

# **Primeline Energy Holdings Inc.**

(an exploration stage company)

Consolidated Financial Statements

**March 31, 2008 and 2007**

## Auditors' Report

### To the Shareholders of Primeline Energy Holdings Inc.

We have audited the consolidated balance sheets of **Primeline Energy Holdings Inc.** as at March 31, 2008 and 2007 (as restated) and the consolidated statements of operations, comprehensive loss and deficit and cash flows for each of 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 March 31, 2008 and 2007 (as restated) and the results of its operations and its cash flows for each of the years then ended in accordance with Canadian generally accepted accounting principles.

*Signed PricewaterhouseCoopers*

### Chartered Accountants

Vancouver, British Columbia  
July 24, 2008

# Primeline Energy Holdings Inc.

(an exploration stage company)

Consolidated Balance Sheets

As at March 31, 2008 and 2007

	2008 \$	2007 \$ (as restated- note 11)
<b>Assets</b>		
<b>Current assets</b>		
Cash and cash equivalents	11,359,080	15,060,665
Prepaid expenses and deposit	46,868	98,122
	<u>11,405,948</u>	<u>15,158,787</u>
<b>Deferred petroleum exploration costs</b> (note 3)	31,747,134	28,940,206
	<u>43,153,082</u>	<u>44,098,993</u>
<b>Liabilities</b>		
<b>Current liabilities</b>		
Accounts payable and accrued liabilities	896,284	850,824
Advances from an affiliate company (note 6)	266,406	132,207
	<u>1,162,690</u>	<u>983,031</u>
<b>Future income tax liability</b> (note 7)	404,428	428,510
	<u>1,567,118</u>	<u>1,411,541</u>
<b>Shareholders' Equity</b>		
<b>Capital stock</b> (note 4)	64,309	64,309
<b>Contributed surplus</b> (note 4)	51,299,441	50,444,630
<b>Deficit</b>	<u>(9,777,786)</u>	<u>(7,821,487)</u>
	<u>41,585,964</u>	<u>42,687,452</u>
	<u>43,153,082</u>	<u>44,098,993</u>

**Nature of operations** (note 1)

**Commitments** (notes 3 and 5)

**Subsequent Events** (note 10)

**Approved by the Board of Directors**

(signed) Guang Ming Wang

Director

(signed ) Brian Chan

Director

# Primeline Energy Holdings Inc.

(an exploration stage company)

Consolidated Statements of Operations, Comprehensive Loss and Deficit

For the years ended March 31, 2008 and 2007

	2008 \$	2007 \$ (as restated- note 11)
<b>Revenue</b>		
Interest income	504,265	770,276
<b>Expenses</b>		
Bank charges and interest	4,165	5,759
Business promotion	86,521	30,874
Foreign exchange loss (gain)	1,005,765	(613,112)
Office	256,429	262,726
Professional fees	387,877	409,687
Stock-based compensation (note 4(b))	700,580	5,970,256
Travel	119,272	175,494
	<u>2,560,609</u>	<u>6,241,684</u>
<b>Loss before income taxes</b>	(2,056,344)	(5,471,408)
Future income tax recovery (note 7)	100,046	-
<b>Loss for the year and comprehensive loss</b>	(1,956,299)	(5,471,408)
<b>Deficit - Beginning of year</b>	(7,821,487)	(2,350,079)
<b>Deficit - End of year</b>	<u>(9,777,786)</u>	<u>(7,821,487)</u>
<b>Basic and diluted loss per common share</b>	<u>(0.04)</u>	<u>(0.12)</u>
<b>Weighted average number of common shares outstanding</b>	<u>47,020,623</u>	<u>46,780,258</u>

# Primeline Energy Holdings Inc.

(an exploration stage company)

