

Consolidated Financial Statements

**RUN OF RIVER  
POWER INC.**

Nine Months Ended September 30, 2008  
(Unaudited)

**RUN OF RIVER POWER INC.**  
**Consolidated Financial Statements**  
**September 30, 2008**  
**(Unaudited)**

|   |   |
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The accompanying unaudited consolidated financial statements have been prepared by management and approved by the Audit Committee and Board of Directors. The Company's independent auditors have not performed a review of these financial statements.

**RUN OF RIVER POWER INC.**  
**Consolidated Balance Sheets**  
As at September 30, 2008 and December 31, 2007

|   | (Unaudited)<br>September 30, 2008 | (Audited)<br>December 31, 2007 |
|---|-----------------------------------|--------------------------------|
| <b>Assets</b>                                     |                                   |                                |
| <b>Current</b>                                    |                                   |                                |
| Cash  | \$ 1,500,125                      | \$ 3,597,862                   |
| Restricted cash (Note 5)                          | 574,659                           | 527,769                        |
| Marketable securities                             | 3,623,243                         | 5,595,543                      |
| Amounts receivable                                | 134,285                           | 162,441                        |
| Due from related parties (Note 9)                 | 412,122                           | 271,337                        |
| GST receivable                                    | 381,898                           | 241,079                        |
| Prepaid expenses                                  | 309,629                           | 154,139                        |
|   | <b>6,935,961</b>                  | 10,550,170                     |
| Property, plant and equipment, net (Note 6)       | <b>16,703,549</b>                 | 17,104,332                     |
| Projects under development (Notes 4 and 7)        | <b>9,438,201</b>                  | 4,093,461                      |
| Future income tax assets                          | <b>321,078</b>                    | 321,078                        |
| Licenses and security deposit                     | <b>82,163</b>                     | 82,163                         |
|   | <b>\$ 33,480,952</b>              | \$ 32,151,204                  |
| <b>Liabilities</b>                                |                                   |                                |
| <b>Current</b>                                    |                                   |                                |
| Accounts payable and accrued liabilities (Note 9) | \$ 581,694                        | \$ 329,915                     |
| Current portion of long-term debt (Note 8)        | <b>408,186</b>                    | 389,308                        |
|   | <b>989,880</b>                    | 719,223                        |
| Long-term debt (Note 8)                           | <b>11,228,537</b>                 | 11,520,606                     |
| Non-controlling interest                          | <b>80,355</b>                     | -                              |
| <b>Shareholders' Equity</b>                       |                                   |                                |
| Share capital (Notes 4 and 10)                    | <b>23,703,227</b>                 | 21,313,304                     |
| Contributed surplus (Note 10)                     | <b>3,526,308</b>                  | 3,135,506                      |
| Deficit   | <b>(6,047,355)</b>                | (4,537,435)                    |
|   | <b>21,182,180</b>                 | 19,911,375                     |
|   | <b>\$ 33,480,952</b>              | \$ 32,151,204                  |

Commitments – Notes 8, 10 and 14  
On behalf of the board:

“R.G. “Jako” Krushnisky” Director

“Richard Hopp” Director

**RUN OF RIVER POWER INC.**  
**Consolidated Statements of Operations and Deficit**  
**Nine Months Ended September 30, 2008 and 2007**  
(Unaudited)

|  | Three Months Ended<br>September 30 |                | Nine Months Ended<br>September 30 |                |
|--|------------------------------------|----------------|-----------------------------------|----------------|
|  | 2008                               | 2007           | 2008                              | 2007           |
| <b>Revenues</b>                            |                                    |                |                                   |                |
| Electricity sales                          | \$ 664,168                         | 724,409        | \$ 1,250,096                      | \$ 1,638,446   |
| Royalties                                  | (6,642)                            | (7,244)        | (12,501)                          | (16,384)       |
|  | <b>657,526</b>                     | 717,165        | <b>1,237,595</b>                  | 1,622,062      |
| <b>Expenses</b>                            |                                    |                |                                   |                |
| Plant operations                           | 165,423                            | 212,816        | 485,418                           | 377,767        |
| Depreciation and amortization              | 153,967                            | 153,958        | 468,051                           | 460,902        |
| General and administration                 | 433,695                            | 302,945        | 1,379,469                         | 1,062,771      |
|  | <b>753,085</b>                     | 669,719        | <b>2,332,938</b>                  | 1,901,440      |
| <b>Loss before the following</b>           | <b>(95,559)</b>                    | 47,446         | <b>(1,095,343)</b>                | (279,378)      |
| Interest on long-term debt                 | 188,800                            | 194,802        | 570,985                           | 588,708        |
| Amortization of deferred financing charges | 5,449                              | 3,480          | 16,474                            | 10,439         |
| Interest income                            | (12,089)                           | (107,048)      | (172,882)                         | (151,771)      |
| <b>Net loss for the period</b>             | <b>(277,719)</b>                   | (43,788)       | <b>(1,509,920)</b>                | (726,754)      |
| <b>Deficit, beginning of period</b>        | <b>(5,769,636)</b>                 | (3,850,576)    | <b>(4,537,435)</b>                | (3,167,610)    |
| <b>Deficit, end of period</b>              | <b>\$ (6,047,355)</b>              | \$ (3,894,364) | <b>\$ (6,047,355)</b>             | \$ (3,894,364) |
| <b>Basic and diluted loss per share</b>    | <b>\$ (0.00)</b>                   | \$ (0.00)      | <b>\$ (0.02)</b>                  | \$ (0.02)      |
| <b>Weighted average number of shares</b>   | <b>64,798,501</b>                  | 61,852,207     | <b>63,051,380</b>                 | 45,104,673     |

