

## MANAGEMENT'S REPORT

To the Shareholders of Vero Energy Inc.

The accompanying financial statements of Vero Energy Inc. and all of the information in this Annual Report are the responsibility of management and have been approved by the Board of Directors.

The financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles. When alternative accounting methods exist, management has chosen those methods it deems most appropriate in the circumstances. Financial statements are not precise since they include certain amounts based on estimates and judgments. Management has determined such amounts on a reasonable basis in order to ensure that the financial statements are presented fairly, in all material respects. The financial information contained elsewhere in this report has been reviewed to ensure consistency with the financial statements.

Management has established systems of internal controls, which are designed to provide reasonable assurance that assets are safeguarded from loss or unauthorized use and to produce reliable accounting records for the preparation of financial information.

The Board of Directors is responsible for ensuring that management fulfills its responsibilities for financial reporting and internal controls. It exercises its responsibilities primarily through the Audit Committee, which is comprised of independent, non-management directors. The Audit Committee has reviewed the financial statements with management and the auditors. This has been reported to the Board of Directors which has approved the financial statements.

The financial statements have been audited by PricewaterhouseCoopers LLP, the external auditors, in accordance with auditing standards generally accepted in Canada on behalf of the shareholders.

("Signed")

Douglas J. Bartole  
President and Chief Executive Officer

("Signed")

Gerald N. Gilewicz, C.M.A.  
Vice-President, Finance and  
Chief Financial Officer

Calgary, Canada  
March 12, 2007

March 8, 2007

**Auditors' Report**

**To the Shareholders of  
Vero Energy Inc.**

We have audited the consolidated balance sheets of **Vero Energy Inc.** as at December 31, 2006 and 2005 and the consolidated statements of operations and retained earnings and cash flows for the year ended December 31, 2006 and the period September 23, 2005 to 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, 2006 and 2005 and the results of its operations and its cash flows for the year ended December 31, 2006 and the period September 23, 2005 to December 31, 2005 in accordance with Canadian generally accepted accounting principles.

*PricewaterhouseCoopers LLP*

Chartered Accountants  
Calgary, AB

**VERO ENERGY INC.****Consolidated Statements of Operations and Retained Earnings****(thousands, except per share data)**

	<b>For the year ended December 31, 2006</b>	<b>September 23 to December 31, 2005</b>
<b>REVENUE</b>		
Production revenue	43,948	4,212
Royalties	(10,749)	(1,083)
Interest	94	-
	<u>33,293</u>	<u>3,129</u>
<b>EXPENSES</b>		
Operating	5,564	401
Transportation	734	90
General and administrative	1,750	439
Stock-based compensation (Note 8(f))	2,056	103
Interest and bank charges	1,434	11
Depletion, depreciation and accretion	22,125	876
	<u>33,663</u>	<u>1,920</u>
<b>(LOSS) INCOME BEFORE INCOME TAXES</b>	<b>(370)</b>	<b>1,209</b>
<b>INCOME TAX (RECOVERY) EXPENSE (Note 7)</b>		
Current	(292)	292
Future	(1,113)	252
	<u>(1,405)</u>	<u>544</u>
<b>NET EARNINGS</b>	<b>1,035</b>	<b>665</b>
<b>RETAINED EARNINGS, BEGINNING OF PERIOD</b>	<b>665</b>	<b>-</b>
	<u>1,700</u>	<u>665</u>
<b>RETAINED EARNINGS, END OF PERIOD</b>	<b>1,700</b>	<b>665</b>
<b>NET EARNINGS PER SHARE (Note 11)</b>		
Basic	<u>0.04</u>	<u>0.07</u>
Diluted	<u>0.04</u>	<u>0.07</u>

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**VERO ENERGY INC.****Consolidated Balance Sheets****As at December 31, 2006****(thousands)**

	<u>2006</u>	<u>2005</u>
<b>ASSETS</b>		
<b>CURRENT</b>		
Cash and cash equivalents	-	12,523
Accounts receivable	<b>15,308</b>	6,013
Prepaid expenses and deposits	<b>1,089</b>	155
	<u><b>16,397</b></u>	<u>18,692</u>
Property and equipment (Note 4)	<b>135,427</b>	34,207
Future income tax benefit (Note 7)	-	232
Goodwill (Note 3)	<b>15,034</b>	
	<u><b>166,858</b></u>	<u>53,131</u>
<b>LIABILITIES</b>		
<b>CURRENT</b>		
Accounts payable and accrued liabilities	<b>30,286</b>	9,988
Taxes payable	-	292
Bank debt (Note 5)	<b>35,651</b>	-
	<u><b>65,937</b></u>	<u>10,280</u>
Asset retirement obligations (Note 6)	<b>1,785</b>	380
Future income taxes (Note 7)	<b>10,567</b>	-
	<u><b>78,289</b></u>	<u>10,660</u>
<b>SHAREHOLDERS' EQUITY</b>		
Share capital (Note 8)	<b>84,710</b>	41,703
Contributed surplus (Note 9)	<b>2,159</b>	103
Retained Earnings	<b>1,700</b>	665
	<u><b>88,569</b></u>	<u>42,471</u>
	<u><b>166,858</b></u>	<u>53,131</u>
Commitments (Note 12)		

**APPROVED ON BEHALF OF THE BOARD:**

**("Signed")**  
**Paul R. Baay**  
*Director*

**("Signed")**  
**Douglas J. Bartole**  
*Director*

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## VERO ENERGY INC.

