

CANARY RESOURCES INC. AND SUBSIDIARIES
(A DEVELOPMENT STAGE COMPANY)

CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NINE MONTHS ENDED SEPTEMBER 30, 2007 AND 2006

UNAUDITED

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CANARY RESOURCES INC. AND SUBSIDIARIES
(A DEVELOPMENT STAGE COMPANY) (Note 2)
Condensed Consolidated Balance Sheet
September 30, 2007
Unaudited

ASSETS

Current Assets:

Cash	\$ 74,647
Accounts receivable -	
Trade	114,397
Employee and other	935
Prepaid expenses and other	62,245
Deposits	1,735

Total Current Assets 253,959

Oil and Gas Properties (note 5) 2,061,049

Field Equipment Inventory 78,262

Property, Plant and Equipment, net (note 6) 1,976,660

Total Assets \$ 4,369,930

LIABILITIES

Current Liabilities:

Accounts payable - Trade	\$ 611,276
Accrued liabilities	112,658
Management fees and salaries payable	203,623
Advances from stockholders (note 7)	224,194
Current portion of long-term debt (note 8)	1,046,219
Drilling advances (note 9)	242,840

Total Current Liabilities 2,440,810

Long-term Debt, less current portion (note 8) 314,399

Total Long-term Liabilities 314,399

Total Liabilities 2,755,209

Commitments and Contingencies (note 10)

STOCKHOLDERS' EQUITY

Capital Stock: (note 11)

Class "A" convertible preferred stock, \$0.001 par value; 30,000,000 shares authorized; 18,125,000 shares issued and outstanding 18,125

Common stock, \$0.001 par value, 100,000,000 shares authorized, 36,976,925 issued and 37,076,925 shares outstanding 37,077

Treasury Stock (100,000 shares of common stock, at cost) (65,000)

Additional Paid-in Capital (note 3) 8,261,432

Accumulated (Deficit) and (Deficit) Accumulated During the Development Stage (6,636,913)

Total Stockholders' Equity 1,614,721

Total Liabilities and Stockholders' Equity \$ 4,369,930

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

CANARY RESOURCES INC. AND SUBSIDIARIES

(A DEVELOPMENT STAGE COMPANY) (Note 2)

Condensed Consolidated Statements of Operations

Nine Months Ended September 30, 2007 and 2006, and the Period from Re-entering the Development Stage (January 14, 2005) through to September 30, 2007

Unaudited

	Three Months Ended 2007	Three Months Ended 2006	Nine Months Ended 2007	Nine Months Ended 2006	Period from Re-entering the Development Stage through September 30, 2007 (note 1)
Revenues					
Gas sales	\$ 7,052	\$ -	\$ 15,058	\$ -	\$ 24,768
Gathering fees	2,344	-	2,344	-	2,344
Well services	132,461	84,877	359,436	84,877	522,403
Drilling services	155,941	-	182,069	-	182,069
Yard rentals	1,500	-	4,500	-	8,385
Consulting fees	-	40,000	-	40,000	40,000
Total Revenues	299,298	124,877	563,407	124,877	779,969
Expenses:					
Salaries and wages	309,252	275,926	898,617	679,518	2,098,935
Professional fees	69,228	162,790	237,189	716,319	1,270,153
General and administrative	147,075	131,225	479,903	407,933	1,324,207
Management fees and salaries (note 13)	50,000	50,001	171,530	262,953	1,031,470
Depreciation	56,857	52,683	171,549	108,855	356,165
Lease operating expenses	7,111	-	16,504	-	16,794
Field expenses	10,267	73,824	28,950	146,777	185,271
Rig expenses	75,665	47,808	177,731	47,808	301,554
Stock-based compensation cost (note 12)	65,712	30,379	177,505	81,010	290,964
Allowances paid to related parties (note 13)	10,800	10,800	32,400	41,000	146,600
Pipeline expenses	34,930	-	116,090	-	138,616
Exploratory expenditures	3,178	-	11,392	-	111,568
Total Expenses	840,075	835,436	2,519,360	2,492,173	7,272,297
Loss from Operations	(540,777)	(710,559)	(1,955,953)	(2,367,296)	(6,492,328)
Other Income (Expenses):					
(Loss) gain on sale of properties	(22,503)	143	68,922	143	69,065
Interest income	434	15,112	1,730	90,865	184,417
Interest expense	(34,859)	(43,721)	(248,512)	(70,899)	(389,614)
Total Other Income (Expenses)	(56,928)	(28,466)	(177,860)	20,109	(136,132)
Loss Before Income Taxes	(597,705)	(739,025)	(2,133,813)	(2,347,187)	(6,628,460)
Provision for income taxes (note 15)	-	-	-	-	-
Net Loss	\$ (597,705)	\$ (739,025)	\$ (2,133,813)	\$ (2,347,187)	\$ (6,628,460)
Loss per Share					
Basic and diluted	\$ (0.02)	\$ (0.02)	\$ (0.06)	\$ (0.08)	
Basic and Diluted Weighted Average Number of Shares Outstanding During the Periods	36,854,642	30,892,700	33,675,481	30,892,700	

