

WAVEFORM ENERGY LTD.

APRIL 30, 2007

MANAGEMENT'S DISCUSSION AND ANALYSIS

The following Management's Discussion and Analysis ("MD&A") for WaveForm Energy Ltd. ("WaveForm" or the "Company") should be read in conjunction with the audited financial statements and notes of the Company for the year ended December 31, 2006. This MD&A incorporates information up to and including April 30, 2007. The financial statements have been prepared in accordance with Canadian Generally Accepted Accounting Principles ("GAAP"). All of the amounts reported in this MD&A are in Canadian dollars, unless otherwise indicated. Certain other information with respect to the Company is available on SEDAR, at www.sedar.com and at the Company's website at www.waveformenergy.com. Information can also be obtained by contacting the Company at WaveForm Energy Ltd, Suite 1700, 520, 5th Ave. S.W., Calgary, Alberta, T2P 3R7.

NON-GAAP FINANCIAL MEASUREMENTS

The Company has used certain measures of financial reporting that are commonly used benchmarks within the oil and gas industry in this MD&A that are considered non-GAAP measures. The measures used in this document include "cash flow from operations" and "cash flow from operations per share". The term cash flow from operations contained within the MD&A should not be considered as an alternative to, or more meaningful than, cash flow from operating activities as determined in accordance with GAAP. The Company believes that cash flow from operations is a useful supplementary measure as investors may use this information to analyze operating performance, leverage and liquidity. Cash flow from operations, as disclosed within this MD&A, represents funds from operations before changes in non-cash working capital. The Company presents cash flow from operations per share whereby per share amounts are calculated consistent with the calculation of earnings per share. These non-GAAP measures may not necessarily be comparable to similarly titled measures used by other entities and readers of this MD&A are cautioned in attempting to make such comparisons.

OTHER MEASUREMENTS

For the purposes of calculating unit costs, natural gas has been converted to a barrel of oil equivalent ("BOE") using 6,000 cubic feet (6 Mcf) of natural gas equal to one barrel of oil (6:1), unless otherwise stated. The BOE conversion ratio of 6 Mcf to 1 barrel is based on an energy equivalency conversion method and does not represent a value equivalency. Therefore BOEs may be misleading if used in isolation. References to natural gas liquids ("NGLs") in this MD&A include condensate, propane, butane and ethane and one barrel of NGLs is considered to be equivalent to one barrel of crude oil equivalent (BOE).

ADVISORY REGARDING FORWARD LOOKING STATEMENTS

Certain statements included or incorporated by reference in the MD&A constitute forward-looking statements or forward-looking information under applicable securities legislation. Forward-looking statements or information typically contain statements with words such as “anticipate”, “expect”, “plan”, “intend”, “estimate”, “propose”, or similar words suggesting future outcomes or statements regarding an outlook. Forward-looking statements in this MD&A include, but are not limited to, statements with respect to reserves, crude oil and natural gas prices, well productivity, operating costs, general and administrative costs, taxation rates, interest rates, and capital expenditure plans for 2007 and beyond. Existing or potential investors should not to place undue reliance on forward-looking statements as there can be no assurance that the plans, intentions or expectations they are based on will occur. By their nature, forward-looking statements involve numerous assumptions, known and unknown, risks and uncertainties, both general and specific that contributes to the possibility that although the predictions, forecasts, projections and other forward-looking statements are reasonable, there can be no assurance that such expectations will prove to be correct. Some of the risks and other factors which could cause results to differ materially from those expressed in the forward-looking statements contained in the presentation include general economics, business and market conditions; volatility of energy prices; fluctuations in interest rates; energy supply and demand; competition, access to future funding , timing and amount of capital expenditures, imprecision in estimation future productive capacity, well productivity, operating cost adjustments; cost overruns; and such other risks and uncertainties described from time to time. Existing or potential investors are cautioned that the foregoing list of important factors is not exhaustive. Furthermore, the forward-looking statement contained in this document are made as of the date this report, effective April 30, 2007, and the Company does not take any obligations to update publicly or to revise any of the included forward-looking statements, whether as a result of new information, future events or otherwise, unless so required by applicable securities laws. The forward-looking statements contained herein are expressly qualified by this cautionary statement.

THE COMPANY

WaveForm is a junior oil and gas company whose shares have publicly traded on the TSX Venture Exchange since January, 2005 under the trading symbols “WE.A” and “WE.B” for the Class A and Class B shares respectively. The Company is focused on the acquisition, exploration and development of oil and natural gas production in western Canada. Its principal properties are in the Tableland area of southeast Saskatchewan and Rowley and Ferrier areas of Alberta.

PRINCIPAL PROPERTIES

Tableland

WaveForm currently owns 55,203 acres in the Tableland area of southeast Saskatchewan, consisting of 24,993 of crown lands and 30,201 acres of freehold lands. The Company’s share of production is 38 API oil from 10 wells in the Ratcliff zone. Production at year end was 110 boed net with a yearly average of 168 boed. WaveForm has a 65% working interest in this field. The Company is in the process of acquiring all of the issued and outstanding shares of another company and as a result, its interest in the Tableland area will be increased to 100%.

On March 23, 2007, WaveForm announced that it has entered into a Letter Agreement with a private U. S. based oil and gas company ("Farmee") whereby the Farmee shall have the right to earn a 70% working interest in the Company's non-producing land holdings in the Tableland area. The Farmee has committed to commence drilling operations for a Bakken horizontal well on or before August 31, 2007, and upon fulfilling its obligations, the Farmee shall earn a 70% working interest (after payout) in the section comprising the Bakken well. Thereafter, the Farmee may earn a 70% working interest in the remainder of WaveForm's Tableland non-producing holdings by drilling either a second Bakken horizontal well or by drilling a vertical well to a depth that would test the Winnipegosis Formation. Each well is expected to cost approximately \$3.5 million.

Rowley

Waveform has 1,728 net acres of land in the Rowley area of Alberta. The Company produces natural gas from two wells. One well is 100% working interest with production from the Mannville and Pekisko zones and the other well is 70% working interest with production coming from the Mannville zone. Production at year end was 98 boed net from the two wells. During 2006, the Company shot a 8 square mile 3D seismic in the Rowley field and is currently evaluating these lands for possible drilling locations.

Ferrier

Waveform has 400 net acres and 12 square miles of 3D seismic in the Ferrier area of Alberta. The Company produces natural gas from two wells producing from the Shunda and Ellerslie zones. WaveForm has a 37.5% non operated working interest in one well and a 25% non operated working interest with a 15% gross overriding royalty on 25% of production in the other well which will be converted to a 12.5% working interest after payout which is expected to occur in the second quarter of 2007. Production at year end was 78 boed net. After payout, this would be 103 boed net to WaveForm. There is one potential location remaining to be drilled in the Shunda zone and one potential Rock Creek target as well.

ACQUISITION OF STONE CASTLE EXPLORATION LTD. ("Stone Castle")

On February 20, 2007, the Corporation announced that it had executed a formal agreement with Stone Castle Exploration Ltd. ("Stone Castle") to acquire all of the issued and outstanding shares of Stone Castle. Stone Castle is a private oil and gas company with properties that are jointly held with the Company in Saskatchewan. Shareholders in Stone Castle will receive units comprised of 0.5 Class A share of the Corporation and 0.5 warrant to acquire Class A share. Each warrant will be exercisable at \$0.20 per share until June 30, 2007, \$0.30 per share until December 31, 2007 and \$0.40 per share until expiry on December 31, 2008. Stone Castle has approximately 12,335,000 common shares that are issued and outstanding. Stone Castle also has a loan outstanding of \$1.6 million. The acquisition is anticipated to close in early May 2007.

DRILLING RESULTS

2006	Wells Drilled	Producing Oil Wells	Shut-in	Abandoned
Tableland area	4 (2.6 net)	3 (2.6 net)	1 (1 net)	0
Antler area	9 (4.5 net)	6 (3.0 net)	2 (1 net)	1 (0.5 net)

During 2006, the Company drilled a total of 13 (7.1 net) wells and had 9 (5.6 net) producing oil wells for a 79% success rate. The Antler area was sold effective April 1, 2006. The last well drilled in Tableland in July 2006 did not yield production in commercial quantities and therefore will be abandoned during the second quarter of 2007.

