

SPITFIRE ENERGY LTD.
Financial Statements

(Unaudited)

For the Three and Nine Months ending December 2005 and 2004

Spitfire Energy Ltd.
Balance Sheet

December 31, 2005 *March 31, 2005*
Unaudited *Audited*

	<i>December 31, 2005</i>	<i>March 31, 2005</i>
	<i>Unaudited</i>	<i>Audited</i>
Assets		
Current		
Cash	1,340,795	189,901
Accounts Receivable and Deposits	772,300	458,763
Notes Receivable	237,200	-
	2,350,295	648,664
Property and equipment (Note 3)	6,084,049	4,525,268
	8,434,344	5,173,932
Liabilities		
Current		
Accounts payable and accrued liabilities	1,643,753	955,935
Future income taxes	507,116	408,337
Asset retirement obligations (Note 5)	151,232	138,421
	2,302,101	1,502,693
Shareholders' Equity		
Share capital (Note 6)	6,490,796	4,236,571
Contributed surplus (Note 7)	357,236	290,450
Deficit	(715,789)	(855,782)
	6,132,243	3,671,239
	8,434,344	5,173,932

"Keith N. Chase" (signed)
Keith N. Chase, Director

"Keith W. Templeton" (signed)
Keith W. Templeton, Director

Spitfire Energy Ltd.
Statement of Earnings (Loss) and Deficit

	<i>Three months ended December 31</i>		<i>Nine months ended December 31</i>	
	<i>Unaudited (note 12)</i>		<i>Unaudited</i>	
	2005	2004	2005	2004
Revenue				
Oil and gas revenue	625,390	218,730	1,775,569	499,169
Royalties	(111,174)	(47,767)	(364,200)	(109,830)
Interest income	484	10,775	1,099	32,313
	514,700	181,738	1,412,468	421,652
Expenses				
Operating	90,312	101,965	382,776	197,520
General and administration	125,582	100,619	412,358	262,364
Stock-based compensation	18,091	1,680	147,073	47,385
Interest	1,224	3,116	7,571	10,165
Depletion, depreciation and accretion	99,254	32,736	275,895	117,505
	334,463	240,116	1,225,673	634,939
Net income (loss) before income taxes	180,237	(58,378)	186,795	(213,287)
Future tax (expense) recovery	(31,389)	31,900	(46,802)	68,760
Net earnings (loss)	148,848	(26,478)	139,993	(144,527)
Deficit, beginning of period	(864,637)	(244,593)	(855,782)	(126,544)
Deficit, end of period	(715,789)	(271,071)	(715,789)	(271,071)
Earnings (loss) per share				
Basic	0.01	(0.01)	0.01	(0.01)
Fully Diluted	0.01	(0.01)	0.01	(0.01)

Spitfire Energy Ltd.
Statement of Cash Flows

	<i>Three months ended December 31</i>		<i>Nine months ended December 31</i>	
	<i>Unaudited</i>		<i>Unaudited</i>	
	2005	2004	2005	2004
Cash provided by (used for) the following activities				
Operating				
Net earnings (loss)	148,848	(26,478)	139,993	(144,527)
Add (deduct) items not requiring cash:				
Stock-based compensation	18,091	1,680	147,073	47,385
Depletion, depreciation, & accretion	99,254	32,736	275,895	117,505
Future tax expense (recovery)	31,389	(31,900)	46,802	(68,760)
	297,582	(23,962)	609,762	(48,397)
Net (decrease) in non-cash working capital balances	672,172	317,443	401,154	(794,740)
	969,754	293,481	1,010,916	(843,137)
Investing				
Additions to property and equipment	(761,684)	(768,011)	(1,836,227)	(2,028,078)
Financing				
Proceeds on issue of share capital	1,050,000	-	1,983,555	3,999,970
Share issuance cost	(5,750)	500	(7,350)	(371,046)
Short-term debt payment	-	-	-	(108,521)
	1,044,250	500	1,976,205	3,520,403
Increase (decrease) in cash and cash equivalents during the period	1,252,320	(474,030)	1,150,894	1,464,978
Cash and cash equivalents, at beginning of period	88,475	1,961,394	189,901	22,386
Cash and cash equivalents, at end of period	1,340,795	1,487,364	1,340,795	1,487,364

1. Incorporation and operations

Spitfire Energy Ltd. ("the Company") was incorporated under the Business Corporations Act (Alberta) on August 30, 2001.