Consolidated Statements of Cash Flows

For the years ended March 31, 2008 and 2007

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	2008 \$	2007 \$ (as restated- note 11)
<b>Cash flows from operating activities</b>		
Loss for the year	(1,956,299)	(5,471,408)
Items not affecting cash		
Stock-based compensation	700,580	5,970,256
Future income tax recovery	(100,046)	-
	600,534	5,970,256
Changes in non-cash working capital items		
Prepaid expenses and deposit	51,254	5,763
Accounts payable and accrued liabilities	2,354	(369,569)
	53,608	(363,806)
	(1,302,157)	135,042
<b>Cash flows from investing activities</b>		
Expenditures on deferred petroleum exploration costs	(2,533,627)	(7,548,790)
<b>Cash flows from financing activities</b>		
Advances from Primeline International (Holdings) Inc.	-	(422,506)
Advances from an affiliate company	134,199	132,207
Private placement	-	22,606,440
	134,199	22,316,141
<b>(Decrease) Increase in cash and cash equivalents</b>	(3,701,585)	14,902,393
<b>Cash and cash equivalents - Beginning of year</b>	15,060,665	158,272
<b>Cash and cash equivalents - End of year</b>	11,359,080	15,060,665
<b>Supplemental cash flow information</b>		
<b>Non-cash investing activities</b>		
Accrued expenses capitalized to deferred petroleum exploration costs	43,106	786,836
Stock-based compensation and related future income taxes capitalized as deferred petroleum exploration costs	230,195	1,278,788
<b>Non-cash financing activities</b>		
Debt conversion - Primeline International (Holdings) Inc.	-	7,900,000

# **Primeline Energy Holdings Inc.**

(an exploration stage company)

Notes to Consolidated Financial Statements

**March 31, 2008 and 2007**

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## **1 Nature of operations**

Primeline Energy Holdings Inc. (PEHI) was incorporated under the Companies Law of the Cayman Islands on March 31, 1995 and is in the business of exploration and development of off-shore oil and gas properties. To date, PEHI has not realized any revenues from its oil and gas properties and is considered to be an exploration stage company.

Primeline Energy China Ltd. (PECL), a wholly owned subsidiary, owns a 75% interest in a petroleum sharing contract (the Petroleum Contract) which entitles PECL to participate in the exploration, development and production of oil and gas in Block 25/34 in the East China Sea. The participation interests are detailed in note 3. Primeline Energy Operations International Limited (PEOIL), another wholly owned subsidiary, holds the operator rights under the Petroleum Contract.

PECL is currently exploring for oil and gas under the Petroleum Contract for Block 25/34 in the East China Sea of the People's Republic of China (PRC).

## **2 Significant accounting policies**

### **Principles of consolidation**

These consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles and include the accounts of PEHI and its wholly owned subsidiaries, PECL and PEOIL, also incorporated in the Cayman Islands (collectively, the company). Inter-company balances and transactions are eliminated on consolidation.

### **Cash and cash equivalents**

Cash and cash equivalents consist of cash and highly liquid short-term interest-bearing securities with maturities at the purchase date of three months or less. Cash and cash equivalents are recorded at fair value with change in fair value recorded in Other Comprehensive Income.

### **Deferred petroleum exploration costs**

The company follows the full cost method of accounting for oil and gas exploration expenditures, wherein all costs related to the exploration of oil and natural gas properties are capitalized. Costs capitalized include acquisition costs, geological and geophysical expenditures, rentals on undeveloped properties, costs of drilling productive and non-productive wells, overhead directly related to exploration activities and lease of well equipment. Costs capitalized will be depleted using the unit-of-production method based on proven gross oil and natural gas reserves determined by the company and independent engineers.

# **Primeline Energy Holdings Inc.**

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The company is in the process of exploring off-shore oil and gas properties and has not yet determined the amount of reserves available in its properties. Management's estimate of probable reserves and resources are subject to risks and uncertainties affecting the recoverability of the company's investment in deferred petroleum exploration costs. Although management has made its best estimate of these factors based on current conditions, it is reasonably possible that changes could occur in the near term that could materially affect management's estimate of the recoverability of deferred costs and the need for asset impairment writedowns.

All long-lived assets are tested for recoverability whenever events or changes in circumstances indicate that their carrying value may not be recoverable. If it is determined that the carrying value is not recoverable and exceeds its fair value, a writedown to the fair value amount is made by a charge to earnings.