SELECTED ANNUAL FINANCIAL INFORMATION

	Year Ended December 31, 2006	Year Ended December 31, 2005	Period Ended December 31, 2004
Revenues, net of royalties	\$5,038,309	\$1,715,950	\$72,587
Cash flow from operations (before changes in non cash working capital)	1,011,884	(210,976)	(164,343)
Cash flow from operations (before changes in non cash working capital) per share	0.03	(0.01)	(0.15)
Net loss	(19,162,902)	(10,129,344)	(164,343)
Net loss per share	(\$0.60)	(\$0.45)	\$(0.15)
Total assets at end of year	\$16,949,728	\$24,541,506	\$13,850,391

The Company's revenues have steadily risen over the past three years reflecting the continued growth in the asset and production base of the Company. After initial start up cash flow deficit for two years, the Company has generated positive cash flow from operations (before non cash working capital changes) during 2006 which is expected to continue in the foreseeable future. As a result of impairment to the carrying value of its petroleum and natural gas properties, the Company has suffered significant losses in 2005 and 2006. The reduction in carrying value of petroleum and natural gas properties has also resulted in the total assets declining from 2005 and 2006.

PETROLEUM SALES AND PRODUCTION

	Year Ended December 31, 2006	Year Ended December 31, 2005
Daily average petroleum production (bbls/d)	168	125
Daily average natural gas production (mcf/d)	641	-
Daily average natural gas liquid production (bbls/d)	14	-
Total daily average production (boe/d)	290	125
Average price received – petroleum sales	\$63.47	\$60.20
Average price received – natural gas sales (mcf)	\$6.14	-
Average price received – natural gas liquid sales	\$60.25	-
Total operating revenue, net of royalties	\$5,005,139	\$1,577,991

The Company's average crude oil production has increased from 125 barrels per day in 2005 to 168 barrels per day in 2006 reflecting a full year of production at Tableland during 2006. Natural gas and natural gas liquids production reflects production from Ferrier and Rowley that was acquired in April 2006. Exit production in December 2006 amounted to 287 boe per day. Following the impending acquisition of Stone Castle, the Company's production base is anticipated to be around 350 boe per day. Average price received from crude oil sales increased by 5% during 2006.

ROYALTIES

	Year Ended December 31, 2006	Year Ended December 31, 2005
Crown royalties (net of Alberta Royalty Tax Credit)	\$ 490,171	\$ 37,101
Freehold royalties	56,438	-
Gross overriding royalties	151,569	29,406
Saskatchewan capital tax	11,984	-
Total royalty expense	710,162	66,507
Average royalty rate	12.4%	4.0%

Total royalty expense increased significantly from \$66,507 in 2005 to \$710,162 in 2006. Average royalty rate also increased from 4.0% in 2005 to 12.4% in 2006. Production revenues from Tableland in Saskatchewan has benefited from crown royalty holidays resulting from deep horizontal well incentives. The increase in average royalty rate results from royalties paid on production acquired during 2006.

OPERATING EXPENSES

	Year Ended December 31, 2006	Year Ended December 31, 2005
Operating costs	\$1,337,075	\$632,255
Operating costs per boe	\$12.17	\$23.14

Operating costs per barrel of oil equivalent has declined significantly from \$23.14 per boe in 2005 to \$12.17 per boe in 2006. The reduction is partially as a result of lower operating cost per boe for natural gas properties that were acquired in April 2006. As well, operating costs in 2005 in aggregate were high due to the water disposal costs and work over costs associated with the production on the first two Bakken wells which were shut in late in 2005. Operating costs for gas sales amounted to approximately \$7 per boe in 2006.

DEPLETION AND DEPRECIATION EXPENSE

	December 31, 2006	December 31, 2005
Depreciation of office equipment	\$ 21,657	\$ 14,190
Accretion of asset retirement obligation	32,544	6,371
Depletion and depreciation of petroleum and natural gas properties	22,422,559	14,254,444
Depreciation of technology license	-	1,016,400
Total depletion, depreciation, and accretion	\$22,476,760	\$15,291,405

The Company follows the full cost method of accounting for its oil and gas operations. At each period end, the Company applies a cost recovery impairment test to capitalized costs to ensure they do not exceed the costs of unproved properties plus the undiscounted future net revenues from production of proved reserves. Where the carrying value of capitalized costs is determined to be not recoverable, an impairment loss is recognized as increased depletion and depreciation expense. The carrying value of capitalized costs is reduced to the value of discounted future net revenues from production of proved and probable reserves plus the cost of unproved properties.

During 2006, the carrying value of the Company's petroleum and natural gas properties exceeded the value of undiscounted future net revenues from production of proved and probable reserves plus the cost of its unproved properties. Accordingly, the Company reduced its carrying value of petroleum and natural gas properties and recorded an impairment allowance, by way of increased depletion and depreciation expense in the amount of \$18,458,100 during 2006. The ceiling test write-down consists primarily of costs related to the initial Bakken Formation wells drilled which had no recoverable reserves recorded in the reserve report in 2005.

The office equipment is depreciated at 20% to 30%. The accretion of the asset retirement obligation reflects the passage of time related to the liabilities recorded which have increased resulting from property acquisitions during 2006.

GOODWILL

The Company periodically assessing the carrying value of goodwill for impairment. Concurrent with the write down of the petroleum and natural gas properties, the Company concluded that the carrying value of goodwill was impaired. Accordingly, the entire carrying value was written off by a charge against earnings during 2006.

GENERAL AND ADMINISTRATIVE EXPENSE

	Year Ended December 31, 2006	Year Ended December 31, 2005
General and administrative expense - gross	\$2,162,262	\$1,551,410
Overhead recovery	(165,910)	(189,239)
Capitalized amounts	(58,125)	(67,500)
General and administrative expenses – net	\$1,938,227	\$1,294,671

Gross general and administrative expenses amounted to \$2,162,262 for the year ended December 31, 2006 compared to \$1,551,410 for 2005. The increase principally results from higher manpower and consulting costs, and office costs incurred during 2006.

INCOME TAXES

The Company has recorded a loss before income taxes of \$24,803,902 during 2006 compared with a loss of \$15,747,344 for 2005. As a result, the Company has recorded reduction in future income taxes and in 2006 has reduced its future income taxes to nil. No future income taxes have been recorded in view of the uncertainty of utilization of tax losses in the future.

CASH FLOW FROM OPERATIONS

	Year ended December 31, 2006	Year ended December 31, 2005
Revenues, net of royalties	\$5,038,309	\$1,715,950
Operating costs	(1,337,075)	(632,255)
General and administrative costs	(1,938,227)	(1,294,671)
Interest	(751,123)	-
Cash flow from operations, before changes in non cash working capital	1,011,884	(210,976)
Change in non-cash working capital	759,060	(827,103)
Cash flow from (used in) operating activities	\$1,770,944	\$(1,038,079)

During 2006, the Company generated positive cash flow from operations, before changes in non-cash working capital, in excess of \$1 million. This compares with a deficiency from operations of \$210,976 during 2005. The positive cash flow principally results from the acquisition of producing properties during 2006.

CAPITAL EXPENDITURES

Set out below is the summary of capital expenditures incurred on property and equipment during the years ended December 31, 2006 and 2005. These expenditures do not include the cost of acquiring limited partnerships during 2006.

	Year Ended December 31, 2006	Year Ended December 31, 2005
Land acquisition	\$1,099,292	\$ 3,033,933
Geological and geophysical	689,975	1,660,573
Drilling and completion	7,142,584	19,144,369
Equipment and facilities	657,579	856,369
Other	48,380	45,492
	\$ 9,637,810	\$24,740,736

ACQUISITION OF LIMITED PARTNERSHIP UNITS

On April 20, 2006, the Company acquired all of the units of an arms' length private oil and gas limited partnership for \$18.5 million cash. Major properties associated with this acquisition were in the Rowley area of Alberta and in the Ferrier area of Alberta. The acquisition significantly expanded the Company's reserves and production base and provided the Company with additional drilling locations.

DISPOSAL OF ASSETS

Effective April 1, 2006, the Company sold its interest in the Antler area of Alberta for approximately \$7.1 million. The Antler area had producing wells on stream from early in the first quarter, and with continued drilling throughout the first quarter of 2006, had an exit rate of 38 barrels of oil per day. Total proceeds on disposition, including other minor properties, amounted to \$7,329,457 during 2006.

FINANCING ACTIVITIES

The Company was engaged in a number of financing activities during 2006. In March 2006, the Company issued 2,916,700 Class A "flow through" shares at \$2.40 per share for gross proceeds of \$7 million. Effective December 31, 2006, The Company has renounced \$7 million to investors for income tax purposes. The Company is committed to spend 100% of the proceeds raised on qualifying exploration and development expenditures. At December 31, 2006, the Company is committed to incur expenditures of \$4,632,366 in expenditures during 2006 to meet its flow through obligations.

In March 2006, the Company issued 1,630,500 Class A shares at \$1.84 per share for gross proceeds of \$3,000,120. With proceeds on exercise of options, the Company raised gross proceeds of \$10,055,201 by way of equity. Total share issuance costs amounted to \$784,706 during 2006.

