

Consolidated Financial Statements  
(Expressed in United States dollars)

**BUCKING HORSE ENERGY INC.**

Years ended August 31, 2008 and 2007



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## AUDITORS' REPORT TO THE SHAREHOLDERS

We have audited the consolidated balance sheet of Bucking Horse Energy Inc. as at August 31, 2008 and the consolidated statements of operations and deficit, comprehensive loss, accumulated other comprehensive income (loss) and cash flows for the year 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 audit.

We conducted our audit 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 August 31, 2008 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

The consolidated financial statements as at and for the year ended August 31, 2007, prior to adjustment for the change in the Company's reporting currency as described in note 2 to the consolidated financial statements, were audited by another firm of chartered accountants who expressed an opinion without reservation on those statements in their audit report dated November 23, 2007. We have audited the adjustments to the 2007 financial statements as described in note 2 to the financial statements and in our opinion, such adjustments, in all material respects, are appropriate and have been properly applied.

*KPMG LLP*

Chartered Accountants

Vancouver, Canada

November 28, 2008

# BUCKING HORSE ENERGY INC.

Consolidated Balance Sheets  
(Expressed in United States dollars)

August 31, 2008 and 2007

	2008	2007
		(Restated - note 2)
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 5,391,123	\$ 733,265
Accounts receivable	2,388,437	140,367
Promissory note (note 4)	4,090,058	-
Prepaid expenses (note 13)	37,813	11,156
Benefit under derivative instruments (note 5(b))	2,927,776	-
Income tax receivable	1,294,877	-
	16,130,084	884,788
Investments (note 6)	244,103	-
Oil and natural gas properties (note 7)	160,578,150	2,447,059
Long-term prepaids (note 13)	300,000	-
	\$ 177,252,337	\$ 3,331,847
<b>Liabilities and Shareholders' Equity</b>		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 1,729,609	\$ 17,039
Non-current liabilities:		
Bank indebtedness (note 8)	13,500,000	-
Loan payable (notes 4 and 13)	-	1,419,917
State resource taxes payable	903,831	-
Convertible debentures (note 9)	23,273,493	-
Asset retirement obligations (note 10)	44,066	8,280
Future income taxes (note 14)	54,374,732	-
	92,096,122	1,428,197
Shareholders' equity:		
Share capital (note 12)	61,708,718	2,136,701
Equity portion of debentures payable (note 9)	25,329,139	-
Accumulated other comprehensive income (loss)	(3,203,146)	96,082
Deficit	(408,105)	(346,172)
	83,426,606	1,886,611
Contingency (note 16)		
Subsequent events (notes 5(b), 12(a) 12(b) and 18)		
	\$ 177,252,337	\$ 3,331,847

See accompanying notes to consolidated financial statements.

Approved on behalf of the Board:

"Gordon Nielsen" Director

"Michael Schoen" Director

# BUCKING HORSE ENERGY INC.

Consolidated Statements of Operations and Deficit  
(Expressed in United States dollars)

Years ended August 31, 2008 and 2007

	2008	2007
		(Restated - note 2)
Revenue:		
Oil and natural gas revenue	\$ 15,693,354	\$ 738,830
Direct expenses:		
Depletion, depreciation and accretion	4,248,956	378,938
State resource taxes	1,651,499	-
Royalties	106,450	196,412
Operating expenses	2,845,718	131,984
	8,852,623	707,334
	6,840,731	31,496
Other expenses (income):		
Interest and other	(388,520)	(21,821)
Interest expense	3,648,260	162,109
Financing fees	325,000	-
Accretion expense (note 9)	929,215	-
General and administrative	901,529	69,402
Professional fees	685,870	148,962
Foreign exchange loss	173,751	-
Net gain on derivative instruments (note 5(b))	(2,839,736)	-
Loss on investments (note 6)	474,265	-
	3,909,634	358,652
Earnings (loss) before income taxes	2,931,097	(327,156)
Income tax expense (note 14):		
Current	1,150,315	-
Future	1,625,957	-
	2,776,272	-
Net earnings (loss) for the year	154,825	(327,156)
Deficit, beginning of year	(346,172)	(19,016)
Excess on cancellation of issued common shares (note 12(a))	(216,758)	-
Deficit, end of year	\$ (408,105)	\$ (346,172)
Basic and diluted net earnings (loss) per common share (note 11)	\$ 0.01	\$ (0.04)
Weighted average number of shares outstanding	15,567,746	8,021,712

See accompanying notes to consolidated financial statements.

# BUCKING HORSE ENERGY INC.

Consolidated Statements of Comprehensive Loss  
(Expressed in United States dollars)

Years ended August 31, 2008 and 2007

	2008	2007 (Restated - note 2)
Net earnings (loss) for the year	\$ 154,825	\$ (327,156)
Unrealized loss on available for sale investments, net of tax of \$65,277	(355,867)	-
Realized loss on available for sale investments, net of tax of \$65,277	355,867	-
Unrealized gains and losses on translating financial statements into reporting currency	(3,299,228)	96,082
Comprehensive loss for the year	\$ (3,144,403)	\$ (231,074)

Consolidated Statements of Accumulated Other Comprehensive Income (Loss)  
(Expressed in United States dollars)

Years ended August 31, 2008 and 2007

	2008	2007 (Restated - note 2)
Accumulated other comprehensive income (loss), beginning of year:		
Opening unrealized gains and losses on translating financial statements into reporting currency	\$ 96,082	\$ -
Unrealized gains and losses on translating financial statements into reporting currency	(3,299,228)	96,082
	(3,203,146)	96,082
Unrealized loss on available for sale investments, net of tax of \$65,277	(355,867)	-
Realized loss on available for sale investments, net of tax of \$65,277	355,867	-
	-	-
Accumulated other comprehensive income (loss), end of year	\$ (3,203,146)	\$ 96,082

See accompanying notes to consolidated financial statements.

