

# International Sovereign Energy Corp.

## Interim Consolidated Financial Statements

For the three and nine months ended September 30, 2008

(unaudited- See Notice to Reader)

### **Notice to Reader**

The accompanying unaudited interim financial statements have been prepared by the company's management and the Company's independent auditors have not performed a review of these financial statements.

**Calgary, Alberta**  
**November 13, 2008**

# International Sovereign Energy Corp.

## Consolidated Balance Sheets

September 30, 2008 and December 31, 2007

	September 30 2008 (Unaudited)	December 31 2007 (Audited)
<b>Assets</b>		
<i>Current assets:</i>		
Cash and cash equivalent	\$ 1,948,101	\$ 247,739
Accounts receivable	2,144,655	1,442,687
Advance to operators	792,656	144,749
Prepaid expenses and deposits	116,706	126,173
	5,002,118	1,961,348
Restricted cash (Note 6,7)	2,898,183	-
Property and equipment (Note 3)	30,388,901	33,482,745
	\$ 38,289,202	\$ 35,444,093
<b>Liabilities and Shareholders' Equity</b>		
<i>Current liabilities:</i>		
Accounts payable and accrued liabilities	\$ 4,210,334	\$ 2,668,444
Operating loan (Note 5)	-	2,167,000
	4,210,334	4,835,444
Letter of guarantee (Note 6,7)	2,480,166	-
Future income tax liability	3,879,849	4,458,453
Asset retirement obligation (Note 4)	2,294,904	1,108,664
	12,865,253	10,402,561
<i>Shareholders' equity:</i>		
Share capital (Note 8a)	21,473,236	19,671,569
Warrant (Note 8b)	460,523	-
Contributed surplus (Note 9)	1,435,103	1,174,293
Retained earnings	2,055,087	4,195,670
	25,423,949	25,041,532
	\$ 38,289,202	\$ 35,444,093

*See accompanying notes to financial statements.*

Subsequent events Note 15

Approved by the Board

Signed- "John Lokker"-Director

Signed- "Peter Proszanski" -Director

# International Sovereign Energy Corp.

## Consolidated Statements of Operations and Retained Earnings

For the three and nine months periods ended September 30, 2008 and 2007

(Unaudited)

	Three months ended September 30		Nine months ended September 30	
	2008	2007	2008	2007
<b>Revenues:</b>				
Petroleum and natural gas revenues	\$ 5,563,108	\$ 2,487,542	\$ 14,930,133	\$ 7,126,529
Royalties	(929,812)	(446,288)	(2,826,041)	(1,149,439)
Other income	11,592	27,104	59,604	98,003
	<b>4,644,888</b>	2,068,358	<b>12,163,696</b>	6,075,093
<b>Expenses:</b>				
Operating costs	959,553	642,857	2,279,416	2,065,523
Transportation costs	262,809	205,162	475,565	450,017
Depletion, depreciation and accretion	1,362,863	746,879	3,460,627	2,178,243
Impairments (Note 3)	-	-	5,089,843	-
General and administrative	546,637	448,421	3,297,258	1,450,134
Interest	26,539	142,498	113,563	169,316
Stock based compensation expense (Note 8d)	65,241	47,328	159,897	120,765
Unrealized loss on exchange	3,849	1,954	6,714	8,573
	<b>3,227,491</b>	2,235,099	<b>14,882,883</b>	6,442,571
Earnings before income taxes	<b>1,417,397</b>	(166,741)	<b>(2,719,187)</b>	(367,478)
<b>Income taxes:</b>				
Future income tax (recovery) expense	267,461	852	(578,604)	(125,171)
	<b>267,461</b>	852	<b>(578,604)</b>	(125,171)
Net earnings (loss)	<b>1,149,936</b>	(167,593)	<b>(2,140,583)</b>	(242,307)
Retained earnings, beginning of period	<b>905,152</b>	4,455,747	<b>4,195,670</b>	4,530,461
Retained earnings, end of period	\$ <b>2,055,088</b>	\$ 4,288,154	\$ <b>2,055,087</b>	\$ 4,288,154

See accompanying notes to financial statement.

