



## Eurogas Corporation

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## MANAGEMENT'S DISCUSSION AND ANALYSIS

Eurogas Corporation ("Eurogas" or the "Corporation") is a Canadian-based company whose common shares are traded on the TSX Venture Exchange (TSXV) under the symbol EUG. Eurogas is focused on creating long-term value through the development of high-impact energy projects. The Corporation holds interests, both directly and indirectly, in the development of an underground natural gas storage facility in Spain and in certain exploration programs for oil and natural gas offshore Tunisia.

This interim Management's Discussion and Analysis ("MD&A") has been prepared with an effective date of November 28, 2008 and provides an update on matters discussed in, and should be read in conjunction with the Corporation's unaudited interim consolidated financial statements as at and for the three and nine months ended September 30, 2008 (the "Interim Financial Statements") and the audited consolidated financial statements and MD&A as at and for the year ended December 31, 2007. All amounts are in Canadian dollars unless otherwise specified. Financial data has been prepared in accordance with Canadian generally accepted accounting principles ("GAAP"), unless otherwise specified.

### FORWARD-LOOKING STATEMENTS

Certain information set forth in this document, including management's assessment of the Corporation's future plans and operations, contains forward-looking statements. Forward-looking statements are statements that are predictive in nature, depend upon or refer to future events or conditions or include words such as "expects", "anticipates", "intends", "plans", "believes", "estimates" or similar expressions. By their nature, forward-looking statements are subject to numerous risks and uncertainties, some of which are beyond the Corporation's control, including the impact of general economic conditions, industry conditions, volatility of commodity prices, currency fluctuations, imprecision of reserve estimates, environmental risks, competition from other industry participants, the lack of availability of qualified personnel or management, stock market volatility, the ability to access sufficient capital from internal and external sources, and other risk factors discussed or referred to in the section entitled "Business Risks" in the Corporation's MD&A as at and for the year ended December 31, 2007, and other documents filed from time to time with the securities administrators, all of which may be accessed at [www.sedar.com](http://www.sedar.com). Readers are cautioned that the assumptions used in the preparation of such information, although considered reasonable at the time of preparation, may prove to be imprecise and, as such, undue reliance should not be placed on forward-looking statements. The Corporation's actual results, performance or achievements could differ materially from those expressed in, or implied by, these forward-looking statements and, accordingly, no assurance can be given that any of the events anticipated by the forward-looking statements will transpire or occur, or if any of them do so, what resulting benefits the Corporation will derive. The Corporation disclaims any intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, except as required by law.

### SPANISH OIL AND GAS PROJECTS

The Corporation's 73.7% owned subsidiary, Castor UGS Limited Partnership ("CLP"), holds an interest in the Castor Exploration Permit through its investment in Escal UGS S.L. ("Escal"). The Castor Exploration Permit, which is owned directly by Escal, covers the abandoned Amposta oilfield, which will be utilized by Escal for its underground gas storage project. Upon completion, the Castor project will become a regulated utility forming a crucial element of Spain's energy infrastructure.

## **Business Reorganization of Escal**

As at December 20, 2007, CLP entered into agreements with ACS Servicios Comunicaciones y Energia, S.L. (“ACS”) and Enagas, S.A. (the “ACS Transaction”) pursuant to which Escal issued shares to ACS for cash proceeds of \$5.1 million such that ACS increased its ownership in Escal from 5% to 66.67%, reducing CLP’s interest to 33.33% from 95%. The completion of the ACS Transaction was conditional on receipt of a development concession for the Castor project which was received on May 16, 2008. Upon receipt of the development concession, the Corporation deconsolidated the various assets and liabilities of Escal previously included in the Corporation’s consolidated financial statements and recorded an equity investment in Escal. The Corporation incurred a dilution loss of \$2.3 million on the deconsolidation of Escal.

In addition, and following the dilution described previously, Escal became a self-sustaining operation and, accordingly, the current method is used for translating the results of its operations, with unrealized foreign currency translation gains or losses being included in accumulated other comprehensive income.

Under the terms of the ACS Transaction, ACS agreed that it would repay to CLP most of the amounts it previously invested in the Castor project. These amounts, which have been included in the Corporation’s Interim Financial Statements, as a loan receivable, were approximately €7.9 million (Cdn\$43.4 million) at the time of receipt of the development concession. As at September 30, 2008, CLP had received €18.3 million (Cdn\$29.3 million) against amounts receivable, and approximately €9.3 million (Cdn\$13.9 million) remained outstanding. Subsequent to September 30, 2008, CLP received further payments in respect of this loan in the amount of €7.4 million (Cdn\$11.9 million).

During the third quarter, CLP completed a cash distribution to all of its limited partners in an amount equal to the proceeds received pursuant to the ACS Transaction. Approximately \$21.6 million of this distribution was allocated and paid to the Corporation. The remaining \$7.7 million was allocated to the non-controlling limited partners of CLP, with the proceeds of the distribution being used to repay amounts owed by the non-controlling limited partners to the Corporation. At September 30, 2008, approximately \$1.5 million remained outstanding to the Corporation from non-controlling limited partners of CLP. This amount has been included as notes receivable in the Corporation’s Interim Financial Statements. Subsequent to September 30, 2008, and following receipt of additional cash payments pursuant to the ACS Transaction, CLP completed a further distribution, with the proceeds from the distribution which were allocated to the non-controlling interest limited partners being used to fully repay the remaining \$1.5 million due to the Corporation.

## **The Castor Project**

Following receipt of the development concession for the Castor project in Spain on May 16, 2008, control of Escal and the Castor project was transferred to ACS who will provide and/or arrange for the funding of the Castor project, including guarantees, through to the inclusion of the project in the Spanish gas system.

The Castor project’s anticipated significant working gas storage capacity of 1.3 billion cubic metres is expected to provide a reserve for seasonal and extraordinary peak demands, as well as the ability to respond to normal daily peak demands. The project’s anticipated high delivery rate of 25 million cubic metres per day will contribute strategic storage and reliability of supply to industrial and domestic customers in Spain.

Pursuant to an assistance contract entered into in October 2006, ACS began a Front End Engineering and Design Study (“FEED Study”) and initiated permitting and licensing services associated with the Castor project. The FEED Study was completed in 2007 and produced detailed design specifications for the facility and was used to estimate the cost of the project at approximately \$2 billion, and will also be used as the basis for fixed price, date-certain Engineering, Procurement and Construction (“EPC”) contracts.

The primary project permit, the development concession, was granted by a Royal decree dated May 15, 2008. It was published in the Official Gazette on June 6, 2008, which is the starting date for the concession period.

A number of secondary permit applications were filed on August 4, 2008:

- Environmental Impact Study, in order to secure the Environmental Impact Assessment, addressed to the Ministry of the Environment (Central Government).
- Integrated Environmental Authorization, related to the land on which the onshore plant will be located, addressed to the Department of the Environment, Government of the Region of Valencia.
- Concession for the Occupation of the Maritime-Terrestrial Public Domain, for the pipeline and offshore platforms, addressed to the Ministry of the Environment (Central Government).
- Public Utility Statement, to facilitate the acquisition of land required to build the facilities, addressed to the Ministry of Industry (Central Government).
- Administrative Authorization, for all facilities, addressed to the Ministry of Industry (Central Government).

All of these secondary permits were subject to a single public review period of 30 working days, whereby all the documents related to the permits were available to the public for review and comment in three locations: Vinaros, Castellon and Valencia. The public review period started September 17, 2008 and finished October 23, 2008. Comments were collected by the representative of the Central Government in Castellon, who has distributed them to all concerned parties. These comments are currently under review and once completed, a response will be provided to the government.

## **TUNISIAN OIL AND GAS PROJECTS**

Eurogas International Inc. (“Eurogas International”) is currently conducting exploration and evaluation programs for oil and natural gas offshore Tunisia in the Gulf of Gabes.

### **Business Reorganization of Eurogas International Inc.**

On July 10, 2008, the Corporation announced a restructuring plan that would allow for the distribution of its 100% interest in Eurogas International as a dividend-in-kind to shareholders of the Corporation (the “Restructuring”), such that each shareholder of the Corporation received one newly issued common share of Eurogas International for every five shares of the Corporation held. The Restructuring was completed on August 5, 2008 and the newly issued common shares of Eurogas International were placed in escrow for the benefit of shareholders of the Corporation, pending a public listing of Eurogas International common shares on the TSXV.

Prior to completing the Restructuring, the Corporation agreed to exchange \$45.7 million of amounts owed to it by Eurogas International for additional equity in Eurogas International. The Corporation subsequently exchanged its previous interest in the common shares of Eurogas International for 32,150,000 newly issued Series A Preference Shares and 31,143,635 newly issued common shares of Eurogas International. The Corporation will retain the Series A Preference Shares. As noted previously, the newly issued common shares were distributed to shareholders of the Corporation as part of the Restructuring.