## **Foreign currency translation**

The company translates foreign currency transactions and accounts using the temporal method. Monetary assets and liabilities are translated at the exchange rate in effect on the balance sheet date. Non-monetary assets and liabilities are translated at the exchange rate in effect on the transaction date. Expenses are translated at monthly average exchange rates. Foreign currency translation gains and losses are reflected in the consolidated statements of operations, comprehensive loss and deficit, except for those gains and losses that relate to the deferred petroleum exploration costs which are deferred.

## **Use of estimates, risks and uncertainties**

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions which affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the period. While management believes that these estimates and assumptions are reasonable, actual results could vary significantly.

A significant area requiring the use of management estimates relates to the recoverability of the deferred petroleum exploration costs. Realization of the company's assets is subject to risks and uncertainties, including reserves estimation; future oil and gas prices; estimated costs of future production; changes in government legislation and regulations; and various operational factors.

## **Capitalization of interest**

The company capitalizes interest to deferred petroleum exploration costs until commencement of commercial production.

# **Primeline Energy Holdings Inc.**

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## **Income taxes**

Income taxes are calculated using the liability method. Temporary differences arising from the difference between the tax basis of an asset or liability and its carrying amount on the balance sheet are used to calculate future income tax liabilities or assets. Future income tax liabilities or assets are calculated using enacted or substantively enacted tax rates anticipated to apply in the periods that the temporary differences are expected to reverse. A valuation allowance is applied to the extent that it is not more likely than not that future income tax assets will be realized.

## **Stock-based compensation**

The company applies the fair value method of accounting for stock-based compensation for both employees and non-employees. The fair value method requires recognition of an expense arising from stock options granted to both employees and non-employees, at the date of grant, in an amount equal to the fair value of the options granted. The fair value of options granted is established at the date of grant using the Black-Scholes option pricing model, and the compensation expense, equal to the option's fair value, is then recognized over the option's vesting period. Consideration paid for shares on exercise of stock options is credited to capital stock.

## **Asset retirement obligations**

Asset retirement obligations are recorded for statutory, contractual, or legal obligations associated with the retirement of property, plant and equipment, when those obligations result from the acquisition, construction, development, or normal operation of the assets. The obligations are measured initially at fair value (using present value methodology), and the resulting costs capitalized into the carrying amount of the related asset. In subsequent periods, the liability is adjusted for the accretion of discounts and any changes in the amount or timing of the underlying future cash flows. The related asset is adjusted only as a result of changes in the amount or timing of the underlying cash flows. The capitalized asset retirement cost is depreciated on the same basis as the related asset. Management has determined that, based on the exploration work carried out to date, there is no legal obligation requiring remediation of the company's oil and gas property at this time.

## **Loss per Share**

Basic loss per share is calculated using the weighted-average number of shares outstanding during the period. The company uses the treasury stock method to compute the dilutive effect of options, warrants and similar instruments. Under this method, the dilutive effect on earnings per share is recognized assuming the proceeds that could be obtained upon exercise of options, warrants and similar instruments would be used to purchase common shares at the average market price during the year.

# Primeline Energy Holdings Inc.

(an exploration stage company)

Notes to Consolidated Financial Statements

March 31, 2008 and 2007

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## Adoption of New Canadian Accounting Pronouncements

### a) *Accounting Changes*

Effective April 1, 2007, the company adopted revised CICA Section 1506, *Accounting Changes*, which provides expanded disclosures for changes in accounting policies, accounting estimates and corrections of errors. Under this standard, accounting changes should be applied retrospectively unless otherwise permitted or where impracticable to determine. As well, voluntary changes in accounting policy are made only when required by a primary source of GAAP or the change results in more relevant and reliable information. The adoption of this section had no material impact on the consolidated financial statements of the company.

### b) *Financial Instruments, Comprehensive Income, and Hedges*

On April 1, 2007, the company adopted the CICA Handbook Sections 1530, *Comprehensive Income*; Section 3855, *Financial Instruments – Recognition and Measurement*; Section 3861, *Financial Instruments – Disclosure and Presentation*; and Section 3865, *Hedges*.

