

**Ric Charron**



**Vic Fitch**



## **MANAGEMENT'S REPORT**

To the Shareholders of Xtreme Coil Drilling Corp.

The accompanying financial statements of Xtreme Coil Drilling Corp. ("Xtreme") and all of the information in the annual report are the responsibility of management and have received approval from the Board of Directors.

Management has prepared the financial statements in accordance with Canadian generally accepted accounting principles as outlined in the notes to the financial statements. Financial statements include certain amounts based on estimates and judgments. Management has determined such amounts on a reasonable basis to ensure fair presentation of the financial statements in all material respects. Management has reviewed the financial information contained elsewhere in the annual report to ensure it is consistent with the consolidated financial statements.

Management has developed and maintains a system of internal controls to provide reasonable assurance that transactions are properly authorized, assets are safeguarded and financial records are properly maintained to provide reliable information for the preparation of Xtreme's financial reporting

To express their opinion on the financial statements, PricewaterhouseCoopers LLP, the Corporation's external auditors, conduct an independent examination of the financial statements in accordance with generally accepted auditing standards. Their examination includes such tests and procedures considered necessary to provide reasonable assurance that the financial statements are presented fairly.

Xtreme's Audit Committee has reviewed the financial statement, including notes thereto, with management and PricewaterhouseCoopers LLP. The Board of Directors approved the financial statements on the recommendation of the Audit Committee.

A blue ink signature of Ric Charron, consisting of a stylized 'R' and 'C' followed by a horizontal line.

Ric Charron  
*Chief Executive Officer*

A blue ink signature of Vic Fitch, written in a cursive style.

Vic Fitch  
*Chief Financial Officer*

Calgary, Alberta  
March 15, 2007

## AUDITORS' REPORT

To the Shareholders of Xtreme Coil Drilling Corp.

We have audited the consolidated balance sheets of Xtreme Coil Drilling Corp as at December 31, 2006 and 2005 and the consolidated statements of operations and deficit and of cash flows for the year ended December 31, 2006 and the period May 24, 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 consolidated 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 May 24, 2005 to December 31, 2005 in accordance with Canadian generally accepted accounting principles.

*PricewaterhouseCoopers LLP*

*Chartered Accountants*

March 15, 2007  
Calgary, Alberta

## CONSOLIDATED BALANCE SHEET

	As at December 31, 2006	As at December 31, 2005
<b>ASSETS</b>		
<b>Current assets</b>		
Cash and cash equivalents	\$ 16,740,375	\$ 25,224,576
Accounts receivable	5,831,531	181,934
Prepaid expenses	1,773,820	76,593
Inventory	387,668	-
	<b>24,733,394</b>	<b>25,483,103</b>
<b>Future income tax</b> (note 10)	<b>2,506,589</b>	<b>641,359</b>
<b>Equipment</b> (note 3)	<b>88,511,190</b>	<b>13,527,576</b>
<b>Intangibles</b> (note 4)	<b>1,983,551</b>	<b>1,952,708</b>
	<b>\$ 117,734,724</b>	<b>\$ 41,604,746</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>Current liabilities</b>		
Accounts payable and accrued liabilities	\$ 14,068,993	\$ 1,720,840
Current portion of obligation under capital leases (note 5)	77,536	-
	<b>14,146,529</b>	<b>1,720,840</b>
<b>Long term liabilities</b>		
Obligations under capital leases (note 5)	138,659	-
	<b>14,285,188</b>	<b>1,720,840</b>
<b>SHAREHOLDERS' EQUITY</b>		
Share capital (note 8)	105,913,202	40,183,580
Warrants (note 8e)	1,234,619	-
Contributed surplus (note 8c)	1,477,807	3,063,832
Deficit	(5,176,092)	(3,363,506)
	<b>103,449,536</b>	<b>39,883,906</b>
	<b>\$ 117,734,724</b>	<b>\$ 41,604,746</b>