**RUN OF RIVER POWER INC.**  
**Consolidated Statements of Cash Flows**  
**Nine Months Ended September 30, 2008 and 2007**  
**(Unaudited)**

|  | Three Months Ended<br>September 30 |                     | Nine Months Ended<br>September 30 |                     |
|--|------------------------------------|---------------------|-----------------------------------|---------------------|
|  | 2008                               | 2007                | 2008                              | 2007                |
| <b>Cash flows from (used in) operating activities</b>                |                                    |                     |                                   |                     |
| Net loss for the period  | \$ (277,719)                       | \$ (43,788)         | \$ (1,509,920)                    | \$ (726,754)        |
| Add (deduct) items not affecting cash:                               |                                    |                     |                                   |                     |
| Depreciation and amortization  | 159,416                            | 157,438             | 484,525                           | 471,341             |
| Stock based compensation   | 58,290                             | 76,450              | 230,196                           | 292,457             |
|  | (60,013)                           | 190,100             | (795,199)                         | 37,044              |
| Net changes in non-cash working capital items related to operations: |                                    |                     |                                   |                     |
| Amounts receivable   | 94,385                             | 157,227             | 28,156                            | (106,662)           |
| GST receivable   | (50,910)                           | (50,609)            | (140,819)                         | (21,878)            |
| Prepaid expenses   | 62,572                             | (34,090)            | (155,490)                         | 35,257              |
| Accounts payable and accrued liabilities                             | (117,391)                          | (124,912)           | 2,728                             | (64,374)            |
| Net cash from (used in) operating activities                         | (71,357)                           | 137,716             | (1,060,624)                       | (120,613)           |
| <b>Cash flows from (used in) investing activities</b>                |                                    |                     |                                   |                     |
| Increase in restricted cash  | (15,351)                           | (15,666)            | (46,890)                          | (46,807)            |
| Decrease (increase) in marketable securities                         | 1,999,618                          | (453,758)           | 1,972,300                         | (5,043,772)         |
| Increase in projects under development                               | (654,355)                          | (477,157)           | (2,288,746)                       | (1,006,791)         |
| Property, plant and equipment expenditures                           | (17,329)                           | (23,185)            | (68,568)                          | (26,553)            |
| Increase in intangibles  | -                                  | -                   | -                                 | (1,782)             |
| Increase in loans to related parties                                 | (119,514)                          | -                   | (315,544)                         | -                   |
| Net cash from (used in) investing activities                         | 1,193,069                          | (969,766)           | (747,448)                         | (6,125,705)         |
| <b>Cash flows from (used in) financing activities</b>                |                                    |                     |                                   |                     |
| Repayment of long term debt  | (98,083)                           | (92,082)            | (289,665)                         | (271,943)           |
| Issuance of shares - net of issue costs                              | -                                  | -                   | -                                 | 9,973,990           |
| Exercise of warrants   | -                                  | -                   | -                                 | 232,523             |
| Net cash from (used in) financing activities                         | (98,083)                           | (92,082)            | (289,665)                         | 9,934,570           |
| <b>Change in cash</b>  | <b>1,023,629</b>                   | <b>(924,132)</b>    | <b>(2,097,737)</b>                | <b>3,688,252</b>    |
| <b>Cash, beginning of period</b>                                     | <b>476,496</b>                     | <b>5,509,151</b>    | <b>3,597,862</b>                  | <b>896,767</b>      |
| <b>Cash, end of period</b>   | <b>\$ 1,500,125</b>                | <b>\$ 4,585,019</b> | <b>\$ 1,500,125</b>               | <b>\$ 4,585,019</b> |

Supplemental Disclosures with Respect to Cash Payments (Note 13)

# **RUN OF RIVER POWER INC.**

## **Notes to Consolidated Financial Statements**

### **Nine Months Ended September 30, 2008 and 2007**

#### **(Unaudited)**

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## **1. Nature of Operations**

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Run of River Power Inc. (the “Company”) was incorporated on November 26, 1999 as Healey Capital Corp. pursuant to the provisions of the Alberta Business Corporations Act (“ABCA”). The articles of Healey were amended on February 25, 2000, to remove the private company provisions and the restrictions on resale. On June 9, 2005 the Company changed its name to Run Of River Power Inc. On September 13, 2006, the Company changed its domicile from Alberta to British Columbia.

The Company consolidated the accounts of its nine wholly-owned subsidiaries: 1554675 Ontario Limited, Rockford Energy Corporation (“Rockford”), Jascott Holdings Corp. (“Jascott”), Northwest Cascade Power Ltd., Crawford Energy Corp., Raffuse Energy Inc., Skookum Energy Corp., Sea to Sky Power Corporation and Western Biomass Power Corp. and its 80% owned subsidiary Pacific Northwest Biomass Corporation (see Note 4).

The Company’s main activity of independent power generation commenced on June 9, 2005 with the acquisition of Rockford. Rockford had developed a seven-megawatt hydroelectric facility on Brandywine Creek near Whistler, B.C. (the “Project”). The power output from the Brandywine Project is sold under an Electricity Purchase Agreement with BC Hydro. Under the terms of the Electricity Purchase Agreement, BC Hydro has agreed to purchase all of the plant’s output for 20 years from the commercial operation date. The Company is actively developing other projects in hydroelectricity and biomass power generation.

