

**Calvalley Petroleum Inc.
Consolidated Financial Statements
For the Three Months Ended
September 30, 2007
(Expressed in Thousands of United States
Dollars)
RESTATED**

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In accordance with National Instrument 51-102 released by the Canadian Securities Administrators, the Company discloses that its auditors have not reviewed the unaudited consolidated financial statements for the period ended September 30, 2007.

CALVALLEY PETROLEUM INC. – 2007 3rd Quarter Interim Report
Balance Sheet (Unaudited)
(Expressed in US\$000 unless otherwise noted)

(US\$000)	As at September 30, 2007	As at December 31, 2006
	(Restated, note 3)	
ASSETS		
Current		
Cash and cash equivalents	62,779	64,070
Accounts receivable	5,966	6,292
Due from joint venture partners <i>[note 5]</i>	17,210	14,304
Oil inventory	4,410	929
Prepaid expenses	542	278
	90,907	85,873
Property and equipment <i>[note 6]</i>	60,418	43,794
	151,325	129,667
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current		
Accounts payable and accrued liabilities	16,499	13,521
Deferred revenue (note 7)	3,552	-
	20,051	13,521
Asset retirement obligations <i>[note 8]</i>	58	48
	20,109	13,569
Commitments <i>[note 11]</i>		
Contingency <i>[note 16]</i>		
Shareholders' equity		
Share capital <i>[note 9]</i>	119,485	118,678
Contributed surplus <i>[note 10]</i>	3,740	2,407
Accumulated other comprehensive income <i>[note 4a]</i>	3,963	3,963
Retained earnings (deficit)	4,028	(8,950)
	131,216	116,098
	151,325	129,667

See accompanying notes

On behalf of the Board

"Edmund Shimoon"
Edmund Shimoon

"Gary Robertson"
Gary Robertson

CALVALLEY PETROLEUM INC. – 2007 3rd Quarter Interim Report
Consolidated Statements of Income & Retained Earnings (deficit) (Unaudited)
(Expressed in US\$000 unless otherwise noted)

	Three months ended September 30		Nine months ended September 30	
	2007	2006	2007	2006
<i>(US\$000)</i>				
	(Restated, note 3)		(Restated, note 3)	
REVENUE				
Oil sales [Note 2e]	13,276	20,834	25,192	20,876
Management fee	1,546	125	2,152	426
Royalties (net of Alberta Royalty Credit)	(283)	-	(455)	-
	14,539	20,959	26,889	21,302
Interest and royalties	655	602	1,791	1,613
	15,194	21,561	28,680	22,915
EXPENSES				
Operating	2,076	1,552	5,799	1,558
General and administration	1,862	325	3,932	1,606
Depletion, depreciation and accretion	2,779	4,289	5,435	4,305
Stock-based compensation	141	340	1,497	734
	6,858	6,506	16,663	8,203
Income before other	8,336	15,055	12,017	14,712
Foreign exchange gain	1,345	284	3,998	807
Income before income tax	9,681	15,339	16,015	15,519
Foreign Income tax expense – current	1,774	973	3,037	1,228
Net income for the period	7,907	14,366	12,978	14,291
Retained earnings(deficit), beginning of period	(3,879)	(24,531)	(8,950)	(24,456)
Retained earnings(deficit), end of period	4,028	(10,165)	4,028	(10,165)
Earnings per share [note 12]				
Basic	0.08	\$0.15	0.13	\$0.15
Diluted	0.08	\$0.15	0.13	\$0.15

See accompanying notes

CALVALLEY PETROLEUM INC. – 2007 3rd Quarter Interim Report
Consolidated Statements of Cash Flows (Unaudited)
(Expressed in US\$000 unless otherwise noted)

