Twin Butte Energy Ltd.

FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2006

REPORT TO SHAREHOLDERS

The third quarter of 2006 was Twin Butte's first full operational quarter after the amalgamations with Drilcorp Energy Ltd. and Kerogen Petroleum Ltd. in June 2006.

SIGNIFICANT ACCOMPLISHMENTS DURING THE QUARTER INCLUDED:

- **First full quarter of operations following the Drilcorp and Kerogen acquisitions with average production of 1,047 Boe per day**
- **Cash flow for the quarter of $1.9 million**
- **Completed a 6 section 3D seismic program in the south east Alberta core area.**
- **Completed technical evaluation of all Twin Butte assets which combined with the above 3D program develop inventory for a Q4 2006 and Q1 2007 drilling program of up to 15 wells**
- **Drilled 3 gross (2.4 net) successful wells in south east Alberta and commenced completion and tie in operations**
- **Commenced regulatory approval process for Jayar facility expansion**

OPERATIONS

Production for the first full quarter of operations averaged 1,047 Boe per day comprised of 69 percent natural gas and 31 percent light oil and natural gas liquids. Based on December 31, 2005 independent engineering, the Company had a pro forma net asset value of approximately $0.80 per fully diluted share and proved plus probable reserves of 3.2 mmboe. Twin Butte completed a Q3 capital program of $4.7 million and plans to complete a Q4 capital program of approximately $9.5 million.

During the third quarter Twin Butte focused on the assets acquired in the previously announced corporate amalgamations with Drilcorp Energy Ltd. and Kerogen Petroleum Ltd. and commenced field operations drilling a total of 3.0 (2.4 net) successful gas wells in the Oyen and Hanna areas of south east Alberta.

In the core area of Oyen the Company has drilled and cased two gas wells both of which have been completed and are currently being tied in. Net production additions of approximately 1.5 mmcfd (250 Boe per day) are anticipated in December. The Company also participated in a non-operated well with an industry partner in the Hanna area of south east Alberta which has been cased and completed with tie-in anticipated in late Q4. Additionally, in the third quarter the Company finished a multi section 3D seismic program in south east Alberta which has identified up to eight drilling prospects. The Company plans to drill four of the identified prospects in the upcoming Q4 drilling program. The Company also completed a $2.4 million property acquisition to consolidate working interest and land ownership in its south east Alberta core area. The acquisition increases the Company land base providing operational control and additional drilling opportunities.

At the core area of Jayar in the Peace River Arch region of north west Alberta the Company has completed a technical review and integrated 3D seismic data to set up a Q4 drilling program. Coincident with the planned drilling the Company will be completing stage one of a possible two stage facility expansion at our operated gas processing facility. Stage one of the expansion will accommodate the anticipated Q4 volumes and position the Company to complete the second step of the facility expansion. Facility construction will be completed in Q4 in conjunction with the Jayar drilling program.

The Company has a 7 well drilling program planned for Q4. The program will include 4 wells in the SE Alberta core area of Oyen targeting Mannville and Banff age reservoirs defined on 3D seismic and a 2 well development program at the Jayar core area in north west Alberta targeting the Dunvegan producing interval. The Company also plans to drill with an industry partner an exploratory well in the Boundary Lake area of north west Alberta targeting a proven high impact reservoir and earning the Company additional prospective lands in the area. The production impact of the Q4 drilling program will be realized late in the early part of first quarter 2007.

OUTLOOK

The third quarter presented challenges for the oil and gas industry as softening commodity prices caused many investors to look closely at their investment portfolios. While Twin Butte was not immune to this correction, the solid corporate production base combined with the corporation's tax pools and strong balance sheet continue to position the Company to take advantage of growth opportunities in this current industry environment.

Based on third quarter drilling activity the Company is on track to meet its year end exit target of 1,200 – 1,300 Boe per day. In addition, the Company should exit 2006 with considerable behind pipe production from its fourth quarter drilling program which will ensure production growth thru first quarter 2007.

The Company continues to evaluate potential acquisitions that would enhance shareholder value and generate growth opportunities. This includes active participation at Crown land sales in the Company's core areas adding to the existing land base which is now at 24,000 net undeveloped acres. In addition, the Company is evaluating numerous farm-in opportunities with industry partners that have the potential to create new growth areas.

The management team and Board of Directors continue to focus on cost effective per share growth in reserves, production and cash flow which will be achieved through exploitation of the existing asset base and the integration of accretive acquisitions.

