

**LNG ENERGY LTD.**

**CONSOLIDATED FINANCIAL STATEMENTS**

**September 30, 2010 and 2009  
(stated in Canadian Dollars)**



**KPMG** LLP  
**Chartered Accountants**  
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## **AUDITORS' REPORT TO THE SHAREHOLDERS**

We have audited the consolidated balance sheets of LNG Energy Ltd. as at September 30, 2010 and 2009 and the consolidated statements of operations and comprehensive loss, deficit and accumulated other comprehensive loss and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at September 30, 2010 and 2009 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

**KPMG LLP**

Chartered Accountants

Calgary, Canada

January 25, 2011

**LNG ENERGY LTD.  
CONSOLIDATED BALANCE SHEETS**

	September 30,	
	2010	2009
<b>ASSETS</b>		
<b>Current</b>		
Cash and cash equivalents (Note 12)	\$ 10,036,105	\$ 2,905,297
Short term investments (Note 15)	9,015,750	8,310,500
Amounts receivable	314,242	196,192
Prepaid expenses, advances and other term deposits	423,467	358,690
	<b>19,789,564</b>	<b>11,770,679</b>
<b>Investments</b> (Note 6)	<b>6,176</b>	<b>192,919</b>
<b>Property and equipment</b> (Note 7)	<b>51,050,573</b>	<b>35,775,968</b>
	<b>\$ 70,846,313</b>	<b>\$ 47,739,566</b>
<b>LIABILITIES</b>		
<b>Current</b>		
Accounts payable and accrued liabilities	\$ 1,442,148	\$ 887,303
<b>Long term</b>		
Asset retirement obligation (Note 9)	3,119	2,893
Future income taxes (Note 13)	3,065,151	798,651
<b>Non-controlling interests</b> (Note 14)	-	4,277,161
<b>SHAREHOLDERS' EQUITY</b>		
Share capital (Note 10)	84,033,523	55,738,855
Contributed surplus (Note 10)	7,155,373	7,380,373
Accumulated other comprehensive loss	(987,772)	(721,961)
Deficit	(23,865,229)	(20,623,709)
	<b>66,335,895</b>	<b>41,773,558</b>
	<b>\$ 70,846,313</b>	<b>\$ 47,739,566</b>

Future Operations (Note 2), Commitments (Note 7), Subsequent events (Note 17)

Approved on behalf of the Board of Directors:

"David Cohen"  
\_\_\_\_\_  
Director

"Paul Larkin"  
\_\_\_\_\_  
Director

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

**LNG ENERGY LTD.**  
**CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS**

	YEARS ENDED SEPTEMBER 30,	
	2010	2009
<b>Revenue</b>		
Oil and gas revenue	\$ 258,302	\$ 252,245
Less: Royalties expense	(45,877)	(49,578)
	<b>212,425</b>	<b>202,667</b>
<b>Expenses</b>		
Operating and exploration	175,580	101,707
Accretion, depletion and depreciation	114,370	166,649
General and administration	1,704,283	2,185,321
Loss on disposal of assets (Note 6)	138,791	4,922
Professional fees (Note 11)	905,640	1,098,390
Stock based compensation (Note 10)	72,116	481,494
Travel and business development	482,336	189,535
	<b>(3,593,116)</b>	<b>(4,228,018)</b>
Interest and other income	154,206	359,538
Unrealized gain on investments (Note 6)	9,758	-
Foreign exchange loss	(36,462)	(563,851)
<b>Loss before tax and non-controlling interests</b>	<b>(3,253,189)</b>	<b>(4,229,664)</b>
Current income tax recovery (expense) (Note 13)	(19,664)	86,591
<b>Loss after tax before non-controlling interests</b>	<b>(3,272,853)</b>	<b>(4,143,073)</b>
Non-controlling interests (Note 14)	31,333	6,055
<b>Net loss for the year</b>	<b>(3,241,520)</b>	<b>(4,137,018)</b>
<b>Cumulative translation adjustment</b>	<b>(265,811)</b>	<b>(721,961)</b>
<b>Comprehensive loss</b>	<b>\$ (3,507,331)</b>	<b>\$ (4,858,979)</b>
<b>Basic and diluted loss per share</b>	<b>\$ (0.02)</b>	<b>\$ (0.03)</b>
<b>Weighted average number of shares outstanding</b>	<b>170,550,626</b>	<b>144,095,965</b>

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

**LNG ENERGY LTD.  
CONSOLIDATED STATEMENTS OF DEFICIT AND ACCUMULATED OTHER  
COMPREHENSIVE LOSS**

	YEARS ENDED SEPTEMBER 30	
	2010	2009
<b>Deficit, beginning of year</b>	<b>\$ (20,623,709)</b>	<b>\$ (16,486,691)</b>
Net loss for the year	<b>(3,241,520)</b>	<b>(4,137,018)</b>
<b>Deficit, end of year</b>	<b>\$ (23,865,229)</b>	<b>\$ (20,623,709)</b>
<b>Accumulated other comprehensive loss, beginning of the year</b>	<b>\$ (721,961)</b>	<b>\$ -</b>
Cumulative translation adjustment for the year	<b>(265,811)</b>	<b>(721,961)</b>
<b>Accumulated other comprehensive loss, end of the year</b>	<b>\$ (987,772)</b>	<b>\$ (721,961)</b>