The Series A Preference Shares rank in priority to the common shares of Eurogas International as to the payment of dividends and the distribution of assets on dissolution, liquidation or winding-up of Eurogas International and entitle the Corporation to a fixed preferential cumulative dividend at the rate of 4% per annum. The Series A Preference Shares may be redeemed, at the option of either Eurogas International or the Corporation, at any time, at a price equal to their face value of \$32,150,000. The Corporation has indicated that it does not intend to exercise its redemption entitlement within the next two years.

The Corporation has determined that its holding of Series A Preference Shares in Eurogas International constitutes a variable interest in Eurogas International. Furthermore, the Corporation has concluded that it meets the definition of a primary beneficiary of the variable interest entity and therefore, the Corporation continues to consolidate the assets and liabilities, and the results of operations of Eurogas International in its Interim Financial Statements. Accordingly, the Corporation’s interest in the Series A Preference Shares of Eurogas International, and the dividends paid thereon have been eliminated in the Corporation’s Interim Financial Statements.

Costs associated with the Restructuring, which have been estimated at approximately \$0.5 million, have been recorded in the Corporation's Interim Financial Statements as a charge against retained earnings.

On November 21, 2008, Eurogas International filed a preliminary prospectus with the securities commission.

### Sfax Permit

On September 30, 2008, Eurogas International held a 22.5% interest in the 1.0 million acre Sfax exploration permit. Eurogas International is the non-operating partner in the permit. All costs associated with the Sfax permit are capitalized as part of the pre-production phase of operations.

On April 8, 2008, Eurogas International announced that, along with its operating partner Atlas Petroleum Exploration Worldwide, Ltd. ("APEX"), it had entered into a farmout agreement (the "Farmout Agreement") with Amsterdam based Delta Hydrocarbons B.V. ("Delta") with respect to the Sfax permit. The agreement has received all regulatory approvals. The farmout enables Eurogas International and APEX to meet commitments with respect to the Sfax permit as described below.

Under the agreement, Delta acquired a 50% participation in the Sfax permit, reducing Eurogas International's interest from 45% to 22.5%, subject to spending US\$125 million. Included in this amount, and as part of the transaction, Eurogas International received a cash payment of approximately \$11.2 million, which has been applied to reduce capitalized costs relating to the Tunisian asset pool. After Delta has expended US\$125 million, the project reverts to joint venture participation and Eurogas International will be required to fund its pro-rata share of future expenditures in order to retain its proportionate interest in the project. If Delta does not fulfill the spending commitment of US\$125 million, Eurogas International's interest in the permit would revert to 45%.

In the three and nine months ended September 30, 2008, an aggregate of \$0.3 million (2007 - \$1.6 million) and \$1.7 million (2007 - \$3.9 million), respectively was capitalized to the Tunisian asset pool. The significant decrease in expenditures period-over-period results from Delta's funding of ongoing project costs pursuant to the Delta Farmout Agreement.

The following table shows the components of the Corporation's expenditure for each of the respective periods:

	Three Months Ended September 30		Nine Months Ended September 30	
	2008	2007	2008	2007
Share of restoration and purchase of assets	\$ -	\$ 424,989	\$ 571,825	\$ 2,024,250
Share of permit operator costs	21,493	1,118,509	352,676	1,539,559
Seismic activities	10,046	-	87,424	-
Ras-El-Besh well expenditures	-	-	117,406	-
Corporate general and administrative expenditures	263,000	41,077	473,000	305,077
Capitalized stock based compensation	28,683	18,193	118,508	54,578
Other expenditures	2,465	-	5,512	-
	<u>\$ 325,687</u>	<u>\$ 1,602,768</u>	<u>\$ 1,726,351</u>	<u>\$ 3,923,464</u>

In December 2005, Eurogas International and APEX applied for a development concession over the Ras-El-Besh prospect (the "REB Exploitation Concession") within the Sfax permit. The application was accepted by the Hydrocarbon Committee of the Tunisian government in July 2006 and the concession was gazetted on September 5, 2008 following commencement of drilling the REB-3 well on June 16, 2008. An exploitation concession is granted for a period of 30 years with a condition that concession development work starts within two years from the date of award. The REB-3 well is recognized by the Tunisian government as the commitment well under the terms of the Sfax exploration permit.

The REB-3 well was the first well to be drilled under the Delta Farmout Agreement and reached total depth of 2,204 metres. Well logs and formation pressure tests identified the presence of oil in a high quality, 10-metre thick carbonate interval in the Reineche formation, which was subsequently confirmed by down-hole sampling. The well was plugged back and drilled horizontally to 3,284 metres. The sidetrack intercepted the top of the Reineche formation in a lower fault block approximately 1,000 meters to the northwest of the REB-3 well then drilled horizontally through 400 meters of porous formation. The horizontal section was tested and produced over 1,000 barrels per day of fluid with a 10% oil cut. Oil has now been tested at two locations 1,000 metres apart. REB-3 has been suspended in a manner that it can be re-entered at a later date. Together with our joint venture partners, the Corporation will integrate the new data from REB-3 with the regional 3D seismic and carry out additional geological and geophysical evaluation to determine future plans for the Ras-El-Besh structure and the surrounding area. The drilling rig has been released.

The Jawhara oil structure, located approximately 30 kilometres south of Ras-El-Besh, was drilled in 1973 by Total S.A. (“JAW1”), testing oil to surface at an equivalent rate of 1,200 barrels of oil per day from Douleb – Bireno limestones of Cretaceous age. The Jawhara complex is a series of southwest to northeast fault blocks that are the first structures out of the basin to the east. JAW1 tested oil from the most southern fault block and additional drilling will confirm the northern extent of the trend.

A third independent structure, Salloum, drilled in the 1990’s by British Gas, tested an equivalent oil rate of 1,800 barrels per day from Bireno limestones. This structure is located in the northeast corner of the Sfax permit in shallow waters adjacent to the city of Sfax. In 2007, the Corporation and APEX arranged for 60 kilometres of shallow water three dimensional seismic to be shot and processed over this prospect. Initial mapping of the old two dimensional and new three dimensional seismic demonstrate that the structure is valid and that the structure can be drilled and tested from an onshore location. An onshore operation will reduce drilling and development costs significantly compared to the offshore.

Additional prospects have been identified throughout the Sfax permit based on evaluation of older two dimensional and new three dimensional seismic data.

#### **Expiry of Farmout Option Agreement with Anadarko Petroleum Corporation (“Anadarko”)**

Eurogas International and its joint venture partner had entered into a farmout option agreement with Anadarko in May 2006 pursuant to which Anadarko acquired a 520 km<sup>2</sup> 3-D seismic survey for \$15.5 million. Anadarko did not elect to proceed under the terms of the agreement by April 1, 2008 and accordingly, forfeited all rights to conduct work or receive any interest in the farmout areas.

## **CONSOLIDATED RESULTS OF OPERATIONS**

### **Net Loss**

The Corporation’s current energy projects are in the development stage and therefore, the Corporation does not generate operating revenues.

In the nine months ended September 30, 2008, the Corporation incurred a net loss of \$3.2 million, including a loss of \$1.6 million in the third quarter of this year. This compares with a net loss of \$1.6 million incurred during the nine months ended September 30, 2007, including a loss of \$47,864 incurred in the third quarter of that year.

The net loss incurred during the nine months ended September 30, 2008 includes a dilution loss of \$2.3 million resulting from the deconsolidation and subsequent equity accounting of our investment in Escal, partially offset by a foreign exchange gain of \$0.3 million related to the associated loan receivable. The remaining net loss reflects administrative and financing costs not otherwise attributed to deferred exploration asset pools, net of interest and other miscellaneous revenues.

### **Interest and Other Revenue**

During the three and nine months ended September 30, 2008, the Corporation earned interest and other revenue of \$0.5 million and \$1.0 million, respectively (2007 - \$0.2 million and \$0.6 million, respectively). The increase in interest and other revenue is attributed to higher levels of cash and short term deposits, as well as the Corporation's investments in discounted notes and guaranteed investment certificates. The Corporation also earns interest on amounts outstanding pursuant to its loan and notes receivable.

### **General & Administrative Expenses**

General and administrative expenses ("G&A") not otherwise capitalized to deferred exploration asset pools, totaled \$1.2 million and \$2.5 million during the three and nine months ended September 30, 2008, respectively (2007 - \$0.5 million and \$1.8 million, respectively). The period-over-period increase in G&A expenses is attributable to compensation and severance expenses of \$0.7 million incurred in the third quarter of 2008 pursuant to a business restructuring that was completed in the fourth quarter of 2008.

### **Capitalized G&A Expenses**

During the three and nine months ended September 30, 2008, the Corporation allocated G&A costs, including stock based compensation amounts, of \$0.3 million and \$1.7 million, respectively (2007 - \$0.5 million and \$1.9 million, respectively) to deferred exploration asset pools in association with the development phase of the Corporation's projects, and in accordance with service agreements. The amounts allocated to deferred exploration asset pools is based on the proportion of employee time and resources dedicated to each project or upon specific fees in accordance with service agreements.

