

Twoco Petroleums Ltd.
Consolidated Financial Statements
September 30, 2004

Notice to Reader

The accompanying unaudited interim consolidated financial statements of Twoco Petroleum Ltd. for the nine months ended September 30, 2004, have been prepared by management and approved by the Board of Directors of the Company. These statements have not been reviewed by Twoco Petroleum Ltd.'s external auditors.

Dated November 29, 2004.

On behalf of Twoco Petroleum Ltd.

(signed) "Wayne Malinowski"
Wayne Malinowski
President

(signed) "Tim Bashforth"
Tim Bashforth
Secretary and Treasurer

Twoco Petroleum Ltd.

(Incorporated under the laws of Alberta)

Consolidated Balance Sheets

	September 30, 2004 <i>(unaudited)</i>	December 30, 2003 <i>(audited)</i> <i>(restated - note 2)</i>
Assets		
Current assets		
Cash and cash equivalents	\$ 5,044,584	\$ 1,442,947
Accounts receivable	1,151,164	410,425
Prepaid expenses and deposits	<u>247,927</u>	<u>92,133</u>
	6,443,675	1,945,505
Property, plant and equipment (note 3)	<u>11,809,000</u>	<u>9,208,726</u>
	<u>\$ 18,252,675</u>	<u>\$ 11,154,231</u>
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities	\$ 1,065,294	\$ 343,085
Income taxes payable	170,035	-
Due to directors	<u>370,052</u>	<u>-</u>
	1,605,381	343,085
Due to directors	370,051	740,103
Debentures payable	1,500,000	1,500,000
Future income taxes (note 6)	2,451,000	2,059,000
Asset retirement obligations (note 5)	<u>611,601</u>	<u>220,742</u>
	<u>6,538,033</u>	<u>4,862,930</u>
Shareholders' Equity		
Share capital (note 7)	11,384,594	4,820,467
Special warrants	-	1,861,632
Contributed surplus (note 7[c], [g])	467,901	141,240
Deficit	<u>(137,853)</u>	<u>(532,038)</u>
	<u>11,714,642</u>	<u>6,291,301</u>
	<u>\$ 18,252,675</u>	<u>\$ 11,154,231</u>

Approved by the Board,

(signed) "Larry C. Mah", Director

(signed) "James A.W. Williams", Director

Twoco Petroleum Ltd.

Consolidated Statements of Income (Loss) and Deficit

(unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2004	2003	2004	2003
Revenue				
Petroleum and natural gas sales, net of royalties and ARTC	\$ 1,233,890	\$ 118,516	\$ 3,322,994	\$ 235,802
Processing revenue and other	29,038	-	109,584	-
Interest	<u>65,096</u>	<u>6</u>	<u>91,972</u>	<u>3,560</u>
	<u>1,328,024</u>	<u>118,522</u>	<u>3,524,550</u>	<u>239,362</u>
Expenses				
Operating costs	151,064	16,555	384,163	31,478
Transportation costs	76,061	-	158,313	-
Interest on debentures and due to directors	68,837	-	200,826	-
General and administrative	25,912	105,080	294,966	219,330
Stock-based compensation	32,000	-	33,658	-
Depletion, amortization and accretion	<u>836,174</u>	<u>(15,173)</u>	<u>1,813,790</u>	<u>145</u>
	<u>1,190,048</u>	<u>106,462</u>	<u>2,885,716</u>	<u>250,953</u>
Income (loss) before income taxes	<u>137,976</u>	<u>12,060</u>	<u>638,834</u>	<u>(11,591)</u>
Income taxes - current	91,343	-	171,900	-
- future income	<u>40,000</u>	<u>(103,928)</u>	<u>72,749</u>	<u>-</u>
	<u>131,343</u>	<u>(103,928)</u>	<u>244,649</u>	<u>-</u>
Net income (loss)	6,633	115,988	394,185	(11,591)
Deficit, beginning of period	<u>(144,486)</u>	<u>(556,788)</u>	<u>(532,038)</u>	<u>(429,209)</u>
Deficit, end of period	<u>\$ (137,853)</u>	<u>\$ (440,800)</u>	<u>\$ (137,853)</u>	<u>\$ (440,800)</u>
Net income (loss) per share - basic and diluted	<u>\$ 0.00</u>	<u>\$ (0.03)</u>	<u>\$ 0.04</u>	<u>\$ (0.00)</u>
Weighted average common shares outstanding				
Basic	<u>11,361,197</u>	<u>3,777,600</u>	<u>9,970,557</u>	<u>3,777,600</u>
Diluted	<u>12,226,638</u>	<u>3,777,600</u>	<u>10,780,804</u>	<u>3,777,600</u>

Twoco Petroleum Ltd.
Consolidated Statements of Cash Flows
(unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2004	2003	2004	2003
Operating activities				
Net income (loss)	\$ 6,633	\$ 115,988	\$ 394,185	\$ (11,591)
Add (deduct) items not affecting cash				
Depletion, amortization and accretion	836,174	(15,173)	1,813,790	145
Future income taxes	40,000	(103,928)	72,749	-
Stock-based compensation	<u>32,000</u>	<u>-</u>	<u>33,658</u>	<u>-</u>
	914,807	(3,113)	2,314,382	(11,446)
Change in non-cash working capital	<u>105,987</u>	<u>(311,581)</u>	<u>(248,884)</u>	<u>(259,709)</u>
	<u>1,020,794</u>	<u>(314,694)</u>	<u>2,065,498</u>	<u>(271,155)</u>
Financing activities				
Issuance of common shares, net of issuance costs	395,503	250,000	5,689,775	250,000
Proceeds on debentures issued	-	1,417,500	-	1,417,500
Advances from affiliated companies	-	-	-	50,224
Change in non-cash working capital	<u>59,292</u>	<u>-</u>	<u>-</u>	<u>-</u>
	<u>454,795</u>	<u>1,667,500</u>	<u>5,689,775</u>	<u>1,717,724</u>
Investing activities				
Acquisition of property, plant and equipment	(1,882,793)	(1,465,033)	(4,406,809)	(2,408,836)
Advances from officers and directors	-	866,523	-	828,600
Change in non-cash working capital	<u>(300,748)</u>	<u>299,319</u>	<u>253,173</u>	<u>-</u>
	<u>(2,183,541)</u>	<u>(299,191)</u>	<u>(4,153,636)</u>	<u>(1,580,236)</u>
Cash inflow (outflow)	(707,952)	1,053,615	3,601,637	(133,667)
Cash and cash equivalents, beginning of period	<u>5,752,536</u>	<u>146,686</u>	<u>1,442,947</u>	<u>1,333,968</u>
Cash and cash equivalents, end of period	<u>\$ 5,044,584</u>	<u>\$ 1,200,301</u>	<u>\$ 5,044,584</u>	<u>\$ 1,200,301</u>
Cash and cash equivalents is comprised of:				
Deposits with bank	\$ 4,519,327	\$ 1,200,301	\$ 4,519,327	\$ 1,200,301
Term deposits	<u>525,257</u>	<u>-</u>	<u>525,257</u>	<u>-</u>
	<u>\$ 5,044,584</u>	<u>\$ 1,200,301</u>	<u>\$ 5,044,584</u>	<u>\$ 1,200,301</u>
Supplemental cash flow information:				
Interest paid	<u>\$ 68,837</u>	<u>\$ -</u>	<u>\$ 200,826</u>	<u>\$ -</u>

The non-cash transactions described in (note 8[b]) have been excluded from the statements of cash flows.

Twoco Petroleum Ltd.
Notes to Consolidated Financial Statements
September 30, 2004
(unaudited)

1. Interim financial statements

The unaudited interim consolidated financial statements of Twoco Petroleum Ltd. (the "Company") have been prepared by management in accordance with Canadian generally accepted accounting principles. The interim financial statements have been prepared following the same accounting policies and methods of computation as those utilized in the December 30, 2003 annual financial statements, except as described below. The interim financial statements contain disclosures which are incremental to the Company's annual financial statements. Certain disclosures which are normally required to be included in the notes to the annual financial statements have been condensed or omitted. The interim financial statements should be read in conjunction with the Company's audited financial statements and notes thereto for the year ended December 30, 2003.

These unaudited interim consolidated financial statements include the accounts of Twoco Petroleum Ltd. and its wholly-owned subsidiary, Norranco Oil & Gas Ltd. from June 3, 2004.

2. Change in significant accounting policies

(a) Full Cost Accounting

On December 31, 2003, the Company adopted the Canadian Institute of Chartered Accountants ("CICA") Accounting Guideline 16 "Oil and Gas Accounting - Full Cost". The new guideline modifies the ceiling test calculation and outlines additional disclosure requirements. Under the full cost method of accounting, a limit is placed on the carrying amount of petroleum and natural gas properties. A ceiling test is performed to recognize and measure impairment, if any.

Impairment is recognized if the carrying amount of petroleum and natural gas properties, less the cost of unproved properties not subject to depletion (the "adjusted carrying amount") exceeds the estimated undiscounted future cash flows from the Company's proved reserves. The future cash flows are based on forecast prices and costs, as provided by an independent third party. If recognized, the magnitude of the impairment is measured by comparing the adjusted carrying amount to the estimated, discounted future cash flows of the Company's proved and probable reserves, based on future product prices and costs, and discounted at an appropriate risk-free interest rate. For purposes of the ceiling test, future cash flows are calculated exclusive of indirect costs such as financing charges, general and administrative expenses and income taxes.

Any impairment recognized would be recorded as additional depletion and amortization expense.

The Company performed a ceiling test under AcG-16 and there was no impact on the financial results reported.

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The future prices used in the initial adoption ceiling test are:

Year	Natural Gas	
	AECO Spot <i>(CDN \$/mmbtu)</i>	Company Average <i>(CDN \$/mcf)</i>
2004	\$ 5.50	\$ 5.24
2005	5.20	4.94
2006	5.00	4.74
2007	4.80	4.54
2008	4.90	4.64
Average percentage increase thereafter	2.5 %	2.5 %

Prior to December 31, 2003, an impairment loss was recognized when the carrying amount of a cost centre exceeded its recoverable amount. The recoverable amount was the sum of the undiscounted cash flows expected from the production of proved reserves plus the lower of cost or market of unproved interests less estimated costs for administration, financing and site restoration. The cash flows were estimated using period-end prices and costs.

(b) Asset Retirement Obligations

Effective December 31, 2003, the Company has adopted retroactively, with restatement of prior periods, the CICA's new standard on Asset Retirement Obligations. This new section requires liability recognition for retirement obligations associated with long-lived assets, which would include abandonment of petroleum and natural gas wells, related facilities, compressors and gas plants, removal of equipment from leased acreage and returning such land to its original condition.

Under the new standard, the estimated fair value of each asset retirement obligation is recorded in the period a well or related asset is drilled, constructed or acquired. Fair value is estimated using the present value of the estimated future cash outflows to abandon the asset at the Company's credit-adjusted risk-free interest rate. The discounted obligation is initially capitalized as part of the carrying amount of the related petroleum and natural gas properties and a corresponding liability is recognized. The increase in petroleum and natural gas properties is depleted and amortized on the same basis as the remainder of the petroleum and natural gas properties. The liability is accreted against income until it is settled or the property is sold and is recorded as accretion expense. Actual restoration expenditures are charged to the accumulated obligation as incurred. The effect of adoption of the new standard on the financial statements is disclosed in note 2(f).

The obligation is reviewed regularly by management based upon current regulations, costs, technologies and industry standards.

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Prior to 2004, the Company estimated costs of dismantlement, removal and site restoration and recorded them over the remaining life of the proved reserves on the unit-of-production basis. The annual provision was included in depletion and depreciation expense and was accrued as a site restoration liability on the balance sheet. Actual restoration expenditures were charged to the accumulated obligation as incurred.

(c) Stock-based Compensation

Effective December 31, 2003, the Company elected to retroactively adopt amendments to CICA Handbook Section 3870 "Stock-based Compensation and Other Stock-based Payments". Under the amended standard, the Company must account for all stock options issued at fair value.

Under the transitional provisions of the standard, the Company has elected to apply the amended standard retroactively, with restatement, to all stock options issued after the effective date of implementation, being January 1, 2002. The effect of adoption of the new standard on the financial statements is disclosed in note 2(f).

(d) Flow-through shares

Effective for equity issuances after March 19, 2004, the Company will record the future income taxes associated with the renunciation of expenditures for income tax purposes on the date of renunciation. This change is in accordance with Abstract 146 from the Emerging Issues Committees of the CICA.

Prior to the adoption of this policy, the Company recorded future income taxes when the associated expenditures were incurred, to the extent such liabilities exceeded unrecorded tax assets.

(e) Transportation costs

For the fiscal year beginning December 31, 2003, the Company revised its presentation of transportation costs in accordance with CICA Handbook Section 1100 "Generally Accepted Accounting Principles". As a result, revenue has been presented prior to transportation costs and a separate expense for transportation costs has been presented in the consolidated statements of income (loss) and deficit. The Company has reclassified previously reported amounts to be consistent with the presentation under this new policy. There was no impact on net income or cash flow in the third quarter of 2004 and 2003, nor did it impact restated net income or cash flow for the third quarter of 2003.

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(f) Effect of change in accounting policies

The effects of the change in policies for asset retirement obligations and stock-based compensation are as follows:

Balance Sheets

	September 30, 2004	December 30, 2003
Increase in property, plant and equipment	\$ 500,818	\$ 214,436
Increase in asset retirement obligations	611,601	220,742
Decrease in future removal and site restoration costs	-	57,500
Increase in future income taxes	-	17,000
Increase in contributed surplus	33,658	135,375
Increase in deficit	131,974	101,181

Statements of Income (Loss) and Deficit

	Nine Month Period Ended September 30, 2004	Three Month Period Ended September 30, 2004
Increase in stock-based compensation expense	\$ 33,658	\$ 32,000
Increase in depletion, amortization and accretion expense	44,316	14,766
Increase in future tax expense	<u>54,000</u>	<u>27,000</u>
Increase in deficit	<u>\$ 131,974</u>	<u>\$ 73,766</u>

There was no effect on basic or diluted income (loss) per share as a result of adopting the new policies.

3. Property, plant and equipment

	September 30, 2004			December 30, 2003		
	Cost	Accumulated Amortization	Net Book Value	Cost	Accumulated Amortization	Net Book Value
Oil and gas properties	\$ 13,792,685	\$ 2,047,305	\$ 11,745,380	\$ 9,407,774	\$ 250,000	\$ 9,157,774
Other assets	<u>137,284</u>	<u>73,664</u>	<u>63,620</u>	<u>109,082</u>	<u>58,130</u>	<u>50,952</u>
Net book value	<u>\$ 13,929,969</u>	<u>\$ 2,120,969</u>	<u>\$ 11,809,000</u>	<u>\$ 9,516,856</u>	<u>\$ 308,130</u>	<u>\$ 9,208,726</u>

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During the three and nine months ended September 30, 2004, the Company capitalized \$112,503 of general and administrative expenses related to exploration and development activities. As at September 30, 2004, the depletion calculation excluded unproved properties of \$1.4 million.

4. Bank indebtedness

As at September 30, 2004, the Company has a revolving demand credit facility with a maximum availability of \$5 million and a \$1.5 million general lease line of credit. The current interest rate at September 30, 2004 was prime plus 0.50%. The credit facility is secured by a floating charge over all the assets of the Company.

The Company has not drawn on the credit facility at September 30, 2004.

5. Asset Retirement Obligations

A reconciliation of the asset retirement obligations is provided below:

	Nine Month Period Ended September 30, 2004
Balance, beginning of period	\$ 220,742
Accretion expense	7,255
Liabilities incurred	276,476
Liabilities due to business combination	<u>107,128</u>
Balance, end of period	<u>\$ 611,601</u>

The Company's asset retirement obligations result from net ownership interests in petroleum and natural gas assets including well sites, gathering systems and processing facilities. As at September 30, 2004, the Company estimates the total undiscounted amount of cash flows required to settle its asset retirement obligations is approximately \$800,545 which will be incurred between 2004 to 2014. A credit-adjusted risk-free rate of five percent was used to calculate the fair value of the asset retirement obligations.

6. Income taxes

The future income tax liability is comprised of amounts arising from temporary differences related to oil and gas properties of \$2.5 million at September 30, 2004.

The oil and gas properties owned by the Company have a tax basis of approximately \$3.8 million available for future use as deductions from taxable income.

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7. Share capital

(a) Authorized

Unlimited voting common shares
 Unlimited non-voting preferred shares

(b) Issued

	<u>Number</u>	<u>Stated Value</u>
Balance, June 30, 2004	11,355,406	\$ 12,684,562
Warrants exercised (note 7[d])	<u>10,500</u>	<u>20,475</u>
	<u>11,365,906</u>	12,705,037
Less: Issuance costs, net of tax benefits of \$252,000 (note 7[c])		(749,191)
Tax benefits renounced to flow- through equity holders		<u>(571,252)</u>
Balance, September 30, 2004		<u>\$ 11,384,594</u>

(c) Issuance costs

The fair value of the agent's options related to the initial public offering ("IPO") was estimated to be \$293,000 using the Black-Scholes option pricing model with the following assumptions: expected option life of one year, expected volatility of 85%, risk-free rate of 3%, and a zero dividend yield. This amount has been recorded as a share issuance cost with a corresponding increase in contributed surplus.

(d) Purchase warrants and agent's options

A summary of the Company's purchase warrants and agent's options as at September 30, 2004 and changes during the period then ended is as follows:

	<u>Number</u>	<u>Weighted Average Exercise Price</u>
Outstanding, June 30, 2004	2,411,400	\$ 1.90
Exercised (note 7[c])	<u>(10,500)</u>	1.95
Outstanding and exercisable, September 30, 2004	<u>2,400,900</u>	<u>\$ 1.90</u>

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The purchase warrants and agent's options have a weighted average remaining life of 0.54 years.

On April 16, 2004, the Company closed its IPO of 3,530,000 units at a price of \$1.70 per unit. Each unit is comprised of one common share and one half non-transferable common share purchase warrant. Each whole common share purchase warrant is exercisable until April 16, 2005 into one common share at a price of \$1.95 per share.

The Company paid the agent a 7.5% cash commission on the aggregate proceeds of \$6,001,000 and granted the agent an option to acquire 353,000 agent's units exercisable until April 16, 2005. Each agent's unit consists of one common share exercisable at \$1.70 per share and one-half common share purchase warrant exercisable at \$1.95 per warrant.

(e) Stock Option Plan

The Company has one fixed option plan whereby the Company may grant options to its directors, officers, employees and consultants for up to 10% of the issued and outstanding common shares of the Company of which 910,000 have been granted to date.

A summary of the status of the Company's Stock Option Plan as at September 30, 2004, and changes during the period then ended is as follows:

Assumptions	Number	Weighted Average Exercise Price
Outstanding, June 30, 2004	630,000	\$ 1.27
Granted	<u>280,000</u>	2.20
Options outstanding, September 30, 2004	<u>910,000</u>	<u>\$ 1.55</u>
Options exercisable, September 30, 2004	<u>610,000</u>	<u>\$ 1.25</u>

The fair value of each option granted in 2004 is estimated on the date of grant using the Black-Scholes option pricing model with weighted average assumptions and resulting values for grants as follows:

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	Nine Month Period Ended September 30, 2004
Risk-free interest rate (%)	3.8
Expected life (years)	5.00
Expected volatility (%)	85
Weighted average fair value of each option granted (\$)	1.49

- (f) The following is a continuity of flow-through Common shares issued and outstanding:

	Number of Shares	Amount
September 2002	1,376,000	\$ 1,651,200
December 2003	<u>1,176,500</u>	<u>2,000,050</u>
Balance issued	<u><u>2,552,500</u></u>	<u><u>\$ 3,651,250</u></u>

In 2004, the Company is required to incur \$2,000,050 of qualified expenditures relating to the issuance of flow-through Common shares. As of September 30, 2004, the Company has yet to incur expenditures of approximately \$580,000 to satisfy this obligation.

- (g) Contributed surplus

The following table reconciles the Company's contributed surplus:

	Nine Month Period Ended September 30, 2004	Year Ended December 31, 2003
Balance, beginning of period	\$ 141,243	\$ -
Stock-based compensation expense	33,658	135,375
Agent's option (note 7[c])	<u>293,000</u>	<u>5,868</u>
Balance, end of period	<u><u>\$ 467,901</u></u>	<u><u>\$ 141,243</u></u>

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8. Supplemental cash flow information

(a) Changes in non-cash working capital

	Nine Month Period Ended September 30, 2004
Accounts receivable	\$ (740,739)
Prepaid expenses and deposits	(155,794)
Accounts payable and accrued liabilities	722,209
Current taxes payable	<u>170,035</u>
	(4,289)
 Change in non-cash working capital	
Relating to:	
Investing activities	<u>253,173</u>
Operating activities	<u>\$ (248,884)</u>

(b) Excluded from the statements of cash flows are the following non-cash items:

	<u>Three Months Ended September 30,</u>		<u>Nine Months Ended September 30,</u>	
	2004	2003	2004	2003
Share issuance costs (note 7[c])	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 293,000</u>	<u>\$ 245,718</u>
Tax benefits renounced to flow-through equity holders	<u>\$ -</u>	<u>\$ -</u>	<u>\$ (571,252)</u>	<u>\$ (264,170)</u>
Tax benefits on cash share issuance costs	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 252,000</u>	<u>\$ -</u>

9. Comparative figures

Certain comparative figures have been restated to conform with the current period's presentation from the retroactive adoption of stock-based compensation, asset retirement obligation accounting and transportation cost disclosures in 2004.