During 2005, the Company raised, in aggregate, \$16,418,047 as gross proceeds on issue of equity from treasury. Two major financings were undertaken – a Class A share issue of \$5.4 million shares at \$1.90 per share raising \$10,260,000 and the issuance of Class A shares on a flow through basis of 1,507,453 shares at \$3.40 per share raising \$5,125,340. Total issue costs amounted to \$1,221,987.

With respect to debt, the Company entered into a senior secured debt facility and drew down \$18.1 million to finance the purchase of limited partnership units in April 2006. The facility bears interest at bank prime rate plus 3%. Of the amount drawn, \$8.1 million was repaid within 30 days of drawdown from proceeds on sale of the Antler property. At year end, the Company had \$10 million of loan that remained outstanding. On January 15, 2007, the Company repaid \$2 million of the loan reducing the principal amount to \$8 million. On April 27, 2007, arrangements were agreed to with the lender to extend the loan to December 31, 2007. The Company is breach of certain financial covenants under the loan facility. The lender has waived compliance with such covenants.

During 2006, there were notes receivable that were outstanding in the amount of \$477,253 to certain directors and officers of the Company. During 2006, all of the notes that were outstanding were repaid to the Company in full. At December 31, 2006, no notes remained outstanding.

LIQUIDITY AND CAPITAL RESOURCES

At December 31, 2005, the Company had \$4,653,548 in cash and cash equivalents. Net financing activities during 2006 resulted into cash inflow of \$19,713,402 principally from the issue of equity, the drawdown of loan facilities, net of repayment, and the collection of notes receivable. The Company's investment activities consumed \$25,995,841 of cash resources, principally on acquisition of private oil and gas limited partnership units, capital expenditures of \$9,637,810, offset by proceeds of disposition of properties of \$7,329,457 and changes in non cash working capital of \$4,679,399. As a result, the Company's cash resources were reduced during to 2006 \$142,052 at December 31, 2006.

On January 15, 2007, the Company closed a private placement of 32 million units at \$0.125 per unit, comprising of 32 million Class A shares and 32 million of warrants to purchase Class A shares until December 31, 2008 at prices varying from \$0.125 per share to \$0.40 per share. This private placement raised gross proceeds of \$4 million on closing. In addition, during 2007, to date, the Company issued 11,933,000 Class A shares on the exercise of warrants raising an additional equity of \$1,491,625 in the form of cash which was added to treasury. In aggregate, the Company has raised \$5,491,625 in additional cash by way of equity during 2007 to date.

The Company presently has a loan outstanding of \$8 million repayable on April 30, 2007. Agreement has been reached to extend the loan until December 31, 2007; however, the Company continues to be in a working capital deficit and will need to secure additional equity, term debt or a combination thereof in order to be able to pay off the loan in full on due date.

As of April 30, 2007, the Company has cash resources of approximately \$1.8 million that are available for ongoing operations. In addition, the Company receives free cash flow, after royalties, operating expenses, overhead, and debt servicing costs, on a monthly basis. In May 2007, the Company is scheduled to close the acquisition of all of the issued and outstanding shares of Stone Castle Exploration Ltd. which is expected to provide the Company with approximately 50 barrels per day of additional production and the resultant cash flow. However, the Company remains undercapitalized to exploit all available opportunities that are available to it. The Company has executed a farm out which provides for the drilling of up to two wells on Company lands at no cash cost to the Company. As at December 31, 2006, the Company was committed incur additional exploration and development expenditures of \$4,632,366 in order to meet its flow through obligations. The Company continues to examine all strategic options that are available to it to maximize shareholder value.

EQUITY

Set out below is the Company's equity capital structure as at the dates indicated:

	April 30, 2007	December 31, 2006	December 31, 2005
Class A shares	76,051,631	32,118,631	27,461,264
Class B shares	935,616	935,616	935,616
Warrants to purchase Class A shares	25,167,000		
Stock options	6,725,000	1,645,333	1,871,400

The authorized share capital consists of an unlimited number of Class A and B voting shares. The Class B shares are convertible into Class A shares based on a formula equal to \$10 divided by the greater of \$1 and the then market price of the Class A shares. The Class B shares are convertible at the option of the Company at any time after January 21, 2008 and before January 31, 2010. The Class B shares are convertible at the option of the shareholder, at any time after February 1, 2010 and before March 1, 2010. Any Class B shares not previously converted will automatically convert to Class A shares on March 1, 2010.

In addition, upon the closing of the acquisition of Stone Castle Exploration Ltd., anticipated in early May 2007, the Company anticipates issuing 6,167,500 Class A shares from treasury and 6,167,500 warrants to purchase Class A shares that will be exercisable at \$0.20 per share until June 30, 2007, \$0.30 per share until December 31, 2007 and \$0.40 per share until expiry on December 31, 2008.

As well, upon extension of the senior secured loan payable, the lender will be entitled to 5 million warrants for a two year term to purchase Class A shares at \$0.15 per share until the facility is repaid and at \$0.175 thereafter until expiry.

CONTRACTUAL OBLIGATIONS

The Company has entered into a lease for office space which expires on April 30, 2011. The annual commitments for the next five years are as follows:

Annual Commitments	
2007	\$195,750
2008	195,750
2009	195,750
2010	195,750
2011	65,250

During 2006, the Company incurred \$7 million through the issuance of flow through shares and had renounced \$7 million of exploration expenditures to investors. At December 31, 2006, the Company had incurred \$2,367,714 in eligible expenditures and was committed to incur the remaining \$4,632,366 of expenditures during 2007 to meet its flow through commitments.

RELATED PARTY TRANSACTIONS

During 2006, the Company incurred an expenditure of \$152,612 (2005 - \$60,089) for general corporate legal services payable to a legal firm of which an officer is a partner. These fees are included in general and administrative expense, share issuance costs and acquisition costs. During 2006, the Company incurred \$274,469 (2005 - \$717,087) to an oil and gas service company of which a former director of the Company was the sole shareholder. This amount is included in property and equipment. The Company incurred expenditures of \$16,732 (2005 - \$62,630) payable to an oil and gas service company of which a former director of the Company was a director and officer. This is included in property and equipment. The Company incurred \$25,000 (2005 - \$nil) for financing advisory fees payable to a corporation of which a director of the Company is a director. All transactions were completed on the basis of general market terms and conditions.

NEW ACCOUNTING POLICIES

The Company follows generally accepted accounting principles in Canada. There were no changes in the Company's accounting policies during 2006.

DISCLOSURE CONTROLS AND PROCEDURES

The Company has established disclosure controls and procedures for the preparation of financial and other reports. The Chief Executive Officer and the Acting Chief Financial Officer have concluded, based upon their evaluation as of December 31, 2006, that the design and operation of these disclosure controls and procedures are adequate and effective in providing reasonable assurance that material information related to the Company, is made known to them by employees or third party consultants working for the Company. It should be noted that while the Company's Chief Executive Officer and Acting Chief Financial Officer believe that the disclosure controls and procedures will provide a reasonable level of assurance that they are effective, they do not expect that the disclosure controls and procedures will prevent all errors and fraud. A control system, no matter how well conceived or operated, can provide only reasonable, not absolute assurance that the objectives of the control system are met.

INTERNAL CONTROL OVER FINANCIAL REPORTING

The Chief Executive Officer and Acting Chief Financial Officer of the Company are responsible for designing internal controls over financial reporting or causing them to be designed under their supervision in order to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with GAAP.

The design of the internal control over financial reporting was assessed as of December 31, 2006. During this process, management identified certain material weaknesses in internal controls over financial reporting which are as follows:

- a) Due to the limited number of staff of WaveForm , it is not possible to achieve a proper segregation of duties; and
- b) Due to the limited number of staff, WaveForm does not have technical accounting expertise and knowledge to address all complex and non-routine financial transactions that may arise.

These weaknesses in WaveForm's internal controls over financial reporting result in a more than remote likelihood that a material misstatement would not be prevented or detected. Management and the board of directors work to mitigate the risk of a material misstatement in financial reporting by segregating duties as much as possible under the circumstances. In addition, outside third party consulting expertise is utilized to assist in dealing with complex accounting and technical issues that arise during preparation of quarterly and annual financial statements. In spite of management's best efforts, there can be no assurance that this risk can be reduced to less than a remote likelihood of a material misstatement. No further material weaknesses other than those described above have been identified.

