

Twoco Petroleums Ltd.
Financial Statements
December 31, 2007

Auditors' Report

To the Shareholders of
Twoco Petroleums Ltd.

We have audited the balance sheets of Twoco Petroleums Ltd. as at December 31, 2007 and 2006 and the statements of income (loss), comprehensive income (loss) and retained earnings and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2007 and 2006 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Calgary, Alberta
April 4, 2008

(signed) "Deloitte & Touche LLP"
Chartered Accountants

Twoco Petroleum Ltd.
Balance Sheets
As at December 31, 2007 and 2006

	2007	2006
Assets		
Current assets		
Cash	\$ -	\$ 1,867,708
Accounts receivable	1,829,928	2,043,174
Prepaid expenses and deposits	<u>553,463</u>	<u>386,742</u>
	2,383,391	4,297,624
Deferred financing charges (notes 3 and 5)	-	184,034
Property, plant and equipment (note 6)	<u>50,350,663</u>	<u>44,545,637</u>
	<u>\$ 52,734,054</u>	<u>\$ 49,027,295</u>
Liabilities		
Current liabilities		
Bank indebtedness and credit facility (note 7)	\$ 6,209,859	\$ -
Accounts payable and accrued liabilities (note 13)	2,062,263	2,839,618
Current portion of capital lease obligation (note 8)	<u>220,670</u>	<u>207,756</u>
	8,492,792	3,047,374
Obligations under capital leases (note 8)	539,505	759,854
Convertible debentures payable (notes 3 and 5)	11,840,675	11,880,000
Asset retirement obligations (note 9)	2,762,151	2,551,724
Future income taxes (note 10)	<u>4,636,350</u>	<u>3,849,800</u>
	<u>28,271,473</u>	<u>22,088,752</u>
Shareholders' Equity		
Share capital (note 11)	20,250,003	21,686,393
Equity portion of convertible debentures payable (note 5)	160,000	160,000
Contributed surplus (note 11[g])	1,128,929	985,181
Retained earnings	<u>2,923,649</u>	<u>4,106,969</u>
	<u>24,462,581</u>	<u>26,938,543</u>
	<u>\$ 52,734,054</u>	<u>\$ 49,027,295</u>
Commitments (note 12)		

See accompanying notes to financial statements.

Approved by the Board,

(signed) "Wayne A. Malinowski", Director

(signed) "Larry C. Mah", Director

Twoco Petroleum Ltd.

Statements of Income (Loss), Comprehensive Income (Loss) and Retained Earnings For the Years Ended December 31, 2007 and 2006

	2007	2006
Revenue		
Petroleum and natural gas sales	\$ 15,595,361	\$ 12,898,939
Royalties	<u>(2,854,371)</u>	<u>(2,379,563)</u>
	12,740,990	10,519,376
Alberta Royalty Tax Credit	-	500,000
Interest	<u>11,331</u>	<u>183,888</u>
	<u>12,752,321</u>	<u>11,203,264</u>
Expenses		
Operating	2,040,992	1,295,510
Transportation	622,529	466,799
General and administrative (note 13[a])	651,301	667,145
Interest on bank debt	258,247	44,499
Interest on capital leases	53,446	100,278
Interest on debentures payable (notes 5 and 13[b])	953,332	718,082
Stock-based compensation (notes 11[f] and [g])	165,859	397,113
Amortization of convertible debentures financing charges (note 5)	68,377	61,345
Depletion, amortization and accretion	<u>9,353,042</u>	<u>6,881,173</u>
	<u>14,167,125</u>	<u>10,631,944</u>
Income (loss) before income taxes	<u>(1,414,804)</u>	<u>571,320</u>
Income tax expense (recovery) (note 10)		
Current	4,890	35,457
Future	<u>(563,327)</u>	<u>(236,265)</u>
	<u>(558,437)</u>	<u>(200,808)</u>
Net income (loss) and comprehensive income (loss)	(856,367)	772,128
Retained earnings, beginning of year	<u>4,106,969</u>	<u>3,334,841</u>
	3,250,602	4,106,969
Acquisition of shares in excess of carrying value [note 11[e])	<u>(326,953)</u>	<u>-</u>
Retained earnings, end of year	<u>\$ 2,923,649</u>	<u>\$ 4,106,969</u>
Net income (loss) per share (note 11[h])		
Basic	<u>\$ (0.06)</u>	<u>\$ 0.05</u>
Diluted	<u>\$ (0.06)</u>	<u>\$ 0.05</u>

See accompanying notes to financial statements.

