

OILEXCO INCORPORATED

INTERIM REPORT

**As at and for the three and six month periods ended
June 30, 2006**

OILEXCO INCORPORATED

MANAGEMENT DISCUSSION AND ANALYSIS

The following is management's discussion and analysis ("MD&A") of the operating and financial results of Oilexco Incorporated for the three and six months ended June 30, 2006. The information is provided as of August 11, 2006. The three and six month results have been compared to the same periods of 2005. This discussion and analysis should be read in conjunction with the Company's audited consolidated financial statements for the years ended December 31, 2005 and 2004, together with the accompanying notes, and the December 31, 2005 MD&A and Annual Information Form. These documents and additional information about Oilexco Incorporated are available on SEDAR at www.sedar.com.

This discussion and analysis contains forward-looking statements relating to future events or future performance. In some cases, forward-looking statements can be identified by terminology such as "may", "will", "should", "expects", "projects", "plans", "anticipates" and similar expressions. These statements represent management's expectations or beliefs concerning, among other things, future operating results and various components thereof or the economic performance of Oilexco. The projections, estimates and beliefs contained in such forward-looking statements necessarily involve known and unknown risks and uncertainties, including the business risks discussed in the MD&A and Annual Information Form as at and for the years ended December 31, 2005 and 2004, which may cause actual performance and financial results in future periods to differ materially from any projections of future performance or results expressed or implied by such forward-looking statements. Accordingly, readers are cautioned that events or circumstances could cause results to differ materially from those predicted.

Barrel of oil equivalent (BOE) volumes are reported at 6:1 with 6 MCF = 1 BOE. Financial information in this report is presented in accordance with Canadian generally accepted accounting principles. All amounts are presented in thousands of United States dollars ("\$\$") unless otherwise noted.

BUSINESS OF THE COMPANY

Oilexco is an oil and gas exploration and Production Company headquartered in Calgary, Alberta, active in the United Kingdom and the United States of America. The Corporation's primary producing properties are located in the UK Central North Sea. Exploration activities are focused on the Outer Moray Firth of the UK Central North Sea. The goal of Oilexco in the near term is to achieve oil production from its interests in the North Sea while carrying on an active exploration/development program on both its owned properties plus various joint-venture opportunities currently being considered by the Company.

OVERALL PERFORMANCE

The Brenda/Nicol Field development is currently on schedule and on budget. Fabrication of the major subsea and topside components is complete. Operations have commenced on the subsea installation and topside modification phase of the development. First oil is targeted for October, but could be delayed until early November due to the delayed arrival of one of the contracted subsea installation vessels.

Three horizontal production wells at Brenda were drilled completed during the period. Subsequent flow tests on the three wells indicated combined production capability of 26,438 Bbl/d oil under test conditions, with a calculated production capability of 44,000 Bbl/d oil at an assumed 8% reservoir drawdown. Production rates will be restricted in order to maintain reservoir integrity. The Brenda wells were completed on budget and on schedule.

Operations on the single horizontal production well at Nicol commenced at the end of June, after the Company received field development approval for Nicol from the UK Department of Trade and Industry in May. The subsequent flow test of the horizontal production well realized an oil flow at a maximum rate of 10,165 bbl/d under test conditions. Estimated well flow rates normalized to an approximate 8% reservoir drawdown would have an estimated oil flow of approximately 12,000 Bbl/d.

During the second quarter three wells from the Company's 2006 exploration/appraisal program were drilled with the semi-submersible Bredford Dolphin under a short term three well contract. The first well drilled by the Bredford Dolphin was located at Joy in Block 15/25c north of the Company's Nicol development. This well failed to intersect commercial hydrocarbons. The second well of the three well contract was drilled at Sheryl (formerly Disraeli) located in Block 21/23b. This well intersected a significant oil column in two sidetracks. However, pressure measurements and well testing were not performed because of the highly deviated nature of the well bores. The Company has returned to the Sheryl site with the semi-submersible Sedco 712 to conduct further appraisal drilling to evaluate the extent of the reservoir on the south flank of the structure. These operations are expected to be completed in September. The third well of the contract was drilled at Halibut (Blocks 14/21 and 14/22a). This high risk exploratory well did not encounter commercial quantities of hydrocarbons.

Oilexco submitted bids for ten licences the UK Department of Trade and Industry's (DTI) 24th Offshore Licensing Round, the results of which are expected to be announced in the third quarter.

In May 2006, the Company's wholly owned subsidiary Oilexco North Sea Limited executed a contract extension with Transocean Offshore (North Sea) Ltd. ("Transocean") for the semi-submersible Sedco 712 from March 23, 2008 to March 23, 2010. The total dollar value for the two year extension is US\$248 million, representing a day rate of \$340,000 per day. This increase from \$225,000 per day in the period March 23, 2007 to March 23, 2008, and \$140,000 per day in the period March 23, 2006 to March 23, 2007 reflects the long term increase in world wide demand for offshore drilling equipment. Oilexco considers the long term contract for the Sedco 712 a key component to its overall strategy as it will allow the Company to continue its exploration, appraisal and development programs. The contract provides the Company guaranteed access to a drilling vessel and the ability to budget its capital spending without being exposed to the uncertainty of short term daily rig rates, in addition to allowing the Company flexibility to adjust its drilling schedule should circumstances require.

During the second quarter of 2006, the Company's wholly owned subsidiary also executed a Sale and Purchase Agreement with ConocoPhillips (U.K.) Limited ("COP") and ENI UK Limited ("ENI") related to the Nicol Field. Under the terms of the agreement, COP and ENI will lift a joint total of 1.25 million barrels from their combined 30% ownership of Nicol. After the production milestone is reached, COP and ENI will relinquish their equity and Oilexco will then become the 100% owner of the Nicol Field. In return for the increased ownership, the Company is paying COP and ENI's 30% share of the capital expenditures required to develop Nicol, currently estimated to be approximately US\$16.6 million.

In May Oilexco North Sea Limited, the wholly owned subsidiary of the Company, completed the syndication of its loan led by the Royal Bank of Scotland ("RBS") with the addition of 10 additional lending institutions. As a result of the syndication the total amount of the funds available to the Company increased by \$50 million to \$295 million. While the additional funds are not expected to be required for the Company's current developments, the increased funds will give Oilexco greater flexibility and agility to react to future development projects.

Oilexco finished the second quarter of 2006 in excellent financial condition. The Company had significant cash balances as at June 30, 2006 as a result of an equity financing that closed in December 2005 and draws from the RBS loan facility. Capital assets increased from \$197.0 million at December 31, 2005 to \$347.6 million at June 30, 2006 as a result of drilling three exploration wells, five production wells and additions to the subsea equipment for the Brenda and Nicol development. Current liabilities increased from \$41.9 million at December 31, 2005 to \$56.6 million at June 30, 2006, represented by a \$31.3 million increase in accounts payable and accrued liabilities, and a \$16.5 million decrease in the current portion of the bank loan (due to repayment of the Bridge Facility that was replaced with long-term senior debt from RBS). The long-term debt as at June 30, 2006 amounted to \$119.8 million and relates to the Senior Facility. The Company expects its bank indebtedness to increase by the end of 2006 up to approximately \$225 million. Net working capital was approximately \$48.0 million as at June 30, 2006 compared to \$89.1 million at December 31, 2005. The increase in share capital of approximately \$7.0 million represents funds obtained from warrants and stock options exercised in the first and second quarters of 2006. The Company's 2006 UK North Sea exploration and appraisal drilling program will be fully funded by its cash reserves. The Brenda/Nicol development is funded by the Senior Facility from RBS.

