

**Red Hill Energy Inc.**  
Consolidated Financial Statements  
June 30, 2008  
**(Unaudited, See Advisory to Reader)**

# **Red Hill Energy Inc.**

#2080 - 777 Hornby Street, Vancouver, BC, V6H 1S4  
Tel: (604) 683-7361 Fax: (604) 662-3231

## **Advisory to Reader**

I have prepared these financial statements for Red Hill Energy Inc. in my capacity as Controller. No independent firm of professional accountants has audited, reviewed, compiled, or otherwise attempted to verify the accuracy or completeness of these financial statements.

"D. Frederiksen, CA"

**Red Hill Energy Inc.**  
**Consolidated Balance Sheet**  
**(Unaudited, See Advisory to Reader)**

	<b>June 30, 2008</b>	December 31, 2007
<b>ASSETS</b>		
<b>Current assets</b>		
Cash and cash equivalents	\$ 1,523,477	\$ 993,474
Accounts receivable and accrued interest	8,897	5,336
Prepaid expenses and deposits	<u>1,428</u>	<u>1,388</u>
	<b>1,533,802</b>	<b>1,000,198</b>
<b>Property and equipment, net</b> (Note 4)	<b>96,096</b>	<b>107,746</b>
<b>Reclamation Deposit</b>	<b>2,000</b>	<b>2,000</b>
<b>Mineral properties</b> (Note 5)	<u><b>15,196,789</b></u>	<u><b>15,033,375</b></u>
	<u><b>\$ 16,828,687</b></u>	<u><b>\$ 16,143,319</b></u>
<b>LIABILITIES</b>		
<b>Current liabilities</b>		
Accounts payable and accrued liabilities	\$ 16,796	\$ 154,308
Joint venture funding obligation (Note 5(i))	<u>7,887</u>	<u>46,154</u>
	<b>24,683</b>	<b>200,462</b>
<b>SHAREHOLDERS' EQUITY</b>		
Share capital (Note 6)	<b>30,417,046</b>	<b>30,416,950</b>
Contributed Surplus (Note 6(e))	<b>2,544,760</b>	<b>2,502,567</b>
Share subscriptions	<b>1,611,355</b>	<b>-</b>
Deficit	<u><b>(17,769,157)</b></u>	<u><b>(16,976,660)</b></u>
	<u><b>16,804,004</b></u>	<u><b>15,942,857</b></u>
	<u><b>\$ 16,828,687</b></u>	<u><b>\$ 16,143,319</b></u>

**Approved by the Board:**

" G. Arnold Armstrong "  
 Director

" Ranjeet Sundher "  
 Director

See notes to consolidated financial statements.

**Red Hill Energy Inc.**  
**Consolidated Statement of Income and Deficit**  
**(Unaudited, See Advisory to Reader)**

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	Three months ended		Six months ended	
	June 30		June 30	
	<u>2008</u>	<u>2007</u>	<u>2008</u>	<u>2007</u>
<b>Revenue</b>				
Interest	\$ <u>845</u>	\$ <u>112,224</u>	\$ <u>6,608</u>	\$ <u>142,101</u>
	<u>845</u>	<u>112,224</u>	<u>6,608</u>	<u>142,101</u>
<b>General and Administrative Expenses</b>				
Amortization	<b>7,079</b>	8,531	<b>13,977</b>	15,754
Consulting and management fees (Note 6 (c))	<b>66,335</b>	197,098	<b>120,083</b>	260,897
Director fees (Note 6 (c))	-	350,400	<b>7,628</b>	350,400
Professional fees	<b>22,791</b>	24,232	<b>27,205</b>	35,026
Stock exchange and shareholder services	<b>31,893</b>	58,673	<b>46,529</b>	74,939
Advertising and promotion (Note 6(c))	<b>61,763</b>	162,213	<b>131,163</b>	214,944
Office and administration	<b>23,123</b>	47,679	<b>74,038</b>	100,367
Travel and accommodation	<b>140,730</b>	78,475	<b>166,638</b>	120,059
Foreign exchange loss (gain)	<b>1,040</b>	251,608	<b>5,585</b>	268,925
Bank charges and interest	<b>550</b>	635	<b>1,133</b>	1,198
Insurance	<b>2,842</b>	-	<b>3,902</b>	-
Salary and benefits (Note 6(c))	<b>40,866</b>	87,262	<b>86,012</b>	131,430
	<u>399,012</u>	<u>1,266,806</u>	<u>683,893</u>	<u>1,573,939</u>
<b>Mineral property written-off</b>	<u>308</u>	<u>-</u>	<u>115,212</u>	<u>-</u>
<b>Net income (loss)</b>	<b>(398,475)</b>	(1,154,582)	<b>(792,497)</b>	(1,431,838)
<b>Deficit - beginning of period</b>	<b>(17,370,682)</b>	(13,956,221)	<b>(16,976,660)</b>	(13,678,965)
<b>Deficit - end of period</b>	<b><u>\$(17,769,157)</u></b>	<u>\$(15,110,803)</u>	<b><u>\$(17,769,157)</u></b>	<u>\$(15,110,803)</u>
<b>Earnings (Loss) Per Share</b>	\$ <u>(0.01)</u>	\$ <u>0.03</u>	\$ <u>(0.02)</u>	\$ <u>0.04</u>
<b>Weighted Average Number of Shares</b>				
<b>Outstanding</b>	<u>47,459,869</u>	<u>41,950,784</u>	<u>47,459,857</u>	<u>39,142,954</u>

