

ARAPAHOE ENERGY CORPORATION

Interim Consolidated Financial Statements

For three months ended March 31, 2006 and 2005

(unaudited)

ARAPAHOE ENERGY CORPORATION
Consolidated Balance Sheets
(unaudited)

	Mar 31	Dec 31
	2006	2005
	\$	\$
Assets		
Current assets		
Cash	3,882	1,069,021
Accounts receivable and accruals	4,715,311	1,467,528
Prepaid expenses	660,176	272,818
	<u>5,379,369</u>	<u>2,809,367</u>
Property, plant and equipment (note 2)	<u>25,024,669</u>	<u>23,787,119</u>
	30,404,038	26,596,486
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities	7,070,743	4,910,034
Operating loan (note 4)	2,245,000	-
	<u>9,315,743</u>	<u>4,910,034</u>
Future income tax liability	4,527,222	1,890,546
Asset retirement obligation (note 3)	368,369	359,384
	<u>14,211,334</u>	<u>7,159,964</u>
Shareholders' Equity		
Capital stock (note 5)	17,553,743	20,661,024
Deficit	(2,608,890)	(2,472,353)
Contributed surplus	1,247,851	1,247,851
	<u>16,192,704</u>	<u>19,436,522</u>
	30,404,038	26,596,486
Going concern (note 1)		
Approved by the Board of Directors		

Jeffrey L. Standen

Robert Chenery

ARAPAHOE ENERGY CORPORATION
Consolidated Statements of Loss and Deficit
For three months ended March 31
(unaudited)

	2006	2005
	\$	\$
Revenue		
Oil and gas	837,676	33,996
Royalties (net of ARTC)	(194,617)	(3,995)
Interest income	8,685	-
	651,744	30,001
Expenses		
Operating costs	344,319	7,608
Depletion, depreciation and accretion	374,035	7,036
General and administrative	451,081	152,051
Interest expense and finance charges (note 4)	15,654	74,934
	1,185,089	241,629
Loss for the period before taxes	(533,345)	(211,628)
Income tax recovery	396,808	-
	(136,537)	(211,628)
Loss for the period	(136,537)	(211,628)
Deficit – Beginning of period	(2,472,353)	(240,780)
Deficit – End of period	(2,608,890)	(452,408)
Basic and diluted loss per share	(.00)	(.02)
Going concern (note 1)		

ARAPAHOE ENERGY CORPORATION
Consolidated Statements of Cash Flows
For three months ended March 31
(unaudited)

	2006	2005
	\$	\$
Cash provided by (used in)		
Operating activities		
Loss for the period	(136,537)	(211,628)
Items not affecting cash		
Depletion, depreciation and accretion	374,035	7,036
Expenses settled with shares	-	50,000
Income tax recovery	(396,808)	-
Funds used in operations	(159,310)	(154,592)
Change in non-cash working capital items	(359,273)	2,401,851
Cash-flow used in operations	(518,583)	2,247,259
Financing activities		
Share issue costs	(13,081)	-
Increase in operation loan	2,245,000	
Net change in non-cash financing activities working capital	92,224	(26,356)
	2,324,143	(26,356)
Investing activities		
Net acquisition of other petroleum and natural gas properties	(1,663,316)	(2,103,597)
Net change in non-cash investing activities working capital	(1,207,383)	-
	(2,870,699)	(2,103,597)
Increase (decrease) in cash	(1,065,139)	117,306
Cash – Beginning of period	1,069,021	12,035
Cash – End of period	3,882	129,341

ARAPAHOE ENERGY CORPORATION
Notes to Consolidated Financial Statements
For three months ended March 31, 2006
(unaudited)

1. BASIS OF PRESENTATION & GOING CONCERN

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, 2005

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 \$136,537 and funds used in operations of \$159,310 for three months ended March 31, 2006. The Corporation had a working capital deficit of \$3,936,374 at March 31, 2006. 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. PROPERTY, PLANT AND EQUIPMENT

