

TORRENT ENERGY CORP  
Form 10-Q  
August 14, 2007

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**  
Washington, D.C. 20549

**FORM 10-Q**

(Mark One)

**QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended June 30, 2007

OR

**TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE EXCHANGE ACT**

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 000-19949

**TORRENT ENERGY CORPORATION**

(Exact name of registrant as specified in its charter)

Colorado

(State or other jurisdiction of incorporation or organization)

84-1153522

(I.R.S. Employer Identification No.)

1 SW Columbia Street; Suite 640, Portland, Oregon 97258

(Address of principal executive offices)

503.224.0072

(Issuer's telephone number)

N/A

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

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Large accelerated filer  Accelerated filer  Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).  
Yes  No

State the number of shares outstanding of each of the issuer's classes of common equity, as of the latest practicable date:

**39,828,801 shares of common stock issued and outstanding as of August 10, 2007.**

Transitional Small Business Disclosure Format (Check one): Yes  No

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**PART I FINANCIAL INFORMATION**

**Item 1. Financial Statements**

We have prepared the consolidated financial statements included herein without audit, pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been omitted pursuant to such Securities and Exchange Commission rules and regulations. In our opinion, the accompanying statements contain all adjustments necessary to present fairly the financial position of Torrent Energy Corporation (the Company or Torrent ) as of June 30, 2007, and its results of operations for the three month periods ended June 30, 2007 and 2006 and its cash flows for the three month periods ended June 30, 2007 and 2006. The results for these interim periods are not necessarily indicative of the results for the entire year. The accompanying financial statements should be read in conjunction with the financial statements and the notes thereto filed as a part of our annual report on Form 10-K.

**TORRENT ENERGY CORPORATION**

(formerly Scarab Systems, Inc.)

(An exploration stage enterprise)

**Consolidated Balance Sheets****(UNAUDITED)**

	June 30, 2007	March 31, 2007
<b>ASSETS</b>		
Current Assets		
Cash and cash equivalents	\$ 2,610,106	\$ 5,941,577
Joint venture receivables	328,227	147,928
Inventory	852,760	906,208
Prepaid expenses and deposits	418,058	511,135
<b>Total Current Assets</b>	<b>4,209,151</b>	<b>7,506,848</b>
Oil and gas properties, unproven (Note 4 )	33,520,973	31,234,262
Other assets, net of depreciation of \$59,218 and \$43,762	205,243	215,999
<b>Total Assets</b>	<b>\$ 37,935,367</b>	<b>\$ 38,957,109</b>
<b>LIABILITIES AND STOCKHOLDERS EQUITY (DEFICIT)</b>		
Current Liabilities		
Accounts payable	\$ 1,221,112	\$ 1,379,204
Accounts payable related parties (Note 3)	8,008	8,545
Convertible Series E preferred stock subject to mandatory redemption, 1,600 shares outstanding (March 31, 2007 2,350) (Note 5)	1,600,000	2,350,000
Preferred stock dividends payable	914,159	660,069
Dividend payable on preferred stock subject to mandatory redemption	28,466	-
Current portion of long-term note	37,500	37,500
<b>Total Current Liabilities</b>	<b>3,809,245</b>	<b>4,435,318</b>
<b>Long-term Liabilities</b>		
Long-term note	3,125	9,375
<b>Total Liabilities</b>	<b>3,812,370</b>	<b>4,444,693</b>
<b>Commitments and Contingencies (Note 4)</b>		
<b>STOCKHOLDERS EQUITY (DEFICIT)</b>		
<b>Share Capital</b>		
Convertible Series E preferred stock, \$0.01 par value, 25,000 shares authorized, 21,850 shares issued and outstanding (March 31, 2007 22,650)	218	226
Common stock, \$0.001 par value, 100,000,000 shares authorized, 36,561,953 shares issued and outstanding (March 31, 2007 33,424,941)	36,562	33,425

<b>Additional paid in capital</b>	54,738,544	51,124,541
<b>Deficit accumulated during the exploration stage</b>	(20,652,327)	(16,645,776)
<b>Total stockholders' equity (deficit)</b>	34,122,997	34,512,416
<b>Total liabilities and stockholders' equity (deficit)</b>	\$ 37,935,367	\$ 38,957,109

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

**TORRENT ENERGY CORPORATION**

(formerly Scarab Systems, Inc.)

(An exploration stage enterprise)

**Consolidated Statements of Stockholders Equity (Deficit)  
For the period from October 8, 2001 (inception) to June 30, 2007  
(UNAUDITED)**

	Common Stock		Additional	Share	Deficit	Total
	Shares	Amount	paid- in capital	subscriptions received/ (receivable)	accumulated during exploration stage	Stockholders equity (deficit)
Stock issued for cash at \$0.001 per share in October 2001	5,425,000	\$ 5,425	\$ -	\$ -	\$ -	5,425
Stock issued for intangible asset acquisition at \$0.001 per share in October 2001	200,000	200	-	-	-	200
Issued 1,440,000 common stock at \$0.001 per share in October 2001	1,440,000	1,440	-	(1,440)	-	-
Stock issued at \$0.50 per share in November 2001	675,000	675	336,825	(337,500)	-	-
Stock issued for cash at \$0.50 per share in January 2002	390,000	390	194,610	-	-	195,000
Net(loss)for the period	-	-	-	-	(112,434)	(112,434)
<b>Balance, March 31, 2002</b>	<b>8,130,000</b>	<b>8,130</b>	<b>531,435</b>	<b>(338,940)</b>	<b>(112,434)</b>	<b>88,191</b>
Stock issued for cash at \$0.25 to \$0.50 per share in April 2002	130,000	130	39,870	-	-	40,000
Recapitalization to effect the acquisition of iRV, Inc.	1,446,299	1,446	(1,446))	-	-	-
Acquisition of MarketEdge Direct	-	-	-	337,500	-	337,500
Proceeds of share subscription	-	-	-	1,440	-	1,440
Return of stocks in connection with disposal of MarketEdge Direct	(540,000)	(540)	(358,042))	-	-	(358,582)
Proceeds of 96,000 share subscription at \$0.40 to \$0.50 per share	-	-	-	40,500	-	40,500
241,020 shares allotted for services rendered at \$0.10 to \$0.40 per share	-	-	33,306	-	-	33,306
Net (loss) for the year	-	-	-	-	(396,277)	(396,277)
<b>Balance, March 31, 2003</b>	<b>9,166,299</b>	<b>9,166</b>	<b>245,123</b>	<b>40,500</b>	<b>(508,711)</b>	<b>(213,922)</b>
Stocks issued for services rendered and recorded in fiscal year 2004	241,020	241	(241))	-	-	-

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Stocks issued at \$0.40 to \$0.50 per share	96,000	96	40,404	(40,500)	-	-
Stocks issued for conversion of debt at \$0.10 per share in February 2004	510,000	510	50,490	-	-	51,000
Stocks issued for cash at \$0.10 per share in February and March 2004	1,200,000	1,200	118,800	-	-	120,000
Stocks issued for exercise of stock options at \$0.10 per share in February and March 2004	960,000	960	95,040	-	-	96,000
Issuance of stock options as compensation	-	-	195,740	-	-	195,740
Forgiveness of debt related party	-	-	110,527	-	-	110,527
Net (loss) for the year	-	-	-	-	(374,606)	(374,606)
<b>Balance, March 31, 2004</b>	<b>12,173,319</b>	<b>\$ 12,173</b>	<b>\$ 855,883</b>	<b>\$ -</b>	<b>\$(883,317)</b>	<b>\$(15,261)</b>

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

**TORRENT ENERGY CORPORATION**

(formerly Scarab Systems, Inc.)

(An exploration stage enterprise)

**Consolidated Statements of Stockholders Equity (Deficit)  
For the period from October 8, 2001 (inception) to June 30, 2007  
(UNAUDITED)**

	Series B Preferred Stock		Common Stock		Additional paid-in capital	Deficit accumulated during exploration stage	Total Stockholders equity (deficit)
	Shares	Amount	Shares	Amount			
Stocks issued for exercise of stock options at \$0.10 per share in May, June and July 2004	-	\$ -	640,000	\$ 640	\$ 63,360	\$ -	\$ 64,000
Stocks and warrants issued under a private placement at \$0.35 per share in May 2004	-	-	1,442,930	1,443	503,582	-	505,025
Stocks issued for investor relations services at \$0.54 per share in June 2004			300,000	300	161,700	-	162,000
Stocks issued for acquisition of oil and gas properties at \$0.38 per share in June 2004 and January 2005			1,200,000	1,200	454,800	-	456,000
Stocks and warrants issued under a private placement at \$0.40 per share in July 2004			500,000	500	199,500	-	200,000
Stocks issued under a private placement at \$1.00 per share in 2005, net of share issue costs of \$100,000			2,500,000	2,500	2,397,500	-	2,400,000
Stocks issued for exercise of warrants at \$0.50 and \$0.55 per share			1,614,359	1,614	825,565	-	827,179
Convertible Series B preferred stock issued under a private placement at \$1,000 per Series B share in August 2004, net of issuance costs	2,200	22	-	-	1,934,978	-	1,935,000
Stocks issued for conversion of Series B	(500)	(5)	614,358	615	(610)	-	-



preferred stock at prices ranging from \$0.76 to \$0.89 per share							
Beneficial conversion feature on convertible Series B preferred stock	-	-	-	-	315,245	-	315,245
Accretion of Series B preferred stock beneficial conversion feature	-	-	-	-	-	(210,163)	(210,163)
Series B preferred stock dividend	-	-	-	-	-	(72,672)	(72,672)
Issuance of stock options as compensation	-	-	-	-	701,740	-	701,740
Net (loss) for the year	-	-	-	-	-	(2,418,625)	(2,418,625)
<b>Balance, March 31, 2005</b>	1,700	\$ 17	20,984,966	\$ 20,985	\$ 8,413,243	\$ (3,584,777)	\$ 4,849,468

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**TORRENT ENERGY CORPORATION**

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**Consolidated Statements of Stockholders Equity (Deficit)  
For the period from October 8, 2001 (inception) to June 30, 2007  
(UNAUDITED)**

	Series B		Series C		Common Stock		Additional paid-in capital	Deficit accumulated during exploration stage	Total Stockholders equity (deficit)
	Shares	Amount	Shares	Amount	Shares	Amount			
Stock issued for conversion of Series B preferred stock at prices ranging from \$0.77 to \$1.20 per share	(1,700)	\$ (17)	-	\$ -	1,795,254	\$ 1,795	\$ (1,778)	-	\$ -
Accretion of Series B preferred stock beneficial conversion feature	-	-	-	-	-	-	-	(105,081)	(105,081)
Common stock issued for cashless exercise of stock options	-	-	-	-	89,502	89	(89)		
Cancellation of stock options as compensation	-	-	-	-	-	-	(99,641)		(99,641)
Common stock issued for exercise of warrants ranging from \$0.50 to \$0.55 per share	-	-	-	-	328,571	329	168,956		169,285
Common stock issued at \$2 per share under a	-	-	-	-	1,650,000	1,650	3,273,350		3,275,000