Twooco Petroleum Ltd.
Statements of Cash Flows
For the Years Ended December 31, 2007 and 2006

	2007	2006
Cash provided by (used for)		
Operating activities		
Net income (loss) and comprehensive income (loss)	\$ (856,367)	\$ 772,128
Add items not affecting cash		
Stock-based compensation	165,859	397,113
Future income taxes	(563,327)	(236,265)
Depletion, amortization and accretion	9,353,042	6,881,173
Convertible debentures accretion	53,332	40,000
Amortization of convertible debentures financing charges	68,377	61,345
Settlement of asset retirement obligations	<u>(72,567)</u>	<u>(59,411)</u>
	8,148,349	7,856,083
Change in non-cash working capital (note 15[a])	<u>(1,710,606)</u>	<u>817,327</u>
	<u>6,437,743</u>	<u>8,673,410</u>
Financing activities		
Issuance of common shares, net of issue costs	-	4,331,425
Repayment of obligations under capital lease	(207,435)	(171,565)
Repayments to officers and directors	-	(370,052)
Share issuance costs	(500)	-
Exercise of stock options	74,750	-
Proceeds of convertible debentures, net of financing charges	-	11,754,621
Repurchase of common shares	(509,827)	-
Refund of financing charges on convertible debenture	<u>23,000</u>	<u>-</u>
	<u>(620,012)</u>	<u>15,544,429</u>
Investing activities		
Acquisition of property, plant and equipment	(14,875,074)	(19,744,467)
Change in non-cash working capital (note 15[a])	<u>979,776</u>	<u>(543,884)</u>
	<u>(13,895,298)</u>	<u>(20,288,351)</u>
Net cash inflow (outflow)	(8,077,567)	3,929,488
Cash and cash equivalents (bank indebtedness), beginning of year	<u>1,867,708</u>	<u>(2,061,780)</u>
Cash and cash equivalents (bank indebtedness), end of year	<u>\$ (6,209,859)</u>	<u>\$ 1,867,708</u>
Cash and cash equivalents (bank indebtedness) is comprised of:		
Indebtedness with bank	\$ (6,213,991)	\$ -
Term deposits	4,132	-
Cash	<u>-</u>	<u>1,867,708</u>
	<u>\$ (6,209,859)</u>	<u>\$ 1,867,708</u>
Supplemental cash flow information:		
Interest paid	<u>\$ 1,213,473</u>	<u>\$ 825,747</u>
Taxes paid	<u>\$ 4,890</u>	<u>\$ 35,457</u>

The non-cash transactions described in note 15(b) have been excluded from the statements of cash flows.

See accompanying notes to financial statements.

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1. Nature of operations

Twoco Petroleums Ltd. ("the Company") was incorporated under the Alberta Business Corporations Act on September 21, 2000 and is engaged in the exploration for, and development of, petroleum and natural gas in western Canada.

These comparative figures include the accounts of the Company and its wholly-owned subsidiary. The subsidiary was wound up into the Company on July 1, 2006.

2. Future accounting pronouncements

As of January 1, 2008, the Company will be required to adopt two new CICA standards - Section 3862 "Financial Instruments - Disclosures" and Section 3863 "Financial Instruments - Presentation", which will replace Section 3861 "Financial Instruments - Disclosure and Presentation". The new disclosure standard increases the emphasis on the risks associated with both recognized and unrecognized financial instruments and how those risks are managed. The new presentation standard carries forward the former presentation requirements. The new financial instruments presentation and disclosure requirements were issued in December 2006 and the Company is assessing the impact on its financial statements.

As of January 1, 2008, the Company will be required to adopt CICA Section 1535 "Capital Disclosures", which will require additional disclosures of objectives, policies and processes for managing capital. In addition, disclosures will include whether companies have complied with externally imposed capital requirements. The new capital disclosure requirements were issued in December 2006 and the Company is assessing the impact on its financial statements.

In January 2006, the CICA Accounting Standards Board ("AcSB") adopted a strategic plan for the direction of accounting standards in Canada. As part of the plan, accounting standards in Canada for public companies are expected to converge with International Financial Reporting Standards ("IFRS") for reporting periods beginning on or after January 1, 2011. The Company continues to monitor and assess the impact of the convergence of Canadian GAAP and IFRS.

