Velo Energy Inc.
Consolidated Financial Statements
December 31, 2008 and 2007

MANAGEMENT'S RESPONSIBILITY

To the Shareholders of Velo Energy Inc.

Management is responsible for the preparation and presentation of the accompanying consolidated financial statements**,** including responsibility for significant accounting judgments and estimates in accordance with Canadian generally accepted accounting principles and ensuring that all information in the annual report is consistent with the statements. This responsibility includes selecting appropriate accounting principles and methods, and making decisions affecting the measurement of transactions in which objective judgment is required.

In discharging its responsibilities for the integrity and fairness of the consolidated financial statements, management designs and maintains the necessary accounting systems and related internal controls to provide reasonable assurance that transactions are authorized, assets are safeguarded and financial records are properly maintained to provide reliable information for the preparation of financial statements.

The Board of Directors and Audit Committee are composed primarily of Directors who are neither management nor employees of the Company. The Board is responsible for overseeing management in the performance of its financial reporting responsibilities, and for approving the financial information included in the annual report. The Audit Committee fulfils these responsibilities by reviewing the financial information prepared by management and discussing relevant matters with management and external auditors. The Committee is also responsible for recommending the appointment of the Company's external auditors.

MacKay LLP, an independent firm of Chartered Accountants, is appointed by the shareholders to audit the consolidated financial statements and report directly to them; their report follows. The external auditors have full and free access to, and meet periodically and separately with, both the Audit Committee and management to discuss their audit findings.

April 10, 2009

"Donald Gee"	"Wan Jung"
Chief Executive Officer	Chief Financial Officer

CHARTERED ACCOUNTANTS
MacKay LLP

1100 – 1177 West Hastings Street
Vancouver, BC V6E 4T5
Tel: (604) 687-4511
Fax: (604) 687-5805
Toll Free: 1-800-351-0426
www.MacKayLLP.ca

mackay.ca

AUDITORS' REPORT

To the Shareholders of Velo Energy Inc.

We have audited the consolidated balance sheets of Velo Energy Inc. as at December 31, 2008 and 2007 and the consolidated statements of operations, comprehensive loss and deficit and cash flows for the years then ended. These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the company as at December 31, 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.

"MacKay LLP"
Chartered Accountants

Vancouver, BC
April 1, 2009

Velo Energy Inc.
Consolidated Balance Sheets
As at December 31

		2008		2007
Assets				
Current				
Cash and cash equivalents	$	**1,350,958**	$	83,258
Receivables		**6,125**		82,745
Prepaid expenses and deposits *(note 6)*		**-**		359,735
	$	**1,357,083**	$	525,738
Liabilities				
Current				
Accounts payable and accrued liabilities	$	**195,436**	$	1,501,091
Indemnity payable *(note 5)*		**2,841**		452,133
Asset retirement obligations *(note 6)*		**-**		140,000
		198,277		2,093,224
Shareholders' Equity				
Share Capital *(note 7(a)*)		**7,462,924**		5,583,466
Contributed Surplus *(note 8)*		**289,094**		240,394
Warrants *(note 7(e))*		**-**		48,700
Deficit		**(6,593,212)**		(7,440,046)
		1,158,806		(1,567,486)
	$	**1,357,083**	$	525,738

See note 1 for going concern
See note 14 for contingent liabilities

See accompanying notes to consolidated financial statements

Approved by the Board:

“Donald Gee”	“Wan Jung”
Director	Director

Velo Energy Inc.
Consolidated Statements Of Operations, Comprehensive Loss and Deficit
Years Ended December 31

