# EAGLEWOOD ENERGY INC.
## *(formerly Surge Resources Inc.)*

## ANNUAL REPORT

## FOR THE YEARS ENDED
## JUNE 30, 2008 AND 2007

# PRESIDENT'S MESSAGE

Dear Shareholders:

During the last year work has continued on identifying multiple targets to support an aggressive drill program in Papua New Guinea ("PNG") over the next few years. The first stages of the work program include high resolution aerial gravity and magnetic surveys for the licenses PPL 257 and 258. The contract for this work was awarded in the first half of 2008 and it is anticipated that the work will be completed by the 2008 year end. The data produced from this work will be integrated with existing seismic data to provide improved drill target resolution.

In PPL 260, an extensive field work program has identified numerous positive indications of hydrocarbons, including both oil and gas seeps. Samples have been acquired and are currently being analysed. This work lays the foundation for a seismic acquisition program that will commence during the first half of 2009.

The Company is actively pursuing partners for its initial drilling program. The drill program will require additional equity issues in order to raise capital for the exploration program in PNG. The Company has current working capital of approximately $3,400,000.

While the global project acquisitions market remains highly competitive, the Company is very well positioned to capitalize on these high value opportunities. The market for oil and gas has been somewhat chaotic but continues to be strong and looks likely to continue beyond 2008. The focus on hydrocarbon demand in Southeast Asia further underpins Eaglewood's strategy.
World natural gas demand has resulted in increased activity in PNG and outstanding discoveries have been made. The gas contract between Exxon and the PNG government is evidence of the growing role that PNG will play in the world gas market.

We would like to express appreciation for the continued support of existing shareholders and extend a warm welcome to new shareholders of the Company. We also thank our employees and consultants who continue to provide outstanding commitment and service to your Company.

Hal Hemmerich
President and CEO

# MANAGEMENT'S DISCUSSION AND ANALYSIS

## Years ended June 30, 2008 and 2007

*(Amounts expressed in Canadian Dollars unless otherwise indicated)*

Management's discussion and analysis ("MD&A") of Eaglewood Energy Inc.'s (the "Company" or "Eaglewood") financial condition and results of operations should be read in conjunction with the audited consolidated financial statements for the years ended June 30, 2008 and 2007 and related notes therein prepared in accordance with Canadian generally accepted accounting principles. The effective date of this MD&A is October 8, 2008.

Additional information relating to the Company is available on SEDAR at www.sedar.com and the Company's website at www.eaglewoodenergy.ca .

## FORWARD-LOOKING STATEMENTS

Certain statements contained in this MD&A may constitute forward-looking statements. These statements relate to future events or the Company's future performance. All statements, other than statements of historical fact, may be forward-looking statements. Forward-looking statements are often, but not always, identified by the use of words such as "seek", "anticipate", "plan", "continue", "estimate", "expect", "may", "will", "project", "predict", "propose", "potential", "targeting", "intend", "could", "might", "should", "believe" and similar expressions. These statements involve known and unknown risks, uncertainties and other factors that may cause actual results or events to differ materially from those anticipated in such forward-looking statements. The Company believes that the expectations reflected in those forward-looking statements are reasonable but no assurance can be given that these expectations will prove to be correct and such forward-looking statements included in this MD&A should not be unduly relied upon as actual results may vary. These statements speak only as of the date of this MD&A and are expressly qualified, in their entirety, by this cautionary statement.

In particular, this MD&A contains forward-looking statements, pertaining to the following:

- capital expenditure programs;
- development of resources;
- treatment under governmental regulatory and taxation regimes;
- expectations regarding the Company's ability to raise capital;
- expenditures to be made by the Company to meet certain work commitments; and
- work plans to be conducted by the Company.

With respect to forward-looking statements listed above and contained in this MD&A, the Company has made assumptions regarding, among other things:

- the Papua New Guinea legislative and regulatory environment;
- the impact of increasing competition;
- unpredictable changes to the market prices for oil and natural gas;
- that costs related to development of the oil and gas properties in Papua New Guinea will remain consistent with historical experiences;
- anticipated results of exploration activities;
- availability of additional financing and farm-in or joint venture partners; and
- the Company's ability to obtain additional financing on satisfactory terms.

The Company's actual results could differ materially from those anticipated in these forward-looking statements as a result of the risk factors set forth below and elsewhere in this MD&A:

- volatility in the market prices for oil and natural gas;
- uncertainties associated with estimating resources;
- geological, technical, drilling and processing problems;
- liabilities and risks, including environmental liabilities and risks, inherent in oil and natural gas operations;
- fluctuations in currency and interest rates;
- incorrect assessments of the value of acquisitions;
- unanticipated results of exploration activities;
- competition for, among other things, capital, acquisitions of reserves, undeveloped lands and skilled personnel;
- lack of availability of additional financing and farm-in or joint venture partners;
- unpredictable weather conditions; and
- other factors referred to under "Risk Factors" in the Company's annual information form for the financial year ended June 30, 2007, dated June 25, 2008 and filed on SEDAR on June 25, 2008.

The Company's actual results could differ materially from those anticipated in these forward-looking statements as a result of the risk factors set forth above.

Undue reliance should not be placed on forward-looking statements as the plans, intentions or expectations upon which they are based might not occur. Readers are cautioned that the foregoing lists of factors are not exhaustive. The forward-looking statements contained in this MD&A are expressly qualified by this cautionary statement. The Company does not undertake any obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, unless required by law.

## OVERVIEW

Eaglewood is a Canadian-based junior oil and gas exploration company whose common shares are traded on the TSX Venture Exchange under the symbol "EWD". Eaglewood holds a 100% interest in four petroleum exploration licenses (the "Licenses") granted by the government of Papua New Guinea ("PNG"). The Licenses and related technical data were acquired in October 2007 from Transeuro Energy Corp. and its wholly owned subsidiary (collectively, "Transeuro") in exchange for 30,000,000 common shares of the Company valued at $25,500,000 (the "Transeuro Transaction") (see also FINANCIAL CONDITION).

In the prior year, the Company's name was Surge Resources Inc. and its business was the seeking for, and evaluation of, potential oil and gas projects. The only asset of the Company in the prior year was cash.

Upon completion of the Transeuro Transaction in October 2007, the Company transitioned into an oil and gas company and changed its name to Eaglewood. The Company currently has no production and no oil or natural gas reserves.

For the year ended June 30, 2008, the Company's focus was on completing the Transeuro Transaction and setting up the Company's infrastructure. The Company's major accomplishments during the year were as follows:

- October 2007 – completed the Transeuro Transaction and closed a private placement financing for net proceeds of approximately $9,700,000;
- October 2007 - appointed a Chief Executive Officer, a Chief Financial Officer and added two additional independent directors to the Board;
- November 2007 – hired a Senior Geologist; completed the preparation of the drilling location for PPL 259;
- January 2008 – appointed a Chief Operating Officer based in Australia; initiated the PPL 260 field study and the PPL 257 and 258 aerial gravity and magnetic surveys; and
- June 2008 – hired a PNG Country Manager.

