



powering a cleaner tomorrow

RUN OF RIVER POWER INC.

Consolidated Financial Statements
Nine Months Ended September 30, 2009 and 2008
(Unaudited)

RUN OF RIVER POWER INC.
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Nine Months Ended September 30, 2009 and 2008
(Unaudited)

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NOTICE

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, 2009 and December 31, 2008

| | (Unaudited) September 30, 2009 | (Audited) December 31, 2008 |
|---|-----------------------------------|--------------------------------|
| Assets | | |
| Current | | |
| Cash | \$ 1,386,802 | \$ 875,745 |
| Restricted cash (Note 5) | 624,379 | 589,137 |
| Marketable securities | - | 2,576,725 |
| Amounts receivable | 86,263 | 99,763 |
| Due from related parties (Note 8) | 96,578 | 96,578 |
| GST receivable | 496,106 | 421,981 |
| Prepaid expenses | 78,595 | 251,877 |
| | 2,768,723 | 4,911,806 |
| Property, plant and equipment, net (Note 6) | 16,087,340 | 16,562,292 |
| Projects under development (Notes 4 and 7) | 12,163,582 | 10,484,023 |
| Future income tax assets | 380,469 | 380,469 |
| Licenses and security deposit | 84,676 | 82,945 |
| | \$ 31,484,790 | \$ 32,421,535 |
| Liabilities | | |
| Current | | |
| Accounts payable and accrued liabilities | \$ 182,895 | \$ 461,104 |
| Current portion of long-term debt (Note 9) | 434,787 | 414,680 |
| | 617,682 | 875,784 |
| Long-term debt (Note 9) | 10,815,102 | 11,127,805 |
| Future income tax liabilities (Note 4) | 589,232 | 589,232 |
| | 12,022,016 | 12,592,821 |
| Shareholders' Equity | | |
| Share capital (Note 10) | 23,763,823 | 22,766,588 |
| Contributed surplus (Note 10) | 3,739,100 | 3,620,960 |
| Deficit | (8,040,149) | (6,558,834) |
| | 19,462,774 | 19,828,714 |
| Subsequent event (Note 16) | \$ 31,484,790 | \$ 32,421,535 |

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, 2009 and 2008
(Unaudited)

| | Three Months Ended September 30 | | Nine Months Ended September 30 | |
|---|------------------------------------|----------------|-----------------------------------|----------------|
| | 2009 | 2008 | 2009 | 2008 |
| Revenues | | | | |
| Electricity sales | \$ 434,211 | \$ 664,168 | \$ 1,096,691 | \$ 1,250,096 |
| Royalties | (4,342) | (6,642) | (10,967) | (12,501) |
| | 429,869 | 657,526 | 1,085,724 | 1,237,595 |
| Expenses | | | | |
| Plant operations | 149,514 | 165,423 | 435,734 | 485,418 |
| Depreciation and amortization | 161,444 | 153,967 | 481,819 | 468,051 |
| General and administration | 354,000 | 433,695 | 1,126,152 | 1,379,469 |
| | 664,958 | 753,085 | 2,043,705 | 2,332,938 |
| Loss before the following | (235,089) | (95,559) | (957,981) | (1,095,343) |
| Interest on long-term debt | 182,408 | 188,800 | 552,108 | 570,985 |
| Amortization of deferred financing charges | 5,270 | 5,449 | 15,946 | 16,474 |
| Interest and investment income | (4,688) | (12,089) | (44,720) | (172,882) |
| Net loss and comprehensive loss for the period | (418,079) | (277,719) | (1,481,315) | (1,509,920) |
| Deficit, beginning of period | (7,622,070) | (5,769,636) | (6,558,834) | (4,537,435) |
| Deficit, end of period | \$ (8,040,149) | \$ (6,047,355) | \$ (8,040,149) | \$ (6,047,355) |
| Basic and diluted loss per share | \$ (0.01) | (0.00) | \$ (0.02) | (0.02) |
| Weighted average number of shares | 67,434,371 | 64,798,501 | 66,796,590 | 63,051,380 |

