

KROES

ENERGY INC.

FIRST QUARTER REPORT
For the Three Months Ended March 31, 2007

Kroes Energy Inc. is a junior oil and gas company headquartered in Calgary, Alberta Canada and listed on the TSX Venture Exchange. The Company has a 45% interest in a Ukrainian oil field rehabilitation project; a 25% interest in a small oil field in Trinidad; and has established shallow gas reserves in Western Canada.

Financial and Operating

Net earnings for the quarter totalled \$96,571 compared with \$116,574 earned in the first quarter of 2006. Cash flow from operations totalled \$334,851 compared with the \$276,209 generated in the first quarter last year.

Consolidated crude oil production for the first quarter of 2007 averaged 269 barrels of oil equivalent per day compared with 237 barrels per day in the first quarter of 2006. Production from the Ukrainian joint venture declined by five barrels per day to 227 barrels per day but new natural gas production in Alberta added 37 barrels of oil equivalent per day (222 mcf per day).

The royalty levied by the Ukrainian government on production of crude oil and condensate is now 47% of the value of crude oil produced. For the first quarter 2007 royalty of \$745,834 was paid from the Company's Ukraine revenue of \$1,578,415.

BOE's may be misleading, particularly if used in isolation. A BOE conversion ratio of 6MCF:1Bbl is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead.

Ukraine Operations

In Ukraine, crude oil production for the first quarter of 2007 averaged 227 barrels per day compared with 232 barrels per day in the first quarter of 2006. Well #303 was brought onstream in June of 2006 and initially produced some 75 barrels per day (34 b/d net to Kroes) but has since stabilized at 40 barrels per day (18 b/d net to Kroes). This well produces from the K1 formation but also will be productive in the shallower P1/P2 zone. As with the last few wells drilled, the K1 zone must be depleted before regulations allow production from the more prolific P1/P2 zone. Well #306 began drilling early in March and reached total depth early in May. The well was tested for 24 hours and produced 100 barrels per day (45 b/d net to Kroes). The well is presently being tied in and is expected to begin producing in June, 2007. The rig is now being moved to a surface location some 70 meters from well #306 and will begin drilling development well #304 late in June. This new well will be deviated to a bottom hole location some 400 meters to the southeast.

Western Canada Operations

The shallow gas program in western Canada was initiated in 2006 and at year end, three wells were on production. In the first quarter of 2007, production averaged 222,000 cubic feet per day (37 boe) and the average price received was \$7.80 per mcf. Revenue totalled \$144,366 and the operating netback to the company was \$3.63 per mcf. During the first quarter, two more successful wells were drilled and completed, and are presently awaiting the lifting of road bans to be connected to markets. Capital expenditures in western Canada were \$322,100 for the first quarter 2007.

Other

On March 28, 2007, the Company entered into an agreement with Shelton Canada Corp. ("Shelton") whereby Shelton will acquire Kroes' wholly owned subsidiary Zhoda 2001 Corporation ("Zhoda"). Zhoda's only operating asset is a 45% interest in Kashtan Petroleum Ltd. a joint venture oilfield exploitation and development project in Ukraine.

The completion of the Transaction is subject to a number of conditions including approval for the transaction by the Company's shareholders and all relevant regulatory authorities and due diligence on the part of both Shelton and the Company. Subject to the fulfilment of all conditions, this transaction is expected to close on or before June 30, 2007.

Management's Discussion and Analysis

Revenue

Gross revenue increased to \$1,745,712 in the first quarter 2007 from \$1,364,968 in 2006 due to higher sales volumes of crude oil in Ukraine as well as new gas revenue from the western Canada shallow gas program. A significant portion of the oil sold in Ukraine was in inventory at December 31, 2006.

In Ukraine, production in the first quarter of 2007 was 227 barrels per day compared with 232 barrels per day in the first quarter of 2006. Production was lower due to natural declines in production, as well as the shut-in of wells for mechanical repair.