# International Sovereign Energy Corp.

For the three and nine months periods ended September 30, 2008 and 2007

(Unaudited)

	Three months ended September 30		Nine months ended September 30	
	2008	2007	2008	2007
<b>Cash flows from operating activities:</b>				
Net earnings (loss)	\$ 1,149,936	\$ (167,593)	\$ (2,140,583)	\$ (242,307)
Adjustments for:				
Depletion, depreciation and accretion	1,362,863	746,879	3,460,627	2,178,243
Impairments	-	-	5,089,843	-
Stock based compensation expense	65,241	47,328	159,897	120,765
Future income taxes	267,461	852	(578,604)	(125,171)
Cash flow from operations	2,845,501	627,466	5,991,180	1,931,530
Asset retirement costs incurred	(1,241)	(2,005)	(14,416)	(15,002)
	2,844,260	625,461	5,976,764	1,916,528
Changes in non-cash working capital				
Accounts receivable, prepaid expenses and deposits	903,612	(90,651)	(696,848)	348,613
Accounts payable and accrued liabilities	(170,861)	739,036	3,078,110	2,173,575
	3,577,011	1,273,846	8,358,026	4,438,716
<b>Financing:</b>				
Operating Loan	(3,059,000)	-	(2,167,000)	-
Issuance of common shares	2,363,105	-	2,363,105	-
Exercise of stock options	-	3,250	-	8,450
	(695,895)	3,250	196,105	8,450
<b>Investing:</b>				
Letter of guarantee issued	-	-	(418,017)	-
Addition to property and equipment	(1,146,406)	(1,390,345)	(4,283,970)	(3,612,198)
Proceeds on sale of property and equipment	-	101,151	28,001	166,151
	(1,146,406)	(1,289,194)	(4,673,986)	(3,446,047)
Changes in non-cash working capital				
Accounts receivable, prepaid expenses and deposits	369,614	173,115	(643,563)	(103,347)
Accounts payable and accrued liabilities	(142,941)	20,784	(1,536,220)	(2,692,678)
	(919,733)	(1,095,295)	(6,853,769)	(6,242,072)
<b>Net (decrease) increase in cash</b>	<b>1,961,383</b>	<b>181,801</b>	<b>1,700,362</b>	<b>(1,794,906)</b>
<b>Cash and cash equivalents, beginning of period</b>	<b>(13,282)</b>	<b>(658,475)</b>	<b>247,739</b>	<b>1,318,231</b>
<b>Cash and cash equivalents, end of period</b>	<b>\$ 1,948,101</b>	<b>\$ (476,674)</b>	<b>\$ 1,948,101</b>	<b>\$ (476,675)</b>
<b>Supplementary cash flow information:</b>				
Interest paid	\$ 26,539	\$ 142,498	\$ 113,563	\$ 169,316

See accompanying notes to financial statements.

# International Sovereign Energy Corp.

Notes to Consolidated Financial Statements (Unaudited)

September 30, 2008

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## 1. NATURE OF BUSINESS

International Sovereign Energy Corp., and its wholly owned subsidiaries, International Sovereign Energy Corp SA, and Bellwether International Inc., (collectively the “Company”), are in the business of exploration for and development of petroleum and gas interests.

## 2. ACCOUNTING POLICIES

### **Interim Financial Statements**

The accompanying interim consolidated financial statements of international Sovereign Energy Corp. have been prepared in accordance with the Canadian generally accepted accounting principles, consistent with accounting policies disclosed in the Company’s consolidated financial statements for the years ended with December 31, 2007 and 2006. The note disclosure requirements for annual financial statements provide additional disclosures than required for interim financial statements. Accordingly, the financial statements and notes thereto should be read in conjunction with the Company’s Annual Report for the year ended December 31, 2007.