### **Stock Based Compensation Expense**

During the three and nine months ended September 30, 2008, the Corporation incurred stock based compensation costs of \$0.1 million and \$0.4 million, respectively (2007 - \$0.2 million and \$1.0 million, respectively). In addition, during the same period, \$28,683 and \$48,827, respectively, (2007 - \$0.2 million and \$0.6 million, respectively) of stock based compensation costs were capitalized to deferred exploration asset pools.

### **Share of Earnings of Equity Accounted Investee**

Following receipt of the development concession and completion of the ACS Transaction, the Corporation began to account for its investment in Escal and the Castor project on an equity basis. Accordingly, during the three months ended September 30, 2008, the Corporation incurred a loss of \$10,543, representing the Corporation's proportionate interest in the losses incurred by Escal during that period.

In addition, included in other comprehensive income during the nine months ended September 30, 2008 are foreign exchange gains of \$0.2 million (net of a foreign exchange loss of \$0.2 million in the third quarter of this year), representing the Corporation's share of foreign exchange adjustments incurred on the translation of Escal's operations to Canadian dollars. Amounts of foreign exchange gains and losses reported in other comprehensive income are net of the amounts attributed to the non-controlling limited partners of CLP.

### **Income Taxes**

As at September 30, 2008, the Corporation's net future tax asset was \$nil (December 31, 2007 - \$0.2 million). During the nine months ended September 30, 2008, the Corporation recognized a tax recovery of \$0.1 million relating to certain loss carry backs expected to be realized during 2009.

## **LIQUIDITY AND CAPITAL RESOURCES**

At September 30, 2008, the Corporation had cash and short term deposits of \$32.5 million and a portfolio of investments, including discounted notes and guaranteed investment certificates, with a market value of \$35.3 million. Investments have been classified, and are reported as held-for-trading securities in the Corporation's Interim Financial Statements.

The Corporation's working capital increased to \$81.4 million as at September 30, 2008 from \$2.9 million as at December 31, 2007. The increase in working capital includes the receipt of \$29.6 million, net of issue costs, pursuant to the completion of a rights offering in April 2008. In addition, working capital has increased as a result of cash of approximately \$11.2 million received pursuant to the Delta Farmout Agreement and approximately \$29.3 million of cash received pursuant to the ACS Transaction.

During 2008, the Corporation had drawn \$2 million under the terms of the \$6 million revolving term credit facility provided by Dundee Corporation, the Corporation's controlling shareholder. On completion of the rights offering in April 2008, amounts borrowed pursuant to the facility were fully repaid and the facility was cancelled. While the facility was outstanding, the Corporation incurred interest at the rate of prime plus 2% per annum, and a standby rate of 1% per annum on any undrawn portion of the facility.

In accordance with the terms of the ACS Transaction, ACS will be responsible for funding the Castor project, including providing all guarantees that may be required, from the day it became a majority shareholder of Escal through to the inclusion of the underground storage facility into the Spanish gas system. Based on a FEED Study completed in 2007, the anticipated cost of the Castor project is approximately \$2 billion.

With the granting of the development concession on May 16, 2008, which gave effect to the ACS Transaction, the commitment letter previously provided by Dundee Corporation was cancelled. The commitment letter was originally issued to Escal and the Corporation, committing to either arranging for or providing financing for the Castor project of €45 million until the projected completion of project financing and for the additional estimated equity requirement of €25 million. The Corporation is no longer required to provide any equity or warranties as may have been required by project finance lenders or to provide any bridge financing.

The Delta Farmout Agreement is expected to facilitate development activities on the Sfax permit. As a condition to Delta retaining its 50% participation in the Sfax permit, Delta committed to spend US\$125.0 million on this project, including the cash payment to the Corporation of \$11.2 million referred to previously. As at November 21, 2008, an estimated US\$97.8 million of the US\$125 million commitment has been spent, including US\$70.3 million on the work program and US\$27.5 million on production equipment. Once Delta spends the committed amount, future expenditures must be funded by each joint venture partner on a pro-rata basis in order for each joint venture partner to retain their proportionate interest in the project. Eurogas International is in the process of becoming a separately listed public company. As a public company, Eurogas International will have access to capital markets directly in the event that additional equity is required.

Although the Corporation's interest in Eurogas International is limited to its \$32.2 million investment in preference shares (see "Business Reorganization of Eurogas International Inc."), the Corporation continues to consolidate the accounts of Eurogas International as required by accounting standards.

### **Outstanding Share Data**

On April 24, 2008, the Corporation completed a rights offering pursuant to which it issued 31,143,690 common shares at a subscription price of \$0.97 per share. Proceeds from the rights offering, net of associated expenses of \$0.6 million, were \$29.6 million.

As at November 7, 2008, there were 155,718,453 shares outstanding. The Corporation has also issued 315,000 deferred share units and 5,005,000 stock options with a weighted average exercise price of \$1.23. Stock options outstanding have expiry dates ranging from June 2009 to May 2012.

## SELECTED QUARTERLY FINANCIAL INFORMATION

### Summary Financial Information

#### Three months ended

	September 30, 2008	June 30, 2008	March 31, 2008	December 31, 2007
<b>Interest income</b>	\$ 537,588	\$ 282,481	\$ 160,138	\$ 190,363
<b>Funds provided by (used in) operations</b>				
Continuing operations	(390,087)	(327,546)	(85,775)	(261,901)
Corporate total	(390,087)	(327,546)	(85,775)	(261,901)
<b>Net loss</b>				
Continuing operations	(1,907,940)	(1,412,773)	(136,353)	(173,315)
Equity participation	(10,543)	-	-	-
Non-controlling interest	343,995	(290,878)	237,273	(121,661)
Corporate total	(1,574,488)	(1,703,651)	100,920	(294,976)
Per share basic and fully diluted	(0.01)	(0.01)	-	-
<b>Capital expenditures (gross)</b>	\$ 325,687	\$ 403,891	\$ 2,158,792	\$ 8,649,462

#### Three months ended

	September 30, 2007	June 30, 2007	March 31, 2007	December 31, 2006
<b>Sales, net of royalties</b>				
Discontinued operations	\$ -	\$ -	\$ -	\$ 38,000
<b>Interest income</b>	227,765	181,819	178,002	267,491
<b>Funds provided by (used in) operations</b>				
Continuing operations	71,588	(171,171)	(153,394)	(151,753)
Discontinued operations	-	-	-	(28,728)
Corporate total	71,588	(171,171)	(153,394)	(180,481)
<b>Net loss</b>				
Continuing operations	(241,981)	(1,209,434)	(355,067)	(990,028)
Discontinued operations	194,117	-	-	(28,728)
Corporate total	(47,864)	(1,209,434)	(355,067)	(1,018,756)
Per share basic and fully diluted	-	(0.01)	-	(0.01)
<b>Capital expenditures (gross)</b>	\$ 1,602,768	\$ 5,832,171	\$ 3,814,228	\$ 1,351,721

## CONTINGENCIES, COMMITMENTS AND OFF BALANCE SHEET OBLIGATIONS

Other than as disclosed in the notes to the Interim Financial Statements, there have been no substantive changes in the description and nature of contingencies, commitments and off balance sheet obligations from those described in the audited consolidated financial statements of the Corporation as at and for the year ended December 31, 2007, and the associated MD&A.

## **RELATED PARTY TRANSACTIONS**

During the second quarter of 2008, the Corporation repaid amounts outstanding pursuant to the \$6 million revolving term credit facility provided by Dundee Corporation, and the revolving term credit facility was subsequently cancelled.

As part of the development concession received on May 16, 2008 relating to the Castor project, Dundee Corporation's commitment letter to the Corporation and Escal to arrange for, or provide project financing for the Castor project has been cancelled.

As part of a restructuring initiated by the Corporation in the fourth quarter of 2008, the Corporation intends to enter into a services agreement with Dundee Resources Ltd., pursuant to which Dundee Resources Ltd. will provide the Corporation with administrative support services as well as geophysical, geological and engineering consultation with regard to the Corporation's activities. Dundee Resources Ltd. is a wholly owned subsidiary of Dundee Corporation.

There have been no other significant changes to the nature and scope of related party transactions to those described in Note 11 to the audited consolidated financial statements of the Corporation as at and for the year ended December 31, 2007 and the section entitled "Related Party Transactions" in the associated MD&A.

## **BUSINESS RISKS**

There are a number of inherent risks associated with the Corporation's two energy projects. Many of these risks are beyond the control of management. No changes have been identified to risk factors affecting our business and our approaches to managing these risks from those described in our MD&A as at and for the year ended December 31, 2007.

