



PETRO-CANADA

CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 2008

CONSOLIDATED STATEMENT OF EARNINGS (unaudited)

For the periods ended September 30

(millions of Canadian dollars, except per share amounts)

	Three months ended September 30,		Nine months ended September 30,	
	2008	2007	2008	2007
Revenue				
Operating	\$ 8,068	\$ 5,549	\$ 22,451	\$ 15,945
Investment and other income (expense) (Notes 4 and 6)	218	(52)	67	(129)
	8,286	5,497	22,518	15,816
Expenses				
Crude oil and product purchases	4,518	2,562	11,256	7,392
Operating, marketing and general	741	919	2,676	2,732
Exploration	143	65	471	307
Depreciation, depletion and amortization	513	498	1,508	1,455
Unrealized (gain) loss on translation of foreign currency denominated long-term debt	119	(93)	189	(234)
Interest	61	39	156	122
	6,095	3,990	16,256	11,774
Earnings before income taxes	2,191	1,507	6,262	4,042
Provision for income taxes				
Current	808	607	2,465	1,704
Future (Note 5)	132	124	(28)	127
	940	731	2,437	1,831
Net earnings	\$ 1,251	\$ 776	\$ 3,825	\$ 2,211
Earnings per share (Note 7)				
Basic	\$ 2.58	\$ 1.59	\$ 7.90	\$ 4.50
Diluted	\$ 2.56	\$ 1.58	\$ 7.84	\$ 4.45

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME (unaudited)

For the periods ended September 30

(millions of Canadian dollars)

	Three months ended September 30,		Nine months ended September 30,	
	2008	2007	2008	2007
Net earnings	\$ 1,251	\$ 776	\$ 3,825	\$ 2,211
Other comprehensive income, net of tax				
Change in foreign currency translation adjustment	(196)	(60)	(38)	(256)
Comprehensive income	\$ 1,055	\$ 716	\$ 3,787	\$ 1,955

See accompanying Notes to Consolidated Financial Statements

CONSOLIDATED STATEMENT OF CASH FLOWS *(unaudited)***For the periods ended September 30***(millions of Canadian dollars)*

	Three months ended September 30,		Nine months ended September 30,	
	2008	2007	2008	2007
Operating activities				
Net earnings	\$ 1,251	\$ 776	\$ 3,825	\$ 2,211
Items not affecting cash flow from operating activities:				
Depreciation, depletion and amortization	513	498	1,508	1,455
Future income taxes <i>(Note 5)</i>	132	124	(28)	127
Accretion of asset retirement obligations	20	16	57	50
Unrealized (gain) loss on translation of foreign currency denominated long-term debt	119	(93)	189	(234)
(Gain) loss on sale of assets <i>(Notes 4 and 6)</i>	(121)	(8)	9	(78)
Unrealized (gain) loss related to Buzzard derivative contracts	-	(107)	-	21
Other	102	3	69	10
Exploration expenses	100	20	318	183
(Increase) decrease in non-cash working capital related to operating activities <i>(Note 8)</i>	(837)	111	(754)	196
Cash flow from operating activities	1,279	1,340	5,193	3,941
Investing activities				
Expenditures on property, plant and equipment and exploration	(1,439)	(919)	(4,596)	(2,403)
Proceeds from sale of assets <i>(Note 6)</i>	188	83	233	177
Increase in other assets	-	(73)	-	(105)
(Increase) decrease in non-cash working capital related to investing activities	(252)	32	689	(119)
Cash flow used in investing activities	(1,503)	(877)	(3,674)	(2,450)
Financing activities				
Decrease in short-term notes payable <i>(Note 9)</i>	-	-	(109)	-
Proceeds from issue of long-term debt <i>(Note 9)</i>	-	-	1,482	-
Repayment of long-term debt <i>(Note 9)</i>	-	(3)	(996)	(6)
Proceeds from issue of common shares <i>(Note 10)</i>	1	9	17	33
Purchase of common shares <i>(Note 10)</i>	-	(220)	-	(735)
Dividends on common shares <i>(Note 13)</i>	(97)	(63)	(223)	(192)
Cash flow from (used in) financing activities	(96)	(277)	171	(900)
Increase (decrease) in cash and cash equivalents	(320)	186	1,690	591
Cash and cash equivalents at beginning of period	2,241	904	231	499
Cash and cash equivalents at end of period	\$ 1,921	\$ 1,090	\$ 1,921	\$ 1,090

