

**Twoco Petroleums Ltd.**  
**Consolidated Financial Statements**  
**June 30, 2006**

## Notice to Reader

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The accompanying unaudited interim consolidated financial statements of Twoco Petroleum Ltd. for the quarter ended June 30, 2006 have been prepared by management and approved by the Board of Directors of the Company. These consolidated statements have not been reviewed by Twoco Petroleum Ltd.'s external auditors.

Dated August 18, 2006.

**On behalf of Twoco Petroleum Ltd.**

(signed) "Wayne A. Malinowski"  
Wayne A. Malinowski  
President

(signed) "Tim Bashforth"  
Tim Bashforth  
Secretary and Treasurer

**Twoco Petroleum Ltd.**  
**Consolidated Balance Sheets**

	<b>June 30, 2006</b> <i>(unaudited)</i>	<b>December 31, 2005</b> <i>(audited)</i>
<b>Assets</b>		
Current assets		
Cash	\$ 7,879,661	\$ -
Accounts receivable	2,512,091	3,845,762
Prepaid expenses and deposits	<u>309,562</u>	<u>341,677</u>
	10,701,314	4,187,439
Deferred financing charges (note 2)	136,950	-
Property, plant and equipment	<u>37,534,394</u>	<u>30,519,164</u>
	<u>\$ 48,372,658</u>	<u>\$ 34,706,603</u>
<b>Liabilities</b>		
Current liabilities		
Bank indebtedness (note 3)	\$ -	\$ 2,061,780
Accounts payable and accrued liabilities	2,579,657	4,323,698
Due to officers and directors	-	370,052
Current portion of capital lease obligation	<u>204,406</u>	<u>791,783</u>
	2,784,063	7,547,313
Asset retirement obligations (note 4)	1,817,331	1,447,956
Future income taxes	4,113,900	4,146,155
Obligations under capital lease	864,446	347,392
Convertible debentures payable (note 2)	<u>11,840,000</u>	<u>-</u>
	<u>21,419,740</u>	<u>13,488,816</u>
<b>Shareholders' Equity</b>		
Share capital (note 5)	21,686,395	17,294,878
Equity portion of convertible debentures (note 2)	160,000	-
Contributed surplus (note 6)	786,625	588,068
Retained earnings	<u>4,319,898</u>	<u>3,334,841</u>
	<u>26,952,918</u>	<u>21,217,787</u>
	<u>\$ 48,372,658</u>	<u>\$ 34,706,603</u>

Approved by the Board,

(signed) "Wayne A. Malinowski", Director

(signed) "Larry C. Mah", Director

# Twoco Petroleum Ltd.

## Consolidated Statements of Income and Retained Earnings

(unaudited)

	Three Months Ended		Six Months Ended	
	June 30, 2006	June 30, 2005	June 30, 2006	June 30, 2005
<b>Revenue</b>				
Oil and gas sales	\$ 2,935,502	\$ 2,395,315	\$ 6,728,342	\$ 4,528,845
Less: Royalties	<u>(331,634)</u>	<u>(497,347)</u>	<u>(1,313,889)</u>	<u>(960,875)</u>
	2,603,868	1,897,968	5,414,453	3,567,970
Alberta Royalty Tax Credit	70,466	116,562	298,296	225,512
Processing revenue	243,371	53,931	499,201	96,255
Interest	<u>80,230</u>	<u>30,861</u>	<u>81,731</u>	<u>48,558</u>
	<u>2,997,935</u>	<u>2,099,322</u>	<u>6,293,681</u>	<u>3,938,295</u>
<b>Expenses</b>				
Operating costs	456,740	195,033	1,005,577	369,916
Transportation costs	115,289	84,473	250,939	161,744
General and administrative	256,620	61,551	389,794	200,006
Interest on bank debt	-	29,276	44,499	-
Interest on capital leases	28,204	93,256	68,814	-
Interest on debentures payable	221,918	-	221,918	124,479
Stock-based compensation	99,279	-	198,557	135,159
Amortization of deferred charges (note 2)	12,450	-	12,450	-
Depletion, amortization and accretion	<u>1,612,120</u>	<u>879,236</u>	<u>3,071,482</u>	<u>1,563,950</u>
	<u>2,802,620</u>	<u>1,342,825</u>	<u>5,264,030</u>	<u>2,555,254</u>
Income before income taxes	195,315	756,497	1,029,651	1,383,041
<b>Income tax expense (recovery)</b>				
Current	16,759	(79,394)	16,759	-
Future	<u>(235,010)</u>	<u>324,000</u>	<u>27,835</u>	<u>452,000</u>
	<u>(218,251)</u>	<u>244,606</u>	<u>44,594</u>	<u>452,000</u>
Net income	413,566	511,891	985,057	931,041
Retained earnings, beginning of period	<u>3,906,332</u>	<u>728,927</u>	<u>3,334,841</u>	<u>309,777</u>
Retained earnings, end of period	<u>\$ 4,319,898</u>	<u>\$ 1,240,818</u>	<u>\$ 4,319,898</u>	<u>\$ 1,240,818</u>
<b>Net income per share</b>				
Basic (note 5)	<u>\$ 0.03</u>	<u>\$ 0.04</u>	<u>\$ 0.07</u>	<u>\$ 0.07</u>
Diluted	<u>\$ 0.03</u>	<u>\$ 0.04</u>	<u>\$ 0.06</u>	<u>\$ 0.07</u>