# BUCKING HORSE ENERGY INC.

Consolidated Statements of Cash Flows  
(Expressed in United States dollars)

Year ended August 31, 2008 and 2007

	2008	2007
		(Restated - note 2)
Cash and cash equivalent provided by (used in):		
Operations:		
Net earnings (loss) for the year	\$ 154,825	\$ (327,156)
Items not involving cash:		
Depletion, depreciation and accretion	4,248,956	378,938
Accretion expense	929,215	-
Future income taxes	1,625,957	-
Loss on investments (note 6)	474,265	-
Unrealized gain on derivative instruments (note 5(b))	(2,927,776)	-
Unrealized foreign exchange gain	(274,799)	-
Non-cash interest income	(289,853)	-
Changes in non-cash operating working capital:		
Accounts receivable	853,778	(119,355)
Prepaid expenses	(334,433)	(8,283)
Income taxes receivable	103,917	-
Accounts payable and accrued liabilities	(3,840,417)	(6,398)
State resource taxes payable	925,162	-
	1,648,797	(82,254)
Investments:		
Acquisition of Gemini Energy Corp. (note 4)	(19,172,431)	-
Oil and gas property expenditures	(1,501,379)	(1,443,513)
Accounts payable related to oil and gas expenditures	-	(1,245,707)
Proceeds on sale of investments (note 6)	397,659	-
Acquisition of investments	(235,272)	-
	(20,511,423)	(2,689,220)
Financing:		
Bank indebtedness	13,500,000	-
Issuance of convertible debenture (note 4)	1,707,307	-
Shares purchased for return to treasury (note 12(a))	(339,140)	-
Issuance of common shares (note 12(a))	8,094,709	527,732
Loan payable	-	1,338,091
	22,962,876	1,865,823
Effect of foreign currency translation on cash and cash equivalents	557,608	18,405
Increase (decrease) in cash and cash equivalents	4,657,858	(887,246)
Cash and cash equivalents, beginning of year	733,265	1,620,511
Cash and cash equivalents, end of year	\$ 5,391,123	\$ 733,265

Supplementary information (note 15)

See accompanying notes to consolidated financial statements.

# BUCKING HORSE ENERGY INC.

Notes to Consolidated Financial Statements  
(Expressed in United States dollars, unless otherwise noted)

Years ended August 31, 2008 and 2007

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## 1. Nature of operations:

NRG Investments Inc. was incorporated under the laws of British Columbia, Canada on April 28, 2006. Effective March 4, 2008 the Company changed its name to Bucking Horse Energy Inc. (the Company or Bucking Horse) and acquired two additional wholly-owned subsidiaries, Gemini Energy Corp. (Gemini) and its subsidiary, Arrowhead Resources (U.S.A.) Ltd. (Arrowhead), through the purchase of 100% of the issued and outstanding shares of Gemini (note 4).

The Company's principal business activity is the exploration, development and production of petroleum and natural gas reserves located in Canada and the United States of America.

## 2. Change in reporting currency:

Effective March 4, 2008, the Company changed its reporting currency to the US dollar (USD). This change in reporting currency has been adopted due to the Company's primary focus on acquisition, exploration, development and production of natural gas and oil interests in the United States. The majority of the Company's oil and natural gas property assets are in the United States. Prior to March 4, 2008, the Company reported its annual and quarterly consolidated financial statements in Canadian dollars (CAD). In making this change in reporting currency, the Company followed the recommendations of the Emerging Issues Committee (EIC) of the Canadian Institute of Chartered Accountants (CICA), set out in EIC-130, *Translation Method when the Reporting Currency Differs from the Measurement Currency or there is a Change in the Reporting Currency*.

In accordance with EIC-130, the financial statements for all years presented have been translated into the new reporting currency using the current rate method. Under this method, the statements of operations and cash flow statement items for each year have been translated into the reporting currency using the average exchange rates prevailing during each reporting period. All assets and liabilities have been translated using the exchange rate prevailing at the balance sheet date. All resulting foreign exchange differences arising from the translation are included as a separate component of other comprehensive income. All comparative financial information has been restated to reflect the Company's results as if they had been historically reported in US dollars.

## 3. Significant accounting policies:

### (a) Basis of consolidation:

The consolidated financial statements of the Company have been prepared in accordance with Canadian generally accepted accounting principles. The consolidated financial statements of the Company include its wholly-owned subsidiaries NRG Holdings Corp., incorporated in the State of Nevada, N Holdings Inc., incorporated in the State of Washington and Gemini, incorporated in the Province of British Columbia and its wholly-owned subsidiary, Arrowhead, incorporated in the State of South Dakota. All inter-company transactions and balances have been eliminated upon consolidation.

# BUCKING HORSE ENERGY INC.

Notes to Consolidated Financial Statements  
(Expressed in United States dollars, unless otherwise noted)

Years ended August 31, 2008 and 2007

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### 3. Significant accounting policies (continued):

(b) Adoption of new accounting standards:

(i) Accounting changes:

Effective September 1, 2007, the Company adopted the revised CICA Section 1506, *Accounting Changes*, which require that: (a) a voluntary change in accounting principles can be made if, and only if, the changes result in more reliable and relevant information, (b) changes in accounting policies are accompanied with disclosure of prior period amounts and justification for the change, and (c) for changes in estimates, the nature and amount of the change should be disclosed. The Company has made one voluntary change in accounting principles since the adoption of the revised standard for a change in reporting currency (see note 2).

(ii) Financial instruments:

Effective September 1, 2007, the Company adopted new Canadian Institute of Chartered Accountants (CICA) Handbook Sections 3855 *Financial Instruments - Recognition and Measurement*, CICA 3861 *Financial Instruments - Disclosure and Presentation*, CICA 3865 *Hedges*, CICA 1530 *Comprehensive Income*, CICA 3051 *Investments* and CICA 3251 *Equity*. The new handbook sections establish standards governing the recognition and measurement of financial instruments, when and how hedge accounting may be applied, and the reporting and presentation of comprehensive income, which is defined as the change in equity from transactions and other events from non-owner sources.

Under these new standards, all financial instruments are recorded on the consolidated balance sheet.

Financial assets and liabilities classified as held-for-trading are measured at fair value with realized and unrealized gains and losses recognized in net earnings. Financial assets classified as held-to-maturity, loans and receivables, and financial liabilities other than those classified as held-for-trading, are measured at amortized cost. Financial assets classified as available for sale are measured at fair value with unrealized gains or losses recognized in accumulated other comprehensive income until the asset is sold and the gain or loss realized. The purchase and sale of a financial asset, where the contract requires the asset to be delivered within an established time frame, are recognized on a trade-date basis. Generally, all derivatives, including embedded derivatives that must be accounted for separately from their host contract, generally must be classified as held-for-trading and recorded at fair value in the consolidated balance sheet. Transaction costs for financial instruments classified as other than held-for-trading are expensed as incurred.

# BUCKING HORSE ENERGY INC.

Notes to Consolidated Financial Statements  
(Expressed in United States dollars, unless otherwise noted)

Years ended August 31, 2008 and 2007

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### 3. Significant accounting policies (continued):

(b) Adoption of new accounting standards (continued):

(ii) Financial instruments (continued):

Upon adoption of these new standards, the Company classified its financial instruments into categories as follows:

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Cash and cash equivalents	held for trading
Accounts receivable	loans and receivables
Promissory note	loans and receivables
Benefit under derivative financial instrument	held for trading
Investment in shares of a related entity	available for sale
Investment in warrants of a related entity	held for trading
Accounts payable and accrued expenses	other financial liabilities
Amounts payable to related parties	other financial liabilities
Convertible debentures	other financial liabilities
Bank indebtedness	other financial liabilities
Embedded derivatives	held for trading

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Adoption of these new standards has not resulted in any significant changes to the Company's consolidated financial statements.