### Consolidated Statements of Cash Flows (thousands)

	For the year ended December 31, 2006	September 23 to December 31, 2005
<b>CASH FLOWS RELATED TO THE FOLLOWING ACTIVITIES:</b>		
<b>OPERATING</b>		
Net earnings	1,035	665
Adjustments for:		
Depletion, depreciation and accretion	22,125	876
Future income taxes	(1,113)	252
Stock-based compensation	2,056	103
	<u>24,103</u>	<u>1,896</u>
Changes in non-cash working capital (Note 13(a))	(7,883)	(4,037)
	<u>16,220</u>	<u>(2,141)</u>
<b>FINANCING</b>		
Increase in bank debt	17,131	-
Proceeds from private placement, net of share issue costs	12,061	6,052
Proceeds from warrant exercises	-	14,338
	<u>29,192</u>	<u>20,390</u>
<b>INVESTING</b>		
Corporate acquisition (Note 3)	(18,887)	-
Additions to petroleum and natural gas properties	(57,026)	(13,847)
Disposals of petroleum and natural gas properties	300	-
Additions to administrative assets	(141)	(27)
Changes in non-cash working capital (Note 13(a))	17,819	8,148
	<u>(57,935)</u>	<u>(5,726)</u>
<b>NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS</b>	<b>(12,523)</b>	<b>12,523</b>
<b>CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD</b>	<b>12,523</b>	<b>-</b>
<b>CASH AND CASH EQUIVALENTS, END OF PERIOD</b>	<b>-</b>	<b>12,523</b>

Supplementary cash flow information (Note 13(b))

**Notes to the Financial Statements****For the Year Ended December 31, 2006****and the period from September 23 to December 31, 2005****(thousands, except per share data)****1. NATURE OF OPERATIONS, ORGANIZATION AND BASIS OF PRESENTATION**

Vero Energy Inc. (“Vero” or the “Company”) was incorporated on September 23, 2005 under the laws of the Business Corporations Act (Alberta) and its primary business is the acquisition, exploration, development and production of natural gas, natural gas liquids and crude oil in Alberta. The Company commenced oil and gas operations on November 2, 2005 after the closing of a Plan of Arrangement between Vero, True Energy Inc. (“True”), and TKE Energy Trust (“TKE”). Vero is a public company and commenced trading on the Toronto Stock Exchange on November 7, 2005. On November 2, 2005, certain oil and gas properties of True were transferred to Vero at a total cost of \$27,365. In consideration for the transfer Vero paid True \$6,052 in cash and also issued 9,836 common shares (Note 8) to the shareholders of True. As the shareholders of True were the controlling shareholder group of Vero at the time of the transfer, the assets and liabilities of Vero were accounted for based on the carrying value in True.

**Net assets acquired**

Petroleum and natural gas properties and facilities (carrying value)	<b>27,198</b>
Future tax asset	<b>485</b>
Asset retirement obligation	<b>(318)</b>
	<b>27,365</b>

**Consideration given**

Cash payment	<b>6,052</b>
Shares	<b>21,313</b>
	<b>27,365</b>

On February 24, 2006 the Company acquired all of the issued and outstanding shares of Ledge Resources Limited, a private Alberta oil and gas exploration and development company (Note 3).

The Company’s consolidated financial statements for the year ended December 31, 2006 have been prepared on a going concern basis, which contemplates the realization of assets and the settlement of liabilities and commitments in the normal course of business.

These consolidated financial statements include the accounts of Vero Energy Inc. and its wholly-owned subsidiaries and are presented in accordance with Canadian generally accepted accounting principles. Effective January 1, 2007 Vero and its wholly-owned subsidiaries were amalgamated under the Alberta Business Corporations Act and continued under the name Vero Energy Inc.

