



X·TERRA

RESOURCES CORPORATION

X-TERRA RESOURCES CORPORATION

**INTERIM CONSOLIDATED FINANCIAL STATEMENTS
NINE-MONTHS PERIOD ENDED SEPTEMBER 30, 2008 AND 2007
(unaudited)**

FINANCIAL STATEMENTS

Consolidated Balance Sheets

Consolidated Statements of Operations, Comprehensive loss and Deficit

Consolidated Cash Flows

Notes to Interim Consolidated Financial Statements

The interim consolidated financial statements which are included in this report have not been subject to a review by the Company's external auditors.

X-TERRA RESOURCES CORPORATION

CONSOLIDATED BALANCE SHEETS

As at September 30, 2008 and December 31, 2007

	SEPTEMBER 30 2008	DECEMBER 31 2007
	(unaudited) \$	(audited) \$
Going concern assumption (note 2)		
Assets		
Current assets		
Cash and cash equivalent (note 4)	4,831,767	472,356
Restricted cash	500	500
Taxes receivable	37,771	15,628
Interest receivable	23,772	-
Prepaid expenses	<u>4,767</u>	<u>-</u>
	4,898,577	488,484
Equipment (note 5)	10,607	-
Mining properties (note 6)	996,034	975,864
Deferred exploration expenses (note 7)	<u>141,510</u>	<u>47,430</u>
	<u>6,046,728</u>	<u>1,511,778</u>
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities	...215,529	...51,222
Shareholders' Equity (Deficiency)		
Capital stock (note 8)	26,413,577	23,195,520
Warrants (note 8)	2,048,720	511,185
Contributed surplus (note 9)	736,785	532,794
Deficit	<u>(23,367,883)</u>	<u>(22,778,943)</u>
	<u>5,831,199</u>	<u>1,460,556</u>
	<u>6,046,728</u>	<u>1,511,778</u>

ON BEHALF OF THE BOARD,

(s) Martin Dallaire, Director

(s) Sylvain Champagne, Director

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

X-TERRA RESOURCES CORPORATION

CONSOLIDATED STATEMENTS OF OPERATIONS, COMPREHENSIVE LOSS AND DEFICIT

Three months period ended September 30 / Nine months period ended September 30

	2008	2007	2008	2007
	\$	\$	\$	\$
Going concern assumption (note 2)				
Administrative expenses				
Insurance	3,575	-	9,533	16,000
Professional fees	27,407	19,201	71,866	134,955
General administrative expenses	117,999	40,938	257,672	83,350
Shareholder's communication	2,814	301	9,138	3,331
Transfer agent and regulatory fees	17,314	1,775	24,439	33,157
Stock-based compensation	109,080	35,970	256,520	71,940
Depreciation of equipment	<u>722</u>	<u>-</u>	<u>1,345</u>	<u>-</u>
	<u>278,911</u>	<u>98,185</u>	<u>630,513</u>	<u>342,733</u>
Other expenses (Income)				
Interest income	(35,230)	(2,845)	(41,573)	(3,564)
General exploration expenses	<u>-</u>	<u>-</u>	<u>-</u>	<u>910</u>
	<u>(35,230)</u>	<u>(2,845)</u>	<u>(41,573)</u>	<u>(2,654)</u>
Net loss and comprehensive loss for the period	<u>243,681</u>	<u>95,340</u>	<u>588,940</u>	<u>340,079</u>
Deficit – Beginning of period	<u>23,124,202</u>	<u>22,732,264</u>	<u>22,778,943</u>	<u>22,487,525</u>
Deficit – End of period	<u>23,367,883</u>	<u>22,827,604</u>	<u>23,367,883</u>	<u>22,827,604</u>
Basic and diluted loss per share	<u>0.02</u>	<u>0.02</u>	<u>0.07</u>	<u>0.07</u>
Weighted average number of shares outstanding (basic and diluted)	<u>11,695,618</u>	<u>5,798,194</u>	<u>8,806,494</u>	<u>4,712,580</u>