RUN OF RIVER POWER INC.
Consolidated Statements of Cash Flows
Nine Months Ended September 30, 2009 and 2008
(Unaudited)

| | Three Months Ended September 30 | | Nine Months Ended September 30 | |
|---|------------------------------------|---------------------|-----------------------------------|---------------------|
| | 2009 | 2008 | 2009 | 2008 |
| Cash flows from (used in) operating activities | | | | |
| Net loss for the period | \$ (418,079) | \$ (277,719) | \$ (1,481,315) | \$ (1,509,920) |
| Add items not affecting cash: | | | | |
| Depreciation and amortization | 166,714 | 159,416 | 497,765 | 484,525 |
| Stock based compensation | 27,270 | 58,290 | 75,449 | 230,196 |
| | (224,095) | (60,013) | (908,101) | (795,199) |
| Net changes in non-cash working capital items related to operations: | | | | |
| Amounts receivable | 256,198 | 94,385 | 13,500 | 28,156 |
| GST receivable | (32,737) | (50,910) | (74,125) | (140,819) |
| Prepaid expenses | 20,121 | 62,572 | 173,282 | (155,490) |
| Accounts payable and accrued liabilities | (131,856) | (117,391) | (127,291) | 2,728 |
| Net cash used in operating activities | (112,369) | (71,357) | (922,735) | (1,060,624) |
| Cash flows from (used in) investing activities | | | | |
| Increase in restricted cash | (11,834) | (15,351) | (35,242) | (46,890) |
| Decrease in marketable securities | - | 1,999,618 | 2,576,725 | 1,972,300 |
| Increase in projects under development | (449,821) | (773,869) | (1,781,512) | (2,604,290) |
| Property, plant and equipment expenditures | (1,864) | (17,329) | (13,141) | (68,568) |
| Increase in licenses and security deposit | (231) | - | (1,731) | - |
| Net cash from (used in) investing activities | (463,750) | 1,193,069 | 745,099 | (747,448) |
| Cash flows from (used in) financing activities | | | | |
| Issuance of shares - net of issue costs | 997,235 | - | 997,235 | - |
| Repayment of long term debt | (104,475) | (98,083) | (308,542) | (289,665) |
| Net cash from (used in) financing activities | 892,760 | (98,083) | 688,693 | (289,665) |
| Change in cash | 316,641 | 1,023,629 | 511,057 | (2,097,737) |
| Cash, beginning of period | 1,070,161 | 476,496 | 875,745 | 3,597,862 |
| Cash, end of period | \$ 1,386,802 | \$ 1,500,125 | \$ 1,386,802 | \$ 1,500,125 |

Supplemental Disclosures with Respect to Cash Payments (Note 13)

RUN OF RIVER POWER INC.
Notes to the Consolidated Financial Statements
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1. Nature of Operations

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, Crawford Energy Corp., Jascott Holdings Corp., Northwest Cascade Power Ltd., Raffuse Energy Corporation, Rockford Energy Corporation (“Rockford”), Sea to Sky Power Corporation, Skookum Energy Corp. 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 hydroelectric and biomass power generation.

2. Basis of Presentation

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, 2008 annual consolidated financial statements. It is suggested that these interim consolidated financial statements be read in conjunction with the Company’s December 31, 2008 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.

3. Adoption of New Accounting Standards

i) International Financial Reporting Standards

The Canadian Accounting Standards Board (“ASB”) 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 and is in the process of determining the impact on its financial position and results of operations.

RUN OF RIVER POWER INC.
Notes to the Consolidated Financial Statements
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3. Adoption of New Accounting Standards – (cont'd)

ii) Business combinations, consolidated financial statements and non-controlling interests

In January 2009, the AcSB issued CICA Handbook Sections 1582 – Business Combinations, 1601 – Consolidated Financial Statements and Section 1602 – Non-controlling Interests. Section 1582 is effective for business combinations subsequent to January 1, 2011. This Standard was issued to align Canadian GAAP with IFRS. The Standard requires additional use of fair value measurements, recognition of additional assets and liabilities and increased disclosure. Adoption of this Standard will have a material effect on the method of accounting for business combinations in future periods. Upon adoption of Section 1582, entities are required to adopt Sections 1601 – Consolidated Financial Statements and 1602 – Non-controlling Interests. These two standards require a change to be presented as part of shareholders' equity on the balance sheet. The income statement of the controlling parent will require all of the subsidiaries results and present an allocation between the controlling interest and the non-controlling interest. Adoption of Section 1582 is applied prospectively and Sections 1601 and 1602 are applied retroactively.

