

**INTERIM REPORT**  
**FOR THE THREE AND NINE MONTHS ENDED**  
**SEPTEMBER 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. dated November 24, 2006 is part of the interim report for the three and nine months ended September 30, 2006. It was prepared by management and should be read in conjunction with the unaudited financial statements and notes which 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 2004 and 2005 was incorporated as part of the company's annual reports for 2004 and 2005, and are 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 nine months of 2004, 2005 and 2006**

<b>Financial</b>	<b>September 30 2004</b>	<b>September 30 2005</b>	<b>September 30 2006</b>	<b>2005 to 2006 % Change</b>
Crude oil and natural gas revenue net of Royalties and ARTC	\$1,385,018	\$1,905,044	\$4,551,175	+139
Cash flow from operations*	\$613,280	\$1,067,628	\$2,953,423	+177
Cash flow from operations per share	\$0.03	\$0.06	\$0.13	+117
Net income (loss) for the period	(\$123,091)	(\$60,983)	\$10,723	-
Net income (loss) per share	(\$0.007)	(\$0.003)	\$0.002	-
Capital expenditures	\$758,920	\$1,100,501	\$5,193,926	+372
Bank balance	(\$41,931)	\$99,858	\$846,062	+747
Bank loan	\$1,525,000	\$0.00	\$0.00	-
Shareholders' equity	\$4,331,539	\$6,029,968	\$7,003,587	+16
Weighted average common shares outstanding	17,705,603	21,438,937	22,650,791	+6
<b>Operations</b>	<b>September 30 2004</b>	<b>September 30 2005</b>	<b>September 30 2006</b>	<b>2005 to 2006 % Change</b>
<b>Daily Average Production</b>				
Crude oil and NGL (Bbls/d)	15.51	2.03	16.91	+733
Natural gas (Mcf/d)	763.44	988.98	2,830.08	+186
Total BOE/d	142.75	166.86	488.59	+193
<b>Average Selling Price</b>				
Crude oil (\$per Bbl)	46.03	60.90	63.26	+4
Natural gas (\$per Mcf)	6.44	8.25	7.27	-12
NGL (\$per Bbl)	50.26	62.10	55.17	-11

\* 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.

Petro-Reef had continued growth in production and cash flow in the first three quarters of 2006. Cash flow from operations for the first nine months of the year increased 177% in 2006 compared to the first nine months of 2005. Over the same period, overall production measured in barrels of oil equivalent per day (BOE/d) increased 193%. Production in the first nine months of 2006 averaged 488 BOE/d with cash flow from operations of \$2,953,423 or \$0.13 per share.

The next three tables compare production and revenue for the first nine months of 2006, 2005 and 2004. Average daily production increased from 143 to 166 to 488 BOE/d which are progressively 16% and 193% 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 / D</u>	<u>REVENUE</u> \$	<u>ROYALTIES</u> \$	<u>EXPENSES</u> \$	<u>CASH FLOW</u> \$	<u>NETBACK</u> \$ / BOE
JAN	18,608	600	1,025,344	344,848	142,097	538,399	28.93
FEB	16,645	594	778,902	366,807	140,129	271,966	16.34
MAR	18,112	584	762,604	57,833	106,892	597,879	26.20
APR	16,196	540	707,216	82,792	108,919	515,505	31.83
MAY	16,344	527	604,243	114,509	135,131	354,603	21.70
JUNE	16,003	533	625,757	31,319	135,586	458,852	20.88
JULY	11,915	384	472,345	96,532	119,279	256,534	21.53
AUG	11,786	380	496,237	116,738	127,899	251,600	21.35
SEPT	7,515	251	222,302	(67,603)	113,231	176,674	11.62
<b>TOTAL</b>	<b>133,124</b>	<b>4,393</b>	<b>5,694,950</b>	<b>1,143,775</b>	<b>1,129,163</b>	<b>3,422,012</b>	<b>200.38</b>
<b>AVERAGE</b>	<b>14,792</b>	<b>488</b>	<b>632,772</b>	<b>127,086</b>	<b>125,463</b>	<b>380,224</b>	<b>22.26</b>

