

SPITFIRE ENERGY LTD.
Interim Financial Statements
September 30, 2006
Unaudited

Spitfire Energy Ltd.
Balance Sheets

September 30, 2006 *March 31, 2006*
Unaudited *Audited*

	September 30, 2006	<i>March 31, 2006</i>
	Unaudited	<i>Audited</i>
Assets		
Current		
Cash	-	562,043
Accounts receivable and deposits	667,690	763,372
Notes receivable <i>(Note 6 (i) (ii))</i>	362,200	237,200
	1,029,890	1,562,615
Property and equipment <i>(Note 3)</i>	14,495,638	9,119,616
	15,525,528	10,682,231
Liabilities		
Current		
Bank indebtedness	399,247	-
Accounts payable and accrued liabilities	1,904,042	3,935,431
Short-term debt <i>(Note 4)</i>	5,875,000	-
	8,178,289	3,935,431
Future income taxes	937,636	883,352
Asset retirement obligations <i>(Note 5)</i>	306,348	168,169
	9,422,273	4,986,952
Shareholders' Equity		
Share capital <i>(Note 6)</i>	6,526,035	6,234,893
Contributed surplus <i>(Note 7)</i>	454,967	368,894
Deficit	(877,747)	(908,508)
	6,103,255	5,695,279
	15,525,528	10,682,231

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

"Massimiliano Fantuz" (signed)
Massimiliano Fantuz, Director

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

	<i>Three months ended September 30</i>		<i>Six months ended September 30</i>	
	<i>Unaudited</i>		<i>Unaudited</i>	
	2006	2005	2006	2005
Revenue				
Oil and gas revenue	1,120,547	759,261	2,383,594	1,150,177
Royalties	(176,431)	(174,196)	(455,927)	(253,025)
Interest income	1,310	315	1,971	615
	945,426	585,380	1,929,638	897,767
Expenses				
Operating	265,457	191,063	560,607	292,464
General and administration	245,008	181,210	425,064	286,775
Stock based compensation	37,416	110,891	127,904	128,982
Interest	84,329	3,096	106,958	6,347
Depletion, depreciation and accretion	314,351	111,580	624,060	176,640
	946,561	597,840	1,844,593	891,208
Net income (loss) for the period, before income taxes	(1,135)	(12,460)	85,045	6,559
Future tax (expense) recovery	46,893	739	(54,284)	(15,413)
Net income (loss)	45,758	(11,721)	30,761	(8,855)
Deficit, beginning of period	(923,505)	(852,916)	(908,508)	(855,782)
Deficit, end of period	(877,747)	(864,637)	(877,747)	(864,637)
Loss per Share				
Basic	(0.00)	(0.00)	(0.00)	(0.00)
Fully Diluted	(0.00)	(0.00)	(0.00)	(0.00)

Spitfire Energy Ltd.
Statement of Cash Flows

	<i>Three months ended September 30</i>		<i>Six months ended September 30</i>	
	<i>Unaudited</i>		<i>Unaudited</i>	
	2006	2005	2006	2005
Cash provided by (used for) the following activities				
Operating				
Net loss	45,758	(11,721)	30,761	(8,855)
Add items not requiring cash:				
Stock based compensation	37,416	110,891	127,904	128,982
Depletion, depreciation and accretion	314,351	111,580	624,060	176,640
Future tax expense (recovery)	(46,893)	(739)	54,284	15,413
	350,632	210,011	837,009	312,180
Net increase (decrease) in non-cash working capital balances (note 10)	(265,670)	(211,337)	(249,712)	217,583
	84,962	(1,326)	587,297	529,763
Investing				
Property & equipment expenditures	(2,133,437)	(213,219)	(3,846,073)	(1,074,543)
Property & equipment acquisitions	-	-	(2,000,000)	-
Change in non-cash investing working capital (note 10)	591,348	(63,649)	(1,685,994)	(488,601)
	(1,542,089)	(276,868)	(7,532,067)	(1,563,144)
Financing				
Proceeds on issue of common shares (note 6)	1,500	76,000	108,480	933,555
Share issuance cost	-	(1,600)	-	(1,600)
Advances of short-term debt, net	1,350,000	-	5,875,000	-
	1,351,500	74,400	5,983,480	931,955
Decrease in cash during the period	(105,627)	(203,794)	(961,290)	(101,426)
Cash (deficiency), beginning of period	(293,620)	292,269	562,043	189,901
Cash (deficiency), end of period	(399,247)	88,475	(399,247)	88,475
Supplemental cash flow information				
Interest Paid	84,329	3,096	106,958	6,347

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 financial statements for the year ended March 31, 2006. 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 financial statements for the year ended March 31, 2006.

