

**ARAPAHOE ENERGY CORPORATION**

Consolidated Financial Statements

For the year ended December 31, 2005 and 2004

AUDITORS' REPORT

To the Directors of Arapahoe Energy Corporation

We have audited the consolidated balance sheets of Arapahoe Energy Corporation as at December 31, 2005 and 2004 and the consolidated statements of loss and deficit and retained earnings and cash flows for each of the years in the two year period ended December 31, 2005. These consolidated 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 consolidated financial statements present fairly, in all material respects, the financial position of the company as at December 31, 2005 and 2004 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  
(Signature)

Chartered Accountants  
Calgary, Alberta  
April 17, 2006

**ARAPAHOE ENERGY CORPORATION**  
**Consolidated Balance Sheet**

	<b>Dec 31 2005 \$</b>	<b>Dec 31 2004 \$</b>
<b>Assets</b>		
<b>Current assets</b>		
Cash	1,069,021	12,035
Accounts receivable and accruals	1,467,528	51,055
Due from related parties (note 11)	-	6,357
Prepaid expenses	272,818	10,939
	<u>2,809,367</u>	<u>80,386</u>
<b>Property, plant and equipment</b> (note 3)	<u>23,787,119</u>	<u>2,185,559</u>
	<u>26,596,486</u>	<u>2,265,945</u>
<b>Liabilities</b>		
<b>Current liabilities</b>		
Accounts payable and accrued liabilities	4,910,034	574,924
Due to related parties (note 11)	-	86,130
	<u>4,910,034</u>	<u>661,054</u>
<b>Future income tax liability</b> (note 9)	1,890,546	-
<b>Asset retirement obligation</b> (note 4)	359,384	14,224
	<u>7,159,964</u>	<u>675,278</u>
<b>Shareholders' Equity</b>		
<b>Capital stock</b> (note 8)	20,661,024	1,472,189
<b>Deficit</b>	(2,472,353)	(240,780)
<b>Contributed surplus</b>	1,247,851	359,258
	<u>19,436,522</u>	<u>1,590,667</u>
	<u>26,596,486</u>	<u>2,265,945</u>
<b>Going concern</b> (note 1)		

**Approved by the Board of Directors**

\_\_\_\_\_  
**Jeffrey L. Standen**

\_\_\_\_\_  
**Robert Chenery**

**ARAPAHOE ENERGY CORPORATION**  
**Consolidated Statement of Loss and Deficit**  
**(unaudited)**

---

	<b>2005</b>	<b>2004</b>
	\$	\$
<b>Revenue</b>		
Oil and gas	722,832	106,368
Royalties	(216,775)	(13,136)
Interest income	41,010	-
	547,067	93,232
<b>Expenses</b>		
Operating costs	307,235	15,261
Depletion, depreciation and accretion	291,003	35,015
Stock based compensation (note 8)	450,593	359,258
General and administrative	1,174,881	526,006
Finance charges (note 7)	554,928	-
Reverse takeover transaction costs	-	5,124
	2,778,640	940,664
<b>Loss for the period before taxes</b>	(2,231,573)	(847,432)
<b>Future income tax recovery</b> (note 9)	-	620,834
	(2,231,573)	(226,598)
<b>Loss for the period</b>	(2,231,573)	(226,598)
<b>Deficit – Beginning of period</b>	(240,780)	-
<b>Reverse takeover transaction costs</b> (note 1)	-	(14,182)
	(2,472,353)	(240,780)
<b>Deficit – End of period</b>	(2,472,353)	(240,780)
<b>Basic and diluted loss per share</b>	(.11)	(.02)
<b>Going concern</b> (note 1)		