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## **2. Basis of Presentation**

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While the information presented in the accompanying interim consolidated financial statements is unaudited, it includes all adjustments which are, in the opinion of management, necessary to present fairly the financial position, results of operations and cash flows for the interim periods presented. Except as disclosed below, these interim consolidated financial statements follow the same accounting policies and methods of their application as the December 31, 2007 annual consolidated financial statements. It is suggested that these interim consolidated financial statements be read in conjunction with the Company’s December 31, 2007 audited annual consolidated financial statements. The interim consolidated financial statements contain disclosures which are supplemental to the Company’s annual consolidated financial statements.

Certain comparative figures have been reclassified to conform to the presentation adopted in the current period.

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## **3. Adoption of New Accounting Standards**

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Financial instrument and capital disclosures

The CICA has issued the following accounting standards effective for fiscal years beginning on or after January 1, 2008: Section 1535 “Capital Disclosures”, Section 3862 “Financial Instruments – Disclosures” and Section 3863 “Financial Instruments – Presentation”.

Section 1535 “Capital Disclosures” requires the Company to provide disclosures about the capital of the Company and how it is managed.

**RUN OF RIVER POWER INC.**  
**Notes to Consolidated Financial Statements**  
**Nine Months Ended September 30, 2008 and 2007**  
**(Unaudited)**

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**3. Adoption of New Accounting Standards – (cont'd)**

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Section 3862 “Financial Instruments – Disclosures” and Section 3863 “Financial Instruments – Presentation” replace Section 3861 “Financial Instruments - Disclosure and Presentation”, revising disclosures related to financial instruments, including hedging instruments, and carrying forward unchanged presentation requirements.

The adoption of these new accounting standards did not impact the amounts reported in the financial statements of the Company; however, it did result in expanded note disclosure (see notes 11 and 12).

International Financial Reporting Standards

The Canadian Accounting Standards Board confirmed that Canadian GAAP for publicly accountable enterprises will be converted to International Financial Reporting Standards (“IFRS”) on January 1, 2011. This change in GAAP will be effective for years beginning January 1, 2011. The Company has commenced planning for the implementation of IFRS.

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**4. Business Acquisition**

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**Acquisition of Western Biomass Power Corp.**

On February 1, 2008, the Company completed the acquisition of all of the outstanding shares of Western Biomass Power Corp. (“Western Biomass”). A total of 3,780,301 shares of the Company were issued to the former shareholders of Western Biomass, 3,565,748 of which were held in escrow to be released in two stages. Holders of the escrowed shares are not entitled to exercise their voting rights in respect of the escrowed shares until such time as the shares are released from escrow. In June 2008, 2,305,654 of the escrowed shares were released upon the delivery of a favourable feasibility study in respect of the Western Biomass project and the execution of a definitive joint venture agreement between Western Biomass and the Tsilhqot’in National Government (“TNG”). A further 1,260,094 escrowed shares will be released from escrow upon the execution of a long term electricity purchase agreement (“EPA”) between BC Hydro, Western Biomass and TNG. In the event this condition is not met by December 31, 2009, the shares remaining in escrow will be cancelled and returned to treasury. All shares issued to the former Western Biomass shareholders were subject to a hold period which expired on June 1, 2008. The transaction is considered a related party transaction as 24.2% of the issued shares of Western Biomass are owned by a director and by an officer of the Company.

The acquisition (referred to as the Tsilhqot’in Biomass Project) has been accounted for using the purchase method. The results of Western Biomass have been consolidated from February 1, 2008 and are included in the Company's results of operations.

**RUN OF RIVER POWER INC.**  
**Notes to Consolidated Financial Statements**  
**Nine Months Ended September 30, 2008 and 2007**  
**(Unaudited)**

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**4. Business Acquisition – (cont'd)**

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**Acquisition of Western Biomass Power Corp. - (cont'd)**

The allocation of the purchase price to the net assets acquired is as follows:

|                            |                     |
|----------------------------|---------------------|
| Projects under development | \$ 1,735,795        |
| Equipment                  | 1,016               |
| Non-cash working capital   | 5,926               |
|                            | <u>\$ 1,742,737</u> |

Consideration:

|   |                     |
|---|---------------------|
| Cash  | \$ 192,814          |
| Common shares – 3,780,301 shares valued at \$0.41 per share | 1,549,923           |
|   | <u>\$ 1,742,737</u> |

**Acquisition of Pacific Northwest Biomass Corp.**

In September 2008, the Company completed the acquisition of 80% of the issued and outstanding shares of Pacific Northwest Biomass Corp. (“PNBC”). In connection with the acquisition, a total of 4,000,000 shares of the Company were issued to the shareholders of PNBC. The shares were held in escrow to be released in two stages as follows:

- i) 2,000,000 shares upon receipt of both a final independent engineering study which confirms the economic feasibility and an independent consulting report which confirms the adequacy of the fibre supply of the power plant.
- ii) provided the first condition is met by September 30, 2008, 2,000,000 shares upon execution of an EPA with BC Hydro in respect of the plant by September 30, 2009.

In the event that either of these conditions is not met, all shares held in escrow at the time shall be cancelled and returned to the Company’s treasury.

Should these conditions be met, resulting in the 4,000,000 shares being released from escrow, and an EPA is executed with BC Hydro for a second plant by December 31, 2009, a further 1,000,000 shares of the Company will be issued.

A shareholder and Director of the Corporation is also a 25% shareholder and director of PNBC.

All shares issued to the PNBC shareholders are subject to a hold expiring on January 17, 2009.

