

Q3

Financial Statements of

ARSENAL ENERGY INC.

For the nine months ended September 30, 2003 (unaudited)

To the Shareholders,

For the three quarters ended September 30, 2003, Arsenal Energy had oil and natural gas sales of \$697,851.00 with cash flow of 180,302.00 (\$0.03 per share) and net earnings after depletion and depreciation of \$49,302.00 (\$0.01 per share).

Arsenal participated in drilling nine (9) new oil wells (3.375 net) during the third quarter in the Kerrobert Viking Oil Pool in western Saskatchewan. Light oil production commenced from the new wells near the end of the fiscal third quarter. Oil sales from the new wells should be reflected to a greater degree in the fourth quarter.

During the third quarter Arsenal completed agreements to drill two wildcat prospects in the fourth quarter at no charge to the Company. The first prospect will be evaluating potential economic natural gas accumulations in southern Saskatchewan with three exploratory wells. Arsenal will have a net 15% working interest in each of the exploratory wells. Depending on the success of the said wells Arsenal can, with its partners, earn up to 120 sections or square miles of P&NG rights in the targeted area through continuous drilling obligations.

The second prospect will be drilled targeting oil in western Saskatchewan. Arsenal will operate the test well and earn a 25% working interest at no charge to the Company.

We are excited about the potential impact these prospects will have on your Company.

Yours truly,

Michael Vandale
President
Arsenal Energy Inc.

ARSENAL ENERGY INC.

Balance Sheet

	September 30, 2003 (unaudited)	December 31 2002 (audited)
Assets		
Cash and short-term deposits	\$ 6,654	\$ 2,991
Accounts Receivable	86,010	29,925
Prepaid Expense	<u>2,406</u>	<u>0</u>
	95,070	32,916
Capital Assets (Note 3)	1,964,668	998,122
	<u>\$ 2,059,738</u>	<u>\$ 1,031,038</u>
Liabilities and Shareholders Equity		
Current Liabilities		
Accounts Payable	\$ 209,651	\$ 106,109
Bank Loan (Note 4)	<u>700,000</u>	<u>340,000</u>
	909,651	446,109
Shareholder Loans	303,733	0
Future Site Restoration	2,000	1,000
Shareholders equity		
Share Capital (note 5)	995,150	784,027
<u>Retained earnings (deficit)</u>	<u>(150,796)</u>	<u>(200,098)</u>
	844,354	583,929
	<u>\$2,059,738</u>	<u>\$ 1,031,038</u>

See accompanying notes to financial statement.

ARSENAL ENERGY INC.

Statement of Operations

	Nine Months Ended September 30,		Three Months Ended September 30,	
	2003	2002	2003	2002
	(unaudited)		(unaudited)	
Revenue *				
Petroleum and Natural Gas Sales (Note 7)	\$ 650,952	\$ 0	\$ 181,523	\$ 0
Interest income	0	3,428	0	972
Royalty Income	46,899	0	24,424	0
Freehold Royalties	<u>(107,585)</u>	<u>0</u>	<u>(31,767)</u>	<u>0</u>
Revenue (Net of Royalties)	590,266	3,428	174,180	972
Expenses				
Oil and Gas Production (Note 8)	171,426	0	85,940	0
Depreciation and Depletion	131,000	0	38,800	0
General and administrative	<u>238,538</u>	<u>153,492</u>	<u>50,250</u>	<u>71,767</u>
	540,964	153,492	174,990	71,767
Net (loss) earnings	49,302	(150,064)	(810)	(70,795)
Retained earnings (deficit), beginning of period	(200,098)	(49,186)	(149,986)	(128,455)
Retained earnings (deficit), end of period	<u>\$ (150,796)</u>	<u>\$ (199,250)</u>	<u>\$ (150,796)</u>	<u>\$ (199,250)</u>
Earnings per share (note 4)				
Basic	\$.01	\$ 0	\$ 0	\$ 0
Diluted	.01	0	0	0

* The 'Revenue' format has changed from that used on financial statements to June 30, 2003 in order to provide greater detail to shareholders.

See accompanying notes to financial statements

ARSENAL ENERGY INC.

Statement of Cash Flows

	Nine Months Ended September 30, 2003		Three Months Ended September 30, 2003	
	(unaudited)		(unaudited)	
Cash provided by (used in):				
Operations:				
Net (loss) earnings	\$ 49,302	\$(150,064)	\$ (810)	\$ (70,795)
Items not Involving Cash:				
Provision for Site Restoration	1,000	0	0	0
Depreciation and Depletion	130,000	0	37,800	0
Funds from Operations	180,302	(150,064)	36,990	(70,795)
Changes in non-cash working capital	45,051	46,795	207,618	62,284
	225,353	(103,269)	244,608	8,511
Financing:				
Increase in Bank Debt	360,000	0	(10,000)	0
Cash Acquired on Amalgamation	253,262	0	0	0
Amalgamation costs	(42,139)	0	(1,886)	0
Shareholder Loans	303,733	0	303,733	0
Investing:				
Acquisition of Capital Assets	1,096,546	0	534,381	0
Increase (decrease) in cash and short-term deposits	3,663	(103,269)	2,074	8,511
Cash and short-term deposits, beginning of period	\$ 2,991	\$ 406,100	\$ 4,580	\$ 311,342
Cash and short-term deposits, end of period	6,654	302,831	6,654	302,831
Funds from Operations Per Share				
Basic	\$.03	\$ 0	\$.01	\$ 0
Diluted	.03	0	.01	0

ARSENAL ENERGY INC.