## DESCRIPTION OF LICENSES

Each of the Licenses gives the Company the right to explore for oil and natural gas on specified blocks in PNG. If exploration is successful, the Company can apply to the PNG government for either a retention license or a development license. A retention license is generally applied for if natural gas reserves have been identified but additional time is required to either prepare a development plan or, if the amount of natural gas reserves is not of a sufficient commercial quantity, to explore for further natural gas reserves. A development license is generally applied for if oil and/or natural gas reserves have been discovered and production is commercially viable. The PNG government has historically granted retention or development licenses however there is a risk that a retention or development license may not be granted to the Company when, or on the terms, applied for.

| License | Description |
|---|---|
| PPL 257 | The license was originally granted on October 20, 2004 and has a six year term that expires October 19, 2010 and was transferred to the Company pursuant to the Transeuro Transaction. It covers 1,741,500 gross acres located in the Cape Vogel Basin of PNG. The prospective area is predominantly offshore but includes a significant onshore area that will be significant for conducting geological field work. PPL 257 is an anticipated natural gas play for the Company. |
| PPL 258 | The license was originally granted on October 20, 2004 and has a six year term that expires October 19, 2010 and was transferred to the Company pursuant to the Transeuro Transaction. It covers 2,227,500 gross acres, all onshore, in the North New Guinea Basin of PNG. PPL 258 is an anticipated oil play for the Company. |
| PPL 259 | The license was originally granted on June 30, 2005 and has a six year term that expires June 29, 2011 and was transferred to the Company pursuant to the Transeuro Transaction. It covers 1,377,000 gross acres, all onshore, in the Papuan Basin of PNG. PPL 259 is an anticipated oil play for the Company. |
| PPL 260 | The license was originally granted on March 14, 2005 and has a six year term that expires March 13, 2011 and was transferred to the Company pursuant to the Transeuro Transaction. It covers 1,559,250 gross acres, all onshore, in the Papuan Basin of PNG. PPL 260 is an anticipated natural gas and oil play for the Company. |

The PNG government retains a 22.5 percent back-in right at cost which can be exercised at the time a development license is granted and has a two percent royalty over any oil or natural gas production that may occur with respect to the Licenses.

Pursuant to the Transeuro Transaction, the Company granted Transeuro the right to acquire a 10 percent interest in all, but not less than all, of the Licenses, exercisable within 60 days from the date which the Company completes the drilling and testing of a third well on the Licenses by paying to the Company 10 percent of all costs incurred in respect of the Licenses up to that date and by agreeing to pay 10 percent of the ongoing costs with respect to the exploration and development of the Licenses.

## SELECTED ANNUAL INFORMATION

| ($000's except per share data) | Year ended June 30 | | |
|---|---|---|---|
| | **2008** | 2007 | 2006 |
| Revenue | **195** | 29 | 36 |
| Loss before discontinued operations | **(3,102)** | (157) | (74) |
| Net loss | **(3,102)** | (157) | (74) |
| Loss per share before discontinued operations | **(0.07)** | (0.01) | (0.01) |
| Loss per share | **(0.07)** | (0.01) | (0.01) |

## RESULTS OF OPERATIONS

The Company had a net loss of $3,102,489 for the year ended June 30, 2008. In the prior year, the Company reported a net loss of $157,521. The higher loss in the current year is mainly the result of an increase in expenses. During the current financial reporting year, the Company acquired the Licenses in PNG and established its corporate office in Canada and branch office in PNG. During the prior year periods, the Company had minimal activity as it was in the process of reviewing potential oil and gas projects.

The Company's most significant expenses, in comparison to the prior year, are as follows:

| | Year ended June 30 | |
|---|---|---|
| | **2008** | **2007** |
| General and administrative | **1,142,865** | 26,001 |
| Professional fees | **255,959** | 81,037 |
| Stock-based compensation | **1,250,802** | - |
| Travel | **398,779** | 1,992 |

Compared to the prior year, professional fees increased approximately $175,000 and travel increased approximately $397,000, predominantly as a result of the acquisition of the Licenses. During the year ended June 30, 2008, the Company granted stock options which increased the expenses by approximately $1,251,000. There were no stock options granted in the prior year.

The following table provides a breakdown of the Company's general and administrative expenses by material component:

| | Year ended June 30 | |
|---|---|---|
| | **2008** | 2007 |
| Salaries & wages | **879,542** | - |
| Office costs | **152,845** | 9,699 |
| Office rent | **73,955** | 9,460 |
| Other general and administrative | **36,523** | 6,842 |
| Total | **1,142,865** | 26,001 |

Compared to the prior year, general and administrative expenses increased $1,116,864. The increase in all the above expenses are the result of the Company's setup of the Calgary corporate office and the addition of the PNG branch office during the year ended June 30, 2008. Within general and administrative expenses, the largest increase was in salaries and wages. The Company currently has 17 employees. The Company had no staff in the prior year.

## SELECTED QUARTERLY INFORMATION

The following is a summary of selected financial information for the Company for the periods indicated:

| ($000's except per share data) | Jun 30 2008 | Mar 31 2008 | Dec 31 2007 | Sep 30 2007 | Jun 30 2007 | Mar 31 2007 | Dec 31 2006 | Sep 30 2006 |
|---|---|---|---|---|---|---|---|---|
| Revenue | 40 | 56 | 94 | 5 | 6 | 7 | 7 | 8 |
| Income (loss) before discontinued operations | (736) | (699) | (1,532) | (136) | (52) | (32) | 2 | (76) |
| Net income (loss) | (736) | (699) | (1,532) | (136) | (52) | (32) | 2 | (76) |
| Income (loss) per share before discontinued operations | (0.01) | (0.01) | (0.03) | (0.01) | (0.01) | (0.01) | 0.01 | (0.01) |
| Total income (loss) per share | (0.01) | (0.01) | (0.03) | (0.01) | (0.01) | (0.01) | 0.01 | (0.01) |
| Total assets | 34,345 | 34,863 | 35,858 | 694 | 819 | 839 | 853 | 850 |

Prior to the quarter ended December 31, 2007, the Company's only asset was cash and its business for the previous two years was the seeking for, and evaluation of, potential oil and gas projects. In the quarter ended December 31, 2007, the increase in total assets is the result of the Company's acquisition of the Licenses in PNG in exchange for common shares of the Company valued at $25,500,000 and completion of a private placement financing for net proceeds of approximately $9.7 million. The increase in the loss for the quarters ended June 30, 2008, March 31, 2008 and December 31, 2007 compared to the prior quarters is predominantly the result of increased expenses which are described more fully in RESULTS OF OPERATIONS.

## FINANCIAL CONDITION

At June 30, 2008, the Company had total assets of $34,345,406 compared to $819,364 at June 30, 2007. The increase of approximately $33,526,000 is mainly due to increases in cash and petroleum and natural gas properties.

