KENARTHA OIL AND GAS COMPANY LIMITED

FINANCIAL STATEMENTS

MARCH 31, 2007 AND 2006

Hilborn Ellis Grant LLP
Chartered Accountants
Toronto, Ontario

Hilborn Ellis Grant LLP
Chartered Accountants

Auditors' Report

To the Shareholders of
Kenartha Oil and Gas Company Limited

We have audited the balance sheets of **Kenartha Oil and Gas Company Limited** as at March 31, 2007 and 2006 and the statements of income, 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 March 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.

Hilborn Ellis Grant LLP

Toronto, Ontario
September 21, 2007

Chartered Accountants
Licensed Public Accountants

KENARTHA OIL AND GAS COMPANY LIMITED

Balance Sheets

March 31	2007 $	2006 $
ASSETS		
Current assets		
Cash and short-term investments	**1,831,451**	1,295,867
Accounts receivable	**19,934**	3,000
Deposits and advances	**28,150**	31,782
Prepaid expenses	**4,050**	3,645
Notes receivable (note 3)	**647,582**	-
	2,531,167	1,334,294
Investments (note 4)	**692,000**	127,760
Equipment (note 5)	**30,733**	43,777
Natural gas properties (note 6)	**1,191,022**	367,605
	4,444,922	1,873,436
LIABILITIES		
Current liabilities		
Accounts payable and accrued liabilities	**128,700**	97,843
Notes payable (note 7)	**-**	178,500
	128,700	276,343
Future income taxes (note 8)	**347,055**	424,944
	475,755	701,287
SHAREHOLDERS' EQUITY		
Capital stock (note 10)	**6,438,344**	3,556,240
Deficit	**(2,469,177)**	(2,384,091)
	3,969,167	1,172,149
	4,444,922	1,873,436

Approved on behalf of the Board:

"Ernest W. Harrison", Director

"E.F. Martinello", Director

Statements of Income

Years ended March 31	2007 $	2006 $
Revenue		
Sales of natural gas	**183,950**	201,313
Interest income	**112,091**	4,726
	296,041	206,039
Expenses		
Amortization	**13,044**	18,704
Director's fees	**135,000**	-
Interest (note 7)	**5,988**	14,612
Management fees (note 9(b))	-	24,288
General and administrative	**50,136**	15,930
Professional fees	**68,500**	11,500
Rent (note 9(b))	**28,184**	14,953
Field supplies and maintenance	**71,818**	45,090
Production royalties (note 9(a))	**46,459**	51,156
	419,129	196,233
Income (loss) before income taxes	**(123,088)**	9,806
Future income tax recovery (note 8)	**(38,002)**	(141,329)
Net income (loss) for year	**(85,086)**	151,135
Basic income (loss) per share	**(0.0090)**	0.0172
Average weighted number of shares outstanding (note 10 (f))	**9,411,828**	8,779,972

Statements of Retained Earnings

Years ended March 31	2007 $	2006 $
Deficit, beginning of year	**(2,384,091)**	(2,535,226)
Net income (loss) for year	**(85,086)**	151,135
Deficit, end of year	**(2,469,177)**	(2,384,091)

KENARTHA OIL AND GAS COMPANY LIMITED

Statements of Cash Flows

Years ended March 31	2007 $	2006 $
Cash flows from operating activities		
Net income (loss) for year	**(85,086)**	151,135
Items not affecting cash		
Amortization	**13,044**	18,704
Future income taxes	**(38,002)**	(141,329)
	(110,044)	28,510
Change in non-cash working capital items		
Decrease (increase) in accounts receivable	**(16,934)**	12,701
Decrease in deposits and advances	**3,632**	26,368
Decrease (increase) in prepaid expenses	**(405)**	1,000
Increase (decrease) in accounts payable and accrued liabilities	**30,857**	(27,645)
Increase (decrease) in future income taxes	**(39,887)**	566,273
	(132,781)	607,207
Cash flows from investing activities		
Increase in notes receivable	**(647,582)**	-
Purchase of investments	**(564,240)**	(127,760)
Increase in natural gas properties	**(1,758,417)**	(367,605)
	(2,970,239)	(495,365)
Cash flows from financing activities		
Increase (decrease) in notes payable	**(178,500)**	38,000
Proceeds on sale of working interest (note 6)	**935,000**	-
Proceeds on issuance of common shares, net (note 10)	**2,882,104**	1,129,240
	3,638,604	1,167,240
Increase in cash and short-term investments	**535,584**	1,279,082
Cash and short-term investments, beginning of year	**1,295,867**	16,785
Cash and short-term investments, end of year	**1,831,451**	1,295,867

Supplementary Disclosure of Cash Flow Information

	2007 $	2006 $
Interest paid	**5,988**	14,612

March 31, 2007 and 2006

1. **Basis of presentation**

These financial statements have been prepared on a going concern basis, which contemplates that the company will be able to realize its assets and discharge its liabilities in the normal course of operations.