(iii) Embedded derivatives:

The Company has identified no embedded derivatives other than the conversion option in the convertible debentures (note 9) to be separately accounted for at August 31, 2008.

(iv) Derivative financial instruments:

The Company utilizes derivative financial instruments to manage interest rate and price risk. Derivative financial instruments are measured at fair value with gains and losses recorded in net earnings (loss) for the year.

(c) Cash and cash equivalents:

Cash and cash equivalents are classified as held-for-trading and include short-term money market instruments with terms of maturity, at the date of acquisition, not exceeding ninety days, that are readily convertible to known amounts of cash, and which are subject to an insignificant risk of change in value.

# BUCKING HORSE ENERGY INC.

Notes to Consolidated Financial Statements  
(Expressed in United States dollars, unless otherwise noted)

Years ended August 31, 2008 and 2007

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### 3. Significant accounting policies (continued):

#### (d) Investments:

Investments include investments in shares and warrants of companies as described in note 6. The Company's investment in shares of a related entity is classified as available-for-sale and is measured at cost, as the related entity is privately held and no active market for the entity's shares exists. The Company's investment in warrants of a related entity is classified as held-for-trading and is measured at fair value with gains and losses recorded through the statement of operations. Refer to note 3(b)(ii) for the effect of adoption of financial instruments on September 1, 2007.

The carrying values of the investments are regularly reviewed for possible other than temporary impairment. When there is a loss in value that is other than a temporary decline, the investment is written down to recognize the loss with the writedown recorded as a charge to income.

#### (e) Oil and natural gas properties:

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

The capitalized costs, together with the costs of production equipment, are depleted and depreciated on the unit-of-production method based on the estimated gross proven reserves as determined by external experts. Oil and natural gas reserves and production are converted into equivalent barrels of oil based upon the estimated relative energy content.

Costs of acquiring and evaluating unproven properties are initially excluded from the costs subject to depletion and depreciation. These unproven properties are assessed periodically to ascertain whether or not proved reserves are attributable to the properties or impairment has occurred. When proved reserves are attributed to the unproven properties or the property is considered to be impaired, the cost of the property or the amount of the impairment is added to the costs subject to depletion and depreciation.

The Company evaluates the carrying amounts for impairment annually. The carrying value is not considered to be impaired when the sum of the undiscounted net cash flows expected from the production of proved reserves, less any impairment, of unproved properties and related major development projects exceeds the carrying amount of the cost centre (the "ceiling test"). When the carrying amount is not determined to be recoverable, an impairment loss is recognized to the extent that the carrying amount of the cost centre exceeds the sum of the discounted net cash flows expected from the production of proved and probable reserves, the cost, less any impairment of unproven properties and related major development projects. The cash flows are estimated using expected future product prices and costs based on best information available and are discounted an interest rate of 10%.

Proceeds from the sale of oil and natural gas properties are applied against capitalized costs, with no gain or loss recognized, unless such a sale would significantly alter the rate of depletion and depreciation.

# BUCKING HORSE ENERGY INC.

Notes to Consolidated Financial Statements  
(Expressed in United States dollars, unless otherwise noted)

Years ended August 31, 2008 and 2007

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### 3. Significant accounting policies (continued):

(e) Oil and natural gas properties (continued):

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

(f) Asset retirement obligations:

The Company uses the fair value method of recording the obligation associated with closure, reclamation and restoration of oil and natural gas properties and other asset retirement costs. The fair value of the liability for the Company's asset retirement obligation is recorded in the period in which it is incurred, discounted to its present value using the Company's credit-adjusted, risk-free interest rate and the corresponding amount is capitalized to the carrying amount of the related oil and natural gas properties. The liability amount is increased each reporting period due to the passage of time and the amount of this accretion is charged to earnings in the period. Revisions to the estimated timing of cash flows or to the original estimated undiscounted cost could also result in an increase or decrease to the obligation. Actual costs incurred upon settlement of the retirement obligation are charged against the obligation to the extent of the liability recorded.

(g) Revenue recognition:

Revenues from oil and natural gas operations are recognized when persuasive evidence of a sales agreement exists, the title and risk is transferred to the customer, collection is reasonably assured, and the price is reasonably determinable.

(h) Foreign currency translation:

The Company's functional currency is Canadian dollars and its reporting currency is U.S. dollars. Accordingly, the consolidated financial statements are translated into U.S. dollars using the current rate method.

The Company's investments in NRG Holdings Corp. and N Holdings Inc. are accounted for as integrated foreign operations and accordingly are translated into Canadian dollars using the temporal method. Under this method, monetary items denominated in foreign currencies are translated to Canadian dollars at the exchange rate in effect at the balance sheet date and non-monetary items are translated at the month end rate of exchange in effect when the assets were acquired or obligations incurred. Revenue and expense items are translated at the average exchange rate for the year. Foreign exchange gains and losses are included in net earnings (loss) for the year.

Arrowhead is accounted for as a self sustaining foreign operation and accordingly is translated into Canadian dollars in accordance with the current rate method. Assets and liabilities are translated at the exchange rates prevailing at the balance sheet dates, and revenue and expenses are translated on the basis of average exchange rates during the periods. Any recognized and unrecognized gains or losses arising from the translation of these accounts are recorded in accumulated other comprehensive income (loss). An applicable portion of gains and losses is transferred to net earnings when there is a reduction of the net investment.

# BUCKING HORSE ENERGY INC.

Notes to Consolidated Financial Statements  
(Expressed in United States dollars, unless otherwise noted)

Years ended August 31, 2008 and 2007

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### 3. Significant accounting policies (continued):

(i) Stock-based compensation:

The Company has a stock option plan, which is described in note 12(b). The Company accounts for all stock-based payments using the fair value based method. Consideration paid on the exercise of stock options is recorded as share capital.

Under the fair value based method, stock-based payments to non-employees are measured at the fair value of the consideration received, or the fair value of the equity instruments issued, or liabilities incurred, whichever is more reliably measurable. The fair value of stock-based payments to non-employees is periodically re-measured until counterparty performance is complete, and any change therein is recognized over the period and in the same manner as if the Company had paid cash instead of paying with or using equity instruments. The cost of stock-based payments to non-employees that are fully vested and non-forfeitable at the grant date is measured and recognized at that date.

Under the fair value based method, compensation cost for grants to employees is measured at fair value at the grant date and recognized over the vesting period. For awards that vest at the end of the vesting period, compensation cost is recognized on a straight-line basis; for awards that vest on a graded basis, compensation cost is recognized on a pro-rata basis over the vesting period.

