

PETRO-REEF RESOURCES LTD.

ANNUAL REPORT 2006

MANAGEMENT'S DISCUSSION AND ANALYSIS

The following Management's Discussion and Analysis for Petro-Reef Resources Ltd. should be read in conjunction with the audited financial statements and notes, contained in the annual report for 2006 and are based on information available to April 05, 2007. Additional information regarding Petro-Reef is available in the updated Annual Information Form which has been filed electronically, at the same time as this report, on the System for Electronic Document Analysis and Retrieval (SEDAR) at www.sedar.com or on Petro-Reef's website at www.petro-reef.ca.

ABBREVIATIONS

ARTC	Alberta Royalty Tax Credit	GJs/d	Gigajoules per day
Bbl	barrel	M ³	cubic meters
Bbls	barrels	Mbbls	thousands of barrels
Bcf	billion cubic feet	Mcf	thousand cubic feet
BOE	barrel of oil equivalent (1 BOE = 6 Mcf)	Mcf/d	thousand cubic feet per day
Bbls/d	Barrels per day	MMbbls	millions of barrels
BOPD	Barrels of oil per day	MMcf	million cubic feet
FNR	Future net revenue	MMcf/d	million cubic feet per day
GJ	Gigajoule	NGLs	natural gas liquids
		NPV	net present value

NOTE: In this report all currency values are in Canadian Dollars.

FORWARD-LOOKING STATEMENTS

Some of the statements contained herein (including without limitation, financial and business prospects and financial outlooks) may be forward-looking statements which reflect management's expectations regarding future plans and intentions, growth, results of operations, performance and business prospects and opportunities. Words such as "may", "will", "should", "could", "anticipate", "believe", "expect", "intend", "plan", "potential", "continue" and similar expressions have been used to identify these forward-looking statements. These statements reflect management's current beliefs and are based on information currently available to management. Forward-looking statements involve significant risk and uncertainties. A number of factors could cause actual results to differ materially from the results discussed in the forward-looking statements including, but not limited to, changes in general economic and market conditions and other risk factors. Although the forward-looking statements contained herein are based upon what management believes to be reasonable assumptions, management cannot assure that actual results will be consistent with these forward-looking statements. Investors should not place undue reliance on forward-looking statements. These forward-looking statements are made as of the date hereof and the Corporation assumes no obligation to update or review them to reflect new events or circumstances.

Forward-looking statements and other information contained herein concerning the oil and gas industry and the Corporation's general expectations concerning this industry is based on estimates prepared by management using data from publicly available industry sources as well as from reserve reports, market research and industry analysis and on assumptions based on data and knowledge of this industry which the Corporation believes to be reasonable. However, this data is inherently imprecise, although generally indicative of relative market positions, market shares and performance characteristics. While the Corporation is not aware of any misstatements regarding any industry data presented herein, the industry involves risks and uncertainties and is subject to change based on various factors.

NOTE:

Petro-Reef cautions that "cash flow from operations" and "netbacks" do not have standardized meanings prescribed by Canadian generally accepted accounting principles and are therefore unlikely to be comparable to similar measures presented by other issuers. Management believes "cash flow from operations," defined as cash provided by operations before changes in non-cash working capital, is a useful indicator of the Company's ability to fund future capital expenditures, Petro-Reef calculates netbacks as net dollars per barrel after Crown Royalties, operating expenses and general and administrative expenses.

Reference is made to barrels of oil equivalent (BOE). Barrels of oil equivalent may be misleading, particularly if used in isolation. In accordance with National Instrument 51-101, a BOE conversion ratio for natural gas of 6 Mcf: 1 Bbl has been used, which is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead.

THE YEAR 2006 IN REVIEW

Petro-Reef Resources Ltd. (TSX-V: PER), a Calgary based crude oil and natural gas exploration and production company with producing properties in Alberta, Canada, capitalized on its drilling success and strong commodity prices to earn \$65,060 on cash flow from operations of \$3,557,432 in 2006. This compares to earning of \$248,714 on cash flow from operations of \$2,007,713 in 2005.

Total production for 2006 was 165,471 barrels of oil equivalent (BOE), an increase of 150 percent over the production for 2005 of 66,305 BOE. This is equivalent to 455 BOE/d in 2006 and 182 BOE/d in 2005.

Petro-Reef's production in 2006 came from two core properties, Alexander/Qui Barre and Peavey/Morinville, both located near Edmonton, Alberta. Alexander/Qui Barre produced about 88 percent of total production for about 89 percent of the revenue while, Peavey/Morinville, produced about 11 percent of total production for about 10 percent of the revenue. The remaining production came from minor working interest and royalty properties. About 96 percent of the production was natural gas with about 4 percent as crude oil and natural gas liquids.

Activities during the year included drilling, completions, tie-ins, and work-overs/re-completions. Additional 2-D and 3-D seismic data were acquired, processed and interpreted.

The company continues to use the following exploration criteria on each prospect to assure high profitability and rate of return on capital investment:

- 1) Each exploration prospect must exhibit
 - a) Potential for a minimum of three hydrocarbon zones.
 - b) Potential for:
 - (i) 10:1 profit to capital risk ratio
 - (ii) a minimum of 30% rate of return on capital invested
 - (iii) minimum life of 15 years
- 2) Both 2-D and 3-D seismic are used to identify and confirm potential drilling locations using state-of-the-art technology.

Management uses cash flow from operations per share to analyze operating performance. Cash flow from operations per share does not have any standardized meaning prescribed by Canadian Generally Accepted Accounting Principles ("GAAP") and therefore it may not be comparable with the calculation of similar measures for other entities.

**Highlights of Financial and Operations Results for Fiscal Years 2004-2005-2006.
THREE-YEAR REVIEW AND PERCENT CHANGE FROM 2005-2006**

	2004	2005	2006	% Changes 2005 to 2006
FINANCIAL				
Crude Oil and Natural Gas Revenue Net of royalties and ARTC	\$2,162,656	\$3,224,567	\$5,749,891	+78
Cash Flow from Operations	1,065,076	2,007,713	\$3,557,432	+77
Net (Loss) Earnings from Operations	(\$542,087)	\$248,714	\$65,060	-80
Net (Loss) Earnings per Share	(\$0.03)	\$0.01	\$0.00	-
Capital Expenditures	\$1,148,725	\$2,374,843	\$7,888,288	+232
Total Assets	\$8,691,850	\$10,462,289	\$15,056,446	+44
Bank Balance (Loan)	(\$700,000)	\$397,904	(\$376,613)	-
Shareholder's Equity	\$4,021,268	\$6,029,968	\$7,919,194	+31
Common Shares Outstanding				
End of Period	17,738,937	21,438,924	23,685,291	+10
Weighted Average	17,701,232	18,994,641	22,313,869	+17
OPERATIONS				
Average Production				
Crude Oil and NGLs (Bbls/day)	13	2	25	+1,150
Natural Gas (Mcf/day)	954	1,080	2,615	+142
Total BOE per day 6:1	172	182	455	+150
Finding & Development Cost per BOE P ^{(1)P}	\$9.61	\$5.27	7.15	+37
Netbacks (\$ per BOE) P ^{(3)P}	\$23.70	\$34.90	22.93	-34
Reserve Replacement Ratio	0.66	2.41	7.14	
Average Selling Price				
Crude Oil (\$ per BOE)	\$45.25	59.97	64.15	+7
Natural Gas (\$ per BOE)	\$37.02	57.43	36.90	-36
NGL (\$ per BOE)	\$48.25	55.50	57.20	+3
Reserves (Proved plus Probable)				
Crude Oil and NGLs (Bbls)	16,300	1,000	95,000	+9,400
Natural Gas (MMcf)	2,569	3,754	7,505	+100
Total BOE	444,467	503,500	1,345,833	+167
Present Value of Reserves (M\$) P^{(2)P}				
Undiscounted before Taxes	\$12,848	\$26,119	\$36,499	+39
Discounted before Taxes at 10%	\$9,294	\$18,639	\$23,857	+28
Reserve Life Index (P+P)	32.6 yrs	22.5 yrs	33.9	+51
Reserve Life Index (P)	18.3 yrs	19.3 yrs	33.4	+73

(1) After revisions due to NI51-101.

(2) Using constant prices and costs.

(3) Using a conversion of 6,000 cubic feet of natural gas for one barrel of oil equivalent.

(4) Crude oil sales were non-operated and reported with total oil and gas sales combined.

Netbacks are calculated by subtracting royalty expenses and operating expenses from revenue per barrel of oil equivalent. These calculations are before Alberta Royalty Tax Credits.