**Notes to the Financial Statements**  
**For the Year Ended December 31, 2006**  
**and the period from September 23 to December 31, 2005**  
**(thousands, except per share data)**

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**2. SIGNIFICANT ACCOUNTING POLICIES**

The consolidated financial statements of the Company have been prepared by management in accordance with Canadian generally accepted accounting principles. These consolidated financial statements have, in management's opinion, been properly prepared using careful judgement with reasonable limits of materiality and within the framework of the significant accounting policies summarized below:

*a) Financial instruments*

Financial instruments consist primarily of cash and cash equivalents, accounts receivable, accounts payable, accrued liabilities and bank indebtedness. It is management's opinion that the Company is not exposed to significant interest, currency or credit risks arising from these financial instruments. There are no significant differences between the carrying value of these financial instruments and their estimated fair value.

*b) Cash and cash equivalents*

The Company considers deposits in banks, certificates of deposit and short-term investments with original maturities of three months or less as cash and cash equivalents. Bank borrowings are considered to be financing activities.

*c) Petroleum and natural gas properties and facilities*

The Company follows the full cost method of accounting for petroleum and natural gas operations, whereby all costs relating to the exploration and development of petroleum and natural gas reserves are capitalized on a country-by-country cost centre basis. Such costs include land acquisition costs, costs of drilling both productive and non-productive wells, well equipment, flow-line and facility costs, geological and geophysical expenses, asset retirement costs, and overhead expenses directly related to exploration and development activities.

Proceeds from the sale of petroleum and natural gas properties are applied against capitalized costs, with no gain or loss recognized, unless such a sale would result in a greater than 20% change in the depletion and depreciation rate.

**Notes to the Financial Statements****For the Year Ended December 31, 2006****and the period from September 23 to December 31, 2005****(thousands, except per share data)**

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**2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)***d) Depletion and depreciation*

Petroleum and natural gas properties and facilities costs, together with estimated future capital costs associated with proved reserves, less estimated salvage values and costs related to unproven properties, are depleted using the unit-of-production method based on estimated proven reserves of petroleum and natural gas before the deduction of royalties as determined by independent petroleum engineers. For purposes of this calculation proven natural gas reserves and production are converted to equivalent volumes of crude petroleum based on the approximate energy equivalent ratio of six thousand cubic feet of natural gas to one barrel of crude oil. Costs of acquiring and evaluating unproved properties are initially excluded from the calculation and are periodically assessed for impairment. When proved reserves are assigned or the property is considered to be impaired, the cost of the property or the amount of the impairment is added to costs subject to depletion calculations.

Administrative assets are carried at cost and depreciated on a declining basis at an annual rate of 20% to 30% depending on the asset category.

*e) Ceiling Test*

The Company at least annually assesses the carrying value of its oil and gas properties to determine if impairment has occurred. The Company applies a two-stage ceiling test to capitalized costs to ensure that such costs do not exceed the undiscounted future cash flows from production of proved reserves. Undiscounted future cash flows are calculated based on an independent petroleum engineers estimate of forward indexed prices applied to estimated production of proved reserves plus anticipated proceeds from the sale of undeveloped properties, less estimated future operating costs, royalties net of applicable tax credits, future capital development costs and abandonment costs. When the carrying amount of a cost center is not recoverable the second stage of the process will determine the impairment whereby the cost center would be written down to its fair value. The second stage requires the calculation of discounted cash flows from proved plus probable reserves using a risk-free interest rate plus the cost of undeveloped land, net of any impairment. The fair value is estimated using generally accepted present value techniques, which incorporate risk and other uncertainties when determining expected cash flows.

**Notes to the Financial Statements**  
**For the Year Ended December 31, 2006**  
**and the period from September 23 to December 31, 2005**  
**(thousands, except per share data)**

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**2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

*f) Goodwill*

Goodwill represents the excess of the purchase price of an acquired business over the fair value of the net identifiable assets received. Goodwill is stated at cost less impairment and is not amortized. Goodwill is assessed for impairment annually at year-end or more frequently if events or changes in circumstances indicate that the asset may be impaired. To assess impairment, the fair value of the reporting unit is determined and compared to the carrying value of the reporting unit. If the fair value is less than the carrying value, then a second test is performed to determine the amount of the impairment. The amount of the impairment is determined by deducting the fair value of the reporting unit's assets and liabilities from the fair value of the reporting unit to determine the implied fair value of goodwill and comparing that amount to the book value of the reporting unit's goodwill. Any excess of the book value of goodwill over the implied fair value of goodwill is the impaired amount. Impairment is charged to income in the period in which it occurs.

*g) Asset retirement obligations*

The fair value of obligations associated with the retirement, removal and site restoration of long-lived assets are recorded in the period in which the liability is incurred. The obligations recognized are estimates of statutory, contractual or legal obligations that the Company will reasonably be expected to incur and then discounted to their present value using the Company's credit adjusted risk-free interest rate. The corresponding amount increases the carrying amount of the related asset. The liability is accreted over time for changes in the fair value of the liability through charges to accretion expense. The provision will be revised for the effect of any changes to timing related to cash flow or undiscounted abandonment costs. The costs capitalized to the related assets are amortized to earnings in a manner consistent with the depreciation and depletion of the underlying asset. Actual costs incurred upon settlement of the retirement obligation are charged against the obligation to the extent of the liability recorded.

