Twin Butte Energy Ltd.

To our valued shareholders,

Please find enclosed the 2006 annual audited financial statements, notes and management's discussion and analysis for Twin Butte Energy Ltd. as well as our 2006 Information Circular – Proxy Statement and Notice of Annual meeting. In order that we could continue to focus on value adding activities for our shareholders, reduce the amount of time and money on administration and avoid duplication, we did not undertake to prepare an annual report for 2006 but would like to refer you to the following places where you may obtain additional information regarding our company:

1) The System for Electronic Document Analysis and Retrieval ("SEDAR") website (www.sedar.com) contains all continuous disclosure documents for Twin Butte filed with the Canadian securities regulatory authorities since our inception.

   - Our 2006 annual Information Form which includes reserves data and other oil and gas information as at December 31, 2006 as mandated by National Instrument 51-101 Standards of Disclosure for Oil and Gas Activities of the Canadian Securities Administrators.

   - Our 2006 Fourth Quarter & Year End Reserves press release dated March 26, 2007.

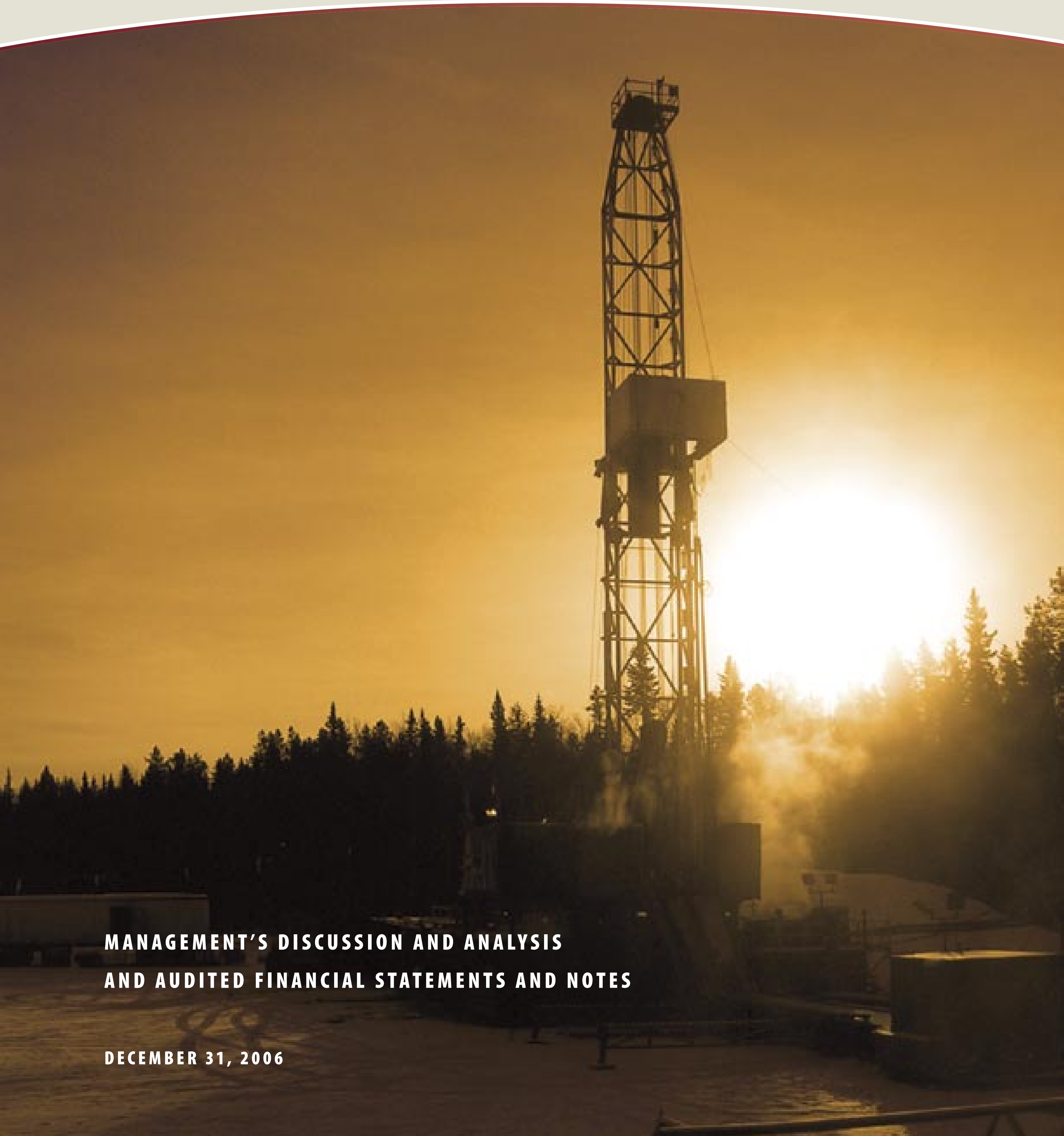
2) Our website (www.twinbutteenergy.com) also contains additional information, including our latest corporate presentation and other useful links and information regarding Twin Butte.

We can appreciate that you may not be able to access these documents electronically, and we would be more than happy to furnish you with copies of any of these disclosure documents that you may require. Copies may be obtained upon request without charge from Twin Butte Energy Ltd., Suite 415, 311 – 6 Avenue SW, Calgary AB, T2P 3H2 or by telephone at (403) 215-2045.

Thanks for your continued interest and support of Twin Butte.

Ron Cawston
President and Chief Executive Officer
Twin Butte Energy Ltd.
March 26, 2007

Twin Butte Energy Ltd.