(j) Earnings per share:

Basic earnings per share are computed by dividing net earnings (loss) by the weighted average number of shares outstanding during the year. Diluted earnings per share are computed using the treasury stock method.

(k) Income taxes:

The Company uses the asset and liability method of accounting for income taxes. Under the asset and liability method, future tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Future tax assets and liabilities are measured using enacted or substantively enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. A valuation allowance is recorded against any future income tax asset if it is more likely than not that the asset will not be realized. The effect on future tax assets and liabilities of a change in tax rates is recognized in earnings in the same period the substantive enactment occurred.

(l) Use of estimates:

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Significant areas requiring the use of estimates is the evaluation of impairment of oil and natural gas properties, valuation of financial instruments, determination of asset retirement obligation, valuation allowance applied against the future income taxes assets and rates for depreciation and depletion. Actual results could differ from those estimates.

# BUCKING HORSE ENERGY INC.

Notes to Consolidated Financial Statements  
(Expressed in United States dollars, unless otherwise noted)

Years ended August 31, 2008 and 2007

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### 3. Significant accounting policies (continued):

(m) Comparative figures:

Certain of the Company's comparative figures have been reclassified to conform to the financial statement presentation adopted in the current year.

(n) Recent accounting pronouncements:

Effective September 1, 2008, the Company is required to adopt the following new CICA accounting standards:

(i) CICA Handbook Section 1535, *Capital Disclosures*:

This section requires additional disclosures of: (A) an equity's objectives, policies and processes for managing capital; (B) quantitative data about what the entity regards as capital; (C) whether the entity has complied with any capital requirements; and (D) if it has not complied, the consequences of such non-compliance.

(ii) CICA Handbook Section 1400, *General Standards of Financial Statement Presentation*:

This section requires management to assess and disclose an entity's ability to continue as a going concern.

(iii) CICA Handbook Section 3862, *Financial Instruments - Disclosure*, and CICA Handbook Section 3863, *Financial Instruments - Presentation*:

These new sections revise and enhance the disclosure and presentation requirements for financial instruments. The significance of financial instruments for the entity's financial position and performance, the nature and extent of the risks arising from financial instruments and how these risks are managed are emphasized.

(iv) International Financial Reporting Standards (IFRS)

In 2006, the Canadian 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 generally accepted accounting principles 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 generally accepted accounting principles. The date is for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011. The 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.

# BUCKING HORSE ENERGY INC.

Notes to Consolidated Financial Statements

(Expressed in United States dollars, unless otherwise noted)

Years ended August 31, 2008 and 2007

## 4. Business combination:

On March 4, 2008, Bucking Horse closed an arrangement transaction (the Arrangement), pursuant to which it acquired 100% of the issued and outstanding shares and options of Gemini. The assets and liabilities of Gemini and its wholly-owned subsidiary Arrowhead, were recorded at their fair values using the purchase method of accounting.

The following table summarizes the estimated fair values of the assets acquired and liabilities assumed at the date of acquisition.

Purchase price:	
Issue of 12,836,713 common shares of Bucking Horse	\$ 51,572,778
Cash	19,959,029
Reduction in promissory note	9,537,381
Issue of convertible debentures	47,508,293
Acquisition costs	290,007
	<hr/>
	\$ 128,867,488
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Net assets acquired:	
Cash and cash equivalents	\$ 1,076,605
Promissory note	15,106,980
Accounts receivable	3,290,390
Income tax receivable	1,490,340
Oil and gas properties	168,269,586
Investments (note 6)	918,552
Accounts payable and accrued liabilities	(5,832,168)
Asset retirement obligations	(41,144)
Future income taxes	(55,411,653)
	<hr/>
	\$ 128,867,488

Under the terms of the Arrangement, Bucking Horse acquired all of the 24,608,642 issued and outstanding common shares of Gemini and all of the 320,000 existing stock options. The acquisition was funded through the issuance of common shares of the Company, the issuance of convertible debentures, the reduction of a promissory note receivable, the draw down of the credit facility and the remainder in cash as described further below. Gemini will survive as a wholly owned subsidiary of the Company and its shares are now delisted from the TSX.

Prior to closing the Arrangement, Gemini had four secured convertible debentures outstanding held by two major shareholders of the Company (the Debenture Holders), each in the principal amount of CAD\$5,000,000. Prior to the Arrangement, Gemini was a related party of the Company as the Debenture Holders were also significant shareholders of Gemini. Two of these debentures were issued in March 2004 (the March Debentures) and the other two were issued in August 2004 (the August Debentures).

# BUCKING HORSE ENERGY INC.

Notes to Consolidated Financial Statements  
(Expressed in United States dollars, unless otherwise noted)

Years ended August 31, 2008 and 2007

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#### 4. Business combination (continued):

The March Debentures were convertible into units of Gemini at a conversion price of CAD\$2.50 per unit, with each unit consisting of one Gemini common share and one share purchase warrant. Each of the March Debentures was converted concurrent with the closing of the Arrangement and the shares issued upon conversion were sold to the Company, together with the share purchase warrants, for the total sum of \$19,083,600 (CAD\$19,000,000), as contemplated under the Arrangement. The \$19,083,600 was paid by the issuance of two new convertible debentures by the Company (note 9).

The August Debentures were convertible into Gemini units at a conversion price of CAD\$4.00 per unit. The August Debentures were cancelled and replaced with two new convertible debentures at the closing of the Arrangement for a total sum of \$10,044,000 (CAD\$10,000,000) having the same terms as the August Debentures, except that they are convertible into units of the Company (note 9).

At the closing of the Arrangement, two additional new debentures for the total sum of \$20,088,000 (CAD\$20,000,000) were issued to the Debenture Holders as consideration for the 2,500,000 and 2,075,043 Gemini shares acquired from the Debenture Holders at CAD\$4.00 per share and as consideration for the \$1,707,307 (CAD\$1,699,828) cash received from one of the Debenture Holders which was used to fund a portion of the cash required to complete the Arrangement (note 9).

As a result of the issuance of the new debentures and the assumption of the August Debentures, the Company has outstanding convertible debentures in the aggregate principal amount of \$49,215,600 (CAD\$49,000,000) held by the Debenture Holders (note 9).