On behalf of the Board of Directors,

Ron Cawston
President and C.E.O.
November 10, 2006

Selected Quarterly Information

OPERATIONAL HIGHLIGHTS

	Three months ended September 30, 2006	Three months ended June 30, 2006	Nine months ended September 30, 2006
FINANCIAL ($'s, except per share amounts)			
Petroleum and natural gas sales	4,569,020	1,719,009	6,294,174
Cash flow [1]	1,860,932	744,519	2,450,443
Per share basic	0.02	0.01	0.05
Per share diluted	0.02	0.01	0.05
Net loss	(2,266,944)	(778,255)	(3,201,154)
Per share basic	(0.03)	(0.02)	(0.06)
Per share diluted	(0.03)	(0.01)	(0.06)
Capital expenditures	4,665,524	456,991	5,122,515
Corporate acquisitions	–	49,092,723	49,092,723
Net debt and working capital deficiency	(7,516,879)	(8,357,900)	(7,516,879)
OPERATING			
Average daily production			
Crude oil (Bbls per day)	298	130	144
Natural gas (Mcf per day)	4,313	1,430	1,930
Natural gas liquids (Bbls per day)	30	8	13
Barrels of oil equivalent (Boe per day, 6:1)	1,047	375	478
Average sales price			
Crude oil ($ per Bbl)	73.79	73.84	73.79
Natural gas ($ per Mcf)	5.95	6.16	6.00
Natural gas liquids ($ per Bbl)	67.75	68.90	67.98
Barrels of oil equivalent ($ per Boe, 6:1)	47.45	50.32	48.22
Operating netback ($ per Boe)	25.38	28.38	26.19
COMMON SHARES (000's)			
Shares outstanding, end of period	95,155,038	86,132,529	95,155,038
Weighted average shares outstanding	90,207,206	50,020,121	53,217,979

[1] Cash flow means earnings before future taxes, depletion, depreciation and accretion, and stock based compensation. See Management's Discussion & Analysis *Non-GAAP Measures*

MANAGEMENT'S DISCUSSION AND ANALYSIS

Dated as of November 10, 2006

The following discussion and analysis as provided by the management of Twin Butte Energy Ltd. ("Twin Butte" or the "Company") should be read in conjunction with the unaudited financial statements for the period ended September 30, 2006 and the audited financial statements for the year ended December 31, 2005.

Basis of Presentation – Twin Butte commenced current operations on June 1, 2006 by amalgamating with Drilcorp Energy Ltd. ("Drilcorp") and Kerogen Petroleum Ltd. ("Kerogen"). This 30 day period serves as the comparative period as prior year numbers are not relevant.

Non-GAAP Measures - The Management's Discussion and Analysis ("MD&A") contains the term cash flow from operations or cash flow which should not be considered an alternative to, or more meaningful than, cash flow from operating activities as determined in accordance with Canadian generally accepted accounting principles ("GAAP") as an indicator of the Company's performance. The Company also presents cash flow from operations per share whereby per share amounts are calculated using weighted average shares outstanding consistent with the calculation of earnings per share. These measures may not be comparable to other companies.

Boe Presentation – Barrels of oil equivalent ("Boe") may be misleading, particularly if used in isolation. A Boe conversion rate of 6 Mcf: 1 Bbl is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead. All Boe conversions in the report are derived by converting gas to oil at the ratio of six thousand cubic feet of gas to one barrel of oil.

Forward-Looking Information – Certain information regarding the Company presented in this document, including management's assessment of the Company's future plans and operations, may constitute forward-looking statements under applicable securities law and necessarily involve risk associated with oil and gas exploration, production, marketing, and transportation such as loss of market, volatility of commodity prices, currency fluctuations, imprecision of reserve estimates, environmental risk, competition from other producers and ability to access sufficient capital from internal and external resources; as a consequence, actual results may differ materially from those anticipated in the forward-looking statements.