See accompanying Notes to Consolidated Financial Statements

CONSOLIDATED BALANCE SHEET *(unaudited)***As at September 30, 2008***(millions of Canadian dollars)*

	September 30, 2008	December 31, 2007
Assets		
Current assets		
Cash and cash equivalents	\$ 1,921	\$ 231
Accounts receivable	3,804	1,973
Income taxes receivable	-	280
Inventories <i>(Note 3)</i>	2,105	668
Future income taxes	44	26
	7,874	3,178
Property, plant and equipment, net <i>(Notes 5 and 6)</i>	22,056	19,497
Goodwill	747	731
Other assets	402	446
	\$ 31,079	\$ 23,852
Liabilities and shareholders' equity		
Current liabilities		
Accounts payable and accrued liabilities	\$ 4,177	\$ 3,512
Income taxes payable	1,275	-
Short-term notes payable <i>(Note 9)</i>	-	109
Current portion of long-term debt <i>(Note 9)</i>	2	2
	5,454	3,623
Long-term debt <i>(Note 9)</i>	4,096	3,339
Other liabilities	896	717
Asset retirement obligations	1,357	1,234
Future income taxes <i>(Notes 3 and 5)</i>	3,269	3,069
Shareholders' equity		
Common shares <i>(Note 10)</i>	1,384	1,365
Contributed surplus <i>(Note 10)</i>	22	24
Retained earnings	14,850	10,692
Accumulated other comprehensive income		
Foreign currency translation adjustment	(249)	(211)
	16,007	11,870
	\$ 31,079	\$ 23,852

CONSOLIDATED STATEMENT OF RETAINED EARNINGS *(unaudited)***For the periods ended September 30***(millions of Canadian dollars)*

	Three months ended September 30,		Nine months ended September 30,	
	2008	2007	2008	2007
Retained earnings at beginning of period	\$ 13,696	\$ 9,826	\$ 10,692	\$ 8,565
Cumulative effect of adopting new accounting standards <i>(Note 3)</i>	-	-	556	-
Net earnings	1,251	776	3,825	2,211
Dividends on common shares <i>(Note 13)</i>	(97)	(63)	(223)	(192)
Excess cost for normal course issuer bid <i>(Note 10)</i>	-	(209)	-	(254)
Retained earnings at end of period	\$ 14,850	\$ 10,330	\$ 14,850	\$ 10,330

See accompanying Notes to Consolidated Financial Statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited)

(millions of Canadian dollars)

1. SEGMENTED INFORMATION

Three months ended September 30,

	Upstream																	
	North American Natural Gas		Oil Sands		International & Offshore						Downstream		Shared Services		Eliminations ⁴		Consolidated	
					East Coast Canada		International											
	2008	2007	2008	2007	2008	2007	2008	2007	2008	2007	2008	2007	2008	2007	2008	2007		
Revenue																		
Sales to customers	\$ 508	\$ 308	\$ 748	\$ 145	\$ 681	\$ 671	\$ 1,352	\$ 1,079	\$ 4,779	\$ 3,346	\$ -	\$ -	\$ -	\$ -	\$ 8,068	\$ 5,549		
Investment and other income (expense) ¹	14	1	-	(3)	9	(5)	136	(34)	50	(3)	9	(8)	-	-	218	(52)		
Inter-segment sales	120	70	445	316	302	114	-	-	4	5	-	-	(871)	(505)	-	-		
Segmented revenue	642	379	1,193	458	992	780	1,488	1,045	4,833	3,348	9	(8)	(871)	(505)	8,286	5,497		
Expenses																		
Crude oil and product purchases ²	126	62	644	112	239	158	-	-	3,511	2,229	-	-	(2)	1	4,518	2,562		
Inter-segment transactions	2	2	13	1	3	2	-	-	851	500	-	-	(869)	(505)	-	-		
Operating, marketing and general	134	124	203	149	68	68	99	144	443	390	(206)	44	-	-	741	919		
Exploration	20	25	3	1	-	5	120	34	-	-	-	-	-	-	143	65		
Depreciation, depletion and amortization	124	108	32	33	102	105	174	180	81	72	-	-	-	-	513	498		
Unrealized (gain) loss on translation of foreign currency denominated long-term debt	-	-	-	-	-	-	-	-	-	-	119	(93)	-	-	119	(93)		
Interest	-	-	-	-	-	-	-	-	-	-	61	39	-	-	61	39		
	406	321	895	296	412	338	393	358	4,886	3,191	(26)	(10)	(871)	(504)	6,095	3,990		
Earnings (loss) before income taxes	236	58	298	162	580	442	1,095	687	(53)	157	35	2	-	(1)	2,191	1,507		
Provision for income taxes																		
Current	33	55	49	5	185	163	645	379	(76)	40	(28)	(35)	-	-	808	607		
Future	38	(52)	40	47	(2)	(14)	(33)	108	50	12	62	23	(23)	-	132	124		
	71	3	89	52	183	149	612	487	(26)	52	34	(12)	(23)	-	940	731		
Net earnings (loss)	\$ 165	\$ 55	\$ 209	\$ 110	\$ 397	\$ 293	\$ 483	\$ 200	\$ (27)	\$ 105	\$ 1	\$ 14	\$ 23	\$ (1)	\$ 1,251	\$ 776		
Expenditures on property, plant and equipment and exploration³	\$ 199	\$ 176	\$ 286	\$ 101	\$ 112	\$ 40	\$ 283	\$ 209	\$ 552	\$ 388	\$ 7	\$ 5	\$ -	\$ -	\$ 1,439	\$ 919		
Cash flow from (used in) operating activities	\$ 269	\$ 155	\$ 77	\$ 176	\$ 348	\$ 403	\$ 543	\$ 455	\$ (89)	\$ 215	\$ 131	\$ (64)	\$ -	\$ -	\$ 1,279	\$ 1,340		
Total assets	\$ 4,197	\$ 3,986	\$ 4,693	\$ 3,121	\$ 2,193	\$ 2,333	\$ 7,641	\$ 5,661	\$ 11,315	\$ 7,668	\$ 1,090	\$ 871	\$ (50)	\$ (8)	\$ 31,079	\$ 23,632		