*h) Future income taxes*

The Company follows the liability method of accounting for income taxes. Under this method the Company records future income tax assets and liabilities based on "temporary differences" (differences between the accounting basis and the tax basis of the assets and liabilities) measured using the substantively enacted tax rates and laws expected to apply when these differences reverse. The effect of a change in substantively enacted income tax rates on future income tax assets and liabilities is recognized in income in the period that the change occurs.

**Notes to the Financial Statements**  
**For the Year Ended December 31, 2006**  
**and the period from September 23 to December 31, 2005**  
**(thousands, except per share data)**

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**2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

*i) Revenue recognition*

Revenue from the sale of natural gas, natural gas liquids and crude oil is recognized based on volumes delivered at contractual delivery points when title passes from the Company to its customers. Costs associated with the operating of wells and facilities, delivery of the commodity, transportation and production-based royalty expenses, are recognized in the same period in which the related revenue is earned and recorded. Royalty tax credits are netted against oil, gas and liquids royalties. Transportation costs are recorded separately.

*j) Stock-based compensation plan*

The Company has a stock based compensation plan enabling officers, directors and employees to purchase common shares at exercise prices equal to the market price on the date the option is granted. Stock option awards are accounted for based on the fair value method of accounting (Note 8(f)). Under this method, stock-based compensation is recorded as an expense over the expected life of the option, with a corresponding increase in contributed surplus. Stock-based compensation expense is based on the estimated fair value of the related stock option at the time of the grant using the Black-Scholes option model. When stock options are exercised, the consideration paid to the Company, along with amounts previously credited to contributed surplus, is credited to share capital. Forfeitures are accounted for as they occur and result in a reduction of compensation expense if the options have not vested.

*k) Measurement uncertainty*

The preparation of the consolidated financial statements 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 consolidated financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results may differ from these estimates.

Recorded amounts for depletion and depreciation of petroleum and natural gas properties and equipment are based on estimates. The ceiling test and impairment calculations are based on estimates of oil and gas reserves, future costs required to develop those reserves and the fair value of unproved properties. By their nature, these estimates are subject to measurement uncertainty and the effect on the financial statements of changes of estimates in future periods could be significant.

**Notes to the Financial Statements**  
**For the Year Ended December 31, 2006**  
**and the period from September 23 to December 31, 2005**  
**(thousands, except per share data)**

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**2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

*k) Measurement uncertainty (continued)*

The value of the asset retirement obligations was based on Vero's net ownership interests in all wells and facilities and depends on estimates of current market interest rates and future restoration and reclamation expenditures. By their nature, these estimates are subject to measurement uncertainty and the effect on the financial statements of changes of estimates in future periods could be significant.

The calculation of future income tax is based on assumptions, which are subject to uncertainty as to timing as well as the tax rates at which temporary differences are expected to reverse.

The Black-Scholes option valuation model was developed for use in estimating the fair value of options, which were fully tradable with no vesting restrictions. This option valuation model requires the input of highly subjective assumptions including the expected stock price volatility. Because the Company's stock options have characteristics significantly different from those of traded options and because changes in the subjective input assumptions can materially affect the calculated fair value, such value is subject to measurement uncertainty.

*l) Joint venture activities*

A significant portion of the Company's exploration, development and production activities are conducted with joint venture partners. These consolidated financial statements reflect only the Company's proportionate interest in such activities.

*m) Per share amounts*

Basic per share amounts are calculated using the weighted average number of shares outstanding during the period. Diluted per share amounts reflect the exercise or conversion of potentially dilutive securities or other contracts to issue shares at the later of the grant of such securities or the beginning of the period. The Company computes diluted earnings per share based on the treasury-stock method to determine the dilutive effect of securities or other contracts. This method assumes that any proceeds obtained on the exercise of outstanding, in-the-money stock options, plus unrecognized stock compensation costs, would be used to purchase common shares of the Company at their average market price during the period.

**Notes to the Financial Statements****For the Year Ended December 31, 2006****and the period from September 23 to December 31, 2005****(thousands, except per share data)****2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)***n) Hedging*

The Company may periodically enter into forward contracts to reduce its exposure to price fluctuations on a portion of its oil and natural gas production. The contracts are not used for speculative trading purposes. Payments or receipts on financial instruments that are designated and effective as hedges are recognized in income concurrently with the hedged transaction. Any financial instrument that does not constitute a hedge is recorded at fair value in the balance sheet with any gain or loss reflected in the statement of operations. Gains or losses on physical and qualifying hedge contracts are reported as adjustments to commodity revenues in the related production month. At December 31, 2006 the Company did not have any hedges outstanding.