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

CANARY RESOURCES INC. AND SUBSIDIARIES

(A DEVELOPMENT STAGE COMPANY) (Note 2)

Condensed Consolidated Statements of Stockholders' Equity

Nine Months Ended September 30, 2007 and 2006, and the Period from Re-entering the Development Stage (January 14, 2005) Through to September 30, 2007 (2005 Restated (Note 3))

	Class "A" Convertible Preferred Stock		Common Stock		Additional Paid-in Capital	Treasury Stock		Accumulated Deficit and Deficit Accumulated During the Development Stage	Total Stockholders' Equity
	Shares	Amount	Shares	Amount		Shares	Amount		
Balance – January 1, 2005	-	\$ -	30,142,700	\$ 30,143	\$ (30,113)	-	\$ -	\$ (8,450)	\$ (8,420)
Common stock issued for cash	-	-	600,000	600	299,400	-	-	-	300,000
Common stock issued for nil consideration (Note 11)	-	-	150,000	150	(150)	-	-	-	-
Preferred stock issued for cash	18,125,000	18,125	-	-	7,231,875	-	-	-	7,250,000
Payment of deferred stock issuance costs	-	-	-	-	(351,598)	-	-	-	(351,598)
Net loss for the year	-	-	-	-	-	-	-	(1,287,538)	(1,287,538)
Restatement for Shelf payment registration event payment (Notes 3 and 10)	-	-	-	-	(1,646,453)	-	-	-	(1,646,453)
Restated Balance - December 31, 2005	18,125,000	\$ 18,125	30,892,700	\$ 30,893	\$ 5,502,961	-	\$ -	\$ (1,295,988)	\$ 4,255,991
Stock option compensation recognized (Note 11)	-	-	-	-	113,459	-	-	-	113,459
Treasury stock from settlement of lawsuits	-	-	(100,000)	-	-	100,000	(65,000)	-	(65,000)
Net loss for the year	-	-	-	-	-	-	-	(3,207,109)	(3,207,109)
Balance - December 31, 2006	18,125,000	\$ 18,125	30,792,700	\$ 30,893	\$ 5,616,420	100,000	\$ (65,000)	\$ (4,503,097)	\$ 1,097,341
Common shares issued for cash	-	-	1,625,000	1,625	573,056	-	-	-	574,681
Common shares issued for event payment settlement	-	-	4,559,225	4,559	1,819,131	-	-	-	1,823,690
"A" Warrants issued	-	-	-	-	46,395	-	-	-	46,395
"B" Warrants issued	-	-	-	-	28,925	-	-	-	28,925
Stock option compensation recognized (Note 12)	-	-	-	-	177,505	-	-	-	177,505
Net loss for the period-adjusted for rounding	-	-	-	-	-	-	-	(2,133,816)	(2,133,816)
Balance - September 30, 2007	18,125,000	\$ 18,125	36,976,925	\$ 37,077	\$ 8,261,432	100,000	\$ (65,000)	\$ (6,636,913)	\$ 1,614,721

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

CANARY RESOURCES INC. AND SUBSIDIARIES

(A DEVELOPMENT STAGE COMPANY) (Note 2)

Condensed Consolidated Statements of Cash Flows

Nine Months Ended September 30, 2007 and 2006, and the Period from Re-entering the
Development Stage (January 14, 2005) through to September 30, 2007

Unaudited

	2007	(Restated, Note 3) 2006	(Restated, Note 3) Period from Re-entering the Development Stage through to September 30, 2007
Cash Flows from Operating Activities:			
Net loss	\$ (2,133,813)	\$ (2,347,187)	\$ (6,628,460)
Adjustments to reconcile net loss to net cash used in operating activities:			
Depreciation and amortization	171,549	108,855	356,165
Gain on sale of property, plant and equipment	-	(143)	(143)
Gain on sale of gas properties	(68,922)	-	(68,922)
Stock option expense recognized	177,505	81,010	290,964
Treasury stock received in legal settlement	-	-	(65,000)
Changes in assets and liabilities:			
Accounts receivable – Trade	20,345	(103,712)	(114,397)
Accounts receivable – Employee and other	2,227	-	(935)
Prepaid expenses and other	(23,336)	(26,923)	(62,245)
Deposits	53,701	(55,036)	(1,735)
Accounts payable – Trade	(76,149)	3,572	611,272
Accrued liabilities	52,862	362,396	107,659
Drilling advances received	617,600	-	617,600
Drilling advances utilized	(374,760)	-	(374,760)
Management fees and salaries payable	114,331	-	203,623
Net Cash Used in Operating Activities	(1,466,860)	(1,977,168)	(5,129,314)
Cash Flows from Investing Activities:			
Acquisition of oil and gas properties	(271,325)	(1,062,771)	(2,146,527)
Proceeds on disposal of oil and gas properties	154,400	-	154,400
Acquisition of property, plant and equipment	(251,720)	(1,389,575)	(2,336,682)
Proceeds on disposal of property, plant and equipment	-	-	4,000
Net adjustments to field equipment inventory	27,753	(68,123)	(78,262)
Net Cash Used in Investing Activities	(340,892)	(2,520,469)	(4,403,071)
Cash Flows from Financing Activities:			
Issuance of common shares for cash	574,680	-	874,680
Issuance of warrants for cash	75,320	-	75,320
Issuance of class “A” convertible preferred stock for cash	-	-	7,250,000
Payment of deferred issuance cost	-	-	(351,597)
Issuance of common shares for event payment settlement	1,823,690	-	1,823,690
Contingent liability (note 3)	(1,698,790)	(652,500)	(1,646,453)
Repayments of principal – long-term debt	(32,423)	182,137	1,360,618
Advances from stockholders	21,516	30,579	220,774
Net Cash Provided by Financing Activities	763,993	(439,784)	9,607,032
Net (Decrease) Increase in Cash	(1,043,759)	(4,937,421)	74,647
Cash - Beginning of Period	1,118,406	5,751,325	-
Cash - End of Period	\$ 74,647	\$ 813,904	\$ 74,647