**ARAPAHOE ENERGY CORPORATION**  
**Consolidated Statement of Cash Flows**  
**For the Year Ended December 31**

	<b>2005</b>	<b>2004</b>
	\$	\$
<b>Cash provided by (used in)</b>		
<b>Operating activities</b>		
Loss for the period	(2,231,573)	(226,598)
Items not affecting cash		
Depletion, depreciation and accretion	291,003	35,015
Stock-based compensation	450,593	359,258
Expenses settled with shares	389,720	
Future tax recovery	-	(620,834)
	<hr/>	<hr/>
Funds used in operations	(1,100,257)	(453,159)
Change in non-cash working capital items	(581,028)	325,090
Cash-flow used in operations	<b>(1,681,285)</b>	<b>(128,069)</b>
<b>Financing activities</b>		
Issuance of capital stock for cash	10,877,759	2,269,728
Net change in non-cash financing activities working capital	35,102	48,371
	<hr/>	<hr/>
	<b>10,912,861</b>	<b>2,318,099</b>
<b>Investing activities</b>		
Acquisition of other petroleum and natural gas properties	(8,565,615)	(2,163,809)
Acquisition of Banks Energy Corp	(252,696)	
Cash received on acquisition of Banks	478,610	
Reverse takeover costs – cash portion	-	(14,186)
Net change in non-cash investing activities working capital	165,111	
	<hr/>	<hr/>
	<b>(8,174,590)</b>	<b>(2,177,995)</b>
<b>Increase in cash</b>	1,056,986	12,035
<b>Cash – Beginning of period</b>	<hr/>	<hr/>
	12,035	-
<b>Cash – End of period</b>	<hr/>	<hr/>
	<b>1,069,021</b>	<b>12,035</b>

ARAPAHOE ENERGY CORPORATION  
Notes to Consolidated Financial Statements  
For the year ended December 31, 2005

---

**1. BASIS OF PRESENTATION & GOING CONCERN**

Crazy Horse Energy Inc. (“Crazy Horse” or the “Company”) was incorporated under the *Business Corporations Act* (Alberta) on April 23, 2001 as 930639 Alberta Ltd. The Company’s name was changed to Crazy Horse Energy Inc. on September 17, 2003. The Company had no previous operations.

Pursuant to a Plan of Arrangement (the “Arrangement”) on February 6, 2004, the Company entered into a reverse takeover of Arapahoe Energy Corporation (“Old Arapahoe”), a public company that traded on the TSX Venture Exchange under the symbol “APR”. The Company continues to operate under Arapahoe Energy Corporation (“Arapahoe”). Arapahoe, a public company, trades on the TSX Venture Exchange under the symbol “AAO”. Upon completion of the Arrangement, the shareholders of the Old Arapahoe held approximately 13% of the common shares of the Company. Transaction costs, to the extent of cash in Old Arapahoe as at February 6, 2004, have been charged to deficit as reverse takeover transaction costs.

The Corporation’s intended primary business activity remains unchanged from the Old Arapahoe. The Corporation is engaged in the exploration, development and production of oil and natural gas in Canada.

The consolidated financial statements of the Corporation have been prepared following the same accounting policies and methods of computation as the financial statements of the Corporation for the year ended December 31, 2004

These financial statements are stated in Canadian dollars and have been prepared in accordance with Canadian generally accepted accounting principles (“GAAP”). The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amount of revenues and expenses during the period. Actual results could differ from these estimates.

**Going concern**

These financial statements have been prepared in accordance with Canadian generally accepted accounting principles (“GAAP”) on a going concern basis, which contemplates the realization of assets and the payment of liabilities in the ordinary course of business. Should the Corporation be unable to continue as a going concern, it may be unable to realize the carrying value of its assets and to meet its liabilities as they become due.

The Corporation reported a loss of \$2,231,573 and cash used in operations of \$1,681,257 for year ended December 31, 2005. The Corporation had a working capital deficit of \$2,100,667 at December 31, 2005. The Corporation’s ability to continue as a going concern is dependent upon the Corporation’s ability to raise capital and the success of the drilling and exploration program. There can be no assurance that the Corporation will be successful with those initiatives.

The accompanying financial statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts and classification of liabilities that might be necessary should the Corporation be unable to continue in existence.

## 2. ACCOUNTING POLICIES

### **Measurement uncertainty**

The amounts recorded for depletion and depreciation of petroleum and natural gas properties and equipment and the provision for asset retirement obligation costs are based on estimates. In addition, the ceiling test calculation is based on estimates of proved reserves, production rates, oil and gas prices, future costs and other relevant assumptions. 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 material.

### **Joint interests**

A portion of the Corporation's exploration, development and production activities is conducted jointly with others. These financial statements reflect only the Corporation's proportionate interest in such activities.

### **Cash and cash equivalents**

Cash and cash equivalents include cash on hand, demand deposits and investments in highly liquid money market instruments, which are convertible to known amounts of cash in less than three months.