On October 1, 2007, the Company completed the Transeuro Transaction and acquired the Licenses granted by the government of PNG and related technical data in exchange for 30,000,000 common shares of the Company valued at $25,500,000. The value of the common shares was determined based upon the average trading price at the time of the announcement of the Transeuro Transaction.

The increase in the Company's cash position is the result of a private placement for 12,000,000 common shares at $0.85 per share for gross proceeds of $10,200,000 (net $9,679,825) which closed on October 01, 2007. Proceeds from the financing were used to fund the construction of a drilling pad on PPL 259, 2-D seismic reprocessing for PPL 258 and general corporate purposes. At June 30, 2008, the Company had remaining cash of approximately $4,800,000.

## LIQUIDITY AND CAPITAL RESOURCES

At June 30, 2008, the Company had net working capital of $4,538,684 compared to net working capital of $528,058 at June 30, 2007. The increase in working capital is mainly due to the cash proceeds from the private placement described in FINANCIAL CONDITION.

Funds used in operations were $1,850,750 for the year ended June 30, 2008 compared to $122,600 for the year ended June 30, 2007. The increase in the funds used in operations for the current year is mainly due to increased expenses as compared to the prior year, as explained in RESULTS OF OPERATIONS.

Net cash used in investing activities for the year ended June 30, 2008 was $3,582,893 compared to $128,249 for the year ended June 30, 2007. Investing activities consisted mainly of the construction of a drilling pad on PPL 259 and reprocessing of 2-D seismic for PPL 258.

Net cash from financing activities for the year ended June 30, 2008 was $9,679,825 compared to net cash used in financing activities of $103,948 for the year ended June 30, 2007. The Company issued 12,000,000 common shares at a price of $0.85 per share pursuant to a private placement which closed on October 01, 2007.

Contributed surplus at June 30, 2008 increased $1,362,402 over June 30, 2007. The increase is due to the stock-based compensation for the year plus the fair value of the options to purchase common shares granted to the agent which acted pursuant to the private placement.

The Company does not currently generate sufficient cash flow from operating activities to fund its activities and has relied upon the issuance of common shares to provide additional funding. The Company's financial statements are presented on a going-concern basis which assumes that the Company will be able to realize its assets and discharge its liabilities in the normal course of operations. The Company's ability to continue as a going concern is dependent upon its ability to raise equity financing and/or enter into joint venture or farm-out arrangements in the licenses within the next twelve months to meet its exploration commitments and working capital requirements. However, there are no assurances that the Company will be successful in achieving these objectives. If the Company is unable to raise equity financing and/or secure farm-out or joint venture partners, the Company may be unable to continue as a going concern. The Company's financial statements do not reflect the adjustments to the carrying values of assets and liabilities, including any impairment in its petroleum and natural gas properties, and the reported expenses and balance sheet classifications that would be necessary if the Company is unable to continue as a going concern, and such adjustments could be material.

## LICENSE COMMITMENTS

Each of the Licenses has specified work and financial commitments that were assumed by the Company when it acquired the Licenses pursuant to the Transeuro Transaction. The remaining commitments are as follows:

| License | Commitment |
|---|---|
| PPL 257 | Drill one exploration well, acquire 1,000 kilometres line of offshore seismic and spend a minimum of US $10,000,000 by October 20, 2008. In July 2008, the Company applied for, and was granted, a one year deferral until October 20, 2009. |
| PPL 258 | Drill one exploration well, acquire 1,000 kilometres of aero-gravity/magnetic survey and spend a minimum of US $10,500,000 by October 20, 2008. In July 2008, the Company applied for, and was granted, a one year deferral until October 20, 2009. |
| PPL 259 | Drill one exploration well and conduct geological and geophysical studies by June 29, 2009. |
| PPL 260 | Drill one exploration well and conduct geological and geophysical studies by March 13, 2009. |

The Company has issued bank guarantees totaling approximately $160,000 (100,000 Papua New Guinea dollars for each license) as security against the capital requirements associated with the Licenses. If the Company does not fulfill its commitments under a License and has not applied for and been granted an extension, it could potentially lose its guarantee and the applicable License could be revoked by the PNG government.

As the Company does not currently generate sufficient cash flow from operating activities to fund its activities, it will need to raise equity financing and/or enter into joint venture or farm-out arrangements in the Licenses to finance its exploration commitments.

## PLANNED WORK PROGRAM

The Company's 2008 work program is currently underway. During the remainder of 2008, the Company plans to complete the following from its current working capital:

- onshore/offshore aero-gravity/magnetic survey in PPL 257 (gross cost approximately US $500,000);
- onshore aero-gravity/magnetic survey in PPL 258 (gross cost approximately US $1,000,000); and
- field work study in PPL 260 (gross cost approximately US $1,000,000).

The Company's planned 2009 work program, for which the Company does not currently have funding and will need to either raise equity financing and/or enter into joint venture or farm-out arrangements in the Licenses is as follows:

- drill one exploration well in PPL 259 (gross cost approximately US $15,000,000);
- conduct seismic survey in PPL 260 (gross cost approximately US $6,000,000);
- drill one exploration well in PPL 258 (gross cost approximately US $15,000,000);
- drill one exploration well in PPL 257 (gross cost approximately US $40,000,000); and
- drill one exploration well in PPL 260 (gross cost approximately US $40,000,000).

As a result of the nature of the petroleum and natural gas exploration, development and exploitation industry, budgets are regularly reviewed with respect to both the success of expenditures and other opportunities that become available. Accordingly, while it is currently intended by management of the Company that the general expenditures set out in the work program above will be made by the Company, actual expenditures may in fact differ from these plans, amounts and allocations.

Additionally, completion of activities are subject to potential barriers such as, but not limited to, lack of capital, lack of available equipment and poor weather which may impact the time of completions. Additional risk factors are disclosed in the Company's Annual Information Form dated October 8, 2008 which is available on SEDAR at www.sedar.com.

## OUTSTANDING SHARE DATA

As at October 8, 2008, the Company had 57,744,942 common shares outstanding and 3,325,000 stock options outstanding under its stock option plan.

## OFF-BALANCE SHEET ARRANGEMENTS

The Company has no off-balance sheet arrangements.

## RELATED PARTY TRANSACTIONS

For the year ended June 30, 2008, the Company paid $102,242 for legal services to a firm of which a current director is a partner.

The Company paid $48,000 in management fees to a company controlled by a director. These fees were paid for administration services which were provided by the director who previously acted as an officer of the Company.

The Company paid $2,741,875 to a company with common directors and a common officer. These payments were in accordance with the terms of the Transeuro Transaction whereby the Company reimbursed certain costs relating to the Licenses incurred prior to the closing of the transaction. The amount reimbursed was predominantly for costs incurred relating to the preparation of the drilling pad in PPL 259 and the 2-D seismic reprocessing for PPL 258. All amounts reimbursed were recorded at cost. The majority of the costs were included in petroleum and natural gas properties and the remainder was general and administrative expenses.