Operating results for the first and second quarter were lower in 2006 compared to the first and second quarter of 2005. The decrease in UK production was a result of maintenance work completed on the Balmoral facility; however increased oil prices helped offset reduced production. The price received for UK oil production for the second quarter of 2006 averaged \$67.01 per barrel compared to \$51.95 for the same period in 2005. While total operating costs at the Balmoral facility in the first and second quarter of 2006 were similar to those of the first and second quarter of 2005, the per barrel costs were significantly higher. The increase in the per barrel cost was due to the decreased production in 2006 and scheduled maintenance of the facility. The per unit operating costs will decline when the Brenda/Nicol production begins later in the fourth quarter of 2006.

General and administrative expenses increased significantly in the second quarter of 2006 compared to 2005 because of continued increase in staffing levels in both Oilexco's head office in Calgary and its wholly owned subsidiary in Aberdeen. The additional expenses are a result of salaries, support and activity required for the Brenda/Nicol development and the ongoing exploration and appraisal drilling program. General and administrative expenses are expected to continue to rise somewhat throughout 2006, though not as sharply as in previous periods. A stock-based compensation expense of \$7.7 million was recognized in the second quarter of 2006, which was \$nil the same period in 2005. The Company continues its compensation policy of combining share options with competitive salaries and benefits packages in order to attract the best qualified staff.

As part of its loan facility agreement with RBS, the Company participated in commodity contracts that involve a costless collar agreement to secure the Company's future cash flow by eliminating its exposure to oil prices below \$40 per barrel for a portion of the anticipated production from Brenda and Nicol. As a result of oil prices at June 30, 2006 compared to those of January 25, 2006, the date at which the commodity contracts were signed, the Company recorded an unrealized loss of \$8.3 million in its financial statements for the second quarter ended June 30, 2006. This is a non cash item. The commodity contracts will not have a negative impact on the Company's cash flow unless the price of dated Brent exceeds a monthly average of \$88 per barrel during the life of the commodity contracts.

The Company experienced a net loss of \$17.8 million for the second quarter of 2006 compared to a \$1.0 million net loss for the corresponding period in 2005. The sharp increase in the 2006 net loss is a result of approximately \$8.3 million unrealized loss on derivative contracts, \$7.7 million in stock based compensation and \$0.6 million increase in general and administrative expenses.

As anticipated, cash flows from operating activities were negative in the second quarter of 2006, similar the corresponding period in 2005. It is expected that this trend will continue until oil production from Brenda and Nicol begins sometime in the fourth quarter of 2006.

RESULTS OF OPERATIONS

REVENUES

| | Three Months ended June 30, | | | Six Months ended June 30, | | |
|---------------------------|-----------------------------|--------------|------------|---------------------------|--------------|------------|
| | 2006 | 2005 | % | 2006 | 2005 | % |
| Oil and Gas United States | 281 | 320 | -12% | 628 | 512 | 23% |
| Oil and Gas UK North Sea | 809 | 1,001 | -19% | 1,397 | 2,024 | -31% |
| Inter-field Tariff | 268 | 201 | 33% | 453 | 451 | - |
| Interest Income | 1,261 | 56 | 2152% | 2,320 | 198 | 1072% |
| Other Income | - | 1 | -100% | 1 | 2 | -50% |
| Total | 2,619 | 1,579 | 66% | 4,799 | 3,187 | 51% |

Oil and gas revenues before royalties from US operations was approximately \$0.3 million and \$0.6 million for the three and six months ended June 30, 2006, respectively, compared to approximately \$0.3 million and \$0.5 million for the same periods of 2005. The increase for six months ended June 30, 2006 can be attributed to higher oil prices in 2006 as compared to same period in 2005.

Sales of oil and gas in the UK North Sea of approximately \$0.8 million for the three months and \$1.4 million for the six months ended June 30, 2006, respectively, compared to approximately \$1.0 million and \$2.0 million for the same periods in 2005 relate to the Company's interest in the Balmoral and Glamis Fields. The decrease reflects the lower sales volume from these fields in 2006 due to the fact that there was no production from Glamis in 2006 and no production from Balmoral in March 2006 due to maintenance work.

The Company also realized income from inter-field tariffs of approximately \$0.3 million for the three months and \$0.5 million for the six months ended June 30, 2006, respectively, compared to approximately \$0.2 million and \$0.5 million for the same periods of 2005. These represent the Company's interest in tariffs on third-party oil processed on the Balmoral floating production facility in the UK North Sea.

The interest income in the first half of 2006 increased significantly due to interest on bank accounts and short-term deposits, as the Company had significant cash balances due to funds raised at the end of 2005 for the UK North Sea operations.

PRODUCTION AND PRICES

| | Three Months ended June 30, | | | Six Months ended June 30, | | |
|----------------------------------|-----------------------------|-------|------|---------------------------|-------|------|
| | 2006 | 2005 | % | 2006 | 2005 | % |
| Oil and Gas – BOE/day | | | | | | |
| United States | 49 | 71 | -30% | 56 | 60 | -7% |
| UK North Sea | 133 | 212 | -37% | 119 | 227 | -47% |
| Average Oil and Gas Price \$/BOE | | | | | | |
| United States | 62.50 | 49.34 | 27% | 62.15 | 47.11 | 32% |
| UK North Sea | 67.01 | 51.95 | 29% | 64.66 | 49.33 | 31% |
| Crude Oil as % of Production | | | | | | |
| United States | 92% | 95% | -3% | 92% | 95% | -3% |
| UK North Sea | 97% | 97% | - | 98% | 97% | 1% |

Average daily sales of oil, gas and liquids in the United States decreased by 30% and 7% for the three and six months ended June 30, 2006 (respectively) compared with the same periods of 2005 and amounted to 49 BOEPD and 56 BOEPD for the three and six month periods ended June 30, 2006. The decrease resulted from lower production from Alabama in the second quarter of 2006 due to water problems.

Average daily sales of oil, gas and liquids in the UK North Sea decreased from 212 BOEPD for the second quarter of 2005 to 133 BOEPD for the second quarter of 2006 and decreased from 227 BOEPD for the six months of 2005 to 119 BOEPD for the six months of 2006. The decrease reflects the fact that there was no production from Glamis in 2006, no production from Balmoral in March 2006 and low production from Balmoral in the second quarter of 2006 due to maintenance work.

Average oil and natural gas prices in respect of the United States operations increased by 27% and 32% for the three and six months ended June 30, 2006 compared with the same periods of 2005. The increase is attributable to the increase in worldwide crude oil prices during the periods under review.

Average oil and natural gas prices in respect of the UK North Sea operations increased by 29% and 31% for the three and six months ended June 30, 2006 compared with the same periods of 2005. The increase is attributable to the increase in worldwide crude oil prices during the periods under review.

OPERATING COSTS

| | Three Months ended June 30, | | | Six Months ended June 30, | | |
|------------------------|-----------------------------|-------|------|---------------------------|-------|------|
| | 2006 | 2005 | % | 2006 | 2005 | % |
| Oil and Gas Production | | | | | | |
| United States | 26 | 42 | -38% | 67 | 84 | -20% |
| UK North Sea | 1,133 | 955 | 19% | 2,136 | 1,919 | 11% |
| | 1,159 | 997 | 16% | 2,203 | 2,003 | 10% |
| Operating costs \$/BOE | | | | | | |
| United States | 5.78 | 6.48 | -11% | 6.66 | 7.64 | -13% |
| UK North Sea | 93.85 | 49.59 | 89% | 98.83 | 46.78 | 111% |

Operating expenses related to oil and natural gas production in the United States decreased by 38% and 20% during the three and six months ended June 30, 2006 compared with same periods of 2005. The decrease relates mainly to lower production from Alabama in 2006. Operating expenses per BOE decreased by 11% and 13% during the three and six months ended June 30, 2006 compared with same periods of 2005.