		2008		2007
Natural gas revenue	$	**-**	$	37,781
Expenses				
General and administrative *(note 10)*		**113,732**		498,710
Interest and penalties		**-**		180,518
Operations		**-**		140,221
Stock based compensation *(note 7(d))*		**-**		72,724
Impairment of oil & gas properties		**-**		4,924,364
Goodwill impairment		**-**		1,026,400
Loss on disposal of assets		**-**		9,895
Depreciation and accretion		**-**		8,833
		113,732		6,861,665
Other items				
Interest income		**17,657**		22,323
Gain on disposal of subsidiary *(note 3)*		**942,909**		-
		960,566		22,323
Net income (loss) before income tax		**846,834**		(6,801,561)
Future income tax recovery *(note 9)*		**-**		128,313
Net and comprehensive income (loss)		**846,834**		(6,673,248)
Deficit, beginning of year		**(7,440,046)**		(766,798)
Deficit, end of year	$	**(6,593,212)**	$	(7,440,046)
Income (loss) per share (basic and diluted)	$	**0.02**	$	(0.23)
Weighted average number of shares outstanding		**44,836,085**		29,618,344

See note 1 for going concern

See accompanying notes to consolidated financial statements

Velo Energy Inc.
Consolidated Statements Of Cash Flows
Years Ended December 31

		2008		2007
Cash Provided By (Used In)				
Operating Activities				
Net income (loss)	$	**846,834**	$	(6,673,248)
Add non-cash items:				
Stock-based compensation		**-**		72,724
Impairment of oil & gas properties		**-**		4,924,364
Goodwill impairment		**-**		1,026,400
Loss on disposal of assets		**-**		9,895
Gain on disposal of subsidiary		**(942,909)**		-
Future income tax recovery		**-**		(128,313)
Amortization		-		8,833
		(96,075)		(759,345)
Net change in non-cash working capital		**(64,990)**		(245,332)
		(161,065)		(1,004,677)
Financing Activities				
Issuance of common shares		**1,500,000**		-
Share issue costs		**(69,834)**		(13,999)
Net change in non-cash working capital		**-**		141,013
		1,430,166		127,014
Investing Activities				
Additions to property, plant and equipment		**-**		(1,180,289)
Net change in non-cash working capital		**-**		(1,053,703)
Sale of subsidiary		**1**		
Disposal of cash		**(1,402)**		
		(1,401)		(2,233,992)
Increase (decrease) in cash during year		**1,267,700**		(3,111,655)
Cash, beginning of year		**83,258**		3,194,913
Cash, end of year	$	**1,350,958**	$	83,258
Supplemental cash flow information				
Interest paid	$	**-**	$	-
Income taxes paid	$	**-**	$	-
Components of cash and cash equivalents				
Cash on deposit	$	**10,958**	$	83,258
Guaranteed investment certificates	$	**1,340,000**	$	-
	$	**1,350,958**	$	83,258

See note 1 for going concern
See accompanying notes to consolidated financial statements

1. Nature of Operations and Going Concern

Velo Energy Inc. ("Velo" or the "Company") was incorporated on July 8, 2004 and was originally classified as a Capital Pool Corporation as defined in Policy 2.4 of the TSX Venture Exchange Corporate Finance Manual and Policies. Effective May 31, 2006, the Company purchased all of the outstanding shares of Velo Energy Ltd. by the issuance of 3,333,334 common shares of the Company. This was an arm's length transaction and constituted the Company's Qualifying Transaction under the rules of the TSX Venture Exchange. As a result of that transaction the Company was in the business of exploration, development and production of crude oil, natural gas and natural gas liquids in Western Canada. On July 9, 2008, the Company disposed of the subsidiary Velo Energy Ltd. for proceeds of $1 (note 3).

These financial statements have been prepared 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 business for the foreseeable future. The continuing operations of the Company are dependant upon its ability to continue receiving financial support from shareholders and directors, raising adequate financing and generating profitable operations in the future. As at December 31, 2008, the Company had an accumulated deficit of $6,593,212 and working capital of $1,158,806. There are no assurances that the Company will achieve profitable operations. These financial statements do not reflect adjustments in the carrying value of the assets and liabilities, the reported revenue and expenses, and the balance sheet classifications used that would be necessary if the going concern assumption were not appropriate, and that such adjustments could be material.

2. Significant Accounting Policies

These consolidated financial statements have been prepared by the Company in accordance with Canadian generally accepted accounting principles and are summarized below.