#### 2005 PRODUCTION & REVENUE SUMMARY (Unaudited)

<u>Month</u>	<u>BOE</u>	<u>BOE / D</u>	<u>REVENUE</u> \$	<u>ROYALTIES</u> \$	<u>EXPENSES</u> \$	<u>CASH FLOW</u> \$	<u>NETBACK</u> \$ / BOE
JAN	6,611	213	279,841	83,162	48,598	148,081	22.40
FEB	6,362	227	268,507	57,520	53,228	157,759	24.80
MAR	6,499	210	358,322	64,833	47,546	245,943	30.05
APR	4,944	165	244,423	60,164	56,818	127,441	25.77
MAY	6,943	224	321,742	13,232	77,416	231,094	33.28
JUNE	3,029	101	156,590	27,569	78,750	50,271	11.87
JULY	3,374	109	196,145	29,505	47,924	118,716	35.19
AUG	3,761	121	220,848	35,417	50,378	135,053	35.91
SEPT	3,810	127	279,143	49,115	70,249	159,779	38.17
<b>TOTAL</b>	<b>45,333</b>	<b>1,497</b>	<b>2,325,561</b>	<b>420,517</b>	<b>530,907</b>	<b>1,374,137</b>	<b>257.44</b>
<b>AVERAGE</b>	<b>5,037</b>	<b>166</b>	<b>258,396</b>	<b>46,724</b>	<b>58,990</b>	<b>152,682</b>	<b>28.60</b>

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

<u>Month</u>	<u>BOE</u>	<u>BOE / D</u>	<u>REVENUE</u> \$	<u>ROYALTIES</u> \$	<u>EXPENSES</u> \$	<u>CASH FLOW</u> \$	<u>NETBACK</u> \$ / BOE
JAN	2,470	80	122,263	9,797	39,959	72,507	29.36
FEB	3,751	129	140,902	15,657	42,573	82,672	22.04
MAR	3,416	110	128,037	11,461	55,978	60,598	17.24
APR	5,598	187	224,532	15,713	56,168	152,651	27.27
MAY	3,937	127	178,234	14,613	37,916	125,705	31.93
JUNE	4,048	135	169,458	10,530	55,831	103,097	25.47
JULY	3,399	110	143,608	19,751	41,369	82,488	24.27
AUG	3,850	124	145,028	6,861	81,313	56,854	14.77
SEPT	8,578	286	311,973	74,859	61,631	175,483	18.20
<b>TOTAL</b>	<b>39,047</b>	<b>1,288</b>	<b>1,564,036</b>	<b>179,242</b>	<b>472,738</b>	<b>912,056</b>	<b>210.55</b>
<b>AVERAGE</b>	<b>4,339</b>	<b>143</b>	<b>173,782</b>	<b>19,916</b>	<b>52,526</b>	<b>101,340</b>	<b>23.39</b>

**SUMMARY OF TWO YEARS OF QUARTERLY RESULTS**

	<u>Dec. 31</u> <u>2005</u>	<u>Mar. 31</u> <u>2006</u>	<u>Jun. 30</u> <u>2006</u>	<u>Sep. 30</u> <u>2006</u>
Crude oil and natural gas revenue net of Royalties and ARTC	\$1,319,524	\$1,797,362	\$1,708,596	\$1,045,216
Cash flow from operations	\$940,085	\$1,252,007	\$1,111,085	\$590,330
Cash flow from operations per share	\$0.05	\$0.06	\$0.05	\$0.03
Net income (loss) for the period	(\$309,697)	\$75,453	\$2,619	(\$67,349)
Net income (loss) per share	(\$0.02)	\$0.00	\$0.00	\$0.00
Capital expenditures	\$1,338,764	\$497,869	\$2,218,013	\$2,478,043
Bank balance	\$397,904	\$1,031,868	\$1,348,297	\$846,062
Bank loan	\$0.00	\$0.00	\$0.00	\$0.00
Shareholders' equity	\$6,029,968	\$6,103,921	\$6,600,111	\$7,003,587
Weighted average common shares outstanding	21,438,924	21,438,924	22,134,124	22,650,791
	<u>Dec. 31</u> <u>2004</u>	<u>Mar. 31</u> <u>2005</u>	<u>Jun. 30</u> <u>2005</u>	<u>Sep. 30</u> <u>2005</u>
Crude oil and natural gas revenue net of Royalties and ARTC	\$777,638	\$701,154	\$621,790	\$582,100
Cash flow from operations	\$451,795	\$473,740	\$349,331	\$244,558
Cash flow from operations per share	\$0.03	\$0.03	\$0.02	\$0.01
Net income (loss) for the period	(\$418,997)	(\$14,869)	(\$24,224)	(\$21,890)
Net income (loss) per share	(\$0.02)	\$0.00	\$0.00	\$0.00
Capital expenditures	\$389,971	\$430,681	\$425,409	\$244,411
Bank balance	(\$411,771)	(\$235,011)	(\$28,759)	\$99,858
Bank loan	\$700,000	\$650,000	\$1,000,000	\$0.00
Shareholders' equity	\$4,021,268	\$4,059,186	\$4,173,767	\$5,665,500
Weighted average common shares outstanding	17,738,937	17,738,937	17,938,937	21,438,937