#### (i) Financial Instruments

Under Section 3855, financial assets and liabilities, including derivative instruments, are initially recognized and subsequently measured based on their classification as held-for-trading, available for sale financial assets, held to maturity, loans and receivables, or other financial liabilities as follows:

- Held-for-trading financial instruments are measured at their fair value with changes in fair value recognized in net income for the period.
- Available for sale financial assets are measured at their fair value and changes in fair value are included in other comprehensive income until the asset is removed from the balance sheet.
- Held-to-maturity investments, loans and receivables and other financial liabilities are measured at amortized cost using the effective interest rate method.
- Derivative instruments, including embedded derivatives, are measured at their fair value with changes in fair value recognized in net income for the period unless the instrument is a cash flow hedge and hedge accounting applies in which case changes in fair value are recognized in other comprehensive income.

Upon adoption of this new standard, the company designated its cash and cash equivalents as available for sale, which is measured at fair value. Deposits have been designated as loans and receivables, which are measured at amortized cost. Accounts payable and accrued liabilities and due to related parties are classified as other financial liabilities, which are measured at amortized cost.

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

Section 3861 establishes standards for presentation of financial instruments and non-financial derivatives, and identifies the information that should be disclosed about them.

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(ii) Comprehensive Income

Section 1530 introduces the concept of comprehensive income, which is calculated by including other comprehensive income with net income. Other comprehensive income represents changes in shareholders' equity arising from transactions and other events with non-owner sources such as unrealized gains and losses on financial assets classified as available-for sale.

(iii) Hedges

Section 3865 specifies the circumstances under which hedge accounting is permissible and how hedge accounting may be performed, as well as the disclosure requirements. Hedge accounting enables the recording of gains, losses, revenues and expenses from derivative financial instruments in the same period as for those related to the hedged item. The company did not hold any derivative instruments during the year ended March 31, 2008.

Upon adoption of these new sections, the transition rules require that the company adjusts either the opening deficit or accumulated other comprehensive income as if the new rules had always been applied in the past, without restating comparative figures of prior years. The company has evaluated the impact of these new sections on its consolidated financial statements and determined that no significant adjustments were required upon adoption.

c) *Equity*

Effective April 1, 2007, the company adopted CICA Section 3251, *Equity*, which establishes standards for the presentation of equity and changes in equity during the reporting periods presented. As there are no changes resulting from the adoption of Section 1530, discussed above, the adoption of this policy had no impact on the company's consolidated financial statements for any of the periods presented.

## Recent Canadian Accounting Pronouncements

Recent Canadian accounting pronouncements that have been issued but are not yet effective, and which may affect the company's financial reporting are summarized below:

(i) Capital Disclosures

In December 2006, the Canadian Institute of Chartered Accountants ("CICA") issued Handbook Section 1535, *Capital Disclosures*, which establishes standards for disclosing information about an entity's capital and how it is managed. The entity's disclosure should include information about its objectives, policies and processes for managing capital and disclosure whether or not it has complied and the consequences of non-compliance with any capital requirements to which it is subject. This new standard will become effective for the company beginning on April 1, 2008. The company is currently evaluating the impact of this standard upon its adoption on April 1, 2008.

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(ii) Financial Instruments – Disclosures and Financial Instruments - Presentation

In December 2006, the CICA issued Handbook Sections 3862, *Financial Instruments – Disclosures*, and 3863, *Financial Instruments – Presentation*. Section 3862 modifies the disclosure requirements of Section 3861, *Financial Instruments – Disclosure and Presentation*, including required disclosure for the assessment of the significance of financial instruments for an entity's financial position and performance and of the extent of risks arising from financial instruments to which the company is exposed and how the company manages those risks, whereas Section 3863 carries forward the presentation related requirements of Section 3861. These new standards will become effective for the company beginning on April 1, 2008. The company is currently evaluating the impact of this standard upon its adoption on April 1, 2008.