The operating expenses from the UK North Sea represent the Company's interest in the oil and gas production costs of the Balmoral and Glamis Fields as well as the Company's share of operating costs of the Balmoral floating production facility. Therefore, the comparison of operating costs (especially per BOE) is not meaningful as the significant portion of operating costs relates to the floating production vessel which currently operates below its capacity. Additionally, operating costs per BOE do not reflect the Company's share of the tariff income, which offsets the relatively high fixed-costs component at the facility. The Company expects the UK North Sea operating costs per BOE to decrease in the last quarter of 2006 when the Brenda field production comes on stream and is processed through the Balmoral floating production facility.

ROYALTIES – United States

| | Three Months ended June 30, | | | Six Months ended June 30, | | |
|-------------------------------------|-----------------------------|-------|------|---------------------------|-------|-----|
| | 2006 | 2005 | % | 2006 | 2005 | % |
| Royalties – United States | 55 | 64 | -14% | 124 | 103 | 20% |
| Royalties as % of Oil and Gas Sales | 19.6% | 20.0% | -2% | 19.8% | 20.1% | -2% |
| Royalties \$/BOE | 12.23 | 9.85 | 24% | 12.30 | 9.44 | 30% |

Royalties relate to the Company's operations in the United States. The increase in royalties per BOE by 24% and 30% for the three and six months ended June 30, 2006 and 2005, respectively is a reflection of higher oil prices in 2006.

No royalties are payable on UK North Sea production.

GENERAL AND ADMINISTRATIVE

| | Three Months ended June 30, | | | Six Months ended June 30, | | |
|----------------------------|-----------------------------|-------|-----|---------------------------|-------|-----|
| | 2006 | 2005 | % | 2006 | 2005 | % |
| General and Administrative | 2,254 | 1,644 | 37% | 4,193 | 2,739 | 53% |
| Employment as at June 30 | 25 | 16 | - | 25 | 16 | - |

The increase in general and administrative expenses in 2006, compared with 2005, relates mainly to the addition of new employees and consultants at the Head Office in Calgary and the Oilexco North Sea Limited office in Aberdeen as a result of continuous development of the Company's UK North Sea operation.

DEPLETION, DEPRECIATION AND ACCRETION

| | Three Months ended June 30, | | | Six Months ended June 30, | | |
|--|-----------------------------|-------|------|---------------------------|-------|------|
| | 2006 | 2005 | % | 2006 | 2005 | % |
| Depletion, Depreciation and Accretion (DD&A) | 1,484 | 405 | 266% | 2,378 | 879 | 171% |
| DD&A \$/BOE | 89.59 | 15.74 | 469% | 74.98 | 16.95 | 342% |

The increase in DD&A relates mainly to a significant change in the depletable base due to the inclusion of costs related to unsuccessful wells drilled in the last quarter of 2005 and the first two quarters of 2006. Additionally, DD&A includes an accretion expense with respect to Assets Retirement Obligations ("ARO"), which for the UK North Sea operation amounts to approximately \$0.1 million per quarter.

IMPAIRMENT OF CAPITAL ASSETS

| | Three Months ended June 30, | | | Six Months ended June 30, | | |
|------------------------------|-----------------------------|------|---|---------------------------|------|---|
| | 2006 | 2005 | % | 2006 | 2005 | % |
| Impairment of Capital Assets | - | - | - | 12,471 | - | - |

In the first quarter of 2006, an impairment of approximately \$12.5 million was recognized primarily in relation to unsuccessful exploratory wells drilled at Palomino (drilled over the year end 2005) and Joy (drilled partially in March 2006), compared to the fair value of proved and probable reserves of the Balmoral field. Brenda and Nicol, the Company's major development project, was subject to a separate impairment test resulting in no impairment.

The Company's major development project, Brenda and Nicol, is in an advanced stage and the production is estimated to commence in the fourth quarter of 2006. Therefore, the Company has decided to include Brenda and Nicol in the UK cost centre as at June 30, 2006 and performed a second quarter ceiling test calculation based on this combined basis, resulting in no impairment.

FOREIGN EXCHANGE

| | Three Months ended June 30, | | | Six Months ended June 30, | | |
|------------------------------|-----------------------------|------|-----|---------------------------|------|-------|
| | 2006 | 2005 | % | 2006 | 2005 | % |
| Foreign Exchange Gain/(Loss) | 550 | 565 | -3% | (306) | 789 | -139% |

The Company's foreign exchange gains and losses relate mainly to the fluctuation of the Canadian dollar against the British pound and US dollar. In the second quarter of 2006 and 2005, the Company experienced foreign exchange gains of \$0.6 million, while the cumulative six months results showed a foreign exchange loss of \$0.3 million in 2006 and a foreign exchange gain of \$0.8 million in 2005. These results reflect the fact that in the first quarter of 2006 the Canadian dollar weakened against the British pound and was fairly stable against the US dollar, while in second quarter of 2006 the Canadian dollar weakened further against the British pound but strengthened significantly against the US dollar. During the first six months of 2005, the Canadian dollar strengthened against the British pound but weakened against the US dollar.

STOCK-BASED COMPENSATION

| | Three Months ended June 30, | | | Six Months ended June 30, | | |
|----------------------------------|-----------------------------|------|---|---------------------------|------|------|
| | 2006 | 2005 | % | 2006 | 2005 | % |
| Stock-Based Compensation Expense | 7,683 | - | - | 8,271 | 779 | 962% |

A compensation expense of approximately \$8.3 million has been recognized for the six months ended June 30, 2006 as a result of stock options granted to employees and consultants to acquire common shares at an exercise price as follows:

- January 5, 2006 - 375,000 stock options at C\$3.75 (\$3.23) per share;
- May 24, 2006 - 4,250,000 stock options at C\$4.75 (\$4.23) per share.

All stock options vest immediately on the date of grant and have an expiration date five years from the date of grant. Fair value of each option granted is estimated on the date of grant using the Black-Scholes option pricing model (assumptions used for the model are discussed in the notes accompanying the Company's unaudited consolidated interim financial statements as at and for the three and six month periods ended June 30, 2006).

UNREALIZED LOSS ON DERIVATIVES

| | Three Months ended June 30, | | | Six Months ended June 30, | | |
|--------------------------------|-----------------------------|------|---|---------------------------|------|---|
| | 2006 | 2005 | % | 2006 | 2005 | % |
| Unrealized Loss on Derivatives | 8,287 | - | - | 18,657 | - | - |

On January 25, 2006, as part of the loan facility agreement, the Company entered into a costless collar agreement with RBS in order to secure its future cash flow and to enhance the repayment of the loan facility with RBS by limiting the Company's exposure to downward fluctuations in the price of crude oil. The collar is comprised of the following components:

- 7.1 million barrels from 2007 to 2010 with a floor price of \$40 per barrel and a cap price of \$88 per barrel;
- Put options for 1.6 million barrels over the period from October 2006 to March 2007 with a strike price of \$40 per barrel.

The volume of oil hedged by the above commodity contract is considered conservative as it represents 50% of Brenda proved reserves from the December 31, 2005 reserves report as prepared by the Company's independent engineers under the guidelines of National Instrument 51-101.

As a result of an increase in oil prices as at June 30, 2006, as compared to January 25, 2006, and in accordance with GAAP requirements, a mark-to-market valuation resulted in an unrealized loss on derivatives of approximately \$18.7 million recognized in Company's financial statements as at and for the six months ended June 30, 2006. This is a non-cash item that does not affect the Company's existing cash flow.

NET LOSS AND CASH FLOWS FROM OPERATING ACTIVITIES

| | Three Months ended June 30, | | | Six Months ended June 30, | | |
|-----------------------------------|-----------------------------|---------|-------|---------------------------|---------|-------|
| | 2006 | 2005 | % | 2006 | 2005 | % |
| Net Loss | (17,753) | (966) | 1738% | (43,804) | (2,527) | 1633% |
| Cash Used in Operating Activities | (1,673) | (1,258) | 33% | (3,763) | (3,219) | 17% |

In the second quarter of 2006, the Company's net loss amounted to \$17.8 million, versus a net loss of \$1.0 million in the second quarter of 2005. The magnitude of the net loss in the second quarter of 2006 resulted mainly from the recognition of stock-based compensation expense of \$7.7 million, an unrealized loss on derivative contracts of approximately \$8.3 million, an increase in depletion expense of \$1.1 million and an increase in general and administrative expenses of \$0.6 million.