1 Investment and other income (expense) for the International segment includes unrealized gains related to the Buzzard derivative contracts of \$nil for the three months ended September 30, 2008 (\$107 million for the three months ended September 30, 2007) (Note 4).

2 Downstream crude oil and product purchases account for substantially all of the Downstream inventories recognized as an expense during the period.

3 Consolidated expenditures include capitalized interest in the amount of \$17 million for the three months ended September 30, 2008 (\$8 million for the three months ended September 30, 2007).

4 Eliminations relate to sales between segments recorded at transfer prices based on current market prices, and to unrealized inter-segment profits and losses on inventories. Prior period figures have been reclassified to conform to the current period's presentation.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited)

(millions of Canadian dollars)

1. SEGMENTED INFORMATION
Nine months ended September 30,

	Upstream														Consolidated	
	North American				International & Offshore				Downstream		Shared Services		Eliminations ⁴			
	Natural Gas		Oil Sands		East Coast Canada		International		2008	2007	2008	2007	2008	2007		
	2008	2007	2008	2007	2008	2007	2008	2007	2008	2007	2008	2007	2008	2007	2008	2007
Revenue																
Sales to customers	\$ 1,519	\$ 1,016	\$ 1,682	\$ 458	\$ 2,183	\$ 2,052	\$ 4,041	\$ 2,654	\$13,026	\$ 9,765	\$ -	\$ -	\$ -	\$ -	\$22,451	\$15,945
Investment and other income (expense) ¹	(129)	66	(1)	(3)	7	(11)	133	(163)	18	(7)	39	(11)	-	-	67	(129)
Inter-segment sales	346	238	1,123	759	614	352	-	-	12	12	-	-	(2,095)	(1,361)	-	-
Segmented revenue	1,736	1,320	2,804	1,214	2,804	2,393	4,174	2,491	13,056	9,770	39	(11)	(2,095)	(1,361)	22,518	15,816
Expenses																
Crude oil and product purchases ²	357	165	1,403	366	649	545	-	-	8,892	6,308	-	-	(45)	8	11,256	7,392
Inter-segment transactions	5	6	27	11	7	6	-	-	2,054	1,338	-	-	(2,093)	(1,361)	-	-
Operating, marketing and general	394	368	577	436	180	186	341	421	1,257	1,100	(73)	221	-	-	2,676	2,732
Exploration	91	122	8	25	-	14	372	146	-	-	-	-	-	-	471	307
Depreciation, depletion and amortization	396	325	85	112	284	319	509	478	233	213	1	8	-	-	1,508	1,455
Unrealized (gain) loss on translation of foreign currency denominated long-term debt	-	-	-	-	-	-	-	-	-	-	189	(234)	-	-	189	(234)
Interest	-	-	-	-	-	-	-	-	-	-	156	122	-	-	156	122
	1,243	986	2,100	950	1,120	1,070	1,222	1,045	12,436	8,959	273	117	(2,138)	(1,353)	16,256	11,774
Earnings (loss) before income taxes	493	334	704	264	1,684	1,323	2,952	1,446	620	811	(234)	(128)	43	(8)	6,262	4,042
Provision for income taxes																
Current	93	157	119	(5)	547	488	1,805	1,005	14	157	(113)	(95)	-	(3)	2,465	1,704
Future (Note 5)	61	(71)	87	82	(20)	(48)	(344)	37	149	106	62	21	(23)	-	(28)	127
	154	86	206	77	527	440	1,461	1,042	163	263	(51)	(74)	(23)	(3)	2,437	1,831
Net earnings (loss)	\$ 339	\$ 248	\$ 498	\$ 187	\$ 1,157	\$ 883	\$ 1,491	\$ 404	\$ 457	\$ 548	\$ (183)	\$ (54)	\$ 66	\$ (5)	\$ 3,825	\$ 2,211