3. Change in accounting policy

As at January 1, 2007, the Company adopted the revised CICA Handbook Section 1506 - "*Accounting Changes*". Accounting Changes provides expanded disclosures for changes in accounting policies, accounting estimates and correction of errors. Under the new standard, accounting changes should be applied retrospectively unless otherwise permitted or where impracticable to determine. As well, voluntary changes in accounting policy are made only when required by a primary source of GAAP or when the change results in more relevant and reliable information.

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Effective January 1, 2007, the Company adopted the Canadian Institute of Chartered Accountants ("CICA") Section 3855, "Financial Instruments - Recognition and Measurement", Section 3861, "Financial Instruments - Disclosure and Presentation", Section 3865, "Hedges", Section 3251, "Equity", and Section 1530, "Comprehensive Income". These standards have been adopted prospectively.

(a) Financial instruments

Section 3855 establishes a framework for classifying and measuring financial instruments. Under this section, all financial instruments must be initially recognized at their fair value on the balance sheet. In accordance with Section 3855, the Company has classified each financial instrument into the five categories set out in the standard: Financial assets and liabilities held for trading, financial assets held to maturity, loans and receivables, financial assets available for sale and other liabilities. Measurement of each of these items is contingent upon initial classification. Unrealized gains and losses on financial instruments classified as held for trading are recognized in earnings in the period incurred. Gains and losses on financial assets available for sale are recognized in other comprehensive income, and are recognized in earnings when the asset is removed from the balance sheet. The effective interest rate method using amortized cost is applied to the remaining categories of financial instruments.

Section 3861 establishes standards for enhancing financial statement users' understanding of the significance of financial instruments to an entity's financial position, performance and cash flows. It establishes standards for presentation of financial instruments and non-financial derivatives, and identifies the information that should be disclosed about them. This section sets forth standards on the presentation and classification of financial instruments between liabilities and equity, the classification of related interest, dividends, losses and gains, and the circumstances in which financial assets and liabilities are offset. The standard outlines required disclosures surrounding factors that affect the amount, timing and certainty of an entity's future cash flows relating to financial instruments. Disclosure of information about the nature and extent of an entity's use of financial instruments, the business purposes they serve, the risks associated with them and management's policies for controlling those risks are also required.

Adoption of the new standards have the following effect on the financial statements:

Convertible debentures payable are classified as a financial liability and are measured at amortized cost. Amortized cost is the amount at which the financial liability is measured at initial recognition minus principal repayments plus the cumulative amortization of any deferred financing charges and the convertible debenture discount using the effective interest method.

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Prior to January 1, 2007, deferred financing charges related to the convertible debentures payable were presented as a separate asset on the balance sheet and amortized on a straight-line basis. Under the new standards, deferred financing charges are recognized as an offset to the carrying value of convertible debentures payable and are amortized using the effective interest method.

(b) Derivative instruments and hedging

The Company does not have any outstanding derivative or hedging contracts as at December 31, 2007.

(c) Comprehensive income

Comprehensive income is the change in equity of the Company from net income and other comprehensive income ("OCI"). OCI consists of the change in the fair value of any financial instruments classified as available for sale. Amounts recognized in OCI must eventually be reclassified to income when the related gains or losses are realized.

The Company has no transactions that are categorized as OCI and, as such, has not presented a statement of accumulated OCI in the financial statements.

(d) Equity

Section 3251 - "Equity" establishes standards for the presentation of equity and changes in equity during the reporting period. This section specifies that changes in equity for the period arising from net income, OCI, other changes in deficit, changes in contributed surplus, and changes in unitholders' capital must be presented separately.

4. Significant accounting policies

(a) Use of estimates

The financial statements of the Company have been prepared by management in accordance with Canadian generally accepted accounting principles. Because a precise determination of many assets and liabilities is dependent upon future events, the preparation of financial statements for a period involves the use of estimates and approximations, which have been made using careful judgment. The financial statements have, in management's opinion, been properly prepared within the framework of the significant accounting policies summarized below.

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(b) Measurement uncertainty

The amounts recorded for depletion and amortization of property, plant and equipment, the asset retirement obligation and the ceiling test calculation are based on estimates of proven reserves, production rates, petroleum and natural gas prices, future costs and other relevant assumptions.