## CHANGES IN ACCOUNTING POLICIES

Effective July 1, 2007, the Company adopted the CICA Handbook Section 3855, *Financial Instruments – Recognition and Measurement* and Section 3861, *Financial Instruments – Presentation and Disclosure*. These sections establish the standards for recognizing and measuring financial instruments in the financial statements. All financial instruments are classified into specific categories: financial assets available-for-sale, assets and liabilities held-for-trading, loans and receivables, investments held-to-maturity and other financial liabilities. As a result of the adoption of these standards, the Company classified its cash as held-for-trading which is measured at fair value with changes recognized in net income. Accounts receivable is classified as loans and receivables and accounts payable and accrued liabilities are classified as other liabilities, both of which are measured at amortized cost. The Company has elected to measure all derivatives and embedded derivatives at fair value and the Company has maintained its policy not to use hedge accounting.

Effective July 1, 2007, the Company adopted the CICA Handbook Section 1530, *Comprehensive Income*. Comprehensive income is the change in shareholders' equity resulting from transactions and events from sources other than the Company's shareholders. These transactions and events include changes in currency translation adjustments and unrealized gains and losses resulting from changes in fair value of certain financial instruments. The adoption of this section requires the Company to present comprehensive income as part of its consolidated financial statements.

Effective July 1, 2007, the Company adopted the CICA Handbook Section 3251, *Equity*. This section establishes the standards for presentation of equity and recognizing changes in equity occurring in the reporting period as a result of the adoption and application of Section 1530, Comprehensive Income, discussed above.

Effective July 1, 2007, the Company adopted the CICA Handbook Section 1506, *Accounting Changes*, the only effect of which is to provide disclosure and the resulting impact to the Company when an entity has not applied a new source of Generally Accepted Accounting Principles ("GAAP") that has been issued but is not yet effective. This applies to Section 1535, *Capital Disclosure*, Section 3862, *Financial Instruments - Disclosures* and Section 3863, *Financial Instruments - Presentations* which are required to be adopted for fiscal years beginning on or after October 1, 2007. The Company intends to adopt these standards on July 1, 2008.

## NEW ACCOUNTING PRONOUNCEMENTS

The CICA has issued Section 1535, *Capital Disclosure* which will be effective for Eaglewood on July 1, 2008. The adoption of this section will have no impact on the amounts that the Company reports in its consolidated financial statements.

The CICA has issued Section 3862, *Financial Instruments - Disclosures* and Section 3863, *Financial Instruments - Presentations* which will be effective for Eaglewood on July 1, 2008. The recommendations will result in additional disclosures regarding the significance of financial instruments for the Company's financial position and performance, and the nature, extent and management of risks arising from financial instruments to which the Company is exposed.

The CICA has issued Section 3064, *Goodwill and Intangible Assets*, replacing Section 3062, *Goodwill and Other Intangible Assets*, and Section 3450, *Research and Development Costs*. This section will be effective for Eaglewood's beginning 2009. Eaglewood is currently evaluating the impact of the adoption of this new section on its consolidated financial statements. The Company does not expect that the adoption of this new section will have a material impact on its consolidated financial statements.

In February 2008, the Accounting Standards Board ("AcSB") confirmed that effective for interim and annual financial statements related to fiscal years beginning on or after January 1, 2011, International Financial Reporting Standards ("IFRS") will replace Canada's current GAAP for all publicly accountable profit-oriented enterprises. Eaglewood is currently assessing the impact of adopting IFRS on its consolidated financial statements.

## FINANCIAL INSTRUMENTS AND OTHER INSTRUMENTS

The Company's financial instruments consist of cash and cash equivalents, accounts receivable and accounts payable. Unless otherwise noted, it is management's opinion that the Company is not exposed to significant interest, currency or credit risks arising from these financial instruments. The fair values of these financial instruments approximate their carrying values, unless otherwise noted.

## ADDITIONAL DISCLOSURE FOR VENTURE ISSUERS WITHOUT SIGNIFICANT REVENUE

The Company is a venture issuer that has not had significant revenue from operations in either of its last two financial years. In accordance with National Instrument 51-102, additional disclosure on material costs, other than general and administrative expenses, is presented below. Additional disclosure on general and administrative expenses has been included in RESULTS OF OPERATIONS.

| | **Year ended June 30** | |
|---|---|---|
| | **2008** | 2007 |
| Capitalized exploration and development costs | **29,371,010** | - |
| Deferred development costs | **-** | 128,249 |

**Deloitte.**

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**AUDITORS' REPORT**

To the Shareholders of
**Eaglewood Energy Inc.:**

We have audited the consolidated balance sheets of **Eaglewood Energy Inc.** (formerly Surge Resources Inc.) as at June 30, 2008 and 2007 and the consolidated statements of net loss, comprehensive loss and deficit and cash flow 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 June 30, 2008 and 2007 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Deloitte & Touche LLP

Chartered Accountants

September 4, 2008, except as to Note 7 (c)
which is as of October 2, 2008

## CONSOLIDATED BALANCE SHEETS

| As at | | June 30 2008 | | June 30 2007 |
|---|---|---|---|---|
| **ASSETS** | | | | |
| **Current Assets** | | | | |
| Cash and cash equivalents | $ | **4,829,458** | $ | 583,276 |
| Accounts receivable | | **57,180** | | 3,891 |
| Prepaid expenses | | **13,007** | | - |
| | | **4,899,645** | | 587,167 |
| Petroleum and natural gas properties (note 6) | | **29,445,761** | | - |
| Deferred costs | | **-** | | 128,249 |
| Deferred financing costs | | **-** | | 103,948 |
| | $ | **34,345,406** | $ | 819,364 |
| **LIABILITIES AND SHAREHOLDERS' EQUITY** | | | | |
| **Current Liabilities** | | | | |
| Accounts payable and accrued liabilities | $ | **360,961** | $ | 59,109 |
| **Shareholders' Equity** | | | | |
| Share capital (note 7) | | **40,771,686** | | 5,807,409 |
| Contributed surplus (note 7) | | **1,657,069** | | 294,667 |
| Deficit | | **(8,444,310)** | | (5,341,821) |
| | | **33,984,445** | | 760,255 |
| | $ | **34,345,406** | $ | 819,364 |

*See accompanying notes to consolidated financial statements*

Contingencies and commitments (note 12)