Petro-Reef's reserve replacement ratio for 2006 using proved reserves only was 7.14 to 1, an increase of 196 percent over the comparative number for 2005. Reserve replacement ratio for a given year is calculated by dividing total reserves at the end of the year by the total reserves at the beginning of the year. The reserve life index for proven plus probable reserves increased by 47 percent from 22.5 years to 33.9 years.

Operating costs for 2006 averaged about \$125,247 per month, an increase from an average of about \$63,000 per month for 2005. The increased costs were a result of costs of fieldwork required to produce the one new well drilled in June 2006 and the re-completion, and reworking of more wells than in 2005.

Net general and administration costs had a modest increase to approximately \$96,513 per month in 2006 from approximately \$34,514 per month in 2005 and approximately \$33,048 per month in 2004. Except for some minor increases, the highest costs since 2003 were due to additional reporting requirements, legal, accounting, engineering and related third party charges.

Capital expenditures for 2006 were \$7,888,288 compared with \$2,374,843 in 2005, an increase of 232 percent.

The net present value of proved plus probable reserves at constant prices and costs (undiscounted), before income tax, for 2006 is \$36,499,000. This is a 40 percent increase from \$26,119,000 in 2005. The comparable numbers at a 10 percent discount of future net revenues are \$23,857,000 for 2006, and \$18,639,000 for 2005, a 30 percent increase.

There are no long-term financial liabilities and there have been no dividends declared.

At year end the bank loan plus cheques drawn in excess of bank was \$376,613.

Revenues fluctuated during 2006 because of changes in volumes of product produced and with changes in product price. Because Petro-Reef produces more than 96 percent natural gas, natural gas prices fluctuations had more impact than prices for crude oil. The following table shows natural gas prices received by Petro-Reef for 2004, 2005 and 2006 by month and by quarter.

Product Price for Natural Gas (\$ per Gigajoule)

Years: 2004-2005-2006

Month of:	\$ Price Per GJ Year 2004	\$ Price Per GJ Year 2005	\$ Price Per GJ Year 2006
January	6.659749	6.233800	8.13720
February	5.757239	6.260490	6.918360
March	5.881507	7.000700	6.229420
Average Price per Quarter:	6.099498	6.498330	7.094967

April	6.274938	7.347800	6.272940
May	6.950898	6.562240	5.269670
June	6.564088	7.052828	5.532040
Average Price per Quarter:	6.596645	6.987623	5.69150

July	6.479279	7.058280	5.385630
August	5.724071	8.727350	6.069370
September	5.326431	10.478270	4.412930
Average Price per Quarter:	5.843260	8.754633	5.289310

October	6.170750	11.725960	5.557470
November	5.878970	8.837250	7.308530
December	6.382450	11.414247	6.669890
Average Price per Quarter:	6.1440570	10.659152	6.511963

Average Price for Year	6.17	8.22	6.15
------------------------	------	------	------

Note: 1 gigajoule = 1.054615 thousand cubic feet

Crude oil sales prior to May 2006 were insignificant and came from non Petro-Reef operated wells. From May through December 3,382 barrels of crude oil were produced from a well in the Alexander area. The revenue for the sale of the oil was \$216,946 for an average price of \$64.15.

2004 PRODUCTION AND REVENUE SUMMARY BY PRODUCTION DATE

(0)	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
Month	BOE	BOE/Day	REVENUE	ROYALTIES	EXPENSES	(3)-(4)-(5)	NETBACK	NET G&A	(6)-(8)
			\$	\$	\$	\$	\$/BOE	\$	\$
JAN	2,825.17	91.13	137,355.77	12,709.29	43,284.05	81,362.43	28.80	18,837.22	62,525.21
FEB	3,641.01	125.55	133,496.03	13,771.13	42,704.64	77,020.29	21.15	29,074.94	47,945.35
MAR	3,417.61	110.25	127,525.48	14,289.24	48,280.94	64,955.30	19.01	15,259.65	49,695.65
APR	5,770.79	192.36	233,092.98	15,498.94	61,999.80	155,594.24	29.96	45,816.05	109,778.19
MAY	3,992.75	128.80	180,722.54	15,395.47	43,759.92	121,567.15	30.45	16,384.28	105,182.87
JUNE	3,466.69	115.56	145,289.96	13,848.70	48,927.05	82,514.21	23.80	39,837.73	42,676.48
JUL	3,715.14	119.84	152,414.21	13,674.49	37,332.76	101,406.96	27.30	35,132.52	66,274.44
AUG	3,905.77	125.99	149,652.72	23,671.87	80,493.17	45,487.68	11.65	12,289.45	33,198.23
SEP	8,257.77	275.26	281,082.07	62,951.32	58,432.77	159,647.98	19.33	25,906.62	133,741.36
OCT	8,447.87	272.51	342,544.17	71,917.97	55,010.69	215,615.51	25.52	25,410.16	190,205.35
NOV	8,070.05	269.00	320,631.26	85,299.54	52,887.68	182,444.04	22.61	24,348.22	158,095.82
DEC	7,425.08	239.52	318,982.17	91,470.06	43,000.63	184,511.48	24.85	108,273.16	76,238.32
ARTC			253,789.39			1,472,127.27			1,075,557.27
			76,388.00			76,388.00			76,388.00
Total	62,935.71	2,065.77	2,600,177.39	434,498.02	616,164.70	1,548,515.27	284.43	396,570.00	1,151,945.27
Average	5,244.64	172.15	216,681.45	36,208.17	51,347.06	129,042.94	23.70	33,047.50	95,995.44

NOTES:

- (3) Product sales and royalty income
 - (6) Net revenue after royalties and operating expenses
 - (9) Net profit before bank debt
- ARTC – Alberta Royalty Tax Credit

2005 PRODUCTION AND REVENUE SUMMARY BY PRODUCTION DATE WITHIN ACCOUNTING

(0)	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
Month	BOE	BOE/Day	REVENUE	ROYALTIES	EXPENSES	(3)-(4)-(5)	NETBACK	NET G&A	(6)-(8)
			\$	\$	\$	\$	\$/BOE	\$	\$
JAN	7,367.51	237.66	310,711.42	70,680.79	64,643.59	175,387.04	23.81	22,325.27	153,061.77
FEB	6,773.74	241.92	288,734.03	60,640.03	59,529.17	168,564.83	24.89	22,844.63	145,720.20
MAR	7,191.67	231.99	343,926.08	68,857.01	60,307.95	214,761.12	29.86	19,485.05	195,276.07
APR	5,609.23	186.97	283,212.95	59,962.41	54,385.15	168,865.39	30.10	10,822.37	158,043.02
MAY	4,970.16	160.33	222,242.41	44,181.74	38,870.44	139,190.23	28.01	20,272.25	118,917.98
JUNE	2,986.45	99.55	140,777.82	19,392.12	75,196.28	46,189.42	15.47	15,554.30	30,635.12
JUL	3,095.79	99.86	179,998.70	31,696.59	62,789.33	85,512.78	27.62	87,883.82	(2,371.04)
AUG	3,901.35	125.85	229,811.06	37,950.26	59,278.69	132,582.11	33.98	32,723.56	99,858.55
SEP	3,825.79	127.53	266,590.43	45,765.99	63,607.76	157,216.68	41.09	31,017.72	126,198.96
OCT	3,107.61	100.25	245,614.59	40,079.51	49,190.15	156,344.93	50.31	10,397.90	145,947.03
NOV	3,418.72	113.96	202,850.89	39,535.41	46,393.77	116,921.71	34.20	28,003.25	88,918.46
DEC	14,141.01	456.16	1,086,446.35	253,558.01	119,574.69	713,313.59	50.44	112,837.66	600,475.93
Total	66,389.03	181.84 ⁽¹⁾	3,800,916.73	772,299.93	753,766.97	2,274,849.83	34.27 ⁽³⁾	414,167.78	1,860,682.05
Other Months	(84.00)	(0.23) ⁽¹⁾	(2,644.73)	(45,699.28)	3,936.03	39,118.52	0.63	-	-
Total	66,305.03	-	3,798,272.00	726,600.65	757,703.00	2,313,968.35	-	-	-
ARTC	-	-	152,896.00	-	-	152,896.00	-	-	152,896.00
Total	-	-	3,951,168.00	-	-	2,466,864.35	-	-	2,013,578.05
Average	5,525.42	181.61	329,264.00	60,550.05	63,141.92	205,572.03	34.90	34,513.98	167,798.17

Column (3) Product sales and royalty income
Column (6) Net revenue after royalties and operating expenses
Column (9) Net profit before bank debt
⁽¹⁾ Average
ARTC Alberta Royalty Tax Credit