(iii) Going Concern

In April 2007, the CICA approved amendments to Handbook Section 1400, *General Standards of Financial Statement Presentation*. These amendments require management to assess an entity's ability to continue as a going concern. When management is aware of material uncertainties related to events or conditions that may cast doubt on an entity's ability to continue as a going concern, those uncertainties must be disclosed. In assessing the appropriateness of the going concern assumption, the standard requires management to consider all available information about the future, which is at least, but not limited to, twelve months from the balance sheet date. The new requirements of the standard are applicable for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2008. The company is currently evaluating the impact of this standard upon its adoption on April 1, 2008.

(iv) International Financial Reporting Standards (“IFRS”)

In January 2006, CICA Accounting Standards Board (“AcSB”) adopted a strategic plan for the direction of accounting standards in Canada. As part of that plan, accounting standards in Canada for public companies are expected to converge with International Financial Reporting Standards (“IFRS”) by the end of 2011. The company continues to monitor and assess the impact of convergence of Canadian GAAP and IFRS.

(v) Goodwill and Intangible Assets

The CICA has also issued the new Handbook Section 3064, “Goodwill and Intangible Assets”, which will replace Section 3062, “Goodwill and Intangible Assets”. The new standard establishes revised standards for the recognition, measurement, presentation and disclosure of goodwill and intangible assets. The new standard also provides guidance for the treatment of preproduction and start-up costs and requires that these costs be expensed as incurred. The new standard applies to annual and interim financial statements relating to fiscal years beginning on or after October 1, 2008. Management is currently assessing the impact of these new accounting standards on its financial statements. Adoption of this standard will result in the withdrawal of EIC 27.

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## 3 Deferred petroleum exploration costs

	2008 \$	2007 \$ (as restated – note 11)
Exploration drilling related services		
Drilling services	5,634,766	5,634,766
Drilling technical supervision and evaluation	318,394	318,394
Exploration Geological & Geophysical Surveys & Works		
Geological & geophysical survey acquisition & processing	9,544,442	8,970,420
Technical evaluations & management	3,956,256	3,566,523
Pre-development study	690,505	-
Interest on funding of deferred exploration expenditure	3,550,713	3,553,393
Deferred costs acquired from Primeline Petroleum Corporation	1,394,307	1,394,307
Project administration	2,369,157	2,103,881
Salaries and benefits	3,182,154	2,560,293
Travel and accommodation	1,376,830	1,094,135
Contract signing fee	539,917	539,917
Foreign exchange gain	(810,307)	(795,823)
	<u>31,747,134</u>	<u>28,940,206</u>

The company and Primeline Petroleum Corporation (PPC), an affiliated company, are contractors (collectively, the Contractors) to the Petroleum Contract dated March 24, 2005 with China National Offshore Oil Corp. (CNOOC) to explore, develop and produce oil and gas reserves that may exist in an area known as Block 25/34 (the Contract Area) in Lishui and Jiaojiang Basins, East China Sea. The Contract Area includes the majority of previous Block 32/32 covered by a prior petroleum contract between the Contractors and CNOOC which was in effect during the period from December 12, 1994 to February 28, 2005. The company and PPC hold 75% and 25% of the Contractors' interest, respectively. The Petroleum Contract became effective on May 1, 2005, and has three periods: exploration, development and production, with a maximum contract term of 30 years. The exploration period is normally seven years while the production period is normally 15 years. The exploration period is further subdivided into three exploration phases, which includes the first phase of three contract years (the first contract year through the third contract year); the second phase of two contract years (the fourth contract year through the fifth contract year); and the third phase of two contract years (the sixth contract year through the seventh contract year). The Contractors are committed to drilling one exploration well in each of the three exploration phases (with additional 200 square kilometres of 3D seismic in phase one) and expending minimum qualifying exploration costs of US\$6,000,000 in the first phase and US\$5,000,000 in each of the second and third phases. At the end of each of the first and second exploration phases, the Contractors must decide whether to enter into the next exploration phase and relinquish 25% of the remaining Contract Area, or terminate the Petroleum Contract. At the end of the third exploration phase, the Contract Area, except for any discovery, development, production area that may exist in the Contract Area, is relinquished.