# Twoco Petroleums Ltd.

## Consolidated Statements of Cash Flows

(unaudited)

	Three Months Ended		Six Months Ended	
	June 30, 2006	June 30, 2005	June 30, 2006	June 30, 2005
Cash provided by (used for):				
Operating activities				
Net income	\$ 413,566	\$ 511,891	\$ 985,057	\$ 931,041
Add (deduct) Items not affecting cash				
Stock-based compensation	99,279	93,256	198,557	135,159
Future income taxes	(235,010)	324,000	27,835	452,000
Amortization of deferred charges	12,450	-	12,450	-
Depletion, amortization and accretion	<u>1,612,120</u>	<u>879,236</u>	<u>3,071,482</u>	<u>1,563,950</u>
	1,902,405	1,808,383	4,295,381	3,082,150
Change in non-cash working capital (note 7[a])	<u>(523,440)</u>	<u>796,531</u>	<u>(293,804)</u>	<u>369,366</u>
	<u>1,378,965</u>	<u>2,604,914</u>	<u>4,001,577</u>	<u>3,451,516</u>
Financing activities				
Repayment to officers and directors	-	-	(370,052)	(370,051)
Exercise of agent's options and warrants	-	2,986,658	-	3,896,528
Issuance of common shares, net of issuance costs	4,331,427	-	4,331,427	-
Proceeds of convertible debentures, net of financing charges	-	-	11,850,600	-
Repayment of obligations under capital lease	(32,415)	-	(70,323)	-
Change in non-cash working capital (note 7[a])	<u>221,918</u>	<u>5,997</u>	<u>221,918</u>	<u>(34,202)</u>
	<u>4,520,930</u>	<u>2,992,655</u>	<u>15,963,570</u>	<u>3,492,275</u>
Investing activities				
Acquisition of property, plant and equipment	(4,692,320)	(2,936,327)	(9,717,337)	(5,121,823)
Change in non-cash working capital (note 7[a])	<u>3,015</u>	<u>(29,645)</u>	<u>(306,369)</u>	<u>(59,610)</u>
	<u>(4,689,305)</u>	<u>(2,965,972)</u>	<u>(10,023,706)</u>	<u>(5,181,433)</u>
Cash inflow	1,210,590	2,631,597	9,941,441	1,762,358
Cash and cash equivalents (bank indebtedness), beginning of period	<u>6,669,071</u>	<u>3,075,830</u>	<u>(2,061,780)</u>	<u>3,945,069</u>
Cash and cash equivalents, end of period	<u>\$ 7,879,661</u>	<u>\$ 5,707,427</u>	<u>\$ 7,879,661</u>	<u>\$ 5,707,427</u>
Cash and cash equivalents is comprised of:				
Deposits with bank	\$ 7,879,661	\$ 199,471	\$ 7,879,661	\$ 199,471
Term deposits	<u>-</u>	<u>5,507,956</u>	<u>-</u>	<u>5,507,956</u>
	<u>\$ 7,879,661</u>	<u>\$ 5,707,427</u>	<u>\$ 7,879,661</u>	<u>\$ 5,707,427</u>
Supplemental cash flow information:				
Interest paid	<u>\$ 28,204</u>	<u>\$ 55,554</u>	<u>\$ 115,356</u>	<u>\$ 158,681</u>
Income taxes paid	<u>\$ -</u>	<u>\$ 98,476</u>	<u>\$ -</u>	<u>\$ 98,476</u>

**Twoco Petroleum Ltd.**  
**Notes to Consolidated Financial Statements**  
**June 30, 2006**  
*(unaudited)*

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1. Basis of presentation

The interim consolidated financial statements of Twoco Petroleum Ltd. ("the Company") have been prepared by management in accordance with Canadian generally accepted accounting principles. The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary. The interim consolidated financial statements have been prepared following the same accounting policies and methods of computation as those utilized in the December 31, 2005 annual consolidated financial statements. The interim consolidated financial statements contain disclosures which are supplemental to the Company's annual consolidated financial statements. Certain disclosures which are normally required to be included in the notes to the annual consolidated financial statements have been condensed or omitted. The interim consolidated financial statements should be read in conjunction with the Company's audited consolidated financial statements and notes thereto for the year ended December 31, 2005.

2. Convertible debentures payable

On March 31, 2006, the Company closed a private placement financing through the issuance of \$12 million of redeemable, convertible, unsecured debentures ("Convertible Debentures"). The Convertible Debentures bear interest at a rate of 7.5% per annum, payable commencing September 30, 2006 and quarterly thereafter and will mature three years following the closing date (the "Maturity Date"). Finder's fees and commissions of \$149,400 have been recorded as deferred financing charges and will be amortized over the term of the debentures of three years on a straight-line basis. Amortization expense of \$12,450 has been recognized for the three month period ended June 30, 2006.

