

CONSOLIDATED BALANCE SHEETS

As at	June 30,	December 31,
	2006	2005
<i>(\$000s) (unaudited)</i>		
Assets		
Current assets		
Accounts receivable	46,058	40,716
Prepaid expenses and deposits	1,581	1,795
Financial instruments <i>(note 7)</i>	2,186	763
	49,825	43,274
Property, plant and equipment <i>(note 3)</i>	618,085	493,330
Long-term investment, at cost	1,150	1,000
Deferred charges	–	251
Goodwill <i>(note 2)</i>	251,881	215,835
	920,941	753,690
Liabilities and Shareholders' Equity		
Current liabilities		
Accounts payable and accrued liabilities	44,745	47,403
Bank indebtedness <i>(note 5)</i>	60,951	104,707
	105,696	152,110
Future income taxes	86,980	84,167
Asset retirement obligations <i>(note 4)</i>	7,657	5,898
Deferred lease inducements	450	492
Shareholders' equity		
Share capital <i>(note 6)</i>	673,982	479,496
Contributed surplus <i>(note 6)</i>	6,391	3,627
Retained earnings	39,785	27,900
	720,158	511,023
Subsequent event <i>(note 9)</i>	920,941	753,690

See accompanying notes to the consolidated financial statements.

CONSOLIDATED STATEMENTS OF EARNINGS AND RETAINED EARNINGS

	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
<i>(\$000s, except per share amounts) (unaudited)</i>				
Revenues				
Oil and gas revenues	61,644	23,013	123,450	37,986
Royalties, net of Alberta Royalty Tax Credits	(17,952)	(5,841)	(37,946)	(9,657)
Financial instruments				
Realized gains (losses)	1,840	(1,254)	2,308	(2,135)
Unrealized gains (losses)	(719)	59	1,423	59
	44,813	15,977	89,235	26,253
Interest and other income	19	5	37	5
	44,832	15,982	89,272	26,258
Expenses				
Operating costs	7,348	3,267	14,243	4,663
Transportation costs	794	677	1,312	897
General and administrative	2,197	1,507	4,192	2,353
Depletion, depreciation and accretion	29,755	8,620	58,915	14,053
Interest and finance costs	748	534	1,891	1,358
Stock-based compensation <i>(note 6)</i>	1,435	494	2,955	772
	42,277	15,099	83,508	24,096
Earnings before taxes	2,555	833	5,764	2,162
Taxes (reduction)				
Current	(307)	81	(127)	131
Future <i>(note 8)</i>	(7,732)	834	(5,994)	1,295
	(8,039)	915	(6,121)	1,426
Net earnings (loss)	10,594	(32)	11,885	736
Retained earnings, beginning of period	29,191	16,394	27,900	23,992
Stock dividend and adjustment	–	–	–	(8,366)
Retained earnings, end of period	39,785	16,362	39,785	16,362
Net earnings per share <i>(note 6)</i>				
Basic	0.20	(0.00)	0.24	0.03
Diluted	0.20	(0.00)	0.23	0.03

See accompanying notes to the consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
<i>(\$000s) (unaudited)</i>				
Cash provided by (used in):				
Operating Activities				
Net earnings (loss)	10,594	(32)	11,885	736
Items not involving cash:				
Depletion, depreciation and accretion	29,755	8,620	58,915	14,053
Future income taxes (reduction)	(7,732)	834	(5,994)	1,295
Stock-based compensation	1,435	494	2,955	772
Unrealized losses (gains) on financial instruments	719	(59)	(1,423)	(59)
Abandonment expenditures	(46)	—	(46)	—
Amortization of deferred lease inducements	(21)	—	(42)	—
Funds from operations	34,704	9,857	66,250	16,797
Change in non-cash operating working capital	10,569	(8,709)	(5,552)	(14,566)
	45,273	1,148	60,698	2,231
Financing Activities				
Common shares issued for cash, net of share issue costs	(7)	67,191	96,274	67,192
Proceeds on exercise of stock options	85	—	1,083	—
(Decrease) increase in bank indebtedness	26,595	(35,148)	(48,226)	(6,003)
Deferred charges	—	658	—	—
	26,673	32,701	49,131	61,189
Investing Activities				
Property, plant and equipment additions	(46,590)	(19,839)	(93,359)	(54,596)
Purchase of investments	—	—	(150)	—
Net cash paid on business combination <i>(note 2)</i>	—	(430)	(527)	(430)
Deferred charges	—	—	251	—
Change in non-cash investing working capital	(25,356)	(13,580)	(16,044)	(8,394)
	(71,946)	(33,849)	(109,829)	(63,420)
Change in cash and cash equivalents	—	—	—	—
Cash and cash equivalents, beginning of period	—	—	—	—
Cash and cash equivalents, end of period	—	—	—	—
Cash interest paid	827	557	1,575	674
Cash taxes paid	88	90	368	296