**Commitments** (note 12)

See accompanying notes to the consolidated financial statements

Approved by the Board of Directors



Marc Staniloff, Director



Ric Charron, Director

## CONSOLIDATED STATEMENT OF OPERATIONS AND DEFICIT

	Year ended December 31, 2006	Period from May 24, 2005 to December 31, 2005
<b>Sales</b>	\$ 4,817,276	\$ -
<b>Expenses</b>		
Operating expenses	4,185,423	-
Selling, general and administrative	3,704,105	706,671
Depreciation of capital assets	524,271	24,307
Amortization of intangibles	103,859	46,875
Stock-based compensation	401,226	3,063,832
Foreign exchange (gain) loss	(38,183)	86,223
Interest on long term debt and capital leases	141,492	-
Interest (income)	(1,663,790)	(418,854)
<b>Loss before taxes</b>	(2,541,127)	(3,509,054)
<b>Future tax recovery</b> (note 10)	728,541	145,548
<b>Net loss for the period</b>	(1,812,586)	(3,363,506)
<b>Deficit, beginning of period</b>	(3,363,506)	-
<b>Deficit, end of period</b>	\$ (5,176,092)	\$ (3,363,506)
<b>Net loss per common share - basic and diluted</b>	(0.07)	(0.24)
Weighted average number of common shares - basic	24,997,450	13,813,036
Weighted average number of common shares - diluted (note 8f)	27,459,694	15,806,369

See accompanying notes to the consolidated financial statements

## CONSOLIDATED STATEMENT OF CASH FLOWS

	Year ended December 31, 2006	Period from May 24, 2005 to December 31, 2005
<b>CASH PROVIDED BY (USED IN)</b>		
<b>Operating activities</b>		
Net loss for the period	\$ (1,812,586)	\$ (\$3,363,506)
Items not affecting cash:		
Depreciation and amortization	628,130	71,182
Signing bonus settled in shares	-	32,500
Stock-based compensation	401,226	3,063,832
Unrealized foreign exchange gain	(10,913)	-
Future taxes	(728,541)	(145,548)
	(1,522,684)	(341,540)
Changes in non-cash operating working capital	(5,565,945)	(57,265)
	(7,088,629)	(398,805)
<b>Financing activities</b>		
Proceeds from shares issued upon amalgamation	1,802,412	-
Proceeds from shares issued	65,658,731	39,255,018
Financing costs	(3,609,930)	(1,474,749)
Capital lease payments	(46,925)	-
	63,804,288	37,780,269
<b>Investing activities</b>		
Acquisitions of equipment	(75,244,764)	(13,551,883)
Increase in Intangibles	(134,702)	(124,583)
Change on non-cash working capital relating to capital items	10,179,606	1,519,578
	(65,199,860)	(12,156,888)
<b>Increase in cash and cash equivalents during the period</b>	<b>(8,484,201)</b>	<b>25,224,576</b>
<b>Cash and cash equivalents - beginning of period</b>	<b>25,224,576</b>	<b>-</b>
<b>Cash and cash equivalents - end of period</b>	<b>\$ 16,740,375</b>	<b>\$ 25,224,576</b>
<b>Supplemental disclosure of cash flow information</b>		
Interest received	\$ 1,683,049	\$ 369,058
Interest paid	\$ 141,492	-
Income taxes paid	-	-
<b>Non-cash transactions</b>		
Purchase of patents in exchange of shares	-	1,875,000
Signing bonus settled in shares	-	32,500
Shares issued in exchange for advance to shareholder	-	300,000

See accompanying notes to the financial statements

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### 1. NATURE OF OPERATIONS

Xtreme Coil Drilling Corp. (the "Company" or "Xtreme"), was incorporated May 24, 2005 under the Business Corporations Act of Alberta. Xtreme is in the business of operating coiled tubing drilling rigs using new patent pending coiled rig designs and technology. At year-end December 31, 2006, the Company's patents for the designs were pending in the United States. Upon completion of the coiled tubing drilling rigs, Xtreme contracts out these rigs to oil and gas exploration and development companies in both Canada and the United States. Activities are currently directed from Xtreme's head office in Calgary, Alberta, Canada and an operating office in Casper, Wyoming, United States.