**3. ACQUISITION OF LEDGE RESOURCES LIMITED**

Effective February 24, 2006 Vero acquired all of the outstanding common shares of Ledge Resources Limited ("Ledge"). Ledge shareholders received \$1.90 and 0.49473 Vero common shares for each Ledge share held. A total of 4,754,945 Vero shares were issued. The price ascribed to the common shares of \$6.44 was based on the trading prices of Vero common shares on the five days prior, the day of, and the five days following the announcement of the purchase. The operating results and corresponding cash flow and earnings related to the acquisition were included in the Company's consolidated financial statements effective February 25, 2006. The acquisition was accounted for using the purchase method and the purchase price was allocated based on fair values as follows:

<b>Consideration paid:</b>	
Cash paid to Ledge shareholders	18,261
Issuance of 4,754,945 common shares	30,622
Transaction costs	626
	<b>49,509</b>
<b>Allocation of purchase price:</b>	
Current assets	3,837
Current liabilities	(3,678)
Debt assumed	(18,520)
	<b>(18,361)</b>
Property, plant and equipment	65,738
Goodwill	15,034
Asset retirement obligations	(666)
Future income taxes	(12,236)
	<b>49,509</b>

**Notes to the Financial Statements****For the Year Ended December 31, 2006****and the period from September 23 to December 31, 2005****(thousands, except per share data)****3. ACQUISITION OF LEDGE RESOURCES LIMITED (CONTINUED)**

The purchase equation was adjusted at December 31, 2006 from the initial calculation to reflect revised estimates for tax information regarding expected temporary difference reversals. As a result, the future tax liability was increased by \$231 and goodwill was increased by a corresponding amount.

**4. PROPERTY AND EQUIPMENT**

	<b>December 31, 2006</b>		
	Cost	Accumulated Depletion and Depreciation	Net Book Value
Petroleum and natural gas properties and facilities	158,150	(22,846)	<b>135,304</b>
Administrative assets	169	(46)	<b>123</b>
	<u>158,319</u>	<u>(22,892)</u>	<u><b>135,427</b></u>
	<b>December 31, 2005</b>		
	Cost	Accumulated Depletion and Depreciation	Net Book Value
Petroleum and natural gas properties and facilities	35,050	(870)	34,180
Administrative assets	28	(1)	27
	<u>35,078</u>	<u>(871)</u>	<u>34,207</u>

Costs of acquiring unproved properties and salvage values in the aggregate of \$12,157 were excluded from the depletion calculation as at December 31, 2006 (2005 - \$5,090). Management performed an impairment test and determined that the carrying values of unproved properties were not impaired as at December 31, 2006. Future development costs on proved undeveloped reserves of \$4,846 (2005 - \$6,469) are included in the depletion calculation.

During 2006, the Company capitalized \$322 (2005 - \$36) in salaries and wages directly related to exploration and development activities.

**Notes to the Financial Statements****For the Year Ended December 31, 2006****and the period from September 23 to December 31, 2005****(thousands, except per share data)****4. PROPERTY AND EQUIPMENT (continued)**

The Company performed a ceiling test calculation as of December 31, 2006. The table below summarizes the benchmark prices for the next eleven years used by the external engineering firm in preparing the Company's reserve report. No write-down was required for the year ended December 31, 2006 based on the expected realized future commodity prices.

	WTI Cushing Oklahoma (\$US/bbl)	Edmonton Par 40 d API (\$Cdn/bbl)	Alberta AECO-C (\$Cdn/mmbtu)	Natural Gas Liquids (Pentanes) (\$Cdn/bbl)
2007	65.73	74.10	7.72	75.88
2008	68.82	77.62	8.59	79.49
2009	62.42	70.25	7.74	71.94
2010	58.37	65.56	7.55	67.14
2011	55.20	61.90	7.72	63.40
2012	56.31	63.15	7.85	64.67
2013	57.43	64.42	7.99	65.98
2014	58.58	65.72	8.12	67.30
2015	59.75	67.04	8.26	68.66
2016	60.95	68.39	8.40	70.04
2017	62.17	69.76	8.54	71.45

The annual escalation rate used after 2017 is 2.0%.

**5. BANK DEBT**

The Company has a \$45,000 (2005 - \$7,000) revolving, demand credit facility with a Canadian Chartered Bank. The authorized limit is subject to an annual review and re-determination of the Company's borrowing base by the bank. The facility is secured with a \$75,000 floating charge debenture over all of the assets of the Company. The availability under this facility is subject to an annual review. The advances bear interest at bank prime.