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

CANARY RESOURCES INC. AND SUBSIDIARIES

(A DEVELOPMENT STAGE COMPANY)

Notes to Condensed Consolidated Financial Statements

September 30, 2007 and 2006

Unaudited

1. Operations and Business

Canary Resources Inc. (the "Company"), was incorporated on April 16, 1997 as The Heritage Collection Limited under the laws of the State of Delaware. The Heritage Collection Limited was incorporated with the intent to manufacture and market various personal jewelry items, however, it never operated in this area. On June 25, 2004, the Heritage Collection Limited changed its name to Sakha Resource Technologies Corporation ("Sakha"). Sakha operated with the intent of developing forest products, but was unable to raise capital and remained inactive in this area.

On January 12, 2005, Sakha changed its name to Canary Resources Inc. ("Canary"). On January 14, 2005, the Company subscribed for 100% of the common stock of Canary, a private Nevada corporation. Canary is a coal bed methane exploration and production company with acreage in the Eastern Forest City Basin of Kansas and Missouri, for which it is the operator. Canary currently has twenty-one wells shut-in pending pipeline connection, eleven producing wells, and three wells in the drilling phase. The purchase, site preparation, and construction of the pipeline interconnect have been completed. On January 14, 2005, the Company was considered to have re-entered the development stage. On August 29, 2005, Canary changed its name to Canary Operating Corporation.

On May 25, 2006, the Company subscribed to 100% of the common stock of Canary Pipeline, Inc. ("Canary Pipeline"); RLC Drilling, Inc. ("RLC"); and Willis Well Services, Inc. ("Willis") which are all Kansas corporations. Canary Pipeline is a gas gathering company providing services to Canary and third parties. RLC is a coal-bed methane drilling company which drills wells for Canary and third parties. On September 7, 2006, RLC changed its name to Canary Drilling, Inc. ("Canary Drilling"). Willis is a well servicing company that provides services to Canary and third parties.

2. Development Stage Activities and Going Concern

The accompanying condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America with the assumption that the Company will be able to realize its assets and discharge its liabilities in the normal course of business.

CANARY RESOURCES INC. AND SUBSIDIARIES

(A DEVELOPMENT STAGE COMPANY)

Notes to Condensed Consolidated Financial Statements

September 30, 2007 and 2006

Unaudited

2. Development Stage Activities and Going Concern (cont'd)

The Company is in the development stage and has realized minimal revenues from its planned operations. The Company has sustained losses of \$(2,133,813) and \$(2,347,187) for the nine-month periods ended September 30, 2007 and 2006, respectively. As of September 30, 2007, the Company had working capital deficit of \$(2,186,851) and an accumulated deficit of \$(6,636,913). The Company has funded operations primarily through the issuance of capital stock. On July 22, 2005, the Company closed a private placement for gross proceeds of \$7,250,000 (see note 11). On December 28, 2006, the Company obtained \$1,000,000 through debt financing (see note 8). On May 8, 2007, the Company entered into an unincorporated joint venture agreement with KC Clean Energy, LLC which is participating on a turnkey cost basis. KC Clean Energy, LLC will have a 50% working interest in 20 of Canary's wells. As of September 30, 2007, the Company had received gross proceeds of \$650,000 in a private equity placement. Management's plan is to continue raising additional funds through future equity or debt financing until it achieves profitable operations from its oil and gas drilling activities. Although the Company plans to pursue additional financing there can be no assurance that the Company will be able to secure financing when needed or obtain such on terms satisfactory to the Company, if at all. The Company's continuation as a going concern depends upon its ability to raise funds and achieve and sustain profitable operations.

The accompanying condensed consolidated financial statements do not include any adjustments to reflect the possible future effects on the recoverability and classification of assets or the amounts and classification of liabilities that may result from the inability of the Company to continue as a going concern.