### 2. SIGNIFICANT ACCOUNTING POLICIES

#### Basis of presentation

The consolidated financial statements are prepared in accordance with Canadian generally accepted accounting principles (GAAP) and include only the accounts of the Company.

#### Use of estimates

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the period. Actual results could differ from those reported. Amortization rates and the recoverable amounts for equipment and intangibles are the more significant items subject to estimates in these consolidated financial statements.

#### Principles of consolidation

The consolidated financial statements include the accounts of Xtreme and its subsidiaries. All are wholly-owned subsidiaries and are fully consolidated. Xtreme includes joint venture accounts on a proportionate basis and has eliminated all inter-entity transactions.

#### Cash and cash equivalents

Cash and cash equivalents consist of cash on deposit and commercial paper with maturities at the date of acquisition of 90 days or less and are recorded at cost.

#### Inventory

Inventory is composed of coiled tubing and spare rig parts and is recorded at lower of cost and replacement cost.

#### Equipment

Xtreme records equipment at cost. The Company provides for depreciation using the methods outlined below to amortize the cost of the equipment, software, furniture and leaseholds over its estimated useful life.

Computer equipment	3 years
Computer software	1 year
Office furniture	5 years
Vehicles	3.3 years
Leaseholds	6 years (over term of lease)
Drill pipe	8 years

Drilling equipment under construction will be depreciated once available for use. Xtreme records equipment at cost and depreciates it using a unit of production method based on 5,000 drill days with an estimated residual value of 20 percent.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### Intangibles

Xtreme's pending United States coil drilling and technology patents are being amortized on a straight line basis over a period of 20 years which is the life of the patent.

### Foreign currency translation

Xtreme considers United States operations integrated foreign operations and translates them using the temporal method under which all foreign currency transactions are translated at the rate in effect as at the transaction date. Monetary assets and liabilities are translated at the rate in effect as at the balance sheet date, non-monetary assets and liabilities are translated at their historical rate and gains and losses are recognized into the consolidated statements of operations in the period that they arise.

### Stock-based compensation

Xtreme has a stock-based compensation plan as described in note 8(d). The Company uses the fair value method of accounting for stock-based compensation. The fair value of stock options awarded to employees under the Company's stock option plan is determined using the Black-Scholes option pricing model. The amount of the fair value is charged to earnings over the vesting period of the stock option and a corresponding credit is made to contributed surplus. Upon the exercise of the stock options, consideration paid together with the amount previously recognized in contributed surplus is recorded as an increase in share capital. In the event that options expire without being exercised, previously recognized compensation expense associated with such stock options is not reversed.

### Income taxes

The Company uses the asset and liability method of accounting for income taxes. Under the asset and liability method, future tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Future tax assets and liabilities are measured using substantively enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on future tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the date of substantive enactment.

### Per share amounts

Basic per share amounts are calculated by dividing earnings from operations by the weighted average number of common shares outstanding for the period. Diluted per share amounts reflect the potential dilution that could occur if securities or other contracts to issue common shares were exercised or converted to common shares. The Company uses the treasury stock method to determine the dilutive effect of stock options for the calculation of diluted per share amounts.

### Impairment of long-lived assets

The Company tests for impairment whenever events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable. Recoverability is assessed by comparing the carrying amount to the projected future net cash flows the long-lived assets are expected to generate through their direct use and eventual disposition. When a test for impairment indicates that the carrying amount of the asset is not recoverable, an impairment loss is recognized to the extent carrying value exceeds its fair value. In assessing fair value, discounted cash flow calculations are considered.