SELECTED QUARTERLY INFORMATION

2006	Quarter 1	Quarter 2	Quarter 3	Quarter 4
Revenue (net of royalties)	\$1,138,547	\$1,530,342	\$1,278,057	\$1,091,363
Net loss	(520,957)	(492,643)	(14,508,892)	(3,640,410)
Loss per share	\$(0.02)	\$(0.01)	\$(0.44)	\$(0.13)

2005	Quarter 1	Quarter 2	Quarter 3	Quarter 4
Revenue	\$42,565	\$94,529	\$600,261	\$978,595
Net loss	(159,630)	(269,406)	(155,725)	(9,544,583)
Loss per share	\$(0.01)	\$(0.01)	\$(0.01)	\$(0.34)

The Company has been steadily increasing its revenues until the second quarter of 2006 and thereafter the revenues have declined principally as a result of lower production levels. Substantially losses in the fourth quarter of 2005 and the third and fourth quarter of 2006 result from providing for impairment allowance against the carrying value of the petroleum and natural gas properties.

FOURTH QUARTER RESULTS

	Three Months Ended December 31, 2006	Three Months Ended December 31, 2005
Daily average petroleum production (bbls/d)	108	194
Daily average natural gas production (mcf/d)	805	-
Daily average natural gas liquid production (bbls/d)	25	-
Total daily average production (boe/d)	267	194
Average price received – petroleum sales	\$58.35	\$55.48
Average price received – natural gas sales (mcf)	\$7.28	-
Average price received – natural gas liquids sales	\$56.83	-
Revenue (net of royalties)	\$1,091,363	\$978,595
Operating costs	\$395,462	\$632,255
Operating costs per boe	\$14.94	\$23.14
Net loss	\$(3,640,410)	\$(9,544,583)
Loss per share	\$(0.13)	\$(0.34)

During the three months ended December 31, 2006, revenues, net of royalties, increased marginally from the same period in 2005. Oil production has declined in 2006. During the latter part of 2005, a number of new wells came on production in Tableland which has now stabilized at current production levels. Gas and liquids production represents production from properties acquired in April 2006. Operating costs per boe has declined resulting from lower boe cost associated with gas production. The Company recorded an additional impairment to its petroleum and natural gas properties in the fourth quarter of 2006 resulting in a net loss for the quarter. An impairment was also recorded in the last quarter of 2005.

OUTLOOK

The Company's existing financial position provides the Company with limited flexibility with respect to exploiting its asset base. The Company continues to generate positive cash flow, after expenses, that provides the Company with funds for ongoing capital expenditure programs and for debt reduction; however, further equity infusion will be required to finance the ongoing capital program. The Company has announced the farm out of the Bakken play in Saskatchewan where at least one deep well is expected to commence drilling prior to the end of August 2007. The Company is continuing to evaluate the inventory of its drilling locations. The acquisition of Stone Castle will add to the operating cash flow of the Company. The Company continues to examine strategic alternatives to maximize shareholder value.

RISKS AND UNCERTAINTIES

The Company's business is subject to risks encountered in the oil and gas industry. The risks and uncertainties below are not the only issues facing the Company. Additional risks and uncertainties not presently known to WaveForm or that the Company currently considers immaterial may also impair the business and operations of WaveForm. If any of the following risks actually occur, the Company's business may be harmed and the financial condition and results of operations may suffer significantly.

Limited Operating History

WaveForm has a limited operating history upon which a prospective investor can evaluate the business. The Company is subject to the risks, expenses and uncertainties encountered by companies in the resource sector.

Exploration, Development and Production Risks

Oil and natural gas exploration involves a high degree of risk and there is no assurance that expenditures made on future exploration by the Company will result in new discoveries of oil or natural gas in commercial quantities. It is difficult to project the costs of implementing an exploratory drilling program due to the inherent uncertainties of drilling in unknown formations, the costs associated with encountering various drilling conditions such as over pressured zones and tools lost in the hole, and changes in drilling plans and locations as a result of prior exploratory wells or additional seismic data and interpretations thereof.

The Company currently has a limited number of specific identified drilling prospects. The long-term commercial success of the Company depends on its ability to find, acquire, and develop and commercial produce oil and natural gas reserves. No assurance can be given that the Company will be able to locate additional drilling prospects. Substantial amounts may be expended on properties where reserves have yet to be proven.

Future oil and gas exploration may involve unprofitable efforts, not only from dry wells, but from wells that are productive but do not produce sufficient net revenues to return a profit after drilling, operating and other costs. Completion of a well does not assure a profit on the investment or recovery of drilling, completion and operating costs. In addition, drilling hazards or environmental damage could greatly increase the cost of operations and various field operating conditions may adversely affect the production from successful wells. These conditions include delays in obtaining governmental approvals or consents, shut-ins of connected wells resulting from extreme weather conditions, insufficient storage or transportation capacity or other geological or mechanical conditions. While close well supervision and effective maintenance operations can contribute to maximizing production rates over time, production delays and declines from normal field operating conditions cannot be eliminated and can be expected to adversely affect revenue and cash flow levels to varying degrees.

In addition, oil and gas operations are subject to the risks of exploration, development and production of oil and natural gas properties, including encountering unexpected formations or pressures, premature declines or reservoirs, blow-outs, sour gas releases, fires and spills. Losses resulting from the occurrence of any of these risks could have a materially adverse effect on future results of operations, liquidity and financial condition.

Insurance

The Company's involvement in the exploration for and development of oil and gas properties may result in the Company becoming subject to liability for pollution, blow-outs, property damage, personal injury or other hazards. Although the Company has obtained insurance in accordance with industry standards to address such risks, such insurance has limitations on liability that may not be sufficient to cover the full extent of such liabilities. In addition, such risks may not, in all circumstances be insurable or, in certain circumstances, the Company may elect not to obtain insurance to deal with specific risks due to the high premiums associated with such insurance or other reasons. The payment of such uninsured liabilities would reduce the funds available to the Company. The occurrence of a significant event that the Company is not fully insured against, or the insolvency of the insurer of such event, could have a material adverse effect on the Company's financial position, results of operations or prospects.

Prices, Markets and Marketing of Crude Oil and Natural Gas

Oil and natural gas are commodities whose prices are determined based on world demand, supply and other factors, all of which are beyond the control of the Company. World prices for oil and natural gas have fluctuated widely in recent years. Any material decline in prices could result in a reduction of net production revenue. Certain wells or other projects may become uneconomic as a result of a decline in world oil prices and natural gas prices, leading to a reduction in the volume of the Company's oil and gas reserves. The Company might also elect not to produce from certain wells at lower prices. All of these factors could result in a material decrease in the Company's future net production revenue, causing a reduction in its oil and gas acquisition and development activities. In addition, bank borrowings available to the Company are in part determined by the borrowing base of the Company. A sustained material decline in prices from historical average process could limit or reduce the Company's borrowing base therefore reducing the bank credit available to the Company, and could require that a portion of any existing bank debt of the Company be repaid.

In addition to establishing markets for its oil and natural gas, the Company must also successfully market its oil and natural gas to prospective buyers. The marketability and price of oil and natural gas which may be acquired or discovered by the Company will be affected by numerous factors beyond its control. The Company will be affected by the difference between the price paid by refiners for light quality oil and the grades of oil produced by the Company. The ability of the Company to market its natural gas may depend upon its ability to acquire space on pipelines which deliver natural gas to commercial markets.

The Company will also likely be affected by deliverability uncertainties related to the proximity of its reserves to pipelines and processing facilities and related to operational problems with such pipelines and facilities and extensive government regulation relating to price, taxes, royalties, land tenure, allowable production, the export of oil and natural gas and many other aspects of the oil and natural gas business. The Company has a limited direct experience in the marketing of oil and natural gas.

Substantial Capital Requirements; Liquidity

The Company anticipates that it will make substantial capital expenditures for the acquisition, exploration, development and production of oil and natural gas reserves in the future. If the Company's revenues or reserves decline, the Company may have limited ability to expend the capital necessary to undertake or complete future drilling programs. There can be no assurance that debt or equity financing, or cash generated by operation will be available or sufficient to meet these requirements or for other corporate purposes or, if debt or equity financing is available, that it will be on terms acceptable to the Company. Moreover, future activities may require the Company to alter its capitalization significantly. The inability of the Company to access sufficient capital for its operations could have a material adverse effect on the Company's financial condition, results of operations or prospects.

Competition

The oil and gas industry is highly competitive. The Company's competitors for the acquisition, exploration, production and development of oil and natural gas properties, and for capital to finance such activities, include companies that have greater financial and personnel resources available to them than the Company.

The Company's ability to successfully bid on and acquire additional property rights, to discover reserves, to participate in drilling opportunities and to identify and enter into commercial arrangements with customers will be dependent upon developing and maintaining close working relationships with its future industry partners and joint operators and its ability to select and evaluate suitable properties and to consummate transactions in a highly competitive environment.