MANAGEMENT'S DISCUSSION AND ANALYSIS AND AUDITED FINANCIAL STATEMENTS AND NOTES

DECEMBER 31, 2006

MANAGEMENT'S DISCUSSION AND ANALYSIS

Dated as of March 26, 2007

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 audited financial statements for the years ended December 31, 2005 and 2006, and the unaudited financial statements for the three quarters ended March 31, 2006, June 30, 2006, and September 30, 2006.

Basis of Presentation – Twin Butte commenced current operations on June 1, 2006 by amalgamating with Drilcorp Energy Ltd. ("Drilcorp") and Kerogen Petroleum Ltd. ("Kerogen"). There is no 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 December 31, 2006	Year ended December 31, 2006
Average Realized Commodity Prices		
Crude oil ($ per bbl)	59.31	67.84
Natural gas ($ per Mcf)	7.29	6.57
Natural gas liquids ($ per bbl)	56.64	62.06
$'s		
Crude oil	1,624,100	4,520,835
Natural gas	3,016,495	6,177,856
Natural gas liquids	214,880	450,958
Total petroleum and natural gas sales	4,855,475	11,149,649
Average Daily Production		
Crude oil & natural gas liquids (bbl/day)	339	202
Natural gas (mcf/day)	4,499	2,577
Total (boe/d)	**1,089**	**632**

For the three month period ended December 31, 2006, Twin Butte recorded $4.9 million in petroleum and natural gas sales and $11.1 million for the year ended December 31, 2006.

The Company's production for the fourth quarter averaged 1,089 boe/d representing a slight increase from the third quarter average of 1,047 boe/d. Production for the fourth quarter consists of 413,925 Mcf of gas, 27,381 bbl of oil and 3,794 bbl of natural gas liquids. The Company's sales volumes are 69% natural gas for the fourth quarter compared to 68% on a year to date basis.

ROYALTIES

For the three months ended December 31, 2006 total royalties net of ARTC were $0.7 million or $7.21 per boe resulting in an average royalty rate of 15%. For the year ended December 31, 2006, total royalties were $1.8 million or $7.86 per boe resulting in an average royalty rate for the year to date of 16%.

The Company's royalty burdens are predominantly Crown, along with some overriding and freehold royalties. The Company average royalty rate of 16% for the year is net of ARTC amounting to a reduction in royalty rate of approximately 2%. With the elimination of ARTC effective January 1, 2007, the Company expects to realize an increase in the overall royalty rate for 2007.

OPERATING EXPENSES

For the three months ended December 31, 2006 operating expenses were $1.1 million or $11.38 per boe, compared to operating expenses of $2.6 million, or $11.32 per boe, for the year ended December 31, 2006.

Management is continuing an examination of the current operational efficiency of the Company's assets and undertaking steps to reduce the operating costs. Included in that examination is the purchase of one or more rental compressors that are a component of the Company's operating expenses. Further to that, expected increases in sales volumes in 2007 should contribute to reducing operating expenses on a boe basis.

TRANSPORTATION EXPENSES

For the three months ended December 31, 2006 transportation expenses were $0.3 million or $2.77 per boe compared to $0.6 million, or $2.56 per boe for the year ended December 31, 2006. Transportation costs are expected to remain fairly consistent on a per boe basis throughout 2007.

GENERAL AND ADMINISTRATIVE EXPENSES

	Three months ended December 31, 2006	Year ended December 31, 2006
General and administrative expenses	831,581	1,620,738
Recoveries	(99,338)	(132,194)
Capitalized general and administrative expenses	(212,431)	(379,609)
Total net general and administrative expenses	**519,812**	**1,108,935**

General and administrative expenses for the fourth quarter were $0.5 million, or $5.19 per boe after recoveries and capitalized costs. For the year ended December 31, 2006, general and administrative expenses were $1.1 million or $4.81 per boe after recoveries and capitalized costs.

General and administrative expenses for the fourth quarter were increased from the third quarter and included a one time TSX listing fee in the amount of $85 thousand. With the exception of minor changes when required, the Company believes that it is adequately staffed to execute the currently planned 2007 operational and capital expenditure program.

STOCK BASED COMPENSATION EXPENSE

During the three month period ended December 31, 2006, the Company expensed $1.6 million in stock based compensation expense relating to the outstanding stock options and management warrants, of which $1.5 million relates to management warrants. Stock based compensation expense for the year ended December 31, 2006 amounts to $3.8 million, of which $3.4 million relates to management warrants.

The majority of the expense is comprised of stock based compensation expense relating to the management warrants in the amount of $1.5 million for the fourth quarter and $3.4 million for the year ended December 31, 2006. All management warrants were exercised during the year. No further stock based compensation expense will be recognized on these management warrants as the full fair value of the warrants has been recognized.

INTEREST EXPENSE

Interest expense for the three month period ended December 31, 2006 amounting to $141,797 consists of interest on bank indebtedness in the amount of $110,436 and flow through interest expense charges in the amount of $31,361.

Interest expense for the year ended December 31, 2006 amounts to $553,653. 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 $255,583 related to interest on bank indebtedness and $179,122 related to flow through interest expense charges.

INCOME TAXES

Future income tax recovery amounted to $1.8 million for the three month period ended December 31, 2006 and $3.1 million for the year period ended December 31, 2006. The Company has existing tax losses and pools of approximately $124.8 million of which $77.9 are non-capital losses. The Company has no current tax expense and based on current reserve forecasts will be able to realize the benefit of the majority of the non-capital losses and remain non-taxable to at least 2011.