Approved by the Board of Directors

*"signed"*
Ray Antony, Director

*"signed"*
Roy Hudson, Director

## CONSOLIDATED STATEMENTS OF NET LOSS, COMPREHENSIVE LOSS AND DEFICIT

| | | For the year ended June 30 | | |
|---|---|---|---|---|
| | | **2008** | | 2007 |
| **Revenue** | | | | |
| Interest income | **$** | **194,508** | $ | 28,623 |
| **Expenses** | | | | |
| Bank charges and interest | | **5,509** | | 255 |
| Management fees | | **48,000** | | 24,000 |
| General and administrative | | **1,142,865** | | 26,001 |
| Professional fees | | **255,959** | | 81,037 |
| Public company | | **90,826** | | 10,927 |
| Consulting | | **54,395** | | 32,753 |
| Stock-based compensation | | **1,250,802** | | - |
| Depreciation | | **16,097** | | - |
| Travel | | **398,779** | | 1,992 |
| Other | | **729** | | 9,179 |
| Foreign exchange loss | | **33,036** | | - |
| | | **3,296,997** | | 186,144 |
| **Net loss and comprehensive loss for the year** | | **(3,102,489)** | | (157,521) |
| **Deficit, beginning of year** | | **(5,341,821)** | | (5,184,300) |
| **Deficit, end of year** | **$** | **(8,444,310)** | $ | (5,341,821) |
| Net loss per common share - basic and diluted | **$** | **(0.07)** | $ | (0.01) |
| Weighted average common shares - basic and diluted | | **47,187,565** | | 15,744,942 |

*See accompanying notes to consolidated financial statements*

## CONSOLIDATED STATEMENTS OF CASH FLOW

| | For the year ended June 30 **2008** | **2007** |
|---|---|---|
| **Cash flows related to the following activities:** | | |
| **Operating Activities** | | |
| Net loss | **$ (3,102,489)** | $ (157,521) |
| Items not involving cash: | | |
| Stock-based compensation | **1,250,802** | - |
| Depreciation | **16,097** | - |
| | **(1,835,590)** | (157,521) |
| Changes in non-cash working capital (note 10) | **(15,160)** | 34,921 |
| | **(1,850,750)** | (122,600) |
| **Investing Activities** | | |
| Additions to petroleum and natural gas properties | **(3,833,609)** | - |
| Deferred costs | - | (128,249) |
| Changes in non-cash working capital (note 10) | **250,716** | - |
| | **(3,582,893)** | (128,249) |
| **Financing Activities** | | |
| Issue of common shares | **10,200,000** | - |
| Share issue costs | **(520,175)** | - |
| Deferred financing costs | - | (103,948) |
| | **9,679,825** | (103,948) |
| **Net increase (decrease) in cash** | **4,246,182** | (354,797) |
| **Cash and cash equivalents, beginning of year** | **583,276** | 938,073 |
| **Cash and cash equivalents, end of year** | **$ 4,829,458** | $ 583,276 |
| Cash and cash equivalents is composed of: | | |
| Cash in banks | **829,458** | 583,276 |
| Term deposits | **4,000,000** | - |
| | **$ 4,829,458** | $ 583,276 |
| Supplementary information: | | |
| Interest received | **$ 183,987** | $ 28,623 |
| Interest paid | **$ -** | $ - |
| Taxes paid | **$ -** | $ - |

*See accompanying notes to consolidated financial statements*

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
## AS AT JUNE 30, 2008 AND FOR THE YEARS ENDED JUNE 30, 2008 AND 2007

### 1. NATURE OF OPERATIONS AND GOING CONCERN

Eaglewood Energy Inc. (collectively with its subsidiary, the "Company" or "Eaglewood") is listed and traded on the TSX Venture Exchange under the trading symbol EWD. The Company is engaged in the business of oil and gas exploration in Papua New Guinea ("PNG"). The Company was formerly named Surge Resources Inc. and changed its name effective October 30, 2007.

The Company's consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles on a going concern basis which assumes that the Company will be able to realize its assets and discharge its liabilities in the normal course of operations. The Company has not generated any petroleum revenue to date and for the year ended June 30, 2008, the Company reported a net loss of approximately $3.1 million. At June 30, 2008, the Company had an accumulated deficit of approximately $8.4 million and net working capital of approximately $4.5 million. In addition to its ongoing working capital requirements, the Company has financial commitments related to its Papua New Guinea licenses as described in note 12 (b). These circumstances raise substantial doubt as to the ability of the Company to continue as a going concern.

The Company's ability to continue as a going concern is dependent upon its ability to raise equity financing and/or enter into joint venture or farm-out arrangements in the next twelve months. However, there are no assurances that the Company will be successful in achieving these objectives. These financial statements do not reflect the adjustments to the carrying values of assets and liabilities, including any impairment in the petroleum and natural gas properties, and the reported expenses and balance sheet classifications that would be necessary if the Company is unable to continue as a going concern, and such adjustments could be material.

### 2. FINANCIAL STATEMENT PRESENTATION

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiary Eaglewood Energy (BVI) Ltd. which was incorporated on July 4, 2007. The consolidated financial statements are presented in Canadian dollars and in accordance with Canadian generally accepted accounting principles ("GAAP").

### 3. SIGNIFICANT ACCOUNTING POLICIES

*Cash and cash equivalents*
Cash and cash equivalents include cash in bank accounts and short-term deposits that are redeemable at any time.

*Petroleum and natural gas properties*
The Company follows the full cost method of accounting for oil and gas operations whereby all costs associated with the exploration for and development of oil and natural gas reserves are capitalized on a country-by-country basis. Such costs include land acquisition costs, geological and geophysical expenses, costs of drilling both productive and non-productive wells, related production equipment costs and overhead charges directly related to acquisition, exploration and development activities.

Capitalized costs, excluding costs related to unproven properties, are depleted and depreciated using the unit-of-production method based on estimated proven oil and natural gas reserves as determined by independent petroleum engineers.  Oil and natural gas reserves are converted to equivalent barrels of oil using a ratio of six thousand cubic feet of natural gas to one barrel of oil.

Costs of acquiring and evaluating unproven properties are initially excluded from the depletion calculation. The unproven properties are assessed periodically to ascertain whether impairment has occurred. When proved reserves are assigned or the property is considered impaired, the cost of the property or the amount of the impairment is added to costs subject to depletion.

The net amount at which oil and gas interests are carried is subject to an impairment test (the "ceiling test"). The ceiling test is a two-stage process which is performed at least annually. The first stage is a test whereby undiscounted estimated future cash flows from proved reserves at oil and natural gas prices in effect at the balance sheet date plus the cost of unproved properties, less any impairment, is compared to the net book value of the oil and gas interests to determine if the assets are impaired. An impairment loss exists if the net book value of the oil and gas interests exceeds such undiscounted estimated cash flows. The second stage determines the amount of the impairment loss to be recorded. The impairment is measured as the amount by which the net book value of the oil and gas interests exceeds the future estimated discounted cash flows from proved plus probable reserves at oil and natural gas prices in effect at the balance sheet date, plus the cost of unproved properties less any impairment. Any impairment is recorded as additional depletion expense.

Equipment and furniture are depreciated at declining balance rates of 20 to 30 percent.

*Asset Retirement Obligations*
The Company recognizes the estimated fair value of future retirement obligations associated with capital assets as a liability in the period in which they are incurred, normally when the asset is purchased or developed. 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 the wells and well sites under the terms of the exploration licenses. Actual retirement obligations settled during the period reduce the asset retirement liability.

*Stock-based Compensation*
The Company uses the fair value method for valuing stock option grants. The estimated fair value is expensed over the vesting period with a corresponding increase to contributed surplus. Upon exercise of the stock options, consideration paid by the option holder together with the amount previously recognized in contributed surplus is recorded as an increase to share capital.