3. Restatement of 2005 Consolidated Financial Statements

On July 31, 2006, management concluded that the Company's consolidated financial statements for the fiscal year ended December 31, 2005 and the first interim period of 2006 should be restated to correct an error relating to the accounting of shelf registration event payments ("Event Payments"). The Company failed to file an Initial Registration Statement by September 30, 2005 in accordance with Section 6.1 of the Securities Purchase Agreement dated July 22, 2005. This event requires that Event Payments be made monthly to the purchasers in the amount of 1% of the aggregate securities' purchase price paid by each purchaser until the event is cured but no later than the second anniversary of the Securities Purchase Agreement's closing date. Event Payments incur interest of 1.5% per month until paid in full beginning ten days after demand. Demand was made on April 28, 2006. The Company's total potential liability was \$1,646,453 excluding interest. The Company has determined that this liability should have been recorded as of December 31, 2005. The effect of these restatements to the Company's consolidated financial statements as of December 31, 2005 and March 31, 2006 was a decrease to paid-in capital and an increase in liabilities of \$1,646,453. In May 2007, an agreement was reached with the purchasers to waive all defaults and breaches under the Securities Purchase Agreement in exchange for payment, the majority of which was in the form of shares (see note 10).

CANARY RESOURCES INC. AND SUBSIDIARIES

(A DEVELOPMENT STAGE COMPANY)

Notes to Condensed Consolidated Financial Statements

September 30, 2007 and 2006

Unaudited

4. Summary of Significant Accounting Policies

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Form 10-QSB. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete consolidated financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Interim results are not necessarily indicative of the results that may be expected for a full year. There have been no significant changes of accounting policies since December 31, 2006. These condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in the Company's Annual Report for the fiscal year ended December 31, 2006.

Recent Accounting Pronouncement

In February 2007, the Financial Accounting Standards Board ("FASB") issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statement No. 115". This statement permits entities to choose to measure many financial instruments and certain other items at fair value. The objective is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. This statement is expected to expand the use of fair value measurement, which is consistent with the Board's long-term measurement objectives for accounting for financial instruments. This statement also establishes presentation and disclosure requirements designed to facilitate comparisons between entities that choose different measurement attributes for similar types of assets and liabilities. This statement does not affect any existing accounting literature that requires certain assets and liabilities to be carried at fair value. This statement does not establish requirements for recognizing and measuring dividend income, interest income, or interest expense. This statement does not eliminate disclosure requirements included in other accounting standards, including requirements for disclosures about fair value measurements included in FASB Statements No. 157, "Fair Value Measurements", and No. 107, "Disclosures about Fair Value of Financial Instruments." This statement is effective as of the beginning of the entity's first fiscal year that begins after November 15, 2007. The Company is currently reviewing the effect, if any, the proposed guidance will have on its financial statements.

In May 2007, the FASB issued a FASB Staff Position on FIN 46(R)-7, "Application of FASB Interpretation No. 46(R) to Investment Companies" ("FSP FIN 46 (R)-7"). FSP FIN 46(R)-7 addresses the application of FASB Interpretation No. 46 (revised December 2003), "Consolidation of Variable Interest Entities", by an entity that accounts for its investments in accordance with the specialized accounting guidance in the American Institute of Certified Public Accountants ("AICPA") Audit and Accounting Guide, "Investment Companies" (the "Guide"). The adoption of FSP FIN 46(R)-7 did not have a material impact on the Company's results of operations and financial condition.

CANARY RESOURCES INC. AND SUBSIDIARIES

(A DEVELOPMENT STAGE COMPANY)

Notes to Condensed Consolidated Financial Statements

September 30, 2007 and 2006

Unaudited

4. Summary of Significant Accounting Policies (cont'd)

In June 2007, the AICPA issued Statement of Position ("SOP") No. 07-1, "Clarification of the Scope of the Audit and Accounting Guide Investment Companies and Accounting by Parent Companies and Equity Method Investors for Investments in Investment Companies ("SOP No. 07-1"). SOP No. 07-1 clarifies when an entity may apply the provisions of the Guide. Investment companies that are within the scope of the Guide report investments at fair value; consolidation or use of the equity method for investments is generally not appropriate. SOP No. 07-1 also addresses the retention of specialized investment company accounting by a parent company in consolidation or by an equity method investor. SOP No. 07-1 is effective for fiscal years beginning on or after December 15, 2007 with early adoption encouraged. The Company is currently evaluating the impact, if any of SOP No. 07-1 on the Company's consolidated financial statements.

In May 2007 the FASB issued FASB Interpretation FIN No. 48-1, "Definition of Settlement in FASB Interpretation 48" ("FIN 48-1"). FIN 48-1 amends FIN 48, "Accounting for Uncertainty in Income Taxes—an interpretation of FASB Statement No. 109", to provide guidance on how an enterprise should determine whether a tax position is effectively settled for the purpose of recognizing previously unrecognized tax benefits. FIN 48-1 is effective retroactively to January 1, 2007. The adoption of FIN 48-1 did not have a material effect on the Company's consolidated condensed financial statements.