Environmental Risks

All phases of the oil and natural gas business present environmental risks and hazards and are subject to environmentally regulation pursuant to a variety of international conventions and state and municipal laws and regulations. Environmental legislation provides for, amount other things, restrictions and prohibitions on spills, releases or emissions of various substances produced in association with oil and gas operations. The legislation also requires that wells and facility sites be operated, maintained, abandoned and reclaimed to the satisfaction of applicable regulatory authorities. Compliance with such legislation can require significant expenditures and a breach may result in the imposition of fines and penalties, some of which may be material. Environmental legislation is evolving in a manner expected to result in stricter standards and enforcement, larger fines and liability and potentially increased capital expenditures and operating costs. The discharge of oil, natural gas or other pollutants into the air, soil or water may give rise to liabilities to government and third parties and may require the Company to incur costs to remedy such discharge. No assurance can be given that environmental laws will not result in a curtailment of production or a material increase in the costs of production, development or exploration activities or otherwise adversely affect to Company's financial condition, results or operations or prospects.

Reserve Replacement

The Company's future oil and natural gas reserves, production, and cash flows to be derived there from are highly dependent on the Company successfully acquiring or discovering new reserves. Without the continual addition of new reserves, any existing reserves the Company may have at any particular time and the production there from will decline over time as such existing reserves are exploited. A future increase in the Company's reserves will depend not only on the Company's ability to select and acquire suitable producing properties or prospects. There can be no assurance that the Company's future exploration and development efforts will result in the discovery and development of additional commercial accumulations of oil and natural gas.

Reliance on Operators

The Company may not be the operator of certain oil and gas properties in which it acquires an interest. To the extent the Company is not the operator of its oil and gas properties, the Company will be dependent on such operators for the timing of activities related to such properties and will largely be unable to direct or control the activities of the operators.

Corporate Matters

Certain of the directors and officers of the Company may also be directors and officers of other oil and gas companies involved in natural resource exploration and development, and conflicts of interest may arise between their duties as officers and directors of the Company and as officers and directors of such other companies. Such conflicts must be disclosed in accordance with, and are subject to such other procedures and remedies as apply under the ABCA.

Permits and Licenses

The operations of the Company may require licenses and permits from various governmental authorities. There can be no assurance that the Company will be able to obtain all necessary licenses and permits that may be required to carry out exploration and development at its projects.

Additional Funding Requirements

The Company's cash flow from its reserves may not be sufficient to fund its ongoing activities at all times. From time to time, the Company may require additional financing in order to carry out its oil and gas acquisition, exploration and development activities. Failure to obtain such financing on a timely basis could cause the Company to forfeit its interest in certain acquisition opportunities and reduce or terminate its operations. If the Company's revenues from its reserves decreases as a result of lower oil and natural gas prices or otherwise, it will affect the Company's ability to expend the necessary capital to replace its reserves or to maintain its production. If the Company's cash flow from operations is not sufficient to satisfy its capital expenditure requirements, there can be no assurance that additional debt or equity financing will be available on favorable terms.

Issuance of Debt

From time to time, the Company may enter into transactions to acquire assets or the shares of other Companies. These transactions may be financed partially or wholly with debt, which may increase the Company's debt levels above industry standards. Neither the Company's articles nor its by-laws limit the amount of indebtedness that the Company may incur. The level of the Company's indebtedness from time to time could impair the Company's ability to obtain additional financing in the future on a timely basis to take advantage of business opportunities that may arise.

Availability of Drilling Equipment and Access Restrictions

Oil and natural gas exploration and development activities are dependant on the availability of drilling and related equipment in the particular areas where such activities will be conducted. Demand for such limited equipment or access restrictions may affect the availability of such equipment to the Company and may delay exploration and development activities.

Kyoto Protocol

Canada is a signatory to the United Nations Framework Convention on Climate Change and has ratified the Kyoto Protocol established hereunder to set legally binding targets to reduce nationwide emissions of carbon dioxide, methane, nitrous oxide and other so-called "greenhouse gases". The Company's exploration and production facilities and other operations and activities will emit a small amount of greenhouse gases which may subject the Company to legislation regulating emissions of greenhouse gases. The Government of Canada has put forward a Climate Change Plan for Canada which suggests further legislation will set greenhouse gases emission reduction requirements for the various industrial activities, including oil and gas exploration and production. Future federal legislation, together with provincial emission reduction requirements, such as those proposed in Alberta's Bill 32: Climate Change and Emissions Management may require the reduction of emissions or emissions intensity with the Company's operations and facilities. The direct or indirect costs of these regulations may adversely affect the business of the Company.

Tax Treatment of Flow-Through Shares

The tax treatment applicable with respect to oil and gas activities and Flow-Through shares constitutes a major factor when considering an investment in the Flow-Through shares. There is no guarantee that the taxation laws and regulations and the current administrative practices of both the federal and provincial tax authorities will not be amended or constructed in such a way that the tax consideration for a subscriber holding Class A Shares or Class B Shares will not be altered, and moreover there is no guarantee that there will not be any difference of opinion between the federal and provincial tax authorities with respect to the tax treatment of the Class A Shares or Class B Shares, the status of the Class A Shares or Class B Shares and the activities contemplated by the Company's exploration and development programs.

The Class A Shares and Class B Shares are designed for investors whose income is subject to high marginal tax rates. The right to deduct CEE accrued to the initial purchaser of Units and is not transferable. No guarantee can be given that Canadian tax laws will not be amended, that the amendments announced with respect to such laws will be adopted or that the current administrative practices of the tax authorities will not be modified. In addition, there is no guarantee that the projected tax deductions will be accepted by the Canada Revenue Agency. Consequently, the tax considerations for subscribers holding or selling Class A Shares or Class B Shares may be fundamentally altered.

There is no guarantee that an amount equal to the total proceeds or the sale of the Class A Shares and Class B Shares forming part of the Units will be expended on or prior to December 31, 2007 as Qualifying Expenditures. If the Company does not expend an amount equal to the proceeds from the sales of the Class A Shares and Class B Shares comprising of the Units so as to incur Qualifying Expenditures prior to December 31, 2007, the Company shall restate the amount of expenses that it has renounced in favor of the investors and the investors will be reassessed and will be requested to remit the tax benefits from which they would have benefited.

Financial Statements of

WaveForm Energy Ltd.

Year Ended December 31, 2006

AUDITORS' REPORT TO THE SHAREHOLDERS

We have audited the balance sheets of WaveForm Energy Ltd. as of December 31, 2006 and 2005 and the statements of operations and deficit and cash flow for the years then ended. These financial statements are the responsibility of the Corporation'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 financial statements present fairly, in all material respects, the financial position of the Corporation as at December 31, 2006 and 2005 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

Chartered Accountants

Signed "KPMG LLP"

Calgary, Canada

April 30, 2007

WAVEFORM ENERGY LTD.
BALANCE SHEETS
 As at December 31, 2006 and 2005

	2006	2005
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 142,052	\$ 4,653,548
Accounts receivable	1,241,300	4,048,137
Prepaid expenses	87,553	17,365
	1,470,905	8,719,050
Future income taxes (note 7)	-	2,606,000
Property and equipment (note 4)	15,478,823	12,739,203
Notes receivable (note 5)	-	477,253
	\$ 16,949,728	\$ 24,541,506
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 1,804,347	\$ 8,495,682
Loan payable (note 6)	10,000,000	-
	11,804,347	8,495,682
Asset retirement obligation (note 8)	522,765	421,937
	12,327,112	8,917,619
Shareholders' equity		
Share capital (note 9)	33,379,327	25,695,900
Contributed surplus (note 9i)	699,878	221,674
Deficit	(29,456,589)	(10,293,687)
	4,622,616	15,623,887
Nature of business and future operations (note 1)		
Commitments (note 10)		
Subsequent events (note 14)		
	\$ 16,949,728	\$ 24,541,506

See accompanying notes to financial statements.

Approved by the Board:

Signed "Dinesh Dattani" Director

Signed "Robert F. Goods" Director

WAVEFORM ENERGY LTD.

STATEMENTS OF OPERATIONS AND DEFICIT

For the years ended December 31, 2006 and 2005

	2006	2005
REVENUE		
Crude oil, natural gas, and natural gas liquids sales	\$ 5,715,301	\$ 1,644,498
Royalties	(710,162)	(66,507)
Interest and other income	33,170	137,959
	5,038,309	1,715,950
EXPENSES		
Operating	1,337,075	632,255
General and administrative	1,938,227	1,294,671
Depletion, depreciation and accretion	22,476,760	15,291,405
Write-off of goodwill	2,841,890	-
Stock based compensation	497,136	244,963
Interest	751,123	-
	29,842,211	17,463,294
LOSS BEFORE INCOME TAXES	(24,803,902)	(15,747,344)
TAXATION		
Future income tax reduction	(5,641,000)	(5,618,000)
NET LOSS	(19,162,902)	(10,129,344)
DEFICIT, BEGINNING OF YEAR	(10,293,687)	(164,343)
DEFICIT, END OF YEAR	\$ (29,456,589)	\$ (10,293,687)
Net loss per share-basic and diluted (note 9f)	\$ (0.60)	\$ (0.45)

See accompanying notes to financial statements.