In September 2008, 2,000,000 shares were released from escrow subsequent to the completion of the first stage described above.

**RUN OF RIVER POWER INC.**  
**Notes to Consolidated Financial Statements**  
**Nine Months Ended September 30, 2008 and 2007**  
**(Unaudited)**

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**4. Business Acquisition – (cont'd)**

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**Acquisition of Pacific Northwest Biomass Corp. - (cont'd)**

The acquisition (referred to as the Suskwa Biomass Project) is accounted for using the purchase method. The results of PNBC have been consolidated from September 1, 2008 and are included in the Company's results of operations.

The allocation of the purchase price to the net assets acquired is as follows:

|  |                   |
|--|-------------------|
| Projects under development               | \$ 1,043,679      |
| Accounts payable and accrued liabilities | <u>(203,679)</u>  |
|  | <u>\$ 840,000</u> |

Consideration:

|   |                   |
|---|-------------------|
| Common shares – 4,000,000 shares valued at \$0.21 per share | <u>\$ 840,000</u> |
|---|-------------------|

The amounts recorded on the acquisitions above are based on information available to management as of the date of this report and are subject to change if the information obtained by management changes subsequent to the date of this report.

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**5. Restricted Cash**

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Restricted cash is comprised of the following:

|                           | <u>September 30, 2008</u> | <u>December 31, 2007</u> |
|---------------------------|---------------------------|--------------------------|
| Major Maintenance Reserve | \$ 143,735                | \$ 108,267               |
| Debt Service Reserve      | 430,924                   | 419,502                  |
|                           | <u>\$ 574,659</u>         | <u>\$ 527,769</u>        |

Interest received on funds held in the Major Maintenance Reserve account and the Debt Service Reserve account was added to the respective reserve accounts. In the period ended September 30, 2008, the Major Maintenance Reserve was supplemented by a total of \$32,145 (2007 - \$31,209) pursuant to the agreement with the lender (see Note 8).

**RUN OF RIVER POWER INC.**  
**Notes to Consolidated Financial Statements**  
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**(Unaudited)**

**6. Property, Plant and Equipment**

|  | September 30, 2008   |                             |                      |
|--|----------------------|-----------------------------|----------------------|
|  | Cost                 | Accumulated<br>Amortization | Net                  |
| Brandywine Creek Project                     |                      |                             |                      |
| - Penstock                                   | \$ 7,885,747         | \$ 625,682                  | \$ 7,260,065         |
| - Powerhouse, turbines and related equipment | 6,938,172            | 899,104                     | 6,039,068            |
| - Intake and diversion weir                  | 2,738,274            | 222,337                     | 2,515,937            |
| - Interconnect costs                         | 689,289              | 112,010                     | 577,279              |
| - Transmission line                          | 200,737              | 32,620                      | 168,117              |
| - Land                                       | 24,979               | -                           | 24,979               |
|  | <u>18,477,198</u>    | <u>1,891,753</u>            | <u>16,585,445</u>    |
| Office Equipment                             | 69,746               | 28,615                      | 41,131               |
| Leasehold Improvements                       | 51,394               | 39,394                      | 12,000               |
| Vehicles                                     | 56,797               | 19,018                      | 37,779               |
| Other Equipment                              | 21,314               | 15,295                      | 6,019                |
| Furniture and Fixtures                       | 28,072               | 6,897                       | 21,175               |
|  | <u>227,323</u>       | <u>109,219</u>              | <u>118,104</u>       |
|  | <u>\$ 18,704,521</u> | <u>\$ 2,000,972</u>         | <u>\$ 16,703,549</u> |

|  | December 31, 2007    |                             |                      |
|--|----------------------|-----------------------------|----------------------|
|  | Cost                 | Accumulated<br>Amortization | Net                  |
| Brandywine Creek Project                     |                      |                             |                      |
| - Penstock                                   | \$ 7,885,747         | \$ 477,823                  | \$ 7,407,924         |
| - Powerhouse, turbines and related equipment | 6,938,172            | 690,957                     | 6,247,215            |
| - Intake and diversion weir                  | 2,738,274            | 170,993                     | 2,567,281            |
| - Interconnect costs                         | 689,289              | 86,161                      | 603,128              |
| - Transmission line                          | 200,737              | 25,092                      | 175,645              |
| - Land                                       | 24,979               | -                           | 24,979               |
|  | <u>18,477,198</u>    | <u>1,451,026</u>            | <u>17,026,172</u>    |
| Office Equipment                             | 40,124               | 15,880                      | 24,244               |
| Leasehold Improvements                       | 39,394               | 29,546                      | 9,848                |
| Vehicles                                     | 38,870               | 10,941                      | 27,929               |
| Other Equipment                              | 21,314               | 12,229                      | 9,085                |
| Furniture and Fixtures                       | 10,659               | 3,605                       | 7,054                |
|  | <u>150,361</u>       | <u>72,201</u>               | <u>78,160</u>        |
|  | <u>\$ 18,627,559</u> | <u>\$ 1,523,227</u>         | <u>\$ 17,104,332</u> |

**RUN OF RIVER POWER INC.**  
**Notes to Consolidated Financial Statements**  
**Nine Months Ended September 30, 2008 and 2007**  
**(Unaudited)**

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**7. Projects under Development**

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At September 30, 2008, projects under development represent costs incurred for additional hydroelectric and biomass sites as well as project development expenses that have been capitalized.