## **ACTIVITY REVIEW AND CORPORATE UPDATE**

Petro-Reef's production in the first nine months of 2006 came mainly from its core area at Alexander/Qui Barre, northwest of Edmonton, Alberta. This area accounted for about 97% of the total production and about 95% of the total revenue. Of the total production, about 97% was natural gas and about 3% was crude oil and a minor amount of condensate. Approximately 3% of the company's total production came from other minor interest revenue and royalty properties.

The following is an update of Petro-Reef's current activities and operations:

During the third quarter of 2006 Petro-Reef drilled three successful wells. A well drilled in October also was successful.

The first of these wells was drilled at 9-33 and was reported in a news release on September 14, 2006 as follows:

“Petro-Reef Resources Ltd. (TSX-V:PER) 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.”

Subsequently the 9-33 well has been placed on stream and is producing from the Mannville formation at about 1.4 million cubic feet of natural gas per day (MMcf/d). It may be possible, if no liquids are produced in the near future, to add about another 1.4 million cubic feet of natural gas per day from the Basal Quartz formation. If fluids are encountered a twin well may be drilled to optimize production from this location.

The second of these wells was drilled at 3-7 and was reported in a news release on September 25, 2006 as follows:

“Petro-Reef Resources Ltd. (TSX-V:PER) 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 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 well is a step-out 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.”

Currently efforts are being made to tie-in the well at 3-7 for natural gas in the Basal Quartz formation at about 2.27 MMcf/d as soon as all regulatory conditions have been met. This is expected to occur before the end of 2006.

The third of these wells was drilled at 8-29 and was reported along with an update of other operations in a news release on October 20, 2006 as follows:

“Petro-Reef Resources Ltd. (TSX-V: PER) 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:

<b>Well</b>		<b>Flow Rate</b>	<b>Petro-Reef Interest</b>	<b>Petro-Reef Estimated Net Potential BOE/d</b>
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 2.1 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 1,100 and 1550 BOE/d.”

Current Production & Production Forecast to Year End 2006

WELL	ZONE	FLOW RATE	%	PER BOE	COMMENTS
08-29	Basal Quartz	827 Mcf/d	54.00	74	To be tied-in by Dec. 20
09-33	Basal Quartz	1,440 Mcf/d	63.67	153	To be drilled Dec. Twin Well
	Barrhead	1,080 Mcf/d	63.67	115	On Stream
03-07	Devonian	836 Mcf/d	54.00	75	To be drilled Dec. Twin Well
	Basal Quartz	2,270 Mcf/d	54.00	204	Being tied-in – Dec. 20
12-33	Basal Quartz	500Mcf/d	54.00	56	On Stream
		20 bop/d	54.00		
12-28	Basal Quartz	1,970 Mcf/d	34.00	112	On Stream
11-27	Basal Quartz	849 Mcf/d	54.00	76	On Stream
	Barrhead	431 Mcf/d	54.00	39	On Stream
16-30	Belly River	232 Mcf/d	34.00	13	On Stream
05-31	Devonian	275 Mcf/d	64.00	40	On Stream
		17 bop/d			
10-30	Basal Quartz	100 Mcf/d	35.13	6	On Stream
06-01	Basal Quartz	34 bop/d	44.00	15	On Stream
02-01	Devonian		84.00		To be production tested
09-30	Basal Quartz	700 Mcf/d	71.50	83	On Stream
<b>TOTAL GAS</b>		<b>10,070 Mcf/d</b>		<b>1,061</b>	
<b>TOTAL OIL</b>		<b>71 Bbl/d</b>			

**Note:** Does not include approximately 30 BOE/d from minor interest wells.

Estimated and anticipated production.