iii) Goodwill and intangible assets

The CICA has issued Section 3064 – Goodwill and Intangible Assets to replace Section 3062 – Goodwill and Other Intangible Assets. Section 3064 gives guidance on the recognition of intangible assets as well as the recognition and measurement of internally developed assets. Section 3064 – Goodwill and Intangible Assets is effective for annual and interim financial statements relating to fiscal years beginning on or after October 1, 2008. These changes are effective on January 1, 2009 and implementation does not have a material impact on the Company's financial position or results of operations.

4. Business Acquisitions

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 Tsilhqot'in 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 would be released from escrow upon the execution of a long term electricity purchase agreement ("EPA") between BC Hydro, Western Biomass and the TNG. In the event that this condition would not be met by December 31, 2009, the shares remaining in escrow would be cancelled and returned to treasury. Due to delays in BC Hydro's EPA process, the Company agreed in September 2009 to extend the deadline to December 31, 2010 for 50% of the escrowed shares. The remaining 50% have been cancelled and returned to treasury.

The Company cannot reasonably determine the outcome of this contingency and accordingly the value attributed to the shares remaining in escrow has not been recognized. In the event that they are released, the cost of the projects under development and related future income tax liabilities will be increased by \$349,080 and \$90,761 respectively and \$258,320 will be recorded in share capital. All shares issued to the former Western Biomass shareholders were subject to a hold period which expired on June 1, 2008. 24.2% of the issued shares of Western Biomass were owned by a director and by an officer of the Company. As part of the acquisition, the Company also advanced \$192,814 to Western Biomass.

RUN OF RIVER POWER INC.
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4. Business Acquisitions – (cont’d)

Western Biomass Power Corp. – (cont’d)

The acquisition (referred to as the Tsilhqot’in Biomass Project) has been accounted for using the asset purchase method. The results of Western Biomass have been consolidated from February 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 | \$ | 1,589,258 |
| Equipment | | 1,016 |
| Non-cash working capital deficiency | | (186,888) |
| Future income tax liabilities | | (370,102) |
| | <u>\$</u> | <u>1,033,284</u> |

Consideration (reflecting cancellation of escrow shares):

| | | |
|--|-----------|------------------|
| Common shares – 3,150,254 shares valued at \$0.41 per share | \$ | 1,291,604 |
| Less shares held in escrow – 630,047 shares valued at \$0.41 per share | | (258,320) |
| | <u>\$</u> | <u>1,033,284</u> |

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”). A shareholder and director of the Corporation was also a 25% shareholder and director of PNBC. In connection with the acquisition, a total of 4,000,000 shares of the Company were issued to the shareholders of PNBC. All shares issued to the PNBC shareholders were subject to a hold period which expired on January 17, 2009. 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 confirmed the economic feasibility and an independent consulting report which confirmed the adequacy of the fibre supply of the power plant. These shares have been released from escrow.
- 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. Due to delays in BC Hydro’s EPA process, the Company agreed in September 2009 to extend the deadline to December 31, 2010 for 50% of the escrowed shares. The remaining 50% have been cancelled and returned to treasury.

The Company cannot reasonably determine the outcome of this contingency and accordingly the value attributed to the shares remaining in escrow has not been recognized. In the event that they are released, the cost of the projects under development and related future income tax liabilities will be increased by \$283,784 and \$73,784 respectively and \$210,000 will be recorded in share capital.

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4. Business Acquisitions – (cont’d)

Pacific Northwest Biomass Corp. – (cont’d)

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 would be issued. The value of the 1,000,000 shares that are contingently issuable cannot be determined at this time.