See accompanying notes to the consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Six Months Ended June 30, 2006 and 2005

1. Significant Accounting Policies

The interim consolidated financial statements of Highpine Oil & Gas Limited (the "Company") have been prepared by management in accordance with Canadian generally accepted accounting principles and follow the same accounting policies as the most recent audited annual consolidated financial statements. Certain disclosures normally required to be included in the notes to the annual consolidated financial statements have been condensed or omitted. The interim consolidated financial statements should be read in conjunction with the audited annual consolidated financial statements and notes thereto for the year ended December 31, 2005.

2. Acquisition of White Fire Energy Ltd.

On February 21, 2006, Highpine acquired White Fire Energy Ltd. ("White Fire") for consideration of 4.1 million class A common shares with an ascribed value of \$95.5 million. White Fire was a public oil and gas exploration and production company active in the Western Canadian Sedimentary Basin. The transaction has been accounted for using the purchase method with the allocation of the purchase price as follows:

(\$000s)

Net assets acquired and liabilities assumed

Property, plant and equipment (including unproved properties totaling \$25,800)	89,651
Goodwill	36,046
Working capital (deficiency)	(13,810)
Bank indebtedness	(4,470)
Asset retirement obligations	(1,145)
Future income taxes	(10,265)
	<hr/> 96,007

Consideration

Acquisition costs	527
Class A common shares issued	95,480
	<hr/> 96,007

The above amounts are estimates made by management based on currently available information. Amendments may be made to the purchase equation as the cost estimates and balances are finalized.

3. Property, Plant and Equipment

At June 30, 2006, approximately \$140.0 million (December 31, 2005 – \$112.4 million) of unproved property costs were excluded from the depletion calculation. Future development costs of \$11.0 million (December 31, 2005 – \$13.3 million) were included in the depletion calculation. During the six months ended June 30, 2006, general and administrative expenses of \$1.3 million (June 30, 2005 – \$0.3 million) were capitalized.

4. Asset Retirement Obligations

At June 30, 2006, the estimated total undiscounted cash flows required to settle asset retirement obligations were \$12.5 million. Expenditures to settle asset retirement obligations will be incurred between 2006 and 2026. Estimated cash flows have been discounted using an annual credit adjusted risk-free interest rate of 8.0% per annum and have been inflated using an inflation rate of 2.0% per annum.

Changes to asset retirement obligations were as follows:

	Six Months Ended June 30, 2006	Year Ended December 31, 2005
<i>(\$000s)</i>		
Asset retirement obligations, beginning of period	5,898	1,974
Liabilities acquired	1,145	1,903
Liabilities incurred	392	1,694
Liabilities settled	(46)	–
Accretion expense	268	327
Asset retirement obligations, end of period	7,657	5,898

5. Bank Indebtedness

At June 30, 2006, the Company had available a \$130 million revolving term credit facility and a \$20 million demand operating credit facility with Canadian financial institutions. The revolving term credit facility revolves until May 29, 2007 unless it is extended for a 364-day period. The revolving term credit facility bears interest within a range of the lenders' prime rate to prime plus 0.25% depending on the Company's ratio of consolidated debt to net income before interest, taxes, depletion, depreciation, accretion and stock-based compensation expense. The demand operating facility bears interest at the lenders' prime rate. The facilities are secured by a general security agreement and a first floating charge over all of the Company's assets.