The amounts disclosed relating to the fair value of stock options issued are based on estimates of the expected lives of the options, expected stock price volatility, expected dividends and other relevant assumptions.

The amount recorded as the equity portion of the convertible debentures is based upon an estimate of the difference between the debenture proceeds and the estimated present value of debentures without a conversion feature.

By their nature, these estimates are subject to measurement uncertainty, and the effect of changes in such estimates on the financial statements of future periods could be significant.

(c) Property, plant and equipment

(i) Petroleum and natural gas properties

The Company follows the full cost method of accounting for its petroleum and natural gas properties and related facilities, whereby all costs related to the acquisition of, exploration for and development of petroleum and natural gas reserves, whether productive or unproductive, are capitalized in a single Canadian cost centre and charged to income as set out below. Such costs include lease acquisition, drilling, geological and geophysical expenditures, lease rentals on undeveloped properties, lease and well equipment costs and overhead expenses directly related to exploration and development activities.

Proceeds from the disposal of properties are normally applied as a reduction of the cost of the remaining assets, except when such a disposal would alter the depletion and depreciation rate by more than 20%, in which case a gain or loss is recorded.

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(ii) Depletion and amortization

Depletion of petroleum and natural gas properties, equipment under capital leases, and amortization of production equipment is provided using the unit-of-production method based upon estimated proved petroleum and natural gas reserves, as determined by independent engineers. For purposes of the calculation, petroleum and natural gas reserves before royalties are converted to a common unit of measure on the basis of their relative energy content where one barrel of oil or liquids equals six thousand cubic feet of natural gas. In determining its depletion base, the Company includes estimated future capital costs to be incurred in developing proved reserves and excludes the cost of significant unproved properties until it is determined whether proved reserves are attributable to the unproved properties or impairment has occurred. Unproved properties are evaluated separately for impairment based on management's assessment of future drilling or an assessment of current fair values.

(iii) Ceiling test

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. Any recognized impairment is recorded as additional depletion and amortization expense.

(iv) Other assets

Furniture and office equipment are carried at cost and amortized over the estimated useful lives of the assets at a rate varying from 20% to 30% per annum calculated on a declining balance basis. Amortization is charged at half rates in the year of acquisition.

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(d) Asset retirement obligations

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. Any gains or losses on settlement are charged to income in the period of settlement.

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

(e) Stock-based compensation

Compensation costs attributable to all stock options granted are measured at fair value at the date of grant and expensed over the vesting period with a corresponding increase to contributed surplus. Upon the exercise of the stock options, consideration received together with the amount previously recognized in contributed surplus is recorded as an increase to share capital.

The Company has not incorporated an estimated forfeiture rate for stock options that will not vest; rather, the Company accounts for cancellations as they occur.

(f) Joint venture accounting

Substantially all of the Company's exploration, development and production activities are conducted jointly with others and, accordingly, these financial statements reflect only the Company's proportionate interest in such activities.

(g) Income taxes

Income taxes are accounted for using the liability method of income tax allocation. Under the liability method, income tax assets and liabilities are recorded to recognize future income tax inflows and outflows arising from the settlement or recovery of assets and liabilities at their carrying values. Income tax assets are also recognized for the benefits from tax losses and deductions that cannot be identified with particular assets or liabilities, provided those benefits are more likely than not to be realized. Future income tax assets and liabilities are determined based on the substantively enacted tax laws and rates that are anticipated to apply in the period of realization.

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(h) Flow-through shares

The Company records the future income taxes associated with the renunciation of expenditures for income tax purposes on the date the Company files the renouncement forms with the Canada Revenue Agency.

(i) Revenue recognition

Revenues associated with the sale of petroleum and natural gas are recorded when title passes to an external party. Revenues from petroleum and natural gas production from properties from which the Company has an interest with other producers are recognized on the basis of the Company's net working interest.

Processing revenue is recognized at contractual rates as the Company processes third party natural gas volumes in its facilities.

(j) Per share information

Net income per share is calculated based on the weighted average number of common shares outstanding during the year. The diluted weighted average number of shares is adjusted for the dilutive effect of options and convertible debentures. Under the treasury stock method, only "in the money" options and convertible debentures are included in the weighted average diluted number of shares. It is also assumed that any proceeds obtained upon the exercise of options and conversion of debentures plus the unamortized portion of stock-based compensation would be used to purchase common shares at the average price during the year. The weighted average number of shares is then reduced by the number of shares acquired.