<i>(US\$000)</i>	Three months ended September 30		Nine months ended September 30	
	2007	2006	2007	2006
OPERATING ACTIVITIES	(Restated, note 3)		(Restated, note 3)	
Net income (loss) for the period	7,907	14,366	12,978	14,291
Non cash items:				
Depletion and depreciation	2,779	4,289	5,435	4,305
Stock based compensation	141	340	1,497	734
Unrealised foreign exchange gain	(182)	(23)	73	(1,694)
	10,645	18,972	19,983	17,636
Change in non-cash working capital related to operating activities (note 13)	10,356	10	5,050	(193)
Funds provided by (used in) operating activities	21,001	18,982	25,033	17,443
INVESTING ACTIVITIES				
Additions to property & equipment	(8,573)	(5,388)	(24,071)	(18,960)
Change in non-cash working capital related to investing activities	(2,126)	(163)	(2,906)	(3,683)
Cash used in investing activities	(10,699)	(5,551)	(26,977)	(22,643)
FINANCING ACTIVITIES				
Issuance of share capital	-	-	663	49,335
Effect of exchange rate changes on cash and cash equivalents	4	52	(10)	1,697
Increase (decrease) in cash	10,306	13,483	(1,291)	45,832
Cash and cash equivalents beginning of period	52,473	56,637	64,070	24,288
Cash and cash equivalents end of period	62,779	70,120	62,779	70,120

See accompanying notes

CALVALLEY PETROLEUM INC.
SELECTED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)
Nine Months ended September 30, 2007
(Expressed in US\$000 unless otherwise noted)

1. DESCRIPTION OF BUSINESS

Calvalley Petroleum Inc. (the "Company" or "Calvalley") was incorporated on July 1, 1996 under the Canada Business Corporations Act and is engaged in the exploration and development and production of crude oil and natural gas. The Company's activities are carried out in two geographical segments, Canada and Yemen.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

These consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles. In these consolidated financial statements, all dollar amounts are expressed in United States (U.S.) dollars, unless otherwise indicated. All references to US\$ or \$ are to United States dollars and reference to C\$ are to Canadian dollars.

a) Consolidation

The consolidated financial statements include the financial statements of the Company and its wholly owned subsidiaries, Calvalley Petroleum (Cyprus) Ltd. and Cangulf Exploration Inc. Inter-company accounts and balances are eliminated upon consolidation.

b) Joint Interests

Substantially all of the Company's exploration and development activities are conducted jointly with other parties. These financial statements reflect only the Corporation's proportionate interest in such activities.

c) Foreign Currency Translation

The activities of the Canadian parent have been translated into United States dollars using the temporal method. Under this method, monetary assets and liabilities are translated at exchange rates in effect at the balance sheet date. Non-monetary assets and liabilities are translated at rates in effect on the dates the assets were acquired or liabilities were incurred. Revenue and expenses are translated at the rates of exchange prevailing at the date of the transaction. Foreign exchange gains and losses are included in net income in the period in which they arise.

d) Measurement Uncertainty

The preparation of consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and revenue and expenses during the reporting period. Actual results, including petroleum and natural gas sales, royalties and operating expenses can differ from these estimates.

In particular, amounts recorded for depreciation and depletion and amounts used for ceiling test calculations are based on estimates of petroleum and natural gas reserves and future costs required to develop those reserves. The Company's reserve estimates are evaluated annually by an independent engineering firm. By their nature, these estimates of reserves and the related future cash flows are subject to measurement uncertainty and the impact on the consolidated financial statements of future periods could be material.

CALVALLEY PETROLEUM INC.
SELECTED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)
Nine Months ended September 30, 2007
(Expressed in US\$000 unless otherwise noted)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options which were fully tradable with no vesting restrictions. This option valuation model requires the input of highly subjective assumptions including the expected stock price volatility. Because the Company's stock options and warrants have characteristics significantly different from those of traded options and because changes in the subjective input assumptions can materially affect the calculated fair value, such value is subject to measurement uncertainty.

e) Revenue Recognition

Revenues associated with the sale of the Company's crude oil are recognized when the title passes from the Company to its buyer which occurs when crude oil is transferred from the shipping terminal at Ras Isa, Yemen to an international tanker.

Pursuant to the crude oil sales agreement, the Block 9 joint venture is entitled to invoice the buyer in any month that the crude oil available for sale but not purchased by the buyer exceeds 100,000 barrels (commonly referred to as a "take or pay" feature). The price used in such a take or pay invoice is the price that would apply had a crude oil transfer occurred in that particular month and is based on the average of the Brent benchmark price for the applicable month. Due to the revenue recognition accounting policy stated above, take or pay invoice amounts are not recorded as sales revenue. Rather, such amounts are reported as deferred revenue in the current liabilities section of the balance sheet. These amounts will be recognized as revenue in the period in which the underlying crude oil is sold.