*Foreign Currency Translation*
The Company's reporting currency is Canadian dollars.

Business conducted in Papua New Guinea is considered to be an "integrated foreign operation" for accounting purposes and therefore its financial statements are translated into Canadian dollars using the temporal method. Under the temporal method, foreign denominated monetary assets and liabilities are translated at the exchange rates in effect at the balance sheet date. Foreign denominated non-monetary assets and liabilities are translated at historical exchange rates.

Foreign denominated revenues and expenses are translated at the average exchange rate for the period, except for charges related to non-monetary assets which are translated at the historical exchange rate for the assets to which the charge relates, and material items where a specific date can be indentified for the transaction which is translated at the exchange rate on that specific date. Any resulting foreign exchange gains or losses are included in the determination of net income.

*Per share amounts*
Basic per share amounts are calculated using the weighted average number of common shares outstanding for the period. The Company follows the treasury stock method to calculate diluted per share amounts. The treasury stock method assumes that any proceeds from the exercise of in-the-money stock options or other dilutive instruments, in addition to stock-based compensation not yet recognized, would be used to purchase common shares at the average market price during the period. Diluted earnings per share do not include any anti-dilutive conversions.

*Income taxes*
The Company follows the liability method of accounting for income taxes. Under this method, income tax liabilities and assets are recognized for the estimated tax consequences attributed to differences between the amounts reported in the financial statements and their respective tax bases, using substantively enacted income tax rates. The effect of a change in income tax rates on future income tax assets is recognized in income in the period that the change occurs.

*Deferred Financing Costs*
Financing costs relating to equity offerings underway are deferred on the balance sheet and are recorded as a reduction of share capital when the issuance of equity is completed or expensed if the issuance of equity is not completed.

*Deferred Costs*
Costs incurred in the evaluation of potential oil and gas acquisitions are deferred on the balance sheet and are recorded as an addition to petroleum and natural gas properties if the acquisition is successful or expensed if the acquisition is unsuccessful.

*Measurement uncertainty*
The timely preparation of the consolidated financial statements in conformity with GAAP requires that management make estimates and assumptions and use judgment regarding the reported amounts of assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the period. Such estimates primarily relate to unsettled transactions and events as of the date of the consolidated financial statements. Accordingly, actual results may differ from estimated amounts as future confirming events occur.

Amounts recorded for depreciation, depletion and accretion, amounts used for the ceiling test and impairment calculations and amounts used in the determination of the future tax liability are based on estimates of natural gas and crude oil reserves and future costs required to develop those reserves. By their nature, these estimates of reserves, including the estimates of future prices and costs, and the related future cash flows are subject to measurement uncertainty.

## 4. CHANGES IN ACCOUNTING POLICIES

**Financial Instruments – Recognition and Measurement**

On July 1, 2007, the Company adopted the CICA Handbook Section 3855, *Financial Instruments – Recognition and Measurement* and Section 3861, *Financial Instruments – Presentation and Disclosure*. These sections establish the standards for recognizing and measuring financial instruments in the financial statements. All financial instruments are classified into specific categories: financial assets available-for-sale, assets and liabilities held-for-trading, loans and receivables, investments held-to-maturity and other financial liabilities. Financial instruments are measured at fair value with subsequent measurement based on initial classification. Non-exempt derivative and embedded derivative financial instruments, part of a hedging relationship or not, have to be measured at fair value.

All changes in their fair value are recorded in net income unless hedge accounting is utilized, which then requires any changes in fair value to be recorded in other comprehensive income until such time as the underlying hedge transaction is recognized in net income. If a hedge ceases to be effective, it is immediately recognized in net income.

As a result of the adoption of these standards, the Company classified its cash and cash equivalents as held-for-trading which are measured at fair value with changes recognized in net income. Accounts receivable is classified as loans and receivables and accounts payable and accrued liabilities are classified as other liabilities, both of which are measured at amortized cost.

The Company has elected to measure all derivatives and embedded derivatives at fair value and the Company has maintained its policy not to use hedge accounting.

**Comprehensive Income**

On July 1, 2007, the Company adopted the CICA Handbook Section 1530, *Comprehensive Income*. This section describes reporting and disclosure recommendations with respect to comprehensive income and its components. Comprehensive income is the change in shareholders' equity resulting from transactions and events from sources other than the Company's shareholders. These transactions and events include changes in currency translation adjustments and unrealized gains and losses resulting from changes in fair value of certain financial instruments. The adoption of this section requires the Company to present comprehensive income as part of its consolidated financial statements.

**Equity**

On July 1, 2007, the Company adopted the CICA Handbook Section 3251, *Equity*. This section establishes the standards for presentation of equity and recognizing changes in equity occurring in the reporting period as a result of the adoption and application of Section 1530, Comprehensive Income, discussed above.

**Accounting Changes**

On July 1, 2007, the Company adopted CICA Handbook Section 1506, *Accounting Changes*, the only effect of which is to provide disclosure and the resulting impact to the Company when an entity has not applied a new source of GAAP that has been issued but is not yet effective.

This applies to Section 1535, *Capital Disclosure* which is required to be adopted for fiscal years beginning on or after October 1, 2007. Eaglewood intends to adopt this standard on July 1, 2008. This section requires disclosure regarding the Company's definition of capital and its objectives, policies and process for managing capital. In addition, this section requires disclosure as to whether the Company has complied with externally imposed capital requirements. The adoption of this section will have no impact on the amounts that Eaglewood reports in its consolidated financial statements.

This also applies to Section 3862, *Financial Instruments - Disclosures* and Section 3863, *Financial Instruments - Presentations* which are required to be adopted for fiscal years beginning on or after October 1, 2007. Eaglewood intends to adopt these standards on July 1, 2008 and it is expected that the only effect on the Company will be additional disclosures regarding the significance of financial instruments for the entity's financial position and performance, and the nature, extent and management of risks arising from financial instruments to which the entity is exposed.

**Goodwill and Intangible Assets**

In February 2008, the 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 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 and does not expect that the adoption of this new section will have a material impact on its consolidated financial statements.

**International Financial Reporting Standards**

In February 2008, the Accounting Standards Board confirmed that effective for interim and annual financial statements related to fiscal years beginning on or after January 1, 2011, International Financial Reporting Standards will replace Canada's current GAAP for all publicly accountable profit-oriented enterprises. The Company is currently evaluating the impact of this changeover on its consolidated financial statements.

## 5. ACQUISITIONS

On October 1, 2007 the Company acquired a 100% interest in four exploration prospecting licenses granted by the Government of Papua New Guinea and all related geological, seismic and technical data (the "Licenses") from Transeuro Energy Corp. and its wholly owned subsidiary (collectively, "Transeuro"). As consideration for the Licenses, the Company issued to Transeuro 30,000,000 common shares of the Company with a deemed price of $0.85 per share for total consideration of $25,500,000 (the "Transeuro Transaction"). The value of the common shares was determined based upon the average trading price at the announcement date of the Transeuro Transaction.