## **ACCOUNTING POLICIES AND ESTIMATES**

The preparation of consolidated financial statements in accordance with GAAP requires management to make judgements and estimates on matters that are uncertain. These estimates affect the reported amounts of assets and liabilities as well as revenues and expenses. While management reviews its estimates regularly, new information and changed circumstances may result in actual results or changes to estimated amounts that differ materially from current estimates. The Interim Financial Statements follow the same accounting principles and methods of application as those described in Note 1 to the Corporation's audited consolidated financial statements as at and for the year ended December 31, 2007, except as described below under "Changes in accounting policies adopted in 2008". A summary of the more significant judgements and estimates made by management is provided in the section entitled "Critical Accounting Estimates" in the Corporation's MD&A as at and for the year ended December 31, 2007.

## **CHANGES IN ACCOUNTING POLICIES ADOPTED IN 2008**

As of January 1, 2008, the Corporation adopted the provisions of CICA Handbook sections 3862 "*Financial Instruments - Disclosures*", 3863 "*Financial Instruments - Presentation*" and 1535 "*Capital Disclosures*". The new standards include enhanced disclosure requirements on the nature and extent of risks arising from financial instruments and how the Corporation manages those risks. In addition, section 1535 requires qualitative and quantitative disclosures that enable the users to evaluate the Corporation's objectives, policies and processes for managing capital.

The financial assets and financial liabilities are not subject to significant market risk, credit risk or liquidity risk. Financial instruments are recorded on the consolidated balance sheet at carrying values that are representative of, or approximate, fair value. (Refer also to Note 1 to the Interim Financial Statements.)

The Corporation defines the capital that it manages as its shareholders' equity. The Corporation's objectives when managing capital include ensuring that the Corporation is able to meet its financial obligations as they become due and ensuring that the Corporation has sufficient capital available to benefit from opportunities, should they arise, in order to ensure shareholder value.

## **FUTURE ACCOUNTING CHANGES**

On February 13, 2008, the CICA Accounting Standards Board announced the adoption of International Financial Reporting Standards ("IFRS") for publicly accountable enterprises. IFRS will replace Canadian GAAP. The implementation will apply to the Corporation's interim and annual financial statements beginning with January 1, 2011, including the restatement of comparative amounts for 2010. While the Corporation has begun to assess the adoption of IFRS, the financial reporting impact of the transition to IFRS cannot be reasonably estimated at this time.

In February 2008, the CICA issued Section 3064, "*Goodwill and Intangible Assets*", which replaces Section 3062, "*Goodwill and Other Intangible Assets*". This new standard provides guidance on the recognition, measurement, presentation and disclosure of goodwill and intangible assets and is effective beginning January 1, 2009. Concurrent with the issuance of this standard, EIC-27, "*Revenues and Expenditures in the Pre-operating Period*", has been withdrawn. As a result of the withdrawal of EIC-27, the Corporation will no longer be able to defer costs and revenues incurred prior to commercial production at new operations.

## **DISCLOSURE CONTROLS AND INTERNAL CONTROLS OVER FINANCIAL REPORTING**

The Corporation's Chief Executive Officer (CEO) and Chief Financial Officer (CFO), with the participation of the Corporation's management, are responsible for establishing and maintaining disclosure controls and procedures as well as internal controls over financial reporting for the Corporation.

### **Disclosure Controls and Procedures**

Disclosure controls and procedures have been designed to provide reasonable assurance that information required to be disclosed by the Corporation in its annual filings, interim filings or other reports filed or submitted by it under securities legislation is accumulated and communicated to the Corporation's management, as appropriate, to allow timely decisions regarding required disclosures. The Corporation has conducted a review and evaluation of the design of disclosure controls and procedures with the conclusion that it has an effective system of disclosures and controls. While the Corporation believes that it has adequate disclosure controls and procedures in place, there can be no assurance that such controls and procedures will prevent all occurrences of errors and fraud, as such control systems can provide only reasonable, not absolute, assurance.

### **Internal Control Over Financial Reporting**

The Corporation's CEO and CFO are responsible for the Corporation's design of internal controls over financial reporting in order to provide reasonable assurance regarding the reliability of financial reporting and preparation of financial statements for external purposes in accordance with GAAP. Management has evaluated the design of the Corporation's internal controls and procedures over financial reporting. In common with other small companies, the Corporation is not of a sufficient size to justify optimal segregation of duties. However, the Corporation has established certain compensating controls, including key management authorizations and reviews. Otherwise, based on such evaluation, the CEO and CFO believe the design of internal controls over financial reporting to be sufficient to provide reasonable assurance. During the nine months ended September 30, 2008, there have been no material changes in internal control over financial reporting.

## **ADDITIONAL INFORMATION**

Additional corporate information, including the Corporation's most recent financial statements and annual information form can be accessed through the System for Electronic Document Analysis and Retrieval ("SEDAR") website at [www.sedar.com](http://www.sedar.com) and the Corporation's website at [www.eurogascorp.com](http://www.eurogascorp.com).

**EUROGAS CORPORATION**  
**Consolidated Balance Sheets**  
**(Unaudited)**

September 30, 2008    December 31, 2007

<b>ASSETS</b>			
<b>Current</b>			
Cash and short-term deposits	\$	32,450,880	\$ 1,180,753
Restricted cash		-	5,124,936
Accounts receivable		509,360	206,306
Investments (Note 3)		35,344,639	-
Prepays and other		37,774	2,155,871
Notes receivable (Note 4)		199,068	7,639,629
Loan receivable (Note 5)		13,882,221	-
Taxes recoverable		130,223	196,957
		<u>82,554,165</u>	<u>16,504,452</u>
Notes receivable (Note 4)		1,263,611	1,222,059
Property, plant and equipment (Note 6)		16,220,983	80,428,862
Equity investment in Escal (Note 2)		4,139,543	-
Future income taxes		-	193,127
	\$	<u>104,178,302</u>	\$ <u>98,348,500</u>
<b>LIABILITIES</b>			
<b>Current</b>			
Accounts payable and accrued liabilities (Note 7)	\$	1,201,098	\$ 8,468,930
Advance from ACS		-	5,124,936
		<u>1,201,098</u>	<u>13,593,866</u>
Asset retirement obligation		-	617,688
Non-controlling interest (Note 8)		3,997,619	11,981,554
		<u>5,198,717</u>	<u>26,193,108</u>
<b>SHAREHOLDERS' EQUITY</b>			
Share capital (Note 10)		97,499,768	67,898,790
Contributed surplus (Note 10)		4,828,880	4,117,269
Retained earnings (deficit)		(3,527,343)	139,333
Accumulated other comprehensive income		178,280	-
		<u>98,979,585</u>	<u>72,155,392</u>
	\$	<u>104,178,302</u>	\$ <u>98,348,500</u>

*The accompanying notes are an integral part of these interim consolidated financial statements*

**Commitments and contingencies (Note 13)**

**EUROGAS CORPORATION**  
**Consolidated Statements of Operations**  
(Unaudited)

	Three Months Ended September 30		Nine Months Ended September 30	
	2008	2007	2008	2007
<b>REVENUE</b>				
Interest and other	\$ 537,588	\$ 227,765	\$ 980,207	\$ 587,586
<b>EXPENSES</b>				
General and administrative	1,168,344	473,831	2,496,017	1,849,499
Interest (Note 9)	-	15,123	52,418	44,876
Depreciation and accretion	6,425	10,025	26,299	41,824
Foreign exchange (gain) / loss	1,189,716	111,829	(322,838)	431,165
	2,364,485	610,808	2,251,896	2,367,364
<b>LOSS FROM OPERATIONS</b>	(1,826,897)	(383,043)	(1,271,689)	(1,779,778)
Dilution loss (Note 2)	-	-	(2,302,131)	-
Share of earnings of equity accounted investee (Note 2)	(10,543)	-	(10,543)	-
<b>INCOME TAXES</b>				
Current	60,916	(129,103)	60,916	(2,337)
Future	9,584	(11,959)	(188,213)	29,041
	70,500	(141,062)	(127,297)	26,704
<b>NET LOSS BEFORE NON-CONTROLLING INTEREST</b>	(1,907,940)	(241,981)	(3,457,066)	(1,806,482)
Non-controlling interest (Note 8)	343,995	194,117	290,390	194,117
<b>NET LOSS FOR THE PERIOD</b>	\$ (1,563,945)	\$ (47,864)	\$ (3,166,676)	\$ (1,612,365)
<b>BASIC AND DILUTED</b>				
<b>NET LOSS PER SHARE (Note 10)</b>	\$ (0.01)	\$ -	\$ (0.02)	\$ (0.01)

*The accompanying notes are an integral part of these interim consolidated financial statements*