2006 PRODUCTION AND REVENUE SUMMARY BY PRODUCTION DATE

	(1) <u>BOE</u>	<u>BOE / Day</u>	(3) <u>REVENUE</u> \$	(4) <u>ROYALTIE</u> \$ \$	(5) <u>EXPENSES</u> \$	(6) <u>(3)-(4)-(5)</u> \$	(7) <u>NET BACK</u> \$/BOE	(8) <u>NET G + A</u> \$ ⁽³⁾	(9) <u>(6) - (8)</u> \$
JAN	18,750	605	1,030,866	328,676	142,097	560,093	30.04	20,865	539,228
FEB	16,658	595	778,359	215,596	140,129	422,634	25.79	103,284	319,350
MAR	18,091	584	761,372	207,405	106,892	447,075	24.35	31,016	416,059
APR	16,172	539	706,282	180,048	108,919	417,315	25.46	119,622	297,693
MAY	16,424	530	606,923	157,342	135,131	314,451	18.53	81,268	233,182
JUNE	15,931	531	624,749	138,578	135,586	350,586	21.41	146,966	203,620
JUL	11,831	382	471,832	99,319	119,279	253,234	22.22	83,721	169,513
AUG	9,816	317	416,339	90,931	127,899	197,509	21.92	134,073	63,436
SEP	9,485	316	303,147	60,446	113,231	129,469	13.54	46,494	82,975
OCT	9,014	291	341,579	56,717	131,277	153,585	16.09	73,721	79,864
NOV	11,405	380	559,747	99,835	116,841	343,071	31.03	119,134	223,937
DEC	12,144	393	555,399	138,913	125,687	290,799	24.75	197,997	92,802
Total Before the Following	165,721	5,463	7,156,594	1,773,806	1,502,968	3,879,820	275	1,158,160	2,721,660
ARTC	-	-	367,103	-	-	367,103	-	-	367,103
Total	165,721	5,463	7,523,697	1,773,806	1,502,968	4,246,923	275	1,158,160	3,088,763
Average	13,810	454	626,975	147,817	125,247	353,910	22.92	96,513	257,397

Column (3) Product sales and royalty income
Column (6) Net revenue after royalties and operating expenses
Column (9) Net profit before bank debt
ARTC Alberta Royalty Tax Credit

PROPERTY REVIEW

Petro-Reef Resources Ltd. operated the drilling of ten development wells and four exploration wells in the Alexander/Qui Barre area in 2006. Of these, ten wells were completed as natural gas wells, one was completed as a crude oil well, three were dry and abandoned, for a success ratio of 79 percent. The Peavey/Morinville area saw no new drilling activity, is still primarily outside operated and although still part of the larger core area for Petro-Reef represents a much smaller percentage of the company's production and revenue stream. Shareholders were kept up to date on the progress of field activity with news releases whenever significant new information became available.

A news release dated March 20, 2006 provides details on the renewed drilling program by Petro-Reef as follows:

As part of the renewed program, Petro-Reef plans to drill five more wells offsetting a successful natural gas discovery in October 2005. In October, the Company announced that it had completed a new natural gas well at 12-28 in its core area of Alexander/Qui Barre. The well tested at 11.91 million cubic feet per day (mmcf/d), equivalent to 1,958 barrels of oil equivalent per day (boe/d). The well was placed on production in December 2005 and has been producing at a stabilized rate of 4.18 mmcf/d (697 boe/d). Petro-Reef's interest in the well is 84 percent before payout of a 400% penalty.

As a result of the success of the 12-28 well drilled in October 2005, Petro-Reef has increased its interest in the Alexander/Qui Barre area by 20 percent, taking its interest in an additional fifteen (15) wells to a range of between 54 percent and 64 percent on 9271 gross acres (4966 net acres) for an average of 51%.

A second well drilled as part of the program in November 2005 was anticipated to produce at 66 bo/d net. This well has since been suspended due to water production. Petro-Reef has a 44 percent interest in the well. Early production from the well was not included in Petro-Reef's 2005 forecasts.

A subsequent news release dated May 09, 2006 further updated the shareholders as follows:

Petro-Reef Resources Ltd. is in the process of completing a five-well drilling program offsetting its October 2005 natural gas discovery in Alexander, Alberta. Based on the initial success of the program announced on March 20, 2006, Petro-Reef plans to drill a sixth well in the area within two weeks. Petro-Reef expects to drill up to 25 wells (11.94 net) in 2006 (including the previously announced five well drilling program), rig availability permitting.

Petro-Reef's gas discovery at 12-28 in the Alexander area of Alberta has continued to produce at 4.18 million cubic feet of natural gas per day (697 barrels of oil equivalent per day) since it was put on production in December. The company's interest in the well is 84% (585 boe/d) until revenue from the well reaches 400% of drilling costs. Petro-Reef's interest then reverts to 34%.

The first well offsetting the 12-28 natural gas discovery was drilled at 12-33. Based on well logs, Petro-Reef believes it has hit the same natural gas zone as the 12-28 and identified a previously unknown oil zone. The company has set production casing and expects to complete the well within two weeks. Petro-Reef has a 54% interest in the well.

The second well in the five-well program was drilled at 6-1. Production casing was set and the well has been perforated, fractured and swabbed. Based on the encouraging results of the swab test, Petro-Reef has started a 30-day production test. Petro-Reef's interest in the well is 44%.

The third well in the program was drilled at 5-31. The company has identified a pay zone containing both oil and natural gas. Petro-Reef anticipates starting a 30-day production test on the well in the oil zone within the next week. Petro-Reef has a 64% interest in the well.

The fourth well was drilled at 13-21. The well was deemed to be uneconomic and has been abandoned. The company had a 54% interest in the well.

The fifth well of the program is to be drilled in the next two weeks at 11-27 where Petro-Reef has a 54% working interest.

And again on June 14, 2006 the following information was sent by news release which stated in part that:

The October 2005 natural gas discovery at 12-28 has continued to produce at approximately 4.18 million cubic feet of natural gas per day (697 barrels of oil equivalent per day) since it was put on production in December 2005. The company's interest in the well is 84% (585 BOE/d) until revenue from the well reaches 400% of drilling and completion costs plus 200% of equipping and tie-in costs. Petro-Reef's interest then reverts to 34%. Based on current production levels and commodity prices, this reversion is anticipated to occur in August 2006. The 12-28 is the only well in Petro-Reef's 2006 drilling program that features a working interest agreement of this kind.

The first well offsetting the 12-28 natural gas discovery was drilled about two kilometers north at 12-33. The company set production casing and has completed the same zone as 12-28 with an initial flowing production test of 525 Mcf/d and a crude oil rate of 48 barrels per day. Petro-Reef has 54% interest in the well. Net to Petro-Reef is 73 BOE/d.

The second well in the five-well program was a re-entry at 6-1. The production casing was perforated and fracture stimulated. The well was placed on production May 2, 2006 and is producing crude oil at a rate of 38 barrels per day with 80 Mcf/d of natural gas. Petro-Reef has a 44% interest in the well. Net to Petro-Reef is 22 BOE/d.

The third well in the program was drilled at 5-31. The company has identified a pay zone with 123 feet of gross natural gas and crude oil pay. The well was perforated and fractured in the oil zone and was placed on stream as a flowing oil well on May 19, 2006. After three weeks of production the well is flowing at 42 barrels of crude oil per day with 592 Mcf/d of natural gas. Petro-Reef has a 64% interest in the well. Net to Petro-Reef is 90 BOE/d.

The fourth well was drilled at 13-21. As announced on May 9, 2006, the well was deemed to be uneconomic and has been abandoned.

The fifth well was drilled at 11-27, two kilometers east of the discovery at 12-28. Based on well logs, Petro-Reef has identified four potential crude oil and/or natural gas zones. The zone that is producing at 12-28 was drill stem tested at 11-27 with a maximum wellhead absolute open flow (AOF) potential rate of 7.312 MMcf/d.

A second zone up-hole in the wellbore was drill stem tested with a maximum wellhead AOF potential rate of 2.464 MMcf/d. The combined AOF for the two zones was 9.776 MMcf/d (1,620 BOE/d). Petro-Reef has a 54% interest in the well. A production test will be conducted in the next two weeks to determine the production rate.

Both the first well at 12-33 and the fifth well at 11-27 are anticipated to be placed on stream by August 1, 2006. The other two successful wells have been placed on stream.

After the initial five-well drilling program Petro-Reef drilled an additional well at 1-31 and re-entered a well at 10-33. Both wells have been cased and will be production tested in the next two to three weeks.