### **Financial instruments**

The fair market value of cash and cash equivalents, receivables, other current assets, payables and bank debt approximate their carrying value. From time to time, the Corporation 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 Corporation are related to an underlying financial position or to future petroleum and natural gas production. The Corporation does not use derivative financial instruments for speculative trading purposes.

### **Property, plant and equipment**

The Corporation follows the full cost method of accounting whereby all costs relating to the exploration and development of petroleum and natural gas reserves are capitalized. Such costs include land acquisition, geological and geophysical, drilling of productive and non-productive wells, production equipment and facilities, carrying costs directly related to unproved properties and costs related to acquisition of petroleum and natural gas assets directly or by means of a business combination. These capitalized costs along with estimated future capital expenditures to be incurred in order to develop proved reserves, are depleted and depreciated on a unit of production basis using estimated proved petroleum and natural gas reserves as evaluated by independent engineers. For the purposes of this calculation, petroleum and natural gas reserves are converted to a common unit of measurement on the basis of their relative energy content where six thousand cubic feet of gas equates to one barrel of oil. Costs of acquiring and evaluating unproved properties are excluded from costs subject to depletion and depreciation until it is determined whether proved reserves are attributable to the properties or impairment occurs.

Gains or losses on the disposition of properties are not recognized unless the proceeds on disposition result in a change of 20 percent or more in the depletion rate.

Depreciation of furniture and office equipment is provided using the declining balance method at a rate of 20 percent.

ARAPAHOE ENERGY CORPORATION  
Notes to Consolidated Financial Statements  
For the year ended December 31, 2005

---

The net amount at which petroleum and natural gas properties are carried is subject to a cost recovery test (the “ceiling test”). Under this test, an estimate is made of the ultimate recoverable amount from undiscounted future net cash flows based on proved reserves, which are determined by using forecasted future prices, plus unproved properties. If the carrying amount exceeds the ultimate recoverable amount, an impairment loss is recognized in net earnings. The impairment loss is limited to the amount by which the carrying amount exceeds: (i) the sum of the fair value of proved and probable reserves; and (ii) the costs of unproved properties that have been subject to a separate impairment test and contained no probable reserves.

**Asset retirement obligations**

Estimated future costs relating to retirement obligations associated with oil and gas well sites and facilities are recognized as a liability, at fair value. The asset retirement cost, equal to the fair value of the retirement obligation, is capitalized as part of the cost of the related asset. These capitalized costs are amortized on a unit-of-production basis, consistent with depletion and depreciation. The liability is adjusted at each reporting period to reflect the passage of time, with the accretion charged to earnings. Actual costs incurred upon settlement of the obligations are charged against the liability.

**Future income taxes**

The Corporation follows the liability method of accounting for income taxes. Temporary differences arising from the differences between the tax basis of an asset or liability and its carrying amount on the balance sheet are used to calculate future income tax assets or liabilities. Future income tax assets or liabilities are calculated using tax rates anticipated to apply in the periods that the temporary differences are expected to reverse.

**Flow-through shares**

Resource expenditure deductions for income tax purposes related to exploration and development activities funded by flow-through share issues are renounced to investors in accordance with income tax legislation. The estimated tax benefits transferred to shareholders are recorded as a future income tax liability at the time of filing of the renouncement documents with the tax authorities and a reduction in share capital.

**Revenue recognition**

Revenue from the sale of oil and natural gas is recorded when title passes to an external party.

**Stock-based compensation**

The Corporation has a stock-based compensation plan. The Corporation adopted the fair-value method to record compensation expense with respect to stock options and warrants granted. The fair value of each option or warrant granted is estimated on the date of grant and a provision for the costs is provided for as contributed surplus over the term of the option agreement. Compensation expense associated with options issued to employees, consultants, officers and directors of the Corporation are expensed while compensation expense related to broker warrants issued are recorded as share issue costs and deducted from share capital. The consideration received by the Corporation on the exercise of share options is recorded as an increase to share capital together with corresponding amounts previously recognized in contributed surplus. Forfeitures are accounted for as they occur which could result in recoveries of the compensation expense.