PETROLEUM AND NATURAL GAS SALES

Twin Butte realized the following production volumes, commodity prices and revenues:

	Three months ended September 30, 2006	Three months ended June 30, 2006	Nine months ended September 30, 2006
Average Realized Commodity Prices			
Crude oil ($ per Bbl)	73.79	73.84	73.79
Natural gas ($ per Mcf)	5.95	6.16	6.00
Natural gas liquids ($ per Bbl)	67.75	68.90	67.98
$'s			
Crude oil	2,020,412	870,178	2,896,735
Natural gas	2,360,469	800,892	3,161,361
Natural gas liquids	188,139	47,939	236,078
Total petroleum and natural gas sales	**4,569,020**	**1,719,009**	**6,294,174**
Average Daily Production			
Crude oil & natural gas liquids (bbls/day)	328	137	157
Natural gas (mcf/day)	4,313	1,430	1,930
Total (boe/d)	**1,047**	**375**	**478**

For the three month period ended September 30, 2006, Twin Butte recorded $4.6 million in petroleum and natural gas sales compared to $1.7 million for the three month period ended June 30, 2006.

The Company's production for the third quarter averaged 1,047 Boe per day. Increases in production and sales resulted from the amalgamations of Drilcorp and Kerogen into Twin Butte effective June 1, 2006, resulting in the first full quarter of production from the two acquisitions. Production for the third quarter consists of 396,759 Mcf of gas, 27,380 Bbls of oil and 2,777 Bbls of natural gas liquids. The company's sales volumes are 69% natural gas for the third quarter compared to 67% on a year to date basis.

ROYALTIES

For the three months ended September 30, 2006 total royalties net of ARTC were $0.8 million or $7.91 per Boe resulting in an average royalty rate of 16.7%. For the nine months ended September 30, 2006, total royalties were $1.1 million or $8.35 per Boe resulting in an average royalty rate for the year to date of 17.3%.

OPERATING EXPENSES

For the three months ended September 30, 2006 operating expenses were $1.1 million or $11.76 per Boe, compared to operating expenses of $0.3 million, or $9.94 per Boe, for the three months ended June 30, 2006.

For the nine months ended September 30, 2006 operating expenses were $1.5 million or $11.28 per Boe.

Higher levels of activity in the industry and the associated high demands for supplies and services are putting upward pressure on the industry operating cost structure. Management is examining the current operational efficiency of the Company's assets and undertaking steps to improve the operating costs.

TRANSPORTATION EXPENSES

For the three months ended September 30, 2006 transportation expenses were $0.2 million or $2.40 per Boe compared to $0.1 million, or $2.38 per Boe for the three months ended June 30, 2006.

GENERAL AND ADMINISTRATIVE EXPENSES

	Three months ended September 30, 2006	Three months ended June 30, 2006	Nine months ended September 30, 2006
General and administrative expenses			
General and administrative expenses	586,656	187,907	789,156
Recoveries	(21,770)	(11,085)	(32,855)
Capitalized general and administrative expenses	(150,411)	(16,767)	(167,178)
Total net general and administrative expenses	**414,475**	**160,055**	**589,123**

General and administrative expenses for the third quarter were $0.4 million, or $4.30 per Boe after recoveries and capitalized costs. For the nine months ended September 30, 2006, general and administrative expenses were $0.6 million or $4.51 per Boe after recoveries and capitalized costs. In the past quarter, general and administrative expenses included flow through interest expense charges. Those amounts have been reclassified and are now presented as part of interest expense in the current and comparative periods.

STOCK BASED COMPENSATION EXPENSE

During the three month period ended September 30, 2006, the Company expensed $1.6 million in stock based compensation expense relating to the outstanding stock options and management warrants. Stock based compensation expense for the nine month period ended September 30, 2006 amounts to $2.2 million.

INTEREST EXPENSE

Interest expense for the three month period ended September 30, 2006 amounting to $169,326 consists of interest on bank indebtedness in the amount of $116,918 and flow through interest expense charges in the amount of $52,408.

Interest expense for the nine month period ended September 30, 2006 amounts to $411,856. This consists of interest expense of $118,948 incurred in the first quarter for interest expense on convertible debentures. All debentures were converted to Common Shares in March 2006. The remaining balance consists of $145,147 related to interest on bank indebtedness and $147,761 related to flow through interest expense charges.

INCOME TAXES

Future income tax recovery amounted to $1.1 million for the three month period ended September 30, 2006 and $1.3 million for the nine month period ended September 30, 2006. The Company has existing tax losses and pools in excess of $115.0 million. The Company has no current tax expense.