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private placement in July 2005, net of issuance cost									
Series C preferred stock issued under a private placement at \$1,000 per Series C share in July 2005, net of issuance costs	-	-	12,500	125	-	-	11,551,875	-	11,552,000
Beneficial conversion feature on convertible Series C preferred stock	-	-	-	-	-	-	845,763	-	845,763
Accretion of Series C preferred stock beneficial conversion feature	-	-	-	-	-	-	-	(845,763)	(845,763)
Series C stock dividend	-	-	-	-	-	-	-	(308,442)	(308,442)
Common stock issued for conversion of Series C preferred stock ranging from \$1.64 to \$2.27 per share	-	-	(4,125)	(41)	2,083,614	2,084	(2,043)	-	-
Common stock issued for acquisition of oil and gas properties at \$0.38 per share in February 2006	-	-	-	-	600,000	600	227,400	-	228,000
Stock based compensation	-	-	-	-	-	-	2,075,422	-	2,075,422

for the period									
Net (loss) for the period	-	-	-	-	-	-	-	(4,036,286)	(4,036,286)
<b>Balance,</b> March 31, 2006	- \$	- 8,375 \$	84 27,531,907 \$	27,532 \$	26,452,458 \$	(8,880,349)\$			17,599,725

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**TORRENT ENERGY CORPORATION**

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**Consolidated Statements of Stockholders' Equity (Deficit)  
For the period from October 8, 2001 (inception) to June 30, 2007  
(UNAUDITED)**

	Series C		Series E		Common Stock		Additional Paid-In Capital	Deficit accumulated during exploration stage	Total Stockholders' Equity (Deficit)	
	Shares	Amount	Shares	Amount	Shares	Amount				
Beneficial conversion feature on convertible Series C Preferred Stock	-	\$ -	-	\$ -	-	\$ -	-	\$ 710,110	\$ -	710,110
Accretion of Series C beneficial conversion feature	-	-	-	-	-	-	-	(710,110)	(710,110)	
Series C stock dividend	-	-	-	-	-	-	-	(35,270)	(35,270)	
Common Stock Issued for conversion of Series C Preferred stock ranging from \$1.64 to \$2.27 per share	(8,375)	(84)	-	-	5,339,320	5,339	(5,255)	-	-	
Common Stock Issued in lieu of cash dividend on Series C Preferred stock at a price of \$1.50 per share	-	-	-	-	228,714	229	343,483	-	343,712	

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Series E Preferred stock issued under Private Placement at \$1,000 per Series E share net of issuance costs (Note 5)	-	-	25,000	250	-	-	23,114,750	-	23,115,000
Series E Preferred stock reclassified to liability per SFAS No. 150		(2,350)		(24)			(2,349,976)		(2,350,000)
Series E stock dividend	-	-	-	-	-	-	-	(660,069)	(660,069)
Stock based compensation for the period	-	-	-	-	-	-	2,465,796		2,465,796
Common stock issued for Services	-	-	-	-	125,000	125	227,375	-	227,500
Exercise of stock options					200,000	200	165,800		166,000
Net (Loss) for the Period	-	-	-	-	-	-	-	(6,359,978)	(6,359,978)
Balance, March 31, 2007	- \$	-	22,650 \$	226	33,424,941 \$	33,425	\$ 51,124,541	\$ (16,645,776)	\$ 34,512,416

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**TORRENT ENERGY CORPORATION**

(formerly Scarab Systems, Inc.)

(An exploration stage enterprise)

**Consolidated Statements of Stockholders' Equity (Deficit)  
For the period from October 8, 2001 (inception) to June 30, 2007  
(UNAUDITED)**

	Series E Preferred Stock		Common Stock		Additional Paid-In Capital	Deficit accumulated during exploration stage	Total Stockholders' Equity (Deficit)
	Shares	Amount	Shares	Amount			
Common stock issued for settlement of Preferred Stock liability at \$0.50 per share (Note 5)	-	-	3,100,000	\$ 3,100	\$ 4,124,900	\$ -	\$ 4,128,000
Common stock issued in lieu of cash dividends on Series E preferred stock at a price of \$0.50 per share (Note 5)	-	-	37,012	37	49,498	-	49,535
Convertible Series E preferred stock reclassified to liability per SFAS No. 150 (Note 5)	(800)	(8)	-	-	(799,992)	-	(800,000)
Series E preferred stock dividend	-	-	-	-	-	(272,596)	(272,596)
Stock based compensation for the period	-	-	-	-	239,597		239,597
Net (Loss) for the period	-	-	-	-	-	(3,733,955)	(3,733,955)
Balance, June 30, 2007	21,850	\$ 218	36,561,953	\$ 36,562	\$ 54,738,544	\$ (20,652,327)	\$ 34,122,997

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

**TORRENT ENERGY CORPORATION**

(formerly Scarab Systems, Inc.)

(An exploration stage enterprise)

**Consolidated Statements of Operations****(UNAUDITED)**

	<b>Cumulative October 8, 2001 (inception) to June 30, 2007</b>	<b>Three Months Ended June 30, 2007</b>	<b>Three Months Ended June 30, 2006</b>
<b>Expenses</b>			
Payroll expense	\$ 1,422,293	\$ 361,466	\$ 148,462
Consulting (Note 3)	2,492,877	115,675	209,404
Stock-based compensation	5,678,295	239,597	730,251
Investor relations	1,737,353	118,364	217,867
Directors fees	140,000	30,000	7,500
Depreciation and amortization	64,991	15,456	2,648
Insurance	325,679	45,855	16,850
Legal and accounting	1,102,656	62,119	96,622
Lease rental expense	193,713	-	85,903
Office and Miscellaneous	453,831	34,148	23,271
Rent	290,296	35,648	25,825
Shareholder relations	216,794	2,313	4,515
Telephone	143,477	17,695	7,355
Travel	851,194	76,806	92,754
Shrinkage on inventory	52,473	-	-
Purchase investigation costs	103,310	-	-
Interest expense	35,966	28,466	-
Interest expense on long term debt	16,569	-	-
<b>Operating (loss)</b>	<b>(15,321,767)</b>	<b>(1,183,608)</b>	<b>(1,669,227)</b>
<b>Other income (expense)</b>			
Loss on conversion of preferred stock	(2,609,029)	(2,609,029)	-
Interest income	510,561	58,682	12,866
Gain on sale of equipment	261	-	-
Gain on settlement of debt	37,045	-	-
Write-off of goodwill	(70,314)	-	-
<b>Loss from continued operations</b>	<b>(17,453,243)</b>	<b>(3,733,955)</b>	<b>(1,656,361)</b>
<b>Net income from discontinued operations</b>	<b>21,082</b>	<b>-</b>	<b>-</b>
<b>Net loss for the period</b>	<b>(17,432,161)</b>	<b>(3,733,955)</b>	<b>(1,656,361)</b>
<b>Series B preferred stock dividend</b>	<b>(72,672)</b>	<b>-</b>	<b>(35,270)</b>
<b>Series C preferred stock dividend</b>	<b>(343,712)</b>	<b>-</b>	<b>(3,699)</b>
<b>Series E preferred stock dividend (Note 5)</b>	<b>(932,665)</b>	<b>(272,596)</b>	<b>-</b>



<b>Dividend accretion of Series B preferred stock</b>			
<b>beneficial conversion feature</b>	(315,244)	-	-
<b>Dividend accretion of Series C preferred stock</b>			
<b>beneficial conversion feature</b>	(1,555,873)	-	(710,110)
<b>Net loss for the period applicable to common</b>			
<b>stockholders</b>	\$ (20,652,327)	\$ (4,006,551)	\$ (2,405,440)
<b>Basic and diluted (loss) per share</b>	-	\$ (0.11)	\$ (0.08)
<b>Weighted average number of common</b>			
<b>shares outstanding</b>	-	35,046,608	31,169,065

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

**TORRENT ENERGY CORPORATION**  
(formerly Scarab Systems, Inc.)  
(An exploration stage enterprise)  
**Consolidated Statements of Cash Flows**  
**(UNAUDITED)**

	<b>Cumulative October 8, 2001 (inception) to June 30, 2007</b>	<b>Three Months Ended June 30, 2007</b>	<b>Three Months Ended June 30, 2006</b>
<b>Cash flows provided by</b>			
<b>(used in) operating activities</b>			
Net (loss) for the period	\$ (17,432,161)	\$ (3,733,955)	\$ (1,656,361)
Adjustments to reconcile net loss to net cash used in operating activities:			
- depreciation and amortization	64,991	15,456	2,648
- stock-based compensation	5,678,295	239,597	730,251
-Loss on conversion of preferred stock	2,609,029	2,609,029	
- interest expense on Series E Stock subject to mandatory redemption	28,466	28,466	-
- shrinkage on inventory	26,821	-	-
- foreign exchange	1,398	-	-
- write-off of goodwill	70,314	-	-
- debt forgiven	37,045	-	-
-gain on sale of equipment	(261)	-	-
- net income from the discontinued operations	(21,082)	-	-
- common shares issued for service rendered	195,306	-	-
- reversal of option expense charged for services	(99,641)	-	-
Changes in non-cash working capital items:			
Joint venture receivables	(328,227)	(180,299)	25,406
Inventory	(879,581)	53,448	74,786
Prepaid expenses	(251,304)	32,896	70,394
Accounts payable	(2,969,496)	(1,092,153)	(204,211)
<b>Net cash used in operating activities</b>	<b>(13,270,088)</b>	<b>(2,027,515)</b>	<b>(957,087)</b>
<b>Cash flows provided by (used in) investing activities</b>			
Oil and gas properties	(28,511,516)	(1,293,006)	(2,079,585)
Loan	(62,684)	-	-
Proceeds from sale of equipment	7,415	-	-
Acquisition of other assets	(202,388)	(4,700)	(1,844)
<b>Net cash used in investing activities</b>	<b>\$ (28,769,173)</b>	<b>\$ (1,297,706)</b>	<b>\$ (2,081,429)</b>

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**TORRENT ENERGY CORPORATION**

(formerly Scarab Systems, Inc.)

(An exploration stage enterprise)

**Consolidated Statements of Cash Flows (continued)****(UNAUDITED)**

	<b>Cumulative October 8, 2001 (inception) to June 30, 2007</b>	<b>Three Months Ended June 30, 2007</b>	<b>Three Months Ended June 30, 2006</b>
<b>Cash flows provided by (used in)</b>			
<b>financing activities</b>			
Proceeds from issuance of common stock	\$ 7,988,414	\$ -	\$ -
Net proceeds from issuance of Series B preferred stock	1,935,000	-	-
Net proceeds from issuance of Series C preferred stock	11,552,000	-	-
Net proceeds from issuance of Series E Preferred stock	23,115,000	-	8,315,000
Payment of Series B preferred stock dividend	(72,672)	-	-
Proceeds from promissory notes	30,000	-	-
Repayment of promissory notes	(64,375)	(6,250)	-
Proceeds from shareholder loan	80,000	-	-
Repayment of shareholder loan	(80,000)	-	-
Proceeds from exercise of stock options	166,000	-	-
<b>Net cash provided by (used in) financing activities</b>	<b>44,649,367</b>	<b>(6,250)</b>	<b>8,315,000</b>
<b>Increase (decrease) in cash and cash equivalents</b>	<b>2,610,106</b>	<b>(3,331,471)</b>	<b>5,276,484</b>
<b>Cash and cash equivalents, beginning of period</b>	<b>-</b>	<b>5,941,577</b>	<b>2,658,719</b>
<b>Cash and cash equivalents, end of period</b>	<b>\$ 2,610,106</b>	<b>\$ 2,610,106</b>	<b>\$ 7,935,203</b>
<b>Supplemental cash flow information:</b>			
Interest paid	\$ 13,013	\$ -	\$ -
<b>Non-cash transactions:</b>			
Common stock issued pursuant to conversion of promissory note	\$ 55,000	\$ -	\$ -
Common stock issued for investor relations services	\$ 162,000	\$ -	\$ -
Common stock issued for prepaid technical services	\$ 227,500	\$ -	\$ -
Forgiveness of accrued consulting fees payable to directors and officers	\$ 110,527	\$ -	\$ -
Common stock issued for oil and gas properties	\$ 684,000	\$ -	\$ -

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Property acquired through issuance of note	\$	75,000	\$	-	\$	-
Payment of Series B dividends with issuance of common stock	\$	343,712	\$	-	\$	-
Payment of Series C dividends with issuance of common stock	\$	35,270	\$	-	\$	35,270
Payment of Series E dividends with issuance of common stock	\$	49,535	\$	49,535	\$	-
Common stock issued for settlement of Preferred Stock liability	\$	4,128,000	\$	4,128,000	\$	-

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

**TORRENT ENERGY CORPORATION**

**(formerly SCARAB SYSTEMS INC.)**

(An exploration stage enterprise)

Notes to Consolidated Financial Statements

June 30, 2007 and 2006

**(UNAUDITED)**

**Note 1. Incorporation and Continuance of Operations**

Torrent Energy Corporation (the Company or Torrent ) is an exploration stage company engaged in the natural gas exploration and development of oil and gas properties, primarily in Oregon and Washington State. The Company has generated no revenue to date, has incurred ongoing operating losses, and requires additional funds to meet its obligations and to maintain its operations. These circumstances raise substantial doubt about the Company's ability to continue as a going concern. These financial statements do not include any adjustments that might result from an adverse outcome related to this uncertainty.