Prior to closing the Arrangement, Gemini completed the sale of 12,000,000 common shares of XXL Energy Corp., (XXL) an entity related to the Company by virtue of common directors, to Q Investments Ltd. (QIL), a major shareholder of the Company which is controlled by the Debenture Holders. The total consideration of \$15,106,980 (CAD\$15,040,800) was initially paid by QIL's issuance of a promissory note in favour of Gemini which was acquired by the Company pursuant to the Arrangement. The amount owing under the promissory note was reduced by \$9,537,381 (CAD\$9,495,600) as consideration for the 2,373,900 Gemini shares acquired from QIL at CAD\$4.00 per share pursuant to the Arrangement. The amount owing under the promissory note was further reduced through the cancellation of the Company's pre-existing loan payable to QIL of \$1,506,600 (CAD\$1,500,000) together with accrued interest. The net remaining promissory note receivable from QIL of \$4,062,999 (CAD\$4,045,200) has a term of one year and bears interest at the rate of 15% per annum. The promissory note is secured by a fixed charge over the XXL shares purchased by QIL. Interest of \$302,220 (CAD\$300,896) has been accrued at year end. The remaining 5,000,000 common shares and 150,000 warrants of XXL held by Gemini were acquired by the Company (note 6).

The Company issued 12,836,713 common shares of Bucking Horse to former Gemini shareholders, including 1,645,350 shares issued to one of the Debenture Holders, in exchange for 12,836,713 of the Gemini shares acquired at a deemed value of CAD\$4.00 per share for total consideration of \$51,572,778 (CAD\$51,346,852).

The Company paid cash of \$19,376,829 (CAD\$19,291,944) to acquire the remaining 4,822,986 of the Gemini shares. The Company also paid the aggregate sum of \$582,200 (CAD\$579,650) in exchange for the surrender and cancellation of existing Gemini stock options and incurred \$290,007 (CAD\$288,737) in transaction costs associated with the Arrangement.

# BUCKING HORSE ENERGY INC.

Notes to Consolidated Financial Statements  
(Expressed in United States dollars, unless otherwise noted)

Years ended August 31, 2008 and 2007

## 5. Financial instruments:

- (a) The carrying values of cash and cash equivalents, accounts receivable, promissory note, income tax receivable and accounts payable and accrued liabilities approximate their fair values due to the short terms to maturity of these financial instruments.

The fair value of the bank indebtedness has been estimated by management by discounting the future contractual cash flows under current financing arrangements at discount rates which represent borrowing rates presently available to the Company for a loan with similar terms, risks and maturities. Management estimates that at August 31, 2008, the fair value of the bank indebtedness is equal to the carrying value reflecting the actual interest rates incurred by the Company being the same as equivalent current rates.

- (b) Derivative instruments:

In May 2008 the Company entered into the following open commodity derivative financial contracts to manage price risk on a portion of its natural gas production for the periods referenced below.

Type	Volume MMBTU/Day	Contract period	Price US\$/MMBTU
Swap <sup>(1)</sup>	2,000	June to December 2008	\$9.65 / MMBTU
Costless collar <sup>(1)</sup>	2,000	June to December 2008	\$8.00 / MMBTU Floor \$12.14 / MMBTU Ceiling
Swap <sup>(2)</sup>	2,500	Calendar 2009	\$11.24 / MMBTU

<sup>(1)</sup> Panhandle Eastern basis

<sup>(2)</sup> Dominion South

As at August 31, 2008, the unrealized gain on outstanding derivative financial contracts is \$2,927,776. The realized loss on settlement of derivative financial contracts during the year was \$88,040. The net gain on derivative financial contracts for the year of \$2,839,736 has been included in other expenses for the year.

On November 5, 2008 the Company canceled its Dominion South swap contract and replaced it with a Panhandle Eastern basis contract, tabled below.

Type	Volume MMBTU/Day	Contract period	Price US\$/MMBTU
Swap <sup>(1)</sup>	2,500	Calendar 2009	\$9.66 / MMBTU

# BUCKING HORSE ENERGY INC.

Notes to Consolidated Financial Statements  
(Expressed in United States dollars, unless otherwise noted)

Years ended August 31, 2008 and 2007

## 6. Investments:

As at August 31, investments consist of:

	2008	2007
Investment in shares of Giant Energy Limited (Giant)	\$ 235,272	\$ -
Investment in warrants of XXL	8,831	-
	<u>\$ 244,103</u>	<u>\$ -</u>

On May 21, 2008, the Company participated in a private placement conducted by Giant pursuant to which the Company acquired 1,000,000 common shares of Giant at a price of CAD\$0.25 per shares for a total cost of \$235,272 (CAD\$250,000). This is a non-arm's length transaction by virtue of a common officer of both companies and a common shareholder. The investment in shares of Giant is carried at cost as there is no active market for Giant's shares.

The Company acquired an investment in shares and warrants of XXL as part of the Arrangement (note 4). The shares were subsequently sold resulting in a loss of \$421,144 which has been included in other expenses during the year.

As at August 31, 2008, the Company holds 150,000 warrants of XXL each of which entitles the Company to purchase one common share of XXL at an exercise price of \$20.00 per share. The warrants expire August 18, 2010. XXL is a related party by virtue of common directors. These warrants are classified as held-for-trading and are marked-to-market on an ongoing basis with changes in fair value recognized in earnings. The unrealized loss on the warrants of \$53,121 has also been included in other expenses during the year.

The warrant's fair value was determined using the Black-Scholes model using the following assumptions:

Expected life	1.96 years
Volatility	94%
Risk free rate	2.71%
Dividend rate	0%

## 7. Oil and natural gas properties:

	2008	2007
Proven, explored and impaired properties:		
Exploration and drilling costs	\$ 60,166,711	\$ 1,309,105
Acquisition and lease costs	98,147,394	1,531,784
Well equipment	6,811,694	-
Asset retirement	44,066	5,068
	<u>165,169,865</u>	<u>2,845,957</u>
Less accumulated depletion and depreciation	(4,591,715)	(398,898)
	<u>\$ 160,578,150</u>	<u>\$ 2,447,059</u>

# BUCKING HORSE ENERGY INC.

Notes to Consolidated Financial Statements  
(Expressed in United States dollars, unless otherwise noted)

Years ended August 31, 2008 and 2007

## 7. Oil and natural gas properties (continued):

At August 31, 2008, the cost of unproven properties of \$1,709,000 (2007 - \$1,425,000) were excluded from the depletion calculation.

For the year ended August 31, 2008, the Company has not capitalized any general and administrative expenses.

The Company has agreements to participate in the exploration of certain oil and natural gas leases. Failure by the Company to pay its share of a proposed capital program could result in the dilution or forfeiture of the Company's interest in these properties.

The Company performed a ceiling test calculation at August 31, 2008 for its US and Canadian properties to assess the recoverable value of its oil and natural gas properties. The oil and natural gas future prices for the August 31, 2008 ceiling test are based on the August 31, 2008 commodity price forecast of the Company's independent reserve evaluators. These prices have been adjusted for commodity price differentials specific to the Company. The following table summarizes the benchmark prices used in the ceiling test calculation. Based on these assumptions, the undiscounted value of future net revenues from the Company's proved reserves exceeded the carrying value of oil and natural gas properties at August 31, 2008 and accordingly no impairment was recorded.

