

**INTERIM REPORT  
FOR THE THREE AND SIX MONTHS ENDED  
JUNE 30, 2006**

**PETRO-REEF RESOURCES LTD.**

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**PETRO-REEF RESOURCES LTD.**

**MANAGEMENT'S DISCUSSION AND ANALYSIS**

This Management's Discussion and Analysis for Petro-Reef Resources Ltd. is part of the interim report for the first half of 2006 ended June 30, dated August 25, 2006. It was prepared by management and should be read in conjunction with the unaudited financial statements and notes which also are part of the same interim report, as well as in conjunction with the 2004 and 2005 annual audited financial statements and Management's Discussion and Analysis.

Petro-Reef's Management's Discussion and Analysis for 2005 was incorporated as part of the company's annual report for 2005, and is available for review on the SEDAR website ([www.sedar.com](http://www.sedar.com)).

Petro-Reef Resources Ltd. is a Calgary based crude oil and natural gas exploration and production company with producing properties in Alberta, Canada.

**Highlights of Financial and Operations Results for the First Half of 2004, 2005 and 2006**

<b>Financial</b>	<b>June 30 2004</b>	<b>June 30 2005</b>	<b>June 30 2006</b>	<b>2005 to 2006 % Change</b>
Crude oil and natural gas revenue net of Royalties and ARTC	\$885,879	\$1,322,944	\$3,505,958	+165
Cash flow from operations	\$391,364	\$823,070	\$2,363,091	+227
Cash flow from operations per share	\$0.02	\$0.05	\$0.06	+20
Net income (loss) for the period	\$(157,177)	\$(39,093)	\$78,072	-
Net income (loss) per share	\$(0.01)	\$0.00	\$0.00	-
Capital expenditures	\$644,682	\$856,090	\$2,715,881	+217
Bank balance (loan)	\$(1,425,000)	\$(1,000,000)	\$1,348,297	-
Shareholders' equity	\$4,280,289	\$4,173,767	\$6,600,111	+58
Weighted average common shares outstanding	17,690,226	17,800,815	22,134,124	+24
<b>Operations</b>	<b>June 30 2004</b>	<b>June 30 2005</b>	<b>June 30 2006</b>	<b>2005 to 2006 % Change</b>
<b>Daily Average Production</b>				
Crude oil and NGL (Bbls/day)	17	1	11	+1000
Natural gas (Mcf/day)	654	1134	3,300	+191
Total BOE/day	126	190	563	+196
<b>Average Selling Price</b>				
Crude oil (\$per Bbl)	47.43	52.38	62.55	+19
Natural gas (\$per Mcf)	6.71	7.12	6.74	-5
NGL (\$per Bbl)	43.71	50.78	54.70	+8

Petro-Reef continued to grow its production and cash flow in the first half of 2006. Cash flow from operations for the first six months of the year increased 227% in 2006 compared to the first six months of 2005. Over the same period, overall production measured in barrels of oil equivalent per day (BOE/d) increased 196%. Production in the second quarter of 2006 averaged 532 BOE/d with cash flow from operations of \$1.1 million, or \$0.05 per share.

The first half average product price for natural gas decreased 5% to \$6.74 per thousand cubic feet (Mcf) in 2006 from \$7.12 per Mcf in 2005.

The next three tables compare production and revenue for the first half of 2006, 2005 and 2004. Average daily production increased from 126 to 190 to 563 BOE/d which are progressively 50% and 196% increases. The “cash flow” column shows cash flow after royalties and operating expenses but before Alberta Royalty Tax Credits, general and administrative costs, interest expense, and income taxes. Refer to the financial statements for further details.

### 2006 PRODUCTION & REVENUE SUMMARY (Unaudited)

<u>Month</u>	<u>BOE</u>	<u>BOE / Day</u>	<u>REVENUE</u> \$	<u>ROYALTIES</u> \$	<u>EXPENSES</u> \$	<u>CASH FLOW</u> \$	<u>NETBACK</u> \$ / BOE
JAN	18,750.18	604.84	1,030,854.08	328,594.26	138,283.88	563,975.94	30.08
FEB	16,657.65	594.92	778,352.10	215,212.04	131,262.92	431,877.14	25.93
MAR	18,091.38	583.59	761,366.59	206,890.53	112,689.36	441,786.70	24.42
APR	16,171.27	539.04	706,245.77	179,274.58	109,758.70	417,212.49	25.80
MAY	16,422.18	529.75	606,857.47	156,149.12	142,588.46	308,119.89	18.76
JUNE	15,838.17	527.94	620,007.78	155,526.08	125,549.24	338,932.46	21.40
<b>Average/ Total</b>	<b>101,930.83</b>	<b>563.35</b>	<b>4,503,683.79</b>	<b>1,241,646.61</b>	<b>760,132.56</b>	<b>2,501,904.62</b>	<b>24.55</b>