Cumulative project costs incurred by the Company are as follows:

|                               | December 31, 2007<br>Net Book Value | 2008<br>Net Expenditure | September 30, 2008<br>Net Book Value |
|-------------------------------|-------------------------------------|-------------------------|--------------------------------------|
| <b>Hydroelectric Projects</b> |                                     |                         |                                      |
| Upper Pitt River Cluster      | \$ 2,491,300                        | \$ 854,730              | \$ 3,346,030                         |
| Mamquam Cluster               | 1,208,083                           | 512,673                 | 1,670,756                            |
| Other                         | 394,078                             | 579,630                 | 973,708                              |
|                               | <u>4,093,461</u>                    | <u>1,947,033</u>        | <u>6,040,494</u>                     |
| <b>Biomass Projects</b>       |                                     |                         |                                      |
| Tsilhqot'in Power Project     | -                                   | 2,145,931               | 2,145,931                            |
| Suskwa Power Project          | -                                   | 1,251,776               | 1,251,776                            |
|                               | <u>-</u>                            | <u>3,397,707</u>        | <u>3,397,707</u>                     |
|                               | <u>\$ 4,093,461</u>                 | <u>\$ 5,344,740</u>     | <u>\$ 9,438,201</u>                  |

|                               | December 31, 2006<br>Net Book Value | 2007<br>Net Expenditure | December 31, 2007<br>Net Book Value |
|-------------------------------|-------------------------------------|-------------------------|-------------------------------------|
| <b>Hydroelectric Projects</b> |                                     |                         |                                     |
| Upper Pitt River Cluster      | \$ 787,682                          | \$ 1,703,618            | \$ 2,491,300                        |
| Mamquam Cluster               | 1,018,054                           | 190,029                 | 1,208,083                           |
| Other                         | 372,078                             | 22,000                  | 394,078                             |
|                               | <u>2,177,814</u>                    | <u>1,915,647</u>        | <u>4,093,461</u>                    |

During the period ended September 30, 2008, \$401,499 of general and administrative expenses (September 30, 2007 - \$Nil) and \$160,606 of non-cash stock based compensation expenses (September 30, 2007 - \$Nil) ) were capitalized and included in the costs of projects under development.

**RUN OF RIVER POWER INC.**  
**Notes to Consolidated Financial Statements**  
**Nine Months Ended September 30, 2008 and 2007**  
**(Unaudited)**

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**8. Long-Term Debt**

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|                               | September 30, 2008   | December 31, 2007    |
|-------------------------------|----------------------|----------------------|
| Loans payable                 | \$ 11,865,018        | \$ 12,154,683        |
| Less deferred financing costs | (228,295)            | (244,769)            |
|                               | 11,636,723           | 11,909,914           |
| Less current portion          | (408,186)            | (389,308)            |
|                               | <u>\$ 11,228,537</u> | <u>\$ 11,520,606</u> |

On August 2, 2005 the Company borrowed \$13,000,000 pursuant to two agreements providing for a 20 year term of repayment. The loan is collateralized by a first charge over the assets of the Company, bears interest at 6.33% per annum and requires monthly payments of \$95,628 for the 20 year term.

The Company set aside restricted cash of \$382,511 as a debt service reserve and \$40,000 in respect of a major maintenance reserve. The major maintenance reserve requires an annual increase of 3% of the previous year's total for each elapsed year. These amounts are deposited every year in the Major Maintenance Escrow Account, to be used by the Company solely to fund major maintenance costs. Under the terms of the Loan Agreements, the payments are made in equal quarterly instalments.

At September 30, 2008, long term debt repayments over the next five years are as follows:

|                                      |                      |
|--------------------------------------|----------------------|
| Three months ended December 31, 2008 | \$ 99,643            |
| 2009                                 | 414,679              |
| 2010                                 | 441,703              |
| 2011                                 | 470,489              |
| 2012                                 | 501,150              |
| Remaining                            | 9,937,354            |
|                                      | <u>\$ 11,865,018</u> |

**RUN OF RIVER POWER INC.**  
**Notes to Consolidated Financial Statements**  
**Nine Months Ended September 30, 2008 and 2007**  
**(Unaudited)**

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**9. Related Party Transactions**

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During the period ended September 30, 2008 and 2007 the Company incurred the following expenses involving officers, directors and companies with directors in common:

|                    | Nine Months Ended<br>September 30, 2008 | Nine Months Ended<br>September 30, 2007 |
|--------------------|---|---|
| Consulting         | \$ -                                    | \$ 77,490                               |
| Directors' fees    | 26,000                                  | 15,250                                  |
| Professional fees  | 11,050                                  | 70,582                                  |
| Wages and benefits | 516,127*                                | 79,833                                  |
|                    | <u>\$ 531,121</u>                       | <u>\$ 243,155</u>                       |

\* \$211,957 of this amount was capitalized during the period.

The Company also incurred consulting fees of \$42,500 (2007 - \$120,500) with a company controlled by a former officer of the Company. \$38,250 (2007 - \$120,500) of the consulting fees was capitalized to projects under development in the period.

These charges were measured by the exchange amount, which is the amount agreed upon by the transacting parties.

At September 30, 2008, the Company was owed \$96,578 (December 31, 2007 - \$96,578) by Rockford Technology Corporation. The loan is unsecured and bears interest at 9%. The original loan due September 17, 2006 was extended for two years under the same terms and was further extended to December 17, 2008. Interest in the amount of \$17,384 has been paid in cash during the period. Also included in due from related parties of \$412,122 (December 31, 2007 - \$271,337) are \$80,355 (December 31, 2007 - \$Nil) due from shareholders of PNBC (Susqua Biomass Project) and \$233,692 (December 31, 2007 - \$Nil) due from the partners of a joint venture (Tsilhqot'in Biomass Project) entered into by Western Biomass.. These advances are repayable on demand and bear no interest.