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

**LNG ENERGY LTD.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**

	YEARS ENDED SEPTEMBER 30	
	2010	2009
<b>Cash flows used by operating activities</b>		
Net loss for the year	\$ (3,241,520)	\$ (4,137,018)
Items not affecting cash:		
Accretion, depletion and depreciation	114,370	165,686
Stock based compensation	72,116	481,494
Impairment (gain) of property and equipment	(874)	963
Loss on disposal of assets	138,791	-
Unrealized foreign exchange loss (gain)	28,249	(341,184)
Other write-downs	1,809	49,896
Unrealized gain on investments	(9,758)	(3,226)
Non-controlling interests	(31,333)	(6,055)
	<b>(2,928,150)</b>	<b>(3,789,444)</b>
Changes in non-cash working capital (Note 12)	191,897	(485,784)
	<b>(2,736,253)</b>	<b>(4,275,228)</b>
<b>Cash flows from investing activities</b>		
Proceeds from sale of investments	70,000	-
Acquisition of subsidiary	-	(7,993,634)
Property and equipment purchased	(154,105)	(193,344)
Proceeds on disposal of property and equipment	-	142,953
Oil and gas property expenditures	(8,284,006)	(2,306,914)
Short term investments	(705,250)	6,340,762
Changes in non-cash working capital (Note 12)	304,093	(115,374)
	<b>(8,769,268)</b>	<b>(4,125,551)</b>
<b>Cash flows from financing activities</b>		
From issuance of special warrants	18,540,929	-
Shares issued on exercise of options	95,400	-
Capital lease payments	-	(13,322)
	<b>18,636,329</b>	<b>(13,322)</b>
<b>Net increase (decrease) in cash and cash equivalents</b>	<b>7,130,808</b>	<b>(8,414,101)</b>
<b>Cash and cash equivalents, beginning of year</b>	<b>2,905,297</b>	<b>11,319,398</b>
<b>Cash and cash equivalents, end of year (Note 12)</b>	<b>\$ 10,036,105</b>	<b>\$ 2,905,297</b>

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

# LNG Energy Ltd.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
For the Years Ended September 30, 2010 and 2009  
(in Canadian dollars)

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## 1. NATURE OF OPERATIONS

LNG Energy Ltd. (the "Company") was incorporated on February 24, 2000 in the Province of British Columbia. Effective March 28, 2008, the Company changed its name to "LNG Energy Ltd." from Invicta Oil and Gas Ltd. The Company's common shares began trading under the new symbol "LNG" on the TSX Venture Exchange on March 28, 2008. The Company is engaged in exploration and development activities of oil and gas properties in Papua New Guinea, Poland and the United States of America.

## 2. FUTURE OPERATIONS

These consolidated financial statements have been prepared on the basis of accounting principles applicable to a going concern. These principles assume that the Company will be able to realize its assets and discharge its obligations in the normal course of operations for the foreseeable future.

As at September 30, 2010, the Company had net working capital of \$18,347,416 (September 30, 2009 - \$10,883,376) and incurred a net loss of \$3,241,520 for the year ended September 30, 2010 (year ended September 30, 2009 - \$4,137,018). The continuing application of the going concern assumption is dependent upon the Company's continuing ability to obtain the necessary financing to carry out its exploration program and ultimately achieve profitable operations.

Management believes the going concern assumption to be appropriate for these financial statements. If the going concern assumption was not appropriate, adjustments would be necessary to the carrying values of assets and liabilities, reported revenues and expenses, and the balance sheet classifications used in the consolidated financial statements.

## 3. BASIS OF PRESENTATION

The consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles and are stated in Canadian dollars.

## 4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

### a) Principles of Consolidation

These audited consolidated financial statements presented are those of LNG Energy Ltd. ("LNG") and the consolidated financial statements of its 100% owned subsidiaries LNG Energy US Inc. ("LNG US"), LNG Energy (BC) Ltd. ("LNG BC"), Kunagu Real Estate ("Kunagu") and LNG's 60% owned subsidiary, Kaynes Capital S.a.r.l. ("Kaynes"). The consolidated statements include LNG BC's wholly-owned subsidiaries Telemu No. 18 Ltd. ("Telemu"), LNG Energy (PNG) Limited, ("LNG PNG"), LNG Energy No. 2 Limited ("LNG No. 2"), and Scotia Petroleum Inc. ("Scotia BC"). The consolidated financial statements also include Kunagu's 100% owned subsidiary, Basin Tishomingo Holdings Inc. ("BTH"), Kunagu's 40% share of Kaynes and LNG US's 60% owned subsidiary, BWB Exploration, LLC ("BWB"). All intercompany transactions have been eliminated on consolidation.

# LNG Energy Ltd.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
For the Years Ended September 30, 2010 and 2009  
(in Canadian dollars)

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## 4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

### b) Foreign Currency Translation

The Company's PNG operations are considered financially and operationally integrated and the Canadian dollar is the functional currency. As a result, monetary assets and liabilities denominated in foreign currencies are translated at exchange rates in effect at the balance sheet date and non-monetary assets and liabilities are translated at rates in effect when the assets were acquired or liabilities incurred. Revenues and expenses are translated at rates of exchange prevailing on the transaction dates. Foreign exchange gains and losses are recorded in the statement of operations.

The Company's US and Poland operations are considered to be self-sustaining and the United States dollar is the functional currency. As a result, the US and Poland subsidiaries' assets and liabilities are translated into Canadian dollars at the exchange rates prevailing at the balance sheet date. Revenues and expenses are translated at rates of exchange prevailing on the transaction dates. Foreign exchange gains and losses are included in a separate component of shareholders' equity under accumulated other comprehensive income as a currency translation adjustment.

### c) Cash and Cash Equivalents

Cash and cash equivalents consist of cash and short term deposits which, on acquisition, have a maturity of less than ninety days.

### d) Loss Per Share

Basic loss per share figures have been calculated using the weighted monthly average number of shares outstanding during the respective years. Diluted loss per share figures are equal to those of basic loss per share for each period as the effects of stock options have been excluded since they are anti-dilutive. The Company uses the treasury stock method to determine the dilutive effect of stock options and other dilutive instruments. The treasury stock method assumes that proceeds received from in-the-money stock options are used to repurchase common shares at the average market rate during the year.