DEPLETION, DEPRECIATION AND ACCRETION EXPENSE

For the three month period ended September 30, 2006, depletion and depreciation of capital assets and the accretion of the asset retirement obligations was $3.6 million. Depletion of capital assets amounts to $37.14 per Boe for the quarter, compared to $33.80 in the second quarter. The cost of undeveloped property excluded from the depletion base as at September 30, 2006 was $5.4 million.

For the nine month period ended September 30, 2006, depletion, depreciation, and accretion expense was $4.8 million, with depletion of capital assets amounting to $36.17 per Boe.

CASH FLOW FROM OPERATIONS AND NET EARNINGS

Cash flow from operations for the three month period ended September 30, 2006 was $1.9 million equating to basic and diluted cash flow from operations of $0.02 per share. Cash flow from operations for the nine month period ended September 30, 2006 was $2.5 million equating to basic and diluted cash flow from operations of $0.05 per share.

The Company incurred a net loss of $2.3 million for the three month period ended September 30, 2006, equating to a basic and diluted net loss per share of $0.03, compared to a net loss of $3.2 million for the nine month period ended September 30, 2006, equating to basic and diluted net loss per share of $0.06.

The following table summarizes netbacks on a barrel of oil equivalent basis:

($ per boe)	Three months ended September 30 2006	Three months ended June 30, 2006	Nine months ended September 30 2006
Petroleum and natural gas sales	47.45	50.32	48.22
Royalties	(7.91)	(9.63)	(8.35)
	39.54	40.69	39.87
Operating expenses	(11.76)	(9.93)	(11.28)
Transportation expenses	(2.40)	(2.38)	(2.40)
Operating netback	25.38	28.38	26.19
General and administrative expenses	(4.30)	(4.69)	(4.51)
Interest expense	(1.76)	(2.64)	(3.16)
Cash flow from operations	19.32	21.05	18.52

QUARTERLY FINANCIAL SUMMARY

The following table highlights Twin Butte's performance:

($ thousands, except per share amounts)	Three months ended September 30 2006	Three months ended June 30, 2006	Nine months ended September 30 2006
Average production (Boe/d)	1,047	375	478
Petroleum and natural gas sales	4,569	1,719	6,294
Operating netback (per Boe)	25.38	28.38	26.19
Cash flow from operations	1,861	745	2,450
Per share basic	0.02	0.01	0.05
Per share diluted	0.02	0.01	0.05
Net loss	2,267	778	3,201
Per share basic	(0.03)	(0.02)	(0.06)
Per share diluted	(0.03)	(0.01)	(0.06)
Capital expenditures	4,666	457	5,123
Corporate acquisitions	–	49,093	49,093
Total assets	67,060	66,609	67,060
Net debt and working capital deficiency	7,517	8,358	7,517

CAPITAL EXPENDITURES

During the third quarter of 2006, the Company incurred $4,665,524 of capital expenditures. Capital expenditures for the nine months ended September 30, 2006 were $5,122,515.

	Three months ended September 30, 2006	Three months ended June 30, 2006	Nine months ended September 30, 2006
Land acquisition	184,104	201,892	385,996
Geological and geophysical	832,362	190,891	1,023,253
Drilling and completions	862,864	–	862,864
Equipping and facilities	191,190	43,193	234,383
Property acquisitions	2,432,346	–	2,432,346
Other	162,658	21,015	183,673
Total capital expenditures	**4,665,524**	**456,991**	**5,122,515**

The above capital expenditures exclude the acquisition expenditures related to the amalgamations with Drilcorp and Kerogen.

LIQUIDITY AND CAPITAL RESOURCES

At September 30, 2006, the Company had a net debt and working capital deficiency of $7.5 million. The Company has a demand revolving operating credit facility of $17.0 million with a Canadian chartered bank.

Subsequent to September 30, 2006 a total of $60,000 in proceeds were received by the Company on exercise of management warrants with an additional $435,099 expected to be received on exercise of the remaining warrants and management warrants prior to expiry at year end.

SHARE CAPITAL

As at November 10, 2006, the Company has 95,305,038 Common Shares outstanding, 58,369 warrants outstanding, 1,025,000 management warrants outstanding and 7,825,000 stock options outstanding.

CONTRACTUAL OBLIGATIONS

At September 30, 2006, the Company has a commitment to incur approximately $2.9 million in flow-through expenditures by December 31, 2006.