On Stream Oct. 31, 2006: 387 BOE/d

On Stream Nov. 30, 2006: 555 BOE/d

On Stream Dec. 31, 2006: 1,061 BOE/d

Plus production from 2-1 & 11-14. The 2-1 is expected to be production tested by year end and the 11-14 is awaiting regulatory approval.

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. In addition the delays in regulatory applications for tie-ins of the 8-29 and 3-7 wells and the twin wells yet to be drilled at 3-7 and 9-33 has resulted in a further revision in projected cash flow from operations to \$4.3 million for the year ending December 31, 2006.

Exploration and development spending during the third quarter of 2006 was as follows:

	Q3/2006
Land and property acquisitions	\$70,508
Seismic data and geological and geophysical	\$9,439
Intangible drilling, completions and re-completions	\$1,371,021
Well Equipment and facilities	\$781,185
Capitalized general and administrative expenses	-
Other	\$244,097
Total capital expenditures	\$2,476,250

At September 30, 2006 the company has committed to future payments as follows:

Contractual Obligations	Payments Due by Period		
	Less Than 1 Year	1 – 3 Years	4 – 5 Years
Long-Term Debt	-	-	-
Capital Lease Obligations	19,188	230,253	383,755
Operating Leases	7,592	91,100	151,834
Purchase Obligations	-	-	-

Petro-Reef has no long term contractual obligations.

The following is an update of Petro-Reef's liquidity and capital resources:

As reported previously, 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. 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.

In November, the National Bank of Canada increased two sources of financing available to Petro-Reef. Credit Facility A is a revolving line of credit for \$3.75 million, at prime plus 1.25 percent. Credit Facility B is for acquisitions and development in the amount of \$1 million at prime plus 1.5 percent. At September 30, 2006 the bank loan was zero and the bank balance was a positive \$846,061.43. Both credit facilities were increased by the bank in November, 2006 from \$2.2 million for Credit Facility A and from \$500,000 for Credit Facility B.

At September 30, 2006, Petro-Reef had a working capital deficit of \$2,815,606, primarily due to its active third quarter capital program and lower than forecast cash flow. The company's undrawn credit facilities are sufficient to cover this working capital deficit.

Petro-Reef's equity in the third quarter of 2006 was increased by the exercise of options for \$25,000 cash. At September 30, 2006 the company had 22,650,000 common shares outstanding.

The private placement completed in September 2005 was for 3,499,987 shares at \$0.45, with the same number of warrants and 500,000 warrants as a finder's fee at \$0.70. At September 30, 2006 there had been 351,867 warrants exercised, leaving the remainder of 3,648,120 to be exercised by February 17, 2007 for a cash value of \$2,553,684. By November 24, 2006 an additional 578,000 warrants were exercised, leaving a balance of 3,070,120 warrants unexercised. The value of the unexercised warrants is \$2,149,084.

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

Petro-Reef had no related party transactions or off balance sheet arrangements in the third quarter of 2006.

During the third quarter of 2006 and up to the date of this report 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).

2006-07-27	Petro-Reef Resources Ltd. reports continued drilling success at Alexander
2006-08-30	Petro-Reef Resources Ltd. reports cash flow of \$1.1 million in Q2, 2006
2006-09-14	Petro-Reef Resources Ltd. encounters three potential zones at 9-33 and grant of options
2006-09-25	Petro-Reef Resources Ltd. encounters three potential zones at 3-7 at Alexander and grant of options
2006-10-20	Petro-Reef Resources Ltd. announces successful production test results
2006-11-09	Petro-Reef Resources Ltd. announces grant of options