### e) Use of Estimates

The preparation of the consolidated audited financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, and the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses recorded during the reporting periods. Most significant estimates relate to the valuation of undeveloped land and calculation of stock based compensation expense. Actual results could differ from these estimates and these differences could have a significant impact on the consolidated financial statements.



# LNG Energy Ltd.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
For the Years Ended September 30, 2010 and 2009  
(in Canadian dollars)

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## 4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

### f) Financial Instruments

The Company classifies all financial instruments as either held-to-maturity, available-for-sale, held-for-trading or loans and receivables. Financial assets 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 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 gains and losses recognized in the Statement of Operations.

The Company has classified its financial instruments as follows:

Cash and cash equivalents	Held for trading
Short term investments	Held for trading
Amounts receivable	Loans and receivables
Investments	Held for trading
Accounts payable and accrued liabilities	Other liabilities

### g) Property and Equipment

#### Oil and Gas Interest

The Company follows the full cost method of accounting, whereby all costs associated with the exploration for and development of oil and gas reserves are capitalized on a country-by-country basis. Such costs include land acquisitions, drilling, well equipment, geological and geophysical, and overhead expenses related to exploration and development activities. Gains or losses are not recognized upon disposition of oil and gas properties unless crediting the proceeds against accumulated costs would result in a material change in the rate of depletion and depreciation.

Costs capitalized in the cost centres, including facilities and well equipment, together with estimated future capital costs associated with proven reserves, are depleted and depreciated using the unit-of-production method which is based on gross production and estimated proven oil and gas reserves as determined by the Company. The cost of significant unevaluated properties is excluded from the depletion and depreciation base. These properties are assessed periodically to ascertain whether valuation impairment has occurred. When proven reserves are assigned to such properties or valuation impairment has occurred, the costs of the properties are included in capitalized costs for purposes of the depletion and depreciation expense calculation. For purposes of the depletion and depreciation calculations, oil and gas reserves are converted to a common unit of measure on the basis of their relative energy content.

The Company carries out the ceiling test pertaining to the measurement of impairment of petroleum and natural gas properties for each of its cost centres in Papua New Guinea, the United States and Poland. The Company evaluates petroleum and natural gas assets to determine that the carrying amount in each cost centre is recoverable and does not exceed the fair value of the properties in the cost centre. The carrying amounts are assessed to be recoverable when the sum of the undiscounted cash flows expected from the production of proved reserves and the lower of cost and the market of unproved properties exceeds the carrying amount of the cost centre.

# LNG Energy Ltd.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
For the Years Ended September 30, 2010 and 2009  
(in Canadian dollars)

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## 4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

### g) Property and Equipment (Continued)

When the carrying amount is not recoverable, an impairment loss is recognized to the extent the carrying amount of the cost centre exceeds the sum of the discounted cash flows (calculated by using the Company's risk-free rate) expected from the production of proved and probable reserves and the lower of cost and market of unproved properties of the cost centre.

#### Other Assets

Depreciation is based on the estimated useful lives of the assets and is computed using the declining balance method. Equipment is recorded at cost on acquisition. Depreciation is provided using the following rates:

Office furniture and equipment	15%
Vehicles	30%
Computer equipment and software	15% - 50%
Technical License	Straight line over 10 years

### h) Asset Retirement Obligations

The fair value of obligations associated with the retirement of tangible long-lived assets is recorded in the period the asset is put into use, with a corresponding increase to the carrying amount of the related asset. The obligations recognized are statutory, contractual or legal obligations. The liability is accreted over time for changes in the fair value of the liability through charges to accretion, which is recorded as accretion expense. The costs capitalized to the related assets are amortized in a manner consistent with the depletion and depreciation of the related asset.

### i) Revenue Recognition

Revenue associated with sales of oil, natural gas and natural gas liquids is recognized when title passes to the purchaser.

### j) Stock-Based Compensation

The Company has a stock-based compensation plan, whereby stock options are granted to employees and non-employees. The fair value of all share purchase options granted to employees are expensed over their vesting period with a corresponding increase to contributed surplus or warrant capital. Options granted to non-employees, to the extent unvested, are fair valued on subsequent reporting dates. Upon exercise of share purchase options, the consideration paid by the option holder, together with the amount previously recognized in contributed surplus or warrant capital, is recorded as an increase to share capital. The Company has not incorporated an estimated forfeiture rate for stock options that may not vest. The Company accounts for forfeitures as they occur.

The Company uses the Black-Scholes option valuation model to calculate the fair value of share purchase options at the date of grant. Option pricing models require the input of subjective assumptions, including the expected price volatility. Changes in these assumptions can materially affect the fair value estimate and, therefore, the existing models do not necessarily provide a reliable single measure of the fair value of the Company's share purchase options.

# LNG Energy Ltd.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
For the Years Ended September 30, 2010 and 2009  
(in Canadian dollars)

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## 4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

### k) Income Taxes

The Company follows the asset and liability method of tax allocation. Under this method, future tax assets and liabilities are determined based on differences between the financial reporting and tax basis of assets and liabilities, and measured using the substantially enacted tax rates and laws that will be in effect when the differences are expected to reverse. In the case of unused tax losses, income tax reductions, and certain items that have a tax basis but cannot be identified with an asset or liability on the balance sheet, the recognition of future income tax assets is determined by reference to the likely realization of future income tax reductions.

### l) Joint Interest Activities

Certain of the Company's exploration, development and production activities are conducted jointly with other entities and accordingly the consolidated financial statements reflect only the Company's proportionate interest in such activities.

### m) Comparative Figures

Certain comparative figures have been reclassified to conform to the current year's presentation. Such reclassification is for presentation purposes only and has no effect on the Company's previously reported results.