In Yemen, the government receives crude oil production as payment of the Company(s) profit taxes on the profit oil share of production. The company recognizes this amount as revenue with a corresponding income tax expense when the oil is delivered to the receiving facility in Block 18, Yemen.

The Company recognizes management fee revenue in the period the services are rendered.

f) Oil Inventory

Oil Inventory represents the volume of crude oil in storage, which is valued at the aggregate of average production costs and depletion costs per barrel. Inventory is stated at the lower of cost and net realizable value.

g) Property and Equipment

The Company follows the full cost method of accounting for oil and gas operations whereby all costs relating to the acquisition of, exploration for and development of petroleum and natural gas properties are capitalized in cost centers on a country-by-country basis. Such costs include lease acquisition costs, geological and geophysical expenditures, lease rentals, costs of drilling and equipping productive and non-productive wells and certain overhead expenditures related to exploration and development activities. Overhead expenditures relating to petroleum and natural gas cost centers in the pre-production stage of development are capitalized. Proceeds from the disposal of properties are applied as a reduction of the cost of the remaining assets except where such a disposal would alter the depletion and depreciation rate by more than 20 percent, in which case a gain or loss would be recognized.

The Company tests the impairment of producing cost centers using undiscounted future net revenue from proven reserves using expected future production prices and costs. Impairment is recognized when the carrying amount is greater than the undiscounted future net revenues, at which time assets are written down to the fair value of proved and probable reserves plus the cost of unproved properties, net of impairment allowances. Fair value is determined using expected future product prices and costs, and amounts are discounted using a risk free interest rate.

CALVALLEY PETROLEUM INC.
SELECTED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)
Nine Months ended September 30, 2007
(Expressed in US\$000 unless otherwise noted)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

The recoverability of new undeveloped cost centers is assessed annually based on results of geological and geophysical assessments, drilling activity and planned operations.

h) Depletion and Depreciation

Capitalized costs of properties, including a provision for future costs to develop proved reserves, are amortized through depletion and depreciation charges using the unit of production method based on estimated proved crude oil and natural gas reserves in that cost centre. For purposes of these calculations, production of crude oil, natural gas liquids, natural gas, and proved reserves before royalties are converted to a common unit of measure on the basis of their approximate relative energy content. Costs of acquiring and evaluating unproved properties are excluded from costs subject to depletion until it is determined whether proved reserves are attributable to the properties or impairment occurs.

Other capital assets are depreciated using the declining balance method based on the estimated service lives of the assets, which vary from three to five years.

i) Asset Retirement Obligations

The fair value of the estimated asset retirement obligations is recognized in the consolidated balance sheet when the liability is incurred. Asset retirement obligations include those legal obligations where the Company will be required to retire tangible long-lived assets such as producing well sites. The asset retirement cost equal to the estimated fair value of the asset retirement obligation, is capitalized as part of the cost of the related long-lived asset. Asset retirement costs for natural gas and crude oil assets are amortized using the unit-of-production method.

Amortization of asset retirement costs capitalized is included in depletion and depreciation on the consolidated statements of operations. Increases in the asset retirement obligation resulting from the passage of time are recorded as accretion on the consolidated statements of operations. Actual expenditures incurred are charged against the accumulated obligation. Gains or losses on the actual settlement are recorded as income or loss in the period of settlement. The Company's asset retirement obligations are comprised of expected costs to be incurred upon termination of operations, dismantling, demolition and disposal of facilities, remediation and restoration of sites.

j) Income Taxes

The Company follows the liability method of accounting for income taxes. Under this method, future tax liabilities and assets are recognized for the estimated tax consequences attributable to differences between the financial statement carrying amounts of assets and liabilities and their respective tax bases. Future tax liabilities and assets are measured using enacted or substantively enacted tax rates. The effect on future tax liabilities and assets of a change in tax rates is recognized in income in the period that the change occurs. Future income tax assets are evaluated and if realization is not considered "more likely than not", a valuation allowance is provided.

In Yemen, the government receives production in lieu of income tax. The Company records this production as current income tax expense.

k) Financial Instruments

Financial instruments of the Company consist mainly of cash and cash equivalents, accounts receivable, balances due from joint venture partners, and accounts payable and accrued liabilities. The fair value of these financial instruments approximates their carrying values.

