

ARAPAHOE ENERGY CORPORATION

Interim Consolidated Financial Statements

For three and six months ended June 30, 2006 and 2005

(unaudited)

ARAPAHOE ENERGY CORPORATION
Consolidated Balance Sheets
(unaudited)

	Jun 30	Dec 31
	2006	2005
	\$	\$
Assets		
Current assets		
Cash	39,078	1,069,021
Accounts receivable and accruals	2,036,598	1,467,528
Prepaid expenses & deposits	1,288,926	272,818
	<u>3,364,602</u>	<u>2,809,367</u>
Property, plant and equipment (note 2)	<u>31,656,799</u>	<u>23,787,119</u>
	35,021,401	26,596,486
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities	4,126,552	4,910,034
Bank loan (note 4)	6,100,000	-
	<u>10,226,552</u>	<u>4,910,034</u>
Future income tax liability	3,756,004	1,890,546
Asset retirement obligation (note 3)	388,001	359,384
	<u>14,370,557</u>	<u>7,159,964</u>
Shareholders' Equity		
Capital stock (note 5)	21,439,832	20,661,024
Deficit	(2,436,260)	(2,472,353)
Contributed surplus	1,647,272	1,247,851
	<u>20,650,844</u>	<u>19,436,522</u>
	35,021,401	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
(unaudited)

	Three months ended June 30		Six months ended June 30	
	2006	2005	2006	2005
	\$	\$	\$	\$
Revenue				
Oil and gas	1,676,190	28,432	2,513,866	62,428
Royalties (net of ARTC)	(361,046)	(7,936)	(555,663)	(11,931)
	1,315,144	20,496	1,958,203	50,497
Expenses				
Operating costs	295,292	7,079	639,611	14,687
Depletion, depreciation and accretion	589,338	8,915	963,373	15,951
Stock based compensation	399,421	303,686	399,421	303,686
General and administrative	505,296	261,893	956,377	413,944
Interest expense	42,782	92,624	58,436	109,005
Financing costs amortization	-	175,660	-	234,213
	1,832,129	849,857	3,017,218	1,091,486
Other income				
Other income	14,392	-	23,077	-
Loss for the period before taxes	(502,593)	(829,361)	(1,035,938)	(1,040,989)
Future income tax recovery	675,223	-	1,072,031	-
Income (loss) for the period	172,630	(829,361)	36,093	(1,040,989)
Deficit, beginning of period	(2,608,890)	(452,408)	(2,472,353)	(240,780)
Deficit, end of period	(2,436,260)	(1,281,769)	(2,436,260)	(1,281,769)
Net loss per share				
Basic and Diluted	(0.00)	(0.05)	(0.00)	(0.07)
Going concern (note 1)				

ARAPAHOE ENERGY CORPORATION
Consolidated Statements of Cash Flows
(unaudited)

	Three months ended June 30		Six months ended June 30	
	2006	2005	2006	2005
Cash provided by (used in)	\$	\$	\$	\$
Operating activities				
Income (loss) for the period	172,630	(829,361)	36,093	(1,040,989)
Items not affecting cash				
Depletion, depreciation & accretion	589,338	8,915	963,373	15,951
Stock-based compensation	399,421	303,686	399,421	303,686
Financing cost amortization	-	175,660	-	234,213
Future tax recovery	(675,223)	-	(1,072,031)	-
	486,166	(341,100)	326,856	(487,139)
Change in non-cash working capital	173,393	(190,476)	(185,880)	(280,263)
	659,559	(531,576)	140,976	(767,402)
Financing activities				
Increase bank loan	3,855,000		6,100,000	
Issuance of capital stock for cash	3,790,094	4,542,955	3,777,013	4,542,955
Net change in non-cash financing activities working capital	(63,442)	(1,423,443)	28,782	1,033,287
	7,581,652	3,119,512	9,905,795	5,576,242
Investing activities				
Acquisition of petroleum and natural gas properties	(7,648,268)	(169,442)	(12,153,801)	(2,273,040)
Proceeds from disposal of petroleum and natural gas properties	446,432	2,531,567	3,288,649	2,531,567
Net change in non-cash investing activities	(1,004,179)	(731,424)	(2,211,562)	(731,424)
	(8,206,015)	1,630,701	(11,076,714)	(472,897)
Increase (decrease) in Cash	35,196	4,218,637	(1,029,943)	4,335,943
Cash, beginning of period	3,882	129,341	1,069,021	12,035
Cash, end of period	39,078	4,347,978	39,078	4,347,978

ARAPAHOE ENERGY CORPORATION
Notes to Financial Statements
For six months ended June 30, 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 income of \$36,093 and funds generated from operations of \$326,856 for six months ended June 30, 2006. The Corporation had a working capital deficit of \$6,861,950 at June 30, 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.

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2. PROPERTY, PLANT AND EQUIPMENT

	Cost \$	Accumulated Depreciation Depletion Accretion	Jun 30, 2006 Net Book Value	Dec 31, 2005 Net Book Value
P&NG Properties	32,560,356	1,182,169	31,378,187	23,505,792
Field vehicle	25,000	6,938	18,062	21,250
Office assets	302,603	42,053	260,550	260,077
TOTAL	32,887,959	1,231,160	31,656,799	23,787,119

The depletion calculation excluded unproved property costs of \$16,156,112 (June 30, 2005 \$2,185,876). The Corporation has not capitalized any general and administrative expenses for the six months ended June 30, 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**

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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 \$388,001 at June 30, 2006 based on a total undiscounted future liability of \$847,222 as at June 30, 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.