The acquisition of PNBC (referred to as the Suskwa Biomass Project) is accounted for using the asset 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 | \$ | 842,809 |
| Accounts payable and accrued liabilities | | (203,679) |
| Future income tax liabilities | | (219,130) |
| | | <hr/> |
| | \$ | 420,000 |
| | | <hr/> |
| Consideration (reflecting cancellation of escrow shares): | | |
| Common shares – 3,000,000 shares valued at \$0.21 per share | \$ | 630,000 |
| Less shares held in escrow – 1,000,000 shares valued at \$0.21 per share | | (210,000) |
| | | <hr/> |
| | \$ | 420,000 |
| | | <hr/> |

5. Restricted Cash

Restricted cash is comprised of the following:

| | September 30, 2009 | December 31, 2008 |
|---------------------------|--------------------|-------------------|
| Major Maintenance Reserve | \$ 189,244 | \$ 155,563 |
| Debt Service Reserve | 435,135 | 433,574 |
| | <hr/> | <hr/> |
| | \$ 624,379 | \$ 589,137 |
| | <hr/> | <hr/> |

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, 2009, the Major Maintenance Reserve was supplemented by a total of \$33,110 (2008 - \$32,145) pursuant to the agreement with the lender (see Note 9).

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Notes to the Consolidated Financial Statements
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(Unaudited)

6. Property, Plant and Equipment

| | September 30, 2009 | | |
|--|----------------------|-----------------------------|----------------------|
| | Cost | Accumulated Amortization | Net |
| Brandywine Creek Project | | | |
| - Penstock | \$ 7,885,747 | \$ 822,825 | \$ 7,062,922 |
| - Powerhouse, turbines and related equipment | 6,938,172 | 1,176,631 | 5,761,541 |
| - Intake and diversion weir | 2,738,274 | 290,793 | 2,447,481 |
| - Interconnection costs | 689,289 | 146,474 | 542,815 |
| - Transmission line | 200,737 | 42,659 | 158,078 |
| - Land | 24,979 | - | 24,979 |
| | <u>18,477,198</u> | <u>2,479,382</u> | <u>15,997,816</u> |
| Leasehold Improvements | 80,482 | 65,311 | 15,171 |
| Office Equipment | 71,608 | 46,064 | 25,544 |
| Vehicles | 56,797 | 29,836 | 26,961 |
| Other Equipment | 21,314 | 18,003 | 3,311 |
| Furniture and Fixtures | 32,061 | 13,524 | 18,537 |
| | <u>262,262</u> | <u>172,738</u> | <u>89,524</u> |
| | <u>\$ 18,739,460</u> | <u>\$ 2,652,120</u> | <u>\$ 16,087,340</u> |

| | December 31, 2008 | | |
|--|----------------------|-----------------------------|----------------------|
| | Cost | Accumulated Amortization | Net |
| Brandywine Creek Project | | | |
| - Penstock | \$ 7,885,747 | \$ 674,967 | \$ 7,210,780 |
| - Powerhouse, turbines and related equipment | 6,938,172 | 968,485 | 5,969,687 |
| - Intake and diversion weir | 2,738,274 | 239,451 | 2,498,823 |
| - Interconnection costs | 689,289 | 120,626 | 568,663 |
| - Transmission line | 200,737 | 35,131 | 165,606 |
| - Land | 24,979 | - | 24,979 |
| | <u>18,477,198</u> | <u>2,038,660</u> | <u>16,438,538</u> |
| Leasehold Improvements | 73,193 | 45,027 | 28,166 |
| Office Equipment | 69,746 | 33,683 | 36,063 |
| Vehicles | 56,797 | 22,008 | 34,789 |
| Other Equipment | 21,314 | 16,317 | 4,997 |
| Furniture and Fixtures | 28,072 | 8,333 | 19,739 |
| | <u>249,122</u> | <u>125,368</u> | <u>123,754</u> |
| | <u>\$ 18,726,320</u> | <u>\$ 2,164,028</u> | <u>\$ 16,562,292</u> |