DEPLETION, DEPRECIATION AND ACCRETION EXPENSE

For the three month period ended December 31, 2006, depletion and depreciation of capital assets and the accretion of the asset retirement obligations was $3.1 million. Depletion of petroleum and natural gas properties amounts to $30.87 per boe for the quarter, compared to $33.87 year ended December 31, 2006. The cost of undeveloped property excluded from the depletion base as at December 31, 2006 was $5.6 million.

For the year period ended December 31, 2006, depletion, depreciation, and accretion expense was $7.9 million, with depletion of petroleum and natural gas properties amounting to $33.87 per boe. The Company expects the depletion rate per boe to decline in 2007 as reserves in the probable category convert to proven.

CASH FLOW FROM OPERATIONS AND NET EARNINGS

Cash flow from operations for the three month period ended December 31, 2006 was $2.1 million equating to basic and diluted cash flow from operations of $0.02 per share. Cash flow from operations for the year period ended December 31, 2006 was $4.5 million equating to basic and diluted cash flow from operations of $0.07 per share.

The Company incurred a net loss of $0.9 million for the three month period ended December 31, 2006, equating to a basic and diluted net loss per share of $0.01, compared to a net loss of $4.1 million for the year period ended December 31, 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 December 31, 2006	Year ended December 31, 2006
Petroleum and natural gas sales	48.48	48.33
Royalties	(7.21)	(7.86)
	41.27	40.47
Operating expenses	(11.38)	(11.32)
Transportation expenses	(2.77)	(2.56)
Operating netback	27.12	26.59
General and administrative expenses	(5.19)	(4.81)
Interest expense	(1.42)	(2.40)
Cash flow from operations	20.51	19.38

QUARTERLY FINANCIAL SUMMARY

The following table highlights Twin Butte's performance by quarter and in total for 2006:

	Three months ended				**Year ended**
($ thousands, except per share amounts)	March 31	June 30	Sep 30	Dec 31	**Dec 31**
Average production (boe/d)	1	357	1,047	1,089	**632**
Petroleum and natural gas sales	6	1,719	4,569	4,855	**11,150**
Operating netback (per boe)	$56.80	28.38	25.38	27.12	**26.59**
Cash flow from operations	(156)	745	1,861	2,054	**4,504**
Per share basic	(0.01)	0.01	0.02	0.02	**0.07**
Per share diluted	(0.01)	0.01	0.02	0.02	**0.07**
Net earnings (loss)	(156)	(778)	(2,267)	(881)	**4,082**
Per share basic	(0.00)	(0.02)	(0.03)	(0.01)	**(0.06)**
Per share diluted	(0.00)	(0.01)	(0.03)	(0.01)	**(0.06)**
Capital expenditures	–	457	4,666	9,580	**14,703**
Corporate acquisitions	–	49,093	–	–	**49,093**
Total assets	3,869	66,609	67,060	78,697	**78,697**
Net debt and working capital surplus (deficiency)	3,440	(8,358)	(7,517)	(14,558)	**(14,558)**

CAPITAL EXPENDITURES

During the fourth quarter of 2006, the Company incurred $9,580,622 of capital expenditures. Capital expenditures for the year ended December 31, 2006 were $14,703,138.

	Three months ended December 31, 2006	Year ended December 31, 2006
Land acquisition	188,325	574,320
Geological and geophysical	82,344	1,105,597
Drilling and completions	6,997,275	7,860,139
Equipping and facilities	2,101,425	2,335,808
Property acquisitions	(29,805)	2,402,542
Other	241,058	424,732
Total capital expenditures	**9,580,622**	**14,703,138**

Capital expenditures for the fourth quarter consisted primarily of drilling and completing seven successful (6.6 net) wells.

At the core area of Oyen, four successful (4.0 net) wells were drilled late in the fourth quarter with the majority of the completions underway before year end. These wells came on production in February and March 2007.

At the core are of Jayar, three successful (2.6 net) wells were drilled late during the fourth quarter. Drilling of an additional well at Jayar was begun before year end with rig release in January. A fifth well was drilled and completed subsequent to year-end. These wells were brought on to production during the first quarter of 2007.

At Boundary Lake the Company began drilling an exploratory (0.4 net) well with drilling completed after year end. Completion of the well commenced in March 2007.

For the year ended December 31, 2006, capital expenditures totaled $14.7 million. The majority of the costs for the year were a result of the Company drilling a total of ten successful (9.0 net) wells and related completion, equip and facilities costs. The Company completed the first phase of a plant expansion at Jayar in the amount of $0.9 million included in equipping and facilities expenditures. In addition, the Company completed a $2.4 million property acquisition to consolidate working interest and land ownership in its south east Alberta core area of Oyen. Other expenditures include crown land acquisition costs and seismic activity to acquire and identify future drilling inventory.

The above capital expenditures exclude the acquisition expenditures related to the acquisitions of Drilcorp and Kerogen.

LIQUIDITY AND CAPITAL RESOURCES

At December 31, 2006, the Company had a net debt and working capital deficiency of $14.6 million. The Company has a demand revolving operating credit facility of $17.0 million with a Canadian chartered bank. The annual review of the existing credit facility is expected to be completed in April 2007.

Subsequent to December 31, 2006 the Company closed a bought deal private placement of 14,635,000 flow-through Common Shares at a price of $0.82 per share for gross proceeds of $12.0 million.

SHARE CAPITAL

As at March 26, 2007, the Company has 111,012,007 Common Shares outstanding, reflecting the issuance of 14,635,000 flow-through Common Shares since December 31, 2006. There are also 7,075,000 stock options outstanding.

CONTRACTUAL OBLIGATIONS

The issuance of flow through shares in February 2007 for proceeds of $12.0 million will require the Company to spend $12.0 million of flow-through share eligible Canadian Exploration Expenditures, as defined in the Canadian Income Tax Act, by December 31, 2008.

