Income Taxes

At August 31, 2007, the Company has accumulated Canadian exploration and development expenses totalling \$93,906, non-capital losses in Canada totalling \$1,025,940 and net operating losses in the U.S. of \$7,580,993, which may be applied against future years' taxable income. The non-capital losses expire as follows:

	<u>U.S.</u>	<u>Canada</u>
2008	\$ -	\$ 74,263
2009	-	99,354
2010	-	125,475
2014	-	112,758
2015	-	104,294
2026	-	125,678
2027	<u>7,580,993</u>	<u>384,118</u>
	<u>\$ 7,580,993</u>	<u>\$ 1,025,940</u>

A reconciliation of income taxes at statutory rates is as follows:

	<u>2007</u>	<u>2006</u>
a) Loss before income taxes	<u>\$ 1,084,602</u>	<u>\$ 306,565</u>
Statutory income tax rates	<u>34.12%</u>	<u>34.12%</u>
Computed income tax recovery	\$ 370,066	\$ 104,600
Non-deductible stock-based compensation and other items	(289,649)	4,606
Share issue costs	23,287	-
Net change in valuation allowance	<u>(103,704)</u>	<u>(109,206)</u>
Total income taxes (recovery)	<u>\$ -</u>	<u>\$ -</u>

Note 10 Income Taxes – (cont'd)

Significant components of the Company's future tax assets and liabilities, after applying enacted corporate income tax rates, are as follows:

	<u>2007</u>	<u>2006</u>
Future income tax assets		
Non-capital losses	\$ 3,003,398	\$ 255,791
Exploration and development costs	(2,621,307)	30,896
Equipment and other	(5,092)	694
Marketable securities	-	34,693
Share issue costs remaining	<u>93,146</u>	<u>-</u>
	470,145	322,074
Less: valuation allowance	<u>(470,145)</u>	<u>(322,074)</u>
Net future income tax assets	<u>\$ -</u>	<u>\$ -</u>

The Company has recorded a valuation allowance against its future income tax assets based on the extent that it is more likely-than-not that sufficient taxable income will not be realized during the carry-forward periods to utilize all the future tax assets.

Note 11 Related Party Transactions

- a) The Company incurred the following fees charged by directors of the Company or by private companies with directors in common with the Company:

	Year ended August 31,	
	<u>2007</u>	<u>2006</u>
Administration and other fees	\$ 72,300	\$ 42,325
Directors' fees	28,500	4,500
Furniture and telephone rental	27,144	24,925
Office and miscellaneous	29,040	26,660
Drilling, completion and other costs	254,249	-
Rent	<u>26,136</u>	<u>23,994</u>
	<u>\$ 437,369</u>	<u>\$ 122,404</u>

These charges were measured by the exchange amount which is the amount agreed upon by the transacting parties.

Note 11 Related Party Transactions – (cont'd)

- b) At August 31, 2007, accounts payable and accrued liabilities include \$42,436 (2006: \$Nil) due to directors of the Company or to private companies with directors in common with the Company and \$583,495 (2006: \$Nil) due to a private company controlled by a significant shareholder of the Company.
- c) At August 31, 2007 advances payable include \$84,600 (2006: \$Nil) due to a company with a director in common and \$529,090 (2006: \$Nil) due to a significant shareholder of the Company.
- d) During the year ended August 31, 2006, the Company recorded interest income of \$3,653 in respect to advances to a public company with directors in common with the Company.

Note 12 Non-Cash Transactions

Investing and financing activities that do not have a direct impact on current cash flows are excluded from the statements of cash flows.

During the year ended August 31, 2007, the following transactions were excluded from the statement of cash flows:

- a) the Company issued 700,000 common shares valued at \$420,000 as finders fees on a private placement.
- b) the Company issued 700,000 brokers warrants valued at \$259,000 as finders fees on a private placement.
- c) the Company included \$531,632 in oil and gas property costs pursuant to the provision of an asset retirement obligation.
- d) oil and gas property costs include \$1,012,824 of advances payable and \$625,931 of accounts payable outstanding at August 31, 2007.

During the year ended August 31, 2006, the following transaction was excluded from the statement of cash flows:

- a) the Company received 4,067,187 common shares of a public company as settlement of the principal and accrued interest owing on a loan receivable totalling \$203,360.

Note 13 Subsequent Events

Subsequent to August 31, 2007:

- a) the Company issued 4,200,000 units at \$0.50 per unit pursuant to a private placement for gross proceeds of \$2,100,000. Each unit consists of one common share and one share purchase warrant entitling the holder thereof the right to purchase an additional common share for each warrant held at \$0.60 per share for one year. In addition, the Company paid finders' fees of \$52,500 and issued 168,350 units as finders' fees with the same terms as the private placement units.
- b) the Company granted share purchase options entitling the holders thereof the right to purchase 200,000 common shares of the Company at \$0.47 per share until September 20, 2009, 100,000 common shares at \$0.49 per share until October 26, 2012, and 1,250,000 common shares at \$0.60 per share until November 22, 2012.
- c) the Company issued 3,000,000 common shares pursuant to an assignment agreement in which the Company acquired an additional 13.4291% working interest (10.0751% net revenue interest) in the High Island oil and gas lease and a 7.97087% working interest (5.73113% net revenue interest) in the well.

Note 14 Comparative Figures

Certain comparative figures as at August 31, 2006 and for the year then ended have been reclassified to conform with the financial statement presentation adopted for the current year.