Rig availability permitting, the company expects to drill up to 25 wells (11.94 net) in 2006, including the wells that have been drilled to date and the six wells that will be licensed for drilling in the next two to six weeks.

Continued drilling success was announced in a news letter dated July 27, 2006.

Petro-Reef's October 2005 natural gas discovery at 12-28 is currently producing at 2.16 million cubic feet of natural gas per day (306 barrels of oil equivalent per day net to Petro-Reef). Based on current production levels and commodity prices, Petro-Reef expects to retain its 84% interest in the well until October 2006. At that time, Petro-Reef's interest will revert to 34% when revenue from the well reaches 400% of drilling and completion costs plus 200% of equipping and tie-in costs. As stated on June 14, 2006, the 12-28 well is the only well in Petro-Reef's drilling program that features a working interest agreement of this kind.

Production tests on two offsetting wells in the same zone as the 12-28 are now complete at 12-33 (two kilometres north) and 11-27 (two kilometres east). Based on the results, the 12-33 and 11-27 are expected to produce 2.5 MMcf/d of natural gas plus 30 barrels per day of oil (447 BOE/d). The company's interest in these two wells is 54%, or 241 BOE/d. Petro-Reef expects to tie in these wells and bring them on stream by August 10, 2006. Based on the success of the offsetting wells, the company plans to drill two more wells in the same reservoir at the end of August and beginning of September 2006 at 8-29 (one kilometre southwest) and 14-20 (2.1 kilometres southwest).

A re-entry well announced on June 14, 2006 at 6-1 has been on stream for 83 days and continues to produce 35 to 38 barrels of oil per day with 80 Mcf/d of natural gas. At Petro-Reef's 44% interest, net production is 22 BOE/d. By early August 2006, the company plans to re-enter a well at 11-14 (3.7 kilometres to the northwest) to conduct a production test in the same oil zone. Petro-Reef's interest in the 11-14 is 50%.

A well announced at 5-31 on June 14, 2006 continued to flow as an oil well until July 24, 2006 with production rates after 65 days of production of 377 Mcf/d of natural gas and 35 barrels per day of crude oil. With a 64% interest in the well, net production to Petro-Reef has been 63 BOE/d. On July 25, 2006, the company started remedial work to complete and place the up-hole zone on stream. This is expected to occur within two weeks. If required, the well will be placed back on stream with a pump.

An offset well was re-entered in July 2006 at 14-30 (one kilometre south), and was perforated and fracture stimulated, yielding initial production rates of up to 1.1 MMcf/d of

natural gas (183 BOE/d). Petro-Reef has a 54% interest in the well. Net production to Petro-Reef is 99 BOE/d. Completion tests will continue for 10 to 14 days.

In mid August, Petro-Reef plans to drill a well at 2-1 (1.4 kilometres northwest) as an offset test to the 5-31 oil and gas zone. A farmout agreement provides Petro-Reef with an 84% interest in the 2-1 well.

Petro-Reef has completed two other wells since June 14, 2006 at 16-30 and 1-31, resulting in two natural gas wells testing at a combined rate of 1.5 MMcf/d of natural gas (250 BOE/d). Petro-Reef has an interest of 34% in the 16-30 well and 54% in the 1-31 well. Net to Petro-Reef at an anticipated production rate of 900 Mcf/d is 61 BOE/d.

This was followed on September 14, 2006 with information on even more success.

Petro-Reef Resources Ltd. announces that it has encountered natural gas in three potential zones in the recently drilled well at 9-33, 1.7 kilometres northeast of its October 2005 natural gas discovery at 12-28 in Alexander, Alberta. The three potential zones include the producing zone at 12-28 plus two additional natural gas zones.

Weather permitting, the 9-33 will be production tested in the next two weeks to confirm the commercial potential of the three zones. The drilling rig has now been moved to 3-7 and is currently drilling. The 3-7 is exploratory and is being drilled on a new structure.

And on September 25, 2006 by:

Petro-Reef Resources Ltd. announces that it has encountered natural gas in two potential zones as well as crude oil in another potential zone in its recently drilled well at 3-7. The 3-7 well is located 4.8 kilometres northwest of Petro-Reef's October 2005 natural gas discovery in the well at 12-28 in the Alexander area of Alberta. The 3-7 was exploratory and was being drilled on a new structure.

Weather permitting, the well at 3-7 will be production tested in the next two to three weeks to confirm the commercial potential of the two natural gas zones. Petro-Reef expects to drill the oil zone at a later date. The drilling rig will be moved to 2-1 and is expected to begin drilling within three days. The 2-1 is a step-out well from producing wells at 6-1 and 5-31. The 2-1 well will help Petro-Reef determine the extent and boundaries of the producing formation.

And on October 20, 2006 by:

Petro-Reef Resources Ltd. announces that it has completed three successful production tests in the company's core area of Alexander, Alberta. The wells at 8-29, 9-33 and 3-7 were production tested based on extended wellhead deliverability natural gas rates and at existing pipeline operating pressures as follows:

Well		Flow Rate	Petro-Reef Interest	Petro-Reef Estimated Net Potential BOE/d
8-29		827 mcf/d	54.00%	74
9-33	Zone A	1,100 mcf/d	63.67%	117
	Zone B	1,080 mcf/d	63.67%	115
3-7	Zone A	836 mcf/d	54.00%	75
	Zone B	3,930 mcf/d	54.00%	354

Petro-Reef expects to drill two more wells in the next two months at 9-33 and 3-7 to produce the additional gas zones that were tested but cannot be placed on stream due to potential problems with dual zone production. Additional oil zones that have also been identified are expected to be drilled at a later date.

The well at 2-1, which was announced on September 25, 2006, has finished drilling and production casing has been run. This well is a step-out well to the 5-31 and 6-1 producing oil discoveries. The well will be production tested for oil or natural gas in the next 30 days.

Two additional wells previously announced at 14-20 and 11-14 have not yet been drilled and are awaiting regulatory approval.

Petro-Reef's October 2005 natural gas discovery at 12-28 is still producing at 2,100 mcf/d of natural gas. The well has reverted from an 84% interest to 34% after recovery of 400% of drilling and completion costs plus 200% of equipping and tie-in costs. Petro Reef's net production from the well is now 124 barrels of oil equivalent per day (BOE/d).

With Petro-Reef's existing production, the wells currently being tied-in, and the additional well tie-ins at 8-29, 9-33 and 3-7 the company expects net production to be at approximately 950 BOE/d by early December 2006. The company is on target to achieve its 2006 exit production target of between 1100 and 1550 BOE/d.

Petro-Reef provided an operations update in a December 19, 2006 news release.

Petro-Reef is pleased to report continued positive results from its field operations in Alexander. The well at 2-1 tested natural gas at an initial rate of 1.6 million cubic feet per day with approximately 10 barrels of oil per day. The 14-20 well has been drilled and production casing has been run. Testing will be done as soon as practical. The first twin well at 9-33 is drilling and Petro-Reef expects to run production casing before Christmas. Details will follow when available.

Subsequently Petro-Reef in 2007 drilled three additional successful wells with both natural gas and crude oil potential.

Success has created its own challenges. As each new high pressure natural gas well is added to the gathering pipeline system it becomes more difficult for the more distant, lower pressure wells continue producing at their current rate. As a result Petro-Reef is currently designing a major gas compressor facility to correct the problem and thereby significantly increase natural gas production. June has been set as the target date for this project to become operational.

OUTLOOK

Petro-Reef's average March production is estimated to have been approximately 700 BOE/d. The Company expects to spend \$7.5 million to drill 16 wells (9.1 net) in 2007, all within the company's core operating area of Alexander/Qui Barre. Production has been up to 900 BOE/d, but the average was reduced due to having to shut in producing wells while a twin well was being drilled.

FINANCING

On July 19, 2005 Petro-Reef announced a private placement that was reported as follows.

Petro-Reef Resources Ltd. is pleased to announce that it has agreed to issue by way of a private placement assistance of a finder. The Units are priced at \$0.45 and consist of one common Share and one Purchase Warrant. Each Purchase Warrant entitles the holder to purchase one additional Common Share at an exercise price of Cdn \$0.70 per Common Share, if exercised within 18 months after the closing of this Offering. The Units will be issued pursuant to prospectus exemptions available under applicable securities legislation in Alberta and Ontario. Sinalta Investments Ltd. has undertaken to act as "finder" for which it will be paid a finders fee of \$100,000, and subject to the approval of the TSXV, the finder shall also be granted warrants to acquire up to 500,000 Common Shares of Petro-Reef at an exercise price of Cdn \$0.70 per Common Share, if exercised within 18 months after the closing of this Offering. The Company will use the proceeds for oil and gas development and exploration expenditures.