The accompanying unaudited consolidated financial statements have been prepared assuming that we would continue as a going concern. They have been prepared in accordance with the generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation of the interim periods presented have been included. Operating results for the three month period ended June 30, 2007 are not necessarily indicative of the results that may be expected for the year ending March 31, 2008. This interim unaudited financial information should be read in conjunction with the Company's annual report for the year ended March 31, 2007, as filed on Form 10-K.

**Note 2. Summary of Significant Accounting Policies**

a) Principles of Consolidation

The accompanying consolidated financial statements presented are those of the Company and its wholly-owned subsidiaries, Methane Energy Corp. and Cascadia Energy Corp. All significant intercompany balances and transactions have been eliminated.

b) Principles of Accounting

These consolidated financial statements are stated in U.S. dollars and have been prepared in accordance with the U.S. generally accepted accounting principles.

c) Joint Venture Receivables

The accompanying financial statements as of June 30 and March 31, 2007, include the wholly-owned accounts of the Company and its proportionate share of assets, liabilities and results of operations in the joint venture in which it participates. The Company has maintained a 60 percent majority ownership interest in properties in which joint venture participation exists and acts as the operator for the joint venture. The Company incurs 100 percent of the expenses related to the Joint Venture Partner and bills its Joint Partner for 40 percent of applicable costs.

The Company provides for uncollectible receivables using the allowance method of accounting for bad debts. Under this method of accounting, a provision for uncollectible accounts is charged to earnings. The allowance account is increased or decreased based on past collection history and management's evaluation of the receivables. All amounts

considered uncollectible are charged against the allowance account and recoveries of previously charged off accounts are added to the allowance.

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At June 30 and March 31, 2007, net joint venture receivables were \$328,227 and \$147,928, respectively. At June 30 and March 31, 2007, the Company had established no allowance for bad debt, deeming its receivables as likely to be collected.

## d) Stock Subject To Mandatory Redemption

In May 2003, FASB issued SFAS No. 150. Accounting for Certain Instruments with Characteristics of Both Liabilities and Equity. This statement establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. In applying SFAS No. 150, the Company has determined that a portion of the Series E Convertible Preferred Stock ( Series E Stock ) met the characteristics of a liability and, therefore, has been classified as a current liability on the Company's balance sheet as of June 30 and March 31, 2007. (See Notes 5 and 6).

## e) Accounting Estimates

The preparation of the consolidated financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Management makes its best estimate of the ultimate outcome for these items based on the historical trends and other information available when the financial statements are prepared. Changes in the estimates are recognized in accordance with the accounting rules for the estimate, which is typically in the period when new information becomes available to management. Actual results could differ from those estimates and assumptions. Certain amounts reported in prior years have been reclassified to conform to the disclosures in the current fiscal year.

## f) Loss Per Share

Loss per share is computed using the weighted average number of shares outstanding during the year. Diluted loss per share is equivalent to basic loss per share as the stock options, warrants and convertible preferred stock to acquire common shares as disclosed in the notes are anti-dilutive.

<b>Three Months Ended June 30,</b>	<b>2007</b>	<b>2006</b>
Net Loss	\$ (3,733,955)	\$ (1,656,361)
Less Preferred stock dividends	(272,596)	(38,969)
Less Dividend accretion on preferred stock beneficial conversion	-	(710,110)
Net loss applicable to common stockholders	\$ (4,006,551)	\$ (2,405,440)
Weighted Average Shares Outstanding	35,046,608	31,169,065
Basic and Diluted Earnings per Share	\$ (0.11)	\$ (0.08)

**Note 3. Related Party Transactions**

During the three months ended June 30, 2007, the Company paid or accrued \$208,799 (2006 - \$192,430) in consulting fees and salaries to directors and officers of the Company. In addition, the Company paid officers and directors of the Company \$nil (2006 - \$31,896) in compensation for activities relating to the Company's oil and gas leases, \$nil (2006



- \$10,400) for drilling consultation and \$nil (2006 - \$20,613) for geological and geophysical consulting activities, all of which are included in the costs of the oil and gas properties. As of June 30, 2007, there

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was \$8,008 (2006 - \$8,545) representing unpaid expense reimbursements owing to directors and officers. Also see Note 6.

**Note 4. Oil and Gas Properties, Unproven**

**Coos Bay Basin Property.** On May 11, 2004, Methane Energy Corp. entered into a Lease Purchase and Sale Agreement (the Agreement) with GeoTrends-Hampton International LLC (GHI) to purchase GHI's undivided working interest in certain oil and gas leases in the Coos Bay Basin of Oregon. As consideration for the acquisition of these oil and gas leases, the Company paid a total of \$300,000 in cash and issued 1,800,000 restricted common shares in three performance based tranches. The shares were valued at \$0.38 per share, which was the fair value at the time that the agreement was negotiated. GHI also maintains an undivided overriding royalty interest of 4% upon production in the Coos Bay project area. With the subsequent leasing of additional public and private land positions, as of June 30, 2007, Methane Energy Corp. holds a total of approximately 118,000 acres in the Coos Bay Basin.

Related to its Coos Bay exploration program, Methane Energy Corp. had escrowed \$1,000,000 through an attorney to provide assurance of payment to the Company from which it obtained the drilling rig being used to complete a Pilot Exploration Program in the Coos Bay Basin. The escrow was subsequently reduced by \$749,650 by mutual agreement to satisfy a portion of the amounts then owing. The remaining balance, including interest earned on the escrowed funds, totaled \$284,848 at June 30, 2007. The balance of the deposit remains fully refundable upon payment of all obligations owed to the owner of the drilling rig or, alternatively, may be applied to satisfy all or a portion of sums owed at that time. As of June 30, 2007, amounts owing and attributable to this arrangement totaled \$62,283 and are included in accounts payable.

**Chehalis Basin Property.** On August 9, 2005, Cascadia Energy Corp., the Company's wholly-owned subsidiary, executed a lease option agreement with Weyerhaeuser Company to lease 100,000 acres that it may select from an overall 365,000 acreage in the Chehalis Basin located in Washington State. Cascadia Energy Corp. commenced an exploratory work program in 2006 for possible hydrocarbon deposits on acreage it selected from the acreage block. Cascadia Energy Corp. also has been granted a two-year first right of refusal on the balance of the Weyerhaeuser acreage that it does not select during its initial selection process. Cash consideration of \$100,000 was paid for the lease option of which the Company paid \$60,000 (See Joint Venture below). In addition, Cascadia Energy Corp. was allowed to extend the term of its option for an additional year by committing to a work program of \$285,715, pertaining to the full 100,000 acres with proportional reduction should the Company reduce the number of acres selected for exploration activity during the initial option period. In February 2007, Weyerhaeuser Company extended the initial period for completion of the \$285,715 work commitment to August 2007. In July 2007, the Company negotiated an amendment to the option agreement extending the option for an additional 120 days. Pursuant to this amendment, the Company paid Weyerhaeuser \$100,000, and Weyerhaeuser waived the \$285,715 work commitment.

From October 2006 through June 2007, Cascadia Energy Corp has entered into three additional lease agreements with Weyerhaeuser totaling 36,991 acres, two of which required payment of upfront lease bonuses of \$428,610 and one of which requires annual lease payments of \$1,275. Certain provisions of these agreements require Cascadia Energy Corp. to commence a well within the first two years of the lease, or the lease will terminate and the Company would be required to make a payment of \$75,000 to Weyerhaeuser.

Since January 2006, Cascadia Energy Corp. has also acquired 23,735 acres from the State of Washington Trust, which acreage lies directly adjacent or contiguous to Cascadia Energy Corp. s initial 100,000 acres leased from Weyerhaeuser. This acreage was acquired in lease auctions for aggregate lease consideration of \$37,719, and has been included in the Chehalis Basin project. As of June 30, 2007, Cascadia Energy Corp. controls approximately 176,000 acres in the Chehalis Basin through lease options and oil and gas leases.

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On August 12, 2005, Cascadia Energy Corp. entered into a joint venture agreement ( Joint Venture ) with St. Helens Energy LLC ( St. Helens ), a 100% owned subsidiary of Comet Ridge Limited, an Australian coal seam gas exploration company, which is listed on the Australian Stock Exchange. Pursuant to this agreement, Cascadia Energy Corp. serves as operator of the Joint Venture with a 60% interest in the Joint Venture; while St. Helens is to actively assist in evaluating the area, developing exploratory leads and prospects, and provide 40% of the funding to pursue exploration and development of the prospect. Cascadia Energy Corp. records its investment and related expenses associated with the Chehalis Basin project net of St. Helens contribution. During the period commencing with the inception of the Chehalis Basin project and ending June 30, 2007, the Joint Venture had expended a total of \$2,230,109 of which St. Helens' unpaid share as of June 30, 2007 equaled \$328,227 (March 31, 2007 - \$147,928) and is included in Joint Venture Receivables.

The total costs incurred and currently excluded from amortization for the Company's oil and gas properties are summarized as follows:

	Property acquisition	Seismic and land	Drilling and gathering	Geological and geophysical	Total
<b>Coos Bay Basin</b>					
<b>Property</b>					
Three months ended					
June 30, 2007	\$ -	\$ 53,812	\$ 1,404,240	\$ 84,877	\$ 1,542,929
Inception through					
March 31, 2007	984,000	1,438,310	26,433,735	1,578,911	30,434,956
Total	\$ 984,000	\$ 1,492,122	\$ 27,837,975	\$ 1,663,788	\$ 31,977,885
<b>Chehalis Basin</b>					
<b>Property</b>					
Three months ended					
June 30, 2007	\$ -	\$ 216,097	\$ 487,872	\$ 39,813	\$ 743,782
Inception through					
March 31, 2007	-	579,344	93,899	126,063	799,306
Total	\$ -	\$ 795,441	\$ 581,771	\$ 165,876	\$ 1,543,088
Total Oil and Gas					
Properties	\$ 984,000	\$ 2,287,563	\$ 28,419,746	\$ 1,829,664	\$ 33,520,973

**Note 5. Series E Convertible Preferred Stock ( Series E Stock )**

On June 28, 2006, the Company closed a private placement agreement with YA Global Investments, (formerly known as Cornell Capital Partners, LP), under which it sold 25,000 shares of its Series E Convertible Preferred Stock at \$1,000 per share (the "Series E Stock"). The Series E Stock is senior to the common stock with respect to the payment of dividends and other distributions on the capital stock of the Company, including distribution of the assets of the Company upon liquidation. No cash dividends or distributions shall be declared or paid or set apart for payment on the common stock in any year unless cash dividends or distributions on the Series E Stock for such year are likewise declared and paid or set apart for payment. No declared and unpaid dividends shall bear or accrue interest. Upon any

liquidation, dissolution, or winding up of the Company, whether voluntary or involuntary before any distribution or payment shall be made to any of the holders of common stock or any series of preferred stock, the holders of Series E Stock shall be entitled to receive out of the assets of the Company an amount equal to \$1,000 per share of the Series E Stock plus all declared and unpaid dividends thereon, for each share of Series E Stock held by them.