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

7. Projects under Development

At September 30, 2009, 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, 2008 Net Book Value | 2009 Net Expenditure | September 30, 2009 Net Book Value |
|-------------------------------|-------------------------------------|-------------------------|--------------------------------------|
| Hydroelectric Projects | | | |
| Upper Pitt River Cluster | \$ 3,999,741 | \$ 505,957 | \$ 4,505,698 |
| Mamquam Cluster | 2,325,798 | 345,918 | 2,671,716 |
| Other | 624,763 | 73,474 | 698,237 |
| | <u>6,950,302</u> | <u>925,349</u> | <u>7,875,651</u> |
| Biomass Projects | | | |
| Tsilhqot'in Power Project | 2,350,122 | 236,796 | 2,586,918 |
| Suskwa Power Project | 1,183,599 | 517,414 | 1,701,013 |
| | <u>3,533,721</u> | <u>754,210</u> | <u>4,287,931</u> |
| | <u>\$ 10,484,023</u> | <u>\$ 1,679,559</u> | <u>\$ 12,163,582</u> |
| | | | |
| | December 31, 2007 Net Book Value | 2008 Net Expenditure | December 31, 2008 Net Book Value |
| Hydroelectric Projects | | | |
| Upper Pitt River Cluster | \$ 2,491,300 | \$ 1,508,441 | \$ 3,999,741 |
| Mamquam Cluster | 1,208,083 | 1,117,715 | 2,325,798 |
| Other | 394,078 | 230,685 | 624,763 |
| | <u>4,093,461</u> | <u>2,856,841</u> | <u>6,950,302</u> |
| Biomass Projects | | | |
| Tsilhqot'in Power Project | - | 2,350,122 | 2,350,122 |
| Suskwa Power Project | - | 1,183,599 | 1,183,599 |
| | <u>-</u> | <u>3,533,721</u> | <u>3,533,721</u> |
| | <u>\$ 4,093,461</u> | <u>\$ 6,390,562</u> | <u>\$ 10,484,023</u> |

During the period ended September 30, 2009, \$299,826 (2008 – \$303,507) of management wages and salaries and \$56,012 (2008 - \$160,606) of non-cash stock based compensation expenses directly attributable to the projects were capitalized and included in the costs of projects under development.

Accounts payable and accrued liabilities at September 30, 2009 include \$98,486 (December 31, 2008 - \$249,404) related to deferred development costs.

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8. Related Party Transactions

At September 30, 2009, the Company was owed \$96,578 (December 31, 2008 - \$96,578) by Rockford Technology Corporation which has a director in common. The loan is unsecured and bears interest at 9%. The original loan due September 17, 2006 was extended under the same terms to December 17, 2009. At September 30, 2009, accrued interest totalled \$15,211.

During the period the Company incurred certain project costs related to its biomass projects totalling \$206,870 (2008 - \$145,470) which may be recoverable should the projects proceed to completion.

9. Long-Term Debt

| | September 30, 2009 | December 31, 2008 |
|-------------------------------|----------------------|----------------------|
| Loans payable | \$ 11,456,833 | \$ 11,765,375 |
| Less deferred financing costs | (206,944) | (222,890) |
| | 11,249,889 | 11,542,485 |
| Less current portion | (434,787) | (414,680) |
| | <u>\$ 10,815,102</u> | <u>\$ 11,127,805</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. (see Note 5)

At September 30, 2009, long term debt repayments over the next five years are as follows:

| | |
|--------------------------------------|----------------------|
| Three months ended December 31, 2009 | 106,138 |
| 2010 | 441,703 |
| 2011 | 470,489 |
| 2012 | 501,150 |
| 2013 | 533,810 |
| Remaining | 9,403,543 |
| | <u>\$ 11,456,833</u> |

At September 30, 2009, the Debt Service Coverage Ratio was less than 1.00:1 due to abnormally low water flow conditions and resultant reduced revenues. Pursuant to the Loan Agreement, the Company has notified its lenders of this event of default and has received a waiver subsequent to the end of the period.

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10. Share Capital

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 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 630,047 shares in escrow were cancelled in the period pursuant to an amendment to the Escrow Agreement and 630,047 shares are held in escrow at September 30, 2009 (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 1,000,000 shares in escrow were cancelled in the period pursuant to an amendment to the Escrow Agreement and 1,000,000 shares are held in escrow at September 30, 2009 (see Note 4).

The value of the shares issued and held in escrow will not be recognized until such time as the outcome of the conditions for their release can be reasonably determined (see Note 4).