Accounting measurements at interim dates inherently involve greater reliance on estimates than at year-end and the results of operations for the interim periods shown in this report are not necessarily indicative of results to be expected for the fiscal year. In the opinion of management, the accompanying unaudited interim consolidated financial statements include all adjustments (of a normal recurring nature) necessary to present fairly the financial position of the company as of September 30, 2008.

### *Stock-based compensation plan*

The Company uses the fair-value based method of accounting for stock options and recognizes stock compensation expense based on the estimated fair value of the option on the date of grant, which is determined using the Black-Scholes option-pricing model. The fair value of the options is recognized over the vesting period of the options granted as stock compensation expense and contributed surplus. The contributed surplus balance is reduced when the options are exercised and the amount initially recorded as contributed surplus is credited to share capital.

### **New accounting policies**

#### *Section 1506 “Accounting Changes”*

As of January 1, 2008 the Company has adopted CICA Handbook section 1535, “Capital Disclosures”, which requires entities to disclose their objectives, policies and processes for managing capital, and in addition, whether the entity has complied with any externally imposed capital requirements. Refer to Note 13 for further information regarding the Company’s management of capital.

In February 2008, the Canadian Institute of Chartered Accountants (“CICA”) issued Section 3064, Goodwill and intangible assets, replacing Section 3062, Goodwill and other intangible assets and Section 3450, Research and development costs. Various changes have been made to other sections of the CICA Handbook for consistency purposes. The new Section will be applicable to financial statements relating to fiscal years beginning on or after October 1, 2008. Accordingly, the Company will adopt the new standards for its fiscal year beginning January 1, 2009. It establishes standards for the recognition, measurement, presentation and disclosure of goodwill subsequent to its initial recognition and of intangible assets by profit-oriented enterprises. Standards concerning goodwill are unchanged from the standards included in the previous Section 3062. The Company is currently evaluating the impact of the adoption of this new Section on its consolidated financial statements.

The CICA Accounting Standards Board (“AcSB”) adopted a strategic plan for the direction of accounting standards in Canada. As part of that plan, accounting standards in Canada for public companies are expected to converge with International Financial Reporting Standards (“IFRS”) by the start of 2011. The Company continues to monitor and assess the impact of convergence of Canadian GAAP and IFRS.

International Sovereign Energy Corp.  
Notes to Consolidated Financial Statements (Unaudited)  
September 30, 2008

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2. ACCOUNTING POLICIES (Cont)

*Comprehensive Income*

The new standards introduce comprehensive income, which consists of net earnings and other comprehensive income ("OCI"). Because the Company does not have any OCI, the Company's consolidated financial statements do not include a Statement of Comprehensive Income, which would otherwise describe the components of comprehensive income. Accordingly, since there are no cumulative changes in OCI to be included in accumulated other comprehensive income ("AOCI"), the Company has not presented AOCI as a new category within shareholder's equity in the consolidated balance sheet and has not included a Statement of Accumulated Other Comprehensive Income, which would otherwise provide the continuity of the AOCI balance.

*Financial Instruments*

The Company has made the following classifications:

Cash and cash equivalents are designated as "held-for-trading" and are measured at fair value with no adjustment made to carrying value due to the short-term nature of these instruments. Accounts receivable are designated as "loans and receivables". Accounts payable, accrued liabilities, and operating loan are designated as "other liabilities".