In September 2007, the FASB published Proposed FASB Staff Position ("FSP") No. APB 14-a, "Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion." The proposed FSP applies to convertible debt instruments that, by their stated terms, may be settled in cash (or other assets) upon conversion, including partial cash settlement, unless the embedded conversion option is required to be separately accounted for as a derivative under SFAS No.133. Convertible debt instruments within the scope of the proposed FSP are not addressed by APB 14. Therefore, the liability and equity components of convertible debt instruments within the scope of the proposed FSP shall be separately accounted for in a manner that will reflect the entity's nonconvertible debt borrowing rate. This will require an allocation of the convertible debt proceeds between the liability component and the embedded conversion option (i.e., the equity component). The difference between the principal amount of the debt and the amount of the proceeds allocated to the liability component would be reported as a debt discount and subsequently amortized to earnings over the instrument's expected life using the effective interest method. The proposed FSP is expected to be effective for fiscal years beginning after December 15, 2007 and will require retrospective application. The Company is currently reviewing the effect, if any, if the proposed FSP were to be adopted.

CANARY RESOURCES INC. AND SUBSIDIARIES

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Notes to Condensed Consolidated Financial Statements

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Unaudited

5. Oil and Gas Properties

The carrying value of the Company's oil and gas properties are attributable to unproved properties and eleven proved properties. The proved costs are not currently being depreciated, depleted or amortized as they are not material to the condensed consolidated financial statements at September 30, 2007. The Company anticipates recording depletion, depreciation, and amortization expense in the fourth quarter of 2007 to coincide with significant commercial production.

As exploration and development work progresses and the reserves on these properties are proven, capitalized costs attributable to the properties will be reclassified to producing properties and subject to depletion. If the exploration and development work were to be unsuccessful, the capitalized costs of the properties related to this unsuccessful work would be expensed in the year in which the determination was made. The timing of any write downs of these unproven properties, if warranted, depends upon the nature, timing and extent of future exploration and development activities and their results. The Company believes its exploration and development efforts will allow it to realize the unproved property balance.

The following is a breakdown of oil and gas properties:

Unproved property acquisition costs	\$ 1,510,292
Wells-in-progress	330,697
Proved gas properties	<u>220,060</u>
	<u>\$ 2,061,049</u>

CANARY RESOURCES INC. AND SUBSIDIARIES

(A DEVELOPMENT STAGE COMPANY)

Notes to Condensed Consolidated Financial Statements

September 30, 2007 and 2006

Unaudited

6. Property, Plant and Equipment, net

Property, plant and equipment are comprised as follows:

	<u>Cost</u>	<u>Accumulated Depreciation</u>
Land	\$ 25,000	\$ -
Land improvements	14,736	7,006
Building	286,068	12,456
Leasehold improvements	2,339	975
Office and furniture	22,501	6,027
Computer equipment	59,990	42,079
Software	1,195	100
Vehicles	202,441	91,468
Drilling equipment	371,960	62,219
Field equipment	331,737	69,062
Heavy trucks and trailers	390,280	62,551
Pipeline	624,436	2,080
	<u>\$ 2,332,683</u>	<u>\$ 356,023</u>
Net carrying amount		<u>\$ 1,976,660</u>

7. Advances from Stockholders

The advances from stockholders include non-interest bearing expense reimbursements as well as a \$100,000, 8% per annum interest bearing note with no fixed terms of repayment. The advances are unsecured with no fixed terms of repayment.

8. Long-term Debt

a. Promissory Note	\$ 1,000,000
b. Mortgage	214,952
c. Loans	<u>145,666</u>
	1,360,618
Less: Current portion	<u>(1,046,219)</u>
Long-term portion	<u>\$ 314,399</u>

CANARY RESOURCES INC. AND SUBSIDIARIES

(A DEVELOPMENT STAGE COMPANY)

Notes to Condensed Consolidated Financial Statements

September 30, 2007 and 2006

Unaudited

8. Long-term Debt (cont'd)

- a) On December 28, 2006, the Company obtained a bridge loan in the amount of \$1,000,000 bearing interest at the rate of 10% per annum payable monthly, secured by a promissory note that matures December, 2007. The note also provides for an additional \$1,000,000 advance, by agreement of the parties. The loan provides funding for completion of the Company's pipeline tap and for development of the Company's coal-bed methane gas properties.
- b) On December 30, 2005, the Company purchased a 23,000 square foot warehouse set on approximately 7 acres located in Drexel, Missouri at a total cost of \$306,110, including all survey, environmental and closing costs. This facility is near the initial drilling field, which is located in the southwest corner of Cass County, Missouri, and the warehouse will be used primarily for equipment repair, storage and bulk inventory delivery. This property was purchased with a combination of cash coupled with a \$221,250 initial 10-year mortgage from a commercial bank, amortized on a 30-year basis at a fixed interest rate of 8.43% per annum, and is repayable in blended monthly payments of \$1,789.
- c) As of September 30, 2007, the Company had purchased six vehicles for operations that were financed by loans for a total of \$199,347, amortized over 5-year basis with an average fixed interest rate of 6.95% per annum and repayable in blended monthly payments of \$4,270. The loans have various maturity dates ranging from January 2009 to May 2011. Vehicles (note 6) with a net carrying value of \$110,973 at September 30, 2007 were used as security for these loans.