In September 2009, the Company issued 5,900,000 units at a price of \$0.17 per unit pursuant to a private placement. Each unit consists of one common share and one-half of a share purchase warrant. Each whole warrant entitles the holder to purchase one additional common share at a price of \$0.26 until September 15, 2011.

Shares issued and outstanding:

| | Number | Amount |
|--|-------------|---------------|
| Balance – December 31, 2007 | 61,952,207 | \$ 21,313,304 |
| Issued on business acquisition - Western Biomass – Note 4 | 3,780,301 | 1,033,284 |
| Issued on business acquisition – PNBC – Note 4 | 4,000,000 | 420,000 |
| Balance – December 31, 2008 | 69,732,508 | 22,766,588 |
| Issued pursuant to private placement | 5,900,000 | 1,003,000 |
| Share issue costs | | (5,765) |
| Cancelled pursuant to amendment to Escrow Agreement – Note 4 | (630,047) | - |
| Cancelled pursuant to amendment to Escrow Agreement – Note 4 | (1,000,000) | - |
| Balance – September 30, 2009 | 74,002,461 | \$ 23,763,823 |

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10. Share Capital – (cont'd)

b) Commitments

Warrants

A summary of warrants outstanding at September 30, 2009 is as follows:

| | Number | Weighted Average Exercise Price |
|---|------------------|------------------------------------|
| Outstanding at December 31, 2007 | 36,210,000 | \$0.58 |
| Expired | (4,450,000) | \$0.49 |
| Outstanding at December 31, 2008 | 31,760,000 | \$0.59 |
| Expired | (31,760,000) | \$0.59 |
| Issued | 2,950,000 | \$0.26 |
| Outstanding at September 30, 2009 and expiring on September 15, 2011 | <u>2,950,000</u> | \$0.26 |

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 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.

In December 2008, the Company granted options to its employees to purchase 800,000 shares of the Company at an exercise price of \$0.10 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 April 2009, the Company granted options to its non-executive directors to purchase up to 200,000 shares of the Company at an exercise price of \$0.10 per share. The options are exercisable for a period of five years. 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)

b) Commitments – (cont'd)

Stock-Based Compensation Plan - (cont'd)

A summary of the outstanding and exercisable share purchase options is as follows:

| | Number | Weighted Average Exercise Price |
|-----------------------------------|-----------|------------------------------------|
| Outstanding at December 31, 2007 | 4,370,000 | \$0.53 |
| Granted | 550,000 | \$0.41 |
| Granted | 150,000 | \$0.32 |
| Granted | 800,000 | \$0.10 |
| Outstanding at December 31, 2008 | 5,870,000 | \$0.45 |
| Granted | 200,000 | \$0.10 |
| Outstanding at September 30, 2009 | 6,070,000 | \$0.44 |
| Exercisable at September 30, 2009 | 4,771,654 | \$0.50 |

At September 30, 2009, 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 Price | Expiry Date | Weighted average remaining contractual life (years) |
|-----------|----------------|-------------------|--|
| 25,000 | \$0.30 | January 31, 2010 | 0.3 |
| 1,900,000 | \$0.60 | June 9, 2010 | 0.7 |
| 200,000 | \$0.60 | July 1, 2010 | 0.8 |
| 400,000 | \$0.40 | June 22, 2011 | 1.8 |
| 570,000 | \$0.60 | June 14, 2012 | 2.7 |
| 80,000 | \$0.65 | July 19, 2012 | 2.8 |
| 1,195,000 | \$0.41 | November 23, 2012 | 3.2 |
| 550,000 | \$0.41 | February 15, 2013 | 3.4 |
| 150,000 | \$0.32 | June 10, 2013 | 3.7 |
| 800,000 | \$0.10 | December 10, 2013 | 4.2 |
| 200,000 | \$0.10 | April 28, 2014 | 4.6 |
| 6,070,000 | | | 2.4 |

The weighted fair value of share purchase options granted in 2009 was \$0.06 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:

| | |
|-------------------------|---------|
| Expected dividend yield | 2009 |
| Expected volatility | 0.00% |
| Risk-free interest rate | 117% |
| Expected term in years | 1.69% |
| | 5 years |