Expenditures on property, plant and equipment and exploration³	\$ 457	\$ 497	\$ 689	\$ 297	\$ 194	\$ 126	\$ 1,803	\$ 538	\$ 1,433	\$ 928	\$ 20	\$ 17	\$ -	\$ -	\$ 4,596	\$ 2,403
Cash flow from (used in) operating activities	\$ 847	\$ 561	\$ 405	\$ 405	\$ 1,503	\$ 1,230	\$ 2,080	\$ 1,088	\$ (64)	\$ 749	\$ 422	\$ (92)	\$ -	\$ -	\$ 5,193	\$ 3,941
Total assets	\$ 4,197	\$ 3,986	\$ 4,693	\$ 3,121	\$ 2,193	\$ 2,333	\$ 7,641	\$ 5,661	\$11,315	\$ 7,668	\$ 1,090	\$ 871	\$ (50)	\$ (8)	\$31,079	\$23,632

1 Investment and other income (expense) for the International segment includes unrealized losses related to the Buzzard derivative contracts of \$nil for the nine months ended September 30, 2008 (\$21 million for the nine months ended September 30, 2007) (Note 4).

2 Downstream crude oil and product purchases account for substantially all of the Downstream inventories recognized as an expense during the period.

3 Consolidated expenditures include capitalized interest in the amount of \$45 million for the nine months ended September 30, 2008 (\$21 million for the nine months ended September 30, 2007).

4 Eliminations relate to sales between segments recorded at transfer prices based on current market prices, and to unrealized inter-segment profits and losses on inventories. Prior period figures have been reclassified to conform to the current period's presentation.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited)

(millions of Canadian dollars, unless otherwise stated)

2. BASIS OF PRESENTATION

The note disclosure requirements for annual financial statements provide additional disclosure to that required for interim financial statements. Accordingly, these interim Consolidated Financial Statements should be read in conjunction with the December 31, 2007 audited Consolidated Financial Statements. The interim Consolidated Financial Statements are presented in accordance with Canadian generally accepted accounting principles (GAAP) and follow the accounting policies summarized in the notes to the annual Consolidated Financial Statements, except for changes as described in Note 3.

3. CHANGES IN ACCOUNTING POLICIES

In 2006, Canada's Accounting Standards Board ratified a strategic plan that will result in Canadian GAAP, as currently used by the Company, being converged with International Financial Reporting Standards (IFRS) over a transitional period, with a changeover date for the fiscal year beginning on January 1, 2011. The Company has completed the scoping phase of its IFRS changeover plan, including a detailed timeline for assessing resources and training and analyzing key differences. The Company is in the process of assessing the impact on accounting policies, data systems, internal controls over financial reporting, and business activities.

The Company adopted Canadian Institute of Chartered Accountants (CICA) Handbook Section 1535, *Capital Disclosures*; Section 3031, *Inventories*; Section 3862, *Financial Instruments – Disclosures*; and Section 3863, *Financial Instruments – Presentation* on January 1, 2008.

As a result of adopting CICA Section 1535, *Capital Disclosures*, the Company now discloses details about its capital management (Note 13).