**EUROGAS CORPORATION**  
**Consolidated Statements of Comprehensive Loss**  
(Unaudited)

	Three Months Ended September 30		Nine Months Ended September 30	
	2008	2007	2008	2007
<b>LOSS FOR THE PERIOD</b>	\$ (1,563,945)	\$ (47,864)	\$ (3,166,676)	\$ (1,612,365)
Other comprehensive income				
Net foreign currency (loss) income on investment in self-sustaining operations, net of taxes for three and nine months ended September 30, 2008 of recovery of \$24,295 (2007, \$nil) and provision of \$34,557 (2007, \$nil) respectively (Note 2)	(170,071)	-	241,896	-
Non-controlling interest (Note 8)	44,725	-	(63,616)	-
<b>OTHER COMPREHENSIVE (LOSS) INCOME</b>	(125,346)	-	178,280	-
<b>COMPREHENSIVE LOSS FOR THE PERIOD</b>	\$ (1,689,291)	\$ (47,864)	\$ (2,988,396)	\$ (1,612,365)

*The accompanying notes are an integral part of these interim consolidated financial statements*

**EUROGAS CORPORATION**  
**Consolidated Statements of Changes in Shareholders' Equity**  
**(Unaudited)**

As at and for the nine months ended September 30, 2008 and year ended December 31, 2007

	Common Shares	Contributed Surplus	Retained Earnings (Deficit)	Accumulated Other Comprehensive Income	Total
Balance, December 31, 2006	\$ 67,719,390	\$ 2,066,878	\$ 2,046,674	\$ -	\$ 71,832,942
Net loss	-	-	(1,907,341)	-	(1,907,341)
Stock based compensation	-	2,050,391	-	-	2,050,391
Exercise of options	179,400	-	-	-	179,400
Balance, December 31, 2007	67,898,790	4,117,269	139,333	-	72,155,392
Net loss	-	-	(3,166,676)	-	(3,166,676)
Other comprehensive income	-	-	-	178,280	178,280
Rights offering, net of costs	29,600,978	-	-	-	29,600,978
Dividend-in-kind (Note 2)	-	-	(500,000)	-	(500,000)
Stock based compensation	-	711,611	-	-	711,611
Balance, September 30, 2008	\$ 97,499,768	\$ 4,828,880	\$ (3,527,343)	\$ 178,280	\$ 98,979,585

*The accompanying notes are an integral part of these interim consolidated financial statements*

**EUROGAS CORPORATION**  
**Consolidated Statements of Cash Flows**  
(Unaudited)

	Three Months Ended September 30		Nine Months Ended September 30	
	2008	2007	2008	2007
<b>OPERATING ACTIVITIES</b>				
Net loss from operations	\$ (1,563,945)	\$ (47,864)	\$ (3,166,676)	\$ (1,612,365)
Depreciation and accretion	6,425	10,025	26,299	41,824
Provision for (recovery of) future income taxes	172,537	(11,959)	(25,260)	29,041
Stock based compensation	138,632	203,674	662,783	1,051,475
Share of earnings from equity accounted investees	10,543	-	10,543	-
Dilution loss	-	-	2,302,131	-
Foreign exchange (gain) / loss	1,189,716	111,829	(322,838)	431,165
Non-controlling interest	(343,995)	(194,117)	(290,390)	(194,117)
	(390,087)	71,588	(803,408)	(252,977)
Change in non-cash working capital (Note 11)	994,506	809,255	(692,446)	1,200,153
Cash (used in) provided by operating activities	604,419	880,843	(1,495,854)	947,176
<b>FINANCING ACTIVITIES</b>				
Issue of share capital, net (Note 10)	(180,738)	-	29,437,944	179,400
Proceeds on issuance of partnership units	-	-	-	430,002
Proceeds on issuance of shares in subsidiary	-	139,445	-	139,445
Line of credit - advances	-	-	2,000,000	-
Line of credit - repayment	-	-	(2,000,000)	-
Dividend-in-kind (Note 2)	(500,000)	-	(500,000)	-
Change in non-cash working capital (Note 11)	(29,883)	(178,574)	(265,363)	(206,023)
Cash (used in) provided by financing activities	(710,621)	(39,129)	28,672,581	542,824
<b>INVESTING ACTIVITIES</b>				
Proceeds from sale of interest in oil and gas properties (Note 6)	-	-	11,161,266	-
Investment in property, plant and equipment (Note 6)	(297,002)	(4,124,216)	(2,843,188)	(13,132,048)
Investment in discounted notes and guaranteed investment certificates (Note 3)	-	-	(34,999,918)	-
Repayment of loan receivable	29,143,513	-	29,143,513	-
Change in fair value of investments (Note 3)	(308,436)	-	(344,721)	-
Change in cash resulting from deconsolidation of Escal	-	-	3,112,352	-
Change in non-cash working capital (Note 11)	22,431	(258,761)	(1,264,359)	1,540,529
Cash provided by (used in) investing activities	28,560,506	(4,382,977)	3,964,945	(11,591,519)
Foreign exchange gain (loss) on cash held in foreign currency	29,220	(111,829)	128,455	(431,165)
<b>INCREASE (DECREASE) IN CASH AND SHORT-TERM DEPOSITS</b>	28,483,524	(3,653,092)	31,270,127	(10,532,684)
<b>CASH AND SHORT-TERM DEPOSITS, BEGINNING OF PERIOD</b>	3,967,356	11,858,950	1,180,753	18,738,542
<b>CASH AND SHORT-TERM DEPOSITS, END OF PERIOD</b>	\$ 32,450,880	\$ 8,205,858	\$ 32,450,880	\$ 8,205,858

*The accompanying notes are an integral part of these interim consolidated financial statements*

# EUROGAS CORPORATION

## Notes to the Consolidated Financial Statements

As at and for the three and nine months ended September 30, 2008

(Unaudited)

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### 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

These unaudited interim consolidated financial statements of Eurogas Corporation (“Eurogas” or the “Corporation”) as at and for the three and nine months ended September 30, 2008 have been prepared by management in accordance with Canadian generally accepted accounting principles (“Canadian GAAP”). These interim consolidated financial statements follow the same accounting principles and methods of application as those disclosed in Note 1 to the Corporation’s audited consolidated financial statements as at and for the year ended December 31, 2007 (“2007 Audited Consolidated Financial Statements”) except as noted below. The Corporation’s interim consolidated financial statements do not include all disclosures required by Canadian GAAP for annual consolidated financial statements and, accordingly, should be read in conjunction with the 2007 Audited Consolidated Financial Statements.

The preparation of interim consolidated financial statements in accordance with Canadian GAAP requires management to make estimates and assumptions that may affect the reported amounts of assets and liabilities, the disclosure of contingencies as at the date of the interim consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. All amounts are in Canadian dollars unless otherwise specified.

#### **Basis of Presentation**

The consolidated financial statements include the accounts of the Corporation, all of its subsidiaries and, a variable interest entity for which the Corporation is the primary beneficiary. Subsidiaries of the Corporation include Castor GP Ltd., Castor UGS Limited Partnership (“CLP”), Amposta Energy Europe AB and Amposta Resources S.L. Pursuant to a reorganization (see Note 2), Eurogas International Inc. (“Eurogas International”) is considered a variable interest entity for which the Corporation is the primary beneficiary and accordingly, the accounts of Eurogas International continue to be consolidated in these financial statements. On May 16, 2008 and following the granting of the development concession (Note 2), the Corporation’s interest in Escal UGS S.L. (“Escal”) was deconsolidated and CLP’s interest in Escal has subsequently been accounted for using the equity method. Previously, the Corporation’s interest in Escal was consolidated.

#### **Changes in Accounting Policies**

As of January 1, 2008, the Corporation adopted the provisions of the Canadian Institute of Chartered Accountants (“CICA”) Handbook sections 3862 “Financial Instruments - Disclosures”, 3863 “Financial Instruments - Presentation” and 1535 “Capital Disclosures”. The new standards include enhanced disclosure requirements on the nature and extent of risks arising from financial instruments and how the Corporation manages those risks. In addition, section 1535 requires qualitative and quantitative disclosures that enable the users to evaluate the Corporation’s objectives, policies and processes for managing capital.

#### ***Financial Instruments***

The Corporation’s financial instruments include cash and short-term deposits, accounts receivable, accounts payable, notes receivable and a loan receivable. Financial instruments are recorded on the consolidated balance sheet at carrying values that are representative of, or approximate, fair value.

Eurogas also holds investments in discounted notes and GICs. These financial instruments are designated as held-for-trading. Held-for-trading financial instruments are measured at fair value, with gains and losses recognized in income in the period in which they arise.

# EUROGAS CORPORATION

## Notes to the Consolidated Financial Statements

As at and for the three and nine months ended September 30, 2008

(Unaudited)

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### Market Risk

Market risk is the risk that the fair value of a financial instrument will fluctuate because of changes in market prices. For purposes of this disclosure, the Corporation segregates market risk into three categories: fair value risk, interest rate risk and currency risk.

### Fair Value Risk

Fair value risk is the potential for loss from an adverse movement, excluding movements relating to changes in interest rates and foreign exchange currency rates, because of changes in market prices. The Corporation is not exposed to such risk.