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10. Share Capital – (cont'd)

c) Dilutive Common Shares

For the period ended September 30, 2009, potentially dilutive common shares (relating to share purchase options and warrants outstanding and conditional shares held in escrow pursuant to the acquisition agreements) totaling 10,650,047 (2008 – 40,090,094) were not included in the computation of loss per share as the effect would be anti-dilutive.

d) Contributed Surplus

The following table reconciles the Company's contributed surplus:

| | |
|------------------------------|---------------------|
| Balance – December 31, 2007 | \$ 3,135,506 |
| Options | 485,454 |
| Balance – December 31, 2008 | <u>3,620,960</u> |
| Options | 118,140 |
| Balance – September 30, 2009 | <u>\$ 3,739,100</u> |

11. Capital Disclosures

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

| Components of Capital: | September 30, 2009 | December 31, 2008 |
|--|----------------------|----------------------|
| Shareholders' equity | \$ 19,462,774 | \$ 19,828,714 |
| Long – term debt | 11,249,889 | 11,542,485 |
| Less: | | |
| Cash, cash equivalents and marketable securities | (2,011,181) | (4,041,607) |
| | <u>\$ 28,701,482</u> | <u>\$ 27,329,592</u> |

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.

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11. Capital Disclosures – (cont’d)

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 quarter rolling average Debt Service Coverage Ratio not less than 1.00:1. This ratio is as follows:

| | |
|--------------------|------|
| December 31, 2008 | 0.91 |
| March 31, 2009 | 0.84 |
| June 30, 2009 | 1.01 |
| September 30, 2009 | 0.91 |

At September 30, 2009, March 31, 2009 and December 31, 2008, the Debt Service Coverage Ratio was less than 1.00:1 due to abnormally low water flow conditions and resultant reduced revenues. Pursuant to the Loan Agreement, the Company has notified its lenders of this event of default and has received a waiver subsequent to the end of each period.

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

12. Financial Risk Management

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. 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. The Company had neither available-for-sale, nor held-to-maturity instruments during the period ended September 30, 2009.

The fair value of the current financial instruments approximates their carrying value as they are short term in nature or have interest at floating rates. The fair value of the long term debt also approximates its carrying value based on future cash flows discounted using the current market rate for similar instruments.

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12. Financial Risk Management – (cont'd)

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 in 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.
- (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 fulfill 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, 2009.

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12. Financial Risk Management – (cont'd)

Financial risk management – (cont'd)

(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, cash equivalents and marketable securities. 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.

The current volatile economic and financial conditions have impacted the availability of financing for the Company's development initiatives. Furthermore, the associated terms have changed to reflect the increased risk. It is the Company's view that project financing will be available for the development projects bid into the BC Hydro calls, albeit under more stringent financing conditions. The credit quality of long-term Energy Purchase Agreements with BC Hydro along with the nature of the Company's development projects facilitates completion of financing in these circumstances.

13. Cash Payments

The following cash payments have been made in the periods ended September 30, 2009 and 2008:

| | 2009 | 2008 |
|----------|------------|------------|
| Interest | \$ 552,108 | \$ 570,985 |
| 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 (see Note 4 and Note 7).

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14. Commitments

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 at its Brandywine Creek facility.

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. Maximum payments that can be projected with certainty total \$635,000 for the 12 months ended September 30, 2010.

Lease Agreements

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

| | |
|------|----------|
| 2009 | \$20,338 |
| 2010 | \$44,233 |

In 2008, the Company entered into an office equipment lease agreement with a term of 48 months. The lease will expire in April 2012. Minimum payments for the remaining term of the lease total \$8,048.

15. Economic Dependence

The Company's revenue is derived from a single source, BC Hydro, and as a result is dependent on the contract with BC Hydro for all its revenue.

16. Subsequent Event

Subsequent to quarter end, an extraordinary outage at a BC Hydro substation led to the outage at the Company's Brandywine facility that resulted in damage to one of two generators. Although the generator is expected to be out of service for up to four months, the Company does not anticipate a significant impact on revenue as plant output is typically captured by one generator during the corresponding period. The Company's insurers are assessing the facility and repairs and business interruption are expected to be covered by insurance, subject to associated deductibles.