**Notes to the Financial Statements****For the Year Ended December 31, 2006****and the period from September 23 to December 31, 2005****(thousands, except per share data)****6. ASSET RETIREMENT OBLIGATIONS**

The Company's asset retirement obligations result from ownership interests in petroleum and natural gas assets, including well sites, gathering systems, batteries and processing facilities. The Company estimates the total undiscounted amount of cash flows required to settle its asset retirement obligations at December 31, 2006 to be \$3,437 (2005 - \$880), which will be incurred at various times between 2007 and 2021. The fair value of the asset retirement obligations incurred in the period ended December 31, 2006 was calculated using a credit-adjusted risk free rate of 8.0% and an inflation factor of 2.0%. Settlement of the obligations will be funded from general corporate funds at the time of retirement or removal. As at December 31, 2006, no funds have been set aside to settle these obligations. Changes to asset retirement obligations during the period were as follows:

	2006	2005
Asset retirement obligations at beginning of period	380	-
Liabilities assumed on Plan of Arrangement	-	318
Liabilities acquired on corporate acquisition (Note 3)	666	-
Liabilities incurred during the period	522	57
Liabilities settled during the period	(11)	-
Change in estimated future cash flows	125	-
Accretion	103	5
Asset retirement obligations at end of period	<b>1,785</b>	380

**Notes to the Financial Statements****For the Year Ended December 31, 2006****and the period from September 23 to December 31, 2005****(thousands, except per share data)****7. INCOME TAXES**

The provision for income tax differs from the amounts that would have resulted from the combined federal and provincial rate had it been applied for the periods ended December 31, 2006 and 2005 as follows:

	<u>2006</u>	<u>2005</u>
(Loss) income before income taxes	<u>(370)</u>	<u>1,209</u>
Expected income tax (benefit) expense at the statutory rate of 34.5% (2005 – 37.6%)	(128)	455
Tax effect of non-deductible and non-taxable amounts related to:		
Non-deductible crown payments	1,183	272
Resource allowance	(913)	(186)
Non-deductible stock-based compensation expense	718	39
Alberta Royalty Tax Credit and Attributed Canadian Royalty Income	(376)	(36)
Change in tax rates	(1,600)	6
Reversal of prior year tax provision	(292)	-
Other	3	(6)
Total income taxes	<u>(1,405)</u>	<u>544</u>

The tax provision is comprised of:

	<u>2006</u>	<u>2005</u>
Current income taxes	(292)	292
Future income taxes	(1,113)	252
	<u>(1,405)</u>	<u>544</u>

The future income tax (liability) asset is comprised of the following:

	<u>2006</u>	<u>2005</u>
<b>Future Income Tax Benefit</b>		
Temporary differences relating to capital assets	-	78
Asset retirement obligations	518	128
Financing costs and other	339	-
Attributed Canadian Royalty Income	388	26
	<u>1,245</u>	<u>232</u>
<b>Future Income Liabilities</b>		
Temporary differences relating to capital assets	(11,812)	-
	<u>(10,567)</u>	<u>232</u>

**Notes to the Financial Statements**  
**For the Year Ended December 31, 2006**  
**and the period from September 23 to December 31, 2005**  
**(thousands, except per share data)**

**8. SHARE CAPITAL**

	Shares (000's)	Amount \$
Authorized		
Unlimited number of common shares		
Unlimited number of first preferred shares		
Issued		
<i>Common shares</i>		
<b>Balance September 23, 2005</b>	-	-
Shares issued pursuant to the Plan of Arrangement (a)	9,836	21,313
Private placement (c)	2,726	6,052
Conversion of warrants to common shares (b)	6,459	14,338
<b>Balance December 31, 2005</b>	19,021	41,703
Issuance of shares on corporate acquisition (d)	4,755	30,622
Private placement, net of share issue costs (c)	2,131	12,061
Adjustment for tax benefits from share issue costs	-	324
<b>Total share capital at December 31, 2006</b>	25,907	84,710

a) Plan of Arrangement

Pursuant to the Plan of Arrangement with True, 9,836 shares were issued in partial consideration for the conveyance of certain oil and gas assets (Note 1).

b) Conversion of warrants

Pursuant to the Plan of Arrangement on November 2, 2005 103,101 warrants were issued to the shareholders of True. The warrants were exercisable for a period of thirty days ending on December 2, 2005. Each warrant was exercisable into 0.0655 of a Vero common share at the price of \$2.22 per whole Vero common share. 98,606 warrants were exercised and 4,495 expired.

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**8. SHARE CAPITAL (continued)**

c) Private placements

On November 2, 2005, the Company closed two private placements. One was for the issuance of 2,252 common shares at a price of \$2.22 per share. The net proceeds of this issuance were \$5,000. The second private placement was for the issuance of 474 common shares at price of \$2.22. The net proceeds of this issuance were \$1,052.