The Company has other commitments and guarantees in the normal course of business, consisting of an office space lease and equipment rentals which are not considered material.

Subsequent to year end the Company has entered into fixed price swap hedge arrangements on a total of 3,500 GJ/d for the period of April 1, 2007 to October 31, 2007 at an average price of $6.99/GJ.

RELATED PARTY TRANSACTIONS

During the year the Company expensed and capitalized legal fees totaling $433,102 for services rendered by a professional firm related to a director of the Company. The fees were incurred in the normal course of business and recorded at the exchange amount.

NEWLY ADOPTED ACCOUNTING POLICIES

There were no significant accounting policies newly adopted during the three months ended December 31, 2006.

CRITICAL ACCOUNTING ESTIMATES

Management is required to make judgments and use estimates in the application of generally accepted accounting principles that have a significant impact on the financial results of the Company.

Full Cost Accounting

The Company follows the Canadian Institute of Chartered Accountants' guideline on full cost accounting in the oil and gas industry to account for oil and gas properties. Under this method, all costs associated with the acquisition of, exploration for and development of natural gas and crude oil reserves are capitalized and costs associated with production are expensed. The capitalized costs are depreciated, depleted and amortized using the unit-of-production method based on estimated proved reserves. Reserve estimates can have a significant impact on earnings, as they are a key component in the calculation of depreciation, depletion and accretion ("DD&A"). A downward revision in a reserve estimate could result in a higher DD&A charge to earnings. In addition, if net capitalized costs are determined to be in excess of the calculated ceiling, which is based largely on reserve estimates, the excess must be written off as a expense and charged against earnings. In the event of a property disposition, proceeds are normally deducted from the full cost pool without recognition of a gain or loss unless there is a change in the DD&A rate of 20 percent or greater.

Asset Retirement Obligations

The Company records a liability for the fair value of legal obligation associated with the retirement of long-lived tangible assets in the period in which they are incurred, normally when the asset is purchased or developed. On recognition of the liability there is a corresponding increase in the carrying amount of the related asset and the asset retirement obligation. The total amount of asset retirement obligation is an estimate based on the Company's net ownership interest in all wells and facilities and the estimated costs to abandon and reclaim the wells and facilities and the estimated timing of the costs to be incurred in the future periods. The total amount of the estimated cash flows required to settle the asset retirement obligation; the timing of those cash flows are estimates subject to measurement uncertainty. Any changes in these estimates would impact the asset retirement liability.

Reserves Determination

The proved crude oil, natural gas and natural gas liquid reserves used in determining our depletion rates, the magnitude of the borrowing base available to us from our lender and the ceiling test are based upon management's best estimates, and are subject to uncertainty. Through the use of geological, geophysical and engineering data, the reservoirs and deposits of natural gas, crude oil and natural gas liquids are examined to determine quantities available for future production, given existing operating and economic conditions and technology. The evaluation of recoverable reserves is an ongoing process impacted by current production, continuing development activities and changing economic conditions as reflected in crude oil and natural gas prices and costs. Consequently, the reserves are estimates which are subject to variability. To assist with the reserve evaluation process, we employ the services of independent oil and gas reservoir engineers.

Income Taxes

The determination of the Company's income and other tax liabilities require interpretation of complex laws and regulations often involving multiple jurisdictions. All tax filings are subject to audit and potential reassessment after lapse of considerable time. Accordingly, the actual income tax liability may differ significantly from the liability estimated or recorded.

Other Estimates

The accrual method of accounting requires management to incorporate certain estimates including estimates of revenues, royalties and production costs as at a specific reporting date but for which actual revenues and costs have not yet been received; and estimates on capital projects which are in progress or recently completed where actual costs have not been received at a specific reporting date.

Ceiling Test

Under the full costs accounting method, a ceiling test is performed at least annually to ensure that the net capitalized costs do not exceed the undiscounted future net revenues from proved plus probable reserves, plus the cost of unproved properties. Any excess capitalized costs will be written off as an expense and charged to earnings; however, future depletion and depreciation expense would be reduced.

FINANCIAL INSTRUMENTS

The following standards regarding financial instruments are effective for January 1, 2007; 3855 "Financial Instruments – Recognition and Measurement", 3861 "Financial Instruments – Disclosure and Presentation", 1530 "Comprehensive Income", and 3865 "Hedges". The standards require all financial instruments other than held-to-maturity investments, loans and receivables to be included on a company's balance sheet at their fair value date. The standards create a new statement for comprehensive income that will include changes in the fair value of certain financial instruments. As a result of these new standards, the Company will record the fair value of any derivative contracts under its risk management program.

INTERNAL CONTROL REPORTING

In March 2006 Canadian Securities Administrators decided to not proceed with proposed multilateral instrument 52-111 "Reporting on Internal Control over Financial Reporting" and instead proposed to expand multilateral instrument 52-109 "Certification of Disclosure in Issuers' Annual and Interim Fillings." The major changes resulting from this are that the Chief Executive Officer and Chief Financial Officer will be required to certify in the annual certificates that they have evaluated the effectiveness of internal controls over financial reporting ("ICOFR") as of the end of the financial year and disclose in the annual MD&A their conclusions about the effectiveness of ICOFR. There will be no requirement to obtain an internal control audit opinion from the issuer's auditors concerning management's assessment of the effectiveness of ICOFR. There is also no requirement to design and evaluate internal controls against an external control framework. This proposed amendment is expected to apply for the year ended December 31, 2008. Twin Butte is continuing with its evaluation of ICOFR to ensure it meets the criteria for the proposed certification of December 31, 2008.