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	Sept 30, 2006 Net book value	March 31, 2006 Net book value
Petroleum and natural gas properties	16,445,543	(2,017,461)	14,428,082	9,080,062
Computer and office equipment	104,329	(36,773)	67,556	39,554
	\$16,549,872	\$(2,054,234)	\$14,495,638	\$9,119,616

As at September 30, 2006, unproven properties with capitalized costs of \$3,532,035 were not subject to depletion. Comparatively, for the year ending March 31, 2006 unproven properties with capitalized costs of \$3,889,982 were not subject to depletion.

During the three-month period ending September 30, 2006 the Company capitalized \$76,653 (2005 - \$28,520) of Geological and Geophysical expenses and for the six-month period ending September 30, 2006, \$165,164 (2005 - \$59,002) was capitalized. During the three-month period ending September 30, 2006, the Company capitalized \$7,664 (2005 - \$4,171) of Stock-Based Compensation associated with Geological and Geophysical services and for the six-month period ending September 30, 2006, \$15,761 (2005 - \$8,342) was capitalized.

The Company capitalized nil (2005 - \$ 3,587) and settled \$5,763 (2005 - \$nil) of Asset Retirement Obligations during the three-month period ending September 30, 2006 and for the six-month period ending September 30, 2006 \$112,050 (2005 - \$3,587) was capitalized.

For the first quarter ending September 30, 2006, 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. Short-term debt

Credit facilities

The Company has available a revolving operating demand loan with a maximum available credit of \$6,600,000 (March 31, 2006 - \$3,000,000), bearing interest at prime plus 0.5% (March 31, 2006 – prime plus 0.75%) and a development or acquisition line of credit of \$2,000,000 (March 31, 2006 - \$500,000), bearing interest at prime plus 1.0% (March 31, 2006 – prime plus 1.25%). Both credit facilities are secured by a general assignment of book debts and a \$25,000,000 (March 31, 2006 – \$5,000,000) debenture with a floating charge over all assets of the Company. As at September 30, 2006 the amount drawn on the operating demand loan was \$4,825,000 (March 31, 2006 - \$nil) and the amount drawn on the development or acquisition line of credit was \$1,050,000 (March 31, 2006 - \$nil)

The revolving operating demand loan requires various covenants be maintained. At September 30, 2006, no default or event of default has occurred. The Company is compliant with the covenants outlined in the agreement.

5. Asset retirement obligations

	<i>Three months ended September 30, 2006</i>	<i>Six months ended June 30, 2006</i>	<i>Twelve months ended March 31, 2006</i>
<i>Balance, beginning of period</i>	289,208	168,169	138,421
Additional obligations	-	112,050	18,750
Obligation Settled	(5,723)	-	-
Accretion	22,863	26,129	10,998
<i>Balance, end of period</i>	\$306,348	\$306,348	\$168,169

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 \$1,153,000 (March 31, 2006 - \$764,654). The obligations have been discounted using a credit adjusted risk free rate of eight percent (March 31, 2006 – 8%) and an inflation rate of 2 percent per year (March 31, 2006 – 2%). 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, March 31, 2005</i>	20,511,011	4,236,571
Warrants exercised	1,960,667	686,233
Agent options exercised	571,066	171,320
Options exercised	102,000	18,400
Private placement (<i>i</i>)	1,160,000	406,000
Flow-through shares issued	1,500,000	1,050,000
Share issue costs		(8,504)
Effect of future income taxes on share issue costs		44,624
Effect of future income taxes on flow-through shares expenditures		(449,612)
Reversal of contributed surplus on exercised options		79,861
<i>Balance, March 31, 2006</i>	25,804,744	\$6,234,893
Private placement (<i>ii</i>)	350,000	287,000
Options exercised	3,000	980
<i>Balance, June 30, 2006</i>	26,157,744	\$6,522,873
Options exercised	10,000	1,500
Reversal of contributed surplus on exercised options		1,662
<i>Balance, September 30, 2006</i>	26,167,744	\$6,526,035

(*i*) On September 30th, 2005, the Company issued 1,160,000 common shares by private placement to two key employees. The common shares were placed at a price of \$0.27 per share in exchange for cash of \$76,000 and a note receivable of \$237,200. The market price at the time of the private placement agreement was \$0.35 per share. The fair value of \$406,000 of the common stock was recognized in Share Capital with the discount of \$92,800 being recorded as stock based compensation.