Adoption of New Accounting Standards

Effective January 1, 2008, the Company implemented the new CICA Handbook Section 1400 "General standards of financial presentation" to include requirements to assess and disclose the Company's ability to continue as a going concern.

2. Significant Accounting Policies (continued)

Adoption of New Accounting Standards (continued)

Effective January 1, 2008, the Company adopted the new recommendations of the Canadian Institute of Chartered Accountants ("CICA") under Section 3862, *Financial Instruments Disclosures*, Section 3863, *Financial Instrument - Presentation* and Section 1535, *Capital Disclosures*. *Financial Instruments* Section 3862 requires entities to provide disclosures in their financial statements that enable users to evaluate (a) the significance of financial instruments for the entity's financial position and performance; and (b) the nature and extent of risks arising from financial instruments to which the entity is exposed during the period and at the balance sheet date, and how the entity manages those risks. The principles in this section complement the principles for recognizing, measuring and presenting financial assets and financial liabilities in Section 3855, *Financial Instruments - Recognition and Measurement*, Section 3863 and Section 3865,*Hedges*. Section 3863 is to enhance financial statement users' understanding of the significance of financial instruments to an entity's financial position, performance and cash flows. This section establishes standards for presentation of financial instruments and non-financial derivatives. It deals with the classification of financial instruments, from the perspective of the issuer, between liabilities and equity, the classification of related interest, dividends, losses and gains, and the circumstances in which financial assets and financial liabilities are offset.

The adoption of Sections 3862 and 3863 had no impact on the Company's consolidated financial statements. *Capital Disclosures* Section 1535 establishes standards for disclosing information about an entity's capital and how it is managed.

The Company has included the required disclosure in Notes 11 and 12.

Basis of Consolidation

These consolidated financial statements include the accounts of Velo Energy Inc. and Velo Energy Ltd., its wholly-owned subsidiary from the date of acquisition, May 31, 2006 to the date of disposal, July 9, 2008.

Revenue Recognition

The Company recognizes interest income as it is earned and natural gas revenue when it is delivered.

Property, Plant and Equipment

The Company has adopted the Canadian Institute of Chartered Accountants Accounting Guideline 16 on Full Cost Accounting for Oil and Gas Companies. In applying the full cost guideline, all costs relating to the acquisition of, exploration for and development of oil and gas reserves are accumulated in a single Canadian cost centre. Such costs include lease acquisition, lease rentals on undeveloped properties, geological and geophysical, drilling both productive and non-productive wells, production equipment and overhead charges directly related to acquisition, exploration and development activity.

Gains or losses are not recognized upon the disposition of oil and gas properties unless such a disposition would change the depletion rate by 20% or more. Gains and losses are recognized upon the disposition of other assets.

2. Significant Accounting Policies (continued)

Property, Plant and Equipment (continued)

All costs of acquisition, exploration and development of oil and gas reserves, associated tangible plant and equipment costs (net of salvage value), and estimated costs of future development of proven undeveloped reserves are depleted and depreciated by the unit of production method based on estimated gross proven reserves as determined by independent engineers.

Costs of unproved properties and seismic costs on undeveloped land are excluded from oil and gas properties for the purpose of calculating depletion.

The relative volumes of oil and natural gas reserves and production are converted to equivalent barrels of oil based on the relative energy content of each product on a 1 barrel to 6 thousand cubic feet basis.

In applying the full cost guideline, the Company calculates its ceiling test by comparing the carrying value of property, plant and equipment to the sum of the undiscounted cash flows expected to result from the future production of proved reserves and the sale of unproved properties. Cash flows are based on third party quoted forward prices adjusted for transportation and quality. Should the ceiling test result in an excess of carrying value, the Company would then measure the amount of the impairment by comparing the carrying amounts of property, plant and equipment to an amount equal to the estimated net present value of future cash flows from proved plus probable reserves and the sale of unproved properties. A risk free interest rate is used to arrive at the net present value of future cash flows. Any excess is recorded as a permanent impairment.

Other capital assets are recorded at cost and are depreciated on a straight–line basis over their estimated life.