To ensure sound corporate governance, we continue to commit ourselves to establishing and maintaining adequate disclosure controls and procedures, as well as internal control over financial reporting in order to provide reasonable assurance regarding the reliability of our financial disclosure, and ultimately, maintaining our clients' trust and investors' confidence.

INTERNAL CONTROL OVER FINANCIAL REPORTING

Twin Butte has implemented a system of internal controls that it believes adequately protects the assets of the Company and is appropriate for the nature of its business and the size of its operations. These internal controls include disclosure controls and procedures designed to ensure that information required to be disclosed by the Company is accumulated and communicated to management as appropriate to allow timely decisions regarding required disclosure. The Company's Chief Executive Officer (CEO) and Chief Financial Officer (CFO) have concluded, based on their evaluation that Twin Butte's disclosure controls and procedures are effective to provide reasonable assurance that material information related to the Company is made known to them and have been operating effectively during 2006. It should be noted that while the Company's CEO and CFO believe that Twin Butte's disclosure controls and procedures provide a reasonable level of assurance that the system of internal controls are effective, they do not guarantee that the disclosure controls and procedures will prevent all errors and fraud. A control system, no matter how well conceived or operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met.

In addition, in accordance with Multilateral Instrument 52-109, the Company has, under the supervision of its CEO and CFO, designed a process of internal control over financial reporting, which has been affected by the Company's board of directors and management. The process was designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with Canadian generally accepted accounting principles ("GAAP").

Based on the CEO and the CFO's review of the design of internal controls over financial reporting, the CEO and CFO have concluded that the design of internal controls is adequate for the nature of the Corporation's business and size of its operations. As a small organization, and similar to other small organizations, the Company's management is composed of a small number of key individuals, resulting in a situation where limitations on the segregation of duties as well as expertise in such areas as complex calculations and estimations do not exist, as such these risks are compensated by more effective supervision and monitoring by the CEO and CFO as well as reliance on third party expertise where appropriate. It is important to note that in order to eliminate the potential risk associated with these issues the Company would be required to hire additional staff in order to provide greater segregation of duties and expertise in certain areas. Since the increased funding costs of such hiring would be financially constrictive to Twin Butte, the Corporation has chosen to disclose the potential risk in its annual filings and proceed with increased staffing as the Company's growth supports such overhead expansion.

MANAGEMENT'S REPORT

Management, in accordance with Canadian generally accepted accounting principles, has prepared the accompanying financial statements of Twin Butte Energy Ltd. Financial and operating information presented throughout this report is consistent with that shown in the financial statements.

Management is responsible for the integrity of the financial information. Internal control systems are designed and maintained to provide reasonable assurance that assets are safeguarded from loss or unauthorized use and to produce reliable accounting records for financial reporting purposes.

PricewaterhouseCoopers LLP were appointed by the Company's Board of Directors to conduct an audit of the financial statements. Their examination included a review and evaluation of Twin Butte's internal control systems and included such test and procedures, as they considered necessary, to provide a reasonable assurance that the financial statements are presented fairly in accordance with Canadian generally accepted accounting principles.

The Board of Directors is responsible for ensuring that management fulfills its responsibilities for financial reporting and internal control. The Board exercises this responsibility through the Audit Committee, with assistance from the Reserve Committee regarding the annual evaluation of our petroleum and natural gas reserves. The Audit Committee meets regularly with management and the independent auditors to ensure that management's responsibilities are properly discharged, to review the financial statements and recommend that the financial statements be presented to the Board of Directors for approval. The Audit Committee also considers the independence of the external auditors and reviews their fees. The external auditors have access to the Audit Committee without the presence of management.

Ron Cawston
President and Chief Executive Officer

Ivan J. Condic
Controller (acting Chief Financial Officer)

AUDITORS' REPORT

To the Shareholders of Twin Butte Energy Ltd.

We have audited the balance sheets of Twin Butte Energy Ltd. as at December 31, 2006 and 2005 and the statements of operations and deficit and cash flows for the years then ended. These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the company as at December 31, 2006 and 2005 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

PricewaterhouseCoopers LLP

Chartered Accountants
Calgary
March 26, 2007

BALANCE SHEETS

	December 31 2006	December 31 2005
ASSETS		
Current Assets		
Cash and cash equivalents	**$ –**	$ 3,625,587
Accounts receivable	**4,554,362**	884
Deposits and prepaid expenses	**606,175**	–
	5,160,537	3,626,471
Future income taxes	**2,029,400**	–
Property and equipment (note 3)	**71,506,633**	62,500
	$ 78,696,570	$ 3,688,971
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current Liabilities		
Accounts payable and accrued liabilities	**$ 13,399,101**	$ 31,051
Bank indebtedness (note 4)	**6,318,985**	–
Convertible demand notes (note 5)	**–**	4,770,985
	19,718,086	4,802,036
Asset retirement obligation (note 6)	**3,073,325**	–
	22,791,411	4,802,036
Shareholders' Equity		
Share capital (note 7)	**66,397,721**	5,713,339
Contributed surplus (note 7)	**415,713**	–
Deficit	**(10,908,275)**	(6,826,404)
	55,905,159	(1,113,065)
	$ 78,696,570	$ 3,688,971

Commitments (note 11)

See accompanying notes to financial statements

On Behalf of the Board of Directors:

Ron Cawston
Director

Jim Saunders
Director

STATEMENTS OF OPERATIONS AND RETAINED EARNINGS

Year ended December 31,	2006	2005
REVENUE:		
Petroleum and natural gas sales	$ 11,149,649	$ –
Royalties, net of ARTC	(1,812,873)	–
	9,336,776	–
Interest income	33,049	16,648
EXPENSES:		
Operating	2,612,084	–
Transportation	590,699	–
General and administrative	1,108,935	41,247
Stock based compensation	3,819,663	–
Interest	553,653	481,199
Depletion, depreciation and accretion	7,878,607	–
	16,563,641	522,446
Loss before income taxes	(7,193,816)	(505,798)
Income taxes		
Future tax recovery	(3,111,945)	–
	(3,111,945)	–
Net loss	(4,081,871)	(505,798)
Deficit, beginning of year	(6,826,404)	(6,320,606)
Deficit, end of year	$ (10,908,275)	$ (6,826,404)
Basic loss per share	$ (0.06)	$ (0.06)
Diluted loss per share	$ (0.06)	$ (0.06)
Weighted average common shares outstanding		
Basic	63,814,349	8,473,607
Diluted	63,814,349	8,473,607

See accompanying notes to financial statements

STATEMENTS OF CASH FLOWS

Year ended December 31,	2006	2005
Cash provided by (used in):		
OPERATIONS:		
Net loss	$ (4,081,871)	$ (505,798)
Items not involving cash:		
Depletion, depreciation and accretion	7,878,607	–
Future income taxes	(3,111,945)	–
Stock based compensation	3,819,663	–
	4,504,454	(505,798)
Changes in non-cash working capital	(4,081,809)	(450,086)
	422,645	(955,884)
FINANCING:		
Change in bank debt	(5,126,820)	–
Issuance of share capital, net of share issue costs	13,021,809	4,013,323
	7,894,989	4,013,323
INVESTING:		
Expenditures on property and equipment	(14,703,138)	(62,500)
Acquisition expenditures (note 2)	(8,252,364)	–
Changes in non-cash working capital	11,012,281	–
	(11,943,221)	(62,500)
Increase (decrease) in cash and cash equivalents	(3,625,587)	2,994,939
Cash and cash equivalents, beginning of year	3,625,587	630,648
Cash and cash equivalents, end of year	$ –	$ 3,625,587
Cash interest paid	$ 553,054	$ 911,242

See accompanying notes to financial statements

Twin Butte is engaged in the acquisition of, exploration for, and development of petroleum and natural gas properties in Western Canada. On February 3, 2004, a Plan of Arrangement was completed involving Twin Butte (formerly AltaRex Corp.), AltaRex Medical Corp., and Nova Bancorp Investments Ltd. Pursuant to the Arrangement, Twin Butte was transformed into an oil and gas exploration and production company.

NOTE 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.

Summary of significant accounting policies

These financial statements have been prepared by management in accordance with accounting principles generally accepted in Canada. Because the precise determination of many assets, liabilities, revenues and expenses are dependent on future events, the preparation of financial statements for a period necessarily includes the use of estimates and approximations which have been made using careful judgment. Actual results could differ from the estimates. These financial statements have, in management's opinion, been properly prepared within reasonable limits of materiality and within the framework of the accounting policies summarized below:

a) Oil and gas operations

i) Capitalization of costs

The Company follows the full-cost method of accounting for oil and natural gas properties whereby all costs of acquisition, exploration and development of petroleum and natural gas reserves are capitalized and accumulated in a single cost centre representing the Company's activity undertaken exclusively in Canada. Such costs include land acquisition costs, geological and geophysical expenses, lease rentals costs on non-producing properties, costs of drilling both productive and non-productive wells, related production equipment costs, and overhead charges directly related to these activities.

Proceeds received on the disposition of oil and gas properties are credited against property and equipment except when the disposition results in a change in the depletion rate of the 20% or more, in which case a gain or loss is recognized.

Office and computer equipment are depreciated using the straight line method ranging between three and five years.

ii) Depletion and depreciation

Capitalized costs, excluding costs related to unproven reserves and salvage values, are depleted and depreciated using the unit-of-production method based on the estimated gross proven oil and natural gas reserves before royalties as determined by independent engineers. Oil and natural gas reserves are converted on an energy equivalent basis.

iii) Ceiling test

Petroleum and natural gas assets are evaluated on an annual basis to determine that the costs are recoverable and do not exceed the fair value of the properties (the "ceiling test"). The costs are assessed to be recoverable if the sum of the undiscounted cash flows expected from the production of proved reserves and the lower of cost and fair value of unproved properties exceed the carrying value of the petroleum and natural gas assets. If the carrying value of the petroleum and natural gas is not assessed to be recoverable, an impairment loss is recognized to the extent that the carrying value exceeds the sum of the discounted cash flows expected from the production of proved and probable reserves and the lower of cost and fair value of unproved properties. The cash flows are estimated using future commodity prices and costs and are discounted using the Company's risk-free rate.

b) Asset retirement obligations

The Company records the fair value of an asset retirement obligation ("ARO") as a liability in the period in which it incurs a legal obligation associated with the retirement of long-lived assets that result from the acquisition, construction and development of the assets. The associated asset retirement costs are capitalized as part of the carrying amount of the long-lived asset and depleted and depreciated using a unit of production method over estimated proved reserves. The recorded ARO increases over time through accretion charges to earning. Revisions to the estimated amount and timing of the obligations are reflected as increases or decreases to the ARO. Actual asset retirement expenditures are charged to the ARO to the extent of the recorded liability with any difference recorded as a gain or loss in the period in which settlement occurs.

c) Joint Operations

A portion of the Company's exploration and development activities are conducted jointly with others. Accordingly, the financial statements reflect only the Company's proportionate interest in such activities.