## 6. PETROLEUM AND NATURAL GAS PROPERTIES

| June 30, 2008: | Cost | Accumulated depletion and depreciation | Net book value |
|---|---|---|---|
| Petroleum and natural gas properties | $29,371,010 | - | $29,371,010 |
| Office furniture and equipment | 90,848 | 16,097 | 74,751 |
| | **$29,461,858** | **16,097** | **$29,445,761** |

The Company had no petroleum and natural gas properties or office furniture and equipment at June 30, 2007.

As at June 30, 2008, the cost of the petroleum and natural gas properties includes $29,371,010 (as at June 30, 2007 - $nil) relating to unproved properties which have been excluded from costs subject to depletion and depreciation. The majority of these costs relate to unproved properties acquired as described in note 5.

Included in petroleum and natural gas properties is $103,613 (2007 -$nil) of capitalized general and administrative expenses related to exploration activities.

## 7. SHARE CAPITAL

**(a) Authorized:**
The Company is authorized to issue an unlimited number of common shares.

**(b) Common shares issued:**

| | **June 30, 2008** | | June 30, 2007 | |
|---|---|---|---|---|
| | **Number of Shares** | **Amount** | Number of Shares | Amount |
| Opening balance | **15,744,942** | **$ 5,807,409** | 15,744,942 | $5,807,409 |
| Shares issued through private placement (i) | **12,000,000** | **10,200,000** | - | - |
| Shares issued for property acquisition (ii) | **30,000,000** | **25,500,000** | - | - |
| Issue costs | **-** | **(735,723)** | - | - |
| **Closing balance** | **57,744,942** | **$40,771,686** | 15,744,942 | $5,807,409 |

(i) On October 1, 2007, the Company issued 12,000,000 common shares pursuant to a private placement for gross proceeds of $10,200,000. The agent was paid a cash commission of six percent of the gross proceeds and was granted warrants to purchase 600,000 common shares as described in note 7 (c). The fair value of the warrants was included in the issue costs.

(ii) On October 1, 2007, the Company issued 30,000,000 common shares at a price of $0.85 per common share pursuant to the Transeuro Transaction as described in note 5.

**(c) Warrants outstanding:**

| | **Number of Warrants** | **Weighted Average Exercise Price per Share** | **Expiry Date** |
|---|---|---|---|
| Issued pursuant to October 1, 2007 private placement | 600,000 | $0.85 | Sept. 30, 2008 |

Each warrant issued pursuant to the October 1, 2007 private placement entitles the holder thereof to purchase an additional common share of the Company at a price of $0.85, exercisable for a period of 12 months.

The fair value of the warrants was determined to be $111,600 using the Black-Scholes option pricing model based on the following assumptions:

| | At October 1, 2007 |
|---|---|
| Expected life of warrants | 1 year |
| Expected volatility | 50% |
| Risk-free rate of return | 4.26% |
| Dividend yield | 0% |

The warrants were unexercised and expired on September 30, 2008.

**(d) Stock options:**

The Company has a stock option plan for directors, officers, employees and consultants. Under the Company's stock option plan, the Company may grant options of up to 10 percent of the issued and outstanding common shares. The plan is administered by the Board of Directors. In accordance with the policies of the TSX Venture Exchange, the option exercise price, when granted, is based on the closing price of the Company's shares on the TSXV on the last trading day prior to the grant, subject to a permitted discount. Options granted under the plan have an exercise period not exceeding five years. The vesting period is determined at the time of grant at the discretion of the Board of Directors.

**Stock option continuity**

At June 30, the Company had stock options outstanding to acquire common shares as follows:

| As at June 30 | **2008** | | 2007 | |
|---|---|---|---|---|
| | **Number of Options** | **Weighted Average Exercise Price** | Number of Options | Weighted Average Exercise Price |
| Outstanding beginning of year | **600,000** | **$0.45** | 600,000 | $0.45 |
| Granted | **2,775,000** | **$0.95** | - | - |
| Cancelled | **(50,000)** | **$0.85** | - | - |
| Outstanding end of year | **3,325,000** | **$0.86** | 600,000 | $0.45 |
| Exercisable, end of year | **1,341,669** | **$0.76** | 600,000 | $0.45 |

**Stock-based compensation**

The fair value of common share options granted is estimated on the date of grant and is recognized over the vesting period. During the year ended June 30, 2008, compensation expense in the amount of $1,250,802 (2007 - $nil) was recorded in the consolidated statement of loss using the Black-Scholes option pricing model based on the following assumptions:

| | **Year ended June 30, 2008** |
|---|---|
| Expected life of options | 4 years |
| Expected volatility | 57% |
| Risk-free rate of return | 4.11% |
| Dividend yield | 0% |

**Contributed surplus continuity**

| As at June 30 | **2008** | 2007 |
|---|---|---|
| Balance, beginning of year | **$ 294,667** | $ 294,667 |
| Stock-based compensation | **1,250,802** | - |
| Fair value of warrants | **111,600** | - |
| Balance, end of year | **$ 1,657,069** | $ 294,667 |

## 8. FINANCIAL INSTRUMENTS

The Company does not utilize derivative instruments to manage risks. The carrying amounts of financial instruments comprising cash and cash equivalents, accounts receivable and accounts payable approximate their fair values due to the immediate or short term nature of these financial instruments.

The carrying value and fair value of financial assets and liabilities as at June 30, 2008 are summarized below:

| **Classification** | **Carrying Value** | **Fair Value** |
|---|---|---|
| Held-for-trading (Cash and cash equivalents) | $4,829,458 | $4,829,458 |
| Loans and receivables (Accounts receivable) | 57,180 | 57,180 |
| Held-to-maturity | - | - |
| Available-for-sale | - | - |
| Other liabilities (Accounts payable and accrued liabilities) | 360,961 | 360,961 |

## 9. RELATED PARTY TRANSACTIONS

The Company has entered into transactions with related parties in the normal course of business, which were valued at the exchange amount established and agreed to by the related parties. During the year, the related party transactions were as follows:

(a) the Company paid $48,000 (2007 - $24,000) to a company controlled by a director. These fees were paid for administration services which were provided by the director who previously acted as an officer of the Company. At June 30, 2008, $nil (2007 - $nil) was included in accounts payable and accrued liabilities.

(b) the Company paid $102, 242 (2007 - $29,743) for legal services to a law firm of which a director of the Company is a partner. At June 30, 2008, an additional amount of $3,527 (2007 - $35,794) for legal services was included in accounts payable and accrued liabilities.

(c) the Company paid $2,741,875 (2007 - $nil) to a company with common directors and a common officer. These payments were for reimbursement of past costs incurred relating to the Licenses and were predominantly for costs incurred relating to the preparation of a drilling pad and other work performed on the Licenses prior to the closing of the acquisition described in note 5. The amounts reimbursed were recorded at cost. The majority of the costs were included in petroleum and natural gas properties and the remainder was included in general and administrative expenses. At June 30, 2008, additional reimbursable costs in the amount of $96,390 (2007 - $nil) were included in accounts payable and accrued liabilities.