Cash used in operating activities for the three and six month periods ended June 30, 2006 increased by 33% and 17%, respectively as compared to the same periods in 2005. The increasing trend relates mainly to the increase in general and administrative expenses, which in turn resulted from continuous development of the Company's UK North Sea operation.

LIQUIDITY AND CAPITAL RESOURCES

Total net proceeds from financing activities in the first half of 2006 amounted to approximately \$102.3 million and represent:

- Net proceeds from the RBS Senior Facility of approximately \$97.6 million (net of repayment of the Bridge Facility of \$17.8 million and deferred financing costs), and
- Proceeds from the Company's agents' warrants and stock options exercised during the first half of 2006 of approximately \$5.6 million.

The proceeds from above sources as well as cash available at the beginning of the six month period ended June 30, 2006 were used to finance the Company's activities in the UK North Sea, which amounted to approximately \$154.3 million.

As at June 30, 2006, the Company had the following credit facilities in place:

- On January 25, 2006, the Company signed a Senior Facility Agreement of \$225 million ("Project Facility") with RBS to finance development of the Brenda and Nicol fields. On May 12, 2006, the Company signed a Syndication and Amendment Agreement in respect of this Project Facility, which increases the Senior Facility by further \$ 50 million up to total of \$275 million. The Project Facility is to be repaid in portions over the next five years with the final maturity on December 31, 2010. Interest rates are based on LIBOR plus a margin, which ranges from 1.75% to 2% per annum during the facility's five-year period. The interest is payable on interest periods elected by the Company for each drawing; however, the interest must be paid at least every six months. The Project Facility is secured by a first floating charge over the assets of Oilexco North Sea Limited, a guarantee from Oilexco Incorporated, supported by charges over all shares of the parent; subsidiaries (Oilexco North Sea Limited and Oilexco America, Inc.), assignment of insurance proceeds from the Brenda, Nicol and Balmoral fields, and a first charge over the project's bank accounts.
- Additionally, on January 25, 2006, the Company signed a Junior Facility Agreement of \$20 million with RBS as a contingent facility for any overruns of field development budgets. This facility will be available to the Company only after the Project Facility is utilized in full.
- The Company also has a multi-currency overdraft facility of £1.5 million (approximately \$2.8 million) with RBS, repayable on demand. This overdraft facility was not utilized as at June, 2006.

Assuming all warrants and stock options outstanding as at June 30, 2006 are exercised, the Company would realise additional gross proceeds of approximately \$60.4 million.

As at June 30, 2006, the Company had cash of approximately \$92.2 million, net working capital of approximately \$48.0 million and long-term debt of \$119.8 million.

Subsequent to June 30, 2006, 923,419 agents' warrants were exercised for proceeds of approximately \$3.4 million.

The Company currently estimates that future projects can be financed from internal cash flows or additional bank debt.

COMPARATIVE BALANCE SHEET ITEMS

| (\$ 000's) | June 30, 2006 | March 31, 2006 | % | June 30, 2006 | December 31, 2005 | % |
|----------------------|------------------|-------------------|------|------------------|----------------------|------|
| Cash | 92,224 | 131,271 | -30% | 92,224 | 114,880 | -20% |
| Current Assets | 104,595 | 144,480 | -28% | 104,595 | 130,951 | -20% |
| Capital Assets | 347,585 | 245,713 | 41% | 347,585 | 196,975 | 76% |
| Current Liabilities | 56,626 | 50,764 | 12% | 56,626 | 41,858 | 35% |
| Long-term Debt | 119,761 | 68,198 | 76% | 119,761 | - | - |
| Share Capital | 287,916 | 287,055 | 0% | 287,916 | 280,924 | 2% |
| Shareholders' Equity | 261,689 | 258,560 | 1% | 261,689 | 279,309 | -6% |

As indicated in the above table, capital assets, current liabilities and long-term liabilities increased in the first half of 2006, as the Company continued to develop its operations in the UK North Sea.

Cash, and accordingly current assets, decreased in the first half of 2006, as the funds raised in December 2005 are continuously used to cover the Company's exploration program in the UK North Sea.

LONG-TERM FINANCIAL LIABILITIES

As at June 30, 2006, the outstanding Project Facility balance was approximately \$119.8 million (plus approximately \$0.9 million of accrued interest at an average interest rate of 6.71% for the period).

In addition, in accordance with GAAP requirements, the Company recognized the mark-to-market value of its derivative contracts which resulted in an unrealized loss of approximately \$18.7 million as at June 30, 2006. This accounting liability reflects an unrealized loss on these contracts due to increased oil prices as at June 30, 2006 (as compared to January 25, 2006 when the contracts were signed). These derivative contracts represent a collar agreement with RBS, which was entered into by the Company in order to secure future cash flow and enhance the repayment of the loan facility with RBS by limiting its exposure to downward fluctuations in the price of crude oil.

CONTRACTUAL OBLIGATIONS

Payments Due by Period

(\$ 000's)

| | <i>Total</i> | <i>Less than 1 Year</i> | <i>1-3 Years</i> | <i>4-5 Years</i> | <i>After 5 Years</i> |
|-------------------------------|----------------|-----------------------------|------------------|------------------|--------------------------|
| Long term debt principal | 119,761 | - | 119,761 | - | - |
| UKCS Licences | 200 | 200 | - | - | - |
| Drilling Contract Contractors | 367,790 | 58,390 | 219,300 | 90,100 | - |
| Office Lease | 92,300 | 92,300 | - | - | - |
| | 2,133 | 468 | 640 | 356 | 669 |
| Total Obligations | 582,184 | 151,358 | 339,701 | 90,456 | 669 |

Long term debt represents the balance as at June 30, 2006 of the Senior Facility with RBS.

Included in Drilling Contract is the Company's obligation with respect to the Sedco 712 semi-submersible drilling unit contracted from Transocean until March 23, 2010. The Company is obligated under this contract to make certain payments over the next 45 months that will total approximately \$367.8 million.

Contractors' obligations represent sub-sea and host work to develop the Brenda and Nicol fields of approximately \$92.3 million already contracted as at June 30, 2006.

DISCLOSURE CONTROLS AND PROCEDURES

Disclosure Controls and Procedures are controls and procedures designed and implemented by, or under the supervision of Oilexco's Chief Executive Officer (CEO) and Chief Financial Officer (CFO) to ensure that material information relating to the Company is communicated to them by others in the organization as it becomes known and is appropriately disclosed as required under the continuous disclosure requirements of securities legislation. In essence, these types of controls are related to the quality and timeliness of financial and non-financial information in securities filings.

OILEXCO INCORPORATED
Consolidated Balance Sheets
As at
(unaudited)

(in thousands of United States dollars)

| Assets | June 30, 2006 | December 31, 2005 |
|---|--------------------------|------------------------------|
| Current Assets | | |
| Cash and Cash Equivalents | \$ 92,224 | \$ 114,880 |
| Accounts Receivable | 9,024 | 6,557 |
| Other (Note 3) | 3,347 | 9,514 |
| | 104,595 | 130,951 |
| Deferred Financing Costs | 4,343 | - |
| Long-Term Accounts Receivable (Note 4) | 7,398 | - |
| Capital Assets (Note 5) | 347,585 | 196,975 |
| | \$ 463,921 | \$ 327,926 |
| Liabilities and Shareholders' Equity | | |
| Current Liabilities | | |
| Accounts Payable and Accrued Liabilities | \$ 55,744 | \$ 24,474 |
| Current Portion of Bank Loan (Note 6) | 883 | 17,384 |
| | 56,627 | 41,858 |
| Bank Loan (Note 6) | 119,761 | - |
| Derivative Contracts (Note 6) | 18,657 | - |
| Assets Retirement Obligation | 7,187 | 6,759 |
| | 202,232 | 48,617 |
| Commitments (Note 9) | | |
| Shareholders' Equity | | |
| Share Capital (Note 7(a)) | 287,916 | 280,924 |
| Warrants (Note 7(b)) | 1,805 | 2,895 |
| Contributed Surplus | 26,955 | 19,018 |
| Cumulative Translation Adjustment | 27,037 | 14,692 |
| Deficit | (82,024) | (38,220) |
| | 261,689 | 279,309 |
| | \$ 463,921 | \$ 327,926 |

The accompanying notes form an integral part of these consolidated financial statements.