ARAPAHOE ENERGY CORPORATION  
Notes to Consolidated Financial Statements  
For the year ended December 31, 2005

**Per share amounts**

Basic per share amounts are calculated using the weighted average number of shares outstanding during the period. Weighted average number of shares is determined by relating the portion of time within the reporting period that common shares have been outstanding to the total time in that period.

Diluted per share amounts are calculated using the treasury stock method, which assumes that any proceeds obtained on exercise of share options or other dilutive instruments would be used to purchase common shares at the average market price during the period. The weighted average number of shares outstanding is then adjusted by the net change.

**Consolidation**

These consolidated financial statements include the accounts of the Corporation and its wholly owned subsidiary, Torrence Resources Inc.

**Related party transactions**

Related party transactions are conducted in the normal course of operations and are measured at exchange value.

**3. PROPERTY, PLANT AND EQUIPMENT**

	Cost \$	Accumulated Depreciation Depletion Accretion	Dec 31, 2005 Net Book Value	Dec 31, 2004 Net Book Value
<b>P&amp;NG Properties</b>	<b>23,779,441</b>	<b>273,649</b>	<b>23,505,792</b>	<b>2,181,009</b>
<b>Field vehicle</b>	<b>25,000</b>	<b>3,750</b>	<b>21,250</b>	<b>-</b>
<b>Office assets</b>	<b>271,296</b>	<b>11,219</b>	<b>260,077</b>	<b>4,550</b>
<b>TOTAL</b>	<b>24,075,737</b>	<b>288,618</b>	<b>23,787,119</b>	<b>2,185,559</b>

On March 16, 2005, Arapahoe entered into a Farmout Agreement with Tsuu T'ina Energy Corporation pursuant to which it has acquired a 100% working interest in certain petroleum and natural gas rights underlying approximately 21,000 acres (the "Sarcee Farmout Lands") located on the Tsuu T'ina First Nation west of Calgary, Alberta. The Corporation is obligated to drill at least two wells per year, on the Sarcee Farmout Lands, for four (4) years beginning December 1, 2005. During the second quarter of 2005, 25% of this prospect was farmed out resulting in Arapahoe retaining 75% of the lands and drilling commitments thereon.

The depletion calculation excluded unproved property of costs of \$16,875,407 (December 31, 2004 \$2,185,876). The Corporation has not capitalized any general and administrative expenses for the year ended December 31, 2005.

On October 20, 2005, pursuant to the Amalgamation Agreement dated August 9, 2005, Arapahoe completed the amalgamation with Banks Energy Inc. The acquisition has been accounted for by

ARAPAHOE ENERGY CORPORATION  
Notes to Consolidated Financial Statements  
For the year ended December 31, 2005

the purchase method with oil and gas operating results included in the financial statements commencing October 20, 2005. The value of the transaction was \$8,525,079 with fair values as detailed below:

<b>Net assets acquired:</b>	
Petroleum and natural gas assets	\$13,037,346
Cash	478,610
Non-cash working capital	(2,792,077)
Asset retirement obligation	(308,254)
Future income tax liability	(2,913,867)
Recognition of Arapahoe tax assets	1,023,321
<b>Total net assets acquired</b>	<b>\$ 8,525,079</b>

<b>Consideration:</b>	
Common Shares 15,121,206 @ \$0.54	\$8,165,383
Transaction costs paid in common shares 178,336 @ \$0.60	107,000
Transaction costs paid in cash	252,696
<b>Total consideration</b>	<b>\$8,525,079</b>

Based on the ceiling test performed as at December 31, 2005, no impairment of the petroleum and natural gas assets was deemed necessary. The prices used in the ceiling test evaluation of the Corporation's natural gas, crude oil and natural gas liquid reserves at December 31, 2005 were:

	2006	2007	2008	2009	2010	% increase to 2017
Natural Gas (\$/mcf)	10.37	9.65	8.53	7.86	7.12	1.8%
Crude Oil - Light (\$/Bbl)	67.16	65.26	60.78	59.80	60.99	2%
Crude Oil - Heavy (\$/Bbl)	37.01	36.66	35.37	36.85	38.75	2.3%
Natural Gas Liquids (\$/Bbl)	46.51	45.17	42.10	41.41	42.24	2%

#### 4. ASSET RETIREMENT OBLIGATION

The future asset retirement obligations were estimated by management based on the Corporation's working interest in its wells, estimated costs to remediate, reclaim and abandon the wells and estimated timing of the costs to be incurred in future periods. The Corporation has estimated the net present value of its total asset retirement obligation to be \$359,384 at December 31, 2005 based on a total future liability of \$777,487 as at December 31, 2005. These costs are expected to be incurred over the next three to thirty-four years. The Corporation's risk free interest rate of 10% and an inflation rate of 2.2% were used to calculate the net present value of asset retirement obligation.