WAVEFORM ENERGY LTD.
STATEMENTS OF CASH FLOW
For the years ended December 31, 2006 and 2005

	2006	2005
CASH PROVIDED BY (USED IN):		
OPERATIONS:		
Net loss	\$ (19,162,902)	\$ (10,129,344)
Add (deduct) items not involving cash:		-
Depletion, depreciation and accretion	22,476,760	15,291,405
Stock based compensation	497,136	244,963
Write-off of goodwill	2,841,890	
Future income tax reduction	(5,641,000)	(5,618,000)
	1,011,884	(210,976)
Change in non-cash working capital (note 12)	759,060	(827,103)
	1,770,944	(1,038,079)
FINANCING:		
Issue of share capital	10,055,201	16,418,047
Share issuance costs	(784,706)	(1,221,987)
Repayment (issue) of notes receivable	477,253	112,697
Loan advances	18,100,000	
Loan repayment	(8,100,000)	-
Change in non-cash working capital (note 12)	(34,347)	(112,747)
	19,713,401	15,196,010
INVESTMENTS:		
Property and equipment expenditures	(9,637,810)	(24,740,736)
Disposition of property and equipment	7,329,457	-
Acquisition of limited partnership units (note 3)	(19,008,089)	-
Change in non-cash working capital (note 12)	(4,679,399)	5,114,740
	(25,995,841)	(19,625,996)
(DECREASE) IN CASH AND CASH EQUIVALENTS	(4,511,496)	(5,468,065)
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	4,653,548	10,121,613
CASH AND CASH EQUIVALENTS, END OF YEAR	\$ 142,052	\$ 4,653,548

See accompanying notes to financial statements.

SUPPLEMENTARY CASH FLOW INFORMATION

Interest received	\$ 33,170	\$ 137,959
Interest paid	751,123	-

WAVEFORM ENERGY LTD.

NOTES TO THE FINANCIAL STATEMENTS

For the years ended December 31, 2006 and 2005

1. Nature of business and future operations

WaveForm Energy Ltd. (the "Corporation") is incorporated under the laws of the province of Alberta. The Corporation is engaged in the acquisition, development and exploration of petroleum and natural gas in Western Canada.

These financial statements have been prepared on the basis that the Corporation will continue its operations as a going concern. At December 31, 2006, the Corporation had a working capital deficiency of over \$10 million, and had incurred recurring losses. At December 31, 2006, the Company had a loan of \$10 million, of which \$2 million was repaid in January 2007 from proceeds of an equity offering. The balance of the loan, which was due on April 30, 2007, has been extended to December 31, 2007. At December 31, 2006, the Company was not in compliance with certain financial covenants under the loan agreement. The lender has waived compliance with such covenants. Continuing operations are dependant upon the ability of the Company to access adequate capital to continue its exploration and development program, achieve profitable operations and its ability to extend its loan facilities. The financial statements do not reflect adjustments to assets, liabilities and operations that would be necessary should the going concern assumption be inappropriate.

2. Significant accounting policies:

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

(a) Joint operations:

A significant portion of the Corporations exploration, development and production activities are conducted jointly with others and accordingly, the Corporation reflects its proportionate interest in such activities.

(b) Cash and cash equivalents:

Cash and cash equivalents are comprised of cash and investments with an original maturity date of three months or less.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended December 31, 2006 and 2005

2. Significant accounting policies (continued):

(c) Petroleum and natural gas properties:

The Corporation follows the full cost method of accounting for petroleum and natural gas operations. All costs of exploring for and developing petroleum and natural gas properties and related reserves are capitalized. Such costs include lease acquisition, geological and geophysical activities, lease rentals on non-producing properties, drilling of productive and non-productive wells, tangible production equipment, and that portion of overhead costs directly attributable to exploration and development activities. Gains or losses on disposition of petroleum and natural gas properties are not recognized unless crediting the proceeds against the accumulated costs results in a change in the rate of depletion and depreciation by 20 percent or more.

Costs of acquiring unproved properties are initially excluded from the amount subject to depletion and are assessed periodically to ascertain whether impairment has occurred. When proved reserves are assigned to a property or a property is considered to be impaired, the cost of the property or the amount of impairment is added to the amount subject to depletion. Depletion of petroleum and natural gas properties and depreciation of production equipment are calculated using the unit-of production method based upon estimated proved reserves, before royalties, as determined by independent engineers. For purposes of the calculation, natural gas reserves and production are converted to equivalent volumes of petroleum based upon relative energy content, where 6 mcf of natural gas is equivalent to 1 barrel of oil.

The Corporation applies a cost recovery impairment test to capitalized costs to ensure they do not exceed the costs of unproved properties plus undiscounted future net revenues from production of proved petroleum and natural gas reserves. Future net revenues are estimated using expected future product prices and costs, less asset retirement obligations. When the carrying value of capitalized costs is determined to be not recoverable, an impairment loss is recognized as increased depletion and depreciation in the period. The carrying value of capitalized costs is reduced to the value of discounted future net revenues from production of proved and probable reserves plus the cost of unproved properties net of any impairment allowance.

Office equipment is recorded at cost and amortized using the declining balance method at rates of 20% to 30% per year, with a full year's amortization taken in the year of acquisition.

(d) Asset retirement obligations:

The Corporation has obligations to retire petroleum and natural gas assets and restore land to its original state at the end of the useful lives of assets upon abandonment. Expected future asset retirement costs, discounted at the Corporation's credit adjusted risk-free rate, are recorded as liabilities and the carrying value of petroleum and natural gas assets is increased. Costs are estimated by management based on current regulations, technology and industry standards. The assets are subject to depletion and depreciation and the liabilities increased as accretion expense is recognized over time.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended December 31, 2006 and 2005.

2. Significant accounting policies (continued):

(e) Income taxes:

The Corporation uses the asset and liability method of tax allocation accounting. Temporary differences arising from the differences between the tax basis of an asset or liability and the carrying amount on the balance sheet are used to calculate future income taxes or liabilities. Future income tax assets or liabilities are calculated using tax rates anticipated to apply in the periods that the temporary differences are expected to reverse. A valuation allowance is recorded against any future income tax assets if it is more likely that the assets will not be realized.

(f) Flow-through shares

In accordance with tax legislation, the Corporation renounces deductions related to resource expenditures to the extent they have been financed through the issuance of flow-through shares. Future tax liabilities and share capital are adjusted by the estimated cost of the renounced tax deductions upon renouncement.

(g) Stock-based compensation plans:

The Corporation has a stock option plan for its directors, officers, employees, and consultants and had issued warrants to purchase common shares. The fair value of options and warrants granted are estimated using the Black-Scholes valuation model, is measured at the date of grant and charged to earnings on a straight line basis over the vesting period with a corresponding increase in contributed surplus. Consideration paid to the Corporation on the exercise of stock options or warrants is credited to share capital.

(h) Measurement uncertainty:

The amounts recorded for depletion, depreciation and amortization of petroleum and natural gas properties and equipment and the provision for future asset retirement obligations are based on estimates of proved reserves, production rates, oil and gas prices, future prices and costs and other relevant assumptions. Computation of stock-based compensation expense includes estimates of future stock price volatility and dividend policies. By their nature, these estimates are subject to measurement uncertainty and the effect on the financial statements of changes in such estimates in future periods could be significant.

(i) Per share amounts:

Basic per share amounts are computed using the weighted average number of Class A and Class B shares outstanding during the period. Diluted per share amounts are calculated using the treasury stock method, which assumes that any proceeds from the exercise of stock options, and warrants in addition to the unrecognized amount of stock-based compensation expense are used to purchase Class A shares of the Company at the average market price during the reporting period. The weighted average number of shares outstanding is then adjusted by the net change.

(j) Financial instruments:

Financial instruments recognized on the balance sheet include cash and cash equivalents, accounts receivable, notes receivable, accounts payable and accrued liabilities, and loan payable. At December 31, 2006, there are no significant difference between the carrying amounts reported on the balance sheet and their estimated fair values.

WAVEFORM ENERGY LTD.

NOTES TO THE FINANCIAL STATEMENTS

For the years ended December 31, 2006 and 2005.

2. Significant accounting policies (continued):

(k) Revenue recognition

Revenue from the sale of petroleum and natural gas is recognized at the time when title passes to an external party.