See notes to consolidated financial statements.

**Red Hill Energy Inc.**  
**Consolidated Statement of Cash Flows**  
**(Unaudited, See Advisory to Reader)**

	Three months ended		Six months ended	
	<u>June 30</u>		<u>June 30</u>	
	<u>2008</u>	<u>2007</u>	<u>2008</u>	<u>2007</u>
<b>Cash flows from operating activities</b>				
Net income (loss)	\$ (398,475)	\$ (1,154,582)	\$ (792,497)	\$ (1,431,838)
Adjustments non-cash items:				
Stock based compensation	18,475	638,750	42,193	638,750
Mineral properties written off	308	-	115,212	-
Amortization	7,079	8,531	13,977	15,754
	<u>(372,613)</u>	<u>(507,301)</u>	<u>(621,115)</u>	<u>(777,334)</u>
<b>Changes in non-cash working capital</b>				
Accounts receivable	(759)	(80,944)	(3,561)	(35,845)
Prepaid expenses and deposits	9	1,853	(40)	(6,348)
Accounts payable and accrued liabilities	(25,492)	10,849	(137,512)	1,132
	<u>(398,855)</u>	<u>(575,543)</u>	<u>(762,228)</u>	<u>(818,395)</u>
<b>Cash flows from investing activities</b>				
Purchase of capital assets	(2,067)	(25,139)	(2,724)	(29,683)
Expenditures on mineral properties	(139,609)	(327,222)	(316,496)	(814,283)
	<u>(141,676)</u>	<u>(352,361)</u>	<u>(319,220)</u>	<u>(843,966)</u>
<b>Cash flows from financing activities</b>				
Shares issued	96	8,163,519	96	9,071,553
Prepaid share subscription	1,611,355	-	1,611,355	-
	<u>1,611,451</u>	<u>8,163,519</u>	<u>1,611,451</u>	<u>9,071,553</u>
<b>Net increase (decrease) in cash</b>	<b>1,070,920</b>	<b>7,235,615</b>	<b>530,003</b>	<b>7,409,192</b>
<b>Cash and cash equivalents - beginning of period</b>	<b>452,557</b>	<b>1,978,061</b>	<b>993,474</b>	<b>1,804,484</b>
<b>Cash and cash equivalents - end of period</b>	<b>\$ <u>1,523,477</u></b>	<b>\$ <u>9,213,676</u></b>	<b>\$ <u>1,523,477</u></b>	<b>\$ <u>9,213,676</u></b>
<b>Supplemental Cash Flow Information</b>				
Shares issued as finders' fees	\$ -	\$ -	\$ -	\$ -
Shares issued for property	\$ -	\$ -	\$ -	\$ -

See notes to consolidated financial statements.

**Red Hill Energy Inc.**  
**Notes to the Consolidated Financial Statements**  
**(Unaudited, See Advisory to Reader)**

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**For the period ended June 30,**

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**1. Nature of Operations**

The Company is an exploration stage public company. The principal business activity of the Company is the acquisition, exploration and development of mineral properties.

Since June 1, 2003, the Company's principal activity has been the acquisition, exploration and development of mineral properties located in Mongolia held directly and through its subsidiary companies. All of the projects in Mongolia are in the initial stages of contract formalization and obtaining necessary government approvals. The ability of the Company to continue operations is dependent upon the continued financial support of its shareholders, other investors and lenders and with the successful development of the Company's interests in the mineral properties.

**2. Significant Accounting Policies**

(a) Interim financial statements

The interim financial statements follow the same accounting policies and methods of their application as the most recent audited financial statements for the year ended December 31, 2007. However, they do not include all the information and disclosures required by the annual financial statements. In the opinion of management, all adjustments of a normal recurring nature necessary for a fair presentation have been included. The results for the interim periods are not necessarily indicative of the results for the entire year. The information contained in the interim financial statements should be read in conjunction with the Company's latest annual financial statements and notes thereto.