The Convertible Debentures will be convertible into common shares of the Company at the holder's option at any time prior to the Maturity Date at a conversion price equal to \$7.50 per share for a period of two years from the closing date and thereafter at a price of \$8.25 until the Maturity Date. The Company will have the ability to redeem the Convertible Debentures if the closing price of its common shares on the TSX Venture Exchange exceeds \$8.25 for 21 consecutive trading days or in certain circumstances where an offer is made to acquire common shares of the Company.

A market rate of interest for a non-convertible debt offering, representative of the Company's credit standing would be 8%. Therefore, the Company has received an interest benefit of 0.5% for the holder's conversion right, over the three year life of the debentures. The present value of this conversion benefit of \$160,000 was recorded on the interim consolidated financial statements as the equity portion of convertible debentures.

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3. Bank indebtedness

During the second quarter, the Company extended its operating line of credit from \$10 million to \$20 million, secured by a \$25 million debenture (increased from \$15 million at December 31, 2005). All other terms of the operating line of credit remain unchanged from December 31, 2005.

4. Asset retirement obligations

The following table reconciles the Company's total asset retirement obligations:

	June 30, 2006	December 31, 2005
Balance, beginning of period	\$ 1,447,956	\$ 708,230
Accretion expense	40,161	52,198
Liabilities incurred	329,214	508,358
Liabilities incurred due to changes in estimate	<u>-</u>	<u>179,170</u>
Balance, end of period	<u>\$ 1,817,331</u>	<u>\$ 1,447,956</u>

Total estimated future retirement costs of \$2,605,127 (2005 - \$2,164,377) have been inflated at an estimated rate of 2.21% (2005 - 2.20%) and discounted using a credit adjusted risk-free rate of 5.35% (2005 - 5.92%).

5. Share capital

(a) Issued

	Number	Stated Value
<b>Common shares</b>		
Balance, beginning of period	14,773,306	\$ 17,294,878
Pursuant to flow-through share offering	486,500	4,500,125
Share issue costs, net of tax benefits	<u>-</u>	<u>(108,608)</u>
Balance, end of period	<u>15,259,806</u>	<u>\$ 21,686,395</u>

On May 9, 2006, the Company closed a private placement financing of 486,500 common shares issued on a flow-through basis at \$9.25 per share for gross proceeds of \$4,500,125. The flow-through common shares have a hold period until September 10, 2006. The Company paid finder's fees and related financing charges of \$168,698.

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(b) Per share amounts

The weighted average number of shares outstanding for the period ended June 30, 2006 was 14,913,074 (2005 - 12,559,186).

In computing diluted net income per share amounts, 868,780 (2005 - 2,488,536) shares were added to the weighted average number of common shares outstanding during the period ended June 30, 2006 for the dilutive effect of stock options. The convertible debentures (note 2) have an exercise price greater than the average market price and therefore have no effect on diluted securities and earnings.

The following reconciles the denominators for basic and diluted net earnings per share calculations:

	<b>Net Earnings</b> <i>(numerator)</i>	<b>Weighted Average Shares</b> <i>(denominator)</i>	<b>Per Share Amount</b>
Common shares			
Basic net earnings per share	\$ 985,057	14,913,074	\$ 0.07
Dilutive securities:			
Options	-	868,780	
Convertible debentures	-	-	
Diluted net earnings per share	<u>\$ 985,057</u>	<u>15,781,854</u>	<u>\$ 0.06</u>

6. Contributed surplus

The following table reconciles the Company's contributed surplus:

	<b>June 30, 2006</b> <i>(unaudited)</i>	<b>December 31, 2005</b> <i>(audited)</i>
Balance, beginning of period	\$ 588,068	\$ 309,197
Stock-based compensation expense	<u>198,557</u>	<u>278,871</u>
Balance, end of period	<u>\$ 786,625</u>	<u>\$ 588,068</u>

**Twoco Petroleum Ltd.**  
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*(unaudited)*

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7. Supplemental cash flow information

(a) Changes in non-cash working capital

	<b>June 30, 2006</b>	<b>June 30, 2005</b>
Accounts receivable	\$ 1,333,671	\$ (830,149)
Prepaid expenses and deposits	32,115	18,377
Accounts payable and accrued liabilities	(1,744,041)	1,185,803
Current taxes payable	<u>-</u>	<u>(98,477)</u>
	<u><u>\$ (378,255)</u></u>	<u><u>\$ 275,554</u></u>
Change in non-cash working capital relating to:		
Financing activities	\$ 221,918	\$ (34,202)
Investing activities	(306,369)	(59,610)
Operating activities	<u>(293,804)</u>	<u>369,366</u>
	<u><u>\$ (378,255)</u></u>	<u><u>\$ 275,554</u></u>

(b) The following non-cash transactions have been excluded from the consolidated statements of cash flows:

	<b>June 30, 2006</b>	<b>June 30, 2005</b>
Asset retirement costs	<u>\$ 329,214</u>	<u>\$ -</u>
Conversion of debentures	<u>\$ -</u>	<u>\$ 15,000</u>