

**Twoco Petroleums Ltd.**  
**Financial Statements**  
**March 31, 2007**

## **Notice to Reader**

---

The accompanying unaudited interim financial statements of Twoco Petroleums Ltd. for the quarter ended March 31, 2007 have been prepared by management and approved by the Board of Directors of the Company. These statements have not been reviewed by Twoco Petroleums Ltd.'s external auditors.

Dated May 24, 2007.

### **On behalf of Twoco Petroleums Ltd.**

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

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

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

	<b>March 31, 2007</b> <i>(unaudited)</i>	<b>December 31, 2006</b> <i>(audited)</i>
<b>Assets</b>		
Current assets		
Cash and cash equivalents	\$ -	\$ 1,867,708
Accounts receivable	2,327,478	2,043,174
Prepaid expenses and deposits	<u>163,194</u>	<u>386,742</u>
	2,490,672	4,297,624
Deferred financing charges (notes 2 and 3)	-	184,034
Property, plant and equipment	<u>50,171,733</u>	<u>44,545,637</u>
	<u>\$ 52,662,405</u>	<u>\$ 49,027,295</u>
<b>Liabilities</b>		
Current liabilities		
Bank indebtedness	\$ 3,554,946	\$ -
Accounts payable and accrued liabilities	2,854,970	2,839,618
Current portion of capital lease obligation	<u>210,912</u>	<u>207,756</u>
	6,620,828	3,047,374
Asset retirement obligations (note 4)	2,739,404	2,551,724
Future income taxes	5,227,200	3,849,800
Obligations under capital lease	706,007	759,854
Convertible debentures payable (notes 2 and 3)	<u>11,729,747</u>	<u>11,880,000</u>
	<u>27,023,186</u>	<u>22,088,752</u>
<b>Shareholders' Equity</b>		
Share capital (note 5)	20,336,355	21,686,393
Equity portion of convertible debentures payable (note 3)	160,000	160,000
Contributed surplus (note 6)	1,024,354	985,181
Retained earnings and accumulated comprehensive income	<u>4,118,510</u>	<u>4,106,969</u>
	<u>25,639,219</u>	<u>26,938,543</u>
	<u>\$ 52,662,405</u>	<u>\$ 49,027,295</u>

Approved by the Board,

(signed) "Wayne A. Malinowski", Director

(signed) "Larry C. Mah", Director

## Twoco Petroleum Ltd.

### Statements of Operations, Comprehensive Income and Retained Earnings

(unaudited)

	Three Months Ended	
	March 31, 2007	March 31, 2006
Revenue		
Oil and gas sales	\$ 3,853,216	\$ 3,792,840
Less: Royalties	<u>(741,549)</u>	<u>(982,255)</u>
	3,111,667	2,810,585
Alberta Royalty Tax Credit	-	227,830
Interest	<u>3,902</u>	<u>1,501</u>
	<u>3,115,569</u>	<u>3,039,916</u>
Expenses		
Operating costs	375,112	293,008
Transportation costs	136,610	135,650
Interest on debentures payable	235,251	-
General and administrative	107,306	133,173
Stock-based compensation	39,173	99,278
Interest on capital lease	14,529	40,610
Interest on bank debt	9,760	44,499
Amortization of convertible debentures financing charges	20,448	-
Depletion, amortization and accretion	<u>2,138,477</u>	<u>1,459,362</u>
	<u>3,076,666</u>	<u>2,205,580</u>
Income before income taxes	38,903	834,336
Income tax expense		
Future	<u>27,362</u>	<u>262,845</u>
Net income and comprehensive income	11,541	571,491
Retained earnings, beginning of period	<u>4,106,969</u>	<u>3,334,841</u>
Retained earnings, end of period	<u>\$ 4,118,510</u>	<u>\$ 3,906,332</u>
Net income and comprehensive income per share		
- Basic	<u>\$ 0.00</u>	<u>\$ 0.04</u>
- Diluted	<u>\$ 0.00</u>	<u>\$ 0.04</u>

# Twoco Petroleum Ltd.

## Statements of Cash Flows

(unaudited)