### 2005 PRODUCTION & REVENUE SUMMARY (Unaudited)

<u>Month</u>	<u>BOE</u>	<u>BOE / Day</u>	<u>REVENUE</u> \$	<u>ROYALTIES</u> \$	<u>EXPENSES</u> \$	<u>CASH FLOW</u> \$	<u>NETBACK</u> \$ / BOE
JAN	7,367.51	237.66	310,711.42	73,677.99	64,905.41	172,128.02	23.36
FEB	6,768.89	241.75	288,550.33	63,607.96	58,985.61	165,956.76	24.52
MAR	7,144.40	230.46	341,209.02	72,145.99	59,937.19	209,125.84	29.27
APR	5,513.57	183.79	277,682.83	63,387.74	52,999.59	161,295.50	29.25
MAY	4,877.46	157.34	216,391.00	44,276.04	37,449.30	134,665.66	27.61
JUNE	2,831.13	94.37	133,539.72	15,847.04	69,309.99	48,382.69	17.09
<b>Average/ Total</b>	<b>34,389.39</b>	<b>190.27</b>	<b>1,568,084.32</b>	<b>332,942.76</b>	<b>343,587.09</b>	<b>891,554.47</b>	<b>26.04</b>

**2004 PRODUCTION & REVENUE SUMMARY (Unaudited)**

<u>Month</u>	<u>BOE</u>	<u>BOE / Day</u>	<u>REVENUE</u> \$	<u>ROYALTIES</u> \$	<u>EXPENSES</u> \$	<u>CASH FLOW</u> \$	<u>NETBACK</u> \$ / BOE
JAN	2,825.17	91.13	137,355.77	12,652.74	42,247.91	81,455.12	28.83
FEB	3,641.01	125.55	133,298.98	12,261.88	47,978.07	73,059.03	20.07
MAR	3,417.61	110.25	127,525.48	13,443.04	48,266.91	65,815.53	19.26
APR	5,770.79	192.36	233,092.98	15,348.82	60,074.23	157,669.93	27.32
MAY	3,992.75	128.80	180,718.10	14,861.46	42,773.06	123,083.58	30.83
JUNE	3,251.17	108.37	137,528.18	9,637.65	41,665.62	86,244.91	26.52
<b>Average/ Total</b>	<b>22,898.51</b>	<b>126.08</b>	<b>949,549.49</b>	<b>78,205.59</b>	<b>284,005.80</b>	<b>587,308.10</b>	<b>25.65</b>

**SUMMARY OF TWO YEARS OF QUARTERLY RESULTS**

	<u>Sep. 30</u> <u>2005</u>	<u>Dec. 31</u> <u>2005</u>	<u>Mar. 31</u> <u>2006</u>	<u>Jun. 30</u> <u>2006</u>
Crude oil and natural gas revenue net of Royalties and ARTC	\$582,100	\$1,319,524	\$1,797,362	\$1,708,596
Cash flow from operations	\$244,588	\$940,085	\$1,252,007	\$1,111,085
Cash flow from operations per share	\$0.01	\$0.05	\$0.06	\$0.05
Net income (loss) for the period	\$(21,890)	\$309,696	\$75,453	\$2,619
Net income (loss) per share	\$0.00	\$0.02	\$0.00	\$0.00
Capital expenditures	\$244,410	\$1,341,366	\$497,869	\$2,218,013
Bank balance (loan)	\$(900,142)	\$(302,096)	\$1,031,868	\$1,348,297
Shareholders' equity	\$5,665,500	\$6,029,968	\$6,103,921	\$6,600,111
Weighted average common shares outstanding	18,156,064	18,994,641	21,438,924	22,134,124
	<u>Sep. 30</u> <u>2004</u>	<u>Dec. 31</u> <u>2004</u>	<u>Mar. 31</u> <u>2005</u>	<u>Jun. 30</u> <u>2005</u>
Crude oil and natural gas revenue net of Royalties and ARTC	\$499,139	\$777,638	\$701,154	\$621,790
Cash flow from operations	\$221,913	\$451,795	\$473,740	\$349,330
Cash flow from operations per share	\$0.01	\$0.03	\$0.03	\$0.02
Net income (loss) for the period	\$34,086	\$(418,997)	\$(14,869)	\$(24,224)
Net income (loss) per share	\$0.00	\$(0.02)	\$0.00	\$0.00
Capital expenditures	\$114,238	\$412,189	\$430,681	\$425,409
Bank balance (loan)	\$58,069	\$(861,771)	\$(285,011)	\$321,241
Shareholders' equity	\$4,331,539	\$4,021,268	\$4,059,186	\$4,173,767
Weighted average common shares outstanding	17,695,933	17,701,232	17,738,837	17,800,815