ARAPAHOE ENERGY CORPORATION  
Notes to Consolidated Financial Statements  
For the year ended December 31, 2005

The following table provides a reconciliation of the carrying amount of the obligation associated with the retirement of oil and gas properties:

	Dec 31 2005	Dec 31 2004
Asset retirement obligation, beginning of period	14,224	-
Liabilities acquired from Banks Energy Inc.	308,254	
Liabilities incurred	968	12,755
Accretion expense	35,938	1,469
<b>Asset retirement obligation, end of period</b>	<b>359,384</b>	<b>14,224</b>

## 5. OPERATING LOAN

On March 11, 2005 the Corporation entered into a Loan Agreement with Quest Capital Corp. ("Quest") wherein Quest provided the Corporation with a loan for the principal amount \$2,495,820 (the "Loan"). This money was used by the Corporation to acquire the Sarcee Farmout Lands and for working capital purposes. Interest accrues on the amount outstanding under the Loan at the amount of 12% per annum, calculated and compounded monthly, not in advance, and is payable to Quest on the last business day of every month commencing March 31, 2005. The outstanding balance of the Loan was paid to Quest on October 11, 2005. The Corporation issued 1,181,000 Common Shares to Quest as additional consideration for the advance of the Loan. These shares were valued at \$300,000 based on the trading price of the Corporation's common shares on the date of the Loan Agreement, which was set up as a deferred financing cost on the balance sheet along with legal fees, associated with this transaction, in the amount of \$51,857. This amount was amortized over the six month life of the loan and expensed as financing costs on a monthly basis. In support of its obligation to repay the Loan, the Corporation provided Quest with a security interest in all of its assets, including its interest in the Sarcee Farmout Lands. This charge against the assets was released by Quest subsequent to the payout of the loan, which occurred on October 11, 2005.

On May 31, 2005 ATB Financial provided an irrevocable letter of guarantee in the amount of \$4,007,123 in favor of C1 Energy Ltd. on behalf of Arapahoe. This letter of guarantee was in support of a cash call on the Sarcee 12-13-24-4 W5M well. This facility was secured by a term deposit of an equal amount. This letter of guarantee was effective on June 1, 2005 through November 30, 2005.

In August 2005, Arapahoe engaged Quest to guarantee the financing of a potential acquisition. Although the Corporation elected not to proceed with the opportunity, 113,000 shares were issued to Quest to reserve this option during the evaluation process. These shares were valued at \$49,720 based on the trading price of the Corporation's common shares on the date of the Agreement. This amount was expensed as financing costs during the current period.

## 6. BANK LOAN

With the amalgamation of Banks Energy on October 20, 2005, the Corporation assumed a revolving term facility with the National Bank. The credit limit of \$700,000 at the assumption date was extended to \$2,500,000 in December 2005. At December 31, 2005 the Corporation had

ARAPAHOE ENERGY CORPORATION  
Notes to Consolidated Financial Statements  
For the year ended December 31, 2005

no remaining balance drawn on this line of credit. The full facility bears interest at the lenders' prime rate plus 1%. This facility is secured with a general security agreement over the property and assets of the Corporation. This credit facility is dated December 23, 2005 and, pursuant to the terms therein, is subject to an annual review.