	Cost \$	Accumulated Depreciation Depletion Accretion	Mar 31, 2006 Net Book Value	Dec 31, 2005 Net Book Value
P&NG Properties	25,350,735	621,688	24,729,047	23,505,792

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Field vehicle	25,000	5,344	19,656	21,250
Office assets	302,603	26,637	275,966	260,077
TOTAL	25,678,338	653,669	25,024,669	23,787,119

The depletion calculation excluded unproved property of costs of \$17,306,606 (March 31, 2005 \$4,200,282). The Corporation has not capitalized any general and administrative expenses for the three months ended March 31, 2006.

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 the purchase method with oil and gas operating results included in the financial statements commencing October 20, 2005. Subsequent to December 31, 2005, the future income tax liability acquired in the Banks transaction was reduced by \$60,716 which was offset by the reduction of the recognition of Arapahoe tax assets. Purchase equation is detailed below:

Net assets acquired:

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	(2,853,151)
Recognition of Arapahoe tax assets	962,605
Total net assets acquired	\$ 8,525,079

Consideration:

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
Total consideration	\$8,525,079

3. 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 \$368,369 at March 31, 2006 based on a total future liability of \$821,263 as at March 31, 2006. 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.

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

	Mar 31	Dec 31
	2006	2005
Asset retirement obligation, beginning of period	359,384	14,224
Liabilities acquired from Banks Energy Inc.	-	308,254
Liabilities incurred	-	968
Accretion expense	8,985	35,938
Asset retirement obligation, end of period	368,369	359,384

4. BANK LOAN

At March 31, 2006, the Corporation has access to a revolving line of credit with the National Bank of Canada in the amount of \$2,500,000. At March 31, 2006 Arapahoe has drawn \$2,245,000. 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. During the period ended March 31, 2006, Arapahoe incurred interest on this facility totaling \$15,654.

5. SHARE CAPITAL

a) Authorized

Unlimited number of common voting shares of no par value

Unlimited number of preferred shares of no par value

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b) Issued and outstanding

	Number of Shares #	Amount \$
Balance – December 31, 2004	9,813,714	1,472,189
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)
Balance – December 31, 2005	47,787,710	20,661,024
Issued during 2006		
Share issue costs		(13,081)
Share issue costs – tax effect		4,774
Share issue costs – tax effect flow through renoucement		(3,098,974)
Balance – March 31, 2006	47,787,710	17,553,743

*** Flow Through obligation of \$999,184 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

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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 March 31, 2006 and changes during the period ended on that date:

	Three months ended March 31, 2006	
	# Shares	Weighted average exercise price \$
Outstanding – beginning of period	3,498,181	0.58
Expired during period	(355,000)	0.62
Outstanding – end of period	3,143,181	0.58

The following table summarizes information about stock options outstanding at March 31, 2006:

Exercise price	Options outstanding # Outstanding Mar 31, 2006	Options outstanding Weighted average remaining contractual life in years	Options outstanding Weighted average exercise price at Mar 31, 2006	Options exercisable Number exercisable	Options exercisable Weighted average exercise price
\$0.40 - \$0.76	3,143,181	3.49	\$0.58	3,093,181	\$0.58
	3,143,181			3,093,181	

There were no options granted to employees during the three months ended March 31, 2006. Compensation cost of \$0 has been recognized in 2006 (\$450,593 – 2005) for stock options granted. These costs are recorded as stock based compensation expense with the offsetting amount being credited to contributed surplus.

d) Warrants

During three months ended March 31, 2006, there were no warrants issued by the Corporation.