### Interest Rate Risk

Interest rate risk relates to the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates. The Corporation incurs interest rate risk through its discounted notes and GICs and, to a lesser extent, cash and short-term deposits. The investments in discounted notes and GICs are designated as held-for-trading financial instruments and are measured at fair value. As a result, the effect of interest rate changes are recognized in net income in the period incurred. For every 50 basis point change in market interest rates, net income before income taxes related to discounted notes and GICs would change by approximately \$177,000. Notes receivable are at fixed rates of interest and therefore are not subject to interest rate risk.

### Currency Risk

Currency risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates. The Corporation periodically has accounts receivable and accounts payable denominated in foreign currencies, primarily Euros and US dollars. As a result of the deconsolidation of Escal (Note 2), the Corporation has a Euro denominated loan to Escal. A \$0.01 change in the foreign exchange translation rate of Euros to Canadian dollars would change the loan and receivable amounts by approximately \$92,000 with the unrealized foreign exchange amount recognized in income. The equity investment in Escal is considered a self-sustaining operation and the current method is used for translating the results of its operations with unrealized foreign currency translation adjustments included in other comprehensive income. A \$0.01 change in the foreign exchange translation rate of Euros to Canadian dollars would change the value of the Corporation's equity investment in Escal by approximately \$17,000, with the unrealized foreign exchange amount recognized in other comprehensive income. The Corporation also has certain cash balances that are denominated in US dollars in order to facilitate US dollar transactions.

### Credit Risk

Credit risk is the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation. Credit risk arises from cash and short-term deposits held with banks, notes receivable, discounted notes and GICs and, to a lesser extent, accounts receivable. The notes receivable are secured by units in CLP. The maximum exposure to credit risk is equal to the carrying value of these financial instruments less the value of any security held.

### Liquidity Risk

Liquidity risk is the risk that the Corporation will encounter difficulty in meeting obligations associated with financial liabilities. The Corporation's financial liabilities consist of accounts payable. The Corporation's line of credit was repaid in full on April 30, 2008. The Corporation mitigates liquidity risk by planning its project expenditures and securing financing facilities in advance of undertaking significant commitments.

# EUROGAS CORPORATION

## Notes to the Consolidated Financial Statements

As at and for the three and nine months ended September 30, 2008

(Unaudited)

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### *Capital Disclosures*

The Corporation defines the capital that it manages as its shareholders' equity. The Corporation's objectives when managing capital include ensuring that the Corporation is able to meet its financial obligations as they become due and ensuring that the Corporation has sufficient capital available to benefit from opportunities, should they arise in order to ensure shareholder value.

### *Future Accounting Changes*

The Corporation has assessed new and revised accounting pronouncements that have been issued, but not yet effective, and determined that the following may have a significant impact on the Corporation:

On February 13, 2008, the CICA Accounting Standards Board announced the adoption of International Financial Reporting Standards ("IFRS") for publicly accountable enterprises. IFRS will replace Canadian GAAP. The implementation will apply to the Corporation's interim and annual financial statements beginning with January 1, 2011, including the restatement of comparative amounts for 2010. While the Corporation has begun to assess the adoption of IFRS, the financial reporting impact of the transition to IFRS cannot be reasonably estimated at this time.

In February 2008, the CICA issued Section 3064, "Goodwill and Intangible Assets", which replaces Section 3062, "Goodwill and Other Intangible Assets". This new standard provides guidance on the recognition, measurement, presentation and disclosure of goodwill and intangible assets and is effective beginning January 1, 2009. Concurrent with the issuance of this standard, EIC-27, "Revenues and Expenditures in the Pre-operating Period", has been withdrawn. As a result of the withdrawal of EIC-27, the Corporation will no longer be able to defer costs and revenues incurred prior to commercial production at new operations.

## **2. DISPOSITIONS AND REORGANIZATIONS**

### **Disposition of Interest in Escal**

The Corporation's subsidiary, CLP, holds an interest in the Castor Exploration Permit through its investment in Escal. The Castor Exploration Permit, which is owned directly by Escal, covers the abandoned Amposta oil field, which will be utilized by Escal for its underground gas storage project.

As at December 20, 2007, the Corporation (through CLP) entered into agreements with ACS Servicios Comunicaciones y Energia, S.L. ("ACS") and Enagas, S.A., herein referred to as the "ACS Transaction". Under the ACS Transaction, Escal issued shares to ACS for cash proceeds of \$5,124,936 such that ACS increased its ownership in Escal from 5% to 66.67%, thereby reducing the interest of CLP, of which the Corporation is a 73.7% owner, to 33.33% from 95%. Refer also to Note 2 to the 2007 Audited Consolidated Financial Statements.

The ACS Transaction required that, in the event that the development concession for the Castor project was not granted within 180 days of the execution of the ACS Transaction, the change in ownership would be reversed and the agreements would terminate. Current accounting principles did not permit recognition of the transaction until the Spanish authorities approved the development concession and accordingly, the Corporation continued to consolidate the results and balances of Escal in its financial statements until the development concession was granted on May 16, 2008. In addition, the cash received for the shares was reflected as restricted cash on the consolidated balance sheet with a corresponding advance from ACS of \$5,124,936.

# EUROGAS CORPORATION

## Notes to the Consolidated Financial Statements

As at and for the three and nine months ended September 30, 2008

(Unaudited)

Upon the grant of the development concession, the Corporation deconsolidated the various assets and liabilities of Escal previously included in the Corporation's consolidated financial statements and recorded an equity investment in Escal.

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### Deconsolidation of assets and liabilities of Escal

Oil and natural gas properties	\$	55,914,190
Asset retirement obligation		(623,196)
Other net liabilities and non-controlling interest		(497,833)
		<hr/> 54,793,161

### Investment in Escal

Accounts receivable		491,115
Loan receivable (Note 5)		43,347,184
Equity investment in Escal		3,874,727
Future income taxes		(346,932)
		<hr/> 47,366,094
		7,427,067
Cash received from ACS		<hr/> 5,124,936
Dilution loss	\$	<hr/> <hr/> 2,302,131

Following dilution, Escal is considered to be a self-sustaining operation. Accordingly, the current method is used for translating the results of its operations, with unrealized foreign currency translation adjustments being included in accumulated other comprehensive income.

### Eurogas International Reorganization and Dividend-in-Kind

On July 10, 2008, Eurogas announced it would complete a restructuring plan that would allow for 100% of the common shares of Eurogas International to be distributed as a dividend-in-kind to all shareholders on a pro rata basis of one Eurogas International common share for each five Eurogas common shares held.

As part of the restructuring plan and before distribution of the dividend-in-kind, Eurogas agreed to exchange \$45,656,834 of amounts owed to it by Eurogas International for additional equity in Eurogas International. Concurrently, Eurogas approved a resolution to reduce the stated capital of the 100 common shares of Eurogas International by \$23,519,873 and to reduce the deficit of Eurogas International by an equivalent amount. Eurogas subsequently exchanged its previous interest in the 100 common shares of Eurogas International for 32,150,000 newly issued Series A Preference Shares and 31,143,635 newly issued common shares of Eurogas International.

The Series A Preference Shares rank in priority to the common shares of Eurogas International as to the payment of dividends and the distribution of assets on dissolution, liquidation or winding-up of Eurogas International and entitle Eurogas to a fixed preferential cumulative dividend at the rate of 4% per annum. The Series A Preference Shares may be redeemed, at the option of either Eurogas International or Eurogas, at any time, at a price equal to their face value of \$32,150,000. Eurogas has indicated that it does not intend to exercise its redemption entitlement prior to January 1, 2011.

On August 5, 2008, Eurogas completed the distribution of 31,143,635 common shares of Eurogas International as a dividend-in-kind. The Eurogas International common shares are being held in escrow, pending a public listing of Eurogas International shares.

# EUROGAS CORPORATION

## Notes to the Consolidated Financial Statements

As at and for the three and nine months ended September 30, 2008

(Unaudited)

The Corporation has determined that its holdings in the Series A Preference Shares referred to previously represents a variable interest in Eurogas International, of which the Corporation is the primary beneficiary. Accordingly, the Corporation continues to account for its investment in Eurogas International on a consolidated basis, and consolidates the accounts as illustrated in the following table:

	Eurogas International Inc.
<b>ASSETS</b>	
Cash and deposits	\$ 10,087,507
Property, plant and equipment	16,113,198
Other assets	7,621
	<u>\$ 26,208,326</u>
<b>LIABILITIES</b>	
Series A Preference Shares outstanding	\$ 32,150,000
Other liabilities	574,246
	<u>32,724,246</u>
<b>SHAREHOLDERS' EQUITY</b>	<u>(6,515,920)</u>
	<u>\$ 26,208,326</u>

Eurogas' investment in Series A Preference Shares in the amount of \$32,150,000 is eliminated in the Corporation's consolidated financial statements.