d) Flow-through common shares

The Company has financed a portion of its exploration and development activities through the issue of flow-through common shares. Under the terms of the flow-through shares, the income tax attributes of the related expenditures are renounced to the subscribers. To recognize the foregone tax benefits to the Company, the flow-through shares issued are recorded net of the tax benefits when renouncement documents are filed with the tax authorities.

e) Foreign currency translation

Monetary assets and liabilities denominate in foreign currencies are translated at exchange rates in effect at the balance sheet date. Non-monetary assets and liabilities denominated in foreign currencies are translated at rates in effect on the dates the assets were acquired or liabilities were assumed. Revenues and or losses on these items are included in the statements of operations.

f) Income taxes

The Company follows the liability method of income tax allocation. Under this method, future income taxed are recognized for the future income tax consequences attributable to differences between the carrying values of assets and liabilities and their respective income tax basis. Future income tax assets and liabilities are measured using substantively enacted income tax rates expected to apply to taxable income in the years in which temporary differences are expected to be recovered or settled. The effect on future income tax assets and liabilities of a change in rates is included in earnings in the period that includes the date of substantial enactment. Future income tax assets are recorded in the financial statements if realization is considered more likely than not.

g) Stock-based compensation and other stock-based payments

The Company grants stock options to executive officers, directors, employees and consultants pursuant to a stock option plan. Awards of stock options granted to employees, officers and directors are accounted for in accordance with the fair value method and result in compensation expense. The expense is recognized in income over the shorter of the service period of the employees to whom the option was granted or the vesting period of the specific option. The corresponding credit is recorded as a contributed surplus. Any consideration paid on the exercise of stock options is credited to share capital.

h) Per share information

Basic per share amounts are calculated using the weighted average number of common shares outstanding during the period. Diluted per share amounts are calculated adjusting the weighted average number of shares for the dilutive effect of options, using the treasury stock method. Under this method, the dilutive effect of options uses proceeds received on the exercise of options plus the unamortized portion of stock-based compensation to purchase common shares at the average price during the period. The weighted average number of shares outstanding is then adjusted by the net change.

i) Financial instruments

The fair market values of cash and cash equivalents, receivables, other current assets, payables and bank indebtedness approximate their carrying value. From time to time, the Company may use derivative financial instruments to manage exposure to fluctuations in commodity prices and foreign currency exchange rates. All transactions of this nature entered into by the Company are related to an underlying financial position or to future petroleum and natural gas production. The Company does not use derivative financial instruments for speculative trading purposes.

j) Cash and cash equivalents

Cash and cash equivalents consist of cash and term deposits with a maturity date of three months or less.

k) Revenue recognition

Revenue associated with the sale of crude oil and natural gas is recognized when title passes to the purchaser.

NOTE 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 19,630,062 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 14,392,170 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)

NOTE 3. PROPERTY AND EQUIPMENT

	Cost	Accumulated Depletion & Depreciation	Net Book Value
Petroleum and natural gas properties	$ 79,282,575	$ 7,813,637	$ 71,468,938
Office and computer equipment	44,800	7,105	37,695
Total	$ 79,327,375	$ 7,820,742	$ 71,506,633

The Company has capitalized $379,609 of general and administrative expenses directly related to exploration and development activities for the year ended December 31, 2006 ($ nil – year ended December 31, 2005).

The cost of undeveloped property excluded from the depletion base as at December 31, 2006 was $5,630,449 (December 31, 2005 - $nil). Future development costs on proved reserves of $5,785,700 as at December 31, 2006 are included in the calculation of depletion and depreciation (2005 - $nil).

The Company performed a ceiling test calculation as at December 31, 2006 to assess the recoverable value of the property and equipment. The oil and gas future price is based on the January 1, 2007 commodity price forecast of the Company's independent reserve evaluators. The Company had no impairment under the December 31, 2006 year end ceiling test.

For calculation of the December 31, 2006 ceiling test, the benchmark prices used were as follows:

	Oil Edmonton Par Price 40 API CAD $/bbl	Natural Gas AECO – C Spot CAD $/MMbtu
2007	70.80	6.85
2008	69.30	7.05
2009	67.70	7.40
2010	66.10	7.50
2011	64.20	7.70
2012	65.60	7.90
2013	66.80	8.10
2014	68.20	8.25
2015	69.50	8.45
2016	70.90	8.60
2017	72.30	8.75
2018	73.80	8.95
% increase thereafter	2.00%	2.00%

NOTE 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.

NOTE 5. CONVERTIBLE DEMAND NOTES:

On February 3, 2004, the Company issued $4, 770,985 10% demand notes, convertible into non-voting, common shares of the Company at a ratio of 2,583 non-voting shares per $1,000 or principle outstanding. The fair value of the equity component of these notes associated with the conversion option has been estimated to be $nil. The convertible demand notes were converted to 12,323,429 Common Shares of the Company (note 7) in March 2006.

NOTE 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 $3,073,325 at December 31, 2006, based on a total future liability of $3,818,400. 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 were used to calculate the present value of the asset retirement obligation.

Changes to the asset retirement obligation are as follows:

		2006
Carrying amount, beginning of year	$	–
Liabilities incurred		76,481
Acquisitions (note 2)		2,062,312
Revisions in estimated cash outflows		876,988
Accretion of asset retirement obligation		57,544
Asset retirement obligation, end of year	$	3,073,325

NOTE 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, 2004	8,448,036	$ 1,700,016
Issuance of flow-through shares	9,333,310	4,013,323
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	7,000,000	3,010,000
Issued pursuant to private placement for cash	17,000,000	6,800,000
Issued pursuant to acquisitions (note 2)	34,022,232	40,840,359
Issued pursuant to exercise of management warrants for cash	8,250,000	3,300,000
Contributed surplus related to management warrants exercised	–	3,403,950
Tax effect of flow through share issuance	–	(1,352,720)
Share issue and financing costs net of tax	–	(88,191)
Balance, December 31, 2006	**96,377,007**	**$ 66,397,721**

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 with an expiry of December 31, 2006. All warrants were exercised in 2006.