The Company is involved in the production, exploration and development of resource properties in Western Canada.

2. Significant accounting policies

These financial statements have been prepared in accordance with Canadian generally accepted accounting principles. The accounting policies followed in preparing these financial statements are those used by the Company as set out in the audited consolidated financial statements for the year ended March 31, 2005. Certain information and note disclosure normally included in year-end financial statements prepared in accordance with generally accepted accounting principles are not included. These interim financial statements should be read together with the Company's audited consolidated financial statements for the year ended March 31, 2005.

In the opinion of management, all adjustments considered necessary for fair presentation have been included in these financial statements.

3. Property and equipment

	Cost	Accumulated amortization	December, 2005 Net book value	March 31, 2005 Net book value
Computer and office equipment	60,469	(25,497)	34,972	22,202
Petroleum and natural gas properties	7,368,929	(1,319,852)	6,049,077	4,503,066
	\$7,429,398	\$(1,345,349)	\$6,084,049	\$4,525,268

As at December 31, 2005, unproven properties with capitalized costs of \$847,520 were not subject to depletion, comparatively, for the year ending, March 31, 2005 unproven properties with capitalized costs of \$896,414 were not subject to depletion.

During the three-month period ending December 31, 2005 the Company capitalized \$59,093 (2004 - \$32,844) of Geological and Geophysical expenses and for the nine-month period ending December 31, 2005, \$118,095 (2004 - \$60,856) was capitalized. During the three-month period ending December 31, 2005 the Company capitalized \$4,171 (2004 - \$15,124) of Stock-Based Compensation associated with Geological and Geophysical services and for the nine-month period ending December 31, 2005 \$12,513 (2004 - \$28,466) was capitalized.

The Company capitalized \$ nil (2004 - \$ nil) of Asset Retirement Obligations during the three-month period ending December 31, 2005 and for the nine-month period ending December 31, 2005 \$3,587 (2004 - \$ nil) was capitalized.

For the third quarter ending December 31, 2005, a ceiling test was performed under Accounting Guideline 16 with no requirement for an impairment provision. The crude and natural gas future prices used in the ceiling were obtained from third parties and represent management's best estimate of the future-pricing environment for the Company.

4. Credit Facilities

At December 31, 2005 the Company had available a revolving operating demand loan with a maximum available credit of \$1,500,000 (March 31, 2005 – \$260,000), bearing interest at prime plus 0.75% (March 31, 2005 - 1%) and a development/acquisition line of credit of \$500,000 (March 31, 2005 – \$nil) bearing interest prime plus 1.25% (March 31, 2005 – n/a) which are secured by a general assignment of book debts and a \$5,000,000 debenture with a floating charge over all assets of the Company. As at December 31, 2005 the amount drawn was nil (March 31, 2005 - \$nil).

5. Asset retirement obligations

	<i>Three months ended December 31, 2005</i>	<i>Three months ended December 31, 2004</i>	<i>Nine months ended December 31, 2005</i>	<i>Nine months ended December 31, 2004</i>
<i>Balance, beginning of period</i>	148,350	\$72,254	138,421	69,475
<i>Additional obligations</i>	-	-	3,587	-
<i>Accretion</i>	2,882	1,390	9,224	4,169
<i>Balance, end of period</i>	151,232	\$73,644	151,232	\$73,644

Future asset retirement obligations are estimated based on the Company's net ownership interest in all wells and facilities, the estimated costs to reclaim and abandon the wells and facilities and the estimated timing of the costs to be incurred in future periods. The Company estimates the total undiscounted cash flows required to settle the obligations will be \$495,361 (March 31, 2005 – \$517,088). The obligations have been discounted using a credit adjusted risk free rate of 8% (March 31, 2005 – 8%) and an inflation rate of 1.5 % (March 31, 2005 – 1.5%) per year. Most of these obligations are not expected to be paid until about 20 years in the future and will be funded from general Company resources at that time.