Kroes average oil price in the first quarter of 2007 was \$56.88 per barrel, up from the \$54.15 received in 2006. The table below sets out the relevant variables for Kroes' oil and gas production.

| | | Three Months Ended | |
|---|---|---------------------------|-----------------------|
| | | March 31, 2007 | March 31, 2006 |
| | | <u>Liquids</u> | <u>Liquids</u> |
| Revenue | | | |
| | Trinidad | \$22,931 | \$27,570 |
| | Ukraine | \$1,578,415 | \$1,337,398 |
| | Canada | \$144,366 | - |
| | | \$1,745,712 | \$1,364,968 |
| Crude Oil Daily Production Volumes | | | |
| | Trinidad (Bbls per day) | 5 | 5 |
| | Ukraine (Bbls per day) | 227 | 232 |
| | | 232 | 237 |
| Natural Gas Daily Production Volumes | | | |
| | Canada (Mcf per day) | 222 | - |
| | Boe equivalent (6 mcf to 1 barrel) | 269 | 237 |
| Crude Oil | | | |
| | - Barrels Produced | 20,878 | 21,298 |
| | - Barrels Sold (1) | 28,153 | 25,209 |
| Prices per Barrel | | | |
| | - Trinidad | \$56.20 | \$72.94 |
| | - Ukraine | \$56.89 | \$53.86 |
| Prices per Mcf | | | |
| | - Canada | \$7.80 | \$- |

(1) Production in Ukraine is stored in tanks then is periodically sold in 1,000 tonne (7,700 barrel) batches FOB the storage facility.

Royalties

Royalty payments in the first quarter of 2007 were \$790,207 as compared to \$500,915 in the same period of 2006. This is an increase of 58% over the comparable period last year and the majority of the increase was the result of the Ukrainian governments increase in the royalty rates from the first quarter of 2006. The balance of the increase was applicable to the royalties paid on the new natural gas production in western Canada.

In the first quarter 2007, the royalty payments in Ukraine amounted to \$745,834 compared with \$492,575 in the same period 2006.

In western Canada, royalty payments were \$36,421 or approximately 25% of natural gas revenue. The western Canada shallow gas program began late in 2006. There was no revenue in the first quarter of 2006.

In Trinidad, the government amended the petroleum royalties in 2005 and imposed a royalty that varies between 0% and 35% for onshore operations dependent on crude oil prices. The rate is 35% on prices over \$49.51 US per barrel. In the first quarter 2007, the royalty payment in Trinidad was \$7,952 as compared with \$8,340 in the first quarter of 2006.

Operating Expenses

Operating costs were significantly higher in the first quarter 2007 due to higher production and sales than the period a year ago. In the first quarter 2007, total production costs were \$383,907 as compared with \$291,372 in the same period last year. Unit cost of sales were \$12.29 per barrel in 2007 as compared with \$11.56 in 2006. In Ukraine, lifting costs were significantly higher in the first quarter of 2007 as the field operator increased its rates. Trinidad production costs were also higher in the first quarter of 2007 compared with the first quarter of 2006. The addition of western Canada operations added \$36,224 to operating costs in the first quarter of 2007.

General and Administrative Expenses

General and administrative expenses amounted to \$130,057 in the first quarter 2007 down from \$207,054 for the same period in 2006. The table below outlines the changes in the major categories.

| | Three Months Ended | |
|-----------------------------------|---------------------------|-------------------------|
| | March 31, 2007 | March 31, 2006 |
| Administration & Management Fees | \$54,208 | \$90,215 |
| Accounting and auditing | \$15,000 | \$31,570 |
| Legal | \$9,822 | \$9,905 |
| Consulting | \$2,603 | \$23,173 |
| Trustee & Listing Fees | \$6,549 | \$5,106 |
| Public Relations & Communications | \$464 | \$15,396 |
| Office Rent | \$20,727 | \$16,187 |
| Other | <u>\$20,684</u> | <u>\$15,502</u> |
| | <u>\$130,057</u> | <u>\$207,054</u> |

Administration and management fees were lower in 2007 due to a decrease in compensation for officers. Consulting fees and expenses were lower reflecting the termination of a consultant in Ukraine effective July 31, 2006. Public relations and investors communication expenses were lower in 2007 as a result of terminating our investor relations contract in November 2006. Office rent increased by \$4,540 to \$20,727 reflecting higher lease and lease operating costs in 2007.