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: November 24, 2006

## **BUSINESS RISKS**

Petro-Reef is exposed to risks inherent in the oil and gas business. Operationally, the company faces risks associated with finding, developing and producing oil and gas reserves, such as the availability of rigs and inclement weather. The company continues to follow strict exploration criteria on each prospect to assure high profitability and rate of return on capital investment. Exploration risks are managed by hiring skilled technical staff and by concentrating exploration activity on areas in which Petro-Reef has experience and expertise. Petro-Reef operates most of its production, allowing the company to manage costs, timing and sales of production. Estimates of economically recoverable reserves and the future net cash flow are based on factors such as commodity prices, projected production and future capital and operating costs. These assumptions may differ from actual results. The Company has its reserves evaluated annually by an independent engineering firm. Petro-Reef is also exposed to environmental risks and risks associated with the reliance upon relationships with partners. Petro-Reef carries environmental liability, property, drilling and general liability insurance to mitigate its risks. The company is also exposed to financial risks in the form of commodity prices, interest rates, the Canadian to U.S. dollar exchange rate and inflation. Petro-Reef manages commodity prices risks by focusing its capital program on areas that are expected to generate attractive rates of return.

## **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 Company 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 Company'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 Company believes to be reasonable. However, this data is inherently imprecise, although generally indicative of relative market positions, market shares and performance characteristics. While the Company 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:**

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 & Director  
Calgary, Alberta

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

Assistant Secretary & 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

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

Director  
Freeport, The Bahamas

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

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 - 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)**  
**SEPTEMBER 30, 2006 AND 2005**

**PETRO-REEF RESOURCES LTD.**

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

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 September 30, 2006

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

	<b>September 30, 2006</b>	<b>December 31, 2005</b>
<b>ASSETS</b>		
<b>Current assets</b>		
Bank	\$ 846,062	\$ 397,904
Accounts receivable	1,919,812	2,142,072
Prepaid expenses and deposits	29,366	11,192
	<u>2,795,240</u>	<u>2,551,168</u>
<b>Property, plant and equipment</b> (note 2)	<u>10,770,421</u>	<u>7,911,121</u>
	<u>\$ 13,565,661</u>	<u>\$ 10,462,289</u>
<b>LIABILITIES</b>		
<b>Current liabilities</b>		
Accounts payable and accrued charges	\$ 5,610,846	\$ 3,787,579
<b>Future income taxes</b>	602,714	426,827
<b>Asset retirement obligation</b> (note 4)	<u>348,514</u>	<u>217,915</u>
	<u>6,562,074</u>	<u>4,432,321</u>
<b>SHAREHOLDERS' EQUITY</b>		
<b>Share capital</b> (note 5)	6,604,965	5,558,614
<b>Warrants</b> (note 5)	749,627	820,000
<b>Contributed surplus</b> (note 5)	521,226	534,308
<b>Deficit</b>	<u>(872,231)</u>	<u>(882,954)</u>
	<u>7,003,587</u>	<u>6,029,968</u>
	<u>\$ 13,565,661</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 nine and three months ended September 30, 2006 and 2005**  
**Unaudited**

	<b>3 Months Ended September 30, 2006</b>	<b>3 Months Ended September 30, 2005</b>	<b>9 Months Ended September 30, 2006</b>	<b>9 Months Ended September 30, 2005</b>
<b>Revenue</b>				
Oil and gas sales, net of royalties and ARTC	\$ 1,045,216	\$ 582,100	\$ 4,551,175	\$ 1,905,044
<b>Expenses</b>				
Accretion expense	4,156	2,291	11,497	6,893
Depletion and depreciation	311,884	239,683	2,454,160	929,494
General and administrative	264,288	175,134	767,326	399,190
Interest expense	3,329	17,366	5,116	43,586
Loss on settlement of asset retirement obligation	482	1,469	568	2,628
Production	360,409	168,551	1,129,163	530,907
	944,548	604,494	4,367,830	1,912,698
<b>Earnings before the following</b>	100,668	(22,394)	183,345	(7,654)
<b>Interest income</b>	1,483	504	3,265	671
	102,151	(21,890)	186,610	(6,983)
<b>Future income tax</b>	169,500	-	175,887	54,000
<b>Net income (loss) for the period</b>	(67,349)	(21,890)	10,723	(60,983)
<b>Deficit - Beginning of period</b>	(804,882)	(1,170,761)	(882,954)	(1,131,668)
<b>Deficit - End of period</b>	\$ (872,231)	\$ (1,192,651)	\$ (872,231)	\$ (1,192,651)
<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 nine and three months ended September 30, 2006 and 2005**  
**Unaudited**