On April 13, 2006 the Company closed a private placement for the issuance of 2,131 common shares at a price of \$6.10 per share. The net proceeds of the issuance of \$12,061 are comprised of gross proceeds of \$13,000 less expenses of the issue of \$939.

d) Acquisition of Ledge Resources Limited

On February 24, 2006 the Company acquired all of the outstanding shares of a private company. At closing, Vero issued 4,755 common shares at a deemed value of \$30,622 (Note 3).

e) Stock options

The Company has a stock option plan under which options to purchase common shares may be granted to officers, directors, employees and consultants. The Board has approved a policy of reserving up to 10% of the outstanding common shares for issuance to eligible participants. As at December 31, 2006 there were 2,591 shares reserved for issuance under the plan. All options awarded have a maximum term of five years and vest in equal one-third increments on each anniversary of the grant. As at December 31, 2006, the following stock options were outstanding:

	2006		2005	
	Stock Options	Weighted Average Exercise Price \$	Share Options	Weighted Average Exercise Price \$
Outstanding, beginning of year	1,600	4.87	-	-
Granted	721	5.74	1,600	4.87
Exercised	-	-	-	-
Cancelled	-	-	-	-
Outstanding, end of year	2,321	5.14	1,600	4.87
Exercisable, end of year	533		-	

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Exercise Price	Options Outstanding					
	December 31, 2006			December 31, 2005		
	Number of Options Outstanding	Weighted Average Exercise Price \$	Weighted Average Years to Expiry	Number of Options Outstanding	Weighted Average Exercise Price \$	Weighted Average Years to Expiry
\$4.87 - 5.35	1,856	4.91	4.0	1,600	4.87	4.9
\$6.00 - 6.31	465	6.08	4.4	-	-	-
	<b>2,321</b>	<b>5.14</b>	<b>4.1</b>	<b>1,600</b>	<b>4.87</b>	<b>4.9</b>

## f) Stock-based compensation

The Company accounts for its stock options granted to employees, officers, and directors using the fair value method. In accordance with the Company's incentive stock plan, these options have an exercise price equal to the fair value of the security at the date of grant. The fair value of each option granted is estimated on the date of grant using a modified Black-Scholes option-pricing model. The following assumptions have been used:

	2006	2005
Risk free rate (%)	4.2	3.9
Expected life (years)	5	5
Expected volatility (%)	39	25
Expected dividends	-	-

For the period ended December 31, 2006, 721 (2005 – 1,600) stock options granted to employees, officers and directors were outstanding. \$2,056 (2005 - \$103) was recorded as stock compensation expense with respect to the options with a corresponding credit to contributed surplus (Note 9). The option grant during the period had a weighted average fair value expense attributed to them of \$2.32 (2005 - \$1.48) per share.

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**9. CONTRIBUTED SURPLUS**

The following table reconciles the Company's contributed surplus:

	<u>2006</u>	<u>2005</u>
Balance at beginning of period	<b>103</b>	-
Stock-based compensation expense	<b>2,056</b>	103
Balance at end of period	<b>2,159</b>	103

**10. RELATED PARTY TRANSACTIONS**

On November 2, 2005 the Company completed two private placements to persons who are considered to be related parties. The first was a private placement to officers, directors, employees and other service providers of Vero. 2,252 common shares were issued at a price of \$2.22 per share for aggregate proceeds of \$5,000. On the same day, the Company completed the second private placement with a subsidiary of True. In this private placement 474 common shares were issued at a price of \$2.22 per share for aggregate proceeds of \$1,052. The price of \$2.22 used in both of the two related-party private placements was determined by a net asset value calculation for the Vero assets.

As part of the Plan of Arrangement the Company purchased certain producing and non-producing oil and gas assets from True for an aggregate purchase price of \$27,365 (Note 1).

On November 7, 2005 Vero began trading on the Toronto Stock Exchange. Due to the composition of the Board of Directors, management and the public nature of its stock, Vero ceased to consider itself related to True on this date.

**11. NET EARNINGS PER SHARE**

The following table summarizes the shares used in calculating net earnings per share as at December 31:

	<u>2006</u>	<u>2005</u>
Weighted average shares outstanding - basic	<b>24,589</b>	9,379
Dilutive stock options outstanding	<b>1,856</b>	-
Shares notionally repurchased with proceeds from dilutive stock options and returned to treasury	<b>(1,856)</b>	-
Weighted average shares outstanding - diluted	<b>24,589</b>	9,379

At December 31, 2006, 465 (2005 – 1,600) of the issued stock options were excluded from the calculation of diluted weighted average shares outstanding as to include them would be anti-dilutive.

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**12. COMMITMENTS**

In addition to the commitments listed below, the Company has various indemnifications in place in the ordinary course of business, none of which, as assessed by management, are expected to have a significant impact on the Company's financial statements.