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

X-TERRA RESOURCES CORPORATION

CONSOLIDATED CASH FLOWS

Three months period ended September 30 / Nine months period ended September 30

	2008	2007	2008	2007
	\$	\$	\$	\$
Going concern assumption (note 2)				
Operating activities				
Net loss for the period	(243,681)	(95,340)	(588,940)	(340,079)
Adjustment for				
Depreciation of equipment	722	-	1,345	-
Stock-based compensation	<u>109,080</u>	<u>35,970</u>	<u>256,520</u>	<u>71,940</u>
	(133,879)	(59,370)	(331,075)	(268,139)
Changes in non-cash operating working capital items	<u>101,247</u>	<u>(52,864)</u>	<u>113,625</u>	<u>(25,926)</u>
	<u>(32,632)</u>	<u>(112,234)</u>	<u>(217,450)</u>	<u>(294,065)</u>
Financing activities				
Cash inflow relating to capital stock and warrants	5,000,000	-	5,350,198	560,000
Note payable	-	17,500	-	17,500
Due to related party	-	-	-	(11,782)
Purchase of shares under normal course issuer bid	(76,560)	-	(76,560)	-
Share issuance expenses	<u>(570,575)</u>	<u>(500)</u>	<u>(570,575)</u>	<u>(34,650)</u>
	<u>4,352,865</u>	<u>17,000</u>	<u>4,703,063</u>	<u>531,068</u>
Investing activities				
Acquisition of equipment	(3,650)	-	(11,952)	-
Mining properties	(6,277)	(25,000)	(20,170)	(25,000)
Deferred exploration expenses	<u>(72,481)</u>	<u>(1,500)</u>	<u>(94,080)</u>	<u>(1,500)</u>
	<u>(82,408)</u>	<u>(26,500)</u>	<u>(126,202)</u>	<u>(26,500)</u>
Increase (decrease) in cash and cash equivalents during the period	4,237,825	(121,734)	4,359,411	210,503
Cash and cash equivalents – Beginning of period	<u>593,942</u>	<u>346,224</u>	<u>472,356</u>	<u>13,987</u>
Cash and cash equivalents – End of period	<u>4,831,767</u>	<u>224,490</u>	<u>4,831,767</u>	<u>224,490</u>

Cash and cash equivalents are composed of cash and term deposits.

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

**NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2008 AND 2007**

(unaudited)

1 Nature of operations

At the annual and special meeting of shareholders held on August 27, 2008 in Rouyn-Noranda, Québec, shareholders approved a special resolution authorizing the continuance of X-Terra under the *Canada Business Corporations Act*. On September 4, 2008, X-Terra obtained a Certificate and Articles of Continuance under the *Canada Business Corporations Act*, rendering the continuance effective.

The Company is in the business of acquiring, exploring and developing mining and energy properties. As at September 30, 2008, the Company holds the Villedieu, Lindsay, Cool Lake, Rimouski, Rimouski North and Shawinigan properties.

As at September 30, 2008, the Company had cash and cash equivalent of \$4,831,767 and working capital of \$4,683,048.

The interim consolidated financial statements of the Company have been prepared by management in accordance with Canadian generally accepted accounting principles, except that they do not contain all disclosures as required for annual financial statements. The interim consolidated financial statements have been prepared following the same accounting policies as for the consolidated financial statements for the year ended December 31, 2007 except as noted. Accordingly, they should be read in conjunction with the 2007 consolidated financial statements and the notes thereto.

In the opinion of management, all adjustments considered necessary for fair presentation of the results for the periods presented have been reflected in the interim consolidated financial statements.

2 Going concern assumption

These consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles on a going concern basis whereby it is assumed that the Company will realize its assets and assume its liabilities in the normal course of business.

The Company is in the process of exploring its mineral properties and has not yet determined whether these properties contain ore reserves. The recoverability of the amounts shown for mineral properties and related deferred expenditures is dependent upon the ability of the Company to obtain the necessary financing to complete exploration and development and upon future profitable production or proceeds from the disposition of properties. The Company will have to raise additional funds to complete the development phase of its programs and, while it has been successful in doing so in the past, there can be no assurance that it will be able to do so in the future. The application of generally accepted accounting principles on a going concern basis may be inappropriate, since there is a significant doubt as to the going concern assumption.

The financial statements do not reflect the adjustments to the carrying value of assets and liabilities, the reported amounts of revenues and expenses and the classification of balance sheet items if the going concern assumption were inappropriate, and these adjustments could be material. Management did not take these adjustments into account as it believes in the validity of the going concern assumption.

3 New accounting standards

On January 1, 2008, the Company adopted new accounting standards related to general standard of financial statement presentation, capital disclosure and financial instruments that were issued by the Canadian Institute of Chartered Accountants ("CICA"). The new CICA standards are as follows:

Section 1400, General Standard of Financial Statement Presentation

This section specifies requirements to assess an entity's ability to continue as a going concern and disclose any material uncertainties that cast doubt on its ability to continue as a going concern. The Company disclosure reflects such assessment.