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The Series E Stock are non-voting, carry a cumulative dividend rate of 5% per year, when and if declared by the Board of Directors of the Company, and are convertible into common stock at any time by dividing the dollar amount being converted (included accrued but unpaid dividends) by \$2.50 per share if the Company's common shares are trading at an average price of \$2.50 per share or higher for the five trading days preceding a conversion date. If the Company's common shares are trading at an average price greater than \$1.67 but less than \$2.50 per share the Company may, at its exclusive option, force conversion at a price of \$1.67 per share or may redeem the Series E Stock for cash at the original investment amount plus a 20% redemption premium.

As a condition of the Series E Stock, the Company filed a registration statement (the Registration Agreement) registering 15,000,000 shares of common stock into which the Series E Stock would be converted. This Registration Statement was declared effective on February 9, 2007. Subsequently, the Series E Stock investor agreed to an initial registration of 10,000,000 shares to facilitate the Company's compliance with a revision of SEC guidelines related to the form of registration. The 5,000,000 additional shares of Series E Stock will be registered on a separate registration statement.

Net proceeds from the Series E Stock received during the fiscal year ended March 31, 2007 was \$23,115,000, after the payment of issuance costs of \$1,885,000.

Beginning December 1, 2006, the Company incurred a conditional mandatory redemption requirement equal to the pro rata amortization of the remaining outstanding Series E Stock over the period that ends August 2008. If the Company's common shares are trading at an average price less than \$1.67 per share on a mandatory redemption date, the Company will pay cash at the original investment amount per share plus a 20% redemption premium. The holder of the Series E Stock may only convert up to a maximum of \$1,250,000 of Series E Stock into common stock in any 30 day period. Each share of Series E Stock will be automatically converted into common stock immediately upon the consummation of the occurrence of a stock acquisition, merger, consolidation, or reorganization of the Company. The Series E Convertible Preferred Stock investor chose to waive the monthly conditional mandatory redemption payments otherwise due on December 1, 2006 through March 31, 2007. Subsequent to March 31, 2007 and continuing through June 30, 2007, the Series E Convertible Preferred Stock investor elected, in lieu of a cash payment, to accept a limited monthly redemption plus accrued dividends, which has been converted into shares of the Company's common stock as detailed below:

<b>Conversion Date</b>	<b>Shares of Series E Stock</b>	<b>Conversion Price</b>	<b>Shares of Common Stock</b>
April 1, 2007 redemption	250	\$ 0.50	500,000
Related dividends		\$ 0.50	3,150
May 1, 2007 redemption	500	\$ 0.50	1,000,000
Related dividends		\$ 0.50	10,410
June 1, 2007 redemption	800	\$ 0.50	1,600,000
Related dividends		\$ 0.50	23,452
<b>Total</b>	<b>1,550</b>		<b>3,137,012</b>

In accordance with SFAS No. 150, Accounting for Certain Instruments with Characteristics of Both Liabilities and Equity, the Company has determined that the limited redemptions due from July 1, 2007 through August 1, 2007 totaling \$1,600,000 have met the characteristics of a liability and, therefore, have been classified as a current liability

in the Company's financial statements as of June 30, 2007. As of March 31, 2007, \$2,350,000 had met the characteristics of a liability and, therefore, was classified as a current liability in the Company's financial statements. Subsequent to June 30, 2007 and through August 1, 2007, the investor has again elected, in lieu of a cash payment, to accept a limited redemption, totaling \$1,600,000 plus accrued and unpaid dividends, which has been converted into 3,266,848 shares of the Company's common stock at a conversion rate of \$0.50 per share. These shares met

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the conditions of being mandatorily redeemable based on the trailing five day stock price proceeding the assessment date. For those shares that met the characteristics of a liability, the Company has reported the dividends earned on this portion of the Series E Stock as interest expense, in accordance with SFAS No. 150. For the three months ended June 30, 2007, the interest expense related to Series E Stock subject to conditional mandatory redemption was \$28,466 (2006 Nil).

The difference between the \$0.50 per common share conversion price and the market price of the common shares on the Series E Stock conversion dates has been recorded as loss on conversion of Series E Stock in the amount of \$2,609,029 for the three months ended June 30, 2007.

See Note 6 for additional discussion regarding this subsequent event related to the conditional mandatory redemption of the Series E Stock.

**Note 6. Subsequent Events**

As described in Note 5 regarding the Company's Series E Convertible Preferred Stock, the Company is obliged to redeem its Series E shares from the investors in ratable monthly increments ending with a final redemption on August 1, 2008. Subsequent to June 30, 2007, the investor has elected, in lieu of a cash payment, to accept temporarily a limited redemption, totaling to date \$1,600,000 or 1,600 shares of the Series E Stock, plus accrued and unpaid dividends which has been converted into 3,266,848 shares of common stock based on a conversion rate of \$0.50 per share. The Company has no assurance that the investor will continue to limit the contractual redemption or to accept payment in shares of common stock for the contractual redemption in the future. With respect to the Series E shares and unpaid dividends converted in July and August of 2007, the difference between the \$0.50 per common share conversion price and the market price of the common shares on the conversion dates was \$1,502,139 and will be reflected as loss on conversion of Series E Stock in the Company's second quarter results.

On January 1, 2005, the Company entered into a management consulting agreement with MGG Consulting, a company owned by Mark Gustafson, a then director of the Company. Pursuant to the agreement as subsequently amended, the Company was committed to a rate of \$1,000 per day for consulting by MGG Consulting. The consulting agreement was terminated by mutual agreement in July 2007, and Mr. Gustafson voluntarily forfeited 400,000 options granted under the 2005 Equity Incentive Plan.



**Item 2. Management's Discussion and Analysis or Plan of Operations.**

**FORWARD LOOKING STATEMENTS**

This quarterly report contains forward-looking statements as that term is defined in the Private Securities Litigation Reform Act of 1995. These statements relate to future events or our future financial performance. In some cases, you can identify forward-looking statements by terminology such as *may*, *should*, *expects*, *plans*, *anticipates*, *believes*, *estimates*, *predicts*, *potential* or *continue* or the negative of these terms or other comparable terminology. These statements are only predictions and involve known and unknown risks, uncertainties and other factors, including the risks in the section entitled *Risk Factors* in Part II- Item 1A of this quarterly report, that may cause our Company or our industry's actual results, levels of activity, performance or achievements to be materially different from any future results, levels of activity, performance or achievements expressed or implied by these forward-looking statements.

Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements. Except as required by applicable law, including the securities laws of the United States, we do not intend to update any of the forward-looking statements to conform these statements to actual results.

Our consolidated financial statements are stated in United States dollars and are prepared in accordance with United States generally accepted accounting principles. The following discussion should be read in conjunction with our consolidated financial statements and the related notes that appear elsewhere in this quarterly report. All references to *CDN\$* refer to Canadian dollars.

As used in this quarterly report, the terms *our Company*, *we*, *us* and *our* mean Torrent Energy Corporation, and wholly owned subsidiaries, Methane Energy Corp. and Cascadia Energy Corp., unless otherwise indicated.

*Company Overview*

We are an exploration stage company engaged in the exploration for coalbed methane in the Coos Bay region of Oregon and in the Chehalis Basin region of Washington State. We were formed by the merger of Scarab Systems, Inc., a Nevada corporation, with iRV, Inc., a Colorado corporation, on July 17, 2002. We were initially involved in the business of providing services to the e-commerce industry. However, we ceased all activities in the e-commerce industry by the end of the fiscal year ended March 31, 2003. After two unsuccessful business acquisition transactions involving MarketEdge Direct and Catalyst Technologies, Inc., we incorporated an Oregon subsidiary company named Methane Energy Corp. on April 30, 2004 in anticipation of acquiring oil and gas properties in the State of Oregon. On May 11, 2004, Methane Energy Corp. entered into a lease purchase and sale agreement with GeoTrends-Hampton International, LLC to purchase GeoTrends-Hampton International's undivided working interest in certain oil and gas leases for the Coos Bay Basin prospect located onshore in the Coos Bay Basin of Oregon. To reflect the change in our business focus, we obtained shareholder approval on July 13, 2004 to change our name from Scarab System, Inc. to Torrent Energy Corporation.

Through one of our wholly owned subsidiaries, Methane Energy Corp., we now hold leases to approximately 118,000 acres of prospective coalbed methane lands in the Coos Bay Basin. Methane Energy Corp. operates the exploration project in the Coos Bay Basin. Through our other wholly-owned subsidiary, Cascadia Energy Corp., we are evaluating approximately 176,000 acres under private and state leases located in the Chehalis Basin.

**Coos Bay Basin Exploration Prospect**

The Coos Bay Basin is located along the Pacific coast in southwest Oregon, approximately 200 miles south of the Columbia River and 80 miles north of the California border. The onshore portion of the Coos Bay Basin is elliptical



in outline, elongated in a north-south direction and covers over 250 square miles. More than 150,000 acres in the Coos Bay Basin is underlain by the Coos Bay coal field and appears prospective for coalbed methane gas production. The current leasehold position owned by Methane Energy Corp. covers most of the lands believed to be prospective for coalbed methane production in the Coos Bay Basin. Additional leasing, title and curative work continues. Most areas in Coos County are accessible year-round via logging and fire control roads maintained by the county or timber companies. In addition, numerous timber recovery staging areas are present and in many cases can be modified for drill-site locations.

The Coos Bay Basin is basically a structural basin formed by folding and faulting and contains a thick section of coal-bearing sediments. Coal-bearing rocks contained within the Coos Bay Basin form the Coos Bay Coal field. Coal mining from the Coos Bay field began in 1854 and continued through the mid 1950 s. Much of the coal was shipped to San Francisco. Since mining activity ended several companies such as Sumitomo, Shell and American Coal Company have done exploratory work and feasibility studies on the Coos Bay Coal Field but no mining operations were conducted. In addition, approximately 20 exploratory oil and/or gas wells have been drilled in the Coos Bay basin over the years from 1914 to 1993. Many of these wells encountered gas shows in the coal seams that were penetrated during drilling.

Coalbeds are contained in both the Lower and Upper Member of the Middle Eocene Coaledo Formation. The coal-bearing sandstones and siltstones of the Middle Eocene Coaledo formation are estimated to form a section up to 6,400 feet thick. Total net coal thickness for the Lower Coaledo Member can range up to 70 feet and over 30 feet for the Upper Coaledo Member. Coos Bay coal rank ranges from subbituminous to high-volatile bituminous, with a heating value of 8,300 to 14,000 British Thermal Units per pound ( BTU/LB. ), a low sulphur content, and a moderate percentage of ash.

On October 6, 2004, a multi-hole coring program was commenced on the Methane Energy Corp. leases. Coring was needed to collect coal samples so that accurate gas content data could be measured. Cores were collected, desorption work was done on the coals and evaluation completed by mid 2005. This data, as well as other geologic information, was provided to Sproule Associates, Inc., an international reservoir engineering firm, for an independent evaluation. To date, natural gas analyses performed on samples from Methane Energy Corp. coal samples and wells indicate that the gas is pipeline quality and that the coals are fully saturated with gas. It is important to note that technically recoverable gas volumes do not necessarily qualify as proved reserves, and we have not recorded any proven reserves at any of our projects at this time.