During the second quarter of 2006 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.

All management warrants were exercised during the year.

Stock Options

The following table sets forth a reconciliation of stock option plan activity through to December 31, 2006

	Number of Options	Weighted Average Exercise Price
Outstanding at December 31, 2005	–	–
Granted	7,875,000	0.80
Forfeited	(550,000)	0.80
Outstanding at December 31, 2006	7,325,000	$ 0.80

There were no options exercisable as at December 31, 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.

	2006
Contributed surplus balance at beginning of year	**$ –**
Stock based compensation charged for stock options	**415,713**
Stock based compensation charged for management warrants	**3,403,950**
Transfer to share capital on exercise of management warrants	**(3,403,950)**
Contributed surplus balance at end of period	**$ 415,713**

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:

	Year ended December 31, 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:

Years ended December 31,	**2006**	2005
Weighted average number of basic shares	**63,814,349**	8,473,607
Effect of dilutive securities:		
Employee stock options	**–**	–
Weighted average number of diluted shares	**63,814,349**	8,473,607

NOTE 8. TAXES

Tax Expense

The combined provision for taxes in the statement of operations and retained deficit reflects an effective tax rate which differs from the expected statutory tax rate. Differences were accounted for as follows:

	2006	2005
Earnings before taxes	**$ (7,193,816)**	$ (505,798)
Statutory income tax rate	**34.50%**	33.62%
Expected income taxes	**(2,481,867)**	(170,000)
Non-deductible crown charges	**88,789**	–
Resource allowance	**(179,190)**	–
Stock based compensation	**1,317,784**	–
Utilization of previously unrecognized non-capital loss carryforwards	**(2,160,373)**	–
Change in expected tax rate	**302,912**	
Other	**–**	170,000
Future income tax recovery	**$ (3,111,945)**	$ –

Future Income Taxes

	2006	2005
Property, plant, and equipment	**$ 12,213,900**	$ –
Asset retirement obligations	**(930,900)**	–
Share issue cost	**(386,600)**	–
Eligible scientific research & experimental development expenditures	**(4,393,000)**	
Non-capital loss carryforwards	**(23,603,800)**	(27,691,199)
Valuation allowance	**15,071,000**	27,691,199
Future income tax asset	**$ (2,029,400)**	$ –

As at December 31, 2006, the Company has tax deductions of approximately $124.8 million that is available to shelter future taxable income. Included in the above is $77.9 million in non-capital losses that expire as follows:

Year of expiry ($millions)	
2007	$ 16.5
2008	31.5
2009	8.8
2014	3.9
2015	1.1
2026	16.1

NOTE 9. RELATED PARTY TRANSACTIONS

During the year the Company expensed and capitalized legal fees totaling $433,102 (2005 - $nil) for services rendered by a professional firm related to a director of the Company. As at December 31, 2006, no amount is included in accounts payable and accrued liabilities related to these transactions. These fees were incurred in the normal course of business and recorded at the exchange amount.

NOTE 10. FINANCIAL INSTRUMENTS

Financial instruments of the Company carried on the balance sheet consist mainly of cash and short-term investments, accounts receivable and current liabilities including bank indebtedness. The estimated fair value of the financial instruments approximates their carrying values due to their short terms to maturity. Substantially all of the Company's accounts receivable are due from customers in the oil and gas industry and are subject to normal industry credit risk. The Company is exposed to interest rate risk to the extent that changes in market interest rates will impact any bank indebtedness that has a floating interest rate.

NOTE 11. COMMITMENTS

As at December 31, 2006, the Company had contractual obligations and commitments for office space and equipment:

2007	$ 464,194
2008	16,587

Subsequent to year end the Company completed a bought deal private placement of flow through shares (note 12) that will require the Company to spend $12.0 million of flow-through share eligible Canadian Exploration Expenditures, as defined in the Canadian Income Tax Act, by December 31, 2008.

NOTE 12. SUBSEQUENT EVENTS

Fixed Price Swap Hedges

In January 2007 the Company entered into three fixed price swap hedge arrangements on a total of 3,500 GJ/d for the period of April 1, 2007 to October 31, 2007 at an average price of $6.99/GJ as follows:

Volume (GJ/d)	Price ($/GJ)	Index
1,500 GJ	$6.80/GJ	AECO Monthly
1,500 GJ	$7.04/GJ	AECO Monthly
500 GJ	$7.40/GJ	AECO Monthly

Private Placement Financing

On February 27, 2007 the Company closed a bought deal private placement of 14,635,000 flow-through Common Shares at a price of $0.82 per share, for aggregate proceeds of $12,000,700.

CORPORATE INFORMATION

OFFICERS

Ron Cawston
President and Chief Executive Officer

Brian Dunn
Vice President, Engineering and Corporate Development

John Murray
Vice President, Exploration

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

Member of:
[(1)] Audit Committee
[(2)] Reserves Committee
[(3)] Compensation and Governance Committee

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Chartered Accountants, Calgary, AB

BANKERS

National Bank of Canada, Calgary, AB

SOLICITORS

Burnet, Duckworth & Palmer LLP,
Calgary, AB

ENGINEERS

McDaniel & Associates Consultants Ltd. Calgary, AB

REGISTRAR & TRANSFER AGENT

Valiant Trust Company
Calgary, AB

STOCK EXCHANGE LISTING

TSX
Trading Symbol "TBE"