3. Acquisition of limited partnership

On April 20, 2006, the Corporation acquired all of the issued and outstanding partnership units of B&G Energy 2005 Limited Partnership for cash consideration of \$18.5 million. The transaction was effective April 1, 2006; however the net revenues are included in the Corporation's statement of operations from the closing date April 20, 2006 forward. The Corporation acquired natural gas and natural gas liquid producing properties in the Ferrier, and Rowley areas of Alberta.

The purchase price consists of:	
Cash	\$ 18,500,000
Acquisition costs	508,089
	\$ 19,008,089
Fair value of assets and liabilities assumed:	
Property and equipment	\$ 22,873,699
Goodwill	2,841,890
Asset retirement obligation	(66,500)
Future income taxes	(6,641,000)
	\$ 19,008,089

During 2006, the value of goodwill has been assessed to be impaired and has been fully written off.

4. Property and equipment

	December 31, 2006		
	Cost	Accumulated Depletion, Depreciation and amortization	Net Book Value
Petroleum and natural gas properties	\$52,091,798	\$36,677,002	\$15,414,796
Office equipment	103,988	39,961	64,027
	\$52,195,786	\$36,716,963	\$15,478,823

WAVEFORM ENERGY LTD.

NOTES TO THE FINANCIAL STATEMENTS

For the years ended December 31, 2006 and 2005

4. Property and equipment (continued)

	December 31, 2005		
	Cost	Accumulated Depletion, Depreciation and amortization	Net Book Value
Petroleum and natural gas properties	\$26,956,342	\$14,254,444	\$12,701,898
Office equipment	55,608	(18,303)	37,305
	\$27,011,950	\$14,272,747	\$12,739,203

At December 31, 2006, \$868,796 (December 31, 2005 - \$6,986,897) of undeveloped land and seismic costs have been excluded from the depletion calculation. Future development costs of \$1,080,000 (December 31, 2005 - Nil) were added to the depletion calculations. In 2006, \$58,125 (December 31, 2005 - \$67,500) of general and administrative costs have been capitalized.

The Corporation has performed the ceiling test calculation at December 31, 2006 to assess the recoverable value of the petroleum and natural gas properties. The petroleum prices used in the calculation are based on December 31, 2006 benchmark commodity price for forecasts of an independent reserve evaluator and adjusted for commodity price differentials of the Corporation, and are as follows:

	Oil		Natural Gas	
	Corporation Average (Canadian \$/bbl)	Edmonton Par Light Crude (Canadian \$/ bbl)	Corporation Average (Canadian \$/mcf)	AECO – C Hub (Canadian \$/mcf)
2007	62.00	70.25	6.85	7.20
2008	62.50	68.00	7.08	7.45
2009	60.50	65.75	7.36	7.75
2010	59.25	64.50	7.40	7.80
2011	59.25	64.50	7.45	7.85

Thereafter, the estimated market prices increase by an average annual percentage change of 2%.

WAVEFORM ENERGY LTD.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended December 31, 2006 and 2005

4. Property and equipment (continued)

Based on these assumptions the undiscounted value of the future net revenues from Waveform's proved reserves did not exceed the carrying value of the petroleum and natural gas assets. The Corporation recorded an impairment loss of \$18,458,100 which is recognized as increased depletion in the year. The carrying value of capitalized costs was reduced to the value of discounted future net revenues from production of proved and probable reserves plus the cost of unproved properties.

5. Notes receivable

The notes receivables were issued to officers and directors of the Corporation to purchase Class A shares (Note 10b). The notes bear interest at 5.25% and were secured by the shares of the Corporation, and by a personal guarantee of each individual. All notes were fully repaid in 2006.

6. Loan Payable

The Corporation entered into a senior secured debt facility (the "facility") that has a first charge on all assets of the Corporation. The facility was initially drawn for \$18.1 million to finance the acquisition of the limited partnership units (note 3), but was repaid to \$10.0 million within 30 days of the closing of the acquisition. The facility bears interest at bank prime rate plus 3% per annum. At December 31, 2006, the Company had a loan of \$10 million, of which \$2 million was repaid in January 2007 from proceeds of an equity offering (see note 14). The balance of the loan, which was due April 30, 2007, has been extended to December 31, 2007. At December 31, 2006, the Company was not in compliance with certain financial covenants under the loan agreement. The lender has waived compliance to such covenants.

7. Future income taxes

The provision for income taxes in the financial statements differs from the result which would be obtained by applying the federal and provincial tax rate to the Corporation's earnings before income taxes. This difference results from the following items:

	2006	2005
Net loss before income taxes	\$ (24,803,902)	\$ (15,747,344)
Combined federal and provincial tax rate	34.25%	37%
Computed "expected" income tax expense	(8,495,000)	(5,827,000)
Increase resulting from:		
Non-deductible goodwill	973,000	
Non-deductible items	239,000	116,000
Resource allowance	(71,000)	19,000
Change in tax rate	434,000	-
Valuation allowance	1,227,000	
Other	52,000	74,000
Future income tax reduction	\$ (5,641,000)	\$ (5,618,000)

NOTES TO THE FINANCIAL STATEMENTS

For the year ended December 31, 2006 and 2005

7. Future income taxes (continued)

The components of the Corporation's net future income tax asset are as follows:

Property, and equipment	\$ 431,000	\$ 1,611,000
Share issuance costs	696,000	635,000
Non capital losses	100,000	360,000
Valuation allowance	(1,227,000)	
Net future income tax asset	\$ -	\$ 2,606,000

The Corporation has accumulated non-capital losses for income tax purposes of approximately \$308,000 which are available against future taxable income. Unless sufficient taxable income is earned, these losses will expire in 2015.

8. Asset retirement obligation

The Corporation's asset retirement obligations result from net ownership interest in petroleum and natural gas assets. A credit adjusted risk free rate of 7.5% and an inflation rate of 1.5% were used to calculate the fair value of the asset retirement obligation for both 2006 and 2005. Undiscounted estimated cash flow of \$965,000 is required to settle the obligation.

	December 31, 2006	December 31, 2005
Beginning of year	\$ 421,937	\$ -
Liabilities incurred	1,784	415,566
Accretion expense	32,544	6,371
Acquired on acquisition (note 3)	66,500	-
End of year	\$ 522,765	\$ 421,937

9. Share capital

(a) Authorized:

The authorized share capital consists of an unlimited number of Class A and B voting shares. The Class B shares are convertible into Class A shares based on a formula equal to \$10 divided by the greater of \$1 and the then market price of the Class A shares. The Class B shares are convertible at the option of the Corporation at any time after January 21, 2008 and before January 31, 2010. The Class B shares are convertible at the option of the shareholder, at any time after February 1, 2010 and before March 1, 2010. Any Class B shares not previously converted will automatically convert to Class A shares on March 1, 2010.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended December 31, 2006 and 2005

(b) Issued and outstanding:

Class A Shares	2006		2005	
	Number of Shares	Value	Number of Shares	Value
Beginning of year	27,461,264	\$ 20,578,468	18,808,200	\$ 5,251,373
Issued for cash (note 10c)	1,630,500	3,000,120	5,400,000	10,260,000
Flow through shares issued for cash (note 10d)	2,916,700	7,000,080	1,507,453	5,125,340
Stock options exercised (note 10g)	110,167	73,933	235,766	117,596
Warrants exercised	-	-	606,125	757,656
Broker warrants exercised (note 10e)	-	-	903,720	252,170
Future tax effect of flow-through shares		(1,873,000)		(472,080)
Share issue costs (net of future income taxes of \$267,000 (2005 - \$508,400))		(517,706)		(713,587)
End of year	32,118,631	\$ 28,261,895	27,461,264	\$ 20,578,468
Class B Shares				
Beginning of year	935,616	\$ 5,117,432	935,616	\$ 8,165,752
Future tax effect of flow-through shares				(3,461,920)
Future tax effect of share issue costs				413,600
End of year	935,616	\$ 5,117,432	935,616	\$ 5,117,432
End of year – Class A and Class B shares	33,054,247	\$ 33,379,327	28,396,880	\$ 25,695,900

(c) Issued for cash:

In March 2006, the Corporation issued 1,630,500 Class A shares at \$1.84 per share for gross proceeds of \$3,000,120

NOTES TO THE FINANCIAL STATEMENTS

For the year ended December 31, 2006 and 2005

9. Share capital (continued):

(d) Flow-through shares issued:

In December 2005, the Corporation issued 1,507,453 Class A “flow-through” shares at \$3.40 per share for gross proceeds of \$5,125,340. The Corporation is committed to spend 100% of the funds on qualifying exploration and development expenditures. Effective December 31, 2005 in accordance with the terms of the share subscription agreements, the Corporation renounced for income tax purposes, \$5,125,340 to holders of Class A shares. At December 31, 2006 the Corporation had met this commitment.