OILEXCO INCORPORATED
Consolidated Statements of Loss and Deficit
For the Periods Ended
(unaudited)

(in thousands of United States dollars)

| | Three Months June 30, 2006 | Three Months June 30, 2005 | Six months June 30, 2006 | Six months June 30, 2005 |
|---|----------------------------------|----------------------------------|--------------------------------|--------------------------------|
| Revenues | | | | |
| Oil and Gas Sales | \$ 1,090 | \$ 1,321 | \$ 2,025 | \$ 2,536 |
| Royalties | (55) | (64) | (124) | (103) |
| Inter-Field Tariff | 268 | 201 | 453 | 451 |
| Interest Income | 1,261 | 56 | 2,320 | 198 |
| Other Income | - | 1 | 1 | 2 |
| | 2,564 | 1,515 | 4,675 | 3,084 |
| Expenses | | | | |
| General and Administrative | 2,254 | 1,644 | 4,193 | 2,739 |
| Operating | 1,159 | 997 | 2,203 | 2,003 |
| Depletion, Depreciation and Accretion | 1,484 | 405 | 2,378 | 879 |
| Impairment of Capital Assets (Note 5) | - | - | 12,471 | - |
| Foreign Exchange (Gain)/Loss | (550) | (565) | 306 | (789) |
| Stock-Based Compensation (Note 7(c)) | 7,683 | - | 8,271 | 779 |
| Unrealized Loss on Derivatives (Note 6) | 8,287 | - | 18,657 | - |
| | 20,317 | 2,481 | 48,479 | 5,611 |
| Net Loss | (17,753) | (966) | (43,804) | (2,527) |
| Deficit, Beginning of Period | (64,271) | (23,436) | (38,220) | (21,875) |
| Deficit, End of Period | \$ (82,024) | \$ (24,402) | \$ (82,024) | \$ (24,402) |
| Basic and Diluted Loss per Share (Note 7(d)) | \$ (0.09) | \$ (0.01) | \$ (0.23) | \$ (0.02) |

The accompanying notes form an integral part of these consolidated financial statements.

OILEXCO INCORPORATED
Consolidated Statements of Cash Flows
For the Periods Ended
(Unaudited)

(in thousands of United States dollars)

| | Three months June 30, 2006 | Three Months June 30, 2005 | Six months June 30, 2006 | Six Months June 30, 2005 |
|--|----------------------------------|----------------------------------|--------------------------------|--------------------------------|
| Cash Flow from Operating Activities | | | | |
| Net Loss | \$ (17,753) | \$ (966) | \$ (43,804) | \$ (2,527) |
| Items Not Affecting Cash | | | | |
| Depletion, Depreciation and Accretion | 1,484 | 405 | 2,378 | 879 |
| Impairment of Capital Assets | - | - | 12,471 | - |
| Unrealized (Gain)/Loss on Foreign Exchange | (1,154) | 17 | (380) | (4) |
| Stock-Based Compensation | 7,683 | - | 8,271 | 779 |
| Unrealized Loss on Derivatives | 8,287 | - | 18,657 | - |
| | (1,453) | (544) | (2,407) | (873) |
| Changes in Non-Cash Working Capital | (220) | (714) | (1,356) | (2,346) |
| Net Cash Used in Operating Activities | (1,673) | (1,258) | (3,763) | (3,219) |
| Cash Flow from Financing Activities | | | | |
| Proceeds from Issuance of Common Shares, net of Issue Costs | 620 | 51,770 | 5,569 | 65,930 |
| Proceeds of Bank Loan | 47,295 | - | 116,503 | - |
| Repayment of Bank Loan | - | - | (17,831) | - |
| Decrease/(Increase) in Deferred Financing Costs | 172 | - | (4,254) | - |
| Changes in Non-Cash Working Capital | (419) | 348 | (1,140) | 348 |
| | 47,668 | 52,118 | 98,847 | 66,278 |
| Cash Flow from Investing Activities | | | | |
| Additions to Capital Assets | (91,304) | (31,288) | (154,468) | (34,489) |
| Increase in Long-Term Accounts Receivable (Note 4) | 7,357 | - | 7,357 | - |
| Changes in Non-Cash Working Capital | (1,479) | 18,988 | 29,500 | 3,911 |
| | (85,426) | (12,300) | (117,611) | (30,578) |
| Net Increase/(Decrease) in Cash | (39,431) | 38,560 | (22,527) | 32,481 |
| Net Effect of Foreign Exchange on Cash Held in Foreign Currencies | 384 | (555) | (129) | (618) |
| Cash and Cash Equivalents Beginning of Period | 131,271 | 9,682 | 114,880 | 15,824 |
| Cash and Cash Equivalents, End of Period | \$ 92,224 | \$ 47,687 | \$ 92,224 | \$ 47,687 |
| Supplemental Information: | | | | |
| Interest Paid during the Period | 1,012 | - | 2,053 | - |
| Income Taxes Paid during the Period | - | - | - | - |
| Term Deposits as at June 30, 2006 | 9,462 | - | 9,462 | - |

The accompanying notes form an integral part of these consolidated financial statements.

NOTES TO UNAUDITED INTERIM CONSOLIDATED FINANCIAL STATEMENTS AS AT AND FOR THE THREE AND SIX MONTH PERIODS ENDED JUNE 30, 2006

All amounts are presented in thousands of United States dollars unless otherwise noted.

1. DESCRIPTION OF BUSINESS

Oilexco Incorporated and its wholly-owned subsidiaries Oilexco America, Inc. and Oilexco North Sea Limited (together “the Company”) are involved in the exploration, development and production of oil and gas in North America and the North Sea.

The Company’s principal focus is on the exploration, development and production of oil and gas in the UK North Sea. The Company’s main production is from the Balmoral Field located in Block 16-21a in the UK Central North Sea.

The Company’s current exploration activities in the United States are in Mountrail County, North Dakota, and Monroe and Conecuh Counties, Alabama. The Company’s producing property is located at Vocation/Jurassic Park in Monroe County, Alabama.

Effective December 31, 2005, management decided to change the reporting currency of the Company from Canadian dollars (“C\$”) to United States dollars (“\$”), as this currency is more appropriate for the Company’s investors and other users of the financial statements. All comparative financial information presented has been restated as if it had been historically reported in United States dollars.

2. ACCOUNTING POLICIES

The unaudited interim consolidated financial statements are prepared in accordance with Canadian Generally Accepted Accounting Principles (“GAAP”). In the opinion of management, the unaudited consolidated financial statements contain all adjustments of a normal and recurring nature necessary to present fairly Oilexco’s financial position at June 30, 2006 and the results of its operations and its cash flows for the three and six months ended June 30, 2006 and 2005. Management makes estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the unaudited consolidated financial statements, and revenues and expenses during the reporting period. Management reviews these estimates on an ongoing basis. Changes in facts and circumstances may result in revised estimates, and actual results may differ from these estimates. The results of operations and cash flows for the three and six months ended June 30, 2006 are not necessarily indicative of the results of operations or cash flows to be expected for the year ending December 31, 2006. The notes to these interim consolidated financial statements do not conform in all respects to the note disclosure requirements of generally accepted accounting policies for annual financial statements. These unaudited consolidated financial statements should be read in conjunction with the audited consolidated financial statements as at and for the year ended December 31, 2005. The significant accounting policies used in the preparation of these unaudited interim consolidated financial statements are presented in Note 2 of the audited consolidated financial statements as at and for the year ended December 31, 2005, except for noted below.