As a result of adopting CICA Section 3031, *Inventories*, the Company now assigns costs to its crude oil and refined petroleum products inventories on a "first-in, first-out" (FIFO) basis. Previously, costs were assigned to these inventories on a "last-in, first-out" (LIFO) basis. In accordance with the transitional provisions of this new accounting standard, the Company has elected to adjust 2008 opening retained earnings by the difference in the measurement of 2008 opening inventory and not restate prior period amounts. As such, the following balance sheet categories were impacted on January 1, 2008:

	Increase
Inventories	\$ 812
Future income taxes liability	256
Retained earnings	556

As a result of adopting CICA Section 3862, *Financial Instruments – Disclosures*, the Company has expanded its financial risks and financial instruments disclosures (Note 14).

There is no other material impact on the Consolidated Financial Statements from adoption of these new standards.

4. INVESTMENT AND OTHER INCOME (EXPENSE)

Investment and other income (expense) consists of the following amounts:

	Three months ended		Nine months ended	
	September 30,		September 30,	
	2008	2007	2008	2007
Foreign exchange gains (losses)	\$ 26	\$ (33)	\$ 46	\$ (59)
Gain (loss) on Downstream derivative contracts	51	(6)	7	(19)
Net losses related to Buzzard derivative contracts ¹	-	(24)	-	(152)
Gain (loss) on sale of assets (Note 6)	121	8	(9)	78
Other	20	3	23	23
Total investment and other income (expense)	\$ 218	\$ (52)	\$ 67	\$ (129)

¹ Net losses related to Buzzard derivative contracts include unrealized gains (losses) of 107 million and \$(21) million for the three and nine months ended September 30, 2007, respectively and realized gains (losses) of \$(131) million for both the three and nine months ended September 30, 2007.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited)

(millions of Canadian dollars, unless otherwise stated)

5. LIBYA EXPLORATION AND PRODUCTION SHARING AGREEMENTS

On June 19, 2008, the Company signed six new Exploration and Production Sharing Agreements (EPSAs) with the Libya National Oil Corporation (NOC) to convert its existing concession agreements and old EPSA into new EPSA IV agreements. The new EPSAs were ratified as of the signing with an effective date of January 1, 2008. The new EPSAs will have an expected duration of 30 years and will enable the Company to implement jointly with the NOC the redevelopment of major fields and conduct a 100% operated exploration program in the Libyan Sirte Basin.

The Company agreed to pay a signature bonus of \$1 billion US in several installments with the first installment of \$500 million US paid on July 17, 2008 and the remaining installments to be paid through 2013. This cost was discounted to \$951 million based on this payout schedule using the Company's estimated cost of debt at the time of acquisition.

Net earnings for the nine months ended September 30, 2008 include a \$230 million future income tax recovery, which the Company recognized on ratification of the new EPSAs on June 19, 2008.

6. SALE OF ASSETS

In August 2008, the Company completed the sale of its pre-development assets in Denmark, which are part of the Company's International business segment, for net proceeds of \$140 million, resulting in a gain on sale of \$107 million (\$82 million after-tax).

In June 2008, the Company completed the sale of its Minehead assets in Western Canada, which are part of the Company's North American Natural Gas business segment, resulting in a loss on sale of \$153 million (\$112 million after-tax).

The gains and losses on the sales of these assets are included in investment and other income (expense) in the Consolidated Statement of Earnings.

7. EARNINGS PER SHARE

The following table provides the number of common shares used in calculating earnings per share amounts:

<i>(millions)</i>	Three months ended September 30,		Nine months ended September 30,	
	2008	2007	2008	2007
Weighted-average number of common shares outstanding – basic	484.4	487.6	484.0	491.6
Effect of dilutive stock options	3.5	5.0	4.0	5.1
Weighted-average number of common shares outstanding – diluted	487.9	492.6	488.0	496.7

8. SECURITIZATION PROGRAM

On June 24, 2004, the Company entered into a securitization program, expiring on June 24, 2009, to sell an undivided interest of eligible accounts receivable to a third party on a revolving and fully serviced basis. From June 24, 2004 until June 30, 2008, the Company sold outstanding receivables under the program (\$480 million outstanding receivables sold at June 30, 2008). During the three months ended September 30, 2008, the Company suspended all sales of receivables to the program and remitted all funds for receivables previously sold. At September 30, 2008, there were no outstanding receivables sold under the program.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited)
(millions of Canadian dollars, unless otherwise stated)