(b) Basis of presentation

These consolidated financial statements are prepared in accordance with Canadian generally accepted accounting principles and include the accounts of the Company and its wholly owned integrated Mongolian subsidiaries, Chandgana Coal LLC, UGL Enterprises LLC, and Redhill Mongolia LLC. All inter-company balances and transactions have been eliminated.

The Company's interest in a joint venture is included in the accounts of the Company using the proportionate consolidation method whereby a venturer's pro rata share of each of the assets, liabilities, revenues and expenses that are subject to joint control is combined on a line-by-line basis with similar items in the venturer's financial statements. This method of accounting differs from full consolidation in that only the venturer's portion of all assets, liabilities, revenues and expenses is taken up rather than the full amount, offset by non-controlling interests.

(c) Investment in and expenditures on resource properties

The Company follows the practice of capitalizing all costs relating to the acquisition of, exploration for and the development of mineral claims, net of all incidental revenues received. At such time as commercial production commences, these costs will be charged to operations on a unit-of-production method based on estimated recoverable reserves. The aggregate costs related to abandoned mineral claims will be charged to operations at the time of abandonment. General and administrative expenditures that are not directly related to specific mineral properties are expensed in the period in which they are incurred.

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**Notes to the Consolidated Financial Statements**  
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**2. Significant Accounting Policies (continued)**

- (d) Cash and cash equivalents  
Cash and cash equivalents consist of cash and short-term deposits with original maturity of less than three months.
  
- (e) Foreign currency translation  
Amounts recorded in foreign currency are translated into Canadian dollars as follows:
  - (i) Monetary assets and liabilities at the rate of exchange in effect as at the balance sheet date;
  - (ii) Non-monetary assets and liabilities at the exchange rates prevailing at the time of the acquisition of the assets or assumption of the liabilities; and
  - (iii) Revenues and expenses at the average rate of exchange for the year.Gains and losses arising from this translation of foreign currency are included in the determination of net loss for the year.
  
- (f) Loss per share  
Loss per share is calculated using the weighted average number of shares outstanding during the year. Diluted loss per share has not been presented separately as the outstanding stock options are anti-dilutive.
  
- (g) Use of estimates  
The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amount of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements, and the reported amounts for revenues and expenses during the reporting period. Actual results could differ from those estimates and would impact future results of operations and cash flows.
  
- (h) Income taxes  
Income taxes are calculated using the liability method of tax accounting. Temporary differences arising from the difference between the tax basis of an asset or liability and its carrying amount on the balance sheet are used to calculate future income tax assets or liabilities. Future income tax assets or liabilities are calculated using tax rates anticipated to apply in the period that the temporary differences are expected to reverse. A valuation allowance is provided to reduce the asset to the net amount management estimates to be reasonable to carry as a future income tax asset.
  
- (i) Asset retirement obligations  
Effective January 1, 2004, the Company adopted the new Canadian accounting requirements for asset retirement obligations. The new standard requires liability recognition for retirement obligations associated with long-lived assets at fair value. The asset retirement cost equal to the fair value of the retirement obligation is capitalized as part of the cost of the related asset. These capitalized costs are depreciated using a

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**For the period ended June 30,**

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**2. Significant Accounting Policies (continued)**

- (i) Asset retirement obligations (continued)  
straight-line method on the estimated life of the asset. Amounts are recorded once they become known or can be readily estimated.
- (j) Stock-based compensation plans  
The Company accounts for stock options granted to directors, employees and consultants using the fair value method. The fair value of each option granted is estimated on the date of grant using the Black-Scholes option pricing model and charged to earnings over the vesting period with a corresponding increase in contributed surplus. Upon exercise of the stock options, consideration received together with the amount previously recognized in contributed surplus is recorded as an increase to capital stock.
- (k) Amortization of property and equipment is recorded on a declining-balance basis at the following annual rates:
- |                         |     |
|-------------------------|-----|
| Furniture and equipment | 20% |
| Vehicle                 | 30% |
| Computer equipment      | 45% |
- Additions during the year are amortized at one-half the annual rates.
- (l) Revenue recognition  
The Company recognizes interest income on its cash and cash equivalents on an accrual basis at the stated rates over the term to maturity.