Year	Benchmark NYMEX WTI \$US/BBL	US properties NGL / OIL \$US/BBL	Benchmark NYMEX GAS \$US/MMBTU	US properties GAS \$US/MMBTU	Canadian properties GAS \$US/MMBTU
2008	135.00	126.27	13.00	10.74	10.54
2009	125.00	116.23	11.25	9.67	8.64
2010	110.00	101.26	10.50	9.48	8.38
2011	100.00	91.25	10.00	8.77	8.33
2012	100.00	91.25	10.00	8.67	8.25
2013	100.00	91.24	10.00	8.46	8.42
2014	101.35	92.60	10.14	8.65	8.60
2015	103.38	94.64	10.34	8.99	8.77
2016	105.45	96.70	10.54	9.29	8.95
2017	107.56	98.81	10.76	9.60	8.64

Escalate thereafter at 2.0% per year

# BUCKING HORSE ENERGY INC.

Notes to Consolidated Financial Statements  
(Expressed in United States dollars, unless otherwise noted)

Years ended August 31, 2008 and 2007

## 8. Bank indebtedness:

In connection with the Arrangement, Bucking Horse and Gemini (Guarantors) and Arrowhead (Borrower) entered into a credit agreement dated March 4, 2008 for a five year senior revolving credit facility in the aggregate principal amount of up to US\$100,000,000, with an initial borrowing base of US\$30,000,000, available pursuant to the terms set out in the Credit Agreement. The debt is secured by mortgages on the oil and gas properties of Arrowhead.

The facility has an interest rate that floats, based on both the bank prime rate and a spread which will increase based on the percentage of availability drawn, resulting in a current interest rate of approximately 5.5%. The Company currently has drawn \$13,500,000 from the Credit Facility, of which \$10,500,000 was drawn on March 4, 2008 to fund a portion of the cash required to complete the Arrangement (note 4) and has \$16,500,000 left available as at August 31, 2008.

The Company is required to ensure that Arrowhead's interest coverage ratio is greater than 2.5 to 1.0, that Arrowhead's ratio of total indebtedness to earnings before interest income taxes, depletion, depreciation and accretion, and exploration expenses is greater than 3.5 to 1.0, and that the Company's current ratio is greater than 1.0 to 1.0.

## 9. Convertible debentures:

	2008	2007
First Debentures (a)	\$ 17,880,670	\$ -
Second Debentures (b)	9,410,879	-
Third Debentures (c)	18,821,758	-
	46,113,307	-
Less cumulative accretion remaining	(22,839,814)	-
	\$ 23,273,493	\$ -

(a) On March 4, 2008 as part of the Arrangement, two convertible debentures (the First Debentures) were issued by the Company to the Debenture Holders. Each of the First Debentures is in the principal amount of \$8,940,335 (CAD\$9,500,000). The First Debentures mature on March 4, 2018, bear interest at a rate of 10% during the first six years and 15% during the remaining four years and are convertible into units during the first five years at a conversion price of CAD\$4.875 per unit and into shares at a conversion price of CAD\$4.875 per share during the last five years. Each unit consists of one common share of the Company and one share purchase warrant. Each share purchase warrant entitles the holder to purchase one additional common share of the Company for CAD\$4.875 until the fifth anniversary of the date of issuance, at which date these share purchase warrants will expire. The Debenture Holders may elect to accelerate the maturity date to the sixth anniversary date at any time during the first five years. Effective May 16, 2008, as a result of an interest rate acceleration provision, the interest rate applicable to the First Debentures increased from 10% to 15%.

# BUCKING HORSE ENERGY INC.

Notes to Consolidated Financial Statements  
(Expressed in United States dollars, unless otherwise noted)

Years ended August 31, 2008 and 2007

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## 9. Convertible debentures (continued):

### (a) Continued:

Repayment of the First Debentures is guaranteed by the Company's subsidiary Arrowhead, which has provided a mortgage and security agreement to each of the Lenders which is subordinated to other debt under the credit facility. The First Debentures are redeemable by the Company upon thirty days written notice without penalty or bonus; however, the Debenture Holders may elect to convert all or any of the First Debentures during the thirty day notice period.

The equity portion of the First Debentures was assigned a total value of \$10,103,765 (CAD\$10,054,257) upon issuance of the First Debentures, which was recorded in equity portion of debentures payable. The First Debentures were initially recorded net of the Conversion Option and are being accreted to their face value over their term. For the year ended August 31, 2008, accretion of \$305,039 (2007 - nil) has been included in accretion expense. Accretion of the First Debentures is calculated using an effective interest rate of 39.36%.

- (b) On March 4, 2008 as part of the Arrangement, two additional convertible debentures (the Second Debentures) were issued by the Company to Debenture Holders. Each of the Second Debentures is in the principal amount of \$4,705,439 (CAD\$5,000,000). The Second Debentures mature on August 4, 2014, bear interest at a rate of 10% up to August 4, 2010 and 15% during the last four years and are convertible into units up to August 4, 2009 at a conversion price of CAD\$4.00 per unit and into shares at a conversion price of CAD\$4.00 per share during the last five years. Each unit consists of one common share of the Company and one share purchase warrant. Each share purchase warrant entitles the holder to purchase one additional common share of the Company for CAD\$4.00 until August 4, 2009, at which date these share purchase warrants will expire. The Debenture Holders may elect to accelerate the maturity date to August 4, 2010 at any time up to August 4, 2009. Effective May 16, 2008, as a result of an interest rate acceleration provision, the interest rate applicable to the First Debentures increased from 10% to 15%.

Repayment of the Second Debentures is guaranteed by the Company's subsidiary Arrowhead, which has provided a mortgage and security agreement to each of the Lenders which is subordinated to other debt under the credit facility. The Second Debentures are redeemable by the Company upon thirty days written notice without penalty or bonus; however, the Debenture Holders may elect to convert all or any of the Second Debentures during the thirty day notice period.