X-TERRA RESOURCES CORPORATION

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2008 AND 2007

(unaudited)

Section 1535, *Capital Disclosures*

This section specifies the disclosure of information that enables users of an entity's financial statements to evaluate its objectives, policies and processes for managing capital such as qualitative information about its objectives, policies and processes for managing capital, summary quantitative data about what the entity manages as capital, whether it has complied with any capital requirements and, if it has not complied, the consequences of non-compliance. Disclosure requirements pertaining to this section are contained in note 8.

Section 3862, *Financial Instruments Disclosures*

Section 3863, *Financial Instruments Presentation*

These sections replace Section 3861, *Financial Instruments Disclosure and Presentation*, revising and enhancing disclosure requirements while carrying forward its presentation requirements. These new sections place increased emphasis on disclosure about the nature and extent of risk arising from financial instruments and how the entity manages those risks. Disclosure requirements pertaining to this section are contained in note 12.

4 Cash and cash equivalent

As at September 30, 2008, cash and cash equivalent includes an amount of \$131,660 (As at September 30, 2007 – nil) reserved for new exploration activities to be conducted in Canada before December 31, 2008 (note 11). Cash and cash equivalent also includes term deposits of \$4,500,000 which bears interest at 2.98% and 3.15% and are renewable in October 2008. Cash bears interest at base rate less 2.5%.

5 Equipment

	Cost \$	Accumulated Depreciation \$	Net value as at September 30, 2008 \$	Net value as at September 30, 2007 \$
Computer equipment	<u>11,952</u>	<u>1 345</u>	<u>10 607</u>	<u>-</u>

6 Mining properties

	Balance December 31, 2007 \$	Addition \$	Balance September 30, 2008 \$
Villedieu (100 %)	544,570	-	544,570
Lindsay (100%)	431,294	1 999	433,293
Cool Lake (100%)	-	2,172	2,172
Rimouski (100%) ⁽¹⁾	-	3,989	3,989
Rimouski North (100%) ⁽¹⁾	-	5,257	5,257
Shawinigan (100%) ⁽¹⁾	<u>-</u>	<u>6,753</u>	<u>6,753</u>
	<u>975,864</u>	<u>20,170</u>	<u>996,034</u>

All properties are in Canada.

(1) These properties are part of an assignment with Brownstone Ventures Inc., whereby Brownstone will acquire 50% interest (note 15).

X-TERRA RESOURCES CORPORATION

**NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2008 AND 2007**

(unaudited)

7 Deferred exploration expenses

	Balance December 31, 2007	Addition	Balance September 30, 2008
	\$	\$	\$
Villedieu (100 %)	600	-	600
Lindsay (100%)	46,830	67,712	114,542
Cool Lake (100%)	-	25,776	25,776
Rimouski (100%)	<u>-</u>	<u>592</u>	<u>592</u>
	<u>47,430</u>	<u>94,080</u>	<u>141,510</u>
		2008	2007
		\$	\$
Exploration costs			
Accommodations		20,543	28
Maps, printing and drafting		350	13
Assay and geochemical analysis		5,218	-
Geology		23,184	1,500
Geophysics		41,531	-
Project management fees		3,254	67
Salaries and wages		<u>-</u>	<u>802</u>
		94,080	2,410
General exploration expenses		<u>-</u>	<u>(910)</u>
Increase in deferred exploration expenses		94,080	1,500
Deferred exploration expenses – Beginning of period		<u>47,430</u>	<u>-</u>
Deferred exploration expenses – End of period		<u>141,510</u>	<u>1,500</u>

8 Capital stock, warrants and options

Authorized: Unlimited common shares without par value, of which 12,078,069 common shares were issued as at September 30, 2008 (December 31, 2007: 6,776,671).

The Company defines its capital as the shareholder's equity.

The Company's capital management objectives are to:

- have sufficient capital to be able to meet the Company's mining properties exploration and mining development plan in order to ensure the growth of the activities.
- have sufficient cash to fund the exploration expenses and investing activities and the working capital requirements.

X-TERRA RESOURCES CORPORATION

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2008 AND 2007

(unaudited)

8 Capital stock, warrants and options (continued)

Capital stock

The following table details the changes in the Company's capital stock:

	Number of shares	Amount \$
Balance as at December 31, 2007	6,776,671	23,195,520
Private placement ⁽¹⁾	5,000,000	3,585,000
Options exercised	62,400	119,928
Warrants exercised	405,998	417,464
Purchase for cash under normal course issuer bid ^(note 14)	(167,000)	(76,560)
Share issuance expenses ⁽¹⁾	<u>-</u>	<u>(827,775)</u>
Balance as at September 30, 2008	<u>12,078,069</u>	<u>26,413,577</u>

Warrants

The following table details the changes in the Company's warrants:

	Number of warrants	Amount \$
Balance as at December 31, 2007	1,587,998	511,185
Private placement ⁽¹⁾	5,400,000	1,672,200
Exercised during the period	<u>(377,999)</u>	<u>(134,665)</u>
Balance as at September 30, 2008	<u>6,609,999</u>	<u>2,048,720</u>

(1) On July 11, 2008, the Company completed a private placement of 5,000,000 units at a deemed price of \$1.00 per unit for cash consideration of \$5,000,000. Each unit consists of one common share and one common share purchase warrant. Each purchase warrant entitles the holder to purchase one common share of a price of \$1.50 until July 11, 2010. From the total compensation received, \$1,415,000 was assigned to warrants and \$3,585,000 to capital stock, according to their respective estimated fair value.

Share issue expenses include fair value of \$257,200 for 400,000 compensation options, entitling it to purchase 400,000 units at a price of \$1.00 per unit until July 11, 2008. Each unit consists of one common share and one common share purchase warrant. Each purchase warrant entitles the holder to purchase one common share of a price of \$1.50 until July 11, 2010.

The fair value of the compensation option was estimated using a binomial pricing model based on the following assumptions: dividend yield of 0%, volatility of 100%, risk-free interest rate of 3.18% and an expected life of two years. As a result, the fair value of the compensation options was estimated at \$257,200.

X-TERRA RESOURCES CORPORATION

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2008 AND 2007

(unaudited)

8 Capital stock, warrants and options (continued)

Information relating to warrants outstanding as at September 30, 2008 is as follows:

Expiry date	Number of warrants outstanding	Exercise price \$
May 2009	650,000	0.70
October 2009	133,333	0.75
October 2009	426,666	1.00
July 2010	<u>5,400,000</u>	1.50
	<u>6,609,999</u>	

Except for the compensation options, the warrants, when granted, are accounted for at their fair value determined by the Black-Scholes pricing model, based on following assumptions: dividend yield of 0%, volatility of 100%, risk-free interest rate of 3.18% and an expected life of 2 years.

Stock options

In 2002, the Company adopted a stock option plan (the "Option Plan"), as amended, authorizing the granting of stock options to qualified optionees to purchase a total maximum of 10% of the number of outstanding issued common shares of the Company at any time. This is referred to as a "rolling plan". Under the Option Plan, the term of stock options granted may not exceed five years following the date of grant.

The Company applies the fair value method of accounting for stock options, and accordingly the fair value of the stock options for the nine-months period of \$256,520 has been included in administrative expenses. The attributed amount of share purchase options granted during the period was estimated using the Black Scholes pricing model with the following assumptions: life of 5 years for these options, risk-free interest rate of 3.24% and 3.03%, volatility of 97% and 100% and no expected dividends.

X-TERRA RESOURCES CORPORATION

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2008 AND 2007

(unaudited)

8 Capital stock, warrants and options (continued)

The following table summarizes the information relating to the share purchase options as at September 30, 2008.

	Number	Weighted average exercise price \$
Balance as at December 31, 2007	184,900	1.11
Expired	(70,000)	1.86
Exercised	(62,400)	1.08
Granted	<u>770,000</u>	1.58
Balance as at September 30, 2008	<u>822,500</u>	1.49

Expiry Date	Options outstanding	Exercise price \$
June 2012	115,000	1.10
June 2013	437,500	1.90
August 2013	<u>270,000</u>	1.00
	<u>822,500</u>	

9 Contributed surplus

The following table details the changes in the Company's contributed surplus:

	2008 \$
Balance as at December 31, 2007	532,794
Stock-based compensation	256,520
Fair value of options exercised	<u>(52,529)</u>
Balance as at September 30, 2008	<u>736,785</u>

**NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2008 AND 2007**

(unaudited)

10 Related party transactions

The Company is engaged in a lease contract for an office in Rouyn-Noranda with a company controlled by directors and officers of X-Terra Resources Corporation. During the three months period ended September 30, 2008, the Company incurred \$6,000 for this leasing (comparable period of 2007: \$6,000). The Company incurred \$18,000 as management consultant fees from a company controlled by a director of X-Terra (comparable period of 2007: \$0). Also, the Company incurred \$39,000 in administrative services from a company controlled by a director of X-Terra (comparable period of 2007: \$4,475). The Company incurred \$50,000 as consultant fees from a company controlled by two director of X-Terra (comparable period of 2007: \$0).

These transactions are in the normal course of operations and are consistent with industry standards.

11 Commitments

The Company is committed to incurring Canadian exploration expenses of \$320,000 by December 31, 2008, with regard to the transfer of these expenditures to the subscribers of its flow-through share underwriting completed on October 3, 2007. As at September 30, 2008, \$188,340 has been incurred against this commitment.