*a) Transportation costs*

The Company has committed to firm-service contracts for the transportation of its natural gas. The amounts below are the minimum cash obligations that the Company must pay under the terms of the contract. The combined minimum future costs as at December 31, 2006 are as follows:

	<u>2006</u>	<u>2005</u>
2006	-	1
2007	23	4
2008	23	-
2009	23	-
2010	12	-
2011	7	-
2012	2	-
<b>Total minimum payments</b>	<b>90</b>	<b>5</b>

*b) Office lease costs*

The Company has committed to future minimum payments under an operating lease that covers the rental of office space and a proportionate share of operating costs as follows:

2007	<b>758</b>
2008	<b>910</b>
2009	<b>910</b>
2010	<b>910</b>
2011	<b>531</b>
<b>Total minimum payments</b>	<b>4,019</b>

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**12. COMMITMENTS (CONTINUED)**

*c) Indemnifications*

From time to time, the Company may become involved in litigation or have claims sought against it in the normal course of business operations. Management of the corporation is not currently aware of any claims or actions that would materially affect the Corporation's reported financial position or results from operations.

Under the terms of certain agreements and the Company's by-laws the Company indemnifies individuals who have acted at the Company's request to be a director and/or officer of the Company, to the extent permitted by law, against any and all damages, liabilities, costs, charges or expenses suffered by or incurred by the individuals as a result of their service. The Company has no outstanding claims having a potentially material adverse effect on the Company as a whole.

*d) Drilling commitments*

As at December 31, 2006 Vero had committed to drill a total of seven wells in Alberta with varying commencement dates in 2007 pursuant to farm-in agreements with industry partners. The Company expects to satisfy their net portion of these drilling commitments at an estimated cost of \$2,640.

**13. SUPPLEMENTARY INFORMATION**

*a) Changes in non-cash working-capital*

	<b>2006</b>	<b>2005</b>
Accounts receivable	<b>(9,295)</b>	(6,013)
Prepaid expenses and deposits	<b>(934)</b>	(156)
Accounts payable and accrued liabilities	<b>20,298</b>	9,988
Taxes payable	<b>(292)</b>	292
Corporate acquisition of working capital (Note 3)	<b>159</b>	-
Net change in non-cash working capital	<b>9,936</b>	4,111
Investing activities	<b>(17,819)</b>	(8,148)
Operating activities	<b>(7,883)</b>	(4,037)

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**13. SUPPLEMENTARY INFORMATION (CONTINUED)**

*b) Supplementary cash flow information*

	2006	2005
Interest received	94	-
Interest paid	1,362	10

**14. FINANCIAL INSTRUMENTS**

As disclosed in Note 1(a), the Company holds various forms of financial instruments. The nature of these instruments and the Company's operations expose the Company to commodity price, credit and interest rate risks. The Company manages its exposure to these risks by operating in a manner that minimizes this exposure.

*Commodity price risk*

Due to the volatility of commodity prices the Company is exposed to adverse consequences of declining prices. The Company may enter into oil and natural gas contracts in order to protect its cash flow on future sales from the potential adverse impact of declining prices. The contracts reduce the fluctuation in sales revenue by locking in prices with respect to future deliveries of oil and natural gas. As at December 31, 2006, the Company had not entered into any of these contracts.

*Fair values of financial instruments*

The carrying value of financial instruments, which include short-term deposits, accounts receivable, deposits, accounts payable and accrued liabilities approximates amounts at which these instruments could be exchanged in a transaction between knowledgeable and willing parties.

*Credit risk*

Substantially all of the accounts receivable are with customers and joint venture partners in the oil and gas industry and are subject to normal industry credit risks. The Company generally extends unsecured credit to these customers and therefore, the collection of accounts receivable may be affected by changes in economic or other conditions. Management believes the risk is mitigated by entering into transactions with long-standing, reputable, counterparties and partners. The Company has not experienced any credit loss in the collection of accounts receivable.

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**14. FINANCIAL INSTRUMENTS (CONTINUED)**

*Interest rate risk*

The Company's revolving demand loan facility is subject to floating rates. The floating rate debt is subject to interest rate cash flow risk, as the required cash flows to service the debt will fluctuate as a result of changes in market rates.

*Foreign currency exchange risk*

The Company is exposed to foreign currency fluctuations as crude oil prices received are referenced to U.S. dollar denominated amounts.

**15. SUBSEQUENT EVENTS**

*a) Acquisition*

On January 19, 2007 the Company closed an acquisition of a combination producing wells with production of approximately 60 barrels of oil equivalent per day; 2,800 net undeveloped acres of land; and 131 thousand barrels of proved and probable oil equivalent of reserves. The aggregate net purchase price was approximately \$2.3 million, subject to adjustments. The acquisition was funded by the utilization of the Company's bank line.

*b) Hedging*

Effective February 26, 2007, the Company entered into a natural gas costless collar for 5,000 gigajoules per day at a floor of \$7.00 CDN per gigajoule and a ceiling of \$8.80 CDN per gigajoule. The contract term is from April 1, 2007 to October 31, 2007.