## **ACTIVITY REVIEW AND CORPORATE UPDATE**

Petro-Reef's production in the first half of 2006 came mainly from its core area at Alexander/Qui Barre, Alberta. This area accounted for 98% of the total. Approximately 2 % came from Peavey/Morinville north of Edmonton, Alberta and from other minor interest properties. By the end of June, crude oil and natural gas liquids had reached about 11% of total production.

Following is an up-date of Petro-Reef's current activities and operations:

Petro-Reefs October 2005 natural gas discovery at 12-28 is currently producing at 2.16 million cubic feet per day (MMcf/d) of natural gas (306 barrels of oil equivalent per day (BOE/d) 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.

Production tests on the first two offsetting wells in the same zone as the 12-28 well were completed in late July 2006. The first of the two wells two kilometres east at 11-27 was placed on stream on August 21, 2006 at a rate of 2.10 MMcf/d of natural gas. With the company's interest at 54% net production to Petro-Reef is 1.134 MMcf/d of natural gas (189 BOE/d). The second well at 12-33, two kilometres north, has experienced timing delays due to wet weather and regulatory approvals but should be tied-in and on stream by September 20, 2006. The 12-33 well is expected to produce 500 Mcf/d of natural gas plus 30 barrels of crude oil per day (Bopd). With the company's interest at 54% net production to Petro-Reef is 270 Mcf/d of natural gas (45 BOE) plus 16 Bopd.

As announced on July 27, 2006, Petro-Reef expects to drill three wells offsetting the 12-28, 11-27 and 12-33 wells starting on August 30, 2006. Relative to the 12-28 well, the three wells are located one kilometre southwest at 8-29, 2.1 kilometres southwest at 14-20 and 1.75 kilometres northeast at 9-33. In addition to targeting the producing zone at 12-28, the 9-33 well will be evaluating five additional natural gas zones at the up-dip regional side of the prospective lands including the coal bed methane potential.

After almost four months, the well at 6-1 continues to produce at approximately 35 barrels of light sweet crude oil per day with the natural gas rate having dropped from 80 Mcf/d to approximately 10 Mcf/d. With the company's interest at 44%, net production to Petro-Reef is 15 Bopd. With the natural gas rate decreasing the company anticipates producing exclusively for crude oil from the 6-1 well to increase efficiency and strokes per minute for the pump. An off-set well at 11-14, 3.7 kilometres to the northwest, is still waiting for regulatory approval. Petro-Reef has a 50% working interest in this re-entry well, anticipated to commence in the next 30 days.

A well announced at 5-31 on June 14, 2006 has completed its remedial work and has been production tested by swabbing the well at a rate of 250 Mcf/d of natural gas plus 120 Bopd. With the company's interest at 64%, the production test rate net to Petro-Reef is 135 Mcf/d of natural gas, 20 BOE/d, plus 65 Bopd. Facilities are in place and the well is expected to be on-stream in 10 to 14 days.

As announced, a well at 14-30, one kilometre south of 5-31, in the same zone, yielded an initial production test rate of 1.1 MMcf/d of natural gas. With Petro-Reef having a 54% interest, net production to Petro-Reef on the production test is 594 Mcf/d of natural gas (99 BOE/d). The facilities for the well are being built and the company anticipates the well will be on-stream in the next five to seven days.

The well at 2-1, which is to be drilled as an offset to 6-1 and 5-31 will be drilled starting early September 2006. The 2-1 well, 1.4 kilometres northwest of the 5-31 well, provides Petro-Reef with an 84% interest pursuant to a farmout agreement.

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 of natural gas is 61 BOE/d. The well at 16-30 is to be tied in by the end of September 2006 with net production to Petro-Reef at 204 Mcf/d of natural gas (34 BOE/d). The second well at 1-31 will be placed on-stream at a later date after the 16-30 well has produced for at least 60 to 90 days.