### n) Adoption of New Accounting Standards

Effective October 1, 2009, the Company has adopted the following new accounting standards issued by the Canadian Institute of Chartered Accountants ("CICA"). These accounting standards are adopted on a prospective basis with no restatement of prior period financial statements. There was no impact on opening retained earnings. The new standards are as follows:

#### (i) Financial Instruments - Disclosures

Section 3862 "Financial Instruments - Disclosures" requires the Company to include additional disclosure requirements about fair value measurement for financial instruments and liquidity risk disclosures. These amendments require a three level hierarchy that reflects the significance of the inputs used in making the fair value measurements. Fair values of assets and liabilities included in Level 1 are determined by reference to quoted prices in active markets for identical assets and liabilities. Assets and liabilities in Level 2 include valuations using inputs other than quoted prices for which all significant outputs are observable, either directly or indirectly. Level 3 valuations are based on inputs that are unobservable and significant to the overall fair value measurement.

#### (ii) Credit Risk and Fair Value of Financial Assets and Liabilities

As of January 20, 2009, the Company has adopted the Emerging Issues Committee ("EIC") 173 abstract, "Credit Risk and the Fair Value of Financial Assets and Financial Liabilities" which requires the Company to use its own credit risk and the credit risk of the counterparty to assess and determine the fair value of financial assets and financial liabilities, including derivative instruments. The adoption of this standard did not have a material impact on the Company's consolidated financial statements.

# LNG Energy Ltd.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
For the Years Ended September 30, 2010 and 2009  
(in Canadian dollars)

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## 4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

### o) Future Accounting Pronouncements

#### (i) Business combination, non-controlling interest, and consolidation

In January 2009, the CICA issued Handbook Sections 1582, Business Combinations, ("Section 1582"), 1601, Consolidated Financial Statements, ("Section 1601") and 1602, Non-controlling Interests, ("Section 1602") which replaces CICA Handbook Sections 1581, Business Combinations, and 1600, Consolidated Financial Statements. Section 1582 establishes standards for the accounting for business combinations that is equivalent to the business combination accounting standard under International Financial Reporting Standards ("IFRS"). Section 1582 is applicable for the Company's business combinations with acquisition dates on or after January 1, 2011. Early adoption of this Section is permitted. Section 1601 together with Section 1602 establishes standards for the preparation of consolidated financial statements. Section 1601 is applicable for the Company's interim and annual consolidated financial statements for its fiscal year beginning October 1, 2011. Early adoption of this Section is permitted. If the Company chooses to early adopt any one of these Sections, the other two sections must also be adopted at the same time. The Company is currently assessing the impact of these standards on its consolidated financial statements.

#### (ii) International Financial Reporting Standards

In February 2008, the CICA Accounting Standards Board ("AcSB") confirmed the changeover to IFRS from Canadian GAAP will be required for publicly accountable enterprises effective for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011. The Company continues to monitor, and assess, the impact of the conversion of Canadian GAAP to IFRS.

## 5. ACQUISITION

### Kunagu Real Estate, S.A. acquisition

On May 6, 2010, the Company acquired a 100% interest in a private company, Kunagu Real Estate, S.A. ("Kunagu") for a purchase price of \$9,280,000 by issuing 32,000,000 common shares at a price of \$0.29 at the acquisition closing date. Kunagu is a Panamanian company which holds the remaining 40% in BWB Exploration, LLC ("BWB") that the Company did not already own.

Allocation of the purchase price to the assets and liabilities acquired is as follows:

Oil and gas properties	\$	6,475,715
Future income taxes		(2,266,500)
Current assets less current liabilities		837,804
Non-controlling interest (Note 14)		4,232,981
<b>Total net assets acquired</b>	<b>\$</b>	<b>9,280,000</b>
Consideration paid:		
Common shares (Note 10)	\$	9,280,000
<b>Total consideration paid</b>	<b>\$</b>	<b>9,280,000</b>

# LNG Energy Ltd.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
For the Years Ended September 30, 2010 and 2009  
(in Canadian dollars)

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## 6. INVESTMENTS

	September 30,	
	2010	2009
Sterling West Management Ltd.	\$ 2	\$ 2
Cheetah Oil and Gas Ltd.	6,174	5,354
Tyner Resources Ltd.	-	187,563
	<u>\$ 6,176</u>	<u>\$ 192,919</u>

The Company has entered into a service relationship with a group of companies for the provision of administrative, office support and management services. The Company subscribed for one share at \$2 per share in the private company. Upon execution of the agreement, each participant is required to provide a deposit to the entity. The Company's share of the deposit was determined to be \$28,500.

At September 30, 2010 and 2009, the Company owned 100,000 common shares of Cheetah Oil and Gas Ltd. These shares are designated as held for trading and are fair valued at the end of each period. On September 30, 2010, these shares were revalued at \$0.06 resulting in an unrealized gain of \$1,034.

On December 30, 2008, the Company sold its 15% working interest in its Palo Duro assets to Tyner Resources Ltd. ("Tyner"). In consideration of the sale of the interest, Tyner issued 9,378,208 common shares to the Company, which represented 13.2% of the number of the issued and outstanding shares of Tyner following the transaction. The value of the Tyner shares on the date of closing was approximately \$0.02 per share, resulting in aggregate consideration received of \$187,563.

On March 18, 2010, the Company disposed of its investment in Tyner shares for cash proceeds of \$70,000 and recorded a loss of \$117,563 from the sale of its investment (see Note 11).