BALANCE SHEETS

	September 30 2006	December 31 2005
	Unaudited	*Audited*
ASSETS		
Current Assets		
Cash and cash equivalents	$ –	$ 3,625,587
Accounts receivable	2,013,338	884
Share subscription receivable	43,997	–
Deposits and prepaid expenses	702,799	–
	2,760,134	3,626,471
Future income taxes	197,913	–
Property and equipment (note 3)	64,101,968	62,500
	$ 67,060,015	$ 3,688,971
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current Liabilities		
Accounts payable and accrued liabilities	$ 4,729,672	$ 31,051
Bank indebtedness (note 4)	5,547,341	–
Convertible demand notes (note 5)	–	4,770,985
	10,277,013	4,802,036
Asset retirement obligation (note 6)	2,127,235	–
	12,404,248	4,802,036
Shareholders' Equity		
Share capital (note 7)	64,452,943	5,713,339
Contributed surplus (note 7)	230,382	–
Retained deficit	(10,027,558)	(6,826,404)
	54,655,767	(1,113,065)
	$ 67,060,015	$ 3,688,971

Commitments (note 9)

See accompanying notes to financial statements

STATEMENTS OF OPERATIONS AND RETAINED DEFICIT *(unaudited)*

	Three Months Ended September 30		Nine Months Ended September 30	
	2006	2005	**2006**	2005
REVENUE				
Petroleum and natural gas sales	**$ 4,569,020**	$ –	**$ 6,294,174**	$ –
Royalties, net of ARTC	**(761,126)**	–	**(1,090,357)**	–
	3,807,894	–	**5,203,817**	–
Interest income	**904**	11,487	**33,047**	11,487
EXPENSES				
Operating	**1,132,680**	–	**1,472,588**	–
Transportation	**231,385**	–	**312,854**	–
General and administrative	**414,475**	123,832	**589,123**	371,023
Stock based compensation	**1,630,989**	–	**2,175,496**	–
Interest	**169,326**	–	**411,856**	–
Depletion, depreciation and accretion	**3,602,345**	–	**4,756,559**	–
	7,181,200	123,832	**9,718,476**	371,023
Loss before income taxes	**(3,372,402)**	(112,345)	**(4,481,612)**	(359,536)
Income taxes				
Future tax recovery	**(1,105,458)**	–	**(1,280,458)**	–
	(1,105,458)	–	**(1,280,458)**	–
Net loss	**(2,266,944)**	(112,345)	**(3,201,154)**	(359,536)
Retained deficit, beginning of period	**(7,760,614)**	(6,567,797)	**(6,826,404)**	(6,320,606)
Retained deficit, end of period	**$ (10,027,558)**	$ (6,680,142)	**$ (10,027,558)**	$ (6,680,142)
Basic earnings loss per share	**$ (0.03)**	$ (0.01)	**$ (0.06)**	$ (0.04)
Diluted earnings loss per share	**$ (0.03)**	$ (0.01)	**$ (0.06)**	$ (0.04)
Weighted average common shares outstanding				
Basic	90,207,206	8,448,036	**53,217,979**	8,448,036
Diluted	92,315,476	8,448,036	**53,509,672**	8,448,036

See accompanying notes to financial statements

STATEMENTS OF CASH FLOWS *(unaudited)*

	Three Months Ended September 30		Nine Months Ended September 30	
	2006	2005	**2006**	2005
Cash provided by (used in):				
OPERATIONS:				
Net loss	**$ (2,266,944)**	$ (112,345)	**$ (3,201,154)**	$ (359,536)
Items not involving cash:				
Depletion, depreciation and accretion	**3,602,345**	–	**4,756,559**	–
Future income taxes	**(1,105,458)**	–	**(1,280,458)**	–
Stock based compensation	**1,630,989**	–	**2,175,496**	–
	1,860,932	(112,345)	**2,450,443**	(359,536)
Changes in non-cash working capital	**(2,346,566)**	110,235	**(1,384,537)**	312,065
	(485,635)	(2,110)	**1,065,905**	(47,471)
FINANCING				
Change in bank debt	**20,377**	–	**(5,898,464)**	–
Issuance of share capital, net of share issue costs	**3,645,612**	–	**12,535,867**	–
Changes in non-cash working capital	**(37,074)**	–	**(37,354)**	–
	3,628,915	–	**6,600,049**	–
INVESTING:				
Expenditures on property and equipment	**(4,665,524)**	–	**(5,122,515)**	–
Acquisition expenditures (note 2)	**–**	–	**(8,252,364)**	–
Changes in non-cash working capital	**1,522,244**	–	**2,083,338**	–
	(3,143,280)	–	**(11,291,541)**	–
Decrease in cash and cash equivalents	**–**	(2,110)	**(3,625,587)**	(47,471)
Cash and cash equivalents, beginning of period	**–**	585,287	**3,625,587**	630,648
Cash and cash equivalents, end of period	**$ –**	$ 583,177	**$ –**	$ 583,177
Cash and cash equivalents consists of:				
Cash	**–**	33,177	**–**	33,177
Banker's acceptances	**–**	550,000	**–**	550,000
	$ –	$ 583,177	**$ –**	$ 583,177
Cash interest paid	**$ 114,204**	–	**$ 261,381**	–