Drilling and testing programs were then initiated at three pilot sites - Beaver Hill, Radio Hill and Westport. A total of twelve exploratory wells have been drilled. Five exploratory wells were drilled and completed at Beaver Hill; two exploratory wells were drilled at Radio Hill with one completion; and five exploratory wells were drilled at Westport with completions scheduled. Production and flow testing at the pilot well sites as well as continued development work are currently progressing.

#### Natural Gas Market

Until 2005, the port of Coos Bay was one of the largest population centers on the west coast not served by natural gas. A project to bring natural gas into the region via a 52-mile, 12-inch pipeline was approved, funded by Coos County and the State of Oregon, and completed in late 2004 with gas sales beginning in early 2005. While the line is owned by Coos County, the local gas distribution company, Northwest Natural Gas, operates the line. Northwest Natural Gas serves Coos County and most of western Oregon. The pipeline and its associated distribution system represent the most likely market option for delivery of gas, if produced by Methane Energy Corp. in the future. Estimates of local Coos County market requirements are over 10 million cubic feet of gas per day initially, which represents about 10% of ultimate pipeline capacity. Excess capacity is available for additional gas input.

Coos County is also likely to benefit from new industrial, commercial and residential development as natural gas is now available. Expansion of the market is likely to bring greater demand for and value to natural gas. Because of its west coast location, Coos Bay market prices would be subject to pricing standards of the New York Mercantile Exchange for most of the year. Regional gas pricing hubs are located at Malin and Stanfield, Oregon. The closest pricing point, however, would be the Coos Bay City Gate, where Northwest Natural Gas's retail rates are set and

regulated by Oregon's Public Utilities Commission. Seasonal or critical gas demand fluctuations could cause prices to exceed or fall below posted prices on a regular basis.

### Exploration Objectives

The Coos Bay Basin is the southernmost of a series of sedimentary basins that are present in western Oregon and Washington west of the Cascade Range. The region containing this series of basins is generally referred to as the Puget-Willamette Trough. These basins contain thick sequences of predominantly non-marine, coal-bearing sedimentary rock sequences that are correlative in age, closely related in genesis, and very similar in many other characteristics. Methane Energy Corp. is primarily targeting natural gas from coal seams of the Coaledo Formation in the Coos Bay Basin. Secondary objectives are natural gas, and possibly oil, trapped in conventional sandstone reservoirs.

Indications of the hydrocarbon potential in the Puget-Willamette Trough are shown by natural gas production at the Mist Field in northwest Oregon, the presence of excellent quality sand reservoir development at the Jackson Prairie Gas Storage Field in southwest Washington, and numerous oil and/or gas shows from historic oil and gas exploration drilling activity.

### **Chehalis Basin Exploration Prospect**

The Chehalis Basin is located about midway between Portland and Seattle in southwest Washington State, approximately 90 miles north of the Columbia River. The Chehalis Basin lies between the western foothills of the Cascade Range and the eastern border of the Coast Ranges and is a structurally-formed basin that contains and is flanked by a thick section of coal-bearing sediments. The coals are hosted by Lower-Middle-Upper Eocene continental sedimentary rocks. The coal-bearing Eocene sandstone and siltstone section is estimated to be approximately 6,600 feet thick.

The Chehalis Basin is more or less centered within the subbituminous and lignite coal fields of southwestern Washington. Subbituminous and lignite are various types of coal. The Centralia-Chehalis coal district lies to the north and portions of the Morton and Toledo coal fields lie to the east and south, respectively. The Centralia-Chehalis coal district is the largest of the subbituminous and lignite fields of southwestern Washington. At least 13 separate coal seams have been mined or are being mined from the district. Most coal suitable for mining has a subbituminous C rank, contains 14% to 35% moisture, 5% to 25% ash, and has a heating value ranging from 8,300 to 9,500 BTU/LB.

TransAlta currently operates a coal-fired power plant and a gas-fired power plant at their Centralia complex. The coal-fired plant produces 1,404 megawatts, enough electricity to supply a city the size of Seattle. In November 2006, the Centralia coal mine adjacent to the power plant closed due to the high cost of operations. Currently, coal to supply the gas-fired power plant is purchased Wyoming and Montana.

Coals in the Chehalis Basin are relatively thick and continuous. These coals contain a methane gas resource. Limited core and desorption work showed gas content ranging from 6 to 86 standard cubic feet per ton in the coal seams. Two seams, the Blue and the Brown, each attain thicknesses of about 40 feet. Total net coal typically approaches 75 feet and in places, exceeds 100 feet in thickness. More than 250,000 acres in the Chehalis Basin appears prospective for methane production from the coals. In addition, conventional gas potential is present.

During the 1980's Kerr-McGee conducted a shallow coal exploration drilling program along the southwest flank of the Chehalis Basin. They encountered a number of gas shows associated with both coals and sandstones. One of the show wells was offset by Duncan Oil in 2001 and it flow tested 714 thousand cubic feet per day from a sand zone.

Our subsidiary, Cascadia Energy Corp., currently controls, through lease options and oil and gas leases, approximately 176,000 acres in the Chehalis Basin. We are also exploring lease opportunities for additional acres and have identified

specific leasehold ownership positions falling within our Chehalis Basin exploration prospect area. Access to virtually all areas in our Chehalis Basin project area is excellent year-round via logging and fire

control roads maintained by the forest service or the timber industry. Likewise, numerous potential drill-site locations are already constructed as timber recovery staging areas and may be available to be utilized in the initial testing phase of the drilling program. In April 2007, we commenced drilling three stratigraphic/information holes. For the next 12 months ending March 31, 2008, we plan to acquire additional leasehold rights in the Chehalis Basin project area to secure control of prospective acreage adjacent or contiguous to our existing leases.

### Natural Gas Market

Our Chehalis Basin project area is located in close proximity to the Interstate 5 corridor that parallels the route of the principal interstate pipeline providing natural gas to utility, commercial and industrial customers in Washington and Oregon. With anticipated declines in Canadian-sourced natural gas, we believe that robust markets will exist for any gas produced from the Chehalis Basin. Because of its west coast location and ready connection to a major interstate pipeline, Chehalis Basin market prices would be subject to pricing standards of the New York Mercantile Exchange for most of the year. Regional gas pricing hubs are located at Malin and Stanfield, Oregon. However, seasonal or critical gas demand fluctuations could cause prices to exceed or fall below posted prices on a regular basis.

### Exploration Objectives

The Chehalis Basin is located towards the northern end of a series of sedimentary basins that are present in Oregon and Washington west of the Cascade Range. The region containing this series of basins is generally referred to as the Puget-Willamette Trough. These basins contain thick sequences of predominantly non-marine, coal-bearing sedimentary rock sequences that are correlative in age, closely related in genesis, and very similar in many characteristics. Cascadia Energy Corp. is primarily targeting natural gas from coal seams of the Cowlitz Formation in the Chehalis Basin. Secondary objectives are natural gas, and possibly oil, trapped in conventional sandstone reservoirs.

Indications of the hydrocarbon potential in the Puget-Willamette Trough are shown by natural gas production at the Mist Field in northwest Oregon, the presence of excellent quality sand reservoir development at the Jackson Prairie Gas Storage Field in southwest Washington, and numerous oil and/or gas shows from historic oil and gas exploration drilling activity.

## **PLAN OF OPERATIONS AND CASH REQUIREMENTS**

### Land Acquisition

We currently lease approximately 118,000 acres in the Coos Bay Basin of Oregon and 60,720 acres in the Chehalis Basin of Washington with up to an additional 115,280 acres in the Chehalis Basin subject to lease option agreements. Our objective is to achieve a land lease position of approximately 125,000 acres in the Coos Bay Basin and approximately 180,000 acres in the Chehalis Basin by the end of fiscal 2008, although there is no assurance that we can reach these goals.

### Exploration Activities

We are planning to continue an aggressive drilling and exploration program in the Coos Bay Basin. Based on existing data, which provided substantial subsurface information and substantive indications of economic viability, we are planning to continue our current completion program and extend our drilling program during fiscal 2008, with up to ten new wells planned in the Westport area of Coos Bay. Contingent upon successful completion results, we plan to connect any producing wells to the Coos County pipeline.

We also plan to continue our exploratory activities in the Chehalis Basin area with up to five stratigraphic and pilot wells to be drilled in the latter half of 2007 and early 2008. Retrieval, analysis and testing of core samples obtained

from these wells will provide a basis for structuring a plan for a potential resource development program.

We will require additional funds to sustain and expand our oil and gas exploration activities. We anticipate that we will require up to approximately \$18,500,000 to fund our continued operations for the fiscal year ending March 31,



2008. Additional capital will be required to effectively support our operations and to otherwise implement our overall business strategy.

The continuation of our business is dependent on obtaining further financing, positive results from exploratory activities, and achieving a profitable level of business. Currently, we are seeking partners to assist in the development of certain of our properties which would dilute our interest in those properties. We are also seeking additional financing which could dilute our existing shareholders' interests, or we may sell certain interests in our properties outright. Furthermore, if at any stage we determine that it is not expected that our properties can be commercially developed, we may abandon further development work and our interests in the properties.

There are no assurances that we will be able to obtain further funds required for our continued operations. As noted herein, we are pursuing various financing alternatives to meet our immediate and long-term financial requirements. There can be no assurance that additional financing will be available when needed or, if available, that it can be obtained on commercially reasonable terms. If we are not able to obtain the additional financing on a timely basis, we will be unable to conduct our operations as planned, and we will not be able to meet our other obligations as they become due. In such event, we will be forced to scale down or perhaps even cease our operations. Further, there can be no assurance that our exploration will result in any commercial findings of oil and gas.

## **LIQUIDITY AND CAPITAL RESOURCES**

Our Company's principal cash requirements are for exploration expenses which we anticipate will rise as we proceed to determine the feasibility of developing our future property interests.

Our cash on hand was \$2,610,106 as of June 30, 2007, compared to \$5,941,577 at March 31, 2007. Our working capital surplus was \$399,906 as of June 30, 2007 as compared to \$3,071,530 at March 31, 2007.

During the fiscal year ended March 31, 2007, we received net proceeds of \$23,115,000 from the issuance of shares of our Series E preferred stock.

During the three months ended June 30, 2007, we expended cash of \$1,293,006 on our Coos Bay and Chehalis Basin projects compared to \$2,079,585 during the three months ended June 30, 2006. Expenditures on the Coos Bay project for the three months ended June 30, 2007 were \$937,502 (2006 - \$2,052,060) and included \$53,811 (2006 - \$29,262) in seismic and lease costs, \$858,995 (2006 - \$1,829,151) in drilling costs and \$24,695 (2006 - \$193,647) for geological and geophysical consulting fees.

During the three months ended June 30, 2007, cash expenditures for our Chehalis Basin project totaled \$355,504 (2006 - \$27,525) and included \$206,562 (2006 - \$27,525) for seismic and lease costs, \$136,539 (2006 - \$nil) in drilling costs and \$12,403 (2006 - \$nil) for geological and geophysical consulting. The Chehalis Basin expenditures are net of the 40% participation by our joint venture partner.