### Revenue recognition

Xtreme's services are generally sold by contract with the customer and incorporate a fixed or determinable price based upon daily rates. Xtreme recognizes revenue when services are rendered.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### 3. EQUIPMENT

	2006 Dec 31			2005 Dec 31
(\$)	Cost	Accumulated amortization	Net	Net
Office and shop equipment	761,272	206,615	554,657	168,379
Leasehold improvements	66,315	13,458	52,857	53,445
Vehicles	528,393	58,177	470,216	-
Drilling equipment	33,420,824	270,328	33,150,496	-
Drilling equipment - construction in progress	54,282,964	-	54,282,964	13,305,752
	<b>89,059,768</b>	<b>548,578</b>	<b>88,511,190</b>	<b>13,527,576</b>

Xtreme is currently in the process of building coiled tubing drilling rigs under contract with third parties. Drilling rigs will be depreciated at the time the rigs are put in use.

### 4. INTANGIBLES

	2006 Dec 31			2005 Dec 31
(\$)	Cost	Accumulated amortization	Net	Net
Patents	2,134,285	150,734	1,983,551	1,952,708

In June 2005, Xtreme acquired certain pending United States coil drilling patents. In 2006, Xtreme filed additional patent applications. Costs of \$134,702 for legal expenses relating to registration of patent applications were added during the year.

### 5. OBLIGATION UNDER CAPITAL LEASES

Xtreme has field vehicles under capital leases. Minimum lease payments under the capital leases are outlined below.

(\$)	2006 Dec 31
Year ending December 31	
2007	91,508
2008	86,841
2009	63,825
Total minimum lease payments	242,174
Less amounts representing future interest at annual rates between 5 percent and 7 percent	25,979
Balance of obligation	216,195
Less current portion	77,536
	<b>138,659</b>

Amortization of leased equipment is on a straight line basis over forty months. The amount of amortization charged to expense is \$44,913.

(\$)	2006 Dec 31
Capital lease cost	263,120
Accumulated amortization	44,913
	<b>218,207</b>

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### 6. JOINT VENTURE

On December 19, 2006 the Company and a third party jointly incorporated a new entity, Coil-X Drilling Systems Corporation (Coil-X). This joint venture expects to utilize Xtreme's technology to build and operate rigs for the third party. Xtreme currently owns 51 percent of Coil-X. As at December 31, 2006 Coil-X had not commenced active operations.

### 7. AMALGAMATION

On May 1, 2006 Xtreme amalgamated with Norquay Capital Ltd. ("Norquay") pursuant to an amalgamation agreement approved by shareholders of both companies. Under the terms of the amalgamation agreement a new entity ("Amalco") was established and will continue operating under the name "Xtreme Coil Drilling Corp." Former shareholders of Xtreme received one common share of Amalco in exchange for each common share held, with 25,541,680 such shares being issued. Former shareholders of Norquay received one common share of Amalco in exchange for 30 common shares held, with 555,556 such shares being issued. Xtreme's shares were listed and commenced trading on the TSX Venture Exchange on May 4, 2006.

The following table summarizes the fair values of the assets acquired and liabilities assumed at the date of amalgamation.

(\$)	
Cash	1,817,344
Accounts payable	(14,932)
Net assets acquired	1,802,412
Value assigned to common shares issued	1,802,412

### 8. SHARE CAPITAL

#### Authorized and issued shares

The Company is authorized to issue an unlimited number of common voting shares without nominal or par value. Following is a summary of the Company's issued and outstanding Common Shares.