See accompanying notes to financial statements

NOTES TO FINANCIAL STATEMENTS

(Unaudited)

The interim financial statements of Twin Butte Energy Ltd. ("Twin Butte" or the "Company") have been prepared by management in accordance with accounting principles generally accepted in Canada. The interim financial statements have been prepared following the same accounting policies and methods of computation as the audited financial statements for the year ended December 31, 2005. The disclosures provided below are incremental to those included in the audited annual financial statements. These interim financial statements should be read in conjunction with the financial statements and notes thereto in the Company's audited annual financial statements. Certain of the comparative amounts have been reclassified to conform to the presentation adopted in the current period.

Twin Butte is engaged in the acquisition of, exploration for, and development of petroleum and natural gas properties in Western Canada.

1. SIGNIFICANT ACCOUNTING POLICIES

Management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities as at the date of the financial statements and the reported amounts of revenue and expenses. The amounts recorded for depletion and amortization of petroleum and natural gas properties and equipment and the provision for future asset retirement obligation costs are based on estimates. The ceiling test is based on estimates of proved reserves, production rates, future oil and gas prices, future costs and other relevant assumptions. The amounts recorded for future taxes are based on estimates of future taxable income and anticipated income tax rates. The fair value of stock options is based on estimates using the Black-Scholes option pricing model and is recorded as stock-based compensation expense in the financial statements. By their nature, these estimates are subject to measurement uncertainty and the effect on the financial statements of changes in such estimates in future periods could be significant.

2. ACQUISITION EXPENDITURES

On June 1, 2006, the Company closed the amalgamation agreements dated April 1, 2006 with Drilcorp Energy Ltd. ("Drilcorp") and Kerogen Petroleum Ltd. ("Kerogen") to acquire all the issued and outstanding shares of Drilcorp and Kerogen. Twin Butte indirectly acquired each of Drilcorp and Kerogen by creating two wholly-owned subsidiaries that amalgamated with Drilcorp and Kerogen, respectively. The two wholly-owned subsidiaries were subsequently wound up into Twin Butte such that Twin Butte owns all assets formerly owned by Drilcorp and Kerogen.

The purchase price paid by Twin Butte for all of Drilcorp's shares was a total of 19,641,493 common shares of Twin Butte and $7,856,597. The purchase price paid by Twin Butte for all of Kerogen's shares was a total of 14,392,139 common shares of Twin Butte.

The acquisition was accounted for using the purchase method of accounting as follows:

Consideration

	Drilcorp	Kerogen	Total
Shares	$ 23,569,792	$ 17,270,567	$ 40,840,359
Cash	7,856,597	–	7,856,597
Transaction costs	255,123	140,644	395,767
Total consideration	$ 31,681,512	$ 17,411,211	$ 49,092,723

Purchase Price at Fair Value

	Drilcorp	Kerogen	Total
Petroleum and natural gas properties	$ 44,784,967	$ 18,823,624	$ 63,608,591
Future income tax asset	131,236	138,939	270,175
Net working capital deficiency	(11,477,777)	(1,245,954)	(12,723,731)
Asset retirement obligation	(1,756,914)	(305,398)	(2,062,312)
Total purchase price	$ 31,681,512	$ 17,411,211	$ 49,092,723

The net working capital deficiency consists of the following:

	Drilcorp	Kerogen	Total
Accounts receivable	$ 3,292,113	$ 856,979	$ 4,149,092
Deposits and prepaid expenses	331,961	54,436	386,397
Accounts payable and accrued liabilities	(4,443,943)	(1,369,472)	(5,813,415)
Bank indebtedness	(10,657,908)	(787,897)	(11,445,805)
Net working capital deficiency	$ (11,477,777)	$ (1,245,954)	$ (12,723,731)

3. PROPERTY AND EQUIPMENT

	Cost	Accumulated Depletion & Depreciation	Net Book Value
Petroleum and natural gas properties	$ 68,809,576	$ 4,721,759	$ 64,087,817
Office and computer equipment	16,173	2,022	14,151
Total	$ 68,825,749	$ 4,723,781	$ 64,101,968

The Company has capitalized $167,178 of general and administrative expenses directly related to exploration and development activities for the nine months ended September 30, 2006 ($ nil – year ended December 31, 2005).