The financing is scheduled to close on or about July 28, 2005 or such other date as the finder and Petro-Reef may agree upon, and is conditional upon receiving regulatory approval, including approval of the TSX Venture Exchange and completion of definitive documentation.

On February 26, 2007 Petro-Reef Resources Ltd. announced that 3,499,987 out of a total 3,824,987 purchase warrants issued by the Corporation under financing that closed in August and September 2005 had been exercised. The warrants, which were exercisable at a price of \$0.70 per share, expired on February 20, 2007. As a result the Corporation has received aggregated proceeds of \$2,499,990.90.

On December 19, 2006 announced another private placement as follows.

Petro-Reef Resources Ltd. is pleased to announce that it has entered into an engagement letter with Primary Capital Inc. ("Primary") pursuant to which Primary has agreed, subject to completion of satisfactory due diligence, to sell on a "best efforts" basis, up to a maximum of 4,782,609 units ("Units") at a price of \$1.15 per Unit for an aggregate purchase price of \$5,500,000.35 (\$5,115,000.33 net of commissions). Primary will also receive an Over-Allotment Option to offer and sell an additional 478,261 Units for additional gross proceeds of up to \$550,000.15 (the "Over-Allotment Option"), which if exercised and fully sold, would give Petro-Reef gross proceeds of \$6,050,000.50 (\$5,626,500.47 net of commissions). Primary may exercise the Over-Allotment Option up to 2 business days prior to the Closing Date. The Closing Date is expected to be on or about January 19, 2007, or as otherwise agreed by Petro-Reef and Primary.

The Units are comprised of one common share of the Corporation ("Share") and one-half of one warrant ("Warrant"), each whole Warrant being exercisable to purchase one Share for a period of 18 months after the Closing Date at an exercise price of \$1.75 per Share, provided

that if the closing price of the Shares on the TSX Venture Exchange is equal to or greater than \$2.20 per Share for a period of 20 consecutive trading days any time after four months and one day after the Closing Date, the Corporation may accelerate the expiry date of the Warrants by giving notice to the holders thereof and in such case the Warrants will expire on the 30th day after the date on which such notice is given by the Corporation.

Petro-Reef has agreed to pay Primary a commission equal to 7% of the gross proceeds raised, and to issue broker warrants ("Broker Warrants") to it, entitling Primary to purchase up to that number of Units which is equal to 7% of the number of Units issued under the Offering, at an exercise price of \$1.15 per Unit at any time on or before the date which is 18 months after the Closing Date. These Units will be identical to those being offered under the private placement.

Assuming the exercise of all Warrants (including the Warrants comprising the Broker Warrants), Petro-Reef will realize additional gross proceeds of \$4,477,717.68 (\$4,925,489.54 if the Over-Allotment Option is fully exercised).

The Units will be issued as a private placement to certain investors identified by Primary. The net proceeds received from the sale of the Units will be used to fund the continued exploration and development of Petro-Reef's properties. Closing is subject to normal regulatory approvals. The Units will be subject to a four month hold period from the Closing Date.

The closing of this private placement was reported in a news release dated January 26, 2007.

Petro-Reef Resources Ltd. has closed its previously announced private-placement financing, raising gross aggregate proceeds of \$6,050,000.50. The offering, announced on December 19, 2006, was fully subscribed. Petro-Reef plans to use the net proceeds of the offering to fund continued exploration and development of its core area in Alexander, Alberta.

The offering consisted of 5,260,870 units of the Corporation ("Units") at a price of \$1.15 per Unit. Each Unit consisted of one common share and one-half of the one common share purchase warrants of the Corporation. Each whole common share purchase warrant ("Warrant") is exercisable to acquire one common share of the Corporation at an exercise price of \$1.75 for a period ending on July 25, 2008. If the closing price of the common shares is higher than \$2.20 for a period of 20 consecutive days at any time after four months and one day after the closing date, the Corporation may accelerate the expiry date of the Warrants by giving notice to the holders. In such case, the Warrants would expire on the 30th day after the date on which notice is given.

Primary Capital Inc. served as the agent for the private-placement offering and received a 7% cash commission out of the gross proceeds and non-transferable broker warrants ("Broker Warrants") exercisable to acquire 368,260 units of the Corporation ("Broker Units") at a price of \$1.15 per Broker Unit until July 25, 2008. Each Broker Unit consists of one common share of the Corporation and one-half of one common share purchase warrant. Each whole common share purchase warrant exercisable to acquire one common share of the Corporation at a price of \$1.75 for a period ending on July 25, 2008.

After giving effect to this offering, Petro-Reef has 29,103,661 common shares issued and outstanding.

Subsequently on April 02, 2007 Petro-Reef announced a flow through share private placement as follows.

Petro-Reef Resources Ltd. is pleased to announce that it has entered into an engagement letter with Primary Capital Inc. ("Primary") pursuant to which Primary has agreed, subject to completion of satisfactory due diligence, to sell on a "best efforts" basis, up to a maximum of 1,500,000 common Shares ("Flow Through Shares") at a price of \$2.00 per share on a flow through basis for an aggregate purchase price of \$3,000,000 (\$2,805,000 net of commissions). The Closing Date is expected to be on or about April 13, 2007, or as otherwise agreed by Petro-Reef and Primary.

Petro-Reef has agreed to pay Primary a commission equal to 6.5% of the gross proceeds raised, and to issue broker warrants ("Broker Warrants") to it, entitling Primary to purchase up to that number of common shares of Petro-Reef which is equal to 6.5% of the number of Flow Through Shares issued under the Offering, at an exercise price of \$2.00 per share at any time on or before July 25, 2008. These shares will not carry flow through treatment.

The Flow Through Shares will be issued as a private placement to certain investors identified by Primary. The net proceeds received from the sale of the Flow Through Shares will be used to fund the continued exploration and development of Petro-Reef's properties. Closing is subject to normal regulatory approvals. The Flow Through Shares will be subject to a four month hold period from the Closing Date.

The actual closing date was April 25, 2007.

On October 09, 2001 the Corporation entered into an operating line of credit with the National Bank of Canada with a credit facility in the form of a revolving operating demand loan with a limit of one million (\$1,000,000) dollars and a non-revolving acquisition demand loan with a maximum limit of one-half million (\$500,000) dollars.

On December 30, 2003 the operating line of credit was increased to two million (\$2,000,000) dollars with the non-revolving demand loan for acquisitions and development remaining at one-half million (\$500,000) dollars.

On July 24, 2006 the operating line of credit was increased to three million seven hundred and fifty thousand (\$3,750,000) dollars with the non-revolving demand loan for acquisitions and development increasing to one million (\$1,000,000) dollars).

The results of operations in 2004, 2005 and 2006 are set out in the following tables under three categories:

- 1) Land acquisitions
- 2) Petro-Reef operated wells
- 3) Wells where Petro-Reef is not the operator

Joint-venture partnerships are involved in both the operated and non-operated drilling and accounts for the varying interests held by Petro-Reef.

**LAND COSTS FOR THE ACQUISITION OF MINERAL LEASES
(NET OF DISPOSITIONS, RENTALS OR SURFACE LEASES)**

<u>YEAR</u>	<u>PERIOD</u>	<u>GROSS ACRES</u>	<u>NET ACRES</u>	<u>COST (NET)</u>	<u>COMMENTS</u>
2004	Q1	6	3	\$ 480	Lease Service Only
	Q2	-	-	\$ 466	
	Q3	1,189	404	\$16,140	
	Q4	1,829	724	\$61,506	
TOTAL		<u>3,024</u>	<u>1,113</u>	<u>\$78,592</u>	\$71 average per net acre
2005	Q1	1,920	653	\$103,316	Lease Service Only
	Q2	480	206	\$ 32,500	
	Q3	1,920	960	\$ 51,837	
	Q4	968	752	\$ 35,232	
TOTAL		<u>5,288</u>	<u>2,571</u>	<u>\$222,885</u>	\$87 average per net acre
2006	Q1	824	761	\$167,531	
	Q2	353	42	\$ 27,885	
	Q3	253	251	\$ 68,529	
	Q4	423	340	\$ 99,797	
TOTAL		<u>1,853</u>	<u>1,394</u>	<u>\$363,743</u>	\$261 average per net acre

Lease Service Only cost refers to third party land company expenses.

In 2006, 46% fewer net acres were acquired than in 2005, at an increased total cost of 63%.