5. Convertible debentures payable

On March 31, 2006, the Company closed a private placement financing through the issuance of \$12 million of redeemable, convertible, unsecured debentures ("Convertible Debentures"). The Convertible Debentures bear interest at a rate of 7.5% per annum, payable commencing September 30, 2006 and quarterly thereafter and will mature three years following the closing date (the "Maturity Date"). Finder's fees and commissions previously recorded as deferred financing charges have been netted against convertible debentures payable, as disclosed in note 3(a). Amortization expense of \$68,377 has been recognized for the year ended December 31, 2007 (2006 - \$61,345).

The Convertible Debentures will be convertible into common shares of the Company at the holder's option at any time prior to the Maturity Date at a conversion price equal to \$7.50 per share for a period of two years from the closing date and thereafter at a price of \$8.25 until the Maturity Date. The Company will have the ability to redeem the Convertible Debentures if the closing price of its common shares on the TSX Venture Exchange exceeds \$8.25 for 21 consecutive trading days or in certain circumstances where an offer is made to acquire common shares of the Company.

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A market rate of interest for a non-convertible debt offering, representative of the Company's credit standing would be 8%. Therefore, the Company has received an interest benefit of 0.5% for the holder's conversion right, over the three year life of the debentures. The present value of this conversion benefit of \$160,000 was recorded on the financial statements as the equity portion of convertible debentures. The portion of convertible debentures classified as debt was initially determined to be \$11,840,000. The debt portion of the debentures will accrete up to the face value over the term to maturity. Accretion of \$53,332 has been recognized in interest expense for the year ended December 31, 2007 (2006 - \$40,000).

The overall effective interest rate on convertible debentures is 8.58% (2006 - 8.58%).

6. Property, plant and equipment

	<u>2007</u>		
	Cost	Accumulated Amortization	Net Book Value
Petroleum and natural gas properties	\$ 71,682,502	\$ 22,070,316	\$ 49,612,186
Other assets	177,806	132,901	44,905
Equipment under capital leases	<u>1,302,961</u>	<u>609,389</u>	<u>693,572</u>
	<u>\$ 73,163,269</u>	<u>\$ 22,812,606</u>	<u>\$ 50,350,663</u>
	<u>2006</u>		
	Cost	Accumulated Amortization	Net Book Value
Petroleum and natural gas properties	\$ 56,671,952	\$ 13,023,986	\$ 43,647,966
Other assets	169,767	115,438	54,329
Equipment under capital leases	<u>1,302,961</u>	<u>459,619</u>	<u>843,342</u>
	<u>\$ 58,144,680</u>	<u>\$ 13,599,043</u>	<u>\$ 44,545,637</u>

During the current year, the Company capitalized \$247,591 (2006 - \$278,462) in general and administrative expenses related directly to acquisition, exploration and development activities. As at December 31, 2007, the depletion calculation excluded unproved properties of \$6,489,197 (2006 - \$6,190,038).

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The future prices used in the ceiling test as of December 31, 2007 are:

Year	Oil (CDN \$/Bbl)	Natural Gas (CDN \$/mcf)
2008	\$ 63.21	\$ 6.81
2009	63.83	7.66
2010	67.76	8.02
2011	68.63	8.43
2012	67.46	8.58
2013	67.33	9.04
2014	69.71	9.24
2015	72.13	9.44
2016	74.53	9.59
2017	80.74	9.80

7. Bank indebtedness and credit facility

As at December 31, 2007, the Company has a revolving demand credit facility with a maximum availability of \$20.0 (2006 - \$20.0) million and a \$1.5 (2006 - \$1.5) million general lease line of credit. The interest rate at December 31, 2007 was prime of 6% (2006 - prime of 6%). The effective interest rate for 2007 was 6.15% (2006 - 5.36%). The credit facility is secured by a demand debenture of \$25.0 million plus a floating charge over all the assets of the Company. Under the terms of the credit facility agreement, the Company is required to meet certain financial and other reporting requirements.

The Company had drawn \$6.2 million on the credit facility at December 31, 2007 (2006 - \$NIL).

8. Obligations under capital leases

The Company's obligations for equipment under capital leases mature October 2009 to June 2011 and are secured by the specific leased assets with a net book value of \$693,572 (2006 - \$843,342).