The Petroleum Contract provides that the Contractors will fund all costs incurred during the exploration period, and CNOOC has the right to participate up to 51% in any future development and production of oil and/or gas fields in the Contract Area by paying its pro rata share of the development and production costs. The Contractors will remain as operators for the development and production period until at least full cost recovery.

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By an Amendment Agreement dated February 28, 2008 between CNOOC, the company and PPC, the parties have agreed that the Petroleum Contract be amended to provide that the first exploration period shall be for a period of four years from the date of commencement on May 1, 2005, provided that one of the two subsequent two-year exploration periods will be reduced by a corresponding period of one year unless otherwise agreed. The minimum exploration requirement for each of phases 2 and 3 is the drilling of one well to 2,500m and an expenditure of US\$5,000,000.

## 4 Capital stock and contributed surplus

a) Authorized

	<u>Number of shares</u>		
	<u>2008</u>	<u>2007</u>	
Common shares with a par value of US\$0.001 each	500,000,000	500,000,000	
Issued and outstanding			
	<b>Number of common shares</b>	<b>Amount \$</b>	<b>Contributed surplus \$ (as restated - note 11)</b>
Balance - March 31, 2006	25,087,290	34,311	13,147,654
Private placement	16,666,666	22,795	15,307,079
Debt conversion	5,266,667	7,203	6,037,834
Issuance of warrants	-	-	9,131,529
Fair value of options	-	-	6,820,534
Balance - March 31, 2007	47,020,623	64,309	50,444,630
Fair value of options	-	-	854,811
Balance - March 31, 2008	47,020,623	64,309	51,299,441
		<b>2008</b>	<b>2007</b>
Weighted average number of common shares outstanding		47,020,623	46,780,258

On April 4, 2006, the company closed a private placement units offering, comprising 16,666,666 units at a price of \$1.50 per unit for gross proceeds of \$25 million. Each unit consists of one common share and one half of one common share purchase warrant, with each whole warrant entitling the holder thereof to acquire an additional common share upon payment of \$2.00 at any time in the two years following the closing of the private placement. Share issuance costs for the unit offering totalled \$2,393,560. In

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conjunction with the private placement, the company also issued 5,266,667 units with identical terms to those issued in the private placement to settle debt balances due to PIHI totalling \$7.9 million.

b) Stock options

The company has a stock option plan (the Plan), pursuant to which the directors are authorized to grant up to 7,053,000 common shares in options. The options enable the directors, officers, consultants and employees to acquire common shares. The exercise price of a share option will be set by the board of directors, subject to TSX Venture Exchange policy. Options granted under the Plan may have a maximum term of five years and vest in stages over at least 18 months the options vesting equally on a quarterly basis, as determined by the board of directors at the grant date.

The following table summarizes information about the stock options outstanding and exercisable at March 31, 2008 and 2007:

	2008		2007	
	Options outstanding	Weighted average exercise price \$	Options outstanding	Weighted average exercise price \$
Outstanding - Beginning of year	5,500,000	1.52	-	-
Granted	875,000	2.00	5,700,000	1.52
Cancelled	(217,000)	1.60	(200,000)	1.50
Outstanding - End of year	6,158,000	1.59	5,500,000	1.52
Options exercisable – End of year	5,341,141	1.53	3,461,111	1.51

On April 4, 2006, the company granted under the old stock option plan 4,500,000 options at an exercise price of \$1.50 per share to directors, officers, consultants and employees of the company entitling them to purchase shares in the company until April 4, 2011. 200,000 of the 4,500,000 options have been cancelled.

On December 1, 2006, the company awarded options to its non-executive directors, management and consultants to purchase up to 1,200,000 common shares at an exercise price of \$1.60 per share. 217,000 of the 1,200,000 options have been cancelled by agreement with the option holders. 433,000 of the 1,200,000 options will expire on May 31, 2008 while the balance of 550,000 options will expire on November 30, 2011.