Petro-Reef also expects to drill a well in September 2006 at 3-7, 2.7 kilometres north of the 5-31 well. This well is exploratory and will be drilled on a new structure.

Rig availability and commodity prices permitting, the company expects to drill up to 25 wells (13.5 net) in 2006, including the nine wells (five net) drilled to date and the six wells currently being licenced.

Petro-Reef's original projected cash flow from operations for the year 2006 of \$8.5 million was based on a price for natural gas of \$9.99 per Mcf at December 31, 2005 as established by the company's independent engineering evaluators. The forecast natural gas price for 2006 was recently revised to \$6.56 per Mcf. This lower price forecast results in a revised cash flow from operations projection for Petro-Reef of \$5.6 million in 2006.

Although Petro-Reef's cash flow is lower than projected because of lower than forecast natural gas prices, the company's production forecast is on track. By the end of September 2006, Petro-Reef expects its net production to exceed 800 BOE/d. Based on the success of recent drilling and the potential of the next six wells, Petro-Reef expects to achieve its 2006 exit production target of between 1,100 and 1,550 BOE/d ahead of schedule.

The following items are set out in detail in the Notes to Financial Statements which by reference are included as part of Management's Discussion and Analysis.

1. Accounting policies
2. Property, plant and equipment
3. Demand operating facilities
4. Asset retirement obligation
5. Share capital
  - a) Class A common shares
  - b) Warrants
  - c) Contributed surplus
  - d) Per share amounts
6. Stock based compensation
7. Cash flow supplemental information

As reported in the 2005 Annual Report, Petro-Reef's short-term requirements for cash are met by cash on hand, cash flow from operations, the exercise of stock options and warrants, 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.

The National Bank of Canada has made available to Petro-Reef two sources of financing. Credit Facility A is a revolving line of credit for \$2.2 million, at prime plus one and 1.5 percent. Credit Facility B is for acquisitions and development in the amount of \$500,000 at prime plus 1.5 percent. At June 30 the bank loan was nil, the bank balance was \$1,348,297.

Petro-Reef's Annual General Meeting of the shareholders was held June 15, 2006. Ten directors were elected, officers were appointed and five committees were formed. PricewaterhouseCoopers LLP were reappointed as auditors for the ensuing year. Refer to page 8 for details and other corporate information.

There were no related party transactions or off balance sheet arrangements in the second quarter of 2006.

During the second quarter of 2006 Petro-Reef filed the following news releases, available at [www.sedar.com](http://www.sedar.com) and at [www.petro-reef.ca](http://www.petro-reef.ca).

2006-04-03	Petro-Reef Resources Ltd. increases production, cash flow, earnings in 2005
2006-05-04	Petro-Reef Resources Ltd. files 2005 reserves data, MD&A and financials
2006-05-09	Petro-Reef Resources Ltd. reports initial drilling success at Alexander, Alberta
2006-05-24	Petro-Reef Resources Ltd. issues revised form of Proxy
2006-05-31	Petro-Reef Resources Ltd. achieves record cash flow, production in Q1, 2006
2006-06-14	Petro-Reef Resources Ltd. announces positive drilling results
2006-06-20	Petro-Reef Resources Ltd. announces results of the Annual General Meeting
2006-06-22	Petro-Reef Resources Ltd. grants stock options

One other news release to date was made on July 27, 2006 and reported on the continued drilling success at Alexander, Alberta.

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

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

On behalf of Petro-Reef and the board of directors, I would like to thank the shareholders for their continued support. We will continue to endeavour to meet and hopefully exceed your expectations.

"Joseph Werner"  
Joseph Werner  
President and Chief Executive Officer

Dated: August 25, 2006

## **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.

### **ABBREVIATIONS**

ARTC	Alberta Royalty Tax Credit	Mbbls	thousands of barrels
Bbl	barrel	Mcf	thousand cubic feet
Bbls	barrels	Mcf/d	thousand cubic feet per day
Bcf	billion cubic feet	MMbbls	millions of barrels
BOE	barrel of oil equivalent (1 BOE = 6 Mcf)	MMcf	million cubic feet
Bopd	Barrels of oil per day	MMcf/d	million cubic feet per day
FNR	future net revenue	NGL	natural gas liquids
GJ	Gigajoule	NPV	net present value
GJs/d	Gigajoules per day	RLI	reserve life index