Future minimum long-term debt payments required are as follows:

2007	\$ 1,011,232
2008	47,096
2009	42,126
2010	44,133
2011	18,142
Thereafter	<u>197,889</u>
	<u>\$ 1,360,618</u>

9. Drilling Advances

In May 2007 Canary entered into a joint operating agreement for an unincorporated joint venture drilling program with K C Clean Energy, LLC which is participating on a turnkey costs basis (see Note 2). The first phase of the drilling program involves a commitment for Canary to drill 16 new wells in which K C Clean Energy, LLC has acquired a 50% working interest. Canary will operate the 16 new wells and will retain a 50% working interest in them. The drilling advances from K C Clean Energy, LLC will offset the costs of drilling the wells as they are incurred. The Company accounts for the activities of the unincorporated joint venture using the proportionate consolidation method of accounting.

CANARY RESOURCES INC. AND SUBSIDIARIES

(A DEVELOPMENT STAGE COMPANY)

Notes to Condensed Consolidated Financial Statements

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Unaudited

10. Commitments and Contingencies

Contingent Liability

The Company failed to file an Initial Registration Statement by September 30, 2005 in accordance with Section 6.1 of the Securities Purchase Agreement dated July 22, 2005. This event requires that an "Event Payment" be made monthly to the purchasers in the amount of 1% of the aggregate securities' purchase price paid by each purchaser until the event is cured or until the second anniversary of the Securities Purchase Agreement closing date. Event Payments incur interest of 1.5% per month until paid in full beginning ten days after demand. Demand was made on April 28, 2006. The Company's total potential liability was \$1,646,453 excluding interest. At September 30, 2007 the Company had recorded interest of \$237,605 that began accruing May 8, 2006.

In May 2007, agreement was reached with the purchasers to waive all defaults and breaches under the Securities Purchase Agreement and to amend the Securities Purchase Agreement in exchange for payment, the majority of which was in the form of shares. Based upon an agreed value of \$0.40 per share, the Company issued 4,559,225 shares of common stock to the purchasers in order to discharge Event Payment liabilities of \$1,823,690 and paid \$17,562 cash in order to discharge Event Payment liabilities of \$17,562. As of September 30, 2007 the Company had no further Event Payment liabilities under the amended Securities Purchase Agreement.

The Company is required under the amended Securities Purchase Agreement to file a registration statement to list shares on a trading market as soon as practicable, but in any event no later than December 31, 2007. The Company and the purchasers may, by mutual agreement, extend such date if deemed practicable by the parties. If the Company fails to file a registration statement and list its common shares on a trading market by December 31, 2007, and if the Company and the purchasers do not agree to extend such date, the Company will be liable for payments of \$2,500 per month for up to 24 months from December 31, 2007, with unpaid penalties bearing interest at 1.5% per month. The Company expects to list its common shares on a trading market by December 31, 2007.

Lease Obligations

The Company is committed to operating lease payments for its office premises and equipment. Future minimum payments required are as follows:

2007	\$	17,200
2008		26,900
2009		18,900
2010		<u>12,000</u>
	\$	<u>75,000</u>

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10. Commitments and Contingencies (cont'd)

Contingent Royalties Payable

The Company has entered into various contractual land lease agreements with the owners of the gas properties which require the Company to make royalty payments at varying rates. The payments are contingent on the Company's ability to discover, extract and sell gas reserves. As of September 30, 2007, the Company is obligated to make royalty payments. This liability has been recorded.

11. Capital Stock

On June 21, 2004, the Company authorized a ten for one forward stock split of its common shares. This stock split has been retroactively taken into consideration in the condensed consolidated financial statements and the calculation of loss per share.

In March and April 2005, three investors purchased for cash 600,000 common shares of the Company at \$0.50 per share. The price per share is subject to adjustment to lower the price per share to equal the price per share of common stock in any "Qualified Financing" of the Company within one year. A "Qualified Financing" is an equity financing of a minimum of \$1,500,000. In no event was the price per share to be increased.

On July 22, 2005, the Company closed a private placement of its class "A" convertible preferred stock for gross proceeds of \$7,250,000. Expenses associated with the private placement were approximately \$351,598 and a contingent liability of \$1,646,453 was set up for contingent Event Payments as described in note 10. Funds raised from the placement are to be used for development of coal-bed methane in the Eastern Forest City Basin in Kansas and Missouri, and for general working capital purposes.

The private placement was comprised of one convertible preferred stock and one half of one warrant amounting to 18,125,000 convertible preferred shares of a new series designated as Class "A" Convertible Preferred Stock and 9,062,500 Warrants. The Class "A" Convertible Preferred Stock has a par value \$0.001 per share and a conversion price of \$0.40 per share which is subject to usual adjustment provisions. The convertible preferred stock carry no dividend and are convertible at any time. The warrants have a \$1.00 exercise price, and each whole warrant permits the holder to purchase one common share of the Company. The warrants expire on July 22, 2009. The cashless exercise provisions allow the warrant holder to elect instead to receive the Net Number of shares of common stock determined according to the following formula:

$$\text{Net Number} = \{(A \times B) - (A \times C)\} / B$$

Where:

A= the total number of shares with respect to which the warrants are being exercised.