Derivative Financial Instruments and Commodity Contracts

The Company may use derivative financial instruments to manage its exposure to market risks resulting from fluctuations in foreign exchange rates, interest rates and commodity prices. The Company does not enter into derivative financial instruments for trading or speculative purposes.

The Company evaluates its derivative financial instruments in order to determine if the instrument can be designated as a hedge for accounting purposes. Derivative instruments that are not or can not be designated as hedges for accounting purposes are recorded at their fair value as at the balance sheet date with any resulting unrealized gain or loss recognized directly in net income (loss).

As at June 30, 2006 the Company has two commodity contracts in place (as disclosed in Note 6).

3. OTHER CURRENT ASSETS

Other current assets include mainly prepaid amounts and are summarized as follows:

| | June 30, 2006 | December 31, 2005 |
|---------------------|--------------------------|------------------------------|
| Prepaid drilling | \$ 106 | \$ 2,205 |
| Prepaid insurance | 2,848 | 6,692 |
| Prepaid office rent | 135 | 66 |
| Contract deposits | 70 | 240 |
| Other | 188 | 311 |
| | \$ 3,347 | \$ 9,514 |

4. LONG-TERM ACCOUNTS RECEIVABLE

Further to a farm-in agreement between Oilexco North Sea Limited, ConocoPhillips (U.K.) Limited (“COP”) and ENI UK Limited (“ENI”) signed in 2005, the Company drilled an appraisal well on Block 15/25a (licence P.233) and obtained a 70% working interest in this field (referred to as “Nicol”).

In April 2006, the Company (“Buyer”) signed a Sales Purchase Agreement with COP and ENI (“Sellers”) which provides for the conditional purchase of a 30% interest in Nicol by December 31, 2009, subject to:

- Sellers collectively lifting a total of 1.25 million BBLs;
- Buyer pays all expenditures associated with the development and production of Nicol up to the completion date;
- Sellers will pay the operator (Buyer) transportation and processing costs in a single tariff; and
- Legal consents, approvals and waivers.

The long term accounts receivable balance of \$7.4 million represents 30% of Nicol development costs incurred by the Company up to June 30, 2006.

5. CAPITAL ASSETS

To assess the impairment of oil and gas properties and equipment, the Company performs a ceiling test calculation on quarterly basis. As a result, an impairment expense of approximately \$12.5 million was recognized in the first quarter of 2006, primarily in relation to dry exploratory wells drilled at Palomino and Joy, compared to the fair value of proved and probable reserves of the Balmoral Field.

The Company's major development project, Brenda and Nicol, is at an advanced stage. Therefore, the Company has decided to include Brenda and Nicol costs of approximately \$263.4 million in the UK cost centre full cost pool as at June 30, 2006 and performed a second quarter ceiling test calculation based on this combined basis, resulting in no impairment.

Undeveloped and unproved oil and gas properties excluded from the calculation of depletion for the second quarter of 2006 amounted to approximately \$320.4 million as at June 30, 2006. Commencing July 2006, Brenda and Nicol will be included in depletable properties.

The benchmark prices used in the impairment calculation are as follows:

| \$/Barrel | | United States Operations* | | United Kingdom Operations** |
|-------------------|----|--------------------------------------|----|--|
| 2006 | \$ | 60.81 | \$ | 58.81 |
| 2007 | | 61.61 | | 59.58 |
| 2008 | | 54.60 | | 52.54 |
| 2009 | | 50.19 | | 48.10 |
| 2010 | | 47.76 | | 45.64 |
| Average remainder | | 50.33 | | 48.10 |

*West Texas Intermediate Crude Oil prices used for United States operations

**Brent Crude Oil prices used for United Kingdom operations

6. BANK LOAN

On January 25, 2006, the Company signed a Senior Facility Agreement of \$225 million ("Project Facility") with the Royal Bank of Scotland ("RBS") to finance development of the Brenda and Nicol fields. The Project Facility is to be repaid in portions over the next five years with the final maturity on December 31, 2010. Interest rates are based on LIBOR plus a margin, which ranges from 1.75% to 2% per annum during the facility's five-year period. The interest is payable on interest periods elected by the Company for each withdrawal; however, the interest must be paid at least every six months. The Project Facility is secured by a first floating charge over the assets of Oilexco North Sea Limited, a guarantee from Oilexco Incorporated, supported by charges over all shares of the parent's subsidiaries (Oilexco North Sea Limited and Oilexco America, Inc.), assignment of insurance proceeds from the Brenda, Nicol and Balmoral fields, and a first charge over the Project Facility's bank accounts.

Additionally, on January 25, 2006, the Company signed a Junior Facility Agreement of \$20 million with RBS as a contingent facility for any overruns of field development budgets. This facility will be available to the Company only after the Project Facility is utilized in full.

On May 12, 2006, the Company signed a Syndication and Amendment Agreement in respect of the above Senior and Junior Facilities, which increases the Senior Facility by an additional \$50 million, up to maximum of \$275 million. Other major terms and conditions remain unchanged (as described above).

During the first quarter of 2006, the Bridge Facility of \$17.7 million was repaid with funds from the Senior Facility. As at June 30, 2006, the outstanding Senior Facility balance was approximately \$119.8 million (plus approximately \$0.9 million of accrued interest at an average interest rate of 6.71% for the period).

The Company also has a multi-currency overdraft facility of £1.5 million (approximately \$2.6 million) with RBS, repayable on demand. This overdraft facility was not utilized as at June 30, 2006.

Commodity Contracts

On January 25, 2006, as part of the loan facility agreement, the Company entered into a costless collar agreement with RBS in order to secure its future cash flow and to enhance the repayment of the loan facility with RBS by limiting the Company's exposure to downward fluctuations in the price of crude oil. The collar is comprised of the following components:

- 7.1 million barrels from 2007 to 2010 with a floor price of \$40 per barrel and a cap price of \$88 per barrel;
- put options for 1.6 million barrels over the period from October 2006 to March 2007 with a strike price of \$40 per barrel.

The volume of oil hedged by the above commodity contract is considered conservative as it represents 50% of Brenda proved reserves from the December 31, 2005 reserves report as prepared by the Company's independent engineers under the guidelines of National Instrument 51-101.

As a result of an increase in oil prices as at June 30, 2006, as compared to January 25, 2006, and in accordance with GAAP requirements, a mark-to-market valuation resulted in an unrealized loss on derivatives of approximately \$18.7 million recognized in Company's financial statements as at and for the six months ended June 30, 2006. This is a non cash item that does not affect the Company's existing cash flow.

7. SHARE CAPITAL

| (a) Issued | Number | Amount |
|--|--------------------|-------------------|
| Balance December 31, 2005 | 192,738,927 | \$ 280,924 |
| Issued pursuant to exercise of warrants | 2,342,280 | 4,986 |
| Issued pursuant to exercise of stock options | 415,000 | 583 |
| Fair value assigned to warrants exercised | - | 1,090 |
| Contributed surplus on stock options exercised | - | 333 |
| Balance June 30, 2006 | 195,496,207 | \$ 287,916 |

If all warrants and stock options outstanding as at June 30, 2006 are exercised, the total number of shares outstanding would be 216,992,827.