Included in accounts payable is \$13,728 (December 31, 2007 - \$8,974) payable to directors and officers of the Company.

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**10. Share Capital**

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Authorized:

Unlimited number of common voting shares without nominal or par value  
Unlimited number of preferred shares without par value issued in one or more series

**a) Common shares issued**

In June 2007, the Company issued 27,500,000 units pursuant to a private placement at \$0.40 per unit for gross proceeds of \$11,000,000. Each unit consists of one common share and one common share purchase warrant exercisable at a price of \$0.60 to purchase one additional common share of the Company for a period of 24 months from the date of closing of the placement. Proceeds are allocated to the value of the shares with a \$nil value attributed to the warrants. The Agent conducting the private placement received a commission of 8% of the gross proceeds of 26,625,000 units and Agent's warrants exercisable for 2,130,000 units. The Agent's warrants have the same terms and conditions as the units in the Offering.

The units and warrants issued to the Agent for financing fees were valued at \$1,192,800 (2006 - \$147,000). The value was determined using the Black-Scholes model with the assumptions noted below for stock based compensation.

In June 2007, the Company issued 387,538 common shares at \$0.60 per share upon the exercise of warrants.

In December 2007, the Company issued 100,000 common shares at 0.375 per share upon the exercise of warrants.

In February, 2008, with respect to the acquisition of Western Biomass, the Company issued 3,780,301 common shares at \$0.41 per share, of which 1,260,094 shares are held in escrow at September 30, 2008 (see Note 4).

In September 2008, with respect to the acquisition of PNBC, the Company issued 4,000,000 shares at \$0.21 per share, of which 2,000,000 shares are held in escrow at September 30, 2008 (see Note 4).

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**10. Share Capital – (cont'd)**

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**a) Common shares issued – (cont'd)**

Shares issued and outstanding:

|   | Number of<br>Common Shares | Amount        |
|---|----------------------------|---------------|
| Balance – December 31, 2006                             | 33,964,669                 | \$ 12,241,183 |
| Issued for cash pursuant to Private Placement           | 27,500,000                 | 11,000,000    |
| Share issue costs                                       |                            | (2,218,902)   |
| Issued for cash pursuant to exercise of warrants        | 387,538                    | 232,523       |
| Issued for cash pursuant to exercise of warrants        | 100,000                    | 37,500        |
| Transfer of contributed surplus on exercise of warrants |                            | 21,000        |
| Balance – December 31, 2007                             | 61,952,207                 | 21,313,304    |
| Issued on business acquisition                          | 3,780,301                  | 1,549,923     |
| Issued on business acquisition                          | 4,000,000                  | 840,000       |
| Balance – September 30, 2008                            | 69,732,508                 | \$ 23,703,227 |

**b) Commitments**

**Warrants**

A summary of warrants outstanding is as follows:

| Description                           | Number            | Exercise<br>Price | Expiry        |
|---------------------------------------|-------------------|-------------------|---------------|
| Warrants (2007 unit financing)        | 27,500,000        | \$0.60            | June 14, 2009 |
| Warrants (Agent's Warrants)           | 2,130,000         | \$0.40            | June 14, 2009 |
| Warrants attached to Agent's Warrants | 2,130,000         | \$0.60            | June 14, 2009 |
| Outstanding at September 30, 2008     | <u>31,760,000</u> |                   |               |

In 2007, 487,538 warrants were exercised and 8,806,192 warrants expired. In 2008, 4,450,000 warrants expired.

**RUN OF RIVER POWER INC.**  
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**10. Share Capital – (cont’d)**

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**b) Commitments – (cont’d)**

**Warrants – (cont’d)**

The changes in warrants are summarized as follows:

|                                   | Number            | Weighted Average<br>Exercise Price |
|-----------------------------------|-------------------|------------------------------------|
| Outstanding at December 31, 2006  | 13,743,730        | \$0.70                             |
| Issued                            | 31,760,000        | \$0.59                             |
| Exercised                         | (487,538)         | \$0.55                             |
| Expired                           | (8,806,192)       | \$0.81                             |
| Outstanding at December 31, 2007  | 36,210,000        | \$0.58                             |
| Expired                           | (4,450,000)       | \$0.49                             |
| Outstanding at September 30, 2008 | <u>31,760,000</u> | \$0.59                             |

**Stock-Based Compensation Plan**

The Company has established a formal share purchase option plan in accordance with the policies of the TSX-V. These options are granted with an exercise price equal to the market price of the Company’s stock on the date of the grant. The options are for a maximum term of five years.

In June 2007, the Company granted options to directors, officers and consultants to purchase up to 570,000 shares of the Company at an exercise price of \$0.60 per share. 520,000 of the options vested in the following manner: one third of the options vested immediately; one third becomes vested on each of the first and second anniversaries of the grant date. The remaining 50,000 of the options vested over two years with 25% vesting on the grant date, 40% on the first anniversary of the grant date and 35% on the second anniversary.

In July 2007, the Company granted options to an officer and a consultant to purchase up to 80,000 shares of the Company at an exercise price of \$0.65 per share. One third of the options vested immediately; one third becomes vested on each of the first and second anniversaries of the grant date.

In November 2007, the Company granted options to officers, employees and consultants to purchase 1,195,000 shares of the Company at an exercise price of \$0.41 per share. One third of the options vested immediately; one third becomes vested on each of the first and second anniversaries of the grant date.