9. LONG-TERM DEBT

	Maturity	September 30, 2008	December 31, 2007
Debtures and notes			
6.80% unsecured senior notes (\$900 million US)	2038	\$ 942	\$ -
5.95% unsecured senior notes (\$600 million US)	2035	620	577
5.35% unsecured senior notes (\$300 million US)	2033	271	248
7.00% unsecured debentures (\$250 million US)	2028	255	237
7.875% unsecured debentures (\$275 million US)	2026	287	267
9.25% unsecured debentures (\$300 million US)	2021	315	294
6.05% unsecured debentures (\$600 million US)	2018	630	-
5.00% unsecured senior notes (\$400 million US)	2014	420	391
4.00% unsecured senior notes (\$300 million US)	2013	300	275
Syndicated credit facilities	2013	-	995
Capital leases	2008-2022	58	57
		4,098	3,341
Current portion		(2)	(2)
		\$ 4,096	\$ 3,339

On March 31, 2008, the Company filed a final shelf prospectus for the offering of up to \$4 billion US of debt securities with the securities commission or equivalent regulatory authority in each of the provinces and territories of Canada. On April 1, 2008, the same was filed with the United States Securities and Exchange Commission. In May 2008, the Company completed a public offering of debt securities under this prospectus in the form of \$600 million US 6.05% 10-year unsecured senior notes due May 15, 2018 and \$900 million US 6.80% 30-year unsecured senior notes due May 15, 2038. The net proceeds of this offering were used to repay the Company's short-term notes payable and indebtedness outstanding under its syndicated credit facilities. The balance was added to the Company's working capital to fund future capital expenditures.

At September 30, 2008, the Company had in place revolving, committed syndicated credit facilities totalling \$3,570 million (December 31, 2007 – \$2,200 million) which mature in 2013 and revolving bilateral demand credit facilities of \$842 million (December 31, 2007 – \$1,500 million). As of September 30, 2008, the Company had repaid all amounts previously drawn on its syndicated and demand credit facilities. A total of \$293 million of the credit facilities was used for letters of credit and overdraft coverage.

10. SHAREHOLDERS' EQUITY

Changes in common shares and contributed surplus were as follows:

	Shares	Amount	Contributed Surplus
Balance at December 31, 2007	483,459,119	\$ 1,365	\$ 24
Issued under employee stock option and share purchase plans	980,748	19	(2)
Repurchased under normal course issuer bid	-	-	-
Balance at September 30, 2008	484,439,867	1,384	22

The Company has a normal course issuer bid (NCIB) program for the repurchase of its outstanding common shares. This program was renewed in June 2008 to repurchase up to 24 million outstanding common shares during the period from June 22, 2008 to June 21, 2009, subject to certain conditions. During the three and nine months ended September 30, 2008, the Company did not repurchase any common shares. For the three and nine months ended September 30, 2007, the Company repurchased 3,998,000 common shares at a cost of \$220 million and 13,998,000 common shares at a cost of \$735 million. The excess of the purchase price over the carrying amount of the shares repurchased was recorded as a \$nil and \$442 million reduction of contributed surplus and a \$209 million and \$254 million reduction of retained earnings for the three and nine months ended September 30, 2007, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited)

(millions of Canadian dollars, unless otherwise stated)

11. STOCK-BASED COMPENSATION

The total stock-based compensation expense (recovery) recorded was \$(233) million and \$(141) million for the three and nine months ended September 30, 2008, respectively, (\$24 million and \$163 million for the three and nine months ended September 30, 2007, respectively).

(a) Stock Options and Performance Share Units (PSUs)

Changes in the number of outstanding stock options and PSUs were as follows:

	Stock Options		PSUs
	Number	Weighted-Average Exercise Price	Number
Balance at December 31, 2007	21,035,064	\$ 34	1,166,044
Granted	3,486,200	47	249,575
Exercised for common shares	(980,748)	18	n/a
Surrendered for cash payment	(891,604)	35	n/a
Cancelled/Expired	(230,510)	47	(590,398)
Balance at September 30, 2008	22,418,402	\$ 37	825,221

(b) Stock Appreciation Rights (SARs)

Changes in the number of outstanding SARs were as follows:

	SARs	
	Number	Weighted-Average Exercise Price
Balance at December 31, 2007	3,659,450	\$ 44
Granted	4,061,330	47
Exercised	(139,680)	44
Cancelled	(276,152)	47
Balance at September 30, 2008	7,304,948	\$ 46

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited)

(millions of Canadian dollars, unless otherwise stated)

12. EMPLOYEE FUTURE BENEFITS

The Company maintains pension plans with defined benefit and defined contribution provisions and provides certain health care and life insurance benefits to its qualifying retirees. The expenses associated with these plans are as follows:

	Three months ended		Nine months ended	
	September 30,		September 30,	
	2008	2007	2008	2007
Pension Plans:				
Defined benefit plans				
Employer current service cost	\$ 11	\$ 10	\$ 32	\$ 30
Interest cost	23	22	70	66
Expected return on plan assets	(28)	(27)	(83)	(83)
Amortization of transitional asset	(1)	(1)	(4)	(4)
Amortization of net actuarial losses	12	11	36	33
	17	15	51	42
Defined contribution plans	6	5	17	14
	\$ 23	\$ 20	\$ 68	\$ 56
Other post-retirement plans:				
Employer current service cost	\$ 1	\$ 1	\$ 4	\$ 4
Interest cost	3	3	10	9
Amortization of transitional obligation	1	1	2	2
Amortization of net actuarial losses	1	1	2	2
	\$ 6	\$ 6	\$ 18	\$ 17

The Company expects to contribute \$60 million to its pension plans in 2008.

13. CAPITAL MANAGEMENT

The Company's capital management strategy is designed to maintain financial strength and flexibility to support profitable growth in all business environments. The Company's capital consists of debt, which is comprised of long-term debt and short-term notes payable, and shareholders' equity. The Company measures financial strength and flexibility using two key measures: debt-to-cash flow from operating activities, the key short-term measure, and debt-to-debt plus equity, the key long-term measure. These are calculated as follows:

	September 30, 2008	December 31, 2007
Long-term debt	\$ 4,096	\$ 3,339
Add: Current portion of long-term debt	2	2
Total long-term debt	4,098	3,341
Add: Short-term notes payable	-	109
Debt (A)	\$ 4,098	\$ 3,450
Shareholders' equity	16,007	11,870
Debt plus equity (B)	\$ 20,105	\$ 15,320
Cash flow from operating activities (C)¹	\$ 4,591	\$ 3,339
Debt-to-cash flow from operating activities (A/C) (times)	0.9	1.0
Debt-to-debt plus equity (A/B) (%)	20.4	22.5

¹ Cash flow from operating activities is on a 12-month rolling basis.

At September 30, 2008, the debt-to-cash flow from operating activities ratio was within the Company's target range of no more than 2.0 times. Debt-to-debt plus equity was below the target range of 25% to 35%, providing the financial flexibility to fund the Company's capital program and profitable growth opportunities. The Company may exceed target ranges for short periods of time, but always with the goal to return back within the target ranges.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited)

(millions of Canadian dollars, unless otherwise stated)

13. CAPITAL MANAGEMENT, continued

Financial covenants associated with the Company's various bank and debt arrangements are reviewed regularly and controls are in place to maintain compliance with these covenants. The Company complied with all covenants for the three and nine months ended September 30, 2008.

The Company's priority uses of cash are to fund the capital program and profitable growth opportunities, and then to return cash to shareholders through dividends and a share buyback program.

The Company regularly reviews its dividend strategy to ensure the alignment of the dividend policy with shareholder expectations, and financial and growth objectives. Consistent with this objective, on July 23, 2008 the Company declared a 54% increase in its quarterly dividend to \$0.20 per share commencing with the dividend paid on October 1, 2008. In June 2008 the Company renewed its NCIB program for the repurchase of its common shares from June 22, 2008 to June 21, 2009 entitling the Company to purchase up to 5% of its outstanding common shares, subject to certain conditions (Note 10). Due to an increasing capital program share buybacks are expected to be lower in this and future years compared with 2006 and 2007.

The Company's capital management strategy has not changed from the prior period.

14. FINANCIAL RISKS AND FINANCIAL INSTRUMENTS**Financial Risks**

The Company is exposed to a number of financial risks in the normal course of its business operations, including market risks resulting from fluctuations in commodity prices, interest rates and foreign currency exchange rates, as well as credit risks and liquidity risks. The nature of the financial risks and the Company's strategy for managing these risks has not changed significantly from the prior period.

(a) Market Risks

The Company monitors its exposure to market fluctuations and may use derivative contracts to manage these risks as it considers appropriate. The Company does not use derivative contracts for speculative purposes.

Commodity Price Risk

The Company is exposed to commodity price risk as fluctuations in crude oil or natural gas prices could have a materially adverse effect on its financial condition, as well as on the value and amount of the Company's reserves. Prices for crude oil and natural gas fluctuate in response to changes in supply and demand, market uncertainty and a variety of other factors beyond the Company's control.