Stock Based Compensation

In the first quarter of 2007, stock based compensation charges were \$24,692 compared to \$66,723 in the first quarter 2006. Under policies mandated by the regulatory authorities, the Company records compensation expense for stock options granted to directors, officers and employees using the fair value method. Fair values are determined using the Black-Scholes option pricing model. Compensation costs are recognized over the vesting period of the stock options.

Depletion and Depreciation

In the first quarter of 2007, depletion and depreciation increased to \$212,125 from \$95,558 in 2006, mainly due to the reduction in proven reserves in 2006 and increases in Ukrainian and western Canada capital expenditures in 2006. The western Canada shallow gas program added \$84,046 to depletion and depreciation charges during the quarter and are reflective of the initial startup of a capital expenditure program and the lag time in reflecting additional reserves. The unit depletion and depreciation costs in western Canada were \$25.19 per boe in the first quarter of 2007.

Netbacks

The average operating netback to the Company in the first quarter of 2007 was \$18.30 per barrel of oil equivalent versus \$22.72 in 2006. The operating netbacks were negatively affected by the increased royalties in the first quarter of 2007.

| | Three Months Ended March 31 | |
|------------------------------|------------------------------------|----------------|
| | 2007 | 2006 |
| Crude Oil (Per Boe) | | |
| <i>Ukraine</i> | | |
| Revenue | \$56.89 | \$53.86 |
| Royalties | (26.88) | (19.84) |
| Operating costs | <u>(12.09)</u> | <u>(11.06)</u> |
| Netback | \$17.92 | \$22.96 |
| | | |
| <i>Trinidad</i> | | |
| Revenue | \$56.20 | \$72.94 |
| Royalties | (19.48) | (22.06) |
| Operating costs | <u>(29.81)</u> | <u>(44.36)</u> |
| Netback | \$6.91 | \$6.52 |
| | | |
| Natural Gas (Per Mcf) | | |
| <i>Canada</i> | | |
| Revenue | \$7.80 | - |
| Royalties | (1.97) | - |
| Operating costs | <u>(1.96)</u> | <u>-</u> |
| Netbacks - per Mcf | \$3.87 | - |
| - per Boe | \$23.26 | |

Financial, liquidity and solvency

At March 31, 2007 the Company had positive working capital of \$2,622,293 compared with \$1,923,830 at December 31, 2006.

Share Capital and Stock Options

In the first quarter 2007, 100,000 stock options were granted to a contractor at a price of \$0.155.

Securities at the end of the reporting period (see note 5 to the financial statements)

- a) Authorized: An unlimited number of common and preferred shares without par value
Issued: 36,233,488 common shares

b) Stock Options and Warrants Outstanding

Stock Options: 1,075,000 expiring February 21, 2008; exercisable at \$0.25
200,000 expiring January 8, 2009; exercisable at \$0.33
975,000 expiring June 1, 2010; exercisable at \$0.56
100,000 expiring March 21, 2011; exercisable at \$0.345
100,000 expiring March 1, 2012; exercisable at \$0.155
2,450,000

Agent Options Outstanding: 220,417 expiring on December 28, 2007; options to purchase two common shares at \$0.30 each

Warrants Outstanding: 893,750 expiring December 28, 2007; exercisable at \$0.45
110,208 agents warrants expiring on December 28, 2007; exercisable at \$0.45
1,003,958