**3. Financial Instruments**

- (a) Fair value  
The carrying values of cash and cash equivalents, accounts receivable, and accounts payable and accrued liabilities approximate their fair values because of the short-term maturity of these financial instruments. The fair value of the long-term investment is disclosed in note 5.
- (b) Credit risk  
A financial instrument that potentially subjects the Company to concentration of credit risk is its cash. The Company has placed the majority of its cash with a major Canadian commercial bank. The Company is also exposed to credit risk with respect to its accounts receivable, which consists of an amount receivable from a Mongolian company.
- (c) Currency risk  
The Company translates the results of US transactions into Canadian currency using rates approximating the average exchange rate for the year. The exchange rate may vary from time to time. The Company translates Mongolian transactions into Canadian currency at rates approximating the average exchange rate for the year. Management believes that the currency risk is minimal for Mongolian dollars as the risk is mitigated by the fact that the majority of the Mongolian transactions are completed in US currency.



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**For the period ended June 30,** **2008** 2007

**4. Property and equipment**

	<u>2008</u>		<u>2007</u>	
	<u>Cost</u>	<u>Accumulated Amortization</u>	<u>Net</u>	<u>Net</u>
Furniture and Equipment	\$ 91,460	\$ 39,110	\$ 52,350	\$ 58,167
Vehicle <b>46,262</b>	<b>12,837</b>	<b>33,425</b>	39,322	
Computer Equipment	<u>22,980</u>	<u>12,659</u>	<u>10,321</u>	10,257
	<u>\$ 160,702</u>	<u>\$ 64,606</u>	<u>\$ 96,096</u>	<u>\$ 107,746</u>

**5. Investment in and Expenditures on Resource Properties**

The Company's investment in and expenditures on resource properties comprise a significant portion of the Company's assets. Realization of the Company's investment in these assets is dependent on establishing legal ownership of the properties, on the attainment of successful production from the properties or from the proceeds of their disposal.

	<u>2008</u>	<u>2007</u>
<b>Banbury Property</b> (note 5(a))		
Cost	\$ <u>1</u>	\$ <u>1</u>
<b>Gold Ram Property</b> (note 5(b))		
Cost	<b>11,857</b>	11,857
Exploration expenditures	<u>38,430</u>	<u>38,214</u>
	<u><b>50,287</b></u>	<u>50,071</u>
<b>Khondloy Property</b> (note 5(c))		
Cost	<b>33,402</b>	33,402
Exploration expenditures	<u>116,879</u>	<u>116,420</u>
	<u><b>150,281</b></u>	<u>149,822</u>
<b>Naranbulag Property</b> (note 5(d))		
Cost	<b>186,396</b>	186,396
Exploration expenditures	<u>24,773</u>	<u>24,572</u>
	<u><b>211,169</b></u>	<u>210,968</u>
<b>Argalant Property</b> (note 5(e))		
Cost	<b>119,485</b>	119,485
Exploration expenditures	<u>206,406</u>	<u>206,406</u>
	<u><b>325,891</b></u>	<u>325,891</u>

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**For the period ended June 30,** **2008** 2007

**5. Investment in and Expenditures on Resource Properties (continued)**

**Ulan Ovoo Property** (note 5(f))

Cost	<b>10,537,737</b>	10,537,737
Exploration expenditures	<u><b>1,614,965</b></u>	<u>1,418,999</u>
	<u><b>12,152,702</b></u>	<u>11,956,736</u>

**Chandgana Tal Property** (note 5(g))

Cost	<b>814,334</b>	814,334
Exploration expenditures	<u><b>464,358</b></u>	<u>456,585</u>
	<u><b>1,278,692</b></u>	<u>1,270,919</u>

**Chandgana Khavtgai** (note 5(h))

Cost	<b>589,053</b>	589,053
Exploration expenditures	<u><b>511,858</b></u>	<u>466,264</u>
	<u><b>1,100,911</b></u>	<u>1,055,317</u>

**Uranium Properties** (note 5(i))

Cost, net	<b>(86,253)</b>	(86,253)
Write-off of property	<b>(115,212)</b>	-
Exploration expenditures	<b>120,433</b>	53,749
Joint venture funding obligation	<u><b>7,887</b></u>	<u>46,154</u>
	<u><b>(73,145)</b></u>	<u>13,650</u>

**Total Mineral Properties** **\$ 15,196,789** **\$ 15,033,375**

- (a) **Banbury Property**  
The Company owns a 100% undivided interest in six patented mineral claims near Hedley, B.C. described as the Banbury Property. The interest is recorded at a nominal value of \$1.
  
- (b) **Gold Ram Property**  
The Company acquired a 100% interest in the Gold Ram in South Gobi, Mongolia. The Gold Ram project (15,533 hectares) is located in the western Gobi region of Mongolia, 190km southwest of the south Gobi's capital city, Dalanzadgad.
  