**7. FINANCE CHARGES**

During the period ended December 31, 2005, Arapahoe incurred interest and finance charges on debt instruments. These were discharged using a combination of cash and Common Shares of the Corporation. These charges are as follows:

	<b>Shares issued</b>	<b>\$ Amount</b>
Bank debt interest		8,641
Bank facility fee		7,000
Advance of Quest loan - fee	1,181,000	300,000
Legal fees on Quest loan		51,857
Interest on Quest loan		93,956
Letter of Guarantee – ATB fee		39,962
Guarantee of funds – Quest standby fee	113,000	49,720
Legal fees for guarantee		895
Miscellaneous interest		2,897
<b>Total charges</b>	<b>1,294,000</b>	<b>554,928</b>

**8. SHARE CAPITAL**

**a) Authorized**

Unlimited number of common voting shares of no par value

Unlimited number of preferred shares of no par value

**b) Issued and outstanding**

	<b>Number of Shares #</b>	<b>Amount \$</b>
Arapahoe share capital prior to acquisition	3,958,691	10,918,692
Elimination of Arapahoe share capital	(3,958,691)	(10,918,692)
Shares issued to shareholders of Old Arapahoe – based on exchange ratio	1,319,563	-
Crazy Horse share capital	3,766,667	3,767
Elimination of Crazy Horse share capital	(3,766,667)	-
Shares issued to shareholders of Crazy Horse	3,766,667	(228,843)
Debt settlement	80,619	48,371
Private placement	450,000	247,500
Common Share issued as part of offering units	839,373	461,655

ARAPAHOE ENERGY CORPORATION  
Notes to Consolidated Financial Statements  
For the year ended December 31, 2005

Flow Through share issued as part of offering units	3,357,492	1,846,621
Share issue costs	-	(286,048)
Tax effect	-	(620,834)
<b>Balance – December 31, 2004</b>	<b>9,813,714</b>	<b>1,472,189</b>

**Issued during 2005**

Quest Capital Corp. – financing costs	1,181,000	300,000
Common shares issued for cash	2,500,000	1,000,000
Flow Through shares issued for cash*	8,823,225	3,970,451
Quest Capital Corp. – loan guarantee	113,000	49,720
Shares issued for debt	289,910	86,973
Woodstone Capital – consulting fee	100,000	40,000
Exercise of stock options	20,000	8,600
Shares issued for acquisition of Arapahoe Energy Holding Ltd. (Banks Energy)	15,299,542	8,272,383
Common shares issued for cash	3,619,317	2,352,556
Flow Through shares issued for cash*	4,041,337	3,031,003
Flow Through shares issued for cash*	1,986,665	1,490,000
Share issue costs	-	(1,412,851)
<b>Balance – December 31, 2005</b>	<b>47,787,710</b>	<b>20,661,024</b>

\* Flow Through obligation of \$8,491,454 was incurred in 2005 of which \$3,173,980 remains to be met prior to December 31, 2006 by the exploration program.

**c) Stock Option Plan**

The Corporation has a stock option plan, under which the Corporation may grant options to its employees, directors and consultants for up to 10% of the total shares of common stock issued and outstanding at time of option grant. The number of options and the exercise price thereof is set by the Board of Directors at the time of grant, provided that the exercise price shall not be less than the market price of the common shares on the stock exchange on which such shares are then traded. The options granted may be exercisable for a period and may vest at such times as the Board of Directors may determine at the time of grant.

A summary of the status of the Corporation's stock option plan as at December 31, 2005 and changes during the period ended on that date:

ARAPAHOE ENERGY CORPORATION  
Notes to Consolidated Financial Statements  
For the year ended December 31, 2005

	Year ended December 31, 2005 # Shares	Year ended December 31, 2005 Weighted average exercise price \$
Outstanding – beginning of period	872,348	0.58
Granted – May 31, 2005	880,000	0.43
Granted – Sept 8, 2005	185,000	0.61
Granted – Oct 6, 2005	300,000	0.65
Replaced Banks options – Oct 20, 2005	1,305,000	0.66
Granted – Oct 31, 2005	25,000	0.65
Granted – Nov 24, 2005	200,000	0.61
Expired during period	(249,167)	0.49
Exercised during period	(20,000)	0.43
<b>Outstanding – end of period</b>	<b>3,498,181</b>	<b>0.58</b>

The following table summarizes information about stock options outstanding at December 31, 2005:

Exercise price	Options outstanding # Outstanding Dec 31, 2005	Options outstanding Weighted average remaining contractual life in years	Options outstanding Weighted average exercise price at Dec 31, 2005	Options exercisable Number exercisable	Options exercisable Weighted average exercise price
\$0.40 - \$0.94	3,498,181	3.31	\$0.58	3,298,181	\$0.58
	<b>3,498,181</b>			<b>3,298,181</b>	