(b) Warrants

The following is a continuity of warrants as at June 30, 2006:

| | Balance January 1, 2006 | Granted | Exercised | Expired | Balance June 30, 2006 | Expiry Date |
|--------------------------------------|----------------------------|---------|---------------------|---------|--------------------------|-------------------|
| Agents Warrants | | | | | | |
| at \$1.80 (C\$2.22)* | 1,860,000 | - | 1,860,000 | - | - | June 27, 2006 |
| at \$2.42 (C\$3.00)* | 323,100 | - | 323,100 | - | - | February 10, 2006 |
| at \$3.17 (C\$3.70)* | 2,119,800 | - | 159,180 | - | 1,960,620 | December 22, 2006 |
| RBS Warrants | | | | | | |
| at \$2.38 (C\$3.00)* | 400,000 | - | - | - | 400,000 | November 22, 2006 |
| | 4,702,900 | - | 2,342,280 | - | 2,360,620 | |
| Weighted average exercise price** | \$2.51 (C\$3.01) | - | \$2.13 (C\$2.43) | - | \$3.04 (C\$3.58) | |

* The exercise price has been converted into US dollars based on the foreign exchange rate in effect at the date of issuance.

** The weighted average exercise price has been converted into US dollars based on the foreign exchange rate in effect at the date of issuance.

During the three months ended June 30, 2006, 106,185 agents' warrants were exercised for proceeds of approximately \$344 thousands. During the six months ended June 30, 2006, 2,342,280 agents' warrants were exercised for proceeds of approximately \$5.0 million.

The Company increased share capital and decreased the warrants balance (in equity) by approximately \$84 thousand and \$1.1 million during the three and six month periods ended June 30, 2006, respectively, relating to the valuation of the warrants exercised.

Subsequent to June 30, 2006, 923,419 agents' warrants were exercised for proceeds of approximately \$3.4 million.

(c) Stock Options

On January 5, 2006, the Company granted 375,000 stock options to its employees and consultants to acquire common shares at an exercise price of C\$3.75 (\$3.23) per share, expiring on January 5, 2011. On May 24, 2006, the Company granted 4,250,000 stock options to its employees and consultants to acquire common shares at an exercise price of C\$4.75 (\$4.23) per share, expiring on May 24, 2011.

Accordingly, a compensation expense of approximately \$8.3 million (\$0.6 million and \$7.7 million, respectively, for the above stock options granted) has been recognized for the six months ended June 30, 2006. The fair value of each option granted is estimated on the date of grant using the Black-Scholes option pricing model with the following assumptions:

| | 2006 |
|-------------------------|----------------|
| Risk free interest rate | 4.30% to 5.00% |
| Weighted average years | 5.0 |
| Expected volatility | 40% to 50% |
| Expected dividend yield | 0% |

During the three months ended June 30, 2006, 180,000 stock options of the Company were exercised for proceeds of approximately \$276 thousand. During the six months ended June 30, 2006, 415,000 stock options were exercised for proceeds of approximately \$583 thousand.

The Company increased share capital and decreased contributed surplus, representing the compensation expense associated with the above-mentioned stock options, by approximately \$157 thousand and \$333 thousand, during the three and six month periods ended June 30, 2006, respectively.

(d) Loss Per Share Data

| | Three Months ended June 30, 2006 | | | Three Months ended June 30, 2005 | | |
|-------------------|-------------------------------------|--|--------------|-------------------------------------|--|--------------|
| | Net Loss | Weighted Average Shares Outstanding | Per Share | Net Loss | Weighted Average Shares Outstanding | Per Share |
| Basic and Diluted | (17,753) | 195,405,051 | (0.09) | (966) | 119,796,558 | (0.01) |

| | Six Months ended June 30, 2006 | | | Six Months ended June 30, 2005 | | |
|-------------------|-----------------------------------|--|--------------|-----------------------------------|--|--------------|
| | Net Loss | Weighted Average Shares Outstanding | Per Share | Net Loss | Weighted Average Shares Outstanding | Per Share |
| Basic and Diluted | (43,804) | 194,531,895 | (0.23) | (2,527) | 117,405,143 | (0.02) |

8. SEGMENTED INFORMATION

Oilexco's oil and gas activities are conducted in two geographic segments: the United States and the United Kingdom. All activities relate to the exploration, development, production, and marketing of oil, natural gas and petroleum liquids.

| | Three Months June 30, 2006 | | Three Months June 30, 2005 | | Six months June 30, 2006 | | Six months June 30, 2005 | |
|-----------------------------|---------------------------------------|-----------------|-------------------------------|---------|-------------------------------------|-----------------|---------------------------------|---------|
| Oil and Gas Revenues | | | | | | | | |
| United States | \$ | 281 | \$ | 320 | \$ | 628 | \$ | 512 |
| United Kingdom | | 809 | | 1,001 | | 1,397 | | 2,024 |
| Total | \$ | 1,090 | \$ | 1,321 | \$ | 2,025 | \$ | 2,536 |
| Inter-Field Tariff | | | | | | | | |
| United Kingdom | \$ | 268 | \$ | 201 | \$ | 453 | \$ | 451 |
| Net Earnings (Loss) | | | | | | | | |
| Canada | \$ | (8,598) | \$ | (1,083) | \$ | (10,627) | \$ | (2,429) |
| United States | | 147 | | 209 | | 348 | | 313 |
| United Kingdom | | (9,302) | | (92) | | (33,525) | | (411) |
| Total | \$ | (17,753) | \$ | (966) | \$ | (43,804) | \$ | (2,527) |
| Capital Assets | | | | | | | | |
| | | | | | At June 30, 2006 | | At December 31, 2005 | |
| Canada | | | | | \$ | 542 | \$ | 395 |
| United States | | | | | | 904 | | 911 |
| United Kingdom | | | | | | 346,139 | | 195,669 |
| Total | | | | | \$ | 347,585 | \$ | 196,975 |

9. COMMITMENTS

Oilexco North Sea Limited has in place contracts with Transocean Offshore (North Sea) Ltd. ("Transocean") for the provision of a Sedco 712 semi-submersible drilling unit until March 23, 2010. As at June 30, 2006 the Company's obligations for the next 45 months under these contracts with Transocean amounted to approximately \$367.8 million.

The Company's commitments in respect to contractors relating to sub-sea work to develop the Brenda and Nicol fields amounted to approximately \$92.3 million as at June 30, 2006.

Further to licenses granted to Oilexco North Sea, the Company is committed to pay license fees of approximately \$200 thousand in August 2006 in respect to its five North Sea Blocks.

The Company is committed under operating lease agreements for the rental of office space as follows:

| | | |
|---------------------|----|--------------|
| 2006 | \$ | 236 |
| 2007 | | 463 |
| 2008 | | 320 |
| 2009 | | 178 |
| 2010 | | 178 |
| 2011 and thereafter | | <u>758</u> |
| | \$ | <u>2,133</u> |

10. FINANCIAL INSTRUMENTS

Financial instruments are comprised of cash and cash equivalents, accounts receivable, deposits, accounts payable and accrued liabilities, derivative contracts and the bank loan. The fair values of cash and cash equivalents, accounts receivable, deposits and accounts payable and accrued liabilities approximate their carrying values due to the short-term nature of these financial instruments. The fair value of the bank loan approximates its carrying value due to its floating interest rate. Fair value of the derivative contracts is determined based on available market information. In addition to the risk identified in the audited consolidated financial statements as at and for the year ended December 31, 2005, the Company has identified the following additional risk:

Commodity Price Risk

The Company will be subject to commodity price risk for the delivery of crude oil. The Company may manage and minimize risk by entering into commodity contracts.