Notes to Financial Statement

Nine months ended September 30, 2003 (unaudited)

1. Incorporation and organization of the Company:

Arsenal Capital Inc. (the “Company”) was incorporated under the *Business Corporations Act (Alberta)* on August 3, 2000 and was classified as a Capital Pool Company as defined in policy 2.4 of the Canadian Venture Exchange. In 2002 the “Qualifying Transaction” was completed and the name was changed to Arsenal Energy Inc. On October 18, 2002 Arsenal amalgamated with AC Global Corp. and on May 29, 2003 successfully completed a second amalgamation with Legend Capital Corp.

2. Significant Accounting Policies:

(a) Petroleum and Natural gas properties:

The Company follows the full cost method of accounting for petroleum and natural gas properties whereby all costs of exploring for and developing the properties are capitalized by cost center. Costs include land acquisition, drilling of productive and non-productive wells, geological and geophysical expenses and related overhead.

Capitalized costs, excluding costs related to unproven properties, are depleted using the unit-of-production method based on estimated proven reserves of petroleum and natural gas before royalties as determined by independent petroleum engineers. For purposes of the depletion calculation, natural gas reserves and production are converted to equivalent volumes of crude oil based on relative energy content.

The Company applies a “ceiling test” to capitalized costs to ensure that such costs do not exceed future net revenues from estimated production of proven reserves, using prices and costs in effect at the Company’s year end, and the costs of unproven properties less impairment. Future net reserves are undiscounted and are calculated after deducting general and administrative costs, financing costs, income taxes and site restoration and abandonment costs.

Proceeds from the sale of petroleum and natural gas interests are applied against capitalized costs with no gain or loss recognized unless such a sale would significantly alter the rate of depletion and depreciation.

(b) Interest in joint ventures:

A portion of the Company’s petroleum and natural gas exploration and development activities are conducted jointly with others and, accordingly, the financial statements reflect only the Company’s proportionate interest in such activities.

ARSENAL ENERGY INC.

Notes to Financial Statement, page 2

(c) Future site restoration and abandonment costs:

Site restoration and abandonment costs are provided for over the life of the estimated proven reserves on a unit-of-production basis. Costs are estimated each year by management in consultation with the Company's engineers based on current regulations, costs, technology and industry standards. The period charge is expensed and actual site restoration and abandonment expenditures are charged to the accumulated account as incurred.

(d) Use of estimates:

The amounts recorded for depletion, depreciation and amortization of petroleum and natural gas properties and equipment and the provision for future site restoration and abandonment costs are based on estimates. The ceiling test is based on estimates of proven reserves, production rates, oil and gas prices, future costs and other relevant assumptions. These estimates are subject to measurement uncertainty and the effect on the financial statements of changes in such estimates in future periods could be significant.

(e) Stock based compensation plan:

The company has a stock based compensation plan, described in the notes. No compensation expense is recognized for these plans when stock options are issued to employees. Any consideration paid by employees on exercise of stock options is credited to share capital. The Company does not purchase stock or stock options from employees as part of its stock-based compensation plan.

(f) Financial instruments:

The Company uses derivative financial instruments from time to time to hedge its exposure to fluctuations in oil and natural gas prices. Gains or losses from these activities are reported as adjustments to the related revenue or expense accounts.

(g) Income taxes:

The company follows the asset and liability method of tax allocation accounting. Temporary differences arising from the tax basis of an asset or liability and its carrying amount on the balance sheet are used to calculate future income tax liabilities or assets. Future income tax liabilities or assets are calculated using tax rates anticipated in the periods that the temporary differences are expected to reverse.

3. Capital Assets:

	Cost	Accumulated Depreciation	Net Book Value
Petroleum and Natural Gas Properties and Equipment	\$ 2,082,360	\$ 149,600	\$ 1,932,760
Furniture, Fixtures And Equipment	<u>33,808</u>	<u>1,900</u>	<u>31,908</u>
	\$ 2,116,168	\$ 151,500	\$ 1,964,668

ARSENAL ENERGY INC.

Notes to Financial Statement, page 3

4. Bank Loan:

The Company has a demand operating loan in the amount of \$700,000 bearing interest of bank prime rates plus 0.5% per annum and secured by a \$5,000,000 demand debenture with a first and floating charge on all assets with reductions of \$10,000 per month.

5. Share Capital:

(a) Authorized:

- (i) Unlimited number of common shares;
- (ii) Unlimited number of preferred shares, issuable in series (none issued)

(b) Issued common shares:

	Number of shares	Amount
Balance, December 31, 2002	6,660,000	\$ 784,027
On Amalgamation May 29, 2003:		
Issued to Arsenal Shareholders	4,800,000	802,196
Issued to Legend Shareholders	1,165,836	192,954
Balance September 30, 2003	5,965,836	\$ 995,150

(c) Stock options:

The Company has granted its directors and officers options to acquire 974,432 common shares at an exercise price of \$0.20 per share under a stock option plan. The options will expire five years from December 21, 2000.

6. Related Party Transactions:

During the nine months there were no related party transactions.

7. Oil and Gas Sales:

The operator of the nine new Kerrobert Saskatchewan wells assumed September, 2003 production included the recovery of completion fluid. Only 34% of the oil produced from the nine new wells in September, 2003 was recorded as revenue.

8. Oil and Gas Production Expense:

During the quarter, previously unavailable information received from operators of joint interest properties resulted in a significant adjustment to Oil and Gas Production expense. Approximately \$29,000 of the \$85,940 recorded in the third quarter relates to first and second quarter activity.

9. Income Taxes:

The Company has tax pools available for income tax purposes of approximately \$2,500,000. Approximately \$730,000 of the tax pool is non-capital losses of which \$67,000 will expire in 2008 and \$663,000 will expire in 2009. Any benefit of these tax pools has not been recognized in the financial statements.