### **Series E Convertible Preferred Shares**

We are authorized to issue up to 25,000 shares of Series E preferred stock, par value \$0.01. On June 28, 2006, we closed a private placement of Series E Convertible Preferred Stock at \$1,000 per share for 25,000 shares. Our Series E Convertible Preferred Stock is non-voting, carries a cumulative dividend rate of 5% per year, and is convertible into shares of common stock at any time by dividing the dollar amount being converted by \$2.50. The holder of the Series E Convertible Preferred Stock may only convert up to 1,250 Series E Convertible Preferred Stock into common shares in any 30 day period. We may, in our discretion, waive this conversion limitation; and this conversion limitation shall not apply upon the occurrence and continuance of an event of default. We are also required to redeem a certain amount of Series E Convertible Preferred Stock each month starting the month after this registration statement becomes effective or December 1, 2006, whichever is earlier. If the closing trading price of our common stock

exceeds \$2.50 for the five consecutive trading days immediately before a redemption date, then we will not need to make the redemption. We may elect to pay for the redemption of Series E Convertible Preferred Stock by cash or through issuance of our common stock. If we choose to pay for the redemption of Series E Convertible Preferred Stock in cash, we will need to pay the liquidation amount of the Series E Convertible

Preferred Stock to be redeemed plus a 20% redemption premium. If we choose to pay for the redemption of Series E Convertible Preferred Stock through issuance of our common stock, the number of shares of our common stock to be issued is determined by dividing the liquidation amount of the Series E Convertible Preferred Stock to be redeemed by \$1.67. However, if the closing trading price of our common stock as of the redemption date falls below \$1.67, we will not be allowed to pay for the redemption through issuance of our common stock.

As a condition of the private placement, we agreed to file a registration statement registering up to 15,000,000 shares of common stock in order to receive all of the proceeds of the private placement. The Series E Convertible Preferred Stock investor modified this requirement to initially register 10,000,000 shares of common stock. On February 9, 2007, the registration statement was filed and approved by the Securities and Exchange Commission; and we have received all of the proceeds related to the private placement.

The first conditional mandatory redemption payment was due on December 1, 2006 with additional payments due on the first trading day of each subsequent month in an amount sufficient to ratably retire the Series E Convertible Preferred Stock over the period ending August 1, 2008. The Series E Convertible Preferred Stock investor chose to waive the monthly conditional mandatory redemption payments otherwise due on December 1, 2006 through March 31, 2007. Subsequent to March 31, 2007 and through August 1, 2007, the Series E Convertible Preferred Stock investor has elected, in lieu of a cash payment, to accept a conditional mandatory redemption, totaling \$3,150,000 plus accrued and unpaid dividends, which has been converted into 6,403,860 shares of our common stock at a conversion rate of \$0.50 per share. We have no assurance that the Series E convertible preferred stock investor will continue to limit the contractual redemption requirement or to accept payment in shares of our common stock at the \$0.50 per share conversion rate. Please refer to Note 5 and Note 6 to our unaudited consolidated financial statements.

In accordance with the Financial Accounting Standards Board Statement of Financial Accounting Standards (SFAS) No. 150, Accounting for Certain Instruments with Characteristics of Both Liabilities and Equity, we have determined that the conditional mandatory redemption amounts for the months of July and August of 2007, totaling \$1,600,000, have met the characteristics of a liability and, therefore, have been classified as a current liability in our financial statements as of June 30, 2007. Subsequent to March 31, 2007 and prior to the issuance of these financial statements, we and the investor agreed to this limited redemption of 3,150 shares of the Series E Stock as a negotiated settlement to the conditional mandatory redemption provisions that would have required cash redemption payments of \$8,823,529 for 7,353 shares of Series E Stock plus accrued dividends. The difference between the \$0.50 per common share conversion price and the market price of the common shares on the Series E Stock conversion dates has been recorded as loss on conversion of Series E Stock in the amount of \$2,609,029 for the three months ended June 30, 2007. Subsequent to June 30, 2007, additional conditional mandatory redemptions occurred on July 9 and August 1, 2007 resulting in additional loss on conversion of \$1,502,139 which will be recorded in the second quarter results. See Note 6 to our unaudited consolidated financial statements for additional discussion regarding this subsequent event related to the conditional mandatory redemption of the Series E Stock.

#### Additional Financing

We require additional financing in order to complete our stated plan of operations for the next twelve months. There can be no assurance, however, that such financing will be available or, if it is available, that we will be able to structure such financing on terms acceptable to us and that it will be sufficient to fund our cash requirements until we can reach a level of profitable operations and positive cash flows. If we are unable to obtain the financing necessary to support our operations, we may be unable to continue as a going concern. We currently have no firm commitments for any additional capital.

The trading price of our shares of common stock and a downturn in the United States stock and debt markets could make it more difficult to obtain financing through the issuance of equity or debt securities. Even if we are able to raise the funds required, it is possible that we could incur unexpected costs and expenses, fail to collect significant amounts owed to us, or experience unexpected cash requirements that would force us to seek alternative financing. Further, if

we issue additional equity or debt securities, stockholders may experience additional dilution or the new equity securities may have rights, preferences or privileges senior to those of existing holders of our shares of common stock. If additional financing is not available or is not available on acceptable terms, we will have to curtail our operations.

## RESULTS OF OPERATIONS

As we have remained in the early stages of development, we have not yet generated any revenues from our operations.

The results of operations include the results of our Company and its wholly owned subsidiaries, Methane Energy Corp. and Cascadia Energy Corp., for the three-month periods ended June 30, 2007 and 2006. During the three-month periods ended June 30, 2007 and 2006, our Company performed all of the administrative operations while the subsidiaries, Methane Energy Corp. and Cascadia Energy Corp., held the interests in the leases and operated the Coos Bay project and Chehalis Basin project, respectively.

### For the Three Months Ended June 30, 2007 Compared to the Three Months Ended June 30, 2006

Operating expenses. Operating expenses declined during the most current three month period as compared to the same period last year primarily as a result of reduced stock compensation expense. Other less significant operating expense variances during the current three-month period compared to the prior year quarter included employee expenses, consulting, investor relations, lease rentals, directors' fees, accounting and legal, and insurance expense.

Total operating expenses declined \$485,619 for the three months ended June 30, 2007 when compared to same period one year earlier. The largest change occurred in stock-based compensation which declined \$490,654 reflecting both fewer option grants during the current period as well as a decline in the stock-based compensation expense as a result of earlier grants that have now been fully recognized.

Employee payroll expense increased by \$213,004 on a year-over-year basis for the quarter with consulting expense declining by \$93,729 on the same basis. An increase in the number of employees accounted for the increased employee expense. Only clerical personnel have received salary increases since their respective hire dates. Consulting expense declined as more of the functions previously performed by outside consultants have been assumed by full-time employees.

Investor relations expense declined by \$99,503 due to the prior period including increased investor communication efforts related to high levels of convertible preferred stock conversion activity as contrasted with the most current quarter. Lease rental expense declined \$85,903 as a consequence of the absence of recurring lease rentals during the most recent period as compared to the prior year.

Directors' fees increased \$22,500 as a result of three additional independent directors serving during the most recent period as compared to the same period last year.

Legal and accounting expense declined by \$34,503 with reduced financing activity occurring during the most recent quarter, while insurance expense increased by \$29,005 as a result of the growth in our assets and scope of operations.

Our interest income increased by \$45,816 as both our cash balances for the quarter and general interest rates were higher during the most recent period.

We recorded \$2,609,029 of loss on conversion of Series E Stock for the three months ended June 30, 2007, reflecting the difference between the \$0.50 per common share conversion price and the market price of the common shares on the Series E Stock conversion dates.

We recorded \$272,596 in dividend expense related to our Series E Stock during the current quarter as compared to \$38,969 in dividend expense for our Series B and Series C stock during the same period in the preceding year. The prior year's period also reflected \$710,110 in dividend accretion of the Series C Stock beneficial conversion feature with an offsetting amount recorded as additional paid-in capital. In addition we also accrued \$28,466 for dividend interest expense on the conditional mandatory redemption requirements recorded for our Series E Stock (see Notes 5

and 6 to the unaudited consolidated financial statements).

Net Loss for the Period. We recorded a net loss applicable to common stockholders of \$(4,006,551) for the three months ended June 30, 2007, compared with a net loss of \$(2,405,440) for the three months ended June 30, 2006.

### **Item 3. Quantitative and Qualitative Disclosures About Market Risk**

#### *Interest Rate and Credit Rating Risk*

As of June 30, 2007, we had \$2,610,106 in cash, cash equivalents and short term investments, of which \$1,700,482 was held in our operating accounts and \$909,624 was invested in time deposits with 30-day maturities. Based on sensitivity analyses performed on the financial instruments held as of June 30, 2007, an immediate 10% change in interest rates is not expected to have a material effect on our near term financial condition or results.

#### *Commodity Price Risk*

As of June 30, 2007, we have no coalbed methane gas production. At such time as we do record commercial production volumes of coalbed methane gas, we will be subject to commodity price risk related to the sale of such production. Prospectively, commodity prices received for our production will be based on spot prices applicable to natural gas, which are volatile, unpredictable, and beyond our control. Accordingly until such time as we establish measurable production volumes, our vulnerability to fluctuations in the price of natural gas is negligible.

#### *Exchange Rate Sensitivity*

As of June 30, 2007, our suppliers bill us for drilling and other operating costs almost exclusively in U.S. dollars. Accordingly, a 10% change in the U.S./Canadian exchange rate is not expected to have a material effect on our near term financial condition or results.

### **Item 4. Controls and Procedures**

As required under the Securities Exchange Act of 1934, as of the end of the period covered by this quarterly report, being June 30, 2007, we have carried out an evaluation of the effectiveness of the design and operation of our company's disclosure controls and procedures. This evaluation was carried out under the supervision and with the participation of our Company's management, including our Company's president and chief executive officer and our chief financial officer. Based upon that evaluation, our Company's president and chief executive officer and our chief financial officer concluded that our Company's disclosure controls and procedures are effective as at the end of the period covered by this report. There have been no changes in our internal controls over financial reporting that have materially affected, or are reasonably likely to materially affect our internal controls over financial reporting.

Disclosure controls and other procedures are designed to ensure that information required to be disclosed in our reports filed or submitted under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported, within the time period specified in the Securities and Exchange Commission's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed in our reports filed under the Securities Exchange Act of 1934 is accumulated and communicated to management, including our president and chief executive officer and our chief financial officer as appropriate, to allow timely decisions regarding required disclosure.

## PART II OTHER INFORMATION

### Item 1. Legal Proceedings.

We know of no material, active or pending legal proceedings against us, nor are we involved as a plaintiff in any material proceedings or pending litigation. There are no proceedings in which any of our directors, officers or affiliates, or any registered beneficial shareholder are an adverse party or has a material interest adverse to us.

### Item 1A. Risk Factors

Much of the information included in this quarterly report includes or is based upon estimates, projections or other forward-looking statements. Such forward-looking statements include any projections or estimates made by us and our management in connection with our business operations. These include (i) the potential prospective for coalbed methane and conventional natural gas production in the Coos Bay Basin and the Chehalis Basin, (ii) the potential pipeline capacity in the port of Coos Bay area, and (iii) greater market for natural gas in Coos County and the Pacific Northwest region in general. While these forward-looking statements, and any assumptions upon which they are based, are made in good faith and reflect our current judgment regarding the direction of our business, actual results will almost always vary, sometimes materially, from any estimates, predictions, projections, assumptions, or other future performance suggested herein. We undertake no obligation to update forward-looking statements to reflect events or circumstances occurring after the date of such statements.

Such estimates, projections or other forward-looking statements involve various risks and uncertainties as outlined below. We caution readers of this quarterly report that important factors in some cases have affected and, in the future, could materially affect actual results and cause actual results to differ materially from the results expressed in any such estimates, projections or other forward-looking statements. In evaluating us, our business and any investment in our business, readers should carefully consider the following factors.