The company is in the process of exploring its resource properties and developing new properties. The recovery of the amounts shown for investments, resource properties and the related deferred expenditures is dependent upon the existence of economically recoverable reserves and future profitable production.

The financial statements do not give effect to the adjustments, if any, to assets and liabilities that might be necessary should the company be unable to continue as a going concern and, therefore, be required to realize its assets and discharge its liabilities in other than the normal course of business.

2. **Significant accounting policies**

(a) **Natural gas properties**

The company follows the full cost method of accounting whereby all costs related to the acquisition, exploration and development of petroleum and natural gas reserves are capitalized in a Canadian cost centre and charged against income as discussed below. Such costs include lease acquisition costs, geological and geophysical expenditures, lease rentals on non-productive properties, cost of drilling both productive and non-productive wells, equipment costs and general and administrative expenses applicable to these activities.

Gains or losses on sales of properties are recognized only when crediting the proceeds to costs would result in a change of 20 percent or more in the depletion and amortization rate.

(b) **Flow through shares**

The company has issued flow-through shares to finance its exploration expenditure program. Pursuant to the terms of the flow-through share agreements, the tax deductions associated with the expenditures have been renounced to the subscribers. Accordingly, share capital is reduced and a future income tax liability is recorded equal to the estimated amount of future income taxes payable by the company as a result of the renunciations.

(c) **Per share information**

Per share information is calculated on the basis of the weighted average number of shares outstanding during the period.

2. **Significant accounting policies (continued)**

(d) **Investments**

The company follows the cost method of accounting for its investments, written down for any impairment in value that is considered other than temporary.

(e) **Equipment**

Equipment is recorded at cost. The company provides for amortization using the declining balance method at rates designed to amortize the cost of the equipment over its estimated useful life. The annual amortization rates are as follows:

Equipment	20 %
Pipeline	20 %
Compressor	30 %

(f) **Future income taxes**

Income taxes are calculated using the liability method of tax allocation accounting. Temporary differences arising from the difference between the tax basis of an asset or liability and its carrying value on the balance sheet are used to calculate future income tax liabilities or assets. Future income tax liabilities or assets are calculated using tax rates anticipated to apply in the periods that the temporary differences are expected to reverse. The effect on future tax assets and liabilities of a change in tax rates is recognized in income in the period that substantive enactment occurs. To the extent that the company does not consider it to be more likely than not that a future tax asset will be recovered, it provides a valuation allowance against the excess.

(g) **Financial instruments**

The carrying amount of the company's financial instruments, consisting of cash and short-term investments, accounts receivable, deposits and advances, investments, accounts payable and accrued liabilities and notes payable, approximate their fair value unless otherwise noted.

It is management's opinion that, unless otherwise noted, the company is not exposed to significant interest rate, currency or credit risks arising from these financial instruments.

(h) **Management estimates**

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

March 31, 2007 and 2006

2. **Significant accounting policies (continued)**

(i) **Revenue recognition**

Sales of natural gas are recognized as revenue daily when gas is delivered to customer. Interest income is recognized on a pro-rata basis to maturity.

3. **Notes receivable**

	2007 $	2006 $
Geotechnical Business Solutions Inc.	500,329	-
Eran Holdings Limited	147,253	-
	647,582	-

The amount due from Geotechnical Business Solutions Inc. is due on demand, for a period not to exceed 60 days, bearing interest at a rate of 6% compounded monthly. The note has been repaid in full, with interest, subsequent to the year end.

The amount due from Eran Holdings Limited, a minority shareholder, is due on demand, for a period not to exceed three months, bearing interest at a rate of 6% compounded monthly. The note is secured by an assignment of subscribed warrants. The note has been repaid in full, with interest, subsequent to the year end.

4. **Investments**

	2007 $	2006 $
4,000,000 flow-through common shares (2006 - 2,000,000)	600,000	127,760
Advances, non-interest bearing, due on demand	92,000	-
	692,000	127,760

The company's investment in flow-through common shares of Millstream Mines Ltd. is recorded at cost. The company holds 2,000,000 warrants expiring November 14, 2007 to purchase an additional 2,000,000 common shares at $0.10 per share and 2,000,000 warrants, expiring December 31, 2008, to purchase an additional 2,000,000 common shares, at $0.25 per share.

The advances have been repaid subsequent to year end.

Millstream Mines Ltd. and Kenartha Oil and Gas Company Limited have common officers and some common board members.

Millstream Mines Ltd. is a public company reporting under the TSX Venture Exchange and its

4. **Investments (continued)**

principal objective is to enhance and develop known mineral properties to production potential.