Quarterly Information

The following table sets forth certain quarterly financial information of the company for the eight most recent quarters.

| | 2007 | 2006 | | | | 2005 | | |
|--|---------|-----------|---------|-----------|---------|---------|---------|---------|
| | Q1 | Q4 | Q3 | Q2 | Q1 | Q4 | Q3 | Q2 |
| Financial | | | | | | | | |
| Oil and gas gross revenue (\$000's) | \$1,746 | \$1,291 | \$1,998 | \$551 | \$1,365 | \$1,411 | \$1,567 | \$1,257 |
| Royalties (\$000's) | 790 | \$719 | \$783 | \$150 | 501 | \$483 | \$360 | \$108 |
| Cash flow from operations (\$000's) | \$335 | (\$1) | \$404 | \$117 | \$276 | \$154 | \$540 | \$446 |
| Per basic share | \$0.009 | \$0.000 | \$0.011 | \$0.004 | \$0.009 | \$0.005 | \$0.016 | \$0.014 |
| Per fully diluted share | \$0.009 | \$0.000 | \$0.011 | \$0.004 | \$0.008 | \$0.005 | \$0.016 | \$0.014 |
| Net Income (Loss) (\$000's) | \$97 | (\$151) | \$242 | (\$58) | \$117 | \$7 | \$374 | \$323 |
| Per basic share | \$0.003 | (\$0.005) | \$0.007 | (\$0.002) | \$0.004 | \$0.000 | \$0.012 | \$0.010 |
| Per fully diluted share | \$0.003 | (\$0.005) | \$0.007 | (\$0.002) | \$0.004 | \$0.000 | \$0.011 | \$0.010 |
| Weighted shares outstanding (millions) | | | | | | | | |
| Basic | 36.2 | 36.02 | 35.7 | 32.4 | 32.2 | 32.2 | 32.2 | 32.3 |
| Fully diluted | 40.0 | 36.1 | 33.1 | 33.1 | 32.9 | 33.0 | 33.3 | 33.6 |
| Operating | | | | | | | | |
| Liquids production (Bbl/d) | 232 | 238 | 245 | 232 | 237 | 259 | 268 | 246 |
| Natural gas production (Mcf/d) | 222 | - | - | - | - | - | - | - |
| Liquids price \$/bbl - Ukraine | \$56.89 | \$58.81 | \$72.67 | \$59.47 | \$53.86 | \$57.31 | \$57.61 | \$49.44 |
| Liquids price \$/bbl - Trinidad | \$56.20 | \$54.82 | \$64.59 | \$57.33 | \$72.94 | \$56.27 | \$61.33 | \$55.41 |
| Natural gas price \$/Mcf | \$7.80 | \$7.14 | \$5.05 | - | - | - | - | - |

Internal Controls over Financial Reporting

There were no material changes in Kroes' internal controls over financial reporting during the first quarter of 2007 that materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

Directors and officers as at the date of this report:

| | |
|-----------------------|---------------------------------------|
| Fred Callaway | President and Director |
| Edward M. Southern | Director & Executive Vice-President |
| C. James Cummings | Director |
| David E. Powell | Director |
| Dr. James E. Werbicki | Director |
| Darrell M. Zakreski | Director |
| Stewart D. Gossen | Director, Vice President, & Secretary |
| David E. Malarchuk | Controller |

On behalf of the Board,

"Fred Callaway"