B= the closing price of the common stock.

C= the exercise price of the warrants.

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11. Capital Stock (cont'd)

The warrants also carry provisions for mandatory exercise if, inter alia, the Company's common shares trade above \$2.00 per share for twenty days.

The value of each warrant using the Black-Scholes pricing model was \$nil based upon the following assumptions:

Risk-free interest rate	3.75%
Expected life in years	2.0
Exercise price	\$1.00
Stock price	\$0.40
Volatility	30%
Expected dividend yield	0%

The July 22, 2005 private placement met the conditions for a "Qualified Financing," namely an equity financing of a minimum of \$1,500,000 within one year, for price adjustment purposes regarding shares sold to investors in March and April 2005. The pricing of the \$300,000 of shares sold to investors at \$0.50 per common share in March and April 2005 was, therefore, adjusted downwards to reflect the terms of the private placement in July 2005. Adjustment to the common share price from \$0.50 per share to \$0.40 per share resulted in the issuance of an additional 150,000 common shares to those investors who invested in March and April 2005, and those investors also received 375,000 Warrants with the same terms and conditions as the warrants issued in the July 2005 private placement.

In December 2006, the Company received 100,000 shares of restricted common stock from James Osborn as one of the conditions for settlement of the lawsuits. The stock was placed in the treasury thereby reducing the number of outstanding shares of common stock. No monetary consideration was given for the return of the shares placed in the treasury. The treasury stock that was valued at \$65,000 represented by the value of the shares at the date the treasury stock was received. The treasury stock was recorded as a reduction to legal costs.

In May 2007, the Company issued 4,559,225 shares of common stock to purchasers under the Securities Purchase Agreement in order to discharge Event Payment liabilities of \$1,823,690 based upon a value of \$0.40 per share (see note 10).

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11. Capital Stock (cont'd)

The Company entered into a private placement in May 2007 and, under that placement, issued 1,475,000 units in the second quarter of 2007 and 150,000 units in the third quarter of 2007 at a price of \$0.40 per unit for total consideration of \$650,000. Each unit comprised one share of common stock of the Company plus one half of an A-Warrant, plus one half of a B-Warrant. Each whole A-Warrant entitles the holder to purchase one share of common stock of the Company for \$1.00 if exercised within four years. Each whole B-Warrant entitles the holder to purchase one share of common stock of the Company for \$1.50 if exercised within four years. The value of the A-Warrant and B-Warrant using the Black-Scholes pricing model was \$0.06 and \$0.04, respectively, based upon the following assumptions:

	A-Warrant	B-Warrant
Risk-free interest rate	4.792%	4.792%
Expected life in years	4.0	4.0
Exercise price	\$1.00	\$1.50
Stock price	\$0.30	\$0.30
Volatility	59%	59%
Expected dividend yield	0%	0%
Fair value per option granted	\$0.06	\$0.04

As of September 30, 2007, the Company had 36,976,925 common shares, 18,125,000 Class "A" Convertible Preferred Stock, 11,062,500 warrants issued and outstanding, and 3,885,000 stock options issued. After conversion of all of the Class "A" Convertible Preferred Stock and excluding exercise of any Warrants and Options, the Company would have 55,101,925 common shares outstanding.

12. Stock-Based Compensation

On August 12, 2005, the Board of Directors approved an employee stock option plan ("2005 Stock Option Plan"), the purpose of which is to enhance the Company's stockholder value and financial performance by attracting, retaining and motivating the Company's officers, directors, key employees and consultants and to encourage stock ownership by such individuals by providing them with a means to acquire a proprietary interest in the Company's success through stock ownership. Under the 2005 Stock Option Plan, officers, directors, employees and consultants who provide services to the Company may be granted options to acquire common shares of the Company at not less than 110 percent of the fair market value of the stock on the date of grant. Options have a term of 10 years, and vest over three years. The total number of common shares reserved for issuance under the 2005 Stock Option Plan is 7,500,000 of which 3,615,000 options are available.

On January 31, 2006, under the 2005 Stock Option Plan, the Board of Directors granted options to purchase 2,300,000 common shares at a price of \$0.50 per common share until January 30, 2016.

On November 16, 2006, the Board of Directors granted options to purchase 185,000 common shares at a price of \$0.60 per share until November 15, 2016.

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12. Stock-Based Compensation (cont'd)

On February 22, 2007, the Board of Directors granted options to purchase 1,250,000 common shares at a price of \$0.55 per share until February 21, 2017.

On June 26, 2007, the Board of Directors granted options to a non-employee to purchase 150,000 common shares at a price of \$0.50 per share until June 26, 2011.

The compensation cost that has been charged against income for this plan for the nine month period ended September 30, 2007 was \$177,505. No shares had been exercised or forfeited as of September 30, 2007.