## 10. SUPPLEMENTARY CASH FLOW INFORMATION

The following table details the components of non-cash working capital:

| | Year ended June 30 | |
|---|---|---|
| | **2008** | 2007 |
| Provided by (used in): | | |
| Accounts receivable | **(53,289)** | (1,750) |
| Prepaid expenses | **(13,006)** | - |
| Accounts payable and accrued liabilities | **301,853** | 36,671 |
| | **235,556** | 34,921 |
| Operating | **(15,160)** | 34,921 |
| Investing | **250,716** | - |
| | **235,556** | 34,921 |

## 11. INCOME TAXES

The following tables reconcile income taxes calculated at the Canadian statutory rate with recorded income taxes:

| | | Year ended June 30, 2008 | | | |
|---|---|---|---|---|---|
| | | Canada | Papua New Guinea | British Virgin Islands | **Total** |
| Loss before taxes | $ | (2,212,904) | (582,625) | (306,960) | **(3,102,489)** |
| Statutory income tax rate | | 29.5% | 29.5% | 29.5% | **29.5%** |
| | $ | (652,807) | (171,874) | (90,553) | **(915,234)** |
| Non-deductible G&A | | 3,695 | 2,899 | - | **6,594** |
| Stock-based compensation | | 368,987 | - | - | **368,987** |
| Other – interest income in equity | | 33,142 | - | - | **33,142** |
| Change in valuation allowance | | 96,748 | 171,839 | - | **268,587** |
| Income subject to tax in foreign jurisdictions | | - | (2,864) | 90,553 | **87,689** |
| Change in tax rates | | 150,235 | - | - | **150,235** |
| Tax expense | $ | - | - | - | **-** |

| | | Year ended June 30, 2007 | | | |
|---|---|---|---|---|---|
| | | Canada | Papua New Guinea | British Virgin Islands | **Total** |
| Loss before taxes | $ | (157,521) | - | - | **(157,521)** |
| Statutory income tax rate | | 33.12% | - | - | **33.12%** |
| | $ | (52,171) | - | - | **(52,171)** |
| Non-deductible G&A | | - | - | - | **-** |
| Stock-based compensation | | - | - | - | **-** |
| Other – interest income in equity | | - | - | - | **-** |
| Change in valuation allowance | | (74,005) | - | - | **(74,005)** |
| Income subject to tax in foreign jurisdictions | | - | - | - | **-** |
| Change in tax rates | | 126,176 | - | - | **126,176** |
| Tax expense | $ | - | - | - | **-** |

The components of future income tax assets are as follows:

| | | Year ended June 30, 2008 | | | |
|---|---|---|---|---|---|
| | | Canada | Papua New Guinea | British Virgin Islands | **Total** |
| Property, plant and equipment | $ | 38,648 | 4 | - | **38,652** |
| Share issue costs | | 151,609 | - | - | **151,609** |
| Non-capital losses | | 445,254 | 171,835 | - | **617,089** |
| Capital losses | | 472,492 | - | - | **472,492** |
| ECE | | 100 | - | - | **100** |
| Valuation allowance | | (1,108,103) | (171,839) | - | **(1,279,942)** |
| Future tax asset | $ | - | - | - | **-** |

The Company has losses of $2,354,000 to carry forward in Canada and Papua New Guinea that expire in 2028.

| | | Year ended June 30, 2007 | | | |
|---|---|---|---|---|---|
| | | Canada | Papua New Guinea | British Virgin Islands | **Total** |
| Property, plant and equipment | $ | 40,168 | - | - | **40,168** |
| Share issue costs | | 23,578 | - | - | **23,578** |
| Non-capital losses | | 213,854 | - | - | **213,854** |
| Capital losses | | 548,091 | - | - | **548,091** |
| ECE | | 116 | - | - | **116** |
| Valuation allowance | | (825,807) | - | - | **(825,807)** |
| Future tax asset | $ | - | - | - | **-** |

## 12. CONTINGENCIES AND COMMITMENTS

a) Pursuant to the Transeuro Transaction described in note 5, Transeuro has the right to acquire a 10 percent interest in all, but not less than all, of the Licenses exercisable within 60 days from the date that the Company completes the drilling and testing of a third well on the Licenses by paying to the Company 10 percent of all costs incurred in respect of the Licenses up to the election date and by agreeing to pay 10 percent of the ongoing costs with respect to the exploration and development of the Licenses.

b) Pursuant to the terms of Licenses acquired by the Company as described in note 5, the Company has assumed certain financial and work commitments relating to these licenses as described below:

| License | Commitment |
|---|---|
| PPL 257 | Drill one exploration well, acquire 1,000 kilometres line of offshore seismic and spend a minimum of US $10,000,000 by October 20, 2008. In July 2008, the Company applied for, and was granted, a one year deferral until October 20, 2009. |
| PPL 258 | Drill one exploration well, acquire 1,000 kilometres of aero-grav/magnetic survey and spend a minimum of US $10,500,000 by October 20, 2008. In July 2008, the Company applied for, and was granted, a one year deferral until October 20, 2009. |
| PPL 259 | Drill one exploration well and conduct geological and geophysical studies by June 29, 2009. |
| PPL 260 | Drill one exploration well and conduct geological and geophysical studies by March 13, 2009. |

The Company has issued bank guarantees totaling approximately $160,000 (100,000 Papua New Guinea dollars for each license) as security against the capital requirements associated with the Licenses. If the Company does not fulfill its commitments under a License and has not applied for and been granted an extension, it could potentially lose its guarantee and the applicable License could be revoked by the Papua New Guinea (“PNG”) government.

c) The PNG government retains a 22.5 percent back-in right which can be exercised at the time a development license is granted. If the PNG government exercises its back-in right, it would be required to pay the Company 22.5 percent of all costs incurred in respect of the Licenses up to the election date and paying 22.5 percent of the ongoing production and development costs of the Licenses.

## 13. SEGMENTED INFORMATION

The Company has one reportable business segment, that being oil and gas exploration and development. The Company’s operations for the year ended June 30, 2008 were carried on in the following geographic locations:

| | Year ended June 31, 2008 | | |
|---|---|---|---|
| | Canada | Papua New Guinea | Consolidated |
| Total revenues | $ 193,640 | $ 868 | $ 194,508 |
| Expenses | 2,406,545 | 890,452 | 3,296,997 |
| Net loss | $ 2,212,905 | $ 889,584 | $ 3,102,489 |
| Segment assets | $ 4,907,060 | $ 29,438,346 | $ 34,345,406 |
| Segment petroleum and natural gas properties | $ - | $ 29,371,010 | $ 29,371,010 |
| Capital additions | $ 90,600 | $ 29,371,258 | $ 29,461,858 |

The only segment for the year ended June 30, 2007 was Canada.