3. PROPERTY AND EQUIPMENT

	September 30, 2008	December 31, 2007
Petroleum and natural gas properties		
- Canada	\$ 47,815,904	\$ 44,018,401
- International	9,758,925	8,505,971
Furniture and equipment	299,214	287,828
	<u>\$ 57,874,043</u>	<u>\$ 52,812,200</u>
Accumulated depletion and depreciation	22,395,299	19,329,455
Provision for impairment of international assets	5,089,843	-
	<u>\$ 30,388,901</u>	<u>\$ 33,482,745</u>

During the period costs of \$4,524,976 (2007 – \$4,524,976) related to undeveloped properties in Canada and \$9,758,925 (2007 – \$8,121,759) of deferred expenditures related to international projects have been excluded from depletion. Accumulated depletion on international projects at September 30, 2008 was \$7,496,506 (2007 - \$2,334,999). The Company has performed an impairment test calculation on June 30, 2008 in accordance with "AcG-16, Oil and Gas Accounting- Full Cost" to assess the recoverable value of the asset. As a result of this calculation the Company has made a provision against its petroleum and natural gas property in Ecuador, Ghana, Columbia and Yemen, in total, \$5,089,843. None of these international projects have proved reserves assigned to them as at September 30, 2008. During the first and second quarters of 2008 the Company had capitalized G&A of \$844,778 and \$408,176 respectively, relating to international exploration expenses.

# International Sovereign Energy Corp.

Notes to Consolidated Financial Statements (Unaudited)

September 30, 2008

## 4. ASSET RETIREMENT OBLIGATIONS

The Company recognizes as a liability the estimated fair value of the future retirement obligations associated with property and equipment. The fair value is capitalized and amortized over the same period as the underlying asset. The Company estimates the liability based on the estimated costs to abandon and reclaim its net ownership interest in all wells and facilities and the estimated timing of the costs to be incurred in future periods. This estimate is evaluated on a periodic basis and any adjustment to the estimate is prospectively applied. As time passes, the change in net present value of the future retirement obligation is expensed through accretion. Retirement obligations settled during the period reduce the future retirement liability.

	Three months ended September 30		Nine months ended September 30	
	2008	2007	2008	2007
Carrying amount, beginning of period	\$ 1,154,301	\$ 1,050,859	\$ 1,108,664	\$ 1,007,400
Liabilities acquired	21,453	19,245	80,264	76,019
Liabilities incurred	(1,242)	(2,057)	(14,416)	(15,372)
Revision of estimate	1,120,392	-	1,120,392	-
<b>Total</b>	<b>\$ 2,294,904</b>	<b>\$ 1,068,047</b>	<b>\$ 2,294,904</b>	<b>\$ 1,068,047</b>

For the first nine months of 2008 the ARO increased by \$1,186,240; property and equipment decreased by \$96,941 net of depletion and net income decreased by \$491,724 to reflect impact of accretion and depletion expense for the period. In the comparative period of 2007, the ARO increased by \$60,648, property and equipment decreased by \$36,875 net of depletion and net income decreased by \$93,648 to reflect the impact of accretion and depletion expense for the period.

## 5. OPERATING LOAN

The Company's revolving line of credit of \$4,000,000 (December 31, 2007- \$6,000,000) was reinstated on August 27, 2008; however it is subject to a review on September 30, 2008. The operating loan bears interest at prime plus 1% and is secured by a demand debenture for a minimum of \$10,000,000 providing a floating charge over all assets of the Company and a letter of undertaking not to encumber or dispose of assets, other than in the normal course of business without consent of the financial institution and to provide security under section 426 of the bank Act and/or assign natural gas contracts. In addition the financial institution has issued on behalf of the Company letters of credit totaling \$7,500 (2007- \$7,500) to maintain its status as a licensed well operator in the province of British Columbia. There is no bank debt as at September 30, 2008. The Company has an undrawn line of credit of \$4,000,000 available.

# International Sovereign Energy Corp.

Notes to Consolidated Financial Statements (Unaudited)

September 30, 2008

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## 6. ACQUISITION OF BELLWETHER INTERNATIONAL INC.