The estimated fair value of the options was determined using the Black-Scholes option pricing model using the following assumptions:

	<u>1/31/2006</u>	<u>11/16/2006</u>	<u>2/22/2007</u>	<u>6/26/2007</u>
	Grant	Grant	Grant	Grant
Risk-free interest rate	4.66%	4.77%	4.73%	4.96%
Expected life in years	6.0	6.0	6.0	3.5
Exercise price	\$0.50	\$0.60	\$0.55	0.50
Stock price	\$0.45	\$0.60	\$0.50	0.30
Volatility	30%	48%	59%	59%
Expected dividend yield	0%	0%	0%	0%
Fair value per option granted	\$0.16	\$0.27	\$0.29	\$0.10

Stock options outstanding during the period ended September 30, 2007 are 3,885,000 common shares (2006: 2,485,000). The weighted average exercise price was \$0.52 (2006: \$0.51). The weighted average life in years was 8.58 (2006: 9.15). The weighted average grant-date fair value was \$0.20 (2006: \$0.17). The total proceeds that would be generated upon exercising of all issued and outstanding options are approximately \$2,023,500 (2006: \$1,261,000).

13. Related Party Transactions

Allowances of \$32,400 (2006: \$41,000) were paid to a director and companies controlled by directors of the Company. During the nine month period ended September 30, 2007, management fees of \$171,530 (2006: \$262,953) were paid to companies controlled by the directors. These transactions were in the normal course of business and recorded at an exchange value established and agreed upon by the related parties.

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14. Segmented Information

The Company's operations were conducted in the United States.

Revenues by Segment:

Company	\$ -
Canary	19,558
Canary Pipeline	2,344
Canary Drilling	182,069
Willis	<u>359,436</u>

Total consolidated revenues \$ 563,407

Net Operating Loss by Segment:

Company	\$ (927,361)
Canary	(325,960)
Canary Pipeline	(193,841)
Canary Drilling	(309,775)
Willis	<u>(199,016)</u>

Total consolidated net operating loss \$ (1,955,953)

Total Assets by Segment:

Company	\$ 394,425
Canary	2,297,191
Canary Pipeline	631,166
Canary Drilling	693,855
Willis	<u>353,293</u>

Total consolidated assets \$ 4,369,930

CANARY RESOURCES INC. AND SUBSIDIARIES

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15. Income Taxes

The Company has net losses for tax purposes available to be applied against future years income. Due to the losses incurred in the current year and expected future operating results, management determined that it is more likely than not that the deferred tax asset resulting from the tax losses available for carryforward will not be realized through the reduction of future income tax payments. Accordingly a valuation allowance has been recorded for deferred income tax assets.

The Company's current income taxes are as follows:

Expected income tax recovery at the statutory rates of 40% (2006 - 40%)	\$ (853,525)
Stock compensation	<u>71,002</u>
	(782,523)
Valuation allowance	<u>782,523</u>
Provision for income taxes	<u>\$ -</u>

The Company has deferred income tax assets as follows:

Net operating loss carryforward	\$ 2,825,940
Net book value and tax value differences	(294,319)
Valuation allowance for deferred income tax assets	<u>(2,531,621)</u>
	<u>\$ -</u>

As of September 30, 2007 the Company had approximately \$7,335,277 of federal and state net operating loss carryforwards available to offset future taxable income. These losses expire as follows:

2018	\$ 1,900
2019	6,550
2020	1,794,392
2021	3,293,699
2022	<u>2,238,736</u>
	<u>\$ 7,335,277</u>

CANARY RESOURCES INC. AND SUBSIDIARIES
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16. Supplemental Cash Flow Information

	2007	(Restated, Note 3) 2006	Period from Re-entering the Development Stage through to Sept. 30, 2007
Interest paid	<u>\$ 105,691</u>	\$ 70,899	\$ 149,626
Income taxes paid	<u>\$ -</u>	\$ -	\$ -

17. Comparative Figures

Certain of the prior period balances have been reclassified to conform with the current period's financial statement presentations.

18. Subsequent Event

The Company entered into a private placement in May 2007 and, under that placement, issued 25,000 units in October 2007 at a price of \$0.40 per unit for total consideration of \$10,000.

On October 31, 2007, the Company reached agreement with a majority of the holders of the warrants issued under the Securities Purchase Agreement for an exercise price reduction to \$0.20 per common share and immediate exercise of warrants. The Company received \$1,750,000 from the exercise of 8,750,000 Securities Purchase Agreement warrants into 8,750,000 common shares.

CERTIFICATION

I, William Chandler, certify that:

I have reviewed this quarterly report of Canary Resources, Inc. and that, based on my knowledge, such statements and the notes thereto present fairly, in all material respects, the financial position of the issuer and the results of its operations and cash flows for the periods presented, in conformity with accounting principles generally accepted in the United States, consistently applied.

“William Chandler”

William Chandler
Acting as Chief Financial Officer

November 14, 2007

CERTIFICATION

I, William Chandler, certify that:

I have reviewed this quarterly report of Canary Resources, Inc. and that, based on my knowledge, such statements and the notes thereto present fairly, in all material respects, the financial position of the issuer and the results of its operations and cash flows for the periods presented, in conformity with accounting principles generally accepted in the United States, consistently applied.

“William Chandler”

William Chandler
Chief Executive Officer

November 14, 2007