CALVALLEY PETROLEUM INC.
SELECTED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)
Nine Months ended September 30, 2007
(Expressed in US\$000 unless otherwise noted)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

l) Cash and Cash Equivalents

Cash and cash equivalents include short-term deposits with maturity terms of three months or less at the date of investment.

m) Earnings per Common Share

Basic earnings per share is calculated based on net income (loss) for the year divided by the weighted average number of shares outstanding during the year.

The Company follows the treasury stock method in calculating diluted earnings per share. Under this method, the diluted weighted average number of shares is calculated assuming the proceeds from the exercise of options and warrants are used to purchase common shares at the average market price for the year.

n) Stock-based Compensation

The fair value of options and warrants granted is estimated at the date of the grant using the Black-Scholes valuation model. Stock-based compensation is recognized over the vesting period of the options granted. Stock-based compensation expense is recorded with a corresponding increase recorded to contributed surplus. Upon the exercise of the options and warrants consideration paid by employees, consultants or directors together with the amount previously recognized in contributed surplus is recorded as an increase to share capital. The Company has not incorporated an estimated forfeiture rate for stock options that will not vest.

3. RESTATEMENTS

- (a) The Company determined certain adjustments were required to comply with the new CICA Handbook Section 1530, Comprehensive Income and the correct application of the temporal method in translating the financial statements of the Canadian Parent to US dollars. These adjustments resulted in the reversal of \$2,084 of comprehensive income which had been recorded and the adjustment of foreign exchange gain of \$8,771 to a gain of \$3,998.

While the restatement adjustments change the Company's previously reported results of operations in interim reporting period, there was no impact on the audited financial statements filed for the year ended December 31, 2007.

The impact of the restatement on the consolidated balance sheet and statement of income (loss) and deficit for the quarter ended September 30, 2007 is as follows:

CALVALLEY PETROLEUM INC.
SELECTED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)
Nine Months ended September 30, 2007
(Expressed in US\$000 unless otherwise noted)

3. RESTATEMENT (continued)

CONSOLIDATED BALANCE SHEET, RESTATED

	As at September 30, 2007		
	As previously reported	Restatements	As restated
ASSETS			
Current			
Cash	66,856	(4,077)	62,779
Accounts receivable	8,025	(2,059)	5,966
Due from joint venture partners	17,210		17,210
Oil inventory	4,410		4,410
Prepays	542		542
	97,043		90,907
Property and equipment	60,593	(175)	60,418
	157,636		151,325
LIABILITIES AND SHAREHOLDERS' EQUITY			
Current			
Accounts payable and accrued liabilities	16,499		16,499
Deferred revenue	3,552		3,552
	20,051		20,051
Asset retirement obligations	58		58
	20,109		20,109
Share capital	119,349	136	119,485
Contributed surplus	4,626	(886)	3,740
Accumulated other comprehensive income	6,047	(2,084)	3,963
Retained earnings	7,505	(3,477)	4,028
	137,527		131,216
	157,636		151,325

CALVALLEY PETROLEUM INC.
SELECTED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)
Nine Months ended September 30, 2007
(Expressed in US\$000 unless otherwise noted)

3.RESTATEMENT (continued)

CONSOLIDATED STATEMENT OF INCOME (LOSS) & DEFICIT,
RESTATEMENT

	Nine months ended Sept. 30, 2007		
	As previously reported	Restatements	As restated
Revenue			
Oil sales	25,192		25,192
Management Fee	1,545	607	2,152
Royalties (net of ARTC)	(455)		(455)
	26,282		26,889
Interest	1,791		1,791
	28,073		28,680
Expenses			
Operating	5,894	(95)	5,799
General and administrative	4,334	(402)	3,932
Stock-based compensation	1,689	(192)	1,497
Depletion, depreciation and amortization	5,435		5,435
	17,352		16,663
Income(loss) before other	10,721		12,017
Foreign exchange gain (loss)	8,771	(4,773)	3,998
Income before income tax	19,492		16,015
Income tax	3,037		3,037
Net income(loss) and comprehensive income for the period	16,455		12,978

4. CHANGES IN ACCOUNTING POLICIES

On January 1, 2007, the Company prospectively adopted the following new Canadian Institute of Chartered Accountants (CICA) handbook sections:

- CICA Handbook Section 1530, Comprehensive Income;
- CICA Handbook Section 3855, Financial Instruments – Recognition and Measurement

These new accounting standards provide requirements for the recognition and measurement of financial instruments. The standards have been adopted prospectively and as such the comparative interim consolidated financial statements have not been restated. The adoption of these Handbook financial sections had no impact on opening retained earnings.