	Three Months Ended	
	March 31, 2007	March, 31, 2006
Cash provided by (used for):		
Operating activities		
Net income	\$ 11,541	\$ 571,491
Add items not affecting cash		
Stock-based compensation	39,173	99,278
Future income taxes	27,362	262,845
Convertible debentures accretion	13,333	-
Amortization of convertible debentures financing charges	20,448	-
Depletion, amortization and accretion	<u>2,138,477</u>	<u>1,459,362</u>
	2,250,334	2,392,976
Change in non-cash working capital (note 7[a])	<u>(333,447)</u>	<u>229,636</u>
	<u>1,916,887</u>	<u>2,622,612</u>
Financing activities		
Repayments to officers and directors	-	(370,052)
Proceeds of convertible debentures, net of issuance costs	-	11,850,600
Repayments of obligations under capital lease	<u>(50,691)</u>	<u>(37,908)</u>
	<u>(50,691)</u>	<u>11,442,640</u>
Investing activities		
Acquisition of property, plant and equipment	(7,576,893)	(5,025,017)
Change in non-cash working capital (note 7[a])	<u>288,043</u>	<u>(309,384)</u>
	<u>(7,288,850)</u>	<u>(5,334,401)</u>
Cash inflow (outflow)	(5,422,654)	8,730,851
Cash and cash equivalents, beginning of period	<u>1,867,708</u>	<u>(2,061,780)</u>
Cash and cash equivalents, end of period	<u>\$ (3,554,946)</u>	<u>\$ 6,669,071</u>
Cash and cash equivalents is comprised of:		
Deposits with bank	\$ 235,062	\$ 6,669,071
Bank indebtedness	<u>(3,790,008)</u>	<u>-</u>
	<u>\$ (3,554,946)</u>	<u>\$ 6,669,071</u>
Supplemental cash flow information:		
Interest paid	<u>\$ 246,207</u>	<u>\$ 87,152</u>

**Twoco Petroleums Ltd.**  
**Notes to Financial Statements**  
**March 31, 2007**  
*(unaudited)*

---

1. Basis of presentation

The interim financial statements of Twoco Petroleums Ltd. ("the Company") have been prepared by management in accordance with Canadian generally accepted accounting principles. The interim financial statements have been prepared following the same accounting policies and methods of computation as those utilized in the December 31, 2006 annual financial statements. The interim financial statements contain disclosures which are supplemental to the Company's annual financial statements. Certain disclosures which are normally required to be included in the notes to the annual financial statements have been condensed or omitted. The interim financial statements should be read in conjunction with the Company's audited financial statements and notes thereto for the year ended December 31, 2006.

The comparative figures include the accounts of the Company and its wholly-owned subsidiary. The subsidiary was wound up into the Company on July 1, 2006.

2. Changes in accounting policies

Effective January 1, 2007, the Company adopted the Canadian Institute of Chartered Accountants ("CICA") Section 3855, "Financial Instruments - Recognition and Measurement", Section 3865, "Hedges", and Section 1530, "Comprehensive Income". These standards have been adopted prospectively.

(a) Financial instruments

Section 3855 establishes a framework for classifying and measuring financial instruments. Under this section, all financial instruments must be initially recognized at their fair value on the balance sheet. In accordance with Section 3855, the Company has classified each financial instrument into the five categories set out in the standard: Financial assets and liabilities held for trading, financial assets held to maturity, loans and receivables, financial assets available for sale and other liabilities. Measurement of each of these items is contingent upon initial classification. Unrealized gains and losses on financial instruments classified as held for trading are recognized in earnings in the period incurred. Gains and losses on financial assets available for sale are recognized in other comprehensive income, and are recognized in earnings when the asset is removed from the balance sheet. The effective interest rate method using amortized cost is applied to the remaining categories of financial instruments.

Adoption of the new standards have the following effect on the financial statements:

Convertible debentures payable are classified as a financial liability and are measured at amortized cost. Amortized cost is the amount at which the financial liability is measured at initial recognition minus principal repayments plus the cumulative amortization of any deferred financing charges and the convertible debenture discount using the effective interest method.

**Twoco Petroleum Ltd.**  
**Notes to Financial Statements**  
**March 31, 2007**  
*(unaudited)*

---

Prior to January 1, 2007, deferred financing charges related to the convertible debentures payable were presented as a separate asset on the balance sheet and amortized on a straight-line basis. Under the new standards, deferred financing charges are recognized as an offset to the carrying value of convertible debentures payable and are amortized using the effective interest method.

(b) Derivative instruments and hedging

The Company does not have any outstanding derivative or hedging contracts as at March 31, 2007 and January 1, 2007.

(c) Comprehensive income

Comprehensive income is the change in equity of the Company from net income and other comprehensive income ("OCI"). OCI consists of the change in the fair value of any financial instruments classified as available for sale. Amounts recognized in OCI must eventually be reclassified to income when the related gains or losses are realized.