6. Share Capital

Six Months Ended June 30, 2006 (000s)	Shares (#)	Amount (\$)
Class A common shares		
Balance, beginning of period	44,250	479,496
Issued to acquire White Fire Energy Ltd. (note 2)	4,089	95,480
Issued for cash	4,300	100,620
Stock options exercised	157	1,083
Contributed surplus transferred on exercise of stock options	–	191
Share issue costs less tax effect of \$1,458	–	(2,888)
Balance, end of period	52,796	673,982

Per Share Amounts

	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
(#000s)				
Weighted average number of common shares outstanding				
Basic	52,788	31,129	50,306	25,947
Dilutive effect of stock options	953	1,164	979	1,035
Diluted	53,741	32,293	51,285	26,982

Stock Options

The Company has a stock option plan pursuant to which options to purchase class A common shares of the Company may be granted to directors, officers, employees and consultants. The outstanding stock options of the Company are exercisable for a period of six years and vest over a period of four years.

A summary of changes is as follows:

	Six Months Ended June 30, 2006		Year Ended December 31, 2005	
	Class A Common Shares Issuable Upon Exercise of Options (#000s)	Weighted Average Exercise Price (\$)	Class A Common Shares Issuable Upon Exercise of Options (#000s)	Weighted Average Exercise Price (\$)
Balance, beginning of period	3,652	13.06	1,542	5.26
Granted	1,287	21.62	2,308	18.96
Exercised	(157)	(7.22)	(47)	(3.89)
Cancelled	(66)	(12.0)	(224)	(17.00)
Stock dividend adjustment	–	–	73	–
Balance, end of period	4,716	15.62	3,652	13.06
Exercisable, end of period	1,020	8.36	556	4.33

6. Share Capital (Continued)

The fair value of stock options granted is estimated using the Black-Scholes option pricing model. The following assumptions were used for the 2006 grants:

Expected volatility	30%
Risk-free rate of return	5.3%
Expected option life	4 years
Weighted average fair value per option	\$7.68

The Company does not anticipate paying any dividends during the expected life of the options.

Contributed Surplus

	Six Months Ended June 30, 2006	Year Ended December 31, 2005
<i>(\$000s)</i>		
Balance, beginning of period	3,627	511
Stock-based compensation expense, net of recovery	2,955	3,151
Transferred to share capital on exercise of stock options	(191)	(35)
Balance, end of period	6,391	3,627

7. Commodity Price Risk Management

The Company uses a variety of derivative instruments to reduce its exposure to fluctuations in commodity prices. The Company considers all of these transactions to be effective economic hedges; however, these transactions may not qualify as effective hedges for accounting purposes. The following commodity price risk management agreements have been entered into:

Financial WTI Crude Oil Contracts

Term	Contract	Volume <i>(bbls/d)</i>	Fixed Price <i>(\$/bbl)</i>	Unrealized Gain (Loss) As at June 30, 2006 <i>(CDN \$000s)</i>
Jan 06 to Dec 06	Collar	2,000	US \$60.00 to \$69.80	(3,026)
Jan 06 to Dec 06	Collar	1,000	US \$55.00 to \$77.25	(607)
Jan 07 to Dec 07	Collar	1,750	US \$55.00 to \$86.15	(1,751)
Jan 07 to Dec 07	Collar	1,750	US \$60.00 to \$80.70	(2,302)

7. Commodity Price Risk Management (Continued)**Financial AECO Natural Gas Contracts**

Term	Contract	Volume (GJs/d)	Fixed Price (\$/GJ)	Unrealized
				Gain (Loss) As at June 30, 2006 (CDN \$000s)
Jan 06 to Dec 06	Collar	5,000	CDN \$9.00 to \$14.70	2,729
Jun 06 to Mar 07	Collar	5,000	CDN \$5.40 to \$12.00	(116)
Jul 06 to Mar 08	Collar	5,000	CDN \$6.00 to \$11.10	(427)

The financial AECO natural gas contracts have not been designated as effective accounting hedges. Accordingly, the financial AECO natural gas contracts have been accounted for as an asset in the consolidated balance sheet based on their fair value.

8. Income Taxes

The provision for future income taxes for the three and six months ended June 30, 2006 was reduced by \$9.1 million due to the substantively enacted reduction in Canadian federal and Alberta provincial corporate income tax rates.

9. Subsequent Event

On August 1, 2006, the Company closed the previously announced acquisition of Kick Energy Corporation ("Kick") by way of a Plan of Arrangement. Under the Plan of Arrangement, shareholders of Kick received 0.32 of a class A common share of the Company for each common share of Kick held. The Company issued approximately 14.8 million class A common shares to shareholders of Kick.

10. Comparative Balances

Certain of the comparative balances have been reclassified to conform to the current period's presentation.