	2006 Dec 31		2005 Dec 31	
	Number of shares	Amount (\$)	Number of shares	Amount (\$)
Balance before receivable from shareholder, beginning of period	17,641,680	40,483,580	-	-
Shares issued	-	-	6,170,013	9,255,018
Initial private placement for cash	-	-	-	-
Issued in exchange for advance to shareholder	-	-	200,000	300,000
Issued in lieu of signing bonus	-	-	21,667	32,500
Issued in exchange for patents	-	-	1,250,000	1,875,000
Private placement for cash, net of issue costs	8,842,705	60,944,644	10,000,000	28,525,251
Shares issued upon amalgamation, net of issue cost	555,556	1,566,277	-	-
Warrants exercised	666,667	2,000,000	-	-
Agent options exercised	17,017	92,922	-	-
Future income tax effect of share issue costs, at expected tax rates	-	1,125,779	-	495,811
	10,081,945	65,729,622	17,641,680	40,483,580
Receivable from shareholder	-	(300,000)	-	(300,000)
Balance, end of period	27,723,625	105,913,202	17,641,680	40,183,580

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### a. Shares and agent options issued upon amalgamation

Pursuant to the amalgamation 555,556 shares of Xtreme were issued to former shareholders of Norquay in exchange for shares of Norquay. In addition, Xtreme issued Agent options to purchase 23,333 shares of Xtreme with a strike price of \$4.50 per share in exchange for agent options to purchase shares of Norquay. All of the agent options were fully exercisable when issued and expire on May 4, 2008 if not exercised. During the year 17,017 agent options were exercised, leaving 6,316 agent options outstanding.

### b. Private placements

On March 2006, Xtreme completed a private placement of 7,900,000 common shares at a price of \$7.00 per share for gross proceeds of \$55,300,000. The agent was paid a commission of 6 percent of gross proceeds or \$3,318,000. In addition, legal and financing fee costs of \$78,221 resulted in net proceeds of \$51,903,779.

On December 19, 2006 Xtreme completed a private placement of 942,705 shares at a price of \$10.90 per share for net proceeds of \$10,275,484.

### c. Contributed surplus

(\$)	2006 Dec 31	2005 Dec 31
Contributed surplus - opening balance	3,063,832	-
Stock based compensation	401,226	3,063,832
Contributed surplus transferred on exercise of options and warrants	(1,987,251)	-
Contributed surplus - ending balance	1,477,807	3,063,832

### d. Stock options outstanding

Xtreme established a stock option plan for directors, officers, employees and consultants which permits the granting of options to purchase up to a maximum of 10 percent of the Company's issued outstanding shares. The Board of Directors sets the number of options and exercise price at the time of grant provided that such exercise price shall not be less than that from time to time permitted under the rules of any stock exchange or exchanges on which the Xtreme's shares may be listed. The options granted under the plan may be exercisable for a period not exceeding five years, generally with one-third of the options vesting each year for the first three years, commencing one year after grant.

During the year, the Board of Directors approved the granting of 537,000 options at exercise prices ranging between \$3.00 to \$13.52. As of December 31, 2006, a total of 2,079,000 (2005 - 1,610,000) options were outstanding. During the year, a compensation expense of \$401,226 (2005-\$3,063,832) relating to these options was recorded as part of stock-based compensation expense and credited to contributed surplus.

Xtreme uses the fair value method of accounting for stock-based compensation. The fair value of options granted by the Company was estimated on the date of grant using the Black-Scholes option pricing model with weighted average assumptions for grants assuming no dividends are paid on common shares, a risk-free interest rate ranging from 4 percent to 4.5 percent, an average life of 3.0 years and an expected volatility ranging from zero (when private) to 50 percent. The amounts computed according to the Black-Scholes pricing model may not be indicative of the actual values realized upon the exercise of these options by the holders. The amount of the fair value is charged to earnings over the period of vesting of the stock options and a corresponding credit is made to contributed surplus.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

A summary of the status of the stock option plan and the agent options at December 31, 2006, is presented below.