Joint Ventures

The Company conducts exploration, development and production activities jointly with others and, accordingly, these financial statements reflect only the Company's proportionate interest in such activities.

Goodwill

Goodwill is recorded at cost and not amortized. The Company tests for potential impairment of goodwill on an annual basis and, should it be determined that goodwill is impaired, the asset is written down at that time.

2. Significant Accounting Policies (continued)

Asset Retirement Obligations

The Company recognizes the fair value of the liability for an asset retirement obligation in the period in which it is incurred and records a corresponding increase in the carrying value of the related long-lived asset. The fair value is determined through a review of engineering studies, industry guidelines, and management’s estimate on a site by site basis. The liability is subsequently adjusted for the passage of time, and is recognized as an accretion expense in the consolidated statement of operations. The liability is also adjusted due to revisions in either the timing or the amount of the original estimated cash flows associated with the liability. The increase in the carrying value of the asset is amortized using the unit of production method based on estimated gross proven reserves as determined by independent engineers.

Financial instruments

CICA Handbook Section 3251, *Equity*, Section 3855, *Financial Instruments - Recognition and Measurement* and Section 3861, *Financial Instruments - Disclosure and Presentation,* all financial instruments are classified into one of the following five categories: held-for-trading, held-to-maturity investments, loans and receivables, available-for-sale assets or other financial liabilities. All financial instruments, including derivatives, are included on the balance sheet and are measured at fair market value upon inception with the exception of certain related party transactions. Subsequent measurement and recognition of change in the fair value of financial instruments depends on their initial classification. Held-for-trading financial investments are measured at fair value and all gains and losses are included in operations in the period in which they arise. Available-for-sale financial instruments are measured at fair value with revaluation gains and losses included in other comprehensive income until the asset is removed from the balance sheet. Loans and receivables, held to maturity investments and other financial liabilities are measured at amortized cost using the effective interest method. Gains and losses upon inception, de-recognition, impairment write-downs and foreign exchange translation adjustments are recognized immediately. Transaction costs related to financial instruments will be expensed in the period incurred.

The Company has designated its cash and cash equivalents as held-for-trading, which are measured at fair value. Amounts receivable are classified as loans and receivables, which are measured at amortized cost. Accounts payable and accrued liabilities are classified as other financial liabilities, which are measured at amortized cost.

Flow-through Shares

The Company provides certain share subscribers with a flow-through component for tax benefits available on qualifying Canadian exploration, development and related provincial grants. Upon renunciation forms being filed with the appropriate tax authorities, the Company will reduce share capital and record a temporary future income tax liability for the amount of the tax deduction renounced to shareholders. In instances where the Company has sufficient deductible temporary differences available to offset the renounced tax deductions, the realization of the deductible temporary differences will be credited to income in the period of renunciation.

2. Significant Accounting Policies (continued)

Stock-based Compensation

The Company accounts for stock options granted to directors, officers, employees and nonemployees using the fair value method of accounting. Accordingly, the fair value of the options at the date of the grant is determined using the Black-Scholes option pricing model and stock-based compensation is accrued and charged to operations, with an offsetting credit to contributed surplus, on a straight-line basis over the vesting periods. The fair value of stock options granted to non-employees is re-measured at the earlier of each financial reporting or vesting date, and any adjustment is charged or credited to operations upon re-measurement. If and when the stock options are exercised, the applicable amounts of contributed surplus are transferred to share capital. The Company has not incorporated an estimated forfeiture rate for stock options that will not vest; rather the Company accounts for actual forfeitures as they occur.

Future Income Taxes

The Company follows the asset and liability method of accounting for income taxes. Under this method, The Company records future income taxes for the effect of any difference between the accounting and income tax basis of an asset or liability and the benefit of losses carried forward for tax purposes, using the substantively enacted income tax rates. Accumulated future income tax balances are adjusted to reflect changes in income tax rates that are substantively enacted with the adjustment being recognized in earnings in the period that the change occurs. Future tax assets are recognized to the extent that they are more likely than not to be realized.