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

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

**DIRECTORS AND OFFICERS**

**Joseph Werner<sup>(4)</sup>**

Chief Executive Officer  
President & Director  
Calgary, Alberta

**Theodore M. Donhuysen<sup>(4) (5)</sup>**

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

**Robert N. Maertens-Poole<sup>(4)</sup>**

Chief Financial Officer  
Calgary, Alberta

**Gary W. Coleman<sup>(3)</sup>**

Assistant Secretary and Director  
Calgary, Alberta

**Alan P. Hallman<sup>(2) (3)</sup>**

Director  
Calgary, Alberta

**Dennis K. Ulrich<sup>(3)</sup>**

Director  
Medicine Hat, Alberta

**Jack P. Donhuysen<sup>(2) (5)</sup>**

Director  
Calgary, Alberta

**Huba A. Sebo<sup>(1) (5)</sup>**

Director  
Calgary, Alberta

**N. Gary Van Nest<sup>(1) (3)</sup>**

Director  
Calgary, Alberta

**Richard W. DeVries<sup>(1) (2)</sup>**

Director  
Freeport, The Bahamas

**R. Greg Powers<sup>(6)</sup>**

Corporate Secretary  
Legal Counsel  
Calgary, Alberta

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**Stock Listing**

TSX Venture Exchange  
Trading Symbol: **PER**

**Auditors**

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

**Bank**

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

**Registrar and Transfer Agent**

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

**Investor Relations**

Iradesso Communications Corp.  
400, 805 – 10<sup>th</sup> 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, 350 – 7<sup>th</sup> Avenue S.W.  
Calgary, Alberta T2P 3N9

**PETRO-REEF RESOURCES LTD.**  
**FINANCIAL STATEMENTS (UNAUDITED)**  
**JUNE 30, 2006 AND 2005**

**PETRO-REEF RESOURCES LTD.**

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In accordance with National Instrument 51-102 released by the Canadian Securities Administrators, the Company discloses that its auditors have not reviewed the unaudited interim consolidated financial statements for the period ended June 30, 2006

**PETRO-REEF RESOURCES LTD.**  
**Balance Sheet**  
**As at June 30, 2006 and December 31, 2005**  
**Unaudited**

	<b>June 30, 2006</b>	<b>December 31, 2005</b>
<b>ASSETS</b>		
<b>Current assets</b>		
Bank	\$ 1,348,297	\$ 397,904
Accounts receivable	2,190,837	2,142,072
Prepaid expenses and deposits	30,284	11,192
	<u>3,569,418</u>	<u>2,551,168</u>
<b>Property, plant and equipment</b> (note 2)	<u>8,533,945</u>	<u>7,911,121</u>
	<u>\$ 12,103,363</u>	<u>\$ 10,462,289</u>
<b>LIABILITIES</b>		
<b>Current liabilities</b>		
Accounts payable and accrued charges	\$ 4,795,968	\$ 3,787,579
<b>Future income taxes</b>	433,214	426,827
<b>Asset retirement obligation</b> (note 4)	<u>274,070</u>	<u>217,915</u>
	<u>5,503,252</u>	<u>4,432,321</u>
<b>SHAREHOLDERS' EQUITY</b>		
<b>Share capital</b> (note 5)	6,153,430	5,558,614
<b>Warrants</b> (note 5)	792,960	820,000
<b>Contributed surplus</b> (note 5)	458,603	534,308
<b>Deficit</b>	<u>(804,882)</u>	<u>(882,954)</u>
	<u>6,600,111</u>	<u>6,029,968</u>
	<u>\$ 12,103,363</u>	<u>\$ 10,462,289</u>

SIGNED ON BEHALF OF THE BOARD

"Joseph Werner"  
 Director

"Robert N. Maertens-Poole"  
 Chief Financial Officer

**PETRO-REEF RESOURCES LTD.**  
**Statements of Operations and Deficit**  
**For the six months ended June 30, 2006 and 2005**  
**Unaudited**