	2006 Dec 31		2005 Dec 31	
	Number of options	Weighted average exercise price (\$)	Number of options	Weighted average exercise price (\$)
Stock options and agent options outstanding, beginning of period	1,610,000	3.00	-	-
Granted	560,333	7.70	1,610,000	3.00
Exercised	(17,017)	4.50	-	-
Expired/cancelled	(68,000)	7.92	-	-
Stock options and agent options outstanding, end of the period	2,085,316	4.09	1,610,000	3.00
Stock options and agent options exercisable, end of period	542,979	3.02	-	-

Range of exercise prices (\$)	Options outstanding			Options exercisable	
	Number outstanding	Weighted average remaining contractual life	Weighted average exercise price (\$)	Number exercisable	Weighted average exercise price (\$)
3.00 - 4.50	1,761,316	3.6 yrs	3.09	542,979	3.02
7.00 - 13.52	324,000	4.5 yrs	9.49	-	-
	2,085,316	3.8 yrs	4.09	542,979	3.02

### e. Warrants

As part of the private placement in July 2005, Xtreme issued to one officer and two directors 1,000,000 Series 1 and 1,000,000 Series 2 Performance Warrants. Each performance warrant entitles the holder to purchase one common share at a defined strike price of \$0.01 per common share. All warrants expire on July 21, 2008 if not exercised.

During 2006, Xtreme's liquidity value exceeded the threshold value of \$4.75 per share established within the agreement for the 1,000,000 Series 1 Performance Warrants. As a result, all Series 1 Performance Warrants vested and became exercisable. The value allocated to these warrants was \$2,990,000 which was recognized as contributed surplus in 2005. During 2006, a total of 666,667 warrants were exercised, leaving 333,333 warrants exercisable and outstanding.

The Series 2 Performance Warrants are not exercisable and will not vest until the date on which Xtreme acquires any of the initial patents for which applications are outstanding. As the likelihood of this event was not determinable as at December 31, 2006, no value has been attributed to these warrants as at year end.

On December 19, 2006 the private placement of shares had 2,092,574 warrants attached. Once vested each of these warrants entitles the holder to acquire one additional share at an exercise price of \$16.00 per share. The warrant holder must meet certain conditions to contract a specific amount of rigs before the warrants are exercisable. All warrants expire on December 19, 2009 if not exercised. The fair value allocated to these warrants using the Black-Scholes option pricing model is \$1,234,619. The assumptions used in the model are: a risk-free interest rate of 4 percent, an average life of 3.0 years and an expected volatility of 45 percent.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### f. Diluted earnings per share

The common shares potentially issuable in exchange for stock options, agent options and performance warrants are not included in the computation of diluted earnings per share as to do so would be anti-dilutive. Diluted weighted average common shares outstanding is calculated using the treasury stock method, which assumes that any proceeds obtained on exercise of stock options are used to purchase common shares at the average price for the year.

	2006 Dec 31	2005 Dec 31
Weighted average common shares outstanding - basic	24,997,450	13,813,036
Effect of stock options and warrants	2,462,244	1,993,333
Weighted average common shares outstanding - diluted	27,459,694	15,806,369

### 9. CREDIT FACILITIES

In March 2006 Xtreme negotiated credit facilities with a major Canadian bank. The facilities require the Company to maintain certain financial covenants. At December 31, 2006 Xtreme was in compliance with these covenants.

Xtreme has a \$5 million operating loan facility. This facility bears interest at the bank's prime rate plus 0.25 percent and is secured by accounts receivable. At December 31, 2006 no amount was owing under this facility.

The Company has a \$50 million committed 364-day extendible revolving credit facility. The facility is extendible at the bank's discretion for a further period of 364 days and reverts to a term loan to be repaid monthly over a period of 48 months. The extendible revolving facility bears interest at the bank's prime rate plus 0.75 percent. If not extended the term loan bears interest at the bank's prime rate plus 1.00 percent. A standby fee of 0.35 percent per annum applies to the unutilized portion of the facility. The facility is secured by a general security agreement over all present and future assets, excluding intellectual property, of the Company. At December 31, 2006 no amounts had been drawn on this facility.