	<b>3 Months Ended September 30, 2006</b>	<b>3 Months Ended September 30, 2005</b>	<b>9 Months Ended September 30, 2006</b>	<b>9 Months Ended September 30, 2005</b>
<b>Cash provided by (used in)</b>				
<b>Operating activities</b>				
Net income (loss) for the period	\$ (67,349)	\$ (21,890)	\$ 10,497	\$ (60,983)
Items not effecting working capital				
Accretion expense	4,156	2,291	11,497	6,893
Depletion and depreciation	311,884	239,683	2,454,160	929,494
Loss on settlement of asset retirement obligation	482	1,469	568	2,628
Stock based compensation	171,657	23,005	300,588	135,596
Future income taxes	169,500	-	175,887	54,000
	<hr/>	<hr/>	<hr/>	<hr/>
Cash flow from operations	590,330	244,558	2,953,423	1,067,628
Asset retirement obligations	(511)	(3,224)	(999)	(10,587)
Net change in non-cash operating working capital items (note 7)	231,034	(359,114)	1,051,401	(437,467)
	<hr/>	<hr/>	<hr/>	<hr/>
	820,853	(117,780)	4,003,825	619,574
<b>Financial activities</b>				
Bank line of credit	-	(1,000,000)	-	(700,000)
Proceeds from share issue	-	1,575,000	-	1,575,000
Share issue costs	-	(127,882)	(1,500)	(127,882)
Proceeds from exercise of stock options	299,167	-	663,807	79,000
	<hr/>	<hr/>	<hr/>	<hr/>
	299,167	447,118	662,307	826,118
<b>Investing activities</b>				
Expenditures on property, plant and equipment	(2,478,043)	(244,410)	(5,193,926)	(1,100,500)
Net change in non-cash investing working capital items (note 7)	855,788	43,689	975,952	166,437
	<hr/>	<hr/>	<hr/>	<hr/>
	(1,622,255)	(200,721)	(4,217,974)	(934,063)
<b>Change in bank during the period</b>	(502,235)	128,617	448,158	511,629
<b>Bank (cheques drawn in excess of bank)</b>				
- Beginning of period	1,348,297	(28,759)	397,904	(411,771)
	<hr/>	<hr/>	<hr/>	<hr/>
<b>Bank - End of period</b>	\$ 846,062	\$ 99,858	\$ 846,062	\$ 99,858
<b>Supplemental information</b>				
Interest paid	\$ 3,329	\$ 17,366	\$ 5,115	\$ 43,586

**PETRO-REEF RESOURCES LTD.**  
**Notes to Financial Statements**  
**As at September 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 \$2,815,606 as at September 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 September 30, 2006 the Company was not in compliance with the working capital covenant.

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

	<b>September 30, 2006</b>		
	<b>Cost</b>	<b>Accumulated Depletion and Depreciation</b>	<b>Net</b>
Petroleum and natural gas	\$ 18,971,319	\$ 8,216,312	\$ 10,755,007
Furniture and fixtures	\$ 51,016	\$ 35,602	\$ 15,414
	<u>\$ 19,022,335</u>	<u>\$ 8,251,914</u>	<u>\$ 10,770,421</u>

  

	<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
	<u>\$ 13,708,876</u>	<u>\$ 5,797,755</u>	<u>\$ 7,911,121</u>

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

Unproven property costs of \$1,467,570 (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 \$2,2 million. 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 prime plus 1.5% per annum for the Facility B. At September 30, 2006 the balance owing on the current loan was \$Nil (December 31, 2005 - \$Nil).

The facilities are secured by \$5 million 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 November 2006.

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

The terms of the Company's bank facility includes certain financial statement covenants. At September 30, 2006, the Company was in violation of the working capital covenant, whereby it must maintain a 1 to 1 working capital ratio (including in working capital the undrawn portion of the facility).