# LNG Energy Ltd.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
For the Years Ended September 30, 2010 and 2009  
(in Canadian dollars)

## 7. PROPERTY AND EQUIPMENT

	<b>September 30, 2010</b>		
	<b>COST</b>	<b>ACCUMULATED AMORTIZATION, DEPLETION, DEPRECIATION &amp; IMPAIRMENT</b>	<b>NET BOOK VALUE</b>
Oil and gas properties:			
Papua New Guinea	\$ 30,873,351	\$ 820,304	\$ 30,053,047
Poland	1,026,824	-	1,026,824
United States	19,949,608	201,062	19,748,546
Vehicles	100,875	70,210	30,665
Office furnitures and equipment	85,340	23,800	61,540
Computer equipment	67,787	43,440	24,347
Computer software	5,883	3,195	2,688
Technical license	112,403	9,487	102,916
	<b>\$ 52,222,071</b>	<b>\$ 1,171,498</b>	<b>\$ 51,050,573</b>

	<b>September 30, 2009</b>		
	<b>COST</b>	<b>ACCUMULATED AMORTIZATION, DEPLETION, DEPRECIATION &amp; IMPAIRMENT</b>	<b>NET BOOK VALUE</b>
Oil and gas properties:			
Papua New Guinea	\$ 24,110,179	\$ 820,304	\$ 23,289,875
United States	12,480,438	122,915	12,357,523
Vehicles	121,671	76,289	45,382
Office furnitures and equipment	55,454	18,062	37,392
Computer equipment	67,522	38,645	28,877
Computer software	6,135	3,509	2,626
Technical license	14,293	-	14,293
	<b>\$ 36,855,692</b>	<b>\$ 1,079,724</b>	<b>\$ 35,775,968</b>

### Papua New Guinea

The Company holds a 100% working interests in four Petroleum Prospecting License's (PPL) and one Petroleum Retention License (PRL) through permits received from the Minister of Petroleum and Energy for Papua New Guinea. These PPL licenses have a five year term along with expenditure commitments for each license. The work commitments relating to these licenses are US\$12 million over the next two years. The PRL license has been renewed for an additional year and expires on January 27, 2011.

These properties are subject to a 22.5% back-in participation right in favour of the government, which the government may exercise upon payment of 22.5% of the costs incurred in the development of the property. The back-in participation right also includes a 2% revenue royalty payment obligation to indigenous groups, which is only payable if the government exercises its back-in participation right.

# LNG Energy Ltd.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the Years Ended September 30, 2010 and 2009

(in Canadian dollars)

### 7. PROPERTY AND EQUIPMENT (Continued)

The Papua New Guinea asset is considered unproved at September 30, 2010. No production has occurred and no depletion has been recorded.

During the year ended September 30, 2010, \$81,223 of stock based compensation expenses and \$612,235 of general and administrative costs were capitalized. During the year ended September 30, 2009, \$116,569 of stock based compensation and \$618,225 of general and administrative expenses were capitalized.

#### Poland

As at September 30, 2010, the proportionate consolidation of the Company's 20% in our Poland joint venture resulted in an addition into oil and gas properties of \$1,026,624. The Company has rights to three concessions where license commitments will require the Company to participate pro-rata for its 20% ownership to finance the drilling and testing of one exploration well per concession before the end of December 2011. No general and administrative or stock based compensation costs were capitalized in Poland.

#### United States

The Company, through its subsidiary, holds interests in oil and gas properties in the United States. In determining the Company's depletion for the year ended September 30, 2010, the Company excluded the cost of unproved properties of \$3,818,989 (September 30, 2009 - \$9,194,040) from the depletion calculation. During the year ended September 30, 2010 no general and administrative or stock based compensation costs were capitalized. During the year ended September 30, 2009, \$590,458 of general and administrative costs were capitalized, of which \$65,160 related to to capitalized stock based compensation expenses.

The Company performed a ceiling test calculation at September 30, 2010 to assess the recoverable value of its oil and natural gas interests and determined no write-down was required during the year ended September 30, 2010 (September 30, 2009 - \$nil). The prices used in the ceiling test evaluation of the Company's oil and gas assets are summarized below (on a calendar year basis):

(Prices in \$USD)	Oil	Natural gas liquids	Gas
Year	\$/bbl <sup>1</sup>	\$/bbl <sup>2</sup>	\$/Mmbtu <sup>2</sup>
2010	75.60	28.73	4.12
2011	80.57	30.62	4.63
2012	83.76	31.83	5.22
2013	86.09	32.71	5.72
2014	90.22	34.28	6.63
2015	91.57	34.80	7.54
2016	92.64	35.32	8.20
2017	94.34	35.85	8.32
2018	95.75	36.39	8.45
2019	97.19	36.93	8.58
2020	98.65	37.49	8.70

<sup>1</sup> Weighted average plantgate price

<sup>2</sup> Weighted average wellhead price

# LNG Energy Ltd.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the Years Ended September 30, 2010 and 2009

(in Canadian dollars)

### 8. JOINT VENTURE

The Company, through its subsidiary, Kaynes, exercised its option to participate in a 20% net interest in Saponis Investments SP z.o.o. ("Saponis"). Saponis holds 3 oil and gas concessions in Poland: Starogard, Slupsk and Slawno. The original work commitment under these concessions is comprised of additional core analysis, geological work and spudding of one well during the first 18 months from the date of grant on each concession. A second well also has to be drilled on each concession. At September 30, 2010, the Company had invested \$366,213 in the Project.

The terms and conditions of participation requires the Company to fund 20% of all costs related to the concessions. The other partners are BNK Petroleum Inc. ("BNK"), Sorigenia E&P S.p.A., and Rohol-Aufsuchungs Aktiengesellschaft. The Company's net interest in Saponis is accounted for on a proportionate consolidation basis.