### 10. INCOME TAXES

#### Net future income tax asset

Future income taxes arise from temporary differences, which are differences between the tax basis of an asset or liability and its carrying amount in the balance sheet. The components of future income tax balances are as follows.

(\$)	2006 Dec 31	2005 Dec 31
<b>Future income tax assets and liabilities</b>		
Non-capital losses carried forward	1,053,485	181,657
Equipment, differences between net book value and undepreciated capital cost	143,561	8,172
Intangibles, differences between net book value and cumulative eligible capital balance	46,155	15,760
Financing costs	1,263,388	435,770
Net future income tax asset	2,506,589	641,359

The non-capital losses carried forward expire primarily between 2015 and 2026.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

The provision for income taxes in the statement of operations and deficit varies from the amount that would be computed by applying the expected tax rates of 32.12 percent to income before income taxes. The principle reason for the differences between such expected income tax expense and the amount actually recorded are as follows.

<i>(\$ except where indicated)</i>	<b>2006 Dec 31</b>	<b>2005 Dec 31</b>
Loss before tax	<b>2,541,127</b>	3,509,054
Income tax rate <i>(percent)</i>	<b>32.12</b>	33.62
Computed expected income tax recovery	<b>816,210</b>	1,179,744
Increase (decrease) in income taxes resulting from:		
Non-deductible expenses	<b>(15,041)</b>	(4,136)
Stock based compensation	<b>(128,874)</b>	(1,030,060)
Rate reduction on future income tax and other	<b>12,806</b>	-
Higher effective tax rate on non-Canadian operations	<b>43,440</b>	-
	<b>728,541</b>	145,548
Effective income tax recovery rate <i>(percent)</i>	<b>28.67</b>	4.15

### 11. FINANCIAL INSTRUMENTS

#### Fair values

The carrying values of cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities approximate their fair value due to the relatively short periods to maturity of the instruments.

#### Foreign exchange risk

The Company is exposed to risk from fluctuations in foreign currency exchange rates as portions of its financial instruments are denominated in United States dollars. The effect of the foreign exchange gains and losses are included in income as they occur.

#### Credit risk

The Company is exposed to credit risk in relation to its accounts receivable at December 31, 2006 which includes balances owing from customers primarily operating in the oil and gas industry. The Company assesses the credit worthiness of its customers on an ongoing basis and considers the credit risks on these amounts as normal for the industry.

### 12. COMMITMENTS

#### a. Operating leases

Xtreme is committed to operating leases for office and shop space. The approximate annual base rental payments are as follows.

<i>(\$)</i>	
2007	133,540
2008	122,000
2009	122,000
2010	122,000
2011	81,333
	<b>580,873</b>

Under the terms of the leases, Xtreme is also responsible for its proportionate share of realty taxes, operating costs and utilities.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### b. Purchase commitments

The Company has commitments to suppliers with respect to contracts for the construction of the coiled tubing drilling rigs in the amount of \$36.8 million which is not reflected in these consolidated financial statements.

### 13. SEGMENTED INFORMATION

In 2006, Xtreme began contract drilling services in Canada and the United States. The amounts related to each geographic area are as follows.

#### 2006 Drilling services

(\$)	Canada	United States	Total
Revenue	1,359,393	3,457,883	4,817,276
Property and equipment, net	63,036,658	25,474,532	88,511,190

Revenue from three customers of Xtreme's drilling segments in Canada and the United States represent approximately \$4.7 million of the Company's total revenue.

### 14. SUBSEQUENT EVENTS

On February 15, 2007 Xtreme completed a private placement of 5,360,000 shares at a price of \$10.50 per share for gross proceeds of \$56,280,000.

On March 7, 2007 Xtreme was notified that two patents had been issued which related to the Series 2 Performance Warrants. As a result, these performance warrants vested and became exercisable.

On March 9, 2007 a total of 666,667 Series 2 Performance Warrants were exercised, leaving 333,333 Series 2 Performance Warrants exercisable and outstanding.