(*ii*) During the June 30th, 2006 quarter, 350,000 common shares were issued by private placement to one key employee. The common shares were placed at a price of \$0.66 per share in exchange for cash of \$106,000 and a note receivable of \$125,000. The market price at the time of the private placement agreement was \$0.82 per share. The fair value of \$287,000 of the common stock was recognized in Share Capital with the discount of \$56,000 being recorded during the three month period ended June 30, 2006 as stock based compensation.

6. Share capital (continued)

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 September 30, 2006, 247,500 (March 31, 2006 – 495,000) 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 September 30, 2006, 637,501 (March 31, 2006 – 1,275,002) 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 Company's board of directors sets the vesting and expiry terms. The following summarizes information with respect to stock options outstanding:

	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 granted	501,000	0.35 – 0.74	0.44	2010 – 2011
Options exercised	(107,000)	0.15 – 0.20	0.18	2007 – 2009
Options expired	(7,000)	0.15	0.15	2006
<i>Balance, March 31, 2006</i>	2,267,500	0.15 - 0.74	0.25	2006 – 2011
Options granted	310,000	0.82 – 1.00	0.85	2011
Options exercised	(3,000)	0.35	0.35	2010
Options expired	(7,000)	0.35	0.35	2010
<i>Balance, June 30, 2006</i>	2,567,500	0.15 – 1.00	0.32	2006 – 2011
Options exercised	(10,000)	0.15	0.15	2009
Balance, September 30, 2006	2,557,500	0.15 – 1.00	0.32	2006 – 2011

As at September 30, 2006, the balance of vested options exercisable was 1,805,500 (March 31, 2006 - 1,647,500), and had a weighted average exercise price of \$0.25 (March 31, 2006 - \$0.12).

7. Contributed Surplus

	<i>Three months ended September 30, 2006</i>	<i>Six months ended September 30, 2006</i>	<i>Twelve months ended March 31, 2006</i>
<i>Balance, beginning of period</i>	411,479	368,894	290,450
Stock Based Compensation (Note 8)	45,080	87,665	158,305
Fair value of options excersised	(1,592)	(1,592)	(12,138)
Agent options exercised	-	-	(67,723)
<i>Balance, end of period</i>	\$454,967	\$454,967	\$368,894

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.

During the three months ended September 30, 2006, \$37,416 has been recorded as stock-based compensation expense and \$7,664 has been capitalized, based on 547,500 options vesting during the year. The total of \$45,080 has been offset to contributed surplus.

During the six months ended September 30, 2006, \$71,905 has been recorded as stock-based compensation expense and \$15,760 has been capitalized, based on 547,500 options vesting during the year. The total of \$87,665 has been offset to contributed surplus.

As at September 30, 2006, the unamortized fair value of the non-vested options is \$318,072.

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:

	2006
Risk free interest rate (%)	4.0% to 4.25%
Expected volatility (%)	85%-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 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:

Suggest to disclose the 6 month totals as well

	Property and equipment	G&A	Three months ended September 30, 2006	Three months ended September 30, 2005
Land	-	-	-	25,858
Legal	-	5,643	5,643	2,987
Geological & Geophysical	27,000	3,000	30,000	20,976
General and administrative (G&A)	-	-	-	21,853
	\$27,000	\$8,643	\$35,643	\$71,674

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. Supplemental Cash Flow Information

Changes in non-cash working capital, excluding bank debt:

	<i>Three months ended September 30, 2006</i>	<i>Three months ended September 30, 2005</i>	<i>Six months ended September 30, 2006</i>	<i>Six months ended September 30, 2005</i>
Accounts receivable and deposits	51,304	(132,503)	95,683	(173,702)
Accounts payable and accruals	274,374	(142,483)	(2,031,389)	(97,316)
<i>Change in non-cash working capital</i>	\$325,678	(\$274,986)	(\$1,935,706)	(\$271,018)
Relating to:				
Operating Activities	(265,670)	(211,337)	(249,712)	217,583
Investing Activities	591,348	(63,649)	(1,685,994)	(488,601)
<i>Change in non-cash working capital</i>	\$325,678	(\$274,986)	(\$1,935,706)	(\$271,018)