CALVALLEY PETROLEUM INC.
SELECTED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)
Nine Months ended September 30, 2007
(Expressed in US\$000 unless otherwise noted)

4. CHANGES IN ACCOUNTING POLICIES (continued)

a) CICA Handbook Section 1530, Comprehensive Income

Comprehensive income is the change in equity that results from transactions, events and circumstances from sources other than the Company's shareholders and includes items that would not normally be included in net earnings such as unrealized gains and losses on available-for-sale investments. Other comprehensive income includes the holding gains and losses which are not included in net income until realized.

b) CICA Handbook Section 3855, Financial Instruments – Recognition and Measurement

In accordance with this section the Company now classifies all financial instruments as either held-to-maturity, available-for-sale, held for trading, loans and receivables, or other liabilities. Financial instruments held to maturity, loans and receivables and financial liabilities other than those held for trading, are measured at amortized cost. Available-for-sale instruments are measured at their fair value with unrealized gains and losses recognized in other comprehensive income. Instruments classified as held for trading are measured at fair value with unrealized gain and losses recognized in the statement of operations. The adoption of this section had no impact on the Company's financial statements.

5. DUE FROM JOINT VENTURE PARTNERS

Amounts due from joint venture partners are comprised primarily of deficiencies in cash contributions for capital expenditures.

6. PROPERTY AND EQUIPMENT

(US\$000)	As At September 30, 2007		
	Cost	Accumulated Depletion and Depreciation	Net Book Value
Canada			
Oil and gas properties and equipment	116	50	66
Other capital assets	196	96	100
	312	146	166
Yemen			
Oil and gas properties	74,374	14,122	60,252
	74,686	14,268	60,418

(US\$000)	As At December 31, 2006		
	Cost	Accumulated Depletion and Depreciation	Net Book Value
Canada			
Oil and gas properties and equipment	115	51	64
Other capital assets	149	72	77
	264	123	141
Yemen			
Oil and gas properties	50,351	6,698	43,653
	50,615	6,821	43,794

CALVALLEY PETROLEUM INC.
SELECTED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)
Nine Months ended September 30, 2007
(Expressed in US\$000 unless otherwise noted)

6. PROPERTY AND EQUIPMENT (continued)

Canada

The Company disposed of most of its Canadian oil and gas properties in 2004 and existing properties are comprised of a working interest in one property in Saskatchewan and some overriding royalties.

Yemen

The Corporation has a 50% working interest in the Malik Block 9 Joint Venture in Yemen. The Company's right to produce crude oil under the Production Sharing agreement ("PSA") continues to 2025, with a provision for a 5 year extension. The ownership of all assets, tangibles and intangibles, remains with the Yemen authority.

During the nine months ended September 30, 2007, the Company capitalized overhead costs relating to oil and gas exploration and development activities of \$539. The Company excluded from capital costs subject to the depletion expense calculation an amount of \$10,030 (2006 - \$5,475) in respect of the capital costs incurred to September 30, 2007 for resource facilities under construction and not put in place for use as at September 30, 2007.

7. DEFERRED REVENUE

The deferred revenue of \$3,552 (2006 - \$Nil) represents the amount invoiced in respect of 50,000 barrels of Marib light crude oil not taken by the Company's buyer in August, 2007. This amount was not recorded as oil sales in accordance with the revenue recognition policy stated in Note 2(e) because title for the crude oil had not yet passed to the buyer.

The invoiced amounts were received in October, 2007. Also, the buyer lifted 115,000 barrels of crude oil attributable to Calvalley in October. Accordingly, the August deferred revenue will be recorded as oil sales revenue in October.

8. ASSET RETIREMENT OBLIGATIONS

The total undiscounted amount of estimated cash flows required to settle the obligations in Canada is \$58 (2006 - \$48), which has been discounted using a credit adjusted risk-free rate of 7% percent (2006 - 7%). These obligations relate to its Canadian oil and gas property and are expected to be settled by 2011.