	<b>3 Months Ended June 30, 2006</b>	<b>3 Months Ended June 30, 2005</b>	<b>6 Months Ended June 30, 2006</b>	<b>6 Months Ended June 30, 2005</b>
<b>Revenue</b>				
Oil and gas sales, net of royalties and ARTC	\$ 1,708,596	\$ 621,790	\$ 3,505,958	\$ 1,322,944
<b>Expenses</b>				
Accretion expense	3,712	2,394	7,340	4,602
Depletion and depreciation	1,153,263	288,483	2,142,275	689,811
General and administrative	347,873	106,614	503,038	224,056
Interest expense	552	12,833	1,787	26,220
Loss on settlement of asset retirement obligation	41	873	86	1,159
Production	379,636	212,984	768,754	362,356
	1,885,077	624,181	3,423,280	1,308,204
<b>Earnings before the following</b>	(176,481)	(2,391)	82,678	14,740
<b>Interest income</b>	1,619	167	1,781	167
	(174,862)	(2,224)	84,459	14,907
<b>Future income tax (recovery)</b>	(177,481)	22,000	6,387	54,000
<b>Net income (loss) for the period</b>	2,619	(24,224)	78,072	(39,093)
<b>Deficit - Beginning of period</b>	(807,501)	(1,146,537)	(882,954)	(1,131,668)
<b>Deficit - End of period</b>	\$ (804,882)	\$ (1,170,761)	\$ (804,882)	\$ (1,170,761)
<b>Basic and diluted income per common share</b>	\$ 0.00	\$ 0.00	\$ 0.00	\$ 0.00

**PETRO-REEF RESOURCES LTD.**  
**Statement of Cash Flows**  
**For the six months ended June 30, 2006 and 2005**  
**Unaudited**

	<b>3 Months Ended June 30, 2006</b>	<b>3 Months Ended June 30, 2005</b>	<b>6 Months Ended June 30, 2006</b>	<b>6 Months Ended June 30, 2005</b>
<b>Cash provided by (used in)</b>				
<b>Operating activities</b>				
Net income (loss) for the period	\$ 2,619	\$ (24,224)	\$ 78,072	\$ (39,093)
Items not effecting working capital				
Accretion expense	3,712	2,394	7,340	4,602
Depletion and depreciation	1,153,263	288,483	2,142,275	689,811
Loss on settlement of asset retirement obligation	41	873	86	1,159
Stock based compensation	128,931	59,804	128,931	112,591
Future income taxes	(177,481)	22,000	6,387	54,000
	<hr/>	<hr/>	<hr/>	<hr/>
Cash flow from operations	1,111,085	349,330	2,363,091	823,070
Asset retirement obligations	(61)	(4,350)	(489)	(7,363)
Net change in non-cash operating working capital items (note 7)	1,144,571	(99,667)	820,367	(78,353)
	<hr/>	<hr/>	<hr/>	<hr/>
	2,255,595	245,313	3,182,969	737,354
<b>Financial activities</b>				
Bank line of credit	-	350,000	-	300,000
Proceeds from share issue	364,640	-	364,640	-
Share issue costs	-	79,000	(1,500)	79,000
	<hr/>	<hr/>	<hr/>	<hr/>
	364,640	429,000	363,140	379,000
<b>Investing activities</b>				
Expenditures on property, plant and equipment	(2,218,013)	(425,409)	(2,715,881)	(856,090)
Net change in non-cash investing working capital items (note 7)	(85,793)	(42,652)	120,165	122,748
	<hr/>	<hr/>	<hr/>	<hr/>
	(2,303,806)	(468,061)	(2,595,716)	(733,342)
<b>Change in bank during the period</b>	316,429	206,252	950,393	383,012
<b>Bank (cheques drawn in excess of bank) - Beginning of period</b>	1,031,868	(235,011)	397,904	(411,771)
<b>Bank (cheques drawn in excess of bank) - End of period</b>	1,348,297	\$ (28,759)	1,348,297	\$ (28,759)
<b>Supplemental information</b>				
Interest paid	\$ 552	\$ 12,833	\$ 1,786	\$ 26,220

**PETRO-REEF RESOURCES LTD.**  
**Notes to Financial Statements**  
**As at June 30, 2006 and December 31, 2005**

**1. Accounting policies**

The interim financial statements of Petro-Reef Resources Ltd. (the "Company") have been prepared following the same accounting policies and methods of computation as for the financial statements of the Company as at December 31, 2005. 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 except as noted below. The year end financial statements should be read in conjunction with the Company's financial statements and notes thereto for the year ended December 31, 2005.

The Company has a working capital deficit of \$1,226,550 as at June 30, 2006 and \$1,236,411 as at December 31, 2005. The Company is subject to certain debt covenants pertaining to demand operating facilities (Note 3). At June 30, 2006 the Company was in compliance with all covenants.