As a flow-through share investment, the tax cost of the shares is $nil. The fair value of the investment is impracticable to determine as the value is subject to the future financing and development results of the Millstream properties and is also affected by the liquidity and share price for a large block of shares.

5. **Equipment**

	Cost $	Accumulated Amortization $	2007 Net $	2006 Net $
Equipment	4,807	4,789	18	22
Pipeline	76,045	75,103	942	1,182
Compressor	195,445	165,672	29,773	42,573
	276,297	245,564	30,733	43,777

March 31, 2007 and 2006

6. **Natural gas properties**

The company entered into an agreement with Norfolk Oil & Gas Limited (NOG1) to earn a 49% working interest in certain gas wells to be drilled. To obtain the working interest the company was required to finance the drilling costs of each individual well. The number of wells in which the company acquired an interest was dependent on the amount of financing raised by the company. Net profits from the wells are to be first allocated to repay the costs of drilling the wells (to both the company and to its warrant holders as described below) and then to the respective working interests. The company is evaluating and preparing the wells for production.

To finance the company's participation in the project described above, the company issued a private placement offering memorandum dated March 17, 2005, which offered 400 units in the share capital of the company at $5,000 per unit; each unit consisting of 1,000 flow through common shares to be issued from the treasury of the company and one full warrant. The offering was fully subscribed for in fiscal 2006. The company renounced its claim for Canadian Exploration Expenses to the holders of the flow- through common shares effective December 31, 2005.

The warrants exercisable at $2,500 each provide the holders, on exercise, the right to repayment of their initial $5,000 investment from net profits of the project and, thereafter, to retain a pro-rata net profit interest royalty of up to 24% in each of the drilled wells that are purchased by capital raised under the offering memorandum. 374 (2006 - nil) warrants were exercised during the current fiscal year for cash consideration of $935,000 resulting in the company's working interest being reduced to 26.56% for this project. The company has credited the proceeds on disposal of its working interest against the capitalized costs of the project until completion of the development stage of the project.

The fair value of the properties under development cannot be ascertained at this time due to the early stage of progress of the project.

7. **Notes payable**

	2007 **$**	**2006** **$**
Due on demand, bearing interest at the Bank of Nova Scotia's prime lending rate, compounded monthly	-	120,500
Due on demand, bearing interest at 6 per cent, compounded monthly	-	58,000
	-	178,500

The notes payable are due to a related corporation as described in note 9(a). During the year the company paid interest of $5,988 (2006 - $14,612).

8. **Income taxes**

a) The significant components of the future income tax liability are as follows:

	2007 $	2006 $
Future income tax liability		
Temporary differences on renunciation of qualified exploration and development costs	722,400	722,400
Temporary difference on deferred proceeds on disposal of working interest	(337,722)	-
Share issuance costs	(140,035)	(67,110)
Temporary differences due to equipment and resource deductions previously unrecognized	(114,308)	(189,922)
Non-capital loss carry-forwards previously unrecognized	-	(40,424)
Temporary difference on investment in flow-through shares	216,720	-
	347,055	424,944

b) Income taxes expense differs from that which would be expected from applying the combined Canadian federal and provincial income tax rate of 36.12% (2006 - 36.12%) to the income (loss) for before income taxes. The difference results from the following:

	2007 $	2006 $
Income (loss) for the year before income taxes	(123,088)	9,806
Tax on accounting income (loss)	(44,459)	3,542
Tax effect of the following:		
Recognition of non-capital loss carry-forwards previously unrecognized	-	(40,424)
Recognition of prior year temporary differences on equipment and resource deductions previously unrecognized	-	(131,124)
Other	6,457	26,677
Provision for income taxes	(38,002)	(141,329)

March 31, 2007 and 2006

8. **Income taxes (continued)**

The company has approximately $442,000 (2006 - $518,000) in amounts that have been deducted for accounting purposes that have not, as yet, been deducted for income tax purposes, relating to its equipment and resource deductions. The future income tax benefit of the available tax deductions are recognized in the accounts.

The company has net capital losses of $250,607, which can be carried forward indefinitely to be applied against future taxable capital gains.

9. **Related party transactions**

(a) Production royalty expense includes $21,587 (2006 - $25,152) charged by a corporation for which a director of the company is an officer. The corporation has been assigned a 12½% royalty on natural gas sales as an inducement with respect to financial assistance the corporation provided to Kenartha Oil and Gas Company Limited as detailed in note 7.

(b) A corporation, which is a member of the controlling group, provides management services to the company and makes certain payments on its behalf. Management fees and rent expenses of $28,184 (2006 - $24,288) have been charged in this respect. Included in accounts payable are amounts due to the corporation totaling $nil (2006 - $26,809). This corporation also charged the company $116,369 (2006 - $47,715) for services provided in connection with the funding and administration of the Norfolk project that have been capitalized under natural gas properties.