The average cost per net acre increased significantly to \$261 in 2006 from \$87 in 2005.

SELECTED FINANCIAL INFORMATION

FINANCIAL (year-ended December 31)	2004	2005	2006
Crude Oil and Natural Gas Revenue net of royalties and ARTC	\$2,162,656	\$3,224,567	\$5,749,891
Cash Flow from Operations	\$1,065,076	\$2,007,713	\$3,557,432
Net (Loss) Earnings from Operations	(\$542,087)	\$248,714	\$65,060
Net (Loss) Earnings per Share, Basic and Diluted	(\$0.03)	\$0.01	0.00
Capital Expenditures	\$1,148,725	\$2,374,843	\$7,888,288
Total Assets	\$8,691,850	\$10,462,289	\$15,056,446
Bank Balance (Loan)	(\$700,000)	\$397,904	(\$376,613)
Shareholders' Equity	\$4,021,269	\$6,029,968	\$7,919,194

The following table summarizes the results of the 12 most recently completed quarters.

Summary of Quarterly Results For The Last Twelve Quarters				
		Oil & Gas Sales Net of Royalties And ARTC	Net Earnings (Loss)	Basic and Diluted Earnings Per Share
2004			(Restated)	
	Q1	\$354,288	(\$81,806)	\$0.00
	Q2	\$531,591	(\$75,371)	\$0.00
	Q3	\$499,139	\$34,086	\$0.00
	Q4	<u>\$777,638</u>	<u>(\$418,996)</u>	<u>(\$0.03)</u>
Total		<u>\$2,162,656</u>	<u>(\$542,087)</u>	
2005				
	Q1	\$701,154	(\$14,869)	\$0.00
	Q2	\$621,790	(\$24,224)	\$0.00
	Q3	\$582,100	(\$21,890)	\$0.00
	Q4	<u>\$1,319,523</u>	<u>\$309,697</u>	<u>(\$0.01)</u>
Total		<u>\$3,224,567</u>	<u>\$248,714</u>	
2006				
	Q1	\$1,797,362	\$75,453	\$0.01
	Q2	\$1,708,596	\$2,619	\$0.00
	Q3	\$1,045,216	(\$67,349)	\$0.00
	Q4	<u>\$1,198,717</u>	<u>\$54,337</u>	<u>\$0.00</u>
Total		<u>\$5,749,891</u>	<u>\$65,060</u>	

The following table summarizes the results of the 12 most recently completed quarters.

PETRO-REEF RESOURCES LTD. OPERATED WELLS

DRILLING, COMPLETION & WORKOVERS			
YEAR	LOCATION	COST	PER % W.I.
2004			
Q2	14-30-55-26W4	\$147,450	24.00
	05-31-55-26W4	\$21,093	44.00
Q3	14-30-55-26W4	\$23,319	24.00
	05-31-55-26W4	\$17,741	44.00
	09-30-56-24W4	\$4,755	71.50
Q4	05-25-56-25W4	\$192	39.00
	14-30-55-26W4	\$1,757	24.00
	05-31-55-26W4	\$219	44.00
	05-25-56-25W4	\$18,612	39.00
2005			
Q1	10-30-56-27W4	\$17,284	35.13
	13-29-55-26W4	\$2,746	44.00
	05-31-55-26W4	\$1,641	44.00
	06-15-56-27W4	\$152	50.00
	14-25-55-25W4	\$13	15.96
	16-26-55-25W4	\$274	50.00
	16-26-56-25W4	\$332	25.88
	04-19-56-24W4	\$26,689	36.50
	06-35-56-25W4	\$639	61.28
	07-32-56-25W4	\$2,083	72.50
	07-35-56-25W4	\$440	62.27
Q2	05-25-56-25W4	\$166	39.00
	10-30-56-27W4	\$1,253	35.13
	13-29-55-26W4	\$193,660	44.00
	14-30-55-26W4	\$5,411	24.00
	05-31-55-26W4	\$31,294	44.00
	14-25-55-25W4	\$431	15.96
	16-26-55-25W4	\$329	50.00
	05-36-55-25W4	\$308	20.00
	06-35-56-24W4	\$3,333	61.28
	07-32-56-25W4	\$144	72.50
	07-35-56-25W4	\$63	62.27

DRILLING, COMPLETION & WORKOVERS cont.			
YEAR	LOCATION	COST	PER % W.I.
2005			
Q3	12-28-55-26W4	\$68,506	54.00
	13-29-55-26W4	\$34,348	44.00
	05-31-55-26W4	\$61,285	44.00
	06-01-56-27W4	\$7,297	44.00
	06-15-56-27W4	\$1,136	50.00
	14-25-55-25W4	\$59	15.96
	16-26-55-25W4	\$53	50.00
	04-19-56-24W4	\$383	36.5
	05-36-55-25W4	\$965	20.00
	06-35-56-25W4	\$2,183	62.27
	07-32-56-25W4	\$429	72.50
	07-35-56-25W4	\$501	62.27
Q4	10-33-55-26W4	\$13,025	54.00
	11-27-55-26W4	\$3,918	54.00
	12-28-55-26W4	\$488,346	54.00
	12-33-55-26W4	\$5,693	54.00
	13-21-55-26W4	\$4,271	54.00
	13-29-55-26W4	\$927	44.00
	05-31-55-26W4	\$6,362	44.00
	06-01-56-27W4	\$4,303	44.00
	08-01-56-27W4	\$128,790	44.00
	05-36-55-25W4	\$557	20.00
	06-35-56-25W4	\$1,105	61.28
	07-35-56-25W4	\$558	62.27
	05-25-56-25W4	\$25,852	39.00
2006			
Q1	10-33-55-26W4	\$18,228.93	54.00
	12-33-55-26W4	\$129,352.11	44.00
	13-21-055-26W4	\$57,754.60	54.00
	05-31-55-26W4	\$13,943.26	64.00
	06-01-56-27W4	\$75,916.10	44.00
	08-01-56-27W4	\$51.11	59.00
	11-27-55-26W4	\$41,497.10	54.00
	08-22-56-25W4	\$688.05	31.2750257
	05-25-56-25W4	\$284.43	39.00
Q2	01-31-55-26W4	\$412,167.12	54.00
	10-30-55-26W4	\$527.64	35.13
	10-33-55-26W4	\$44,817.76	54.00
	12-28-55-26W4	\$25,976.73	34.00
	12-33-55-26W4	\$297,867.43	44.00
	13-21-55-26W4	\$212,982.06	54.00
	13-29-55-26W4	\$4.14	34.00

DRILLING, COMPLETION & WORKOVERS cont.

YEAR	LOCATION	COST	PER % W.I.
2006			
Q2	14-30-55-26W4	\$63.86	54.00
	05-31-55-26W4	\$340,717.11	64.00
	06-01-56-27W4	\$216,570.91	44.00
	06-15-56-27W4	\$1,327.99	50.00
	08-01-56-27W4	(\$41.82)	59.00
	11-27-55-26W4	\$403,279.33	54.00
	05-36-55-25W4	\$20.00	20.00
	07-35-55-25W4	\$9.95	19.9375
Q3	01-31-55-26W4	\$151,964.82	54.00
	10-33-55-26W4	\$1,200.47	54.00
	11-14-55-26W4	\$16,802.93	50.00
	12-28-55-26W4	\$1,717.00	34.00
	12-33-55-26W4	\$3,874.43	44.00
	13-21-55-26W4	\$3,736.83	54.00
	13-29-55-26W4	\$2,651.61	34.00
	14-20-55-26W4	\$23,460.82	64.00
	14-30-55-26W4	\$171,055.76	54.00
	02-01-56-27W4	\$36,553.06	84.00
	03-07-56-26W4	\$275,794.86	54.00
	05-31-55-26W4	\$174,189.08	64.00
	06-01-56-27W4	\$8,938.44	44.00
	06-15-56-27W4	\$166.90	50.00
	08-01-56-27W4	\$43,037.07	59.00
	08-29-55-26W4	\$65,111.86	54.00
	100/09-33-055-26W4	\$339,944.71	63.67
	11-27-55-26W4	\$50,309.04	54.00
05-36-55-25W4	\$29.92	20.00	
Q4	01-31-55-26W4	\$671.38	54.00
	10-33-55-26W4	\$2,041.70	54.00
	11-14-56-27W4	\$4,262.05	50.00
	12-33-55-27W4	\$2,498.08	44.00
	13-21-55-26W4	\$1,542.11	54.00
	14-20-55-26W4	\$372,319.38	64.00
	14-30-55-26W4	\$75.46	54.00
	02-01-56-27W4	\$559,690.34	84.00
	03-07-56-26W4	\$118,103.48	54.00
	05-31-55-26W4	(\$89.88)	64.00
	06-01-56-27W4	\$23,129.33	44.00
	06-15-56-27W4	\$1,108.97	50.00
	08-01-56-27W4	\$12,891.97	59.00
	08-29-55-26W4	\$265,803.50	54.00
	100/09-33-55-26W4	\$120,655.06	63.67
	102/09-33-55-26W4	\$201,223.23	44.00
	11-27-55-26W4	\$1,152.47	54.00
	09-30-56-24W4	\$63,305.18	71.50