For the years ended September 30, 2010 and 2009, the Company's net share of amounts contributed to the joint venture was as follows:

	As at September 30,	
	2010	2009
<b>Balance sheet:</b>		
Cash and cash equivalents	\$ 26,524	-
Current receivables	82,603	-
Oil and gas properties	1,026,624	-
Accounts payable	(818,561)	-
Net contribution from Joint Venture	317,190	-
<b>Income statement:</b>		
Revenues	-	-
Expenses	(35,143)	-
	\$ (35,143)	\$ -
<b>Cash flows:</b>		
Operating activities	699,301	-
Financing activities	7,517	-
Investing activities	(680,293)	-
	\$ 26,525	\$ -



# LNG Energy Ltd.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
For the Years Ended September 30, 2010 and 2009  
(in Canadian dollars)

## 9. ASSET RETIREMENT OBLIGATION

The following table presents the reconciliation of the beginning and ending aggregate carrying amount of the obligation associated with asset retirement costs of the oil and gas asset in the Berwyn well:

	As at September 30,	
	2010	2009
Balance, beginning of year	\$ 2,893	\$ 16,983
Liabilities incurred	-	3,066
Change in estimate	(117)	(251)
Liabilities disposed (Note 5)	-	(16,983)
Accretion	343	78
<b>Balance, end of year</b>	<b>\$ 3,119</b>	<b>\$ 2,893</b>

The calculation was assessed using a risk-free rate of 10.00% and an assumed inflation rate of 1.45% per annum. The undiscounted cash flow required to settle the obligation is approximately \$8,000 with the expected abandonment date being 2018.

## 10. SHARE CAPITAL AND CONTRIBUTED SURPLUS

### a) Authorized

Unlimited common shares without par value.

### b) Issued

	Number of Shares	Share Capital	Contributed Surplus
Balance September 30, 2008	144,095,965	\$ 55,738,855	\$ 6,365,200
Stock based compensation	-	-	598,063
Warrants expired	-	-	417,110
Balance September 30, 2009	144,095,965	\$ 55,738,855	\$ 7,380,373
Stock based compensation	-	-	153,339
Shares issued on acquisition (Note 5)	32,000,000	9,280,000	-
Share issue costs	-	(1,559,921)	-
Shares issued upon exercise of special warrants	80,403,400	20,100,850	-
Shares issued upon exercise of options	735,000	473,739	(378,339)
<b>Balance September 30, 2010</b>	<b>257,234,365</b>	<b>\$ 84,033,523</b>	<b>\$ 7,155,373</b>

# LNG Energy Ltd.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
For the Years Ended September 30, 2010 and 2009  
(in Canadian dollars)

## 10. SHARE CAPITAL AND CONTRIBUTED SURPLUS (Continued)

### c) Stock Options

The following table summarizes information about stock option transactions:

	Number of Options	Average Exercise Price
Balance, September 30, 2008	13,550,000	\$0.49
Granted	2,290,000	\$0.19
Forfeited	(1,845,000)	\$0.43
Balance, September 30, 2009	13,995,000	\$0.45
Granted	300,000	\$0.30
Exercised	(735,000)	\$0.13
Forfeited	(165,000)	\$0.23
<b>Balance, September 30, 2010</b>	<b>13,395,000</b>	<b>\$0.46</b>

The following table summarizes information about the stock options outstanding at September 30, 2010:

Exercise Price	Outstanding Options	Options Exercisable	Expiry Date
\$0.10	200,000	200,000	November 27, 2011
\$0.67	271,000	271,000	September 20, 2012
\$0.67	379,000	379,000	September 21, 2012
\$0.58	6,000,000	6,000,000	November 27, 2012
\$0.56	750,000	750,000	February 1, 2013
\$0.58	1,500,000	1,500,000	February 1, 2013
\$0.275	1,890,000	1,605,000	May 1, 2013
\$0.19	2,105,000	2,105,000	May 14, 2014
\$0.30	300,000	300,000	January 14, 2015
	13,395,000	13,110,000	

The fair value of the options granted has been estimated on the date of grant using the Black-Scholes option-pricing model.

Assumptions used to value options within the option-pricing model are as follows:

	Year ended September 30,	
	2010	2009
Risk-free interest rate	1.31% - 3.14%	1.83% - 2.47%
Expected life	2.8 - 5 years	3.8 - 5 years
Expected volatility	117.8% - 129%	125% - 131.60%
Expected dividends	Nil	Nil
Average (\$ per option)	0.26	0.4

# LNG Energy Ltd.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
For the Years Ended September 30, 2010 and 2009  
(in Canadian dollars)

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## 10. SHARE CAPITAL AND CONTRIBUTED SURPLUS (Continued)

### d) Special Warrants

On June 29, 2010 ("the Closing date"), the Company completed a private placement ("Private Placement") for 80,403,400 special warrants ("Special Warrants") at a price of \$0.25 per Special Warrant. The Company raised gross proceeds of \$20,100,850. Each Special Warrant entitled the holder to receive, without the payment of any additional consideration, one common share of the Company. The Special Warrants are subject to a four-month and one day holding period commencing on the Closing date and will be automatically exercised on the earlier of (i) the third business day after the date a receipt is issued by the applicable securities regulatory authorities for a final short form prospectus qualifying the Common shares to be issued upon the exercise of the Special Warrants and (ii) the date which is four months and one day from the Closing date.

As consideration for the services of the agents in connection with the private placement, LNG has paid the agents a cash commission equal to 6% of the gross proceeds of the offering.

On August 3, 2010, 80,403,400 special warrants ("Special Warrants") were exercised and converted to common shares.

### e) Escrow Shares

As at September 30, 2010, the Company had no common shares held in escrow (September 30, 2009 – 1,540,312). The final tranche was released on November 28, 2009.

## 11. RELATED PARTY TRANSACTIONS AND BALANCES

Transactions and balances with related parties for the years ended September 30, 2010 and 2009 for amounts paid to companies controlled by directors and officers of the Company were as follows:

	Years Ended September 30,	
	2010	2009
Director fees paid to independent directors of the Company	\$ 32,000	\$ 34,000

During the year ended September 30, 2010, a total of \$98,657 was paid to a director of a subsidiary for other professional services performed not related to director fees (September 30, 2009 - \$29,886). These expenditures are included in professional fees and were measured at the exchange amount, which are amounts agreed upon by the transacting parties.

The Company also disposed of its investment in Tyner Resources Ltd., which is controlled by a common director, for cash proceeds of \$70,000 (see Note 6).