In February 2008, the Company granted options to directors and employees to purchase 550,000 shares of the Company at an exercise price of \$0.41 per share. One third of the options vested immediately; one third becomes vested on each of the first and second anniversaries of the grant date.

In June 2008, the Company granted options to three consultants to purchase 150,000 shares of the Company at an exercise price of \$0.32 per share. One third of the options vested immediately; one third becomes vested on each of the first and second anniversaries of the grant date.

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**10. Share Capital – (cont’d)**

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**b) Commitments – (cont’d)**

**Stock-Based Compensation Plan - (cont’d)**

A summary of share purchase option plan is as follows:

|                                   | Number           | Weighted Average<br>Exercise Price |
|-----------------------------------|------------------|------------------------------------|
| Outstanding at December 31, 2006  | 2,825,000        | \$0.57                             |
| Expired                           | (266,667)        | \$0.60                             |
| Forfeited                         | (33,333)         | \$0.60                             |
| Granted                           | 570,000          | \$0.60                             |
| Granted                           | 80,000           | \$0.65                             |
| Granted                           | 1,195,000        | \$0.41                             |
| Outstanding at December 31, 2007  | 4,370,000        | \$0.53                             |
| Granted                           | 550,000          | \$0.41                             |
| Granted                           | 150,000          | \$0.32                             |
| Outstanding at September 30, 2008 | <u>5,070,000</u> | \$0.52                             |

At September 30, 2008, the Company has share purchase options outstanding entitling the holders thereof the right to purchase one common share for each option held as follows:

| Number           | Exercise<br>Price | Expiry<br>Date    |
|------------------|-------------------|-------------------|
| 25,000           | \$0.30            | January 31, 2010  |
| 1,900,000        | \$0.60            | June 9, 2010      |
| 200,000          | \$0.60            | July 1, 2010      |
| 400,000          | \$0.40            | June 22, 2011     |
| 570,000          | \$0.60            | June 14, 2012     |
| 80,000           | \$0.65            | July 19, 2012     |
| 1,195,000        | \$0.41            | November 23, 2012 |
| 550,000          | \$0.41            | February 15, 2013 |
| 150,000          | \$0.32            | June 10, 2013     |
| <u>5,070,000</u> |                   |                   |

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The following table summarizes information on fully vested stock options outstanding at September 30, 2008:

| Range of exercise prices | Number outstanding | Weighted average remaining contractual life (years) |
|--------------------------|--------------------|---|
| \$0.30                   | 25,000             | 1.3   |
| \$0.32                   | 50,000             | 4.7   |
| \$0.40                   | 400,000            | 2.7   |
| \$0.41                   | 581,667            | 4.2   |
| \$0.60                   | 2,479,167          | 2.1   |
| \$0.65                   | 53,333             | 3.8   |
| \$0.30 – \$0.65          | 3,589,167          | 3.0   |

The weighted fair value of share purchase options granted in 2008 was \$0.34 (2007 - \$0.41) per option and was estimated on the grant date using the Black-Scholes option pricing model. The assumptions used in calculating fair value of options granted are as follows:

|                         | 2008    | 2007    |
|-------------------------|---------|---------|
| Expected dividend yield | 0.00%   | 0.00%   |
| Expected volatility     | 106%    | 114%    |
| Risk-free interest rate | 3.44%   | 3.75%   |
| Expected term in years  | 5 years | 5 years |

**c) Contributed Surplus**

The following table reconciles the Company's contributed surplus:

|   |                            |
|---|----------------------------|
| Balance – December 31, 2006                             | \$ 1,487,784               |
| Options   | 475,922                    |
| Agent warrants  | 1,192,800                  |
| Transfer of contributed surplus on exercise of warrants | <u>(21,000)</u>            |
| Balance – December 31, 2007                             | 3,135,506                  |
| Options   | 390,802                    |
| Balance – September 30, 2008                            | <u><u>\$ 3,526,308</u></u> |

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**11. Capital Disclosures**

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The capital structure of the Company consists of shareholders' equity, long-term debt and cash and cash equivalents as noted below:

|                           | September 30, 2008 | December 31, 2007 |
|---------------------------|--------------------|-------------------|
| Components of Capital:    |                    |                   |
| Shareholders' equity      | \$ 21,182,180      | \$ 19,911,375     |
| Long – term debt          | 11,636,723         | 11,909,914        |
| Less:                     |                    |                   |
| Cash and cash equivalents | (5,698,027)        | (9,721,174)       |
|                           | \$ 27,120,876      | \$ 22,100,115     |

The Company's objectives when managing capital are:

- to manage capital in a manner which balances the interest of equity and debt holders;
- to manage capital in a manner that will maintain compliance with its financial covenants; and
- to maintain a capital base so as to maintain investor, creditor and market confidence and to sustain future development.

The Company manages its capital structure as determined by management and approved by the board of directors. The Company's policy is to make adjustments to its capital structure based on changes in economic conditions and planned requirements. The Company has the ability to adjust its capital structure by issuing new equity or debt, selling assets to reduce debt or balance equity, and making adjustments to its capital expenditures program.

The Company monitors capital using a Debt Service Coverage Ratio that has been externally imposed as part of the loan agreement. The Company is required to maintain a four quarters rolling average Debt Service Coverage Ratio not less than 1.00:1. This ratio is calculated as follows:

|  |      |
|--|------|
| Q1 2007  | 0.51 |
| Q2 2007  | 2.08 |
| Q3 2007  | 1.98 |
| Q4 2007  | 1.41 |
| Q1 2008  | 0.38 |
| Q2 2008  | 1.02 |
| Q3 2008  | 1.20 |
| Four quarters rolling average – December 31, 2007  | 1.50 |
| Four quarters rolling average – September 30, 2008 | 1.00 |

As at September 30, 2008 and December 31, 2007, the Company complied with the terms of the credit facilities.