Costs associated with the dividend-in-kind and the subsequent listing of the Eurogas International common shares have been estimated at \$500,000 and have been recorded as a charge to retained earnings.

### 3. INVESTMENTS

	September 30, 2008	December 31, 2007
GICs	\$ 605,553	\$ -
Discounted notes	34,739,086	-
	<u>\$ 35,344,639</u>	<u>\$ -</u>

The Corporation's investments in GICs and discounted notes are issued by a Canadian Schedule 1 Chartered Bank.

These investments are designated as held-for-trading. During the three and nine months ended September 30, 2008, the fair value of net assets designated as held-for-trading increased by \$308,436 and \$344,721, respectively, which was recorded in interest and other income.

# EUROGAS CORPORATION

## Notes to the Consolidated Financial Statements

As at and for the three and nine months ended September 30, 2008

(Unaudited)

### 4. NOTES RECEIVABLE

	September 30, 2008	December 31, 2007
Notes payable on demand	\$ 196,452	\$ 7,363,644
Accrued interest	2,616	275,985
	199,068	7,639,629
Notes due August 1, 2012	922,547	922,547
Accrued interest	341,064	299,512
	1,263,611	1,222,059
	\$ 1,462,679	\$ 8,861,688

Interest income of \$29,883 (2007 - \$178,574) and \$265,363 (2007 - \$206,023) was recorded on outstanding amounts during the three and nine months ended September 30, 2008, respectively.

The notes payable on demand were originally due on May 17, 2008 and continue to accrue interest. The fair value of the notes approximates the carrying value as reported on the consolidated balance sheet.

During the three months ended September 30, 2008 and following the receipt of payment pursuant to the loan receivable from Escal (Note 5), the Corporation's subsidiary, CLP, completed a distribution to limited partners, of which \$6,744,372 was distributed to non-controlling interests. The proceeds from the distribution were used to repay amounts owing by the non-controlling interests pursuant to the terms of the notes receivable.

### 5. LOAN RECEIVABLE

As a result of the grant of the development concession on May 16, 2008 and the subsequent deconsolidation of CLP's interest in Escal (Note 2), amounts advanced are reflected in the Corporation's consolidated financial statements as a loan receivable from Escal. Previously, these amounts were eliminated as inter-company amounts in the consolidated financial statements. The loan receivable from Escal is denominated in Euros.

During the three months ended September 30, 2008, \$29,143,513 (€8,256,320) of these amounts were repaid and amounts that remained outstanding at September 30, 2008 were \$13,882,221 (€9,302,567).

Subsequent to September 30, 2008, CLP received cash of \$11,911,460 (€7,427,023) as further repayment against the loan receivable balance outstanding.

### 6. PROPERTY, PLANT AND EQUIPMENT

	September 30, 2008	December 31, 2007
Oil and natural gas properties:		
Spain	\$ -	\$ 54,753,345
Tunisia	16,113,198	25,548,113
	16,113,198	80,301,458
Other:		
Office equipment, furniture and fixtures	832,540	831,366
Accumulated depreciation	(724,755)	(703,962)
	\$ 16,220,983	\$ 80,428,862

# EUROGAS CORPORATION

## Notes to the Consolidated Financial Statements

As at and for the three and nine months ended September 30, 2008

(Unaudited)

Net capital investment during the period by cost centre was as follows:

	Three Months Ended September 30		Nine Months Ended September 30	
	2008	2007	2008	2007
Oil and natural gas properties:				
Spain	\$ -	\$ 2,853,605	\$ 1,160,845	\$ 10,174,854
Tunisia	325,687	1,602,768	1,726,351	3,923,464
	325,687	4,456,373	2,887,196	14,098,318
Other:				
Office equipment, furniture and fixtures	-	3,023	1,174	7,477
	\$ 325,687	\$ 4,459,396	\$ 2,888,370	\$ 14,105,795

Oil and natural gas properties include non-cash amounts totalling \$28,683 (2007 - \$160,966) and \$118,508 (2007 - \$638,733) related to stock based compensation charges capitalized during the three and nine months ended September 30, 2008, respectively. In addition, amounts in the nine months ended September 30, 2008 are shown net of a credit of \$69,681, related to forfeited stock options.

### Tunisia

#### *Sfax Permit*

The Corporation, through Eurogas International, is a non-operating partner in the 1.0 million acre Sfax permit located offshore in the Gulf of Gabes, where Eurogas International and its partners are conducting exploration programs for oil and natural gas. Eurogas International's operating partner in the permit is Atlas Petroleum Exploration Worldwide Ltd. ("APEX"). The programs include spending on the development of the Ras-El-Besh ("REB-3") prospect as well as processing seismic data to evaluate the Salloum prospect.

On April 7, 2008, Eurogas International and APEX entered into a Farmout Agreement with Delta Hydrocarbons B.V. ("Delta"), whereby Delta acquired a 50% participation in the Sfax permit, reducing the Corporation's interest to 22.5%, subject to a commitment to spend US\$125,000,000 (the "Spending Commitment"). If Delta does not fulfill the Spending Commitment, Eurogas International's interest in the permit would revert to 45%. The Spending Commitment includes a cash payment to Eurogas International, and funding Delta's, as well as Eurogas International's and APEX's share of future program expenditures. Once the Spending Commitment has been met, additional program expenditures are to be funded on a pro-rata basis by each partner in order for each partner to retain its proportionate share.

The Farmout Agreement provides for a work program of \$80 million and provides \$45 million for the purchase and upgrading of production equipment. These amounts can be re-directed with the consent of all parties. As of September 30, 2008, an estimated US\$91.4 million of the US\$125 million commitment has been spent, including US\$64.9 million on the work program and US\$26.5 million on production equipment.

During the second quarter of 2008, Eurogas International received \$11,161,266, pursuant to the Delta Farmout Agreement which has been applied to reduce the carrying value of the Tunisian asset pool.

# EUROGAS CORPORATION

## Notes to the Consolidated Financial Statements

As at and for the three and nine months ended September 30, 2008

(Unaudited)

Aggregate capital expenditures amounted to \$325,687 (2007 - \$1,602,768) and \$1,726,351 (2007 - \$3,923,464) during the three and nine months ended September 30, 2008, respectively. The following table shows the components of capital expenditures on Tunisian oil and gas properties for each of the respective periods:

	Three Months Ended September 30		Nine Months Ended September 30	
	2008	2007	2008	2007
Share of restoration and purchase of assets	\$ -	\$ 424,989	\$ 571,825	\$ 2,024,250
Share of permit operator costs	21,493	1,118,509	352,676	1,539,559
Seismic activities	10,046	-	87,424	-
Ras-El-Besh well expenditures	-	-	117,406	-
Corporate general and administrative expenditures	263,000	41,077	473,000	305,077
Capitalized stock based compensation	28,683	18,193	118,508	54,578
Other expenditures	2,465	-	5,512	-
	\$ 325,687	\$ 1,602,768	\$ 1,726,351	\$ 3,923,464

The Corporation continues to capitalize general and administrative expenditures to Tunisian asset pools as part of the pre-development phase of operations as well as to capitalize stock based compensation costs. Corporate costs are capitalized to Tunisian asset pools in accordance with service agreements.

During May 2006, Eurogas International and its joint venture partner entered into a farmout option agreement with Anadarko Petroleum Corporation ("Anadarko"). Anadarko acquired a 520 km<sup>2</sup> 3-D seismic survey for \$15.5 million but did not elect to proceed under the terms of the agreement by April 1, 2008 and, accordingly, forfeited all rights to conduct work or receive any interest in the farmout areas.

## 7. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Included in accounts payable and accrued liabilities at September 30, 2008 are severance costs of \$650,750 relating to a corporate reorganization that is to be completed in the fourth quarter of 2008. As part of the reorganization, the Corporation intends to enter into a services arrangement with Dundee Resources Ltd., a wholly owned subsidiary of the Corporation's parent, Dundee Corporation ("Dundee"), pursuant to which Dundee Resources Ltd. will provide the Corporation with administrative support services as well as geophysical, geological and engineering consultation with regard to the Corporation's activities.