# LNG Energy Ltd.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
For the Years Ended September 30, 2010 and 2009  
(in Canadian dollars)

## 12. SUPPLEMENTAL DISCLOSURE WITH RESPECT TO CASH FLOWS

a) Changes in non-cash working capital are as follows:

	Years Ended September 30,	
	2010	2009
Amounts receivable	\$ (808,608)	\$ 124,669
Prepaid expenses, advances and other term deposits	(63,962)	72,734
Accounts payable and accrued liabilities	1,368,560	(798,561)
Change in non-cash working capital	\$ 495,990	\$ (601,158)
Relating to:		
Operating activities	191,897	(485,784)
Investing activities	304,093	(115,374)
Change in non-cash working capital	\$ 495,990	\$ (601,158)

b) Other non-cash transactions that occurred during the year ended September 30, 2010 and 2009:

	September 30	
	2010	2009
Common shares issued related to acquisition of subsidiary (Note 5)	\$ 9,280,000	\$ -

c) Cash and cash equivalents is comprised of the following:

	September 30,	
	2010	2009
Cash	\$ 198,613	\$ 900,688
Cash equivalents	9,837,492	2,004,609
	\$ 10,036,105	\$ 2,905,297

Cash and cash equivalents are classified as "held for trading" and are measured at their carrying value which approximates the fair values due to the short term nature of these instruments with maturity at acquisition not exceeding 90 days. Cash equivalents relates to an interest savings account which bears an interest rate of approximately 0.80% per annum with no maturity date (September 30, 2009 – 0.80% per annum).

# LNG Energy Ltd.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the Years Ended September 30, 2010 and 2009

(in Canadian dollars)

### 13. INCOME TAXES

The Company's provision from income taxes differs from the amounts computed by applying the statutory tax rates to the loss as a result of the following:

	<b>September 30,</b>	
	<b>2010</b>	<b>2009</b>
Statutory rates	29%	30%
Recovery of income taxes computed at statutory rates	\$ (940,041)	\$ (1,241,105)
Non-deductible items	28,000	115,000
Depreciation and amortization in excess of capital cost allowance claimed for income tax purposes	-	-
Share issue cost	-	-
Capital gains tax	-	-
Impact due to rate adjustment	(23,340)	180,105
Other	10,717	3,000
Unrealized foreign exchange loss (gain)	12,000	83,409
Change in valuation allowance	893,000	773,000
	<b>\$ (19,664)</b>	<b>\$ (86,591)</b>

The tax effects on temporary timing differences that give rise to significant components of the future tax assets and future tax liabilities are as follows:

	<b>September 30,</b>	
	<b>2010</b>	<b>2009</b>
Future income tax assets:		
Non-capital loss carry forward	\$ 7,371,000	\$ 3,085,000
Unrealized foreign exchange	208,000	219,000
Capital loss carry forward	53,000	77,000
Share issue costs	593,000	427,000
Property and equipment	5,000	2,000
Resource related assets	(3,909,000)	1,494,000
Less: Valuation allowance	(7,386,151)	(6,102,651)
	<b>\$ (3,065,151)</b>	<b>\$ (798,651)</b>

The Company incurs non-capital losses in its foreign and Canadian subsidiaries. The Company has non-capital losses carried forward of approximately \$24,043,000 which may be available to offset future income for income tax purposes expiring over the periods 2011 to 2028. However it is not likely to realize any taxable income in the near future and any future tax assets are allowed for and do not offset future income tax liabilities. The Company has future income tax assets of approximately \$3,934,600 in Papua New Guinea, \$1,393,200 in the US and \$2,058,300 in Canada.

The Company evaluates its valuation allowance based on projected future operations. When circumstances change and its causes a change in management's judgement about the recoverability of the future tax assets, the impact of the change on valuation allowance is reflected in current income. Due to the uncertainty of realization, the Company has not reflected any benefit recorded from these losses in these financial statements.

# LNG Energy Ltd.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
For the Years Ended September 30, 2010 and 2009  
(in Canadian dollars)

## 14. NON-CONTROLLING INTERESTS

	September 30,	
	2010	2009
Balance, beginning of year	\$ (4,277,161)	\$ (2,385,792)
Acquisition of 10% non-controlling interest of LNG BC	-	2,385,792
40% non-controlling interest of BWB	-	(5,112,400)
Acquisition of 40% non-controlling interest of BWB (note 5)	4,232,981	-
Change in non-controlling interest during the year	31,333	6,055
Change due to foreign exchange translation from US	12,847	829,184
Balance, end of year	\$ -	\$ (4,277,161)

## 15. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

Section 3862 of the CICA Handbook establishes a three-tier fair value hierarchy to reflect the significance of the inputs used in making the fair value of the Company's financial instruments.

### Fair Value as at September 30, 2010

	Total	Level 1	Level 2	Level 3
Short term investments	\$ 9,015,750	9,015,750	-	-
Investments	6,176	6,176	-	-
	\$ 9,021,926	\$ 9,021,926	\$ -	\$ -

The three levels of the fair value hierarchy established by Section 3862 are as follows:

Level 1	Unadjusted quoted prices in active markets for identical assets or liabilities.
Level 2	Inputs, other than quoted prices, included in Level 1 that are observable for the asset or liability (directly or indirectly)
Level 3	Inputs for the asset or liability that are not based on observable market data (unobservable inputs)

### Level 1

The Company values short term investments using the quoted market prices. Investments consisting of marketable securities classified as held for trading, are valued using a market approach based upon unadjusted quoted prices for identical assets in an active market from securities exchanges. As a result, these financial assets have been included in Level 1 of the fair market value hierarchy.

### Level 2 and Level 3

The Company does not hold any financial instruments to be classified in these categories.

### Fair value of financial assets and liabilities

The carrying amount for cash and cash equivalents, short term investments, amounts receivable, and accounts payable and accrued liabilities and capital lease obligations on the balance sheet approximated their fair value because of the limited short term nature of these instruments.