**2. Property, plant, and equipment**

	<b>June 30, 2006</b>		
	<b>Cost</b>	<b>Accumulated Depletion and Depreciation</b>	<b>Net</b>
	\$		\$
Petroleum and natural gas	16,425,263	\$ 7,905,892	8,519,371
Furniture and fixtures	48,712	34,138	14,574
	\$		\$
	16,473,975	\$ 7,940,030	7,940,030
	<b>December 31, 2005</b>		
	<b>Cost</b>	<b>Accumulated Depletion and Depreciation</b>	<b>Net</b>
	\$		\$
Petroleum and natural gas	13,661,763	\$ 5,766,284	7,895,479
Furniture and fixtures	47,113	31,471	15,642
	\$		\$
	13,708,876	\$ 5,797,755	7,911,121

No interest or general and administrative expenses were capitalized during the period.

Unproven property costs of \$390,069 (2005 – \$390,069) have been excluded from capitalized costs subject to depletion.

**3. Demand operating facilities**

Facility A is a revolving operating demand loan with a maximum limit of \$2,200,000. Facility B is a non-revolving acquisition/development demand loan that provides an additional \$500,000 of financing. Interest is at prime plus 1.25% per annum for Facility A and 1.5% per annum for the Facility B. At June 30, 2006 the balance owing on the current loan was \$Nil (December 31, 2005 - \$Nil).

The facilities are secured by \$5,000,000 floating charge debenture over all the Company's assets with a negative pledge and undertaking to provide fixed charges on the Company's major producing properties at the request of the bank. The facilities are repayable on demand and are reviewed periodically by the bank, the next review being scheduled for October, 2006.

**PETRO-REEF RESOURCES LTD.**  
**Notes to Financial Statements**  
**As at June 30, 2006 and December 31, 2005**

**4. Asset retirement obligation**

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 \$274,070 (December 31, 2005 - \$217,915) as at June 30, 2006 based on a total future liability of \$507,974 (December 31, 2005 - \$389,677) which will be incurred between 2006 and 2025. A credit adjusted risk free rate of 6.08% (2005 -6.08%) and an inflation rate of 2% were used to calculate the fair value of the asset retirement obligation.

A reconciliation of the asset retirement obligation is provided below:

	<b>Six Months Ended June 30, 2006</b>	<b>Year Ended December 31, 2005</b>
Balance, beginning of period	\$ 217,915	\$ 155,456
Liabilities incurred in period	49,218	64,423
Liabilities settled in period	(403)	(15,229)
Accretion expense	7,340	13,265
Balance, end of period	<u>\$ 274,070</u>	<u>\$ 217,915</u>

**5. Share capital**

**a) Class A common shares**

	<b>Six Months Ended June 30, 2006</b>		<b>Year Ended December 31, 2005</b>	
	<u>Shares</u>	<u>Amount</u>	<u>Shares</u>	<u>Amount</u>
Balance, beginning of year	21,438,924	\$ 5,558,614	17,738,937	\$ 4,772,876
Exercise of options (ii)	560,000	474,636	200,000	101,060
Exercise of Warrants (ii)	135,200	121,680	-	-
Unit private placement (i)	-	-	3,499,987	874,995
Share issue costs, (net of \$96,500 of tax) (i)	-	(1,500)	-	(190,317)
Balance, end of year	<u>22,134,124</u>	<u>\$ 6,153,430</u>	<u>21,438,924</u>	<u>\$ 5,558,614</u>

- (i) In 2005, the Company issued 3,499,987 Units priced at \$0.45. Each unit consisted of one Common Share and one Purchase Warrant. Each Purchase Warrant entitles the holder to purchase on additional Common Share at an exercise price of \$0.70 per Common Share until February 17, 2007. The warrants have been ascribed a fair value of \$700,000 using the Black-Scholes pricing model assuming a risk-free interest of 3%; weighted average life of 1.5 years; dividend yield of nil; and expected volatility rate of 121%. Sinalta Investments Ltd. was paid a finder's fee of \$100,000, and granted warrants to 500,000 Common Shares at an exercise price of \$0.70 until February 17, 2007. These warrants have been recorded as share issue costs estimated at \$120,000 using the Black-Scholes pricing model assuming a risk-free interest rate of 3%; weighted average life of 1.5 years; dividend yield of nil; and expected volatility rate of 121%. All shares were subject to a hold period to January 17, 2006.