#### Risks Relating to Our Business:

*Our independent auditors have expressed substantial doubt about our ability to continue as a going concern, which may hinder our ability to obtain future financing.*

In their report dated July 2, 2007, our independent auditors stated that our consolidated financial statements for the fiscal year ended March 31, 2007 were prepared assuming that we would continue as a going concern. Our ability to continue as a going concern is an issue raised as a result of recurring losses from operations and periodic working capital deficiencies. Our ability to continue as a going concern is subject to our ability to obtain necessary funding from outside sources, including obtaining additional funding from the sale of our securities. Our continued net operating losses increase the difficulty in meeting such goals and there can be no assurances that such funding methods will prove successful.

*We have a history of losses that may continue, which may negatively impact our ability to achieve our business objectives.*

We have accumulated a deficit of \$20,652,327 to June 30, 2007 and incurred net losses applicable to common shareholders of \$7,765,427 for the fiscal year ended March 31, 2007; and \$5,295,572 for the fiscal year ended March 31, 2006. We cannot assure you that we can achieve or sustain profitability on a quarterly or annual basis in the future. Our operations are subject to the risks and competition inherent in the establishment of a business enterprise. There is no assurance that future operations will be profitable. We may not achieve our business objectives and the failure to achieve such goals would have an adverse impact on us.



*If we are unable to obtain additional funding, our business operations will be harmed; and if we do obtain additional financing, our then existing shareholders may suffer substantial dilution.*

We will require additional funds to sustain and expand our oil and gas exploration activities. We anticipate that we will require up to approximately \$18,500,000 to fund our continued operations for the fiscal year ending March 31, 2008. Additional capital will be required to effectively support our operations and to implement our business strategy. There can be no assurance that financing will be available in amounts or on terms acceptable to us, if at all. The inability to obtain additional capital will restrict our ability to grow and inhibit our ability to continue to conduct business operations. If we are unable to obtain additional financing, we will likely be required to curtail our exploration plans and possibly cease our operations. Any additional equity financing may result in substantial dilution to our then existing shareholders.

*We have a limited operating history and if we are not successful in continuing to grow our business, then we may have to scale back or even cease our ongoing business operations.*

Our Company has a limited operating history in the business of oil and gas exploration and must be considered to be an exploration stage Company. We have no history of revenues from operations and have no significant tangible assets. We have yet to generate positive earnings and there is no assurance that we will ever operate profitably. Our success is significantly dependent on successful lease acquisition, drilling, completion and production programs. Our operations will be subject to all the risks inherent in the establishment of a developing enterprise and the uncertainties arising from the absence of a significant operating history. We may be unable to locate recoverable reserves or operate on a profitable basis. We are in the exploration stage and potential investors should be aware of the difficulties normally encountered by enterprises in the exploration stage. If our business plan is not successful, and we are not able to operate profitably, investors may lose some or all of their investment in our Company.

*If we are unable to retain the services of Mr. Carlson and other senior executives or if we are unable to successfully recruit qualified managerial and field personnel having experience in oil and gas exploration, we may not be able to continue our operations.*

Our success depends to a significant extent upon the continued service of Mr. John Carlson, our president and chief executive officer, and a director. Loss of the services of Mr. Carlson could have a material adverse effect on our growth, revenues, and prospective business. We do not maintain key-man insurance on the life of Mr. Carlson. In addition, in order to successfully implement and manage our business plan, we will be dependent upon, among other things, successfully recruiting qualified managerial and field personnel who have experience in the oil and gas exploration industry. Competition for qualified individuals is intense. There are no assurances that we will be able to find and attract new employees; or to retain existing employees; or to find, attract and retain qualified personnel on acceptable terms.

*As our properties are in the exploration and development stage, there is no assurance that we will establish commercially exploitable discoveries on our properties.*

Exploration for economic reserves of oil and gas is subject to a number of risk factors. Few properties that are explored are ultimately developed into producing oil and/or gas wells. Our properties are in the exploration stage only and are without proven reserves of oil and gas. We may not establish commercially exploitable discoveries on any of our properties; and we may never have profitable operations.

*We are unsure about the likelihood that we will discover and establish a profitable production of gas from coal seams in the Coos Bay or Chehalis Basin regions.*

Currently, there is no commercial production of coal in the state of Oregon or Washington. Additionally, no coalbed methane gas production exists either in Washington or Oregon. Coalbed methane gas only accounts for a small percentage of all natural gas production in the United States. The closest coalbed methane production to the Coos Bay and Chehalis Basin occurs in the state of Wyoming. As a result, it is unlikely that we will discover any significant amount of coalbed methane in the Coos Bay or Chehalis Basins or be able to establish wells that will produce a

profitable amount of coalbed methane gas.

*Even if we are able to discover commercially exploitable resources on any of the properties on which we hold an interest, we may never achieve profitability or may not receive an adequate return on invested capital because the potential profitability of oil and gas ventures depends upon factors beyond the control of our Company.*

The potential profitability of oil and gas properties is dependent upon many factors beyond our control. For instance, world prices and markets for oil and gas are unpredictable, highly volatile, potentially subject to governmental fixing, pegging, controls or any combination of these and other factors, and respond to changes in domestic, international, political, social and economic environments. Additionally, due to worldwide economic uncertainty, the availability and cost of funds for production and other expenses have become increasingly difficult, if not impossible, to project. In addition, adverse weather conditions can also hinder drilling operations. These changes and events may materially affect our future financial performance. These factors cannot be accurately predicted and the combination of these factors may result in our Company not receiving an adequate return on invested capital.

*Even if we are able to discover and complete a gas well, there can be no assurance the well will become profitable.*

We have not yet established a commercially viable coalbed methane gas resource. Even if we are able to do so, a productive well may become uneconomic in the event water or other deleterious substances are encountered which impair or prevent the production of oil and/or gas from the well. In addition, production from any well may be unmarketable if it is impregnated with water or other deleterious substances. In addition, the marketability of oil and gas which may be acquired or discovered will be affected by numerous factors, including the proximity and capacity of oil and gas pipelines and processing equipment, market fluctuations of prices, taxes, royalties, land tenure, allowable production and environmental protection, all of which could result in greater expenses than revenue generated by the well.

*The oil and gas industry is highly competitive and there is no assurance that we will be successful in acquiring more leases.*

The oil and gas industry is intensely competitive. We compete with numerous individuals and companies, including many major oil and gas companies that have substantially greater technical, financial and operational resources. Accordingly, there is a high degree of competition for desirable oil and gas leases, for suitable properties for drilling operations, for necessary drilling equipment, as well as for access to funds. We cannot predict if the necessary funds can be raised or that any projected work will be completed. Our budget anticipates our acquiring additional leases for acreage in both the Coos Bay and Chehalis Basins. This acreage may not become available or, if it is available for leasing, we may not be successful in acquiring clear title to the leases. If we do not acquire the leases, we will not be able to completely fulfill our current business plan. Failure to carry out our business plan may reduce the likelihood of achieving profitable operations and may discourage investors from investing in our Company. If these things happen, we may not be able to raise additional funds when we need them and we may have to cease operations.

*The marketability of natural resources will be affected by numerous factors beyond our control that may result in us not receiving an adequate return on invested capital to be profitable or viable.*

The marketability of natural resources that may be acquired or discovered by us will be affected by numerous factors beyond our control. These factors include market fluctuations in oil and gas pricing and demand, the proximity and capacity of natural resource markets and processing equipment, governmental regulations, land lease tenure, land use, regulation concerning the importing and exporting of oil and gas, and environmental protection regulations. The exact effect of these factors cannot be accurately predicted, but the combination of these factors may result in us not receiving an adequate return on invested capital to be profitable or viable.

*Oil and gas operations are subject to comprehensive regulations that may cause substantial delays or require capital outlays in excess of those anticipated causing an adverse effect on our Company.*

Oil and gas operations are subject to federal, state, and local laws relating to the protection of the environment, including laws regulating removal of natural resources from the ground and the discharge of materials into the

environment. Oil and gas operations are also subject to federal, state, and local laws and regulations that seek to maintain health and safety standards by regulating the design and use of drilling methods and equipment. Various permits from government bodies are required for drilling operations to be conducted; no assurance can be given that such permits will be granted. Environmental standards imposed by federal, state, or local authorities may be changed, and any such changes may have material adverse effects on our activities. Moreover, compliance with such laws may cause substantial delays or require capital outlays in excess of those anticipated, thus causing an adverse effect on our business operations. Additionally, we may be subject to liabilities for pollution or other environmental damages. We believe that our operations comply, in all material respects, with all applicable environmental and health and safety regulations. To date, we have not been required to spend any material amounts on compliance with environmental and health and safety regulations. However, we may be required to do so in the future and this may affect our ability to expand or maintain our operations. Our operating partners maintain insurance coverage customary to the industry; however, we are not fully insured against all possible environmental and health and safety risks.

*Oil and gas exploration and production activities are subject to certain environmental regulations that may prevent or delay the commencement or continuation of our operations.*

In general, our oil and gas exploration and production activities are subject to certain federal, state and local laws and regulations relating to environmental quality and pollution control. Such laws and regulations increase the costs of these activities and may prevent or delay the commencement or continuation of a given operation. Compliance with these laws and regulations has not had a material effect on our operations or financial condition to date. Specifically, we are subject to legislation regarding emissions into the environment, water discharges and storage and disposition of hazardous wastes. In addition, legislation has been enacted which requires well and facility sites to be abandoned and reclaimed to the satisfaction of state authorities. However, such laws and regulations are frequently changed and we are unable to predict the ultimate cost of compliance. Generally, environmental requirements do not appear to affect us any differently or to any greater or lesser extent than other companies in the industry. We believe that our operations comply, in all material respects, with all applicable environmental regulations. Our operating partners maintain insurance coverage customary to the industry; however, we are not fully insured against all possible environmental risks.

*Exploratory drilling involves many risks and we may become liable for pollution or other liabilities that may have an adverse effect on our financial position.*

Drilling operations generally involve a high degree of risk. Hazards such as unusual or unexpected geological formations, power outages, labor disruptions, blow-outs, sour gas leakage, fire, inability to obtain suitable or adequate machinery, equipment or labor, and other risks are involved. We may become subject to liability for pollution or hazards against which we cannot adequately insure or against which we may elect not to insure. Incurring any such liability may have a material adverse effect on our financial position and operations.

*There are a large number of shares issuable upon conversion or redemption of our Series E Convertible Preferred Stock and the sale of these shares may depress the market price of our common stock.*

As of August 10, 2007, we had 39,828,801 shares of common stock issued and outstanding and 21,850 shares of Series E Convertible Preferred Stock outstanding. In addition, we may be obligated to issue between 10,000,000 to approximately 50,000,000 shares of our common stock upon conversion or redemption of the outstanding Series E Convertible Preferred Stock. Ten million shares of our common stock, including all of the shares issuable upon conversion or redemption of the Series E Convertible Preferred Stock may be sold pursuant to a registration statement that became effective on February 9, 2007. Additional shares associated with conversion or redemption of the Series E Convertible Stock may also become available for sale. The sale of these shares may adversely affect the market price of our common stock.

*The issuance of shares upon conversion or redemption of the Series E Convertible Preferred Stock may cause immediate and substantial dilution to our existing stockholders.*

The issuance of shares upon conversion or redemption of the Series E Convertible Preferred Stock may result in substantial dilution to the interests of other stockholders since we may choose to pay for our redemption of the

Series E Convertible Preferred Stock through issuance of our common stock and the selling stockholders may also choose to convert and sell the full amount issuable on conversion. The upper limit of the number of shares of our common stock that may be issued from conversion or redemption of Series E Convertible Preferred Stock in the event of default is approximately 50,000,000 shares, which will have the effect of further diluting the proportionate equity interest and voting power of holders of our common stock.