The equity portion of the Second Debentures was assigned a total value of \$4,589,831 (CAD\$4,567,341) upon issuance of the Second Debentures, which was recorded in equity portion of debentures payable. The Second Debentures were initially recorded net of the Conversion Option and are being accreted to their face value over their term. For the year ended August 31, 2008, accretion of \$303,082 (2007 - nil) has been included in accretion expense. Accretion on the Second Debentures is calculated using an effective interest rate of 39.94%

# BUCKING HORSE ENERGY INC.

Notes to Consolidated Financial Statements  
(Expressed in United States dollars, unless otherwise noted)

Years ended August 31, 2008 and 2007

## 9. Convertible debentures (continued):

(c) On March 4, 2008 as part of the Arrangement, two more convertible debentures (the Third Debentures) were issued by the Company to the Debenture Holders. Each of the Third Debentures is in the principal amount of \$9,410,879 (CAD\$10,000,000). The Third Debentures mature on March 4, 2018, bear interest at a rate of 10% during the first six years and 15% during the last four years and are convertible into units during the first five years at a conversion price of CAD\$4.875 per unit and into shares at a conversion price of CAD\$4.875 per share during the last five years. Each unit consists of one common share of the Company and one share purchase warrant. Each share purchase warrant entitles the holder to purchase one additional common share of the Company for CAD\$4.875 until the fifth anniversary of the date of issuance, at which date these share purchase warrants will expire. The Debenture Holders may elect to accelerate the maturity date to the sixth anniversary date at any time during the first five years. Effective May 16, 2008, as a result of an interest rate acceleration provision, the interest rate applicable to the Third Debentures increased from 10% to 15%.

Repayment of the Third Debenture is guaranteed by the Company's subsidiary Arrowhead, which has provided a mortgage and security agreement to each of the Lenders which is subordinated to other debt under the credit facility. The Third Debentures are redeemable by the Company upon thirty days written notice without penalty or bonus; however, the Debenture Holders may elect to convert all or any of the Third Debentures during the thirty day notice period.

The equity portion of the Third Debentures was assigned a total value of \$10,635,543 (CAD\$10,583,428) upon issuance of the Third Debentures, which was recorded in equity portion of debentures payable. The Third Debentures were initially recorded net of the Conversion Option and are being accreted to their face value over their term. For the year ended August 31, 2008, accretion of \$321,094 (2007 - nil) has been included in accretion expense. Accretion on the Third Debentures is calculated using an effective interest rate of 39.36%.

## 10. Asset retirement obligations:

The Company's asset retirement obligations result from net ownership interest in oil and gas properties including well sites, gathering systems and processing facilities. The Company estimates the total undiscounted amount of cash flows required to settle its asset retirement obligations is approximately \$1,268,000. The majority of the costs will be incurred after 2050. An inflation factor of 2.0% has been applied to the estimated asset retirement costs. A rate of 10% was used to calculate the fair value of the asset retirement obligations. A reconciliation of the asset retirement obligations is provided below:

	2008	2007
Balance, beginning of year	\$ 8,280	\$ 6,843
Additions during the year	34,357	-
Accretion expense	1,429	1,437
Balance, end of year	\$ 44,066	\$ 8,280

# BUCKING HORSE ENERGY INC.

Notes to Consolidated Financial Statements  
(Expressed in United States dollars, unless otherwise noted)

Years ended August 31, 2008 and 2007

## 11. Earnings per share:

The conversion feature of the convertible debentures into 10,500,000 common shares would be anti-dilutive. Therefore, diluted net earnings (loss) per common share equals basis net earnings (loss) per common share.

## 12. Share capital:

### (a) Share transactions:

Authorized capital at August 31, 2008 and 2007 consists of unlimited common shares without par value.

Share transactions for the years ended August 31, 2008 and 2007 were as follows:

	Number of shares	Amount (net)	Contributed surplus
Balance, August 31, 2006	7,500,001	\$ 1,619,123	\$ -
Shares issued for cash:			
Private placement	675,000	585,197	-
Exercise of warrants	50,000	61,171	(14,302)
Share returned to treasury	(1)	(1)	-
Share issue costs	-	(128,789)	14,302
Balance, August 31, 2007	8,225,000	2,136,701	-
Shares issued for cash:			
Private placement	2,000,000	8,094,709	-
Plan of Arrangement	12,836,713	51,599,690	-
Shares repurchased	(44,700)	(122,382)	-
Balance, August 31, 2008	23,017,013	\$ 61,708,718	-

On September 15, 2006, the Company completed a private placement of 150,000 common shares at CAD\$1.00 per share for total gross proceeds of \$133,862 (CAD\$150,000).

On October 12, 2006, the Company completed a private placement of 25,000 common shares at CAD\$1.00 per share for total gross proceeds of \$22,260 (CAD\$25,000).

On December 20, 2006, in connection with its initial public offering, the Company issued 500,000 common shares at CAD\$1.00 for total gross proceeds of \$429,075 (CAD\$500,000). In addition, the Company paid cash commissions of \$57,110 (CAD\$66,550), legal fees and agent's out-of-pocket expenses of \$57,377 (CAD\$66,861), and also granted the agent 50,000 warrants to purchase 50,000 common shares of the Company at a price of CAD\$1.00 per share. These warrants were exercised on July 5, 2007. The fair value of the agent's warrants was estimated at \$14,302 (CAD\$16,666) using the Black-Scholes option pricing model with an expected annual volatility of 55.58%, a risk-free interest rate of 3.97%, an expected life of two years and expected dividend yield of 0%.

# BUCKING HORSE ENERGY INC.

Notes to Consolidated Financial Statements  
(Expressed in United States dollars, unless otherwise noted)

Years ended August 31, 2008 and 2007

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## 12. Share capital (continued):

### (a) Share transactions (continued):

On March 3, 2008, the Company closed a private placement of 2,000,000 common shares at CAD\$4.00 per share, for gross proceeds of \$8,094,709 (CAD\$8,000,000). The proceeds from the private placement were used to provide a portion of the funds required to complete the Arrangement (note 4).

On March 4, 2008, the Company issued 12,836,713 shares to former Gemini shareholders at a deemed price of CAD\$4.00 per share for total consideration of \$51,599,690 (CAD\$51,346,852) in connection with the Arrangement (note 4).

During the year ended August 31, 2008, the Company repurchased 44,700 shares through a normal course issuer bid at a cost of \$122,382. The excess cost of the shares over the assigned value totaled \$216,758 and has been charged to retained earnings. The shares repurchased have not been cancelled and are therefore included in the issued capital of the Company at August 31, 2008.

During the year ended August 31, 2007, 7,500,000 shares were put into escrow in accordance with National Policy 46-201, *Escrow for Initial Public Offering*. During the year ended August 31, 2008, 1,875,000 shares were released from escrow (2007 - 1,875,000). As at August 31, 2008, there are 3,750,000 shares held in escrow (2007 - 5,625,000). The remaining shares will be released from escrow over time with the final shares being released on December 20, 2009.

Subsequent to August 31, 2008, the Company repurchased 14,600 of its common shares pursuant to its normal course issuer bid at a cost of \$98,800.

### (b) Stock option plan:

The Company has a stock option plan for its key employees, directors and certain other persons under certain conditions. Under the plan, options may be granted to purchase up to 10% of the outstanding shares of the Company to a maximum of 822,500 options. Options granted under the plan vest at a rate of 25% per year and expire five years after the date of grant. The exercise price of options granted may not be less than the closing trading price of the Company's shares on the last trading day preceding the date on which the options are granted. As at August 31, 2008 and 2007, no stock options have been issued under the plan.