# EUROGAS CORPORATION

## Notes to the Consolidated Financial Statements

As at and for the three and nine months ended September 30, 2008

(Unaudited)

### 8. NON-CONTROLLING INTEREST

The following table shows the components of non-controlling interest:

	Three Months Ended September 30		Nine Months Ended September 30	
	2008	2007	2008	2007
Balance, beginning of period	\$ 12,050,717	\$ 11,740,350	\$ 11,981,554	\$ 3,946,704
Cash calls in CLP	-	-	-	7,793,646
CLP distribution to partners	(7,664,376)	-	(7,664,376)	-
Issuance of shares in Escal	-	139,445	-	139,445
Effect of change in ownership of non-controlling interest	-	174,214	-	174,214
Non-controlling interest in results of subsidiaries	(343,995)	(194,117)	(290,390)	(194,117)
Non-controlling interest share of other comprehensive income	(44,727)	-	63,614	-
Effect of deconsolidation of Escal	-	-	(92,783)	-
Balance, end of period	\$ 3,997,619	\$ 11,859,892	\$ 3,997,619	\$ 11,859,892

### 9. RELATED PARTY TRANSACTIONS

Eurogas had a \$6,000,000 revolving term credit facility with Dundee Corporation, the Corporation's controlling shareholder. During the three months ended June 30, 2008, amounts drawn of \$1.5 million were repaid and the credit facility was cancelled. The credit facility bore interest at the rate of prime (based on Canadian chartered bank rates) plus 2 percent per annum. Interest was payable monthly, in arrears. The credit facility was secured by a general security agreement over the assets of the Corporation.

Interest expense on amounts drawn on the facility and standby fees related to the credit facility totalled \$nil (2007 - \$14,959) and \$52,418 (2007 - \$44,876) during the three and nine months ended September 30, 2008, respectively.

Dundee had previously provided a commitment letter to the Corporation and Escal in order to satisfy the Spanish authorities of Escal's financial ability to undertake the Castor project. Dundee had committed to either arranging for or providing financing for the project of €45 million (\$72 million) until the projected completion of project financing and for the additional estimated equity requirement of €25 million (\$40 million), if then required, subject to various conditions, including the grant of the development concession and other permits. As the development concession was granted on May 16, 2008, Dundee's obligation pursuant to the commitment letter has been cancelled.

# EUROGAS CORPORATION

## Notes to the Consolidated Financial Statements

As at and for the three and nine months ended September 30, 2008

(Unaudited)

### 10. SHARE CAPITAL

#### Issued and Outstanding:

	Number of Shares	Amount
Common shares, December 31, 2007	124,574,763	\$ 67,898,790
Rights Offering (i)	31,143,690	29,600,978
Common shares, September 30, 2008	155,718,453	\$ 97,499,768

<sup>(i)</sup> On April 24, 2008, Eurogas completed a Rights Offering pursuant to which it issued 31,143,690 common shares at a subscription price of \$0.97 per share. Costs relating to the offering, net of taxes of \$163,034, were \$608,401.

#### Contributed Surplus:

A summary of the changes in the Corporation's contributed surplus is as follows:

Balance, December 31, 2007	\$ 4,117,269
Share options vested (i)	498,811
Deferred share units vested (ii)	212,800
Balance, September 30, 2008	\$ 4,828,880

<sup>(i)</sup> Stock based compensation expense of \$138,632 (2007 - \$203,674) and \$449,983 (2007 - \$952,775) was recognized in association with share options during the three and nine months ended September 30, 2008, respectively. In addition, a total of \$28,683 (2007 - \$160,966) and \$48,828 (2007 - \$638,733) was capitalized to international asset pools during the three and nine months ended September 30, 2008, respectively.

<sup>(ii)</sup> Stock based compensation expense of \$212,800 (2007 - \$98,700) related to deferred share units was recognized during the three months ended June 30, 2008.

#### Stock Based Compensation:

##### Share Option Plan

Details of the Corporation's share option plan are disclosed in Note 13 to the 2007 Audited Consolidated Financial Statements. A summary of the status of the share option plan as at September 30, 2008, is as follows:

	Share Options	Weighted Average Exercise Price
Balance, December 31, 2007	6,005,000	\$ 1.27
Forfeited	(1,000,000)	1.47
Balance, September 30, 2008	5,005,000	\$ 1.23

# EUROGAS CORPORATION

## Notes to the Consolidated Financial Statements

As at and for the three and nine months ended September 30, 2008

(Unaudited)

As at September 30, 2008, options to purchase common shares were exercisable as follows:

Option Price	Options Outstanding	Options Exercisable	Remaining Contractual Life (Years)
\$ 0.32	400,000	400,000	0.8
\$ 1.12	2,650,000	1,766,667	3.7
\$ 1.19	25,000	25,000	1.6
\$ 1.26	450,000	450,000	1.5
\$ 1.50	200,000	200,000	1.5
\$ 1.65	680,000	673,333	2.7
\$ 1.76	600,000	600,000	1.5
	5,005,000	4,115,000	

On October 16, 2008, the Corporation granted 200,000 share options at an exercise price of \$0.54 per share option. The share options have a life of 5 years with one third vesting immediately, the next third vesting on the first year anniversary and the balance vesting on the second year anniversary.

### *Deferred Share Unit Plan*

Details of the Corporation's deferred share unit plan ("DSUP") are disclosed in Note 13 to the 2007 Audited Consolidated Financial Statements. No deferred share units were granted during the three months ended September 30, 2008, and as at September 30, 2008, 3,685,000 common shares remain available for grant under the DSUP.

### *Net loss per share:*

	Three Months Ended September 30		Nine Months Ended September 30	
	2008	2007	2008	2007
Net loss attributable to shareholders	\$ (1,563,945)	\$ (47,864)	\$ (3,166,676)	\$ (1,612,365)
Weighted average number of common shares outstanding	155,718,463	124,574,763	155,718,463	123,970,551
Basic and diluted net loss per share	\$ (0.01)	\$ -	\$ (0.02)	\$ (0.01)

# EUROGAS CORPORATION

## Notes to the Consolidated Financial Statements

As at and for the three and nine months ended September 30, 2008

(Unaudited)

### 11. SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION

Changes in non-cash working capital are comprised of the following:

	Three Months Ended September 30		Nine Months Ended September 30	
	2008	2007	2008	2007
Accounts receivable	\$ 95,656	\$ (114,256)	\$ 203,894	\$ 44,089
Prepays and other	(2,141)	(463,091)	(359,333)	(712,087)
Joint venture receivable	-	53,260	-	463,382
Notes receivable - accrued interest	(29,883)	(178,574)	(265,363)	(206,023)
Accounts payable, accrued liabilities, advance from ACS and taxes payable	923,422	1,074,581	(1,801,366)	2,945,298
Change in non-cash working capital	987,054	371,920	(2,222,168)	2,534,659
Related to:				
Financing activities	(29,883)	(178,574)	(265,363)	(206,023)
Investing activities	22,431	(258,761)	(1,264,359)	1,540,529
Operating activities	\$ 994,506	\$ 809,255	\$ (692,446)	\$ 1,200,153

The Corporation made the following cash outlays in respect of interest expense and income taxes:

	Three Months Ended September 30		Nine Months Ended September 30	
	2008	2007	2008	2007
Interest expense	\$ -	\$ 14,959	\$ 57,514	\$ 44,876
Income taxes	\$ -	\$ 131,146	\$ -	\$ 197,523

During the nine months ended September 30, 2008, the advance from ACS of \$5,124,936 was applied to the proceeds from the shares issued by Escal. These amounts have been excluded from cash flow.

During the three and nine months ended September 30, 2008, distributions to the non-controlling unit-holders of CLP of \$7,664,372 were used to reduce amounts owing on notes receivable. Accordingly, amounts paid have been excluded from cash flow.

### 12. COMPARATIVE FIGURES

Certain comparative figures have been reclassified to conform to the current period's presentation.

### 13. COMMITMENTS AND CONTINGENCIES

Amounts which will be received by the Corporation under the terms of the ACS Transaction (Notes 2 and 5) are subject to adjustment based on regulatory acceptance of the underlying project expenditure. The Corporation does not believe that any adjustment would be material to the financial position and results of operations of the Corporation, however, any adjustment would be charged to operations in the period such adjustment is made.

## **CORPORATE INFORMATION**

### **DIRECTORS**

Ned Goodman <sup>(2)</sup>  
Chairman of the Board  
Toronto, Canada

M. Jaffar Khan  
President &  
Chief Executive Officer  
London, England

Garth A.C. MacRae <sup>(1)(2)</sup>  
Toronto, Canada

Derek H.L. Buntain <sup>(1)(2)</sup>  
George Town, Cayman Islands

Jay Poscente <sup>(1)</sup>  
Calgary, Canada

R. James Kirker  
Calgary, Canada

Jonathan Goodman  
Toronto, Canada

Michael Smith  
Toronto, Canada

(1) Audit Committee  
(2) Compensation Committee

### **OFFICERS**

M. Jaffar Khan  
President &  
Chief Executive Officer

Joanne Ferstman  
Executive Vice President  
& Chief Financial Officer

Lili Mance  
Corporate Secretary

### **AUDITORS**

PricewaterhouseCoopers LLP

### **BANKERS**

Scotiabank

### **RESERVES ENGINEERS**

DeGolyer and MacNaughton  
Canada Limited

### **LEGAL COUNSEL**

Carscallen Leitch LLP

### **TRANSFER AGENT AND REGISTRAR**

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### **President**

Recaredo del Potro

## **HEAD OFFICE**