(US\$000)	Nine months ended September 30, 2007	Year ended December 31, 2006
Opening balance	48	44
Accretion expense	2	4
Foreign exchange adjustment	8	-
Closing balance	58	48

No provision has been made for the retirement obligations associated with the property and equipment situated in Yemen. The PSA provides that all property and equipment will be transferred to the Government of Yemen prior to the end of the expiration of the agreement. All asset retirement activities during the term of the agreement are fully cost recoverable under the PSA.

CALVALLEY PETROLEUM INC.
SELECTED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)
Nine Months ended September 30, 2007
(Expressed in US\$000 unless otherwise noted)

9. SHARE CAPITAL

(a) Class A Common Voting Shares

Authorized:

Unlimited number of Class A Common Voting Shares.

<i>Issued:</i>	Nine months ended September 30, 2007	
	Number	US\$000
Shares outstanding, Dec. 31, 2006	101,007,165	118,678
Issued on the exercise of options	290,000	185
Balance, March 31, 2007	101,297,165	118,863
Issued on the exercise of options	133,333	622
Balance, June 30, 2007 and September 30, 2007	101,430,498	119,485

<i>Issued:</i>	Year ended December 31, 2006	
	Number	US\$000
Shares outstanding, beginning of year	91,330,022	69,388
Issued for cash	9,000,000	50,895
Issued on the exercise of options	270,000	202
Issued on exercise of warrants	407,143	1,690
Share issue costs	-	(3,497)
Balance, end of year	101,007,165	118,678

CALVALLEY PETROLEUM INC.
SELECTED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)
Nine Months ended September 30, 2007
(Expressed in US\$000 unless otherwise noted)

9. SHARE CAPITAL (continued)

(b) Stock options

The Company's restated stock option plan, as approved effective May 21, 2006, provides for the issue of stock options to directors, officers, employees and consultants. Vesting terms are determined by the Board as they are granted and currently include periods ranging from immediately to evenly over 3 or 5 years. The options' maximum term is 5 years (10 years for options granted prior to October 1, 2001).

The total number of options available to be issued is ten percent of the issued and outstanding common shares.

	Nine months ended September 30, 2007			Year ended December 31, 2006		
	Options	Weighted Average Exercise Price		Options	Weighted Average Exercise Price	
		C\$	US\$		C\$	US\$
Opening balance	2,895,000	3.34	2.87	2,890,000	2.31	1.98
Granted	340,000	7.30	6.89	325,000	7.58	6.69
Forfeited	(216,667)	3.94	3.72	(50,000)	8.05	7.23
Exercised	(423,333)	1.71	1.61	(270,000)	0.80	0.71
Ending balance	2,595,000	3.61	3.64	2,895,000	3.34	2.87

As at September 30, 2007, the Company had 2,595,000 stock options issued and outstanding (of which 1,691,667 stock options were exercisable) expiring between 2008 and 2012 at an average exercise price of C\$3.61 (US\$3.64).

For the Nine months ended September 30, 2007, stock based compensation expense of \$1,497 (2006 - \$734) was expensed and credited to contributed surplus. The fair value of the options granted is determined using a Black-Scholes Option Pricing model with the following assumptions:

	Nine months ended September 30, 2007	Year ended December 31, 2006
Risk-free interest rate	4%	4%
Expected hold period to exercise	5 years	5 years
Volatility in the price of the Company's shares	61.5%	65% - 66%
Dividend yield	Nil	Nil

CALVALLEY PETROLEUM INC.
SELECTED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)
Nine Months ended September 30, 2007
(Expressed in US\$000 unless otherwise noted)

10. CONTRIBUTED SURPLUS

(US\$000)	Nine months ended September 30, 2007	Year ended December 31, 2006
Opening balance	2,407	1,806
Stock-based compensation	1,497	949
Stock-based compensation associated with exercised options and warrants	(144)	(326)
Foreign exchange adjustment	(20)	(20)
Closing balance	3,740	2,407

11. COMMITMENTS

The Company is committed to operating leases for office space with payments due and to its proportionate share of various allowances and bonus payments to the Government of Yemen.