Fred Callaway, President
May 28, 2007

Consolidated Balance Sheets

Unaudited

| | March 31, 2007 | December 31, 2006 |
|--|---------------------|----------------------|
| ASSETS | | |
| Current | | |
| Cash and cash equivalents | \$1,349,013 | \$ 892,179 |
| Receivables | 1,901,973 | 1,482,052 |
| Prepays and deposits | 74,033 | 96,649 |
| Inventory | 48,583 | 213,842 |
| | <u>3,373,602</u> | <u>2,684,722</u> |
| Capital assets | | |
| Petroleum and natural gas properties and equipment - net | 6,694,645 | 6,328,516 |
| Restricted Funds (Note 3) | - | 1,001,429 |
| | <u>\$10,068,247</u> | <u>\$ 10,014,667</u> |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| Current Liabilities | | |
| Payables and accruals | \$508,447 | \$ 382,800 |
| Income taxes payable (Note 2) | 242,862 | 378,092 |
| | <u>751,309</u> | <u>760,892</u> |
| Asset retirement obligations | 118,663 | 115,665 |
| Future income taxes | 540,281 | 541,101 |
| Shareholders' equity | | |
| Capital stock (Note 5) | 6,814,320 | 6,814,320 |
| Warrants issued (Note 7) | 131,984 | 131,984 |
| Contributed surplus | 703,112 | 679,167 |
| Foreign currency translation adjustment | (823,647) | (763,370) |
| Retained earnings | 1,832,225 | 1,734,908 |
| | <u>8,657,994</u> | <u>8,597,009</u> |
| | <u>\$10,068,247</u> | <u>\$10,014,667</u> |

Consolidated Statements of Operations and Retained Earnings

Unaudited

| | Three months ended | |
|---|--------------------|--------------------|
| | March 31, 2007 | March 31, 2006 |
| Revenue | | |
| Oil and natural gas sales | \$1,745,712 | \$1,364,968 |
| Royalties | (790,207) | (500,915) |
| | <u>955,505</u> | <u>864,053</u> |
| Expenses | | |
| Operating | 383,907 | 291,372 |
| General and administrative | 130,057 | 207,054 |
| Stock based compensation | 24,692 | 66,723 |
| Depletion and depreciation | 212,125 | 95,558 |
| Accretion of asset retirement obligations | 1,463 | 1,615 |
| Foreign exchange (gain) loss | 8,575 | (4,390) |
| | <u>760,819</u> | <u>657,932</u> |
| Earnings before other items and income taxes | <u>194,686</u> | <u>206,121</u> |
| Other items | | |
| Interest and other income | <u>28,150</u> | <u>28,092</u> |
| Earnings before income taxes | 222,836 | 234,213 |
| Income taxes (Note 2) | 126,265 | 117,639 |
| Net earnings for the period | <u>\$96,571</u> | <u>\$116,574</u> |
| Retained earnings - Beginning of period | \$1,734,908 | \$1,584,867 |
| Change in accounting policy | | |
| Premium on redemption of shares | <u>-</u> | <u>(704)</u> |
| Retained earnings - End of period | <u>\$1,831,479</u> | <u>\$1,700,737</u> |
| Net income attributable per fully diluted common share | <u>\$0.003</u> | <u>\$0.004</u> |
| Weighted average number of fully diluted shares outstanding | <u>36,233,488</u> | <u>32,868,518</u> |

Consolidated Statements of Cash Flows

Unaudited

| | Three months ended | |
|---|--------------------|----------------|
| | March 31, 2007 | March 31, 2006 |
| Increase (decrease) in cash and cash equivalents | | |
| Operating Activities | | |
| Net earnings for period | \$96,571 | \$116,574 |
| Items not affecting cash | | |
| Stock option compensation | 24,692 | 66,723 |
| Depletion and depreciation | 212,125 | 95,558 |
| Accretion expenses | 1,463 | 1,615 |
| Unrealized foreign exchange gain | - | (4,261) |
| Cash flow from operations | 334,851 | 276,209 |
| Change in non-cash working capital | (159,965) | 241,018 |
| | 174,886 | 517,227 |
| Financing | | |
| Proceeds from share issues | - | - |
| Redemption of common shares | - | (1,701) |
| | - | (1,701) |
| Investing | | |
| Additions to capital assets | (626,062) | (354,541) |
| Restricted funds | 908,010 | (9,235) |
| | 281,948 | (363,776) |
| Increase (decrease) in cash | 456,834 | 151,750 |
| Cash and short term investments, beginning of period | 892,179 | 1,558,406 |
| Cash and short term investments, end of period | \$1,349,013 | \$1,710,156 |