PETRO-REEF RESOURCES LTD. OPERATED WELLS

EQUIPPING & TIE-IN			
YEAR	LOCATION	COST	PER % W.I.
2004			
Q1	10-30-56-27W4	\$22,260	35.13
	05-31-55-26W4	\$93,669	44.00
	09-30-56-24W4	\$39,216	71.50
Q2	05-31-55-26W4	\$34,438	44.00
	09-30-56-24W4	\$35,710	71.50
Q3	14-30-55-26W4	\$57,570	34.00
	05-31-55-26W4	\$4,444	44.00
	09-30-56-24W4	\$231	71.50
Q4	14-30-55-26W4	\$278	34.00
	05-31-55-26W4	(\$61)	44.00
2005			
Q1	14-30-55-26W4	\$3,333	24.00
	05-31-55-26W4	\$35,216	44.00
	04-19-56-24W4	\$68,343	36.50
	05-25-56-25W4	\$63,341	39.00
	09-30-56-24W4	\$7,299	71.50
Q2	10-30-56-27W4	\$5,109	35.13
	13-29-55-26W4	\$3,105	34.00
	14-30-55-26W4	\$278	24.00
	04-19-56-24W4	\$221	36.50
	09-30-56-24W4	\$11,895	71.50
Q3	13-29-55-26W4	\$2,112	44.00
	14-30-55-26W4	\$88	44.00
Q4	12-28-55-26W4	\$345,486	54.00
	14-30-55-26W4	\$22,355	24.00
	05-31-55-26W4	\$5,333	64.00
	06-01-56-27W4	\$134	44.00
	08-01-56-27W4	\$97,678	44.00
	05-25-56-25W4	(\$11,032)	39.00
	09-30-56-24W4	\$18,389	71.50
2006			
Q1	12-28-55-26W4	\$2,378.22	34.00
	05-31-55-26W4Plant	\$29,033.20	49.00
	06-01-56-27W4	\$12,194.95	44.00
	08-01-56-27W4	\$8,581.26	59.00
	05-25-56-25W4	\$1,040.54	39.00

PETRO-REEF RESOURCES LTD. OPERATED WELLS

YEAR	LOCATION	COST	PER % W.I.
2006			
Q2	01-31-55-26W4	\$6,706.89	54.00
	10-33-55-26W4	\$10,624.70	54.00
	12-28-55-26W4	\$1,960.55	34.00
	12-33-55-26W4	\$15,028.22	44.00
	16-30-55-26W4	\$544.60	34.00
	06-01-56-27W4	\$82,848.33	44.00
	08-01-56-27W4	(\$49,195.00)	59.00
	11-27-55-26W4	\$24,083.23	54.00
Q3	12-28-55-26W4	\$65,115.48	34.00
	12-33-55-26W4	\$132,477.46	44.00
	14-30-55-26W4	\$74,988.24	54.00
	16-30-55-26W4	\$65,629.04	34.00
	05-31-55-26W4	\$115,650.92	64.00
	05-31-55-26W4Plant	\$10,673.97	49.00
	06-01-56-27W4	\$4,209.47	44.00
	100/09-33055-26W4	\$26,575.34	63.67
11-27-55-26W4	\$275,451.10	54.00	
Q4	12-28-55-26W4	\$13,591.77	34.00
	12-33-55-26W4	\$233,729.05	44.00
	14-20-55-26W4	\$17,758.49	64.00
	14-30-55-26W4	\$1,997.24	54.00
	16-30-55-26W4	\$2,540.93	34.00
	02-01-56-27W4	\$32,726.51	84.00
	03-07-56-26W4	\$142,661.06	54.00
	05-31-55-26W4	\$32,221.22	64.00
	06-01-56-27W4	\$353.77	44.00
	08-01-56-27W4	(\$15,165.15)	59.00
	08-29-55-26W4	\$145,069.75	54.00
	100/09-33-55-26W4	\$152,291.09	63.67
	11-27-55-26W4	\$806.29	54.00
	05-25-56-25W4	(\$29,143.69)	39.00
09-30-56-24W4	\$76,066.95	71.50	

PETRO-REEF RESOURCES LTD. NON-OPERATED WELLS

DRILLING, COMPLETION & WORKOVERS				
Year	Location	Cost	Status	PER % W.I.
2004				
Q4	06-07-56-25W4	\$7,581	Producing Gas Well	12.50
Q4	01-20-56-27W4	\$3,895	Producing Gas Well	1.04
2005				
Q1	15-36-55-27W4	\$2,056.67	Producing Gas Well	2.09375
Q2	06-07-55-25W4	\$23,092.89	Producing Gas Well	12.50
2006				
Q1	07-21-56-27W4	\$713.82	Producing Gas Well	50.00
Q1	14-25-55-25W4	\$13.97	Producing Gas Well	28.0125
Q1	06-35-56-25W4	\$31.84	Producing Gas Well	61.2750257
Q1	06-07-56-25W4	(\$382.50)	Producing Gas Well	60.9375
Q2	06-35-56-25W4	\$30.56	Producing Gas Well	61.2750257
Q3	06-35-56-25W4	\$481.53	Producing Gas Well	61.2750257
Q4	14-29-56-25W4	\$93.19	Producing Gas Well	100.00
Q4	03-05-56-25W4	\$169.93	Producing Gas Well	100.00

PETRO-REEF RESOURCES LTD. NON-OPERATED WELLS

Year	Location	Cost	Status	PER % W.I.
2004				
Q4	06-07-56-25W4	\$9,397	Producing Gas Well	60.9375
Q4	01-20-56-27W4	\$4,236	Producing Gas Well	1.04
Q4	15-25-56-25W4	\$2,756	Producing Gas Well	1.2750257
2005 Note: There were no wells equipped or tied-in where Petro-Reef was not the operator				
2006				
Q1	06-07-56-25W4	\$1,575.40	Producing Gas Well	60.9375
Q1	15-22-58-25W4	\$243.49	Producing Gas Well	100.00
Q2	01-20-56-27W4	\$80.01	Producing Gas Well	1.04
Q2	15-36-55-26W4	\$70,107.91	Producing Gas Well	21.094
Q3	15-36-55-26W4	\$10,413.92	Producing Gas Well	21.094
Q4	15-36-55-26W4	\$4,279.28	Producing Gas Well	21.094

The following table represents the pro-forma budget and cash flow for 2007 as prepared by management in respect of revenues expected, less expenses (royalties, operating, interest, general and administrative and professional fees), cash flow, capital expenditures, and net cash flow for the periods indicated.

PETRO-REEF CASH FLOW AND PRO-FORMA BUDGET FOR 2007
QUARTER ENDED
(\$000's)

	<u>March 31</u>	<u>June 30</u>	<u>Sept. 30</u>	<u>Dec. 31</u>	<u>Total</u>
Gross Crude Oil & Natural Revenue					
Net of Royalties, ARTC and Operating	1,425	1,500	1,782	1,923	6,630
Expenses					
General and Administrative	318	318	318	318	1,272
Cash Flow (Before Capital)	1,107	1,182	1,464	1,605	5,358
Capital Cost					
--Drilling, Completion & Tie-In	1,499	1,333	2,765	1,865	7,462
-Seismic & Land	386	408	568	-	1,362
Net Cash Flow (After Capital)	(778)	(559)	(1,869)	(260)	(3,466)
Bank Loan repaid (\$000's)	(375)				(375)
Other					
- Alberta Royalty Tax Credit	152				152
- Warrants Exercised	2,001				2,001
- Private Placements	5,601	2,800			8,401
Cash on Hand	6,601	8,842	6,973	6,713	6,713

Note (1) Due to plant shut down from May 1-13, 2007 for maintenance, revenue will be reduced

Note (2) Royalties and operating expenses are estimated at 40% of gross revenue

Note (3) Management has determined that the Cash Flow estimates can be attained through a combination of cash on hand, cash flow, private placements and necessary bank financing

Note (4) Revenue from wells drilled during the year is not included. The gross of \$6,630,000 is extracted from the independent engineering report as an estimate and not revenues from existing production

Petro-Reef's short-term requirements for cash are met by cash on hand, current cash flow from operations and bank financing. Management has determined that Petro-Reef's cash flow estimates can be attained through a combination of these sources. Long-term cash requirements will depend on the success of the drilling program. Currently, long-term financing is done with bank financing and current cash flow from operations. Consideration for future financing will include increase in bank financing, and issuance of shares from treasury. The company is not nor does it expect to be in default of any of its obligations.