The cost of undeveloped property excluded from the depletion base as at September 30, 2006 was $5,442,125 (December 31, 2005 - $nil).

4. BANK INDEBTEDNESS:

The Company has a $17.0 million demand revolving operating credit facility with a Canadian chartered bank. The credit facility provides that advances may be made by way of direct advances, banker's acceptances, or standby letters of credit/guarantees. Advances bear interest at the bank's prime lending rate plus 0.25%. The credit facility is secured by a demand debenture and a general security agreement covering all assets of the Company.

5. CONVERTIBLE DEMAND NOTES:

The convertible demand notes were converted to 12,323,429 Common Shares of the Company (note 7).

6. ASSET RETIREMENT OBLIGATIONS

Asset retirement obligations are based on the Company's net ownership in wells and facilities, and management's estimate of future costs to abandon and reclaim those wells and facilities as well as an estimate of the future timing of the costs to be incurred.

The Company has estimated the present value of its total asset retirement obligation to be $2,127,235 at September 30, 2006, based on a total future liability of $3,298,628. Payments to settle asset retirement obligations occur over the operating lives of the underlying assets, estimated to be from 1 year to 19 years with the majority of the costs to be incurred between 2008 and 2016. A credit-adjusted risk free rate of eight percent and an inflation rate of two percent was used to calculate the present value of the asset retirement obligation.

Changes to the asset retirement obligation are as follows:

	Nine months ended September 30, 2006
Carrying amount, beginning of year	$ –
Liabilities incurred	32,465
Acquisitions (note 2)	2,062,312
Accretion of asset retirement obligation	32,458
Asset retirement obligation, end of period	$ 2,127,235

7. SHARE CAPITAL

Authorized

An unlimited number of voting Common Shares and an unlimited number of Preferred Shares.

Issued

	Number of shares	Amount
Common Shares		
Balance, December 31, 2005	17,781,346	$ 5,713,339
Issued on conversion of convertible demand notes	12,323,429	4,770,984
Issued pursuant to exercise of flow-through share warrants for cash	6,941,631	2,984,901
Issued pursuant to private placement for cash	17,000,000	6,800,000
Issued pursuant to acquisitions (note 2)	34,033,632	40,840,359
Issued pursuant to exercise of management warrants for cash	7,075,000	2,830,000
Contributed surplus related to management warrants exercised	–	1,945,114
Tax effect of flow through share issuance		(1,352,720)
Share issue and financing costs	–	(79,034)
Balance, September 30, 2006	**95,155,038**	**$ 64,452,943**

Issue of Common Shares

On June 7, 2006, the Company amended and restated its articles and converted the previously issued and outstanding non-voting Common Shares of the Company to voting Common Shares on a one for one basis. Accordingly, all Common Shares are disclosed as voting Common Shares.

The convertible demand notes were converted to Common Shares in March 2006 (note 5).

At December 31, 2005, a total of 7,000,000 warrants ("warrants") to acquire Common Shares at an exercise price of $0.43 per share were outstanding. The warrants were issued pursuant to a private placement of flow-through shares. A total of 6,941,631 warrants were exercised during the period. A total of 58,369 warrants remain outstanding with an expiry date of December 31, 2006.

During the second quarter the Company pursuant to a private placement issued 17 million Common Shares at a price of $0.40 per share for gross proceeds of $6.8 million.

Management Warrants

The Company has issued 8.25 million warrants ("management warrants") that are registered in the name of Twin Butte Energy Ltd. and are held pursuant to the terms of an employee benefit trust. Each management warrant entitles the holder to acquire one Common Share at an exercise price of $0.40 per share with each management warrant expiring December 31, 2006. The warrants are to be exercised at the discretion of the Company within 10 business days of notice to exercise.