# LNG Energy Ltd.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
For the Years Ended September 30, 2010 and 2009  
(in Canadian dollars)

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## 15. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (Continued)

### **Foreign currency risk**

The Company is subject to normal market risks including fluctuations in foreign exchange rates. The Company received revenues in US dollars, while incurring expenses in US, Canadian dollars and Papua New Guinea Kinas.

Foreign exchange gains and losses are related to the translation from Canadian dollars into Kinas for measurement and reporting purposes. The Company finances its integrated Papua New Guinea subsidiaries in Canadian dollars and a significant change in the currency exchange rates could have a material effect on the Company's results of operations, financial position and cash flows.

The Company's operations in the U.S. and in Poland are considered to be self-sustaining and the United States dollar is the functional currency. All foreign currency translations are reported in accumulated other comprehensive income and a significant change in currency exchange rates would affect the Company's comprehensive income and deficit.

While the Company expects to manage its operations in order to minimize exposure to these risks, the Company has not entered into any derivatives or contracts to hedge or otherwise mitigate this exposure.

### **Credit risk**

Cash and cash equivalents consist of cash bank balances and short-term deposits maturing in less than 90 days. The Company manages the credit exposure related to short-term investments by selecting counter parties based on credit ratings and monitors all investments to ensure a stable return, avoiding complex investment vehicles with higher risk such as asset backed commercial paper.

### **Interest rate risk**

Interest rate risk is the risk that future cash flows will fluctuate as a result of changes in market interest rates. The Company is exposed to interest rate fluctuations on its cash balances and cash equivalents.

The Company is not exposed to material interest rate fluctuations on its short-term investments. At September 30, 2010, the Company had short term investments in GICs totaling \$9,015,750, bearing interest at a fixed rate of 1.15% per annum with the maturity date of September 22, 2011 for two GIC investments of \$4,507,875 each (September 30, 2009 - \$8,310,500 bearing interest at fixed rates of 0.40% per annum).

# LNG Energy Ltd.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
For the Years Ended September 30, 2010 and 2009  
(in Canadian dollars)

## 15. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (Continued)

### Liquidity risk

The Company maintains sufficient capital in order to meet short-term business requirements, after taking into account the Company's holdings of cash and short-term investments. The Company's cash is invested in business accounts which are available on demand. The Company does not invest in asset backed securities. The Company's short-term investments are available on demand after 30 days without penalty. All financial liabilities are due to be settled within 180 days of the balance sheet date.

The Company manages its capital such that there are adequate capital resources to safeguard the Company's ability to continue as a going concern through the optimization of its capital structure. The capital structure consists of shareholder's equity comprising of share capital, contributed surplus and deficit. The basis for the Company's capital structure is dependent on the Company's expected business growth and changes in business environment.

As at September 30, 2010, total managed capital was \$66,335,895 (September 30, 2009 - \$41,773,558), comprised of share capital of \$84,033,523 (September 30, 2009 - \$55,738,855), contributed surplus of \$7,155,373 (September 30, 2009 - \$7,380,373), other comprehensive loss of \$987,772 (September 30, 2009 - \$721,961) and a deficit of \$23,865,229 (September 30, 2009 - \$20,623,709).

## 16. SEGMENT INFORMATION

Geographic Information:

The Company operates in one reportable operating segment, being the exploration of oil and gas properties in the United States, Poland, and Papua New Guinea. The geographical information is as follows:

Year Ended September 30, 2010	Papua New Guinea	United States	Poland	Canada	Total
Current assets	\$ 418,504	\$ 156,547	\$ 109,127	\$ 19,105,386	\$ 19,789,564
Investments	-	-	-	6,176	6,176
Property and equipment	30,165,965	19,748,546	1,026,824	109,238	51,050,573
	\$ 30,584,469	\$ 19,905,093	\$ 1,135,951	\$ 19,220,800	\$ 70,846,313

Year Ended Septemebr 30, 2010	Papua New Guinea	United States	Poland	Canada	Total
Oil and gas revenue	\$ -	\$ 258,302	\$ -	\$ -	\$ 258,302



# LNG Energy Ltd.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
For the Years Ended September 30, 2010 and 2009  
(in Canadian dollars)

## 16. SEGMENT INFORMATION (Continued)

<b>September 30, 2009</b>	<b>Papua New Guinea</b>	<b>United States</b>	<b>Canada</b>	<b>Total</b>
Current assets	\$ 331,527	\$ 197,621	\$ 11,241,531	\$ 11,770,679
Investments	-	-	192,919	192,919
Property and equipment	23,398,849	12,357,523 *	19,596	35,775,968
	<b>\$ 23,730,376</b>	<b>\$ 12,555,144</b>	<b>\$ 11,454,046</b>	<b>\$ 47,739,566</b>

\* Includes the non-controlling interest of \$5,112,400. Refer to Note 5(b).

<b>Year Ended September 30, 2009</b>	<b>Papua New Guinea</b>	<b>United States</b>	<b>Canada</b>	<b>Total</b>
Oil and gas revenue	\$ -	\$ 252,245	\$ -	\$ 252,245

## 17. SUBSEQUENT EVENTS

On October 28, 2010, the Company issued 75,000 common shares for the exercise of stock options for total proceeds of \$14,250.

On November 4, 2010, the Company granted 2,500,000 options to an employee of the Company at an exercise price of \$0.33 per share with an expiry term of 5 years.

On November 15, 2010, the Company issued 135,000 shares for the exercise of stock options for total proceeds of \$37,125.

On November 23, 2010, the Company granted 500,000 options to an employee of the Company at an exercise price of \$0.35 per share with an expiry term of 5 years.

On January 11, 2011, the Company issued 250,000 shares for the exercise of stock options for total proceeds of \$56,000.