There have been no changes to the Company's capital structure, objectives, policies and processes over the prior year.

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**12. Financial Risk Management**

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**Fair value of financial instruments**

The fair value of financial instruments is the amount of consideration that would be agreed upon in an arm's length transaction between knowledgeable, willing parties who are under no compulsion to act. Fair values are determined by reference to quoted market prices, as appropriate, in the most advantageous market for that instrument to which the Company has immediate access. Where quoted market prices are not available, the Company uses the closing price of the most recent transaction for that instrument. In the absence of an active market, fair values are determined based on prevailing market rates for instruments with similar characteristics.

The Company designated cash, restricted cash and marketable securities as held for trading assets, measured at fair value. Changes in the fair value are recorded in net earnings. The fair value of these financial instruments approximates their carrying value as they are short term in nature or have interest at floating rates. Amounts receivable are measured at amortized cost. Accounts payable and accrued liabilities and long-term debt are designated as other financial liabilities and measured at amortized cost. Management did not identify any material embedded derivatives, which require separate recognition and measurement under the new accounting standards. The Company had neither available-for-sale, nor held-to-maturity instruments during the period ended September 30, 2008.

**Financial risk management**

In the normal course of operations, the Company is exposed to various risks such as commodity, interest rate, credit, and liquidity risk. To manage these risks, management determines what activities must be undertaken to minimize potential exposure to risks. The objectives of the Company to managing risk are as follows:

- maintaining sound financial condition;
- financing operations; and
- ensuring liquidity to all operations.

In order to satisfy these objectives, the Company has adopted the following policies:

- prepare budget documents at prevailing market rates to ensure clear, corporate alignment to performance management and achievement of targets;
- recognize and observe the extent of operating risk within the business;
- identify the magnitude of the impact of market risk factors on the overall risk of the business and take advantage of natural risk reductions that arise from these relationships.

There have been no changes in risks that have arisen or how the Company manages those risks from the prior period.

- (i) Electricity commodity risk  
The Company manages the risk of fluctuating commodity prices by entering into long term 20 year fixed price Electricity Purchase Agreements with B.C. Hydro for the sale of its production from its Brandywine Creek facility.

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**12. Financial Risk Management – (cont'd)**

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- (ii) Interest rate risk  
The Company's long term debt bears interest at fixed rates thus mitigating the impact of fluctuations in interest rates.
- (iii) Credit risk  
Credit risk is the risk of loss if counterparties do not fulfil their contractual obligations and arises principally from trade receivables. The maximum exposure to credit risk is the carrying amount of amounts receivable principally from BC Hydro for the sale of production from the Company's Brandywine Creek facility. BC Hydro is a rated, credit worthy counterparty and amounts receivable are current as of September 30, 2008.
- (iv) Liquidity risk  
Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they come due. The Company mitigates this risk through actively managing its capital, which it defines as shareholders' equity, long term debt, net of cash and cash equivalents. Management of liquidity risk over the short and longer term, includes continual monitoring of forecasted and actual cash flows to ensure sufficient liquidity to meet financial obligations when due and maintaining a flexible capital management structure. The Company strives to balance the proportion of debt and equity in its capital structure given its development assets and planned investment opportunities.

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**13. Cash Payments**

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The following cash payments have been made in the period ended September 30, 2008 and 2007:

|          | 2008       | 2007       |
|----------|------------|------------|
| Interest | \$ 570,985 | \$ 588,708 |
| Taxes    | Nil        | Nil        |

Investing and financing activities that do not have a direct impact on current cash flows are excluded from the cash flow statement. The following transactions have been excluded:

During the year ended December 31, 2007, in connection with a private placement, the Company issued 2,130,000 units to the Agent valued at \$1,192,800.

During the period ended September 30, 2008, in connection with a business acquisition, the Company issued 3,780,301 common shares valued at \$1,549,923.

During the period ended September 30, 2008, with respect to the acquisition of PNBC, the Company issued 4,000,000 shares at \$0.21 per share, of which 2,000,000 shares are held in escrow at September 30, 2008.

Accounts payable at September 30, 2008 include \$249,000 (December 31, 2007 - \$102,135) related to deferred development costs and equipment acquisitions.

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**14. Commitments**

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Royalty

The Company has a commitment to pay to two First Nations Organizations a royalty calculated at 1% of the gross revenues resulting from project electricity production of up to 40.5 GWh.

Beginning on the sixteenth year of the 20 year contract with BC Hydro, the royalty will increase to 1.5%. For electricity production in excess of 40.5 GWh, the Company will pay the First Nations a royalty of 5%.

Consulting and Employment Contracts

The Company has entered into various consulting and employment agreements with officers and consultants of the Company whereby the Company has agreed to pay salaries and fees ranging from \$5,000 to \$13,583 per month with various effective terms. Minimum payments that can be projected with certainty total \$635,000 for the 12 months ended September 30, 2009.

Lease Agreements

The Company occupies office space at two locations under leases which provide for future minimum rental payments as follows:

|                                  |          |
|----------------------------------|----------|
| 3 months ended December 31, 2008 | \$20,338 |
| 2009                             | \$81,350 |
| 2010                             | \$44,233 |