3. Convertible debentures payable

On March 31, 2006, the Company closed a private placement financing through the issuance of \$12 million in the aggregate principal amount 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 previously recorded as deferred financing charges have been netted against convertible debentures payable, as disclosed in note 2. Amortization expense on convertible debentures financing charges of \$20,448 has been recognized for the quarter ended March 31, 2007 (March 31, 2006 - \$NIL).

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.

## Twoco Petroleum Ltd.

### Notes to Financial Statements

March 31, 2007

(unaudited)

---

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 debenture. The present value of this conversion benefit of \$160,000 was recorded on the financial statements as the equity portion of convertible debentures. The portion of convertible debentures classified as debt was initially determined to be \$11,840,000. The debt portion of the debentures will accrete up to the face value over the term to maturity. Accretion of \$13,333 has been recognized in interest expense for the quarter ended March 31, 2007 (March 31, 2006 - \$NIL).

#### 4. Asset retirement obligations

The total future asset retirement obligation was estimated by management based on the Company's net ownership interest in all wells and facilities, estimated costs to reclaim and abandon said wells and facilities and the estimated timing of such abandonment.

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

	<b>March 31, 2007</b>	<b>December 31, 2006</b>
Balance, beginning of period	\$ 2,551,724	\$ 1,447,956
Accretion expense	37,846	69,111
Liabilities incurred	149,834	1,094,068
Liabilities settled	<u>-</u>	<u>(59,411)</u>
Balance, end of period	<u>\$ 2,739,404</u>	<u>\$ 2,551,724</u>

Total estimated future retirement costs of \$3,965,201 (2006 - \$3,712,076) have been inflated at a weighted average estimated inflation rate of 1.94% (2006 - 1.92%) and discounted using a weighted average credit adjusted risk-free rate of 6.00% (2006 - 6.01%).

#### 5. Share capital

Per share amounts

The weighted average number of shares outstanding for the period ended March 31, 2007 was 15,259,806 (2006 - 14,773,306).

In computing diluted net income per share amounts, 633,602 (2006 - 844,500) shares were added to the weighted average number of common shares outstanding during the period ended March 31, 2007 for the dilutive effect of stock options.

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

**Twoco Petroleum Ltd.**  
**Notes to Financial Statements**  
**March 31, 2007**  
*(unaudited)*

---

	<b>Net Earnings (numerator)</b>	<b>Weighted Average Shares (denominator)</b>	<b>Per Share Amount</b>
Common shares			
Basic net earnings per share	\$ 11,541	15,259,806	\$ 0.00
Dilutive securities:			
Options	<u>-</u>	<u>633,602</u>	
Diluted net earnings per share	<u>\$ 11,541</u>	<u>15,893,408</u>	<u>\$ 0.00</u>

6. Contributed surplus

The following table reconciles the Company's contributed surplus:

	<b>March 31, 2007</b>	<b>December 31, 2006</b>
Balance, beginning of period	\$ 985,181	\$ 588,068
Stock-based compensation expense	<u>39,173</u>	<u>397,113</u>
Balance, end of period	<u>\$ 1,024,354</u>	<u>\$ 985,181</u>

7. Supplemental cash flow information

(a) Changes in non-cash working capital

	<b>March 31, 2007</b>	<b>March 31, 2006</b>
Accounts receivable	\$ (284,304)	\$ 869,823
Prepaid expenses and deposits	223,548	35,869
Accounts payable and accrued liabilities	<u>15,352</u>	<u>(985,440)</u>
	<u>\$ (45,404)</u>	<u>\$ (79,748)</u>
Change in non-cash working capital relating to:		
Investing activities	\$ 288,043	\$ (309,384)
Operating activities	<u>(333,447)</u>	<u>229,636</u>
	<u>\$ (45,404)</u>	<u>\$ (79,748)</u>

**Twoco Petroleum Ltd.**  
**Notes to Financial Statements**  
**March 31, 2007**  
*(unaudited)*

---

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

	<b>March 31, 2007</b>	<b>March 31, 2006</b>
Asset retirement liabilities incurred	\$ <u>149,834</u>	\$ <u>74,728</u>

8. Comparative figures

Certain comparative figures have been reclassified to conform with the current period's presentation.

9. Subsequent event

On April 23, 2007, the Company granted 15,000 stock options with an exercise price of \$4.46 exercisable into common shares.