Petro-Reef has no off-balance sheet arrangements.

As the time of writing this report Petro-Reef is not considering any proposed acquisitions or dispositions outside the normal course of business. If, as and when the transaction is proposed, and finalized it shall be reported as required.

The present office lease agreement expires on September 30, 2011. Future lease payments, excluding operating costs, to the end of the lease term are as follows:

2007	\$77,577
2008	\$80,922
2009	\$84,258
2010	\$86,762
2011	\$65,070

The preparation of consolidated financial statements in accordance with Canadian GAAP requires management to make estimates and assumptions and to use judgment regarding assets, liabilities, revenues and expenses. Accordingly, actual results may differ from those estimated amounts.

Recorded amounts for depletion and depreciation, asset retirement obligations and abandonment costs, the impairment of oil and natural gas properties and amounts used for the ceiling test and impairment calculations and based on estimates of oil and natural gas reserves and future costs required to develop those reserves. By their nature, these estimates of reserves and the related future cash flows and costs are subject to measurement uncertainty, and the effect on the consolidated financial statements of future periods could be significant.

The total future asset retirement obligation was estimated based on the Company's net ownership in all wells and facilities, estimated costs to reclaim and abandon the wells and the estimated timing of costs to be incurred in future periods. The Company has estimated the net present value of its asset retirement obligation to be \$391,648 (2005 – \$217,915) as at December 31, 2006 based on a total future liability of \$711,198 (2005 – 389,677), which will be incurred between 2006 and 2025. A credit adjusted risk free rate of 5.36 percent (2005 – 6.08 percent) and an inflation rate of two percent were used to calculate the fair value of the asset retirement obligation.

A reconciliation of the asset retirement obligation is provided below:

	<u>2006</u>	<u>2005</u>
Balance, beginning of year	\$217,915	\$155,456
Liabilities incurred in year	142,379	64,423
Liabilities settled in year	(432)	(15,229)
Accretion expense	31,786	13,265
	<hr/>	<hr/>
Balance, end of year	<u>\$391,648</u>	<u>\$217,915</u>

The authorized share capital of the company is comprised of an unlimited number of common shares. Details of the changes in the company's issued share capital during 2006 and 2005 are as follows:

	<u>2006</u>		<u>2005</u>	
Common Shares	Number of shares	Amount \$	Number of shares	Amount \$
Balance – Beginning of year	21,438,924	5,558,614	17,738,937	4,772,876
Issued for the exercise of:				
Stock options	1,180,000	1,042,909		
Unit private placement	1,066,367	959,737	200,000	101,060
Share issue costs (net of \$96,500 of tax)	-	-	3,499,987	874,995
	-	(1,500)	--	190,317
	<hr/>			
Balance – End of year	<u>23,685,291</u>	<u>7,559,760</u>	<u>21,438,924</u>	<u>5,558,614</u>

Basic and diluted earnings (loss) per common share are calculated using the weighted average number of common shares outstanding during the year of 25,413,664 (2005 – 21,747,157).

The company has a stock option plan for directors, officers and key employees. The exercise price of each option equals the market price of the company's stock on the date of grant. Options are vested over three years and expire after a maximum exercise period of five years from the date of issuance. A summary of the status of the company's stock option plan as of December 31, 2006 and 2005 and changes during the year is presented below:

	<u>2006</u>		<u>2005</u>	
	<u>Number of Options</u>	<u>Weighted Average Exercise Price</u>	<u>Number of Options</u>	<u>Weighted Average Exercise Price</u>
Balance beginning of year	2,120,000	\$0.50	1,510,000	\$0.49
Granted	1,040,000	1.24	810,000	0.50
Exercised	(1,180,000)	(0.50)	(200,000)	(0.40)
Expired	-	-	-	-
Balance end of year	<u>1,980,000</u>	<u>0.89</u>	<u>2,120,000</u>	<u>\$ 0.50</u>
Exercisable end of year	<u>940,000</u>	<u>0.50</u>	<u>1,310,000</u>	<u>\$ 0.50</u>

The following table summarizes information about stock options outstanding at December 31, 2006:

<u>Exercise Price</u>	<u>Options outstanding</u>		<u>Options exercisable</u>	
	<u>Number Outstanding</u>	<u>Weighted Average Remaining Contractual Life</u>	<u>Number Exercisable</u>	<u>Weighted Average Remaining Contractual Life</u>
\$0.42	350,000	1.52	350,000	1.52
0.50	430,000	3.54	430,000	3.54
0.52	10,000	3.65	10,000	3.65
0.70	100,000	2.46	100,000	2.46
0.71	50,000	2.21	50,000	2.21
0.90	40,000	4.87	-	-
1.05	50,000	4.73	-	-
1.20	390,000	4.82	-	-
1.30	<u>560,000</u>	4.47	-	-
	<u>1,980,000</u>	<u>3.70</u>	<u>940,000</u>	<u>2.68</u>

Compensation cost of \$481,709 (2005 - \$176,308) has been recognized for stock options granted during the year.

The weighted average fair value of each option granted during the year ended December 31, 2006 is estimated on the date of grant using the Black-Scholes options pricing model with the following weighted average assumptions:

	2006	2005
Fair value of options granted (\$/share)	\$ 0.78	\$0.33
Risk-free interest rate (%)	4.02	3.40
Expected life (years)	3	3
Expected volatility (%)	1.30	102
Expected dividend yield (%)	-	-

CONTRIBUTED SURPLUS

	2006	2005
Balance – Beginning of year	<u>\$534,308</u>	<u>\$380,060</u>
Stock based compensation expense	\$481,709	\$176,308
Adjustment for options exercised in the year	(\$445,408)	(\$22,060)
Balance – End of year	<u>\$570,609</u>	<u>\$534,308</u>

**PETRO-REEF RESOURCES LTD.
CORPORATE INFORMATION**

DIRECTORS AND OFFICERS

Joseph Werner⁽⁴⁾

Chief Executive Officer
President & Director
Calgary, Alberta

Theodore M. Donhuysen^{(4) (5)}

Vice-President Exploration & Production
Chief Operating Officer & Director
Calgary, Alberta

Alan P. Hallman⁽²⁾

Director
Calgary, Alberta

Dennis K. Ulrich⁽³⁾

Director
Medicine Hat, Alberta

Jack P. Donhuysen^{(2) (5)}

Director
Calgary, Alberta

Huba A. SeboP^{(1) (5)}

Director
Calgary, Alberta

Richard W. DeVries^{(1) (2)}

Director
Freeport, The Bahamas

Robert N. Maertens-Poole⁽⁴⁾

Director
Chief Financial Officer
Calgary, Alberta

Gary W. Coleman⁽³⁾

Director, Assistant Secretary
Calgary, Alberta

R. Greg Powers^{(3) (6)}

Director
Corporate Secretary
Legal Counsel
Calgary, Alberta

Head Office

970 – 10655 Southport Road S.W.
Calgary, Alberta T2W 4Y1
Telephone: +1 (403) 265-6444
Facsimile: +1 (403) 264-1348
E-mail: info@petro-reef.ca
Website: www.petro-reef.ca

Stock Listing

TSX Venture Exchange
Trading Symbol: **PER**

Auditors

PricewaterhouseCoopers LLP
Chartered Accountants
3100, 111 - 5th Avenue S.W.
Calgary, Alberta T2P 5L3

Bank

National Bank of Canada
301 – 6th Avenue S.W.
Calgary, Alberta T2P 4M9

Registrar and Transfer Agent

CIBC Mellon Trust Company
600, 333 - 7th Avenue S.W.
Calgary, Alberta T2P 2Z1

Investor Relations

Bryan Mills Iradesso
400, 805 – 10th Avenue S.W.
Calgary, Alberta T2R 0B4

- (1) Member of the Audit Committee
- (2) Member of the Compensation Committee
- (3) Member of the Corporate Governance Committee
- (4) Member of the Management Committee
- (5) Member of the Reserves Committee
- (6) Fasken Martineau DuMoulin LLP
3400 First Canadian Centre
350 – 7th Avenue S.W.
Calgary, Alberta T2P 3N9