The management warrants and the Common Shares to be acquired on exercise of the management warrants are to be held pursuant to a private escrow agreement and the Common Shares on exercise of the management warrants will remain registered in the name of the Company. The Common shares are to be released from escrow with 50% of the Common Shares released May 31, 2007 and the remaining 50% on May 31, 2008.

A total of 7,075,000 management warrants were exercised during the period. A total of 1,175,000 management warrants remained outstanding at September 30, 2006, with an expiry date of December 31, 2006.

Stock Options

The following table sets forth a reconciliation of stock option plan activity through to September 30, 2006

	Number of Options	Weighted Average Exercise Price
Outstanding at December 31, 2005	–	$ –
Granted	6,900,000	$ 0.80
Forfeited	(50,000)	$ 0.80
Outstanding at September 30, 2006	**6,850,000**	**$ 0.80**

There were no options exercisable as at September 30, 2006.

Stock Based Compensation

The Company accounts for its stock based compensation plan using the fair value method. Under this method, a compensation cost is charged over the vesting period for options or warrants granted to employees, consultants, officers, and directors with a corresponding increase to contributed surplus.

The following table reconciles the Company's contributed surplus balance.

Contributed surplus balance at beginning of year	$ –
Stock based compensation charged for stock options	230,382
Stock based compensation charged for management warrants	1,945,114
Transfer to share capital on exercise of management warrants	(1,945,114)
Contributed surplus balance at end of period	$ 230,382

The fair value of each option granted is estimated on the date of grant using the Black-Scholes option pricing model with weighted average assumptions and resulting values for grants as follows:

	Nine months ended September 30, 2006
Expected volatility	50%
Risk free rate of return	4.5%
Expected stock option life	3 years
Expected management warrant life	7 months

The weighted average fair value of stock options granted during 2006 was $0.30 per option. The weighted average fair value of management warrants granted during 2006 was $0.41 per warrant.

Earnings Per Share

The following table sets forth the details of the denominator used for the computation of basic and diluted earnings per share:

	Three Months Ended		Nine Months Ended	
	2006	2005	**2006**	2005
Weighted average number of basic shares	**90,207,206**	8,448,036	**53,217,979**	8,448,036
Effect of dilutive securities:				
Flow-through warrants	**33,270**	–	**26,996**	–
Management warrants	**705,000**	–	**264,697**	–
Employee stock options	**1,370,000**	–	**–**	–
Weighted average number of diluted shares	**92,315,476**	8,448,036	**53,509,672**	8,448,036

8. RELATED PARTY TRANSACTIONS

During the period the Company expensed and capitalized legal fees totaling $411,103 (2005 - $nil) for services rendered by a professional firm related to a director of the Company. As at September 30, 2006, $7,500 is included in accounts payable and accrued liabilities related to these transactions.

9. COMMITMENTS

Twin Butte is committed to incur approximately $4,463,323 in flow-through expenditures by December 31, 2006. Of this balance, $4,013,323 was incurred by an issuance of flow-through shares in December 2005 and approximately $450,000 was inherited from Drilcorp's commitments. As at September 30, 2006, the Company has incurred approximately $1,594,099 of this commitment.

OFFICERS

Ron Cawston
President and Chief Executive Officer

Brian Dunn
Vice President, Engineering and Corporate Development

John Murray
Vice President, Exploration

R. Alan Steele
Vice President, Finance and Chief Financial Officer

Stan Wolny
Vice President, Production and Operations

BOARD OF DIRECTORS

Jim Saunders (1) (2)
Chairman of the Board

Paul Colborne (1) (3)

Craig Hruska (2) (3)

J.G. (Jeff) Lawson (2)

Ken Mullen (1) (3)

Ron Cawston

(1) member of audit committee
(2) member of reserve committee
(3) member of compensation and governance committee

CORPORATE OFFICE

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INVESTOR RELATIONS

info@twinbutteenergy.com

TRUSTEE AND TRANSFER AGENT

Computershare Trust Company of Canada

STOCK EXCHANGE

The TSX Venture Exchange
Trading symbol: TBE

BANKER

National Bank of Canada
Calgary, Alberta

AUDITOR

PricewaterhouseCoopers LLP
Calgary, Alberta

SOLICITOR

Burnet, Duckworth & Palmer LLP
Calgary, Alberta

CONSULTING ENGINEERS

McDaniel & Associates Consultants Ltd.
Calgary, Alberta