	2007	2006
Obligations under capital leases	\$ 760,175	\$ 967,610
Less: Portion due within one year	<u>220,670</u>	<u>207,756</u>
	<u>\$ 539,505</u>	<u>\$ 759,854</u>

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The future minimum lease repayments under the capital leases are as follows:

2008	\$ 260,880
2009	346,410
2010	161,604
2011	<u>67,336</u>
Total minimum lease payments	836,230
Less: Amount representing interest at rates of 5.5% to 6.4%	<u>76,055</u>
	<u>\$ 760,175</u>

9. Asset retirement obligations

A reconciliation of the asset retirement obligations is provided below:

	2007	2006
Balance, beginning of year	\$ 2,551,724	\$ 1,447,956
Accretion expense	139,480	69,111
Liabilities incurred	340,566	1,094,068
Changes in estimate	(197,052)	-
Liabilities settled	<u>(72,567)</u>	<u>(59,411)</u>
Balance, end of year	<u>\$ 2,762,151</u>	<u>\$ 2,551,724</u>

The total future asset retirement obligation was estimated by management based on the Company's net ownership interest in all wells and facilities, estimated costs to reclaim and abandon said wells and facilities and the estimated timing of such abandonment. The Company has estimated the total undiscounted amount required to settle the abandonment obligations to be \$3,927,093 (2006 - \$3,712,076). These payments are expected to be made over the next 2 to 15 years. The Company used a credit adjusted risk free rate of 6.01% (2006 - 6.04%) and an estimated inflation rate of 1.95% (2006 - 1.60%) to calculate the present value of the asset retirement obligation.

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10. Future income taxes

- (a) Current income tax expense differs from that which would be expected from applying the combined effective Canadian federal and provincial income tax rates of 32.12% (2006 - 34.49%) to income before income taxes as follows:

	2007	2006
Computed expected tax provision	\$ (454,435)	\$ 197,048
Increase (decrease) resulting from:		
Non-deductible Crown payments net of Alberta Royalty Tax Credits	-	169,560
Resource allowance	-	(245,154)
Stock-based compensation	53,274	136,964
Impact of future tax rate reductions	(167,689)	(513,234)
Other	<u>10,413</u>	<u>54,008</u>
	<u>\$ (558,437)</u>	<u>\$ (200,808)</u>

- (b) The significant components of the Company's future income tax liability are as follows:

	2007	2006
Carrying value of property, plant and equipment in excess of tax pools	\$ 5,536,909	\$ 4,693,900
Asset retirement obligations	(795,499)	(765,500)
Share issue costs and financing fees	(84,578)	(145,000)
Attributed Canadian Royalty Income carryforward and other	<u>(20,482)</u>	<u>66,400</u>
	<u>\$ 4,636,350</u>	<u>\$ 3,849,800</u>

11. Share capital

- (a) Authorized

Unlimited voting common shares
Unlimited non-voting preferred shares

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(b) Issued

	2007		2006	
	Number	Stated Value	Number	Stated Value
Common Shares				
Balance, beginning of year	15,259,806	\$ 21,686,393	14,773,306	\$ 17,294,878
Pursuant to a normal course issuer bid	(137,200)	(182,874)	-	-
Exercise of stock options (note 11[d])	25,000	96,861	-	-
Pursuant to flow through share offering (note 11[c])	<u>-</u>	<u>-</u>	<u>486,500</u>	<u>4,500,125</u>
	<u>15,147,606</u>	21,600,380	<u>15,259,806</u>	21,795,003
Less: Share issue costs, net of tax benefits (note 11[c])		(500)		(108,610)
Tax benefits renounced to flow-through shareholders (note 11[c])		<u>(1,349,877)</u>		<u>-</u>
Balance, end of year		<u>\$ 20,250,003</u>		<u>\$ 21,686,393</u>

- (c) On May 9, 2006, the Company closed a private placement financing of 486,500 common shares issued on a flow-through basis at \$9.25 per share for gross proceeds of \$4,500,125. The Company paid finder's fees and related financing charges of \$168,698.
- (d) During the year, 25,000 stock options were exercised for gross cash proceeds of \$74,750. \$22,111 was reallocated from contributed surplus relating to these options.
- (e) On October 16, 2006, the Company commenced a normal course issuer bid under which it can repurchase up to 750,000 of its common shares until October 16, 2007. All common shares purchased by the Company will be returned to treasury and cancelled. Although the Company has the intention to acquire common shares, it is not obliged to make any purchases pursuant to the 2006 issuer bid. For the year ended December 31, 2007, the Company acquired 114,000 (2006 - NIL) common shares at an average price of \$3.60 per share pursuant to the normal course issuer bid dated October 16, 2006. The excess cost of re-acquisition over stated value in the amount of \$258,216 (2006 - \$NIL) has been charged to retained earnings.