In March 2006, the Corporation issued 2,916,700 Class A “flow through” shares at \$2.40 per share for gross proceeds of \$7,000,080. The Corporation is committed to spend 100% of the funds on qualifying exploration and development expenditures. Effective December 31, 2006 in accordance with the terms of the share subscription agreements, the Corporation renounced for income tax purposes, \$7,000,080 to holders of Class A shares. At December 31, 2006 the Corporation had incurred \$2,367,714 in eligible expenditures. At December 31, 2006, the Corporation is committed to incur the remaining \$4,632,366 of expenditures during 2007.

(e) Agent’s warrants:

Under the terms of the Agency agreement related to the initial public offering, the agent received 903,720 warrants exercisable into one Class A share, until December 31, 2005, at an exercise price of \$0.20 per share. All warrants were exercised in 2005.

The fair value of the warrants granted during 2004 was calculated using a Black-Scholes Option Pricing Model and the total value was \$71,426, or \$0.079 per warrant. The assumptions used to calculate the value were: risk free rate of 4%, dividend yield of 0%, volatility factor of the market price of the Class A shares of 100%, and an expected life of 1 year. The value of the warrants was recorded in 2004 as a share issuance cost, with an offsetting amount to contributed surplus. During 2005, the \$71,426 was allocated to share capital in conjunction with the exercise of the warrants.

(f) Loss per share:

The weighted average number of Class A and Class B shares outstanding during the year was 32,161,503 (December 31, 2005 - 22,273,525). All warrants and options would have an anti-dilutive effect on the loss per share as the Corporation is in a loss position.

WAVEFORM ENERGY LTD.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended December 31, 2006 and 2005

(g) Stock option plan:

The Corporation has a stock option plan for directors, officers, employees and consultants. The Corporation may grant up to 10% of the aggregate number of Class A and Class B shares outstanding and no one optionee is permitted to hold more than 5% of the total Class A and B shares outstanding. The options vest one third immediately and one third on the first and second anniversary dates of the grant and expire in five years from the date of grant.

	December 31, 2006		December 31, 2005	
	Number of options	Weighted average exercise price	Number of options	Weighted average exercise price
Beginning of year	1,871,400	\$ 0.88	-	\$ -
Granted	400,000	1.00	2,418,000	0.87
Forfeited	(515,900)	1.17	(310,834)	1.21
Exercised	(110,167)	0.50	(235,766)	0.40
Outstanding end of year	1,645,333	\$ 0.60	1,871,400	\$ 0.88
Exercisable – end of year	1,203,662	\$ 0.61	602,733	\$ 0.89

Exercise Price	Options outstanding		Options exercisable	
	Number	Weighted Average Remaining Life (years)	Number	Weighted Average Remaining Life (years)
\$0.40	908,333	1.6	758,331	1.3
\$1.00	400,000	4.5	133,333	4.5
\$1.23	33,333	0.3	33,333	0.3
\$1.40	66,667	0.3	66,667	0.3
\$2.04	237,000	1.2	211,998	0.9
	1,645,333		1,203,662	

The weighted average grant date fair value of all options granted in 2006 was \$0.40 (December 31, 2005 - \$0.45).

The fair value of options granted during the year of \$158,483 (2005 - \$920,431) was calculated using a risk free rate of 4%, dividend yield of 0%, volatility factor of 75%, and an expected life of 5 years. The value of the options was recorded as stock based compensation expense, with an offsetting amount to contributed surplus based on the vesting terms.

WAVEFORM ENERGY LTD.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended December 31, 2006 and 2005

(h) Escrowed shares

Pursuant to an Escrow Agreement dated October 28, 2004 a total of 6,178,867 Class A shares of certain officers, directors, employees, and principal shareholders are being held in escrow. On January 7, 2005 when the shares of the Corporation were listed on the TSX Venture exchange, 10% of the escrowed shares were released. The remaining 90% is being released in 15% increments during consecutive 6 month periods following the listing.

(i) Contributed surplus

A summary of change in the Corporation's contributed surplus balance for the year ended December 31, 2006 and 2005 is as follows:

Balance – January 1, 2005	\$ 71,426
Stock based compensation related to fair value of options granted	244,963
Options and warrants exercised	(94,715)
Balance – December 31, 2005	221,674
Stock based compensation related to fair value of options granted	497,136
Options exercised	(18,932)
Balance – December 31, 2006	\$ 699,877

10. Commitments

The Corporation has the following office rental commitments, which expires April 30, 2011:

2007	\$ 195,750
2008	195,750
2009	195,750
2010	195,750
2011	65,250

WAVEFORM ENERGY LTD.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended December 31, 2006 and 2005

11. Related party transactions

During 2006, the Corporation incurred an expenditure of \$152,612 (2005 - \$60,089) for general corporate legal services payable to a legal firm of which an officer is a partner. These fees are included in general and administrative expense, share issuance costs and acquisition costs. During 2006, the Corporation incurred \$274,469 (2005 - \$717,087) to an oil and gas service company of which a former director of the Corporation was the sole shareholder. This amount is included in property and equipment. The Corporation incurred expenditures of \$16,732 (2005 - \$62,630) payable to an oil and gas service company of which a former director of the Corporation was a director and officer. This is included in property and equipment. The Corporation incurred \$25,000 (2005 - \$nil) for financing advisory fees payable to a Corporation of which a director of the Company is a director. All transactions were completed on the basis of general market terms and conditions.

12. Changes in non-cash working capital

	2006	2005
Decrease (increase) in non-cash working capital		
Accounts receivable	\$ 2,806,837	\$ (3,782,244)
Prepaid expenses	(70,188)	(12,365)
Accounts payable and accrued liabilities	(6,691,335)	8,129,499
Obligation under license agreement	-	(160,000)
Net change in non-cash working capital	\$ (3,954,686)	\$ 4,174,890
Relating to:		
Operations	\$ 759,060	\$ (827,103)
Financing	(34,347)	(112,747)
Investments	(4,679,399)	5,114,740
	\$ (3,954,686)	\$ 4,174,890

13. Financial instruments

The Company's financial instruments recognized in the balance sheet include cash and cash equivalents, accounts receivable, accounts payable and bank loan. The fair values of these instruments approximate their book amounts due to the short term maturity of these instruments and the market rate of interest applied to the loan.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended December 31, 2006 and 2005

13. Financial instruments (continued)

Most of the Company's accounts receivable relate to crude oil and natural gas sales and are exposed to typical industry credit risks and amounts due from joint venture partners. The Company manages its credit risk by entering into sales contracts with only credit worthy entities. Account receivable from joint venture partners on properties that the Company operates are adequately secured by provisions of various joint operating agreements.

The Company does not undertake any hedging activities with respect to its crude oil, natural gas liquids, and natural gas sales. The Company is exposed to fluctuations in commodity prices.

14. Subsequent events

- (a) On January 15, 2007, the Corporation closed a private placement for gross proceeds of \$4,000,000. The Corporation issued 32,000,000 units comprised of one Class A Shares at an issue price of \$0.125 per share and one Class A Share Purchase Warrant. Each full Warrant will entitle the holder to purchase one Class A Share at \$0.125 per share until March 31, 2007, thereafter at \$.20 per share until June 30, 2007, thereafter, at \$.30 per share until December 31, 2007 and thereafter at \$.40 per share until expiry on December 31, 2008. The shares issued in the private placement are subject to a four month hold period pursuant to applicable securities legislation. \$2.0 million of the proceeds were applied to reduce the \$10 million loan facility with balance of proceeds, net of issue costs, added to working capital. In addition, the Corporation issued 1,600,000 broker warrants under similar terms and conditions.
- (b) On February 20, 2007, the Corporation announced that it had executed a formal agreement with Stone Castle Exploration Ltd. ("Stone Castle") to acquire all of the issued and outstanding shares of Stone Castle. Stone Castle is a private oil and gas company with properties that are jointly held with the Company in Saskatchewan. Shareholders in Stone Castle will receive units comprised of 0.5 Class A share of the Corporation and 0.5 warrant to acquire Class A share. Each warrant will be exercisable at \$0.20 per share until June 30, 2007, \$0.30 per share until December 31, 2007 and \$0.40 per share until expiry on December 31, 2008. Stone Castle has approximately 12,335,000 common shares that are issued and outstanding. The acquisition is anticipated to close in early May 2007.
- (c) As at December 31, 2006, the Corporation has a secured loan outstanding in the amount of \$10,000,000. On January 15, 2007, the Corporation repaid \$2,000,000 of the loan from proceeds of the private placement. The balance of the loan, which was due April 30, 2007, has been extended to December 31, 2007.