Subsequent to year end, the stock option plan was amended to increase the maximum number of options available to be granted to 2,306,000 options. The amendment is subject to regulatory approval.

# BUCKING HORSE ENERGY INC.

Notes to Consolidated Financial Statements  
(Expressed in United States dollars, unless otherwise noted)

Years ended August 31, 2008 and 2007

## 13. Related party transactions:

Related party transactions are in the normal course of operations and measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

Related party transactions for the year ended August 31 are as follows:

	2008	2007
General and administrative expenses:		
Office, rent, administration and professional services charged by a company controlled by one of the Debenture Holders	\$ 226,483	\$ 44,970
Oil and gas consulting, operational, technical and business management services provided by a company which has a common officer and shareholder with Bucking Horse	228,995	-
Directors fees	7,947	-
Interest paid to Debenture Holders	3,124,352	-
Interest paid on a loan to a Company with a common director	115,436	162,109

Amounts due to or prepaid to related parties as at August 31 are as follows:

	2008	2007
General and administrative expenses:		
Prepayment of fees for office, rent, administration and professional services	\$ 37,813	\$ -
Retainer paid to Company providing oil and gas consulting, operational, technical and business management services.	300,000	-
Amount payable to Company providing oil and gas consulting, operational, technical and business management services as at August 31, 2008.	74,928	-

On November 10, 2006, the Company entered into a loan agreement with QIL pursuant to which QIL provided the Company with a loan in the principal amount of \$1,327,434 (CAD\$1,500,000). The loan was cancelled as part of the Arrangement (note 4).

Other related party transactions are disclosed in notes 4, 6 and 9.

# BUCKING HORSE ENERGY INC.

Notes to Consolidated Financial Statements  
(Expressed in United States dollars, unless otherwise noted)

Years ended August 31, 2008 and 2007

## 14. Income taxes:

The Company's provision for income taxes differs from the amounts computed by applying the US federal income tax rate of 34% for the following reasons:

	2008	2007
Computed tax provision	\$ 996,573	\$ (118,382)
Increase in valuation allowance	1,474,904	118,382
State and withholding taxes	(34,835)	-
Permanent differences	287,650	-
Other	51,980	-
	<u>\$ 2,776,272</u>	<u>\$ -</u>

Significant components of the Company's future tax assets and liabilities are shown below:

	2008	2007
Future tax assets:		
Write-down of investment	\$ -	\$ -
Non-capital loss carry forwards	4,565,372	-
Petroleum and natural gas interests	53,051	136,024
Cumulative eligible capital	-	280
Share issue costs	-	34,452
Unclaimed exploration and development expenditures	316,937	-
	<u>4,935,360</u>	<u>170,756</u>
Less valuation allowance	<u>(4,935,360)</u>	<u>(170,756)</u>
Net future tax assets	-	-
Future tax liabilities:		
Oil and natural gas properties	(53,392,967)	-
Derivative instrument	(995,444)	-
Asset retirement obligation	13,679	-
Net future tax liabilities	<u>(54,374,732)</u>	<u>-</u>
Net future income tax liability	<u>\$ (54,374,732)</u>	<u>\$ -</u>

In assessing the realizability of future tax assets, management considers whether it is more likely than not that some portion or all of the future tax assets will not be realized. The ultimate realization of future tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Management considers the scheduled reversal of future tax liabilities, projected future taxable income, and tax planning strategies in making this assessment. The amount of the future tax assets considered realizable could change materially in the near term based on future taxable income during the carry forward period.

A valuation allowance has been provided against all future tax assets as the realization of such assets is uncertain.

The Company has losses for tax purposes of approximately \$14,170,471 which are available to offset future years' taxable income in Canada, expiring between 2008 and 2028.

# BUCKING HORSE ENERGY INC.

Notes to Consolidated Financial Statements  
(Expressed in United States dollars, unless otherwise noted)

Years ended August 31, 2008 and 2007

## 15. Supplementary cash flow information:

	2008	2007
Interest paid	\$ 3,510,325	\$ -
Income taxes received	302,894	-
Non-cash investing and financing activities:		
Offset of loan payable against promissory note (note 13)	1,506,600	-
Issuance of common shares as consideration in Gemini acquisition (note 4)	51,572,778	-
Issuance of convertible note as consideration in Gemini acquisition (note 4)	47,508,293	-
Reduction in promissory note as consideration in Gemini acquisition (note 4)	9,537,381	-

## 16. Contingency:

Arrowhead was named as a defendant together with a number of unrelated entities in a lawsuit in which the plaintiffs allege they own a 5% interest in specified oil and gas leases. The Company, together with the other defendants, have denied the allegations and presented defenses. Although the defendants believe their position will be sustained, the outcome and the associated cost, if any, are not determinable. No amounts have been recorded in these consolidated financial statements. Any costs incurred will be recognized when determinable.

## 17. Segmented information:

The Company's activities consist of the exploration and development of oil and natural gas properties in Canada and the United States.

Selected segmented information is as follows:

2008	Canada	United States	Total
Revenue	\$ 631,520	\$ 15,061,834	\$ 15,693,354
Operating earnings (loss)	148,884	6,691,847	6,840,731
Capital expenditures	-	1,501,379	1,501,379
Total assets	7,620,657	169,631,680	177,252,337

  

2007	Canada	United States	Total
Revenue	\$ 738,830	\$ -	\$ 738,830
Operating earnings (loss)	31,496	-	31,496
Capital expenditures	-	1,443,513	1,443,513
Total assets	1,800,063	1,531,784	3,331,847

# BUCKING HORSE ENERGY INC.

Notes to Consolidated Financial Statements  
(Expressed in United States dollars, unless otherwise noted)

Years ended August 31, 2008 and 2007

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## **17. Segmented information (continued):**

The Company's revenues are derived from sales to customers in the oil and gas industry. One customer buys all of the oil and gas produced by the Canadian property. 97% of the sales of the United States property are made to two customers.

## **18. Subsequent events:**

From September 1, 2008 to November 28, 2008 the natural gas prices declined by 28.47%. Management has considered the impact of this decline on the Company and has determined based on the long term prices that there is no significant impairment in the oil and gas properties.

In addition, management has considered the impact of the fluctuations in the foreign exchange rates between Canada and the United States. On November 24, 2008, management entered into a forward contract for the next year to manage the fluctuations in foreign exchange rates. The Company contracted to purchase CAD\$6,113,000 during calendar 2009 at an exchange rate of CAD\$1.2226 per US\$1.00.