- (c) **Khondloy Property**  
The Company purchased a 100% interest in the Khondloy Property (9,078 hectares) located in Bayanhonger Province, Mongolia for US\$25,000.

**Red Hill Energy Inc.**  
**Notes to the Consolidated Financial Statements**  
**(Unaudited, See Advisory to Reader)**

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For the period ended June 30,

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**5. Investment in and Expenditures on Resource Properties (continued)**

(d) Naranbulag Property

The Company purchased a 100% interest in the Naranbulag Property (1,428 hectares) located in Zavkhan Province, about 700km west of Mongolia's capital Ulaan Bataar. The Company agreed to purchase the license from the vendor for US\$26,000 and CDN\$152,000 payable through the issuance of 200,000 shares at a deemed price of \$0.76 per share.

(e) Argalant Property

On October 6, 2005, and amended on August 13, 2006, the Company entered into a letter of intent with Planet Exploration Ltd. ("Planet") which gives the Company an option to earn a 60% interest, and a second option to earn an additional 20% interest, in Planet Exploration's 100% owned Argalant property.

Under the terms of the agreement Red Hill paid Planet US\$100,000 and will incur an aggregate of US\$1,500,000 of exploration expenditures on Argalant within three years. Within a six month period of completing the US\$1,500,000 in expenditures Red Hill is entitled to, at its discretion, pay Planet US\$1,000,000 for an additional 20% interest in the property. If Red Hill does not exercise its second option the two companies will then proceed forward on a 60/40% basis. If Red Hill does exercise its second option the two companies will proceed forward on an 80/20% basis.

(f) Ulan Ovoo Property

On November 15, 2005, the Company entered into a letter of intent with Ochir LLC that sets out the terms to acquire a 100% interest in the property known as Ulan Ovoo coal project. The Ulan Ovoo property is located in Selenge province, Mongolia. It is held by the vendor under a transferable, 55 year mining licence with a 45 year option for extension granted by the Government of Mongolia. The purchase price for the 100% interest, together with all equipment, buildings and other facilities, assembled and constructed at the property is US\$9,600,000.

The original agreement provided the purchase price to be paid as follows:

US\$500,000 within 14 days of the execution of the letter of intent, comprised of a US\$200,000 non-refundable deposit and US\$300,000 secured loan, which will revert to a payment upon completion of a NI 43-101 technical report and receipt of all necessary regulatory approvals;

US\$500,000 on or before March 1, 2006;

US\$500,000 on or before May 1, 2006;

US\$500,000 on or before July 1, 2006;

US\$1,500,000 on or before November 1, 2006; and

US\$6,100,000 on or before November 1, 2007

A finder's fee of 75,000 common shares was paid to a third party by the Company in respect of the Ulan Ovoo purchase.

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**Notes to the Consolidated Financial Statements**  
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**For the period ended June 30,**

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**5. Investment in and Expenditures on Resource Properties (continued)**

(f) Ulan Ovoo Property (continued)

On May 10, 2006, the Company agreed to amend the purchase agreement as follows: Ochir shall incorporate and register with the relevant Mongolian authorities a Mongolian-Canadian Joint Venture Company ("JVC") in Mongolia and transfer into the JVC the Ulan Ovoo Mining and Exploration Licenses. The initial shareholders of the JVC shall be Ochir 51% and Red Hill 49% of the outstanding equity of the JVC.

In consideration for the transfer of the Licenses to the JVC an accelerated payment of US\$500,000 shall be paid by Red Hill to Ochir within 30 days of the successful transfer of the Licenses. The remaining US\$1,000,000 shall remain due on or before November 1, 2006.

Within 30 days of the US\$1,000,000 November 1, 2006 payment by Red Hill to Ochir, Ochir shall transfer to Red Hill its 51% interest in the JVC. The final payment of US\$6,100,000 remains due on or before November 1, 2007.

On September 25, 2006, the Company agreed to amend the purchase agreement as follows:

On signing the amendment US\$750,000 shall be paid and Ochir shall transfer to Red Hill its 51% interest in the JVC. A payment of US\$750,000 shall be due on or before April 1, 2007. The final payment of US\$5,600,000 shall be due on or before November 1, 2007.

As at December 31, 2007, the Company had made payments totalling US\$9,600,000.