11. DIFFERENCES BETWEEN CANADIAN AND UNITED STATES OF AMERICA GENERALLY ACCEPTED ACCOUNTING PRINCIPLES

The Company's unaudited consolidated interim financial statements are prepared in accordance with Canadian GAAP. Any differences in accounting principles as they pertain to the accompanying unaudited consolidated interim financial statements were insignificant as at June 30, 2006 and for the three and six month periods ended June 30, 2006 and 2005, except as described below:

(a) Consolidated Statements of Loss and Deficit

| | Three Months June 30, 2006 | | Three Months June 30, 2005 |
|---|---|----|----------------------------------|
| Deficit, beginning of period in accordance with Canadian GAAP | \$ (64,271) | \$ | (21,550) |
| Stock-based compensation expense (i) | 16,248 | | 7,599 |
| Accumulated depletion and impairment (iii, iv) | 581 | | (1,107) |
| Cumulative Translation Adjustment (b) | (1,921) | | (230) |
| Deficit, beginning of period in accordance with US GAAP | \$ (49,363) | \$ | (15,288) |
| Net (Loss)/Earnings for the period in accordance with Canadian GAAP | \$ (17,753) | \$ | (966) |
| Stock-based compensation expense (i) | - | | - |
| Depletion (iv) | 146 | | 77 |
| Cumulative Translation Adjustment (b) | 553 | - | - |
| Net (Loss)/Earnings for the period in accordance with US GAAP | \$ (17,054) | \$ | (889) |
| Net (Loss)/Earnings per share under US GAAP | | | |
| Basic | \$ (0.09) | \$ | (0.01) |
| Diluted | \$ (0.09) | \$ | (0.01) |

| | Six months June 30, 2006 | | Six months June 30, 2005 |
|---|---|----|---|
| Deficit, beginning of period in accordance with Canadian GAAP | \$ (36,334) | \$ | (19,989) |
| Stock-based compensation expense (i) | 16,248 | | 6,820 |
| Accumulated depletion and impairment (iii, iv) | (446) | | (1,146) |
| Cumulative Translation Adjustment (b) | (1,946) | | (231) |
| Deficit, beginning of period in accordance with US GAAP | \$ (22,478) | \$ | (14,546) |
| Net (Loss)/Earnings for the period in accordance with Canadian GAAP | \$ (43,804) | \$ | (2,527) |
| Stock-based compensation expense (i) | - | | 779 |
| Write down under the ceiling test (iii) | 913 | | - |
| Depletion (iv) | 260 | | 116 |
| Cumulative Translation Adjustment (b) | 578 | | 1 |
| Net (Loss)/Earnings for the period in accordance with US GAAP | \$ (42,053) | \$ | (1,631) |
| Net Loss per share under US GAAP | | | |
| Basic | \$ (0.22) | \$ | (0.01) |
| Diluted | \$ (0.22) | \$ | (0.01) |

The weighted average numbers of common shares outstanding for the purposes of determining the basic and diluted net (loss)/earnings per share are the same numbers as disclosed for Canadian GAAP purposes.

(i) Stock-based compensation:

Prior to January 1, 2004, compensation expense was recognized for Canadian GAAP based on the intrinsic value at the grant date. Effective January 1, 2004, the Company adopted the fair value method of accounting for stock options, on a retroactive basis, without restatement of prior periods for Canadian GAAP.

Under US GAAP, the Company adopted Accounting Principles Board Opinion No. 25 "Accounting for Stock Issued to Employees" ("APB 25"). Under APB 25, companies are not required to record any compensation expense relating to options granted to employees with an exercise price equal to the market price at the date of grant. The adjustment to the opening deficit as at January 1, 2004, in accordance with Canadian GAAP to recognize the stock-based compensation expense for stock options granted to employees since January 1, 2002 was added back in accordance with US GAAP.

In December 2004, the Financial Accounting Standards Board ("FASB") issued a revision to FAS No. 123, "Accounting for Stock-Based Compensation," FAS Statement No. 123 (R), "Share-Based Payment," effective as of the beginning of the annual reporting period after June 15, 2005. Under this revised standard, public entities are required to recognize compensation expense based on grant-date fair value of stock options. Effective January 1, 2006, the Company prospectively adopted this new standard, and as a result, no increase in the opening deficit in accordance with US GAAP occurred, as no unvested stock options previously granted to employees were outstanding as of December 31, 2005. For the first quarter of 2006 there were no differences between Canadian and US GAAP related to stock-based compensation.

(ii) Asset Retirement Obligations:

On January 1, 2004, the Company retroactively adopted the new accounting standard relating to “Asset Retirement Obligations” (“ARO”), which is in line with FAS No. 143, “Accounting for Asset Retirement Obligations” (“FAS 143”). The transitional provisions differ between Canadian GAAP and US GAAP in that Canadian GAAP requires restatement of comparative amounts whereas US GAAP does not allow restatement. An adjustment to the net loss under Canadian GAAP was required to reflect the cumulative effect of the change in accounting policy in 2003 in accordance with US GAAP.

(iii) Impairment Test of Oil and Gas Properties:

Pursuant to Accounting Guideline 16 “Oil & Gas Accounting – Full Cost” (“AcG-16”) the Company performs an impairment test that places a limit on the aggregate carrying value of the oil and gas properties. Under US GAAP, companies using the full cost method of accounting for oil and gas producing activities perform a ceiling test on each cost centre using discounted estimated future net revenue from proved oil and gas reserves using constant prices and a discount factor of 10 percent. Prices used in the US GAAP ceiling tests performed for this reconciliation were those in effect at the applicable year-end. Under Canadian GAAP, a similar ceiling test is performed with the difference being that the estimated future net revenue from proved oil and gas reserves is calculated using undiscounted forecast prices. Under US GAAP the Company would have recognized a write down of approximately \$11.6 million compared to \$12.5 million under Canadian GAAP.

(iv) Depletion Calculation of Oil and Gas Properties:

AcG-16 provides for depletion of oil and gas properties to be determined using proved reserves based on estimated future prices and costs. Under US GAAP proved reserves are calculated based on “prices and costs as of the date the estimate is made” (i.e. constant prices). The depletion charge calculated in accordance with US GAAP is adjusted in the periods following the additional write downs taken under US GAAP to reflect the impact of the reduction of the depletable cost.

(b) Consolidated Balance Sheet

Other Comprehensive Income

US GAAP requires changes in equity during the period from non-owner transactions and other events to be disclosed as other comprehensive income. However, Canadian GAAP does not currently require similar disclosure.

FAS No. 52, “Foreign Currency Translation” (“FAS 52”), requires foreign exchange gains and losses on translation of integrated operations to be recorded as a cumulative translation adjustment, which is a separate component of shareholders’ equity. Under Canadian GAAP, foreign exchange gains and losses on translation of integrated operations are recognized in the income statement. As at June 30, 2006, the balance of the cumulative translation adjustment under US GAAP would be a loss of approximately \$27.0 million and approximately \$6.4 million for the same period in 2005.

11. CORPORATE INFORMATION

Directors

John F. Cowan
London, Canada
W. Fraser Grant
West Vancouver, Canada
William H. Smith QC
Calgary, Canada
Kevin Burke
London, United Kingdom
Arthur S. Millholland
Calgary, Canada
Brian L. Ward
Calgary, Canada

Management

Calgary, Canada

Arthur Millholland
President and Chief Executive Officer

Brian Ward
Chief Financial Officer

Gerry Roe
Chief Operating Officer

Rod Christensen
Vice President Exploration

Michael Cairns
Vice President Corporate Development

Aleksandra Owad
Vice President Controller

Aberdeen, Scotland

David Marshall
General Manager, Oilexco North Sea Limited

Share Listing

The TSX Exchange
Symbol: 'OIL'
AIM Market, London Stock Exchange
Symbol: 'OIL'

Auditors

Deloitte & Touche LLP
Calgary, Canada
Aberdeen, Scotland

Bankers

Royal Bank of Scotland
Aberdeen, Scotland
London, England
Canadian Western Bank
Calgary, Canada

Legal Counsel

McCarthy Tetrault LLP
Calgary, Canada
London, United Kingdom
Field Law LLP
Calgary, Canada

Transfer Agent and Registrar

Computershare Trust Company of Canada

Head Office

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