Loss Per Share

The calculation of basic loss per share is based on the weighted average numbers of shares outstanding.

The treasury stock method of calculating diluted earnings per share is used whereby any proceeds from the exercise of stock options or other dilutive instruments are assumed to be used to purchase common shares at the average market price during the period. The assumed conversion of outstanding common share warrants and options has an anti-dilutive impact in 2008 and 2007.

Use of Estimates

The amounts recorded for amortization and depletion of the petroleum and natural gas properties and for site restoration and reclamation are based on estimates of reserves and future costs. The ceiling test calculation is based on estimates of proven reserves, production rates, oil and gas prices, future costs and other relevant assumptions. By their nature, these estimates, and those related to the future cash flows used to assess impairment, are subject to measurement uncertainty and their impact on the financial statements of future periods could be material.

2. Significant Accounting Policies (continued)

Valuation of equity units issued in private placements

The Company has adopted a residual value method with respect to the measurement of shares and warrants issued as private placement units. The residual value method first allocates value to the more easily measurable component based on fair value and then the residual value, if any, to the less easily measurable component.

The fair value of the common shares issued in the private placements was determined to be the more easily measurable component and were valued at their fair value, as determined by the closing quoted bid price on the announcement date. The balance, if any, was allocated to the attached warrants. Any fair value attributed to the warrants is recorded as contributed surplus.

Accounting Polices to be Adopted

International financial reporting standards ("IFRS")

In 2006, the CICA Accounting Standards Board (AcSB) published a new strategic plan that will significantly affect financial reporting requirements for Canadian companies. The AcSB strategic plan outlines the convergence of Canadian GAAP with IFRS over an expected five year transitional period. In February 2008, the AcSB announced that 2011 is the changeover date for publicly-listed companies to use IFRS, replacing Canada's own GAAP. The date is for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011. The Company's transition date of January 1, 2011 will require the restatement for comparative purposes of amounts reported by the Company for the year ended December 31, 2010. While the Company has begun assessing the adoption of IFRS for 2011, the financial reporting impact of the transition to IFRS cannot be reasonably estimated at this time.

Goodwill and Intangible Assets

The AcSB issued CICA Handbook Section 3064 which replaces Section 3062, Goodwill and Other Intangible Assets, and Section 3450, Research and Development Costs. This new section establishes standards for the recognition, measurement, presentation and disclosure of goodwill subsequent to its initial recognition and of intangible assets. Standards concerning goodwill remain unchanged from the standards included in the previous Section 3062. The section applies to interim and annual financial statements relating to fiscal years beginning on or after October 1, 2008. Management does not expect that the adoption of this new standard will have a material impact on the Company's financial statements.

3. Business Acquisitions and Disposal

On May 31, 2006 the Company acquired all of the shares of Velo Energy Ltd., a private oil and gas company. The acquisition was accounted for by the purchase method and the excess of the purchase price over the net assets acquired was allocated to goodwill.

At December 31, 2007, the Company tested goodwill for impairment and determined that based on the impairment of the oil and gas properties that the goodwill was impaired. As a result a goodwill impairment charge was recorded for $1,026,400.

By agreement dated and effective July 9, 2008, the Company sold the business and all of the assets and liabilities of its wholly-owned subsidiary Velo Energy Ltd. for $1. The gain on disposal was determined as follows:

Cash and cash equivalents	$	1,402
Receivables		45,293
Prepaid expenses and deposits		342,110
Property, plant and equipment		4,939,584
Accumulated amortization and write down of property, plant and equipment		(4,939,584)
		388,805
Accounts payable and accrued liabilities		(1,235,755)
Asset retirement obligations		(133,985)
		(1,369,740)
Net liabilities		980,935
Legal expenses reimbursed by parent in connection with disposal		(38,025)
		942,910
Less: proceeds		(1)
Gain on disposal of subsidiary	**$**	**942,909**

4. Property, Plant and Equipment

	2008		
	Cost	Accumulated Amortization and write down	Net
Oil and gas properties and equipment	$ -	$ -	$ -
Furniture, fixtures and equipment	-	-	-
	$ -	**$ -**	**$ -**

4. Property, Plant and Equipment (continued)

	2007		
	Cost	Accumulated Amortization and write down	Net
Oil and gas properties and equipment	$ 4,915,066	$ 4,915,066	$ -
Furniture, fixtures and equipment	24,518	24,518	-
	$ 4,939,584	**$ 4,939,584**	**$ -**

In 2008 $Nil (2007 - $21,000) of general and administrative expenses were capitalized to property, plant and equipment.