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On October 16, 2007, the Company commenced a normal course issuer bid under which it can repurchase up to 750,000 of its common shares until October 16, 2008. All common shares purchased by the Company will be returned to treasury and cancelled. Although the Company has the intention to acquire common shares, it is not obliged to make any purchases pursuant to this 2007 issuer bid. For the year ended December 31, 2007, the Company acquired 23,200 (2006 - NIL) common shares at an average price of \$4.30 per share pursuant to the normal course issuer bid dated October 16, 2007. The excess cost of re-acquisition over stated value in the amount of \$68,738 (2006 - \$NIL) has been charged to retained earnings.

(f) Stock option plan

The Company has one fixed stock 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 1,457,000 have been granted to date. The maximum number of common shares optioned to any one optionee in a twelve month period shall not exceed 5% of the outstanding common shares of the Company at the time of granting or 2% in the case of consultants and employees conducting investor relations activities on behalf of the Company. Options granted under the plan generally have a five-year term and vest as determined by the Board of Directors. The exercise price of each option is determined by the Board of Directors in accordance with applicable stock exchange policies.

A summary of the status of the Company's stock option plan as at December 31, 2006 and 2007, and changes during those years then ended is as follows:

	2007		2006	
	Number of Options	Weighted Average Exercise Price	Number of Options	Weighted Average Exercise Price
Outstanding, beginning of year	1,442,000	\$ 2.51	1,442,000	\$ 2.51
Issued	15,000	4.46	-	-
Exercised	(25,000)	2.99	-	-
Outstanding, end of year	1,432,000	\$ 2.53	1,442,000	\$ 2.51

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

Outstanding			Exercisable		
Range of Exercise Prices	Number of Options	Average Remaining Life (Years)	Weighted Average Exercise Price	Number of Options	Weighted Average Exercise Price
\$ 1.25	610,000	0.66	\$ 1.25	610,000	\$ 1.25
1.75	20,000	1.36	1.75	20,000	1.75
2.20	280,000	1.62	2.20	280,000	2.20
3.00	218,000	2.02	3.00	218,000	3.00
3.75	170,000	2.33	3.75	170,000	3.75
4.46	15,000	4.32	4.46	-	-
7.10	<u>119,000</u>	2.94	7.10	<u>119,000</u>	7.10
	<u>1,432,000</u>	1.49	\$ 2.53	<u>1,417,000</u>	\$ 2.51

The fair value of options granted under the Company's stock-based compensation plan was estimated on the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions:

	2007	2006
Weighted average risk-free interest rate (%) of each option granted	4.07	-
Option life (years)	2.00	-
Weighted average expected volatility (%) of each option granted	62	-
Weighted average fair value of each option granted (\$)	1.63	-
Dividend yield per share	-	-

(g) **Contributed surplus**

The following table reconciles the Company's contributed surplus:

	2007	2006
Balance, beginning of year	\$ 985,181	\$ 588,068
Exercise of stock options	(22,111)	-
Stock-based compensation expense	<u>165,859</u>	<u>397,113</u>
Balance, end of year	<u>\$ 1,128,929</u>	<u>\$ 985,181</u>

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(h) Per share amounts

The weighted average number of shares outstanding for the year ended December 31, 2007 was 15,220,739 (2006 - 15,087,865).

In computing diluted net income per share amounts, NIL (2006 - 851,551) shares were added to the weighted average number of common shares outstanding during the year ended December 31, 2007 for the dilutive effect of stock options, and convertible debentures. For 2007, stock options and convertible debentures were determined to be anti-dilutive and have been excluded from the calculation of diluted net income per share in 2007. For 2006, certain stock options representing 119,000 underlying shares and the convertible debentures were determined to be anti-dilutive and have been excluded from the calculation of diluted net income per share in 2006.