On November 15, 2006, the Company entered into an agreement with a private Mongolian corporation, to purchase 100% title and interest in five mineral licences including licences that are contiguous and entirely surrounding the Ulan Ovoo property. The aggregate purchase price for the licences is US\$400,000 with \$50,000 being payable within 10 days of signing the agreement and the balance of the payment due upon transfer of ownership title to Red Hill. Under the terms of the agreement the Vendor will retain a 2% Net Smelter Return (NSR) on the five newly acquired licences. The Vendor owes the Company US\$50,000, which amount has been included in the cost of the properties as it became uncollectible.

A finder's fee of 58,500 shares were issued to a third party on the acquisition.

(g) Chandgana Tal Property

The Company entered into an agreement to acquire a 100% interest in a Coal exploration property known as Chandgana Tal. The Chandgana Tal property, consisting of two licenses, is located in the northeast part of the Nyalga coal basin, approximately 290 km east of Ulaan Bataar. Under the terms of the agreement, the Company paid a total of US\$400,000, plus 250,000 common shares of the Company. A finder's fee of 50,000 common shares was paid to a third party by the Company. The purchase price was paid as follows:

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**5. Investment in and Expenditures on Resource Properties (continued)**

(g) Chandgana Tal Property (continued)

within 3 days of the date that the agreement was accepted and approved by the TSX Venture Exchange, the issuance of 250,000 common shares of the Company.

US\$50,000 within 21 days of signing the letter agreement.

US\$75,000 on or before July 1, 2006.

US\$275,000 on or before October 1, 2006.

During the period ended December 31, 2006, payments totaling US\$400,000 were made, 250,000 shares were issued to the Vendor, and 50,000 shares were issued as a finder's fee to a third party.

(h) Chandgana Khavtgai

The Company entered into an agreement to acquire a 100% interest in a Coal exploration property known as Chandgana Khavtgai. The Chandgana Khavtgai property consists of one license, and is located in the northeast part of the Nyalga coal basin, approximately 290 km east of Ulaan Bataar. Under the terms of the agreement, the Company paid a total of US\$570,000. The purchase price was paid as follows:

US\$280,000 within 7 days of signing the letter agreement.

US\$290,000 on or before the date which is 90 days from the date of signing the letter agreement.

During the period ended December 31, 2007, payments totaling US\$570,000 were made.

(i) Mongolia Uranium Option Agreement

On June 14, 2005, the Company entered into a Letter Agreement with Maple Minerals Corp. (now known as Mega Uranium Ltd. "Mega") for uranium exploration and target generation in Mongolia. The agreement covered the Company's current uranium ground holdings in Mongolia, which were then comprised of 18 granted exploration licenses, and an option to earn 100% of two exploration licenses in the Nergui Project. In addition, Mega and the Company will cooperate during the term of the agreement in the generation and acquisition of other uranium exploration targets in Mongolia. The Company's extensive gold/copper property holdings and coal property holdings are not included in this agreement.

Upon completion of a due diligence review by Mega, a definitive formal option agreement was executed. The formal option agreement granted Mega the exclusive option to earn a 50% interest in the Company's uranium properties through the expenditure of US\$1.5 million over three years, with a minimum of US\$350,000 expended within the first year. Mega was required to issue the Company 50,000 common shares in its capital within 3 business days of the date that the executed formal agreement was accepted and approved by the TSX Venture Exchange.

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**5. Investment in and Expenditures on Resource Properties (continued)**

(i) Mongolia Uranium Option Agreement (continued)

Upon Mega earning a 50% interest, a joint venture will be formed with the parties contributing pro-rata. Mega will also have the option to increase its interest to 60% by expending a further US\$2 million over the subsequent three years.

During the period ended December 31, 2007, Mega completed the earn in requirement of expending US\$1.5 million on uranium exploration in Mongolia. Mega has earned a 50% interest in all of Red Hill's uranium claims. Mega declined to exercise its option to expend an additional US\$2 million over three years to earn a 60% interest. A joint venture has been formed and all future uranium exploration will be funded on a 50-50 pro-rata basis. Red Hill's net interest in the joint venture as at June 30, 2008, was \$(73,145) (December 31, 2007, - \$13,650). Mega has pre-funded the joint venture by the amount of \$7,887 (December 31, 2007 - \$46,154). A new Joint Venture LLC was incorporated in Mongolia subsequent to year end for the puposes of this joint venture named Redhill Mega Uranium LLC. the LLC is owned 50% by the Company and 50% by Mega. All the uranium licences have been transferred to the new Joint Venture LLC.

**6. Share Capital**

(a) Authorized  
 Unlimited Common shares without par value.