5. Indemnity Payable

The Company issued $1,977,000 of flow through shares in December, 2006. The Company failed to spend the full $1,977,000 on qualifying expenditures as at December 31, 2007, the final day for qualification. As part of the subscription agreement the Company agreed to indemnify the subscribers of the flow through shares in the event of such an occurrence. The shortfall of $990,536 of qualified expenditures resulted in the indemnity payable of $452,133. The highest marginal tax rate of a subscriber's province of residence was used to calculate the payable.

In July, 2008 the Company extinguished $449,292 of the indemnity claims for common shares of the Company. The issue price of the shares was $0.075 per share, resulting in 5,990,554 shares being issued.

6. Asset Retirement Obligations

At December 31, 2007, the Company had recorded $140,000 for future asset retirement obligations of the subsidiary.

The asset retirement obligation was determined using the following assumptions:

- The total amount of undiscounted future cash flows to settle the liability is estimated to be $140,000
- The liability is estimated to be settled within a year.

Deposits are being held by the Energy Utility Board as collateral for these obligations. The deposits and asset retirement obligation were included in the disposal of the subsidiary (note 3).

7. Share Capital

a) Authorized and Issued Common Shares

Authorized

An unlimited number of common voting shares (the “Common Shares”) without nominal or par value and an unlimited number of preferred shares issuable in series.

Issued Share Capital

The issued share capital is as follows:

	Number of Common Shares	Amount
Balance December 31, 2006	29,618,334	$ 6,177,911
Share issuance costs	-	(13,999)
Indemnity on unspent flow through funds	-	(452,133)
Tax effect of flow-through common shares	-	(128,313)
Balance, December 31, 2007	29,618,334	5,583,466
Issued for payment of debt	5,990,554	449,292
Issued for cash	30,000,000	1,500,000
Share issuance costs	-	(69,834)
Balance, December 31, 2008	65,608,888	$ 7,462,924

Issued Shares

In December 2006, the Company issued 9,885,000 flow-through common shares at $.20 per share for gross proceeds of $1,977,000. Under the terms of the flow-through share agreement, the Company was committed to spend 100% of the gross proceeds on qualifying exploration and development expenditures prior to December 31, 2007. As of December 31, 2007, $986,464 (2006 - $610,401) had been spent on qualifying expenditures (note 6). The Company renounced the income tax benefits on the incurred exploration of $986,464 which were equal to $336,582 and this resulted in an increase to the future income tax liability and a reduction of share capital. The indemnity payable has also reduced share capital by an amount of $452,133.

In July 2008, the Company issued 5,990,554 common shares at a deemed price of $0.075 per share as settlement for $449,292 of the indemnity payable.

In August 2008, the Company issued 30,000,000 common shares at $0.05 per share for gross proceeds of $1,500,000.

7. Share Capital (continued)

b) Escrowed Shares

The 4,000,000 common shares issued to the founders (the "Seed Capital Shares") for a total consideration of $500,000 were deposited with a trustee under an escrow agreement. In accordance with TSX Venture Exchange (the "Exchange") Policy 2.4., 10% of the Seed Capital Shares were released from escrow on the issuance of the Final Exchange Bulletin on June 5, 2006 (the "Initial Release") and an additional 15% will be or have been released on each of the dates which are 6 months, 18 months, 24 months, 30 months, and 36 months following the Initial Release. 600,000 common shares remain in escrow with final release on June 1, 2009.