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On November 1, 2007, the company awarded options to purchase a total of 875,000 common shares at an exercise price of \$2.00 per share. 250,000 of the 875,000 options were awarded to CHF Investor Relations, the company's newly appointed investor relations counsel, while 625,000 options were awarded to executive directors, management and consultants. All such options will expire on October 31, 2012.

The weighted average fair value of the options granted during the year was \$1.09 per option, and was calculated using the Black-Scholes option pricing model.

In connection with the grant of stock options to directors, officers, consultants and employees, the company recognized a stock-based compensation expense of \$700,580 for the year ended March 31, 2008 (March 31, 2007 - \$5,970,256 as restated) and capitalized \$154,231 to deferred exploration costs for the year ended March 31, 2008 (March 31, 2007 - \$850,278 as restated).

Assumptions used in the Black-Scholes option pricing model for measurement of the options granted during the years ended March 31, 2008 and 2007 are as follows:

	2008	2007
Risk-free interest rate	4.16%	3.81-4.06%
Expected life	5 years	1.5-5 years
Expected volatility	82%	71-98%
Expected dividends	Nil	Nil

Option pricing models require the input of highly subjective assumptions, including the expected price volatility. Changes in the subjective input assumptions can materially affect the fair value of stock options granted by the company.

As at March 31, 2008 stock options outstanding and exercisable are as follows:

Exercise price	Number of outstanding options as at March 31, 2008	Weighted average remaining contractual life	Number of exercisable options as at March 31, 2008
1.5	4,300,000	3 years	4,300,000
1.6	433,000	0.2 years	433,000
1.6	550,000	3.7 years	462,315
2.0	875,000	4.6 years	145,826
	<b>6,158,000</b>	<b>2.3 years</b>	<b>5,341,141</b>

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c) Warrants

	Number of warrants	Weighted average exercise price \$
Outstanding - March 31, 2008 and 2007	11,799,999	2.00

On April 4, 2006, the company completed a private placement and a debt conversion (see note 4(a)). This resulted in the issuance of 11,799,999 warrants at an exercise price of \$2.00 per warrant. Each warrant was exercisable on or before April 4, 2008. After October 4, 2006, the warrants were subject to a forced conversion, at the option of the company, if the common shares trade at or above \$3.00 per share for a period of 20 consecutive trading days, in which case the warrants would expire on the 20<sup>th</sup> calendar day following the date that notice of the forced conversion is sent to the warrant holders. Subsequent to the year end, all of the warrants expired unexercised.

The fair market value of the 11,799,999 warrants issued under the private placement and debt conversion using Black-Scholes warrant pricing model amounted to \$9,131,529. Assumptions used in the Black-Scholes warrant pricing model for measurement of the warrants are as follows:

Risk-free interest rate	4.04%
Expected life	2 year
Expected volatility	100%
Expected dividends	Nil

## 5 Commitments

- a) The company entered into a lease agreement for the rental of PEHI's Shanghai office in the People's Republic of China. The lease is for a period of three years from August 24, 2005 to August 31, 2008 with a monthly rental fee of \$4,260 (RMB 28,946).
- b) The company has minimum qualifying exploration commitments of US\$6,000,000 in phase 1 and US\$5,000,000 in both phases 2 and 3 of the exploration period of the petroleum contract (see note 3).
- c) On November 1, 2007, the company entered into an Investors Relations Agreement to provide corporate communications services to the company for a period of 12 months with a monthly retainer fee of \$6,000. In addition, the service provider received options to purchase 250,000 shares in the capital stock of the company at an exercise price of \$2.00 per share. The fair value of these options was estimated at \$108,412 using the Black-Scholes option pricing model.