Selected Notes to Consolidated Financial Statements

Note 1 – Basis of Presentation

The Interim Consolidated Financial Statements of Kroes Energy Inc. has been prepared by management in accordance with accounting principles generally accepted in Canada. The interim consolidated financial statements have been prepared following the same accounting policies and methods of computation as the consolidated financial statements for the year ended December 31, 2006. The statements should be read in conjunction with the financial statements and the notes thereto in the Company's annual report for the year ended December 31, 2006.

Note 2 – Income Taxes

The income tax expense of \$126,265 on the Statement of Operations and Retained Earnings relates entirely to the Ukrainian operation and represents the Company's 45% share of Kashtan's first quarter income tax expense. Similarly, the amount of \$242,862 shown on the Balance Sheet as Income Tax Payable is the 45% portion of Kashtan's income tax payable at the end of the first quarter.

Note 3 – Restricted Funds

The Company's financing obligation with respect to the Ukrainian project was to place a deposit of US\$787,500 with the Calyon Bank in Kyiv, Ukraine to provide 105% security for a US\$750,000 line of credit the Bank extended to Kashtan Petroleum Ltd. On March 22, 2007, the Company recalled US\$ 787,500 from the Calyon Bank deposit it had established as security for the Kashtan operating line of credit. The line of credit had not been used by Kashtan for three years and with the implementation of the new government royalty on the Kashtan project, the Company decided to withdrawal the deposit and it was returned on March 22, 2007.

Note 4 – Asset Retirement Obligations

The following table represents the reconciliation of the beginning and ending aggregate carrying amount of the obligations associated with the retirement of oil and gas assets:

| | Period Ended | |
|---|------------------|-------------------|
| | March 31, 2007 | December 31, 2006 |
| Asset retirement obligations, beginning of period | \$115,665 | \$114,203 |
| Liabilities incurred | - | 3,268 |
| Revision of estimates | 1,535 | (6,903) |
| Accretion expenses | 1,463 | 5,097 |
| Asset retirement obligations, end of period | <u>\$118,663</u> | <u>\$115,665</u> |

Note 5 – Share Capital

| Common Shares Issued | Number of Shares | Amount |
|---------------------------|-------------------|--------------------|
| Balance December 31, 2006 | 36,233,488 | \$6,814,320 |
| Balance March 31, 2007 | <u>36,233,488</u> | <u>\$6,814,320</u> |

Note 6 – Weighted Average Number of Common Shares

The following table summarizes the common shares used in the calculating net income and cash flow from operations per common share.

| | Three Months Ended March 31 | |
|---------------|-----------------------------|------------|
| | 2007 | 2006 |
| Basic | 36,233,488 | 32,158,659 |
| Fully Diluted | 36,233,488 | 32,868,518 |

The reconciling items between the basic and diluted weighted average common shares are outstanding options and broker warrants.

Note 7 – Share Purchase Warrants

As part of the June 2006 financing, the Company issued to subscribers 893,750 share purchase warrants, exercisable at \$0.45 for 18 months from the initial closing of June 27, 2006. The fair value of these warrants approximated \$131,984 or \$0.1477 per warrant. The fair value of these warrants were estimated using the Black-Scholes option pricing model with an average risk-free interest rate of 4.6%, expected life of 1.5 years, volatility in the price of the Company's common shares of 134% and a dividend yield of 0.00%.