A summary of the status of the Corporation's warrants as at March 31, 2006 and changes during the period ended on that date:

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	Three months ended Mar 31, 2006	
	# Shares	Weighted average exercise price \$
Outstanding – beginning of period	6,008,946	1.19
Outstanding – end of period	6,008,946	1.19

The following table summarizes information about warrants outstanding at March 31, 2006:

Exercise price	Warrants outstanding # Outstanding Mar 31, 2006	Warrants outstanding Weighted average remaining contractual life in years	Warrants outstanding Weighted average exercise price at Mar 31, 2006	Warrants exercisable Number exercisable	Warrants exercisable Weighted average exercise price
\$0.40 - \$1.50	6,008,946	0.21	\$1.19	6,008,946	\$1.19
	6,008,946			6,008,946	

There have been no warrants issued in 2006 and therefore no share issue costs have been recorded in 2006 (\$438,000 – 2005) 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.

e) Contributed surplus

	Year ended March 31, 2006
Balance December 31, 2005	1,247,851
Balance March 31, 2006	1,247,851

f) Per share amounts

For three months ended March 31, 2006 the weighted average number of shares were 47,787,710 (Mar 2005 – 10,076,158). 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 calculation takes into account only the options and warrants that are considered in the money at March 31, 2006. The diluted weighted average number of shares for three months ended March 31, 2006 was 48,029,817 (Mar 2005 – 10,448,506).

6. 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.

7. 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.

8. RELATED PARTY TRANSACTIONS

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. During three months ended March 31, 2006, Arapahoe paid to Kinghorn the amount of \$58,569 which represents 3 months rent and operating expenses at \$19,523 per month.

During three months ended March 31, 2006, Arapahoe incurred a liability in the amount of \$92,560 to 559046 Alberta Ltd. ("559046"), a company owned by Sharon Standen, wife of Jeffrey Standen, President and CEO of Arapahoe. This amount resulted from the forfeiture of office rental fees by 559046 as part of a contract to secure 50% rights to certain Sarcee lands.

9. SUBSEQUENT EVENTS

On March 3, 2006, Arapahoe entered into a Letter of Intent with Reconnaissance Energy Corporation ("Reconnaissance"). Under the terms of the Letter of Intent, Reconnaissance will, as part of the cost equalization, pay Arapahoe the sum of \$1,000,000 cash and pay a further \$1,350,733 to Arapahoe in future drilling costs net to Arapahoe's interest. In addition, Reconnaissance will assume and pay 100% of the costs to drill, core and evaluate two test wells to evaluate the CBM potential in the Horseshoe Canyon formation on the Sarcee Lands on behalf of itself and Arapahoe. The first \$1,000,000 payment from Reconnaissance was received on May 12, 2006. Further Reconnaissance has agreed to pay 50% of an estimated \$3,000,000 3D seismic survey on the Sarcee lands. The seismic survey has been completed and is currently being processed. Thereafter all joint venture operations

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on the Sarcee Reserve will be shared Reconnaissance 50% and Arapahoe 50%.

On March 30, 2006, Arapahoe entered into a Letter of Intent with SNRG Participating Income Fund 1, LLC. ("SNRG"). Under the terms of the Letter of Intent, SNRG will pay Arapahoe \$3,750,000 of which \$500,000 was received in April, 2006 and the balance will be received in May, 2006. SNRG has further agreed to pay to Arapahoe an additional \$2,100,000 for a portion of the costs of a planned 60 square mile 3D seismic program to be conducted on the Freemont and Poundmaker Prospect Lands. SNRG will then expend \$3,000,000 on drilling wells on the undeveloped Prospect Lands to conclude its earning obligations. Upon SNRG fulfilling the foregoing earning requirements, Arapahoe and SNRG will be 50% - 50% partners in the previously undeveloped Freemont and Poundmaker Prospect Lands and 50% - 50% partners in an anticipated ongoing two year exploration, development and exploitation program on these lands.

On May 11th Arapahoe signed agreements to purchase and additional 65% interest in the Campbell prospect including the 15-33-56-25 W4M well. At closing, which is expected May 19 2006, Arapahoe will own 77.5% interest in the Campbell prospect and will become the operator.