(b) Issued

	<u>Number</u> <u>of Shares</u>	<u>Amount</u>
Balance, year ended December 31, 2006	<b>35,918,373</b>	<b>\$ 21,199,430</b>
Private placement	<b>9,930,000</b>	<b>8,430,000</b>
Share issuance costs	-	<b>(477,031)</b>
Exercise of warrants	<b>1,431,472</b>	<b>997,552</b>
Exercise of stock options	<b>180,000</b>	<b>83,150</b>
Contributed surplus on exercise of stock options	-	<b>183,849</b>
Balance, year ended December 31, 2007	<b>47,459,845</b>	<b>\$ 30,416,950</b>
Shares issued in trust	<b>28</b>	<b>96</b>
Balance, period ended June 30, 2008	<b><u>47,459,873</u></b>	<b><u>\$ 30,417,046</u></b>

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**6. Share Capital (continued)**

- (b) On April 5, 2007, the Company closed a \$6,000,000 private placement. Under the placement, the Company issued 7,500,000 units, each unit is comprised of one common share and one-half of one share purchase warrant. Each whole share purchase warrant entitles the holder to acquire one additional common share for a period of two years at a price of \$1.00 per share during the first year of the warrant term and \$1.25 per share during the second year of the warrant term, subject to forced exercise provisions. The units issued under the placement are subject to a hold period that expired on July 5, 2007. A finder's fee of 7.5% on the proceeds placed payable in cash was paid on portions of the placement.

On June 8, 2007, the Company closed a \$2,430,000 private placement. Under the placement, the Company issued 2,430,000 units, each unit is comprised of one common share and one-half of one share purchase warrant. Each whole share purchase warrant entitles the holder to acquire one additional common share for a period of two years at a price of \$1.25 per share during the warrant term, subject to forced exercise provisions. The units issued under the placement are subject to a hold period that expired on October 1, 2007. A finder's fee of 6.0% on the proceeds placed payable in cash was paid on portions of the placement

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(c) Share purchase options

Details of the status of the Company's stock option plans as at December 31, 2007 and March 31, 2008 and changes during the respective year are as follows:

	Number	Weighted Average	
	of Shares	Exercise	Expiry Date
		Price	
Outstanding, December 31, 2005	1,840,000	0.50	
Granted January 31, 2006	650,000	0.45	January 31, 2011
Granted February 9, 2006	100,000	0.65	February 9, 2011
Options exercised	(50,000)	0.45	January 31, 2011
Granted March 15, 2006	50,000	1.20	March 15, 2011
Options exercised	(25,000)	0.48	November 24, 2008
Options exercised	(50,000)	0.50	June 10, 2009
Options exercised	(50,000)	0.45	January 31, 2011
Granted April 3, 2006	<u>130,000</u>	<u>1.10</u>	April 3, 2011
Outstanding, December 31, 2006	2,595,000	0.55	
Expired January 21, 2007	(200,000)	0.40	
Granted January 29, 2007	45,000	0.78	January 29, 2010
Granted April 5, 2007	875,000	0.92	April 5, 2012
Options exercised	(30,000)	0.48	November 24, 2008
Options exercised	(50,000)	0.50	June 10, 2009
Options exercised	(25,000)	0.60	March 1, 2010
Options exercised	(25,000)	0.45	January 31, 2011
Granted July 12, 2007	50,000	1.20	July 12, 2012
Granted October 30, 2007	520,000	1.18	October 30, 2012
Options exercised	(50,000)	0.35	March 1, 2010
Options cancelled	(25,000)	0.92	April 5, 2012
Granted December 24, 2007	<u>50,000</u>	<u>0.95</u>	December 24, 2010
Outstanding, December 31, 2007, and Period ended June 30, 2008	<u>3,730,000</u>	<u>\$ 0.74</u>	

The Company applies the fair value method using the Black-Scholes options pricing model to account for options granted to employees, directors and non-employees.



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**6. Share Capital (continued)**

On January 29, 2007, the Company granted 45,000 incentive options to a consultant with an exercise price of \$0.78 vesting 25% every three months expiring January 29, 2010. As a result compensation expense of \$15,728 was recognized as stock-based compensation expense during the year ended December 31, 2007, and \$5,243 was recognized as stock-based compensation expense during the period ended June 30, 2008.

On July 12, 2007, the Company granted 50,000 incentive options to a consultant with an exercise price of \$1.20 vesting 25% every three months expiring July 12, 2012. As a result compensation expense of \$24,625 was recognized as stock-based compensation expense during the year ended December 31, 2007, and \$24,625 was recognized as stock-based compensation expense during the period ended June 30, 2008.