6. Share capital

Authorized

Unlimited number of voting common shares, without nominal or par value and unlimited number of non-voting preferred shares.

Issued: Common Shares

	Number	Amount
<i>Balance at March 31, 2005</i>	20,511,011	4,236,571
Warrants exercised	1,960,667	686,233
Effect of future income taxes on flow-through shares expenditures		(93,576)
Agent options exercised	571,066	171,320
<i>Balance at June 30, 2005</i>	23,042,744	\$5,000,548
Effect of future income taxes on flow-through shares expenditures		54,300
Private placement	1,160,000	406,000
Share issuance cost		(1,600)
<i>Balance at September 30, 2005</i>	24,202,744	\$5,459,248
Flow-through Share Private placement	1,500,000	1,050,000
Effect of future income taxes on share issue costs		44,624
Effect of future income taxes on flow-through shares expenditures		(57,326)
Share issuance cost		(5,750)
<i>Balance at December 31, 2005</i>	25,702,744	\$ 6,490,796

During the period, 1,500,000 flow-through common shares were issued by private placement. The common shares were placed at a price of \$0.70 per share in exchange for cash of \$1,050,000. The effect on future income taxes relating to the private placement will be reflected when renounced in February 2006.

Escrow shares

The 1,650,000 Founders shares are held in escrow and will be released as to 10% thereof following acceptance of the Qualifying Transaction, and as to 15% thereof on each of the 6th, 12th, 18th, 24th, 30th and 36th month anniversary dates following the initial release date of November, 2003. At December 31, 2005, 495,000 (March 31, 2005 - 990,000) shares were held in escrow.

The 4,250,000 shares issued pursuant to the Qualifying Transaction to a Officer and two Directors of the Company are subject to an Escrow Agreement dated November 11, 2003 and will be released as to 10% thereof following acceptance of the Qualifying Transaction (November 27, 2003) and as to 15% thereof on each of the 6th, 12th, 18th, 24th, 30th and 36th month anniversary dates following the initial release date of November 27, 2003. At December 31, 2005, 1,275,002 (March 31, 2005 – 2,550,000) shares were held in escrow.

A private placement to two key employees for 1,160,000 common shares was completed September 30th 2005. These shares are subject to an escrow agreement releasing 10% thereof upon closing and 15% on each of the 6th, 12th, 18th, 24th, 30th and 36th month anniversary dates following the initial release date. At December 31, 2005, 1,044,000 shares were held in escrow.

Stock options

The Company has established a stock option plan whereby options may be granted to the Company's directors, officers and employees for up to 10% of the Company's issued and outstanding common shares. The exercise price of each option may equal the market price of the Company's common shares on the date of the grant less applicable discounts. The vesting and expiry terms are set by the Company's board of directors.

Stock option transactions were as follows:

	Number of Options	Price Range	Weighted/Average Exercise Price	Expiry Date
<i>Balance, March 31, 2005</i>	1,880,500	0.15 - 0.35	0.19	2006 - 2009
Options expired	(12,000)	0.15	0.15	2008
Options granted	10,000	0.35	0.35	2010
<i>Balance, June 30, 2005</i>	1,878,500	0.15 - 0.35	0.19	2006 – 2010
Options granted	250,000	0.40	0.40	2010
<i>Balance, September 30, 2005</i>	2,128,500	0.15 - 0.40	0.23	2006 – 2010
Options granted	<i>nil</i>			
<i>Balance, December 31, 2005</i>	2,128,500	0.15 - 0.40	0.23	2006 – 2010

As at December 31, 2005, the balance of vested options exercisable was 1,621,500 (March 31, 2005 1,037,000) and having a weighted average exercise price of \$0.23 (March 31, 2005 \$0.19).