The margins realized for the Company's refined products are also affected by factors such as crude oil price fluctuations due to the impact on refinery feedstock costs, third-party refined product purchases and the demand for refined petroleum products. The Company's ability to maintain product margins in an environment of higher feedstock costs depends on its ability to pass higher costs on to customers. The Company enters into derivative contracts to reduce exposure in its Downstream operations to these margin fluctuations, including margins on fixed-price product sales, and short-term price fluctuations on the purchase of foreign and domestic crude oil and refined petroleum products. The Company's exposure to these margin fluctuations is limited. As such, the fair value of the outstanding derivative contracts is not material.

Interest Rate Risk

The Company is exposed to interest rate risk as changes in market interest rates affect the fair values of fixed-interest rate liabilities and the cash flows of both floating-interest rate liabilities and future borrowings. Notes, debentures and capital leases all bear interest at fixed rates. Drawings on the syndicated and demand credit facilities bear interest at floating rates. The Company regularly reviews the mix of floating and fixed-rate debt for consistency with its financing objectives.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited)

(millions of Canadian dollars, unless otherwise stated)

14. FINANCIAL RISKS AND FINANCIAL INSTRUMENTS, continued**Foreign Currency Exchange Risk**

The Company's functional currency is Canadian dollars while crude oil, one of the Company's primary products, is priced by reference to U.S. dollar benchmark prices. Therefore, Cdn/U.S. dollar exchange rate fluctuations can have a significant impact on the Company's revenues, crude oil and product purchases, capital expenditures, long-term debt, and associated accounts receivable, accounts payable and off-balance sheet commitments.

The Company is also exposed to foreign currency exchange risk from its self-sustaining foreign operations whose functional currency is different from the Company's functional currency. Gains and losses from the translation of financial instruments within these self-sustaining foreign operations into Canadian dollars are presented as a separate component of other comprehensive income (loss) in the Consolidated Statement of Comprehensive Income.

The Company's outstanding U.S. dollar-denominated long-term debt (Note 9) partially mitigates the exposure to Cdn/U.S. dollar exchange rate fluctuations created from its U.S. dollar-denominated cash flows and other associated financial instruments.

At any time, the Company may also hold a material amount of U.S. dollar cash and cash equivalents to meet immediate capital and/or operating funding requirements. These can create additional exposure to foreign currency exchange risk. At September 30, 2008, the Company holds U.S. dollar cash and cash equivalents of approximately \$645 million US.

(b) Credit Risk

The Company is exposed to credit risk from its counterparties' abilities to fulfil their obligations to the Company. The Company manages this risk through the establishment of credit policies and limits, which are applied in the selection of counterparties. The Company ensures that it has no significant concentrations of credit risk and ensures that no customers represent more than 10% of the Company's consolidated revenues for any period.

The Company's maximum exposure to credit risk at September 30, 2008 is equal to the carrying amount of its financial assets recorded on the Consolidated Balance Sheet. The Company carries adequate provisions for expected losses arising from credit risk associated with all financial assets, including any derecognized securitized receivables. These provisions are not material.

(c) Liquidity Risk

The Company is exposed to liquidity risk from the potential inability to generate or obtain sufficient cash and cash equivalents in a timely and cost-effective manner to discharge its financial liabilities as they come due. The Company manages liquidity risk by forecasting cash flows to identify financing requirements, by maintaining committed and demand credit facilities, and by maintaining access to additional financing at competitive rates through capital markets and highly rated financial institutions. Any debt issued by the Company is managed in accordance with specified liquidity and maturity profiles.

The Company's financial capacity and flexibility has not been significantly impacted by the recent turmoil in the financial markets due to the Company's continuing ability to generate strong cash flow, existing cash balances, significant credit facility capacity and lack of near-term refinancing commitments. For 2009 and beyond, spending on future large projects may result in annual capital expenditures exceeding operating cash flow. The Company anticipates that additional funding requirements will be met by external financing and that additional financial leverage can be managed in the context of the Company's capital management strategy (Note 13).

Financial Instruments

Excluding debentures, senior notes and capital leases, which are recorded as long-term debt, the fair values of financial instruments equals or approximates their carrying amount. The fair value of debentures, senior notes and capital leases was \$3,608 million at September 30, 2008 (December 31, 2007 – \$2,500 million), compared with a carrying amount of \$4,098 million at September 30, 2008 (December 31, 2007 – \$2,346 million). The fair values of debentures, senior notes and capital leases are based on publicly quoted market values for instruments with similar terms and risks.