Compensation cost of \$450,593 has been recognized in 2005, (\$359,258 – 2004), for stock options granted. These costs are recorded as stock based compensation expense with the offsetting amount being credited to contributed surplus. The fair value for options granted to employees and directors was estimated at the date of grant using a Black-Scholes Option Pricing Model with the following assumptions:

Volatility factor of expected market price	139%
Weighted average risk-free interest rate	3.75%
Weighted average expected life in years	3.0
Weighted average option value	\$0.37
Weighted average expected annual dividends per share	Nil

ARAPAHOE ENERGY CORPORATION  
Notes to Consolidated Financial Statements  
For the year ended December 31, 2005

---

**d) Warrants**

Between April 22 and May 5, 2005, in connection with a private placement of 2,500,000 Common Shares and 8,823,225 flow-through shares, Arapahoe issued 1,132,322 broker warrants to purchase Common Shares of the Corporation. These broker warrants were issued in three tranches and are exercisable for a period of 12 months with an expiry date of April 22, 2006. The exercise price of all of these warrants is \$0.40 per share.

On October 20, 2005, Arapahoe amalgamated with Banks Energy Inc. An aggregate of 4,096,500 warrants were issued to replace existing warrants outstanding from Banks. These warrants were issued in two lots. 4,017,500 warrants have an exercise price of \$1.50 and will expire on June 9, 2006. 79,000 warrants had an exercise price of \$0.90 and expired on December 31, 2005.

On October 26 and 27, 2005, the Corporation closed a private placement resulting in the issue of 4,041,337 flow-through shares at a price of \$0.75 per share and 3,619,317 Common Shares at a price of \$0.65 per share. An aggregate of 720,058 broker and advisory warrants were issued. These warrants are exercisable for a period of 12 months, expiring on October 26, 2006 at an exercise price of \$0.75 per share.

On December 22, 2005, the Corporation closed another private placement resulting in the issue of 1,986,665 flow-through shares at a price of \$0.75 per share. An additional 139,066 broker warrants were issued, exercisable for a period of 12 months, expiring on December 22, 2006 at an exercise price of \$0.75 per share.

All other warrants issued by Arapahoe expired during the period ended December 31, 2005.

A summary of the status of the Corporation's warrants as at December 31, 2005 and changes during the period ended on that date:

	<b>Year ended Dec 31, 2005 # Shares</b>	<b>Year ended Dec 31, 2005 Weighted average exercise price \$</b>
Outstanding – beginning of period	3,196,531	0.77
Granted – April 22, 2005	877,521	0.40
Granted – April 28, 2005	108,690	0.40
Granted – May 5, 2005	146,111	0.40
Replaced Banks options – Oct 20, 2005	4,017,500	1.50
Replaced Banks options – Oct 20, 2005	79,000	0.90
Granted – Oct 26, 2005	720,058	0.75
Granted – Dec 22, 2005	139,066	0.75
Expired during period	(3,275,531)	0.78
<b>Outstanding – end of period</b>	<b>6,008,946</b>	<b>1.19</b>

ARAPAHOE ENERGY CORPORATION  
Notes to Consolidated Financial Statements  
For the year ended December 31, 2005

The following table summarizes information about warrants outstanding at December 31, 2005:

Exercise price	Warrants outstanding # Outstanding Dec 31, 2005	Warrants outstanding Weighted average remaining contractual life in years	Warrants outstanding Weighted average exercise price at Dec 31, 2005	Warrants exercisable Number exercisable	Warrants exercisable Weighted average exercise price
\$0.40 - \$1.50	6,008,946	0.46	\$1.19	6,008,946	\$1.19
	<b>6,008,946</b>			<b>6,008,946</b>	

Share issue costs of \$438,000 have been recognized in 2005, (\$0 – 2004), for warrants granted to brokers with respect to current year financings. These costs are recorded as share issue costs and deducted from share capital with the offsetting amount being credited to contributed surplus. The fair value for warrants granted was estimated at the date of grant using a Black-Scholes Option Pricing Model with the following assumptions:

Volatility factor of expected market price	142%
Weighted average risk-free interest rate	3.75%
Weighted average expected life in years	1.0
Weighted average warrant value	\$0.22
Weighted average expected annual dividends per share	Nil