10. **Capital stock**

a) Authorized

2,000,000 voting, redeemable (at 1/10th of 1 cent each) non-participating preference shares
Unlimited common shares

b) Issued

	2007		2006	
	Issued	**Amount $**	**Issued**	**Amount $**
Common shares				
Balance, beginning of year	8,295,790	3,555,740	7,895,790	2,426,500
Flow-through shares issued (note 10(d))	-	-	400,000	2,000,000
Shares issued	1,961,197	3,080,407	-	-
Reduction due to income tax deductions renounced to subscribers (note 10(d))	-	-	-	(722,400)
Share issuance costs (net of income taxes of $112,127 (2006 - $83,888))	-	(198,303)	-	(148,360)
Balance, end of year	10,256,987	6,437,844	8,295,790	3,555,740
Preference shares				
	500,000	500	500,000	500
	10,756,987	6,438,344	8,795,790	3,556,240

c) Common shares

On November 24, 2006, the company completed a private placement of 1,000,000 common shares at an issue price of $1.50 U.S.

On January 29, 2007, the company offered a private placement of 1,000,000 common shares at an issue price of $1.25 U.S. 761,197 shares were taken up under this placement.

On February 23, 2007 the company issued 200,000 common shares in return for services provided in the amount of $310,430.

On March 5, 2007, the company offered a private placement of 2,000,000 common shares at an issue price of $1.00 U.S. No shares were taken up under this placement.

10. **Capital stock (continued)**

d) Flow-through shares

In 2006 the company issued through a private placement offering, as described in note 6, 400,000 flow-through common shares at a price of $5.00 per share. Income tax exploration deductions in the amount of $2,000,000 were renounced to subscribers effective December 31, 2005.

The company through a private placement offering, as described in note 11(d), is intending to issue 400,000 flow-through common shares at a price of $5.50 per share. The offering, either partial or full, will be completed on or before December 31, 2007.

e) Stock option plan

The company has a designated stock option plan ("DSOP") permitting the granting of options to officers, employees and consultants. The limit for the DSOP is 10% of the issued common shares and, for a single participant, 5% of the issued common shares. During the year, 825,000 common share stock options were issued to directors at the price of $3.75 per share. No options have been exercised as at March 31, 2007. Subsequent to the year end the company revised the exercise price to $0.80 per share to reflect current market conditions. No options have been exercised to date.

f) Stock dividend

In January 2007, the company effected a one-for-ten stock split in the form of a special dividend to shareholders of record on April 30, 2007. The dividend is 1 common share for every 10 common shares of the company owned as at the record date. The weighted average number of shares outstanding has been adjusted retroactively to reflect the stock dividend.

11. **Commitments and contingencies**

a) In common with other corporations in the gas industry, the company self-insures for any costs related to environmental matters. No events have occurred which might give rise to liability for site cleanup costs and no estimate can be made of future costs, if any, related to environmental matters.

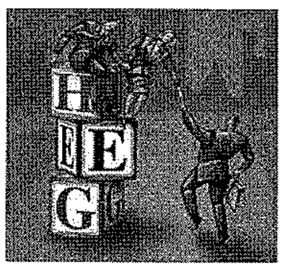
b) The company has asset retirement obligations associated with long-lived assets, which include abandonment of natural gas, related facilities, compressors, and removal of equipment from leased acreage and returning such land to its original condition. Management has determined that the deposits held by government authorities are sufficient to cover such costs at this time.

c) Deposits in the amount of $11,150 (2006 - $11,150) are held by the Ontario Ministry of Natural Resources for the company's three operating gas well leases. Under current legislation, an increase in deposits, to a maximum of $22,000, will be phased in over the next several years.

d) The company has entered into a second agreement with Norfolk Oil & Gas Limited (NOG2) to earn a 49% working interest in 15 gas wells to be drilled. To obtain the working interest the company is required to finance the drilling costs of each individual well. The number of wells in which the company acquires an interest is dependent on the amount of financing raised by the company.

To finance the company's participation in the project , the company issued a private placement offering memorandum dated January 2, 2007, which offered 400 units in the share capital of the company at $5,500 per unit; each unit consisting of 1,000 flow through common shares to be issued from the treasury of the company and one full warrant. The offering has not been fully subscribed as at March 31, 2007. The company will renounce its claim for Canadian Exploration Expenses to the holders of the flow-through common shares effective December 31, 2007.

The warrants are exercisable at $2,500 each and provide the holders, on exercise, the right to repayment of $5,005 of their initial investment from net profits of the project, and thereafter to retain a pro-rata net profit interest royalty of up to 24% in each of the drilled wells that are purchased by capital raised under the offering memorandum. The company's net profit interest will accordingly be reduced from 49% pro-rata on the exercise of the warrants. No warrants have been exercised for this project to the date of the Auditors' Report.



We give your business a hand to succeed.

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Since 1930

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