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

	Jun 30	Dec 31
	2006	2005
	\$	\$
Asset retirement obligation, beginning of period	359,384	14,224
Liabilities acquired from Banks Energy Inc.	-	308,254
Liabilities incurred	7,786	968
Accretion expense	20,831	35,938
Asset retirement obligation, end of period	388,001	359,384

4. BANK LOAN

At June 30, 2006, the Corporation has access to a revolving line of credit with the National Bank of Canada in the amount of \$7,500,000. At June 30, 2006 Arapahoe has drawn \$6,100,000. The limit on this facility was extended from \$2,500,000 at December 31, 2005 to facilitate the company's purchase of an additional 65% interest in the Campbell prospect. 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 May 16, 2006 and, pursuant to the terms therein, is subject to an annual review. During the six month period ended June 30, 2006, Arapahoe incurred interest on this facility totaling \$56,101.

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, 2005	47,787,710	20,661,024
Issued during 2006		
Exercise of warrants	1,132,322	452,929
Flow Through shares issued for cash*	5,615,400	3,650,010
Share issue costs		(325,927)
Share issue costs – tax effect		101,194
Tax effect flow through renouncement		(3,099,398)
Balance – June 30, 2006	54,535,432	21,439,832
* Flow through obligation of \$3,239,719 remains to be met prior to December 31, 2007 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 June 30, 2006 and changes during the six month period ended on that date:

	Six months ended June 30, 2006	
	# Shares	Weighted average exercise price \$
Outstanding – beginning of period	3,498,181	0.58
Granted during period	1,095,000	0.67
Expired during period	(405,000)	0.61
Outstanding – end of period	4,188,181	0.57

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The following table summarizes information about stock options outstanding at June 30, 2006:

Exercise price	Options outstanding # Outstanding Jun 30, 2006	Options outstanding Weighted average remaining contractual life in years	Options outstanding Weighted average exercise price at Jun 30, 2006	Options exercisable Number exercisable	Options exercisable Weighted average exercise price
\$0.40 - \$0.76	4,188,181	3.38	\$0.57	4,124,848	\$0.57
	4,188,181			4,124,848	

There were 1,095,000 options granted to directors, officers and employees during the six months ended June 30, 2006. Compensation cost of \$399,421 has been recognized in the six months ended June 30, 2006 (\$303,686 – 2005) 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	94%
Weighted average risk-free interest rate	12%
Weighted average expected life in years	3.0
Weighted average expected annual dividends per share	Nil

d) Warrants

During the six months ended June 30, 2006, there were 561,540 warrants issued by the Corporation.

A summary of the status of the Corporation's warrants as at June 30, 2006 and changes during the period ended on that date:

	Six months ended Jun 30, 2006	
	# Shares	Weighted average exercise price \$
Outstanding – beginning of period	6,008,946	1.19
Issued during period	561,540	0.65

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Exercised during period	1,132,322	0.40
Expired during period	4,017,500	1.50
Outstanding – end of period	1,420,664	0.71

The following table summarizes information about warrants outstanding at June 30, 2006:

Exercise price	Warrants outstanding # Outstanding Jun 30, 2006	Warrants outstanding Weighted average remaining contractual life in years	Warrants outstanding Weighted average exercise price at Jun 30, 2006	Warrants exercisable Number exercisable	Warrants exercisable Weighted average exercise price
\$0.65 - \$0.75	1,420,664	0.78	\$0.71	1,420,664	\$0.71
	1,420,664			1,420,664	

There have been 561,540 warrants issued in 2006 but the exercise price was above the trading value of Arapahoe shares so no share issue costs have been recorded to date in 2006 (\$280,500 – 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. The fair value for warrants issued was estimated at the date of grant using a Black-Scholes Option Pricing Model with the following assumptions:

Volatility factor of expected market price	94%
Weighted average risk-free interest rate	12%
Weighted average expected life in years	3.0
Weighted average expected annual dividends per share	Nil

e) Contributed surplus

	Six months ended June 30, 2006
Balance December 31, 2005	1,247,851
Options issued	399,421
Balance June 30, 2006	1,647,272

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f) Per share amounts

For six months ended June 30, 2006 the weighted average number of shares were 49,150,098 (June 2005 – 14,713,591). 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 June 30, 2006. The diluted weighted average number of shares for the six months ended June 30, 2006 was 49,390,973 (June 2005 – 14,713,591).

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 fair value. During six months ended June 30, 2006, Arapahoe paid to Kinghorn the amount of \$117,138 which represents 6 months rent and operating expenses at \$19,523 per month.

During six months ended June 30, 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.

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9. SUBSEQUENT EVENTS

In July 2006 Arapahoe drilled and cased 12 wells in S.W Saskatchewan and drilled, cased and cored 2 wells in the Sarcee Area of Alberta. All of the wells are awaiting completion as of August 9, 2006

In July 2006 the Corporation entered into an agreement with Blue Parrot Energy whereby the Corporation will sell a 12.5% interest in the Campbell 15-33 well for \$1,250,000. Closing is expected to occur on or before September 5, 2006.

In July, Arapahoe sold all interest in Torrence Resources Inc., a wholly owned subsidiary. The terms of this agreement required that Arapahoe be paid \$10 and that the intercompany debt of \$214,008 be forgiven.