The 3,333,334 common shares issued to purchase Velo Energy Ltd. are Value Escrow Shares. Under the Value Escrow Agreement and Exchange Policy 5.4, 10% of the Value Escrow Shares were released from escrow at the Initial Release and an additional 15% will be or have been released on each of the dates which are 6 months, 18 months, 24 months, 30 months, and 36 months following the Initial Release. 500,000 common shares remain in escrow with final release on June 1, 2009.

All common shares of the Company acquired in the secondary market prior to the completion of a Qualifying Transaction by a control Person, as defined in the policies of the Exchange, are required to be deposited in escrow.

All Common Shares deposited in escrow and to be released subject to the completion of a Qualifying Transaction will be cancelled upon the issuance of a TSX Venture Exchange bulletin delisting the Common Shares of the Company.

c) Incentive Stock Options

The Company has a stock option plan where the number of common shares reserved under the plan shall not exceed 10% of the issued and outstanding common shares and the number reserved for any one individual may not exceed 5% of the issued and outstanding shares.

On February 15, 2007 the Company granted 350,000 incentive stock options to employees and consultants of the Company to purchase common shares at an exercise price of $0.20 per share. These options expire on February 15, 2011 and vest equally at the date of grant, June 15, 2007, October 15, 2007 and February 15, 2008.

On June 1, 2006 the Company granted 1,400,000 incentive stock options to employees, consultants and directors of the Company to purchase common shares at an exercise price of $0.30 per share. These options expire on June 2, 2011 and vest equally at the date of grant, September 30, 2006, January 31, 2007 and May 31, 2007.

In 2004, the Company granted incentive stock options to its directors and officers or to companies controlled by directors and officers of the Company to purchase up to a maximum of 900,000 of the issued and outstanding Common Shares at a price of $0.25 per Common Shares, expiring December 12, 2009. During 2006, 800,000 of these options were exercised for cash.

7. Share Capital (continued)

d) Incentive Stock Options (continued)

Changes in the number of stock options, with their weighted average exercise prices, are summarized below:

	December 31, 2008			December 31, 2007		
	Number of Options		Weighted average exercise price	Number of Options		Weighted average exercise price
Outstanding, beginning of year	1,150,000	$	0.27	1,250,000	$	0.30
Exercised	-		-	-		-
Forfeited	(700,000)		0.29	(450,000)		0.28
Granted	-		-	350,000		0.20
Outstanding, end of the year	**450,000**	**$**	**0.25**	**1,150,000**	**$**	**0.27**
Exercisable	450,000	$	0.25	1,087,500	$	0.27

During the year, stock-based compensation expense was $Nil (2007 - $72,724) with a corresponding credit to contributed surplus. The weighted average fair value of the options granted during 2007 was $0.07 per share. The fair value of the options was estimated using the Black-Scholes option pricing model, using a risk-free interest rate of 4.03%, expected volatility of 86%, expected life of four years and no expected dividends.

e) Warrants

A summary of the status of the Company's warrants as of December 31, 2008 and changes during the year then ended is as follows:

	December 31, 2008			December 31, 2007		
	Number of Warrants		Weighted average exercise price	Number of Warrants		Weighted average exercise price
Balance, beginning of year	798,500	$	0.20	1,548,500	$	0.25
Issued in the year	-		-	-		0.25
Expired in the year	(798,500)		0.20	(750,000)		0.30
Exercised in the year	-		-	-		-
Balance, end of the year	**-**	**$**	**-**	**798,500**	**$**	**0.20**

In December 2006, the Company granted the agents of the flow-through equity offering, warrants to purchase 798,500 common shares at a price of $.20 per common share. The warrants to purchase the 798,500 common shares expired in June 2008.