As part of the agent's commission the Company issued non-transferable options to the agent to purchase 41,667 units, as well as an option to purchase non-transferable options equalling 10% of the units sold (1,787,500 units). These units have non-transferable warrants attached to them that total 110,208. These warrants are exercisable at \$0.45 for 18 months from the initial closing date of June 27, 2006. The Agent's financing warrants are accounted for as a charge to share issuance costs and a credit to contributed surplus. The fair value of these agent warrants approximated \$16,275 or \$0.1477 per warrant. The fair value of these warrants were estimated using the Black-Scholes option pricing model with an average risk-free interest rate of 4.6%, expected life of 1.5 years, volatility in the price of the Company's common shares of 134% and a dividend yield of 0.00%.

| | Number of Warrants | Amount |
|---------------------------|--------------------|------------------|
| Balance December 31, 2006 | 1,003,958 | \$131,984 |
| None | - | - |
| Balance March 31, 2007 | <u>1,003,958</u> | <u>\$131,984</u> |

Note 8 – Agent Options

In 2006, 220,417 agents financing options were issued in connection with the June 27, 2006 public financing referred to in note 7. One option is composed of two common shares and one half one common share purchase warrant. The unit price is \$0.60 per unit and one full warrant entitles the purchaser to purchase a common share for \$0.45 prior to December 28, 2007.

| | Number of Shares | Exercise Price |
|---------------------------|------------------|----------------|
| Balance December 31, 2006 | 440,834 | \$0.45 |
| Changes | - | - |
| Balance March 31, 2007 | <u>440,834</u> | <u>\$0.45</u> |

Note 9 – Stock-Based Compensation Plans

The Company has a Stock Option Plan for Directors, Officers and Consultants. As of March 31, 2007 there were 2,450,000 options granted with an exercise price of \$0.13, \$0.25, \$0.33, \$0.56, \$0.0345 and \$0.155 per share exercisable at various dates to March 1, 2012. The exercise price of each option equalled or exceeded the market price of the Company's common shares on the date of each grant.

The following table summarises the information about the stock options:

| | March 31, 2007 | | December 31, 2006 | |
|------------------------|-------------------|---------------------------------|-------------------|---------------------------------|
| | Number of Options | Weighted Average Exercise Price | Number of Options | Weighted Average Exercise Price |
| Options | | | | |
| Outstanding, beginning | 2,350,000 | \$0.39 | 2,920,000 | \$0.33 |
| Granted | 100,000 | \$0.155 | 100,000 | \$0.345 |
| Exercised | - | - | (500,000) | \$0.13 |
| Cancelled | - | - | (170,000) | \$0.13 |
| | <u>2,450,000</u> | <u>\$0.38</u> | <u>2,350,000</u> | <u>\$0.39</u> |

The new CICA requirement to determine a compensation cost associated with the granting of Stock Options was implemented by the Company on January 01, 2004

The assumptions used to calculate stock-based compensation expense for the options granted in 2007 is estimated at the date of grant using the Black-Scholes Option Pricing Model with the following weighted average assumptions:

| | | |
|---|-------|-------|
| | 2007 | 2006 |
| Volatility factor of expected market prices (%) | 168% | 143% |
| Weighted average risk-free interest rate (%) | 3.88% | 4.10% |
| Weighted average expected life of options (years) | 5 | 5 |
| Dividend yield (%) | - | - |

The options granted in 2005, 2006 and 2007 vest over a three year period and will be charged to earnings over that three year period.

Note 10 – Shelton Transaction

On March 28, 2007, the Company entered into an agreement with Shelton Canada Corp. ("Shelton") whereby Shelton will acquire Kroes' wholly owned subsidiary Zhoda 2001 Corporation ("Zhoda"). Zhoda's only operating asset is a 45% interest in Kashtan Petroleum Ltd. a joint venture oilfield exploitation and development project in Ukraine.

The completion of the Transaction is subject to a number of conditions including approval for the transaction by the Company's shareholders and all relevant regulatory authorities and due diligence on the part of both Shelton and the Company. Subject to the fulfilment of all conditions, this transaction is expected to close on or before June 30, 2007