On December 24, 2007, the Company granted 50,000 incentive options to a consultant with an exercise price of \$0.95 vesting 25% every three months expiring December 24, 2010. As a result compensation expense of \$6,163 was recognized as stock-based compensation expense during the year ended December 31, 2007, and \$12,325 was recognized as stock-based compensation expense during the period ended June 30, 2008.

During the year ended December 31, 2007, the Company granted a total of 1,540,000 stock options to employees, directors, and non-employees, and, as a result, compensation expense of \$1,181,050 was recognized in the accounts of the Company.

The Black-Scholes model was calculated based on the following assumptions:

Expected life (years)	4.94
Interest rate	4.16%
Volatility	108%
Dividend yield	0%

The stock-based compensation has been included in the statements of operations and deficit as at June 30, 2008 and 2007 as follows:

	<u>2008</u>	<u>2007</u>
Directors' fees	\$ -	\$ 350,400
Advertising and promotion	<b>42,193</b>	98,225
Salaries	-	51,100
Consulting fees	-	146,000
	<u>\$ <b>42,193</b></u>	<u>\$ 645,725</u>

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**6. Share Capital (continued)**

(d) Warrants outstanding

The following warrants are outstanding at December 31, 2007, and June 30, 2008:

Expiry Date	<u>Number of Warrants</u>		Exercise Price
	<u>2008</u>	<u>2007</u>	
December 12, 2008	<b>1,562,500</b>	1,562,500	\$1.25
April 3, 2009	<b>3,750,000</b>	3,750,000	\$1.25
May 31, 2009	<u><b>1,215,000</b></u>	<u>1,215,000</u>	\$1.25
	<u><b>6,527,500</b></u>	<u>6,527,500</u>	

(e) Contributed surplus

	<u>2008</u>	<u>2007</u>
Balance, beginning of year	\$ <b>2,502,567</b>	\$ 1,505,366
Options exercised	-	(183,849)
Stock-based compensation	<u><b>42,193</b></u>	<u>1,181,050</u>
Balance, end of period	<u><b>\$ 2,544,760</b></u>	<u>\$ 2,502,567</u>

**7. Related Party Transactions**

- (a) The Company has paid accounting fees of \$6,000 (2007 - \$6,000), management consulting fees of \$21,000 (2007 - \$18,000), and rent of \$18,330 (2007 - \$9,165) to a company controlled by a common director.
- (b) The Company has paid legal fees of \$18,723 (2007 - \$522) to law firms in which a director and an officer are principals.
- (c) The Company entered into a letter of intent on October 26, 2005 with a company that has a common director (See note 5(h)).

**8. Income Tax Losses**

The Company has operating losses which may be carried forward to apply against future years' income for Canadian income tax purposes. The tax effect has not been recorded in these financial statements.

The losses expire as follows:

2008	\$ 90,000
2009	56,000
2010	194,000
2014	395,000
2015	688,000
2026	615,000
2027	<u>1,873,000</u>
	<u><b>\$ 3,911,000</b></u>

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**8. Income Tax Losses (continued)**

The components of future income tax assets are as follows after applying enacted corporate rates:

	<u>2007</u>
Future Income Tax Assets	
Non-capital loss carry-forwards	\$ 992,740
Tax value over book value of capital assets	44,096
Book value over tax value of share issue costs	107,219
Tax value over book value of mineral properties	<u>1,727,979</u>
	2,872,034
Less: Valuation allowance	<u>(2,872,034)</u>
	<u>\$ -</u>

The valuation allowance reflects the Company's estimate that the tax assets, more likely than not, will not be realized.

**9. Commitments**

The Company has entered into an investor relations services contract with The Richmond Club Corp. expiring December 2008. with a monthly fee of \$1,450.

The Company has entered into an investor relations services contract with Mau Capital expiring in July 2008, with a monthly fee of \$2,500 per month.

On June 24, 2008, the Company entered into a contract with Minarco-MineConsult to prepare a Pre-feasibility Study for the Ulan Ovoo Coal Project.

**10. Subsequent events**

On July 4, 2008, the Company completed a non-brokered private placement. A total of 4,050,000 units were placed at a price of \$0.65 per unit generating gross proceeds of \$2,632,500. Each unit consists of one common share and one half of one share purchase warrant. Each whole share purchase warrant entitles the holder to acquire one additional common share for a period of two years at an exercise price of \$0.90 per share. The securities issued under this placement are subject to a hold period expiring on November 5, 2008. Finders fees payable in cash were paid on portions of this placement.

On July 22, 2008, the Company granted 550,000 incentive stock options to various directors, employees and consultants. The options are exercisable at a price of \$0.88 per share for a period of five years, subject to regulatory approval.