In the quarter ending March 31, 2008 the Company completed the acquisition of Bellwether International Inc. (“BII”), the holder and operator of the Charapa Hydrocarbon Concession Contract, Ecuador (the “Charapa Contract”), pursuant to the Memorandum of Agreement between the Company and South American Investment Inc. (SAI). The Company acquired all the issued and outstanding shares of BII for \$1. The Company will also obtain all rights, title and interest to the US\$2,340,000 BII funds, which funds provide a performance guarantee under the terms and conditions of the Charapa Contract. The guaranteed funds will be progressively released to the Company upon completion of certain qualified expenditures under the Charapa Contract terms and conditions.

The allocation of the purchase price for the assets, based on fair values, was as follows:

Oil and gas assets assumed	US\$ 500,000
Restricted cash	US\$ 2,340,000
Current liabilities assumed	US\$ 500,000
Letter of Guarantee to Petroleos del Ecuador, PetroEcuador	US\$ 2,340,000

The oil and gas assets acquired in Ecuador have been fully provided for (See Note 3). The Company did not record any goodwill on acquisition.

The purchase price is based on information currently available and the Company is allocating purchase price between assets and liabilities as of the date of this statement. The price will be finalized as the information is available. In the first quarter the transaction was not recorded as the financial information was not available to record the assets or liabilities acquired.

## 7. RESTRICTED CASH, LETTER OF GUARANTEE.

The restricted funds US\$2,340,000 acquired through acquisition of BII, provide a performance guarantee of US\$2,340,000 to Petroleos del Ecuador, PetroEcuador under the terms and conditions of the Charapa Contract.

The Company on January 31, 2008 issued unconditional, irrevocable bank guarantee for US\$414,000, in favour of Mari Gas Company Limited with respect to Sukkur block, in relation to petroleum exploration, development and production in Pakistan, to guarantee the Company’s financial obligations. The guarantee will be reduced by an amount proportionate to 50% of the discharge of minimum work, and expires July 20, 2009.

The Company also has a standby letter of credit of \$7,500 (December 31, 2007- \$7,500) to maintain its status as a licensed well operator in the province of British Columbia.

# International Sovereign Energy Corp.

Notes to Consolidated Financial Statements (Unaudited)

September 30, 2008

## 8a. SHARE CAPITAL

### Authorized

Unlimited number of Class A common voting shares  
Unlimited number of Class B common non-voting shares  
Unlimited number of Class A preferred voting, 7%  
Non-cumulative, redeemable shares

### Issued

#### Class A common shares

	Number of Shares	Value
Balance at December 31, 2007	13,928,084	\$ 19,671,569
Issuance of common shares, private placement net of issuance costs	2,168,000	2,262,190
Fair value of warrants, private placement		(460,523)
Balance at September 30, 2008	16,096,084	\$ 21,473,236

On September 19, 2008 the Company issued 2,168,000 units for gross proceeds of \$2,650,000 by way of private placement. Each unit consists of one Class A common share and one half of one transferable Class A common share purchase warrant. Each whole warrant entitles the holder to purchase one Class A common share for a period of 12 months following the closing date at a price of \$1.50 and at \$2.00 per share in the subsequent 12 months. If over a period of 20 consecutive trading days, the Company's stock price before the warrant expiry date exceeds the warrant exercise price by 30% on a daily closing volume weighted average basis, the Company may, within 30 days give notice to the holders that the warrant will expire on the 30th day following the date of the notice unless exercised by the holders. The fair value of each warrant granted by the Company was estimated using the Black-Scholes option pricing model assuming no dividends will be paid on common shares, a risk-free interest rate of 2.80% on an average life of 2 years and a volatility of 85% to be \$460,523 in aggregate, or \$0.42 per warrant.

Issuance costs of \$387,810 have been netted against the proceeds. Included in the share issuance costs are the warrants valuation cost representing the value of 212,000 warrants granted to agent, each warrant being exercisable into one Class A common share at \$1.25 within 24 months of closing. The fair value of each warrant granted by the Company was estimated using the Black-Scholes option pricing model assuming no dividends will be paid on common shares, a risk-free interest rate of 2.80% on an average life of 2 years and a volatility of 85% to be \$100,913 in aggregate, or \$0.48 per warrant.