**e) Contributed surplus**

	Year ended December 31, 2005
Balance December 31, 2004	359,258
Stock-based compensation - options	450,593
Stock-based compensation – broker warrants	438,000
<b>Balance December 31, 2005</b>	<b>1,247,851</b>

**f) Per share amounts**

For the year ended December 31, 2005 the weighted average number of shares were 23,223,660 (2004 - 9,334,490). Diluted earnings per share reflect the exercise of options and warrants as if issued at the later of the date of grant or the beginning of the period. This

ARAPAHOE ENERGY CORPORATION  
Notes to Consolidated Financial Statements  
For the year ended December 31, 2005

calculation takes into account only the options and warrants that are considered in the money at December 31, 2005. The diluted weighted average number of shares for the year ended December 31, 2005 was 23,475,941 (2004 – 9,334,490).

**9. INCOME TAX**

	<b>2005</b>	<b>2005</b>
Loss before income taxes	(2,231,573)	(847,432)
Combined federal and provincial income tax rate	40.50%	38.87%
Tax effect	(903,676)	(329,397)
Crown charges	3,699	3,829
Stock based compensation costs	182,468	139,644
Resource allowance	(59,033)	(31,696)
Benefit of losses not previously recognized	-	(403,214)
Change in valuation allowance and tax estimates	913,563	-
Rate change	(161,294)	-
Other	24,273	-
<b>Future income taxes recovery</b>	<b>0</b>	<b>(620,834)</b>

The components of the net future income tax asset as at December 31, 2005 were as follows:

	<b>2005</b>	<b>2004</b>
Future income tax assets:		
Asset retirement obligation	131,157	4,782
Share issue costs	443,378	96,169
Non-capital losses carried forward	2,156,654	811,701
	<b>2,731,189</b>	<b>912,653</b>
Future income tax liabilities:		
Property, plant and equipment	4,621,735	580,079
Net future income asset before valuation allowance	-	332,574
Valuation allowance	-	(332,574)
<b>Net future income tax liability</b>	<b>1,890,546</b>	<b>-</b>

The Corporation's non-capital losses expire between 2006 and 2015. Given the uncertainty of realization, no future tax asset has been recognized in these financial statements. The Corporation's tax pools associated with its property, plant and equipment expenditures consist of approximately \$3.7 million of Canadian Oil and Gas Property Expenditures (COGPE), \$37,000 of Canadian Development Expenditures (CDE), \$298,000 of Canadian Exploration Expenditures (CEE), \$2.15 million of Undepreciated Capital Costs (UCC) and \$5.9 million of non capital loss (NCL) carry forwards. Flow through obligation of \$8,491,454 was incurred in 2005 of which \$3,173,980 remains to be met prior to December 31, 2006 by the exploration program.

## **10. FINANCIAL INSTRUMENTS**

The fair market value of cash and cash equivalents, receivables, other current assets, payables and bank debt approximate their carrying value due to their short terms to maturity.

### **Risk management activities**

Substantially all of the Corporation's accounts receivable are due from companies in the oil and gas industry and are subject to the normal industry credit risks. The carrying value of accounts receivable reflects management assessment of the associated risks.

## **11. COMMITMENTS**

The Corporation has an obligation under an office lease agreement, through 2010, requiring annual payments of a fixed amount of \$156,000 per year plus operating expenses. Operating expenses are estimated to be \$84,000 in 2006 and increasing each year with inflation. Arapahoe intends to sublet approximately 3,500 sq ft of the 7,800 sq ft until such time as additional space is required to satisfy the corporate growth.

## **12. RELATED PARTY TRANSACTIONS**

For the year ended December 31, 2005 \$7,200 (2004 - \$86,130) was accrued as payables to directors for services provided to the Corporation. A loan to a director for \$6,357 was outstanding as at December 31, 2004 and was non-interest bearing with no fixed repayment terms. On August 25, 2005, 289,910 Common Shares were issued in settlement of these accounts.

In October 2005, Arapahoe entered into an agreement with Kinghorn Resources Ltd (Kinghorn) to lease approximately 7,800 sq ft of office space in the beltline area of Calgary. Kinghorn is a private corporation controlled by Jeffrey Standen, President and CEO of Arapahoe. This transaction was measured at exchange value.