**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 \$348,514 (December 31, 2005 \$217,915) as at September 30, 2006 based on a total future liability of \$763,396 (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>Nine Months Ended September 30, 2006</b>	<b>Year Ended December 31, 2005</b>
Balance, beginning of period	\$ 217,915	\$ 155,456
Liabilities incurred in period	\$ 119,535	\$ 64,423
Liabilities settled in period	\$ (433)	\$ (15,229)
Accretion expense	\$ 11,497	\$ 13,265
Balance, end of period	<u>\$ 348,514</u>	<u>\$ 217,915</u>

**5. Share capital**

**a) Class A common shares**

	<b>Nine Months Ended September 30, 2006</b>		<b>Year Ended December 31, 2005</b>	
	<b>Shares</b>	<b>Amount</b>	<b>Shares</b>	<b>Amount</b>
Balance, beginning of year	21,438,924	\$ 5,558,614	17,738,937	\$ 4,772,876
Exercise of options (ii)	860,000	\$ 731,171	200,000	\$ 101,060
Exercise of Warrants (ii)	351,867	\$ 316,680	-	-
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 period	<u>22,650,791</u>	<u>\$ 6,604,965</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 one 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 September 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 \$417,500 and the compensation expensed previously of \$313,670. The increase in share capital as a result of the exercise of warrants is comprised of cash in the amount of \$246,307 and fair value ascribed previously of \$70,373.

**b) Warrants**

	<b>Nine Months Ended September 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	\$ 0.70	(351,867)	\$ (70,373)
Private placement agent warrants (note 5 (a)(i))		-	-
Unit private placement (note 5 (a)(i))		-	-
Balance, end of period	\$ 0.70	3,648,120	\$ 749,627

	<b>Year Ended December 31, 2005</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	\$ 0.70	3,999,987	\$ 820,000

**c) Contributed surplus**

	<b>Nine Months Ended September 30, 2006</b>	<b>Year Ended December 31, 2005</b>
Balance beginning of period	\$ 534,308	\$ 380,060
Compensation recognized in the period	\$ 300,588	\$ 176,308
Adjustment for options exercised in the period	\$ (313,670)	\$ (22,060)
Balance, end of period	\$ 521,226	\$ 534,308

**PETRO-REEF RESOURCES LTD.**  
**Notes to Financial Statements**  
**As at September 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>Nine Months Ended September 30, 2006</b>	<b>Year Ended December 31, 2005</b>
Basic weighted average common shares	21,793,413	18,994,641
Effect of dilutive options and warrants	857,378	2,752,516
Diluted weighted average common shares	22,650,791	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 September 30, 2006 and December 31, 2005 and changes during the period are presented below:

	<b>Nine Months Ended September 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	860,000	\$ 1.18	810,000	\$ 0.50
Exercised	(860,000)	\$ (0.48)	(200,000)	\$(0.40)
Balance end of period	2,120,000	\$ 0.76	2,120,000	\$ 0.50
Exercisable end of period	1,260,000	\$ 0.57	1,310,000	\$ 0.50

The outstanding options have a range of exercise prices between \$0.30 and \$1.30 per share and a weighted average number of years to expiry of 3.67. The exercisable options have a range of exercise prices between \$0.42 and \$0.71 and have a weighted average number of years to expiry of 3.08.

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

**7. Cash flows – supplemental information**

	Three Months Ended September 30, 2006	Three Months Ended September 30, 2005	Nine Months Ended September 30, 2006	Nine Months Ended September 30, 2005
Changes in non-cash working capital				
Operating activities:				
Accounts receivable	\$ 11,080	\$(268,429)	\$ 198,491	\$ 300,168
Prepaid deposits	\$ 918	\$ 7,947	\$ (18,174)	\$ (13,087)
Accounts payable and accrued charges	\$ 219,036	\$ (98,632)	\$ 871,084	\$(724,548)
	<u>\$ 231,034</u>	<u>\$(359,114)</u>	<u>\$1,051,401</u>	<u>\$(437,467)</u>
Investing activities:				
Accounts receivable	\$ 259,945	\$ 1,884	\$ 23,769	\$ 423,271
Accounts payable and accrued charges	\$ 595,843	\$ 41,805	\$ 952,183	\$(256,834)
	<u>\$ 855,788</u>	<u>\$ 43,689</u>	<u>\$ 975,952</u>	<u>\$ 166,437</u>
	<u>\$1,086,822</u>	<u>\$(315,425)</u>	<u>\$2,027,353</u>	<u>\$(271,030)</u>

**8. Subsequent Events**

The company's bank increased the lending limits to \$3,750,000 from \$2,200,000 for their operating line and to \$1,000,000 from \$500,000 for the development loan in November, 2006.