2007	\$466
2008	\$529
2009	\$533
2010	\$460
2011	\$225

In addition to the payments indicated above, the Company is obligated to pay to the Government of Yemen its 50% proportionate share of a \$2,000, \$3,000 and \$4,000 bonus payments when sustainable production exceeds 25,000, 75,000 and 100,000 barrels of oil per day, respectively.

The Company is also committed to pay \$1.25 per barrel of oil produced from the Yemen properties to an arms length party. The total commitment outstanding at September 30, 2007 under this obligation is approximately \$4,125 (2006 - \$4,800).

12. PER SHARE AMOUNTS

At September 30, 2007, the weighted average number of shares used in the computation of basic earnings per share was 101,321,536 (September 30, 2006 – 97,142,723) and the weighted average number of shares used in the computation of diluted earnings per share was 102,148,931 (September 30, 2006 – 98,007,908). A total of 515,000 options at September 30, 2007 (2006 – 175,000) were excluded from the dilutive calculation.

CALVALLEY PETROLEUM INC.
SELECTED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)
Nine Months ended September 30, 2007
(Expressed in US\$000 unless otherwise noted)

13. SUPPLEMENTAL CASH FLOW INFORMATION

<i>(US\$000)</i>	Three months ended September 30		Nine months ended September 30	
	2007	2006	2007	2006
Change in non-cash working capital				
Accounts receivable	5,992	(2,684)	326	(19,482)
Due from joint venture	(3,025)	(163)	(2,906)	(3,683)
Oil inventory	180	-	(1,469)	-
Prepaid expense	352	4	(264)	18
Accounts payable and accrued liability	8,205	2,690	2,905	19,271
Deferred revenue	(3,474)	-	3,552	-
Total changes in non-cash working capital	8,230	(153)	2,144	(3,876)
Portion related to investing activities	(2,126)	(163)	(2,906)	(3,683)
Portion relating to operating activities	10,356	10	5,050	(193)

During the nine months ended September 30, 2007, the Company paid \$Nil in interest (2006 - \$Nil) and \$1,139 in taxes (2006 - \$7). These amounts do not include the Yemen profit taxes paid in kind through an allocation of crude oil. (See note 2e)

14. GEOGRAPHIC INFORMATION

The Company has defined its continuing operations as oil and gas operations. The majority of the Company's oil and gas operations are located in Yemen with lesser operations in Canada.

Segmented information is as follows:

<i>(US\$000)</i>	September 30, 2007		
	Yemen	Canada	Total
Revenue	25,489	2,584	28,073
Property and equipment	60,252	166	60,418

	December 31, 2006		
	Yemen	Canada	Total
Revenue	30,725	2,136	32,861
Property and equipment	43,653	141	43,794

15. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

Carrying Values and Estimated Fair Values of Financial Assets and Liabilities

Carrying values of financial instruments which include cash and cash equivalents, accounts receivable, due from joint venture partners, accounts payable and accrued liabilities approximate their fair value due to the short-term nature of these amounts.

Credit Risk

All of the Company sales in 2007 were made to one purchaser. The Company entered into a sales agreement with one purchaser for a term of up to eighteen months. Payment is secured by a guarantee issued by the purchaser's parent company. Management believes that credit risk is mitigated by the size and reputation of the company to which they extend credit.

The amount due from joint venture partners is owed by two partners. Management believes that the credit risk is mitigated by the authorization provided by the Joint Operating Agreement to allowing the Company to place the joint venture partners in default which would enable the Company to retain the partners' share of oil sales to discharge their obligations.

Commodity Price Risk Management

The Company has commodity price risk associated with its sale of crude oil.

Currency Exchange Risk

Approximately \$14,430 of the \$68,656 cash and cash equivalents are held in Canadian dollar denominated accounts. As such, the Company is exposed to foreign currency risk. The Company maintains funds in both Canadian and U.S dollar denomination account to mitigate the effect of exchange rate difference.

16. CONTINGENCY

The Company has been named in a claim filed in the Commercial Court of Yemen by a Saudi Arabian company. The claimant alleges that, pursuant to an agency agreement entered into in 1996, it is entitled to a percentage of the net profit attributable to Calvalley. The Company disputes the allegation and intends to vigorously defend the claim. The Company believes the claim is frivolous and without merit. The Company's legal advisors in Sana'a and Calgary are currently defending the action jointly. Accordingly, the Company has not recorded a provision for a potential liability in its financial statements.