7. Contributed Surplus

	Three months ended December 31, 2005	Three months ended December 31, 2004	Nine months ended December 31, 2005	Nine months Ended December 31, 2004
<i>Balance, beginning of period</i>	334,974	112,071	290,450	53,024
Stock-based compensation (Note 8)	22,262	16,802	66,786	75,849
<i>Balance, end of period</i>	\$357,236	\$128,873	\$357,236	\$128,873

8. Stock-based compensation

The Company accounts for stock options granted after December 31, 2002 to directors and officers using the "fair value method", whereby stock-based compensation is recorded equal to the fair value of the options granted. For three months ended December 31, 2005 \$18,091 (December 31, 2004 - \$1,680) has been recorded as a stock-based compensation expense and \$4,171 (December 31, 2004 - \$15,122) has been capitalized, based on 418,500 (2004 - 704,000) options vesting during the year. The total of \$22,262 (2004 - \$16,802) has been offset to contributed surplus. As at December 31, 2005, the unamortized fair value of the non-vested options is \$154,787 (December 31, 2004 - \$162,289).

The fair value of options granted was estimated at the date of grant using the Black-Scholes option-pricing model with the following weighted average assumptions:

	2005
Risk free interest rate (%)	4.0% to 4.25%
Expected volatility (%)	100%
Expected life (years)	5
Expected dividend yield (%)	0%

Option pricing models require the input of highly subjective assumptions including the expected price volatility. Changes in the subjective input assumptions can materially affect the fair value estimate, and therefore, the existing models do not necessarily provide a reliable measure of the fair value of the Company's stock options.

9. Related party transactions

During the three-month period, the following amounts were paid to companies in which directors or officers of the Company are either principals or owners of a significant interest in the related company:

	Property and equipment	G&A	Quarter ended December 31, 2005	Quarter ended December 31, 2004
Land	-	-	-	19,965
Legal	-	-	-	3,820
Geological & Geophysical	18,001	2,762	20,763	22,505
Accounting	-	-	-	22,448
General and administrative (G&A)	-	-	-	30,593
	\$18,001	\$2,762	\$20,763	\$99,331

The above transactions were conducted in the normal course of operations and measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

10. Contingency

The Company and Spitfire Exploration Ltd. have been named as Defendants in a Statement of Claim filed. The claims by the Plaintiffs relate to assets acquired in December 2001, by the Company and Spitfire Exploration. Various forms of relief are being claimed including damages in the sum of \$1,000,000, an accounting for all production on certain lands, certain special and punitive damages in the sum of \$50,000 each, costs, and interest. The claims have been defended completely as having no merit and a Counterclaim has been issued for amounts expended by the Company for costs relating to the joint assets, loss of profits and revenues for the lands, punitive damages, interest and legal costs. The Company and Spitfire Exploration are undertaking appropriate litigation steps.

11. Subsequent events

The Company expanded the revolving operating demand loan from \$1,500,000 to \$3,000,000 on January 17, 2006. The new facility bears interest at prime plus 0.50%. The existing development/acquisition line of credit of \$500,000 was also renewed, bearing interest prime plus 1.00%. These facilities are secured by a general assignment of book debts and a \$5,000,000 debenture with a floating charge over all assets of the Company.

The Company granted a total of 221,000 options to eligible participants pursuant to its Shareholder approved stock option plan. All of the options are exercisable for a five-year term at \$0.47 per common share and vest over three years from the date of grant. Of the options granted, 100,000 are to directors with the remaining grants to employees and consultants. Following the grant, 220,774 common shares remain reserved for issuance pursuant to Spitfire's stock option plan.

12. Comparative figures

The comparative figures for the three and nine months ended December 31, 2005 were unaudited and prepared by management with the approval of the Audit Committee. The Company's external auditors did not review the comparative figures.