*Redemption of shares for cash under the terms of the Series E Convertible Preferred Stock may cause us to scale back or cease our operations if we are unable to obtain substitute funding under acceptable terms.*

Enforcement of the conditional mandatory redemption requirement under the terms of the Series E Convertible Stock would result in a monthly cash outflow of more than \$1 million and could have a material adverse effect on our financial position and operations. Subsequent to March 31, 2007 and through August 1, 2007, the Series E Convertible Preferred Stock investor, YA Global Investments ((formerly known as Cornell Capital Partners, LP), has elected, in lieu of cash payments, to accept a limited redemption of \$3,150,000 of Series E Preferred Stock plus accrued dividends, which has been converted into 6,403,860 shares of our common stock at a conversion price of \$0.50 per share. However, there is no assurance that the Series E Convertible Preferred Stock investor will continue to waive the contractual redemption requirement.

### **Risks Relating to Our Shares of Common Stock:**

*If we fail to remain current in our reporting requirements, we could be removed from the OTC Bulletin Board which would limit the ability of broker-dealers to sell our securities and the ability of stockholders to sell their securities in the secondary market.*

Companies trading on the OTC Bulletin Board, such as us, must be reporting issuers under Section 12 of the Securities Exchange Act of 1934, as amended, and must be current in their reports under Section 13, in order to maintain price quotation privileges on the OTC Bulletin Board. If we fail to remain current on our reporting requirements, we could be removed from the OTC Bulletin Board. As a result, the market liquidity for our securities could be severely adversely affected by limiting the ability of broker-dealers to sell our securities and the ability of stockholders to sell their securities in the secondary market.

*Our shares of common stock is subject to the penny stock rules of the Securities and Exchange Commission and the trading market in our securities is limited, which makes transactions in our shares of common stock cumbersome and may reduce the value of an investment in our shares of common stock.*

The Securities and Exchange Commission has adopted Rule 15c-9 which establishes the definition of a penny stock, for the purposes relevant to us, as any equity security that has a market price of less than \$5.00 per share or with an exercise price of less than \$5.00 per share, subject to certain exceptions. For any transaction involving a penny stock, unless exempt, the rules require:

- that a broker or dealer approve a person's account for transactions in penny stocks; and
- the broker or dealer receives from the investor a written agreement to the transaction, setting forth the identity and quantity of the penny stock to be purchased.

In order to approve a person's account for transactions in penny stocks, the broker or dealer must:

- obtain financial information and investment experience objectives of the person; and
- make a reasonable determination that the transactions in penny stocks are suitable for that person and the person has sufficient knowledge and experience in financial matters to be capable of evaluating the risks of transactions in penny stocks.



The broker or dealer must also deliver, prior to any transaction in a penny stock, a disclosure schedule prescribed by the Securities and Exchange Commission relating to the penny stock market, which, in highlight form:

- sets forth the basis on which the broker or dealer made the suitability determination; and
- that the broker or dealer received a signed, written agreement from the investor prior to the transaction.

Generally, brokers may be less willing to execute transactions in securities subject to the penny stock rules. This may make it more difficult for investors to dispose of our shares of common stock and cause a decline in the market value of our shares of common stock.

Disclosure also has to be made about the risks of investing in penny stocks in both public offerings and in secondary trading and about the commissions payable to both the broker-dealer and the registered representative, current quotations for the securities and the rights and remedies available to an investor in cases of fraud in penny stock transactions. Finally, monthly statements have to be sent disclosing recent price information for the penny stock held in the account and information on the limited market in penny stocks.

*National Association of Securities Dealers Inc. sales practice requirements may also limit a stockholder's ability to buy and sell our shares of common stock.*

In addition to the penny stock rules described above, the National Association of Securities Dealers Inc. has adopted rules that require that in recommending an investment to a customer, a broker-dealer must have reasonable grounds for believing that the investment is suitable for that customer. Prior to recommending speculative low priced securities to their non-institutional customers, broker-dealers must make reasonable efforts to obtain information about the customer's financial status, tax status, investment objectives and other information. Under interpretations of these rules, the National Association of Securities Dealers Inc. believes that there is a high probability that speculative low priced securities will not be suitable for at least some customers. The National Association of Securities Dealers Inc. requirements make it more difficult for broker-dealers to recommend that their customers buy our shares of common stock, which may limit your ability to buy and sell our shares of common stock and have an adverse effect on the market for its shares.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.**

We have not engaged in any unregistered sales of our equity securities in the fiscal quarter ended June 30, 2007, which previously have not been disclosed in our current report on Form 8-K.

**Item 3. Default upon Senior Securities.**

There has not been any material arrearage in the payment of dividends or any other material delinquency not cured within 30 days, with respect to any class of our preferred stock which ranks prior to our common stock.

**Item 4. Submission of Matters to a Vote of Security Holders.**

None.

**Item 5. Other Information.**

None.

**Item 6. Exhibits.**

The following exhibits, required by Item 601 of Regulation S-K, are being filed as part of this quarterly report, or are incorporated by reference where indicated:

Exhibit Number and Exhibit Title

**(3) Articles of Incorporation and Bylaws**

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- 3.1 Restated Articles of Incorporation (incorporated by reference from our Annual Report on Form 10-KSB/A filed on February 11, 2004).
- 3.2 Articles of Amendment to the Restated Articles of Incorporation, changing the name to Torrent Energy Corporation (incorporated by reference from our Registration Statement on Form SB-2 filed on March 30, 2005).
- 3.3 Articles of Amendment to the Restated Articles of Incorporation, creating Series B convertible preferred stock (incorporated by reference from our Current Report on Form 8-K filed on September 1, 2004).
- 3.4 Bylaws of our Company (incorporated by reference from our Annual Report on Form 10-KSB/A filed on February 11, 2004).
- 3.5 Articles of Amendment dated July 13, 2005 creating Series C convertible preferred stock (incorporated by reference from our Current Report on Form 8-K filed on July 20, 2005).
- 3.6 Articles of Amendment dated June 16, 2006 creating Series D convertible preferred stock (incorporated by reference from our Current Report on Form 8-K filed on June 30, 2006).
- 3.7 Articles of Amendment dated June 28, 2006 creating Series E convertible preferred stock (incorporated by reference from our Current Report on Form 8-K filed on June 30, 2006).

#### **(4) Instruments Defining the Rights of Security Holders, including Indentures**

- 4.1 Scarab Systems, Inc. 2004 Non-Qualified Stock Option Plan (incorporated by reference from our Registration Statement on Form S-8 filed on February 19, 2004).
- 4.2 Amended 2005 Equity Incentive Plan, effective March 17, 2005 (incorporated by reference from our Registration Statement on Form S-8 filed on August 31, 2005).
- 4.3 Form of Stock Option Agreement for Amended 2005 Equity Incentive Plan (incorporated by reference from our Registration Statement on Form S-8 filed on August 31, 2005).

#### **(10) Material Contracts**

- 10.1 Lease Purchase and Sale Agreement between our Company, Methane Energy Corp. and Geo-Trends- Hampton International, LLC dated May 11, 2004 (incorporated by reference from our Current Report on Form 8-K filed on May 20, 2004).
- 10.2 Amending Agreement to Lease Purchase and Sale Agreement dated May 19, 2004 (incorporated by reference from our Current Report on Form 8-K filed on June 23, 2004).
- 10.3 Second Amending Agreement to Lease Purchase and Sale Agreement dated June 11, 2004 (incorporated by reference from our Current Report on Form 8-K filed on June 23, 2004).
- 10.4 Investment Rights Agreement dated August 27, 2004 between our Company and Cornell Capital Partners, L.P. (incorporated by reference from our Current Report on Form 8-K filed on September 1, 2004).
- 10.5 Registration Rights Agreement dated August 27, 2004 between our Company and Cornell Capital Partners, L.P. (incorporated by reference from our Current Report on Form 8-K filed on September 1, 2004).
- 10.6 Consulting Agreement dated January 1, 2005 between our Company and MGG Consulting (incorporated by reference from our Registration Statement on Form SB-2 filed on March 30, 2005).
- 10.7 Securities Purchase Agreement dated February 11, 2005 between our Company and Placer Creek Investors (Bermuda) L.P. (incorporated by reference from our Registration Statement on Form SB-2 filed on March 30, 2005).
- 10.8 Securities Purchase Agreement dated February 11, 2005 between our Company and Placer Creek Partners, L.P. (incorporated by reference from our Registration Statement on Form SB-2 filed on March 30, 2005).
- 10.9 Securities Purchase Agreement dated July 11, 2005 between our Company and Placer Creek Partners, L.P. (incorporated by reference from our Current Report on Form 8-K filed on July 20, 2005).
- 10.10 Securities Purchase Agreement dated July 11, 2005 between our Company and Placer Creek Investors (Bermuda) L.P. (incorporated by reference from our Current Report on Form 8-K filed on July 20, 2005).
- 10.11

Securities Purchase Agreement dated July 11, 2005 between our Company and SDS Capital Group SPC, Ltd. (incorporated by reference from our Current Report on Form 8-K filed on July 20, 2005).

10.12 Investment Agreement dated July 12, 2005 between our Company and Cornell Capital Partners, L.P. (incorporated by reference from our Current Report on Form 8-K filed on July 20, 2005).

10.13 Investor Registration Rights Agreement dated July 12, 2005 between our Company and Cornell Capital Partners, L.P. (incorporated by reference from our Current Report on Form 8-K filed on July 20, 2005).

10.14 Lease Option Agreement dated August 9, 2005 between Torrent's wholly-owned subsidiary, Cascadia Energy Corp. and Weyerhaeuser Company (incorporated by reference from our Current Report on Form 8-K filed on August 18, 2005).

10.15 Joint Venture Agreement dated August 12, 2005 between Torrent's wholly-owned subsidiary, Cascadia Energy Corp. and St. Helens Energy, LLC (incorporated by reference from our Current Report on Form 8-K filed on August 18, 2005).

10.16 Option to Acquire Oil & Gas Lease with Pope Resources LP dated May 9, 2006 (incorporated by reference from our Current Report on Form 8-K filed on May 19, 2006).

10.17 Investment Agreement dated June 28, 2006 between our Company and Cornell Capital Partners, L.P. (incorporated by reference from our Current Report on Form 8-K filed on June 30, 2006).

10.18 Registration Rights Agreement dated June 28, 2006 between our Company and Cornell Capital Partners, L.P. (incorporated by reference from our Current Report on Form 8-K filed on June 30, 2006).

**(11) Statements regarding computation of per share earnings (See Note 2 to the unaudited consolidated financial statements).**

**(16) Letter on change in certifying accountant**

16.1 Letter from Moore Stephens Ellis Foster Ltd. dated August 25, 2005 regarding change in independent accountant (incorporated by reference from our Current Report on Form 8-K/A filed on September 13, 2005).

16.2 Letters from Ernst & Young LLP dated March 30, 2006 and April 26, 2006 regarding change in independent accountant (incorporated by reference from our Current Reports on Forms 8-K/A filed on April 7, 2006 and April 27, 2006).

**(21) Subsidiaries**

Methane Energy Corp., an Oregon company

Cascadia Energy Corp., a Washington company

**(31) Section 302 Certifications**

31.1\* Section 302 Certification (filed herewith).

31.2\* Section 302 Certification (filed herewith).

**(32) Section 906 Certifications**

32.1\* Section 906 Certification (filed herewith).

32.2\* Section 906 Certification (filed herewith).

\*Filed herewith

**SIGNATURES**

In accordance with the requirements of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

**TORRENT ENERGY CORPORATION**

By: /s/ John D. Carlson

John D. Carlson

President, Chief Executive Officer and Director

(Principal Executive Officer)

By: /s/ Michael D. Fowler

Michael D. Fowler

Chief Financial Officer, Treasurer and Secretary

(Principal Financial Officer and Principal Accounting Officer)

**Date: August 14, 2007**