# Primeline Energy Holdings Inc.

(an exploration stage company)

Notes to Consolidated Financial Statements

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## 6 Related party transactions

During the year ended March 31, 2008, the company paid the following:

- a) London office rent of \$78,690 (2007 - \$82,575) to a company under common control of which the shareholder of that company is also the shareholder of the company's ultimate holding company, PIHI, a private British Virgin islands corporation, all of the issued and outstanding shares of which are beneficially owned by Mr. Victor Hwang, president and a director of the company, and members of the Hwang family.
- b) fees and expenses of \$24,438 (2007 - \$27,175) to a company controlled by Mr. Peter Kelty, a director for investor relations, securities exchange matters and other administrative services.
- c) advances of \$134,199 (2007 - \$132,207) from a company under common control of which the shareholder of that company is also the shareholder of the company's ultimate holding company PIHI.

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

Other related party balances are disclosed elsewhere in these consolidated financial statements.

## 7 Income taxes

The company is domiciled in an income tax-exempt jurisdiction and carries out its oil exploration activities in the PRC; these activities are subject to PRC income tax at a rate of 25% starting January 1, 2008 (2007 income tax rate was 33%). In accordance with PRC tax regulation, exploration costs incurred by foreign oil and gas enterprises can be deferred and amortized from commencement of oil/gas production.

Significant components of the company's future income tax liabilities are as followed:

	<b>2008</b>	<b>2007</b>
	\$	\$
		(as restated – note 11)
Resource properties	404,428	428,510
Net future income tax liability	404,428	428,510

For certain acquisitions and other payments for mineral property interests, the company records a future income tax liability and a corresponding adjustment to the related asset carrying amount. During the year ended March 31, 2008, the company recorded a future income tax recovery of \$100,046 arising from the change in the income tax rate in the PRC.

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Notes to Consolidated Financial Statements

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## **8 Financial instruments**

### **Interest rate exposure**

All of the company's financial instruments are non-interest bearing except cash and cash equivalents, which earn interest at a floating rate.

### **Fair value of financial assets and liabilities**

The fair values of deposits, accounts payable and accrued liabilities approximate to their carrying values due to the short-term nature of those instruments.

Management has determined that it is not practical to determine the fair value of advances from PIHI and affiliated companies because of the lack of availability of similar borrowing arrangements on an arm's-length basis.

## **9 Segmented reporting**

The company's principal activity is the exploration of oil and gas properties. The company's oil and gas property is located in China as described in note 3.

## **10 Subsequent events**

On May 14, 2008, CNOOC Ltd. Shanghai on behalf of Primeline, entered into an agreement with China Second Oceanographic Research Institute to conduct the Spring Environment survey for an amount of C\$233,280 (RMB 1,600,000).

On April 4, 2008, the warrants to subscribe for a total of 11,799,999 shares in the company at C\$2.00 per share which were previously issued by the company on April 4, 2006, all lapsed and none having been exercised prior to such expiry date.

On May 31, 2008, the options to subscribe for a total of 433,000 shares in the company at C\$1.60 per share which were previously granted by the company on December 1, 2006, all lapsed and none having been exercised prior to such expiry date.

On June 30, 2008, a subsidiary of the company, Primeline Energy Operations International Ltd. entered into an agreement with HISPEC Research Corp. to provide 2D seismic reprocessing for a total cost US\$246,202 plus HFE charges.

## **11 Restatement**

During the year ended March 31, 2008, the company identified an error in the measurement and recording of certain stock options granted to consultants during fiscal 2007 resulting in an overstatement of stock based compensation expense of \$597,143 for the year ended March 31, 2007, and overstatements of deferred petroleum exploration costs of \$107,055 and future income tax liability of \$ 28,818 as at March 31, 2007.

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The company has restated its consolidated balance sheet as at March 31, 2007 and statements of operations and loss and cash flows as at and for the year ended March 31, 2007 as follows:

	As previously reported \$	As restated \$
Stock-based compensation	(6,567,399)	(5,970,256)
Loss for the year	(6,068,551)	(5,471,408)
Basic and diluted loss per common share	(0.13)	(0.12)
Deferred petroleum exploration costs	29,047,261	28,940,206
Future Income tax liability	(457,328)	(428,510)
Contributed surplus	51,120,010	50,444,630
Deficit	(8,418,630)	(7,821,487)