8. Contributed Surplus

	2008	2007
Balance, beginning of year	$ 240,394	$ 88,920
Stock-based compensation	-	72,724
Expired agent warrants	48,700	78,750
Exercised of stock options	-	-
Balance, end of year	**$ 289,094**	**$ 240,394**

9. Future Income Tax

The tax effects of the temporary differences that give rise to the Corporation's future tax assets and liabilities are as follows at December 31:

	2008	2007
Non-capital losses	$ 124,000	$ 555,000
Capital losses	657,000	-
Undeducted financing costs	43,000	76,000
Accounting value of depreciable assets less than (greater than) tax value	-	1,152,000
Asset retirement obligations	-	43,000
Subtotal	824,000	1,826,000
Valuation allowances	(824,000)	(1,826,000)
Future tax assets (liabilities)	$ -	$ -

The provision for income taxes differs from the statutory income tax rate as follows:

	2008	2007
Provision at statutory rates	$ 263,000	$ (2,312,500)
Non-deductible items		
Goodwill impairment	-	349,000
Stock based compensation	-	24,700
Resource allowance	-	21,900
Sale of subsidiary	(783,000)	-
Indemnity payable	-	(153,700)
Effect of tax rate changes	130,000	176,800
Change in valuation allowance	390,000	1,765,487
Future income tax recovery	**$ -**	**$ (128,313)**

The Corporation has approximately $163,000 (2007 - $244,448) related to deductions for share issue costs in excess of amounts deducted for financial reporting purposes.

The Corporation has approximately $478,000 (2007 - $1,336,697) of non-capital losses, which can be applied against taxable income earned in Canada until 2028. The Company also has capital losses of $5,050,000 which carry forward indefinitely to reduce capital gains.

10. Related Party Transactions

Related party transactions are with directors and a company controlled by a director and officer of the Company. In 2008, $2,000 in management fees was paid to a company controlled by a director of the Company (2007 – $nil). Engineering fees of $nil were also paid to a director of the Company (2007 - $58,000). These transactions were in the normal course of operations and are measured at the exchange amount, being the amount of consideration established and agreed to by the related parties.

11. Financial instruments:

a) Fair values

At December 31, 2008 and 2007, the fair values of all financial instruments approximated their carrying values due to their short-term maturity.

b) Credit risk

The Company's receivables are due from companies operating in the petroleum and natural gas industry. The Company believes there is no unusual exposure as regular credit assessments are performed.

c) Interest rate risk

The Company has cash balances. The Company's current policy is to invest excess cash in redeemable guaranteed investment certificates ("GIC") issued by its banking institutions. The Company periodically monitors the investments it makes and is satisfied with the credit ratings of its banks. As of December 31, 2008, the Company's cash balance included $1,340,000 in redeemable guaranteed investment certificates, bearing interest at 4% per annum, maturing December 4, 2010.

12. Capital Management

The Company's objectives when managing capital are to (i) safeguard the entity's ability to continue as a going concern in order to provide returns for shareholders and benefits for other stakeholders; and (ii) maintain a capital structure that provides financing options to the Company when a financing or a refinancing need arises to ensure access to capital on commercially reasonable terms, without exceeding its debt capacity.

In the management of capital, the Company includes all components of shareholders' equity in the definition of capital.

The Company manages the capital structure by monitoring its operational results against various financial scenarios prepared to reflect the changes in market and economic conditions. In order to maintain or adjust the capital structure, the Company may adjust the amount of dividends paid to shareholders, return capital to shareholders, issue debt to replace existing debt with similar or different characteristics, issue new shares, buy back shares or adjust the amount of cash and cash equivalents. The Company is not subject to any capital requirements imposed by a regulator. There were no changes in the Company's capital management policies during the period.

13. Subsequent event

On April 1, 2009, the TSX Venture Exchange accepted for filing an arm's-length joint venture and participation agreement dated July 4, 2008, between Velo Energy Inc. and a private Company, whereby the Company can earn 50 per cent of the private Company's working interest in each well. The Company will pay 100 per cent of the activation costs, up to a maximum of $1 million.

14. Contingent Liabilities

The President of the Company was dismissed during the second quarter of 2007. He has filed a wrongful dismissal action against the Company's previously wholly owned subsidiary, Velo Energy Ltd., which was sold to a third party during the year (note 3).

As of the end of the current year, there are no claims outstanding involving Velo Energy Inc.