**PETRO-REEF RESOURCES LTD.**  
**Notes to Financial Statements**  
**As at June 30, 2006 and December 31, 2005**

- (ii) The increase in share capital as a result of the exercise of stock options is comprised of the amount of cash received of \$270,000 and the compensation expensed previously of \$204,636. The increase in share capital as a result of the exercise of warrants is comprised of cash in the amount of \$94,640 and fair value ascribed previously of \$27,040.

**b) Warrants**

	<b>Six Months Ended June 30, 2006</b>		
	<b>Weighted Average Exercise Price</b>	<b>Number</b>	<b>Amount</b>
Balance, beginning of period	\$ 0.70	3,999,987	\$ 820,000
Exercised during the period		(135,200)	(27,040)
Private placement agent warrants (note 5 (a)(i))		-	-
Unit private placement (note 5 (a)(i))		-	-
Balance, end of period	\$ 0.83	3,864,787	\$ 792,960

	<b>Year Ended December 31, 2006</b>		
	<b>Weighted Average Exercise Price</b>	<b>Number</b>	<b>Amount</b>
Balance, beginning of year	\$ -	-	\$ -
Private placement agent warrants (note 5 (a)(i))	0.70	500,000	120,000
Unit private placement (note 5 (a)(i))	0.70	3,499,987	700,000
Balance, end of year	\$ 0.83	3,999,987	\$ 820,000

**c) Contributed surplus**

	<b>Six Months Ended June 30, 2006</b>	<b>Year Ended December 31, 2005</b>
Balance beginning of period	\$ 534,308	\$ 380,060
Compensation recognized in the period	128,931	176,308
Adjustment for options exercised in the period	(204,636)	(22,060)
Balance, end of period	\$ 458,603	\$ 534,308

**PETRO-REEF RESOURCES LTD.**  
**Notes to Financial Statements**  
**As at June 30, 2006 and December 31, 2005**

**d) Per share amounts**

Earnings per common share are calculated using the weighted average number of common shares outstanding during the period. A reconciliation of the denominators used in the per share calculation is outlined below:

	<b>Six Months Ended June 30, 2006</b>	<b>Year Ended December 31, 2005</b>
Basic weighted average common shares	22,134,124	18,994,641
Effect of dilutive options and warrants	1,583,405	2,752,516
Diluted weighted average common shares	23,717,529	21,747,157

**6. Stock based compensation**

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 vest after one year and expire after a maximum period of five years from the date of issue.

A summary of the status of the company's stock option plan as of June 30, 2006 and December 31, 2005 and changes during the period are presented below:

	<b>Six Months Ended June 30, 2006</b>		<b>Year Ended December 31, 2005</b>	
	<b>Number of Options</b>	<b>Weighted Average Exercise Price</b>	<b>Number of Options</b>	<b>Weighted Average Exercise Price</b>
Balance beginning of period	2,120,000	\$ 0.50	1,510,000	\$ 0.49
Granted	560,000	1.30	810,000	0.50
Exercised	(560,000)	(0.47)	(200,000)	(0.40)
Balance end of period	2,120,000	\$ 0.65	2,120,000	\$ 0.50
Exercisable end of period	950,000	\$ 0.57	1,310,000	\$ 0.50

The outstanding options have a range of exercise prices between \$.30 and \$1.30 per share and a weighted average number of years to expiry of 3.13. The exercisable options have a range of exercise prices between \$.42 and \$.71 and have a weighted average number of years to expiry of 2.45.

**PETRO-REEF RESOURCES LTD.**  
**Notes to Financial Statements**  
**As at June 30, 2006 and December 31, 2005**

**7. Cash flows – supplemental information**

	Three Months Ended June 30, 2006	Three Months Ended June 30, 2005	Six Months Ended June 30, 2006	Six Months Ended June 30, 2005
Changes in non-cash working capital				
Operating activities:				
Accounts receivable	\$(274,171)	\$526,792	\$187,411	\$568,597
Prepaid deposits	8,140	7,007	(19,092)	(21,034)
Accounts payable and accrued charges	1,410,602	(633,466)	652,048	(625,916)
	1,144,571	(99,667)	820,367	(78,353)
Investing activities:				
Accounts receivable	(90,463)	281,511	(236,176)	421,387
Accounts payable and accrued charges	4,670	(324,163)	356,341	(298,639)
	(85,793)	(42,652)	120,165	122,748
	<u>\$1,058,778</u>	<u>\$(142,319)</u>	<u>\$940,532</u>	<u>\$44,395</u>