12 Financial risk factors

The Company's activities are exposed to financial risks: market risk (including currency risk and interest rate risk), credit risk and liquidity risk.

a) Market risks

i) Fair value

The carrying amount of all financial assets and liabilities, as reported on the consolidated balance sheet, approximate their fair value due to the relatively short-term maturities of these instruments.

Fair value estimates are made at the balance sheet date, based on relevant market information and other information about the financial instruments.

ii) Interest rate risk

Interest rate risk is the risk that the fair value of future cash flows of a financial instrument will fluctuate due to changes in market interest rates. All current financial assets and liabilities are not exposed to interest rate risk because of their short-term nature and non-interest bearing.

iii) Currency risk

The Company is not exposed to currency fluctuations as all transactions occur in the functional and reporting currency.

b) Credit risk

Credit risk is the risk that one party to a financial instrument will fail to discharge an obligation and cause the other party to incur a financial loss. Financial instruments that potentially subject the Company to credit risk consist of cash and tax receivable. The Company has reduced its credit risk by investing its cash with a Schedule 1 Canadian chartered bank. Also, as the majority of its receivables are with the governments of Quebec and Canada in the form of sales tax receivables and government's incentives, the credit risk is minimal.

**NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2008 AND 2007**

(unaudited)

c) Liquidity risk

Liquidity risk is the risk that the Company will not be able to meet the obligations associated with its financial liabilities. At the end of September 2008, the Company had enough funds available to meet its financial liabilities and future financial liabilities from its commitments for the current year.

13 Comparative figures

Certain comparative figures have been reclassified to conform to the presentation adopted for the period ended September 30, 2008.

14 Normal Course issuer bid

X-Terra has instituted a normal course issuer bid through the facilities of the TSX Venture Exchange. Under the normal course issuer bid, which is effective from September 15, 2008 to September 14, 2009, X-Terra may repurchase for cancellation a maximum of 612,250 common shares over a twelve-month period, representing approximately 5% of the “public float” of X-Terra’s shares outstanding as at September 3, 2008. Purchases of common shares under the normal course issuer bid will be made at market prices and otherwise in accordance with the policies of the TSX Venture Exchange. X-Terra did not purchase any common shares during the twelve months preceding the normal course issuer bid.

The normal course issuer bid has been instituted in that X-Terra considers that the repurchase of common shares at certain market prices will be beneficial to X-Terra. The normal course issuer bid will be conducted through Desjardins Securities Inc. To the knowledge of X-Terra, no director or senior officer of X-Terra or their associates or affiliates currently intends to sell shares of X-Terra during the course of the normal course issuer bid.

As at September 30, 2008, X-Terra had purchased and cancelled 167,000 common shares pursuant to the normal course issuer bid. As a result, 12,078,069 common shares were issued and outstanding at that date.

Shareholders may, upon request to X-Terra, obtain at no cost a copy of the “Notice of Intention to Make a Normal Course Issuer Bid” filed by X-Terra with the TSX Venture Exchange.

15 Subsequent events

On October 28, 2008, the Company and Brownstone Ventures Inc. have finalized the previously announced acquisition by Brownstone of a 50% interest from the Company in the Québec Shale Licenses (namely, Shawinigan, Rimouski and Rimouski North properties). Pursuant to the assignment agreement Brownstone have issued 2,000,000 common shares and 2,000,000 common share purchase warrants to X-Terra. Each warrant entitles X-Terra to purchase one common share of Brownstone at a price of \$2.00 per share until October 28, 2010. The common shares, warrants and common shares underlying the warrants are subject to a four month hold period expiring on March 1, 2009. Subsequent to the transfer of the 50% interest in the Québec Shale Licenses, X-Terra and Brownstone will entered into an operating agreement pursuant to which Brownstone shall become the operator of an exploration program for the territory covered by the Québec Shale Licences.

In connection with this transaction, X-Terra will issue, subject to regulatory approval, 150,000 units to PowerOne Capital Markets Limited of Toronto, Ontario, as a finder’s fee. Each unit will be comprised of one common share of X-Terra and one common share purchase warrant. Each warrant will entitle PowerOne to purchase an additional common share of X-Terra for a period of two years at a price of \$1.50 per share. Under applicable securities legislation and policies of the TSX Venture Exchange, the common shares and warrants issued in connection with this transaction will be subject to a four months hold period. The Québec Shale Licences cover a total of 159,991 hectares in the Québec Lowlands.

During October 2008, X-Terra had purchased and cancelled 74,500 common shares pursuant to the normal course issuer bid.