## 8b. WARRANT CAPITAL

	Number of Warrants	Value
Balance at December 31, 2007	-	\$ -
Issued with private placement	1,084,000	460,523
Balance at September 30, 2008	1,084,000	\$ 460,523

## 8c. WARRANTS

	Number of Warrants	Weighted Average Exercise Price \$	Expiry date
Issued with private placement	330,644	3.25	November 30, 2011
Issued with private placement	1,084,000	1.50	September 18, 2009
Agents warrants, private placement	212,000	1.25	September 18, 2010
Total warrants outstanding	1,626,644	1.82	

# International Sovereign Energy Corp.

Notes to Consolidated Financial Statements (Unaudited)

September 30, 2008

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The Company has extended the expiry date of the warrants issued in connection with a non-brokered private placement of units on December 29, 2007 from November 30, 2008 to November 30, 2011.

## 8d. STOCK OPTIONS

Under the Company's stock option plan, the Company may grant options to its directors, officers and key employees to purchase Class A common shares ("Common Shares") from the Company at a fixed price not less than the fair market value of the stock on the day preceding the grant date. The Company has reserved 1,400,000 common shares for the grant of options. The options would vest equally over three years. The option's maximum term is five years.

### *Stock-Based Compensation*

On August 19, 2008 the Company issued 530,000 options at an exercise price of \$1.25. The fair value of each option granted by the Company was estimated using the Black-Scholes option pricing model assuming no dividends will be paid on common shares, a risk-free interest rate of 2.80% on an average life of 5 years and a volatility of 85% to be \$443,036 in aggregate, or \$0.84 per option.

On September 23, 2008 the Company issued 50,000 options at an exercise price of \$1.25. The fair value of each option granted by the Company was estimated using the Black-Scholes option pricing model assuming no dividends will be paid on common shares, a risk-free interest rate of 2.80% on an average life of 5 years and a volatility of 85% to be \$36,967 in aggregate, or \$0.74 per option.

The amounts computed according to the Black-Scholes option pricing model will not be indicative of the actual amounts realized upon the exercise of these options by the holder.

The following table summarizes outstanding stock options at September 30, 2008:

	Number of Options	Weighted average Exercise price
Balance as at December 31, 2007	537,667	\$ 1.93
Options Granted	580,000	\$ 1.25
Options Cancelled	(487,667)	\$ 2.00
Outstanding, September 30, 2008	630,000	\$ 1.31
Exercisable, September 30, 2008	33,333	\$ 2.00

## 9. CONTRIBUTED SURPLUS

	September 30, 2008	December 31, 2007
Opening balance	\$ 1,174,203	\$ 1,006,200
Stock based compensation expense	159,987	168,093
Agent warrant expense	100,913	-
	\$ 1,435,103	\$ 1,174,293

# International Sovereign Energy Corp.

Notes to Consolidated Financial Statements (Unaudited)

September 30, 2008

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## 10. EARNINGS PER COMMON SHARE

	3 Months ended September 30		Nine months ended September 30	
	2008	2007	2008	2007
Earnings (loss) per common share				
Basic	\$ 0.08	\$ (0.01)	\$ (0.15)	\$ (0.02)
Diluted	\$ 0.07	\$ (0.01)	\$ (0.14)	\$ (0.02)
Weighted average number of common shares				
Basic	14,210,867	13,928,084	14,023,033	13,928,084
Diluted	15,416,192	13,928,084	14,984,575	13,928,084

Diluted common shares outstanding are calculated using the treasury method. Under this method, in-the-money options are assumed exercised and the proceeds used to repurchase shares at the year-end date of December 31, 2007.

## 11. RELATED PARTY TRANSACTIONS

General and administrative expenses include approximately \$1.2 million unilaterally withdrawn from the Company's bank account prior to the Annual General Meeting on June 23, 2008 by the previous executives of the Company in the second quarter, who considered themselves to be entitled to a change of control payment under their respective employment contracts. The Company is attempting to recover these payments through the courts.

## 12. FINANCIAL INSTRUMENTS

The Company is subject to normal industry credit risk with its accounts receivable with customers and joint venture partners. The Company mitigates these risks by only entering into agreements with credit worthy parties.

### *(i) Commodity price risk*

The Company is exposed to fluctuations in commodity prices for natural gas, crude oil and natural gas liquids. Commodity prices are affected by many factors including supply, demand and the Canadian to US dollar exchange rate.

The Company has no financial hedges or fixed price commodity contracts in place at September 30, 2008 and 2007.

### *(i) Interest rates risk*

The Company's operating loan is also exposed to fluctuations in short-term Canadian interest rates.

### *(ii) Foreign currency exchange rate risk*

At September 30, 2008, \$414,000 USD of cash and cash equivalents held in a bank account denominated in Pakistan rupees, and US\$2,340,000 of cash and cash equivalents was held in a bank account denominated in United States dollars. Subsequent to September 30, 2008 the Company had an additional \$450,000 of cash and cash equivalents held in a bank account denominated in United States dollars. As such, the Company is exposed to foreign exchange currency risk. The Company had no outstanding forward exchange contracts in place at September 30, 2008.

# International Sovereign Energy Corp.

Notes to Consolidated Financial Statements (Unaudited)

September 30, 2008

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## 12. FINANCIAL INSTRUMENTS (Cont)

### *Fair value of financial instruments*

The fair values of financial instruments consisting of cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities approximate their carrying values due to their short-term nature. The operating loan bears interest at a floating market rate and, accordingly, its carrying value approximates fair value.

## 13. CAPITAL MANAGEMENT

The Company's objective when managing capital is to maintain a flexible capital structure which will allow it to execute its capital expenditure program, which includes expenditures in oil and gas activities which may or may not be successful. Therefore, the Company monitors the level of risk incurred in its capital expenditures to balance the proportion of debt and equity in its capital structure.

The Company considers its capital structure to include working capital and shareholders' equity. The Company monitors capital based on annual funds from operations and capital expenditure budgets, which are updated as necessary and are reviewed and periodically approved by the Company's Board of Directors.

The Company manages its capital structure and makes adjustments by continually monitoring its business conditions including the current economic conditions, the risk characteristics of the Company's petroleum and natural gas assets, the depth of its investment opportunities, current and forecasted net debt levels, current and forecasted commodity prices and other factors that influence commodity prices and funds from operations such as quality and basis differentials, royalties, operating costs and transportation costs.

In order to maintain or adjust the capital structure, the Company considers its forecasted funds from operations while attempting to finance an acceptable capital expenditure program including acquisition opportunities, the current level of operating facility credit available from the Company's financial institution as a result of petroleum and natural gas reserve growth, the availability of other sources of debt with different characteristics than operating facility, the sale of assets, limiting the size of the capital expenditure program and the issue of new equity if available on favorable terms.

The Company's capital structure is not subject to external restrictions; however, the Company's operating facility is determined by the lender and based on the lender's borrowing base model which is based on the Company's petroleum and natural gas reserves.

There have been no changes in the Company's approach to capital management during the three months period ended September 30, 2008.

## 14. SEGMENTED INFORMATION

The Company's core area of operation is in Canada. The Company is currently investigating opportunities in other countries. Total costs spent for the period ending September 30, 2008 on international investigations were \$752,954 (2007 - \$968,204).

## 15. SUBSEQUENT EVENTS

On October 7, 2008, the Company issued unconditional, irrevocable bank guarantee for US\$450,000, in favour of Mari Gas Company Limited with respect to Sujawal block, in relation to petroleum exploration, development and production in Pakistan, to guarantee the Company's financial obligations. The guarantee will be reduced by an amount proportionate to 50% of the discharge of minimum work, and expires September 9, 2009.