The following reconciles the denominators for the basic and diluted net income per share calculations:

	Net Earnings (Loss) <i>(numerator)</i>	Weighted Average Shares <i>(denominator)</i>	Per Share Amount
<u>2007</u>			
Basic net income (loss) per share	\$ (856,367)	15,220,739	\$ (0.06)
Dilutive securities:			
Options	-	-	
Convertible debentures	-	-	
Diluted net income (loss) per share	<u>\$ (856,367)</u>	<u>15,220,739</u>	<u>\$ (0.06)</u>
	Net Earnings <i>(numerator)</i>	Weighted Average Shares <i>(denominator)</i>	Per Share Amount
<u>2006</u>			
Basic net income per share	\$ 772,128	15,087,865	\$ 0.05
Dilutive securities:			
Options	-	851,551	
Diluted net income per share	<u>\$ 772,128</u>	<u>15,939,416</u>	<u>\$ 0.05</u>

12. Commitments

The Company is committed under a lease on its office premises (excluding expected occupancy costs) for \$36,839 in 2008.

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13. Related party transactions

- (a) Accounting services in the amount of \$77,674 (2006 - \$73,102) were provided by a partnership of which a director of the Company was a partner. Legal services in the amount of \$53,357 (2006 - \$130,083) were provided by a law firm of which a director of the Company was also an associate. Included in accounts payable and accrued liabilities at December 31, 2007 is \$551 (2006 - \$22,348) owing to these related parties.
- (b) Included in interest on convertible debentures payable (note 5) is \$114,750 (2006 - \$72,066) paid to directors, to debenture holders related to directors and to companies controlled by directors. Included in convertible debentures payable at December 31, 2007 are debentures payable to these related parties with a carrying value of \$1,509,686 (2006 - \$1,267,200).

These transactions are measured at the exchange amount which is the amount agreed to by the related parties based on standard commercial terms.

14. Financial instruments

(a) Fair values

The fair values of cash, bank indebtedness and credit facility, accounts receivable, deposits and accounts payable approximate their carrying values due to the relatively short-term maturity of these instruments. The fair values of the convertible debentures payable and obligations under capital leases approximate their carrying values as they bear interest at market rates for similar instruments.

(b) Credit risk

Virtually all of the Company's accounts receivable are with companies in the petroleum and natural gas industry in Canada and are subject to normal industry credit risks. The Company generally extends unsecured credit to these companies and therefore the collection of accounts receivable may be affected by changes in economic or other conditions. Management believes the risk is mitigated by the size and reputation of the companies to which they extend credit. The Company has not experienced any credit loss in the collection of accounts receivable to date.

The Company's maximum credit risk exposure is limited to the carrying value of its accounts receivable.

(c) Interest rate risk

The Company is exposed to interest rate cash flow risk to the extent that bank indebtedness bears interest at floating interest rates.

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The Company is exposed to interest rate price risk to the extent that the debentures payable are at a fixed interest rate.

(d) Commodity price risk

The nature of the Company's operations results in exposure to fluctuations in commodity prices. Management continuously monitors commodity prices and initiates instruments to manage exposure to these risks when it deems necessary.

15. Supplemental cash flow information

(a) Changes in non-cash working capital

	2007	2006
Accounts receivable	\$ 213,246	\$ 1,802,588
Prepaid expenses and deposits	(166,721)	(45,065)
Accounts payable and accrued liabilities	<u>(777,355)</u>	<u>(1,484,080)</u>
	<u>\$ (730,830)</u>	<u>\$ 273,443</u>
Change in non-cash working capital relating to:		
Investing activities	\$ 979,776	\$ (543,884)
Operating activities	<u>(1,710,606)</u>	<u>817,327</u>
	<u>\$ (730,830)</u>	<u>\$ 273,443</u>

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

	2007	2006
Asset retirement liabilities incurred	<u>\$ 143,514</u>	<u>\$ 1,094,068</u>

16. Subsequent events

Pursuant to the Normal Course Issuer Bid dated October 16, 2007, the Company repurchased 64,400 common shares at prices ranging between \$2.85 to \$3.80 per share for gross consideration of \$203,331. This Normal Course Issuer Bid expires October 16, 2008.

Subsequent to year-end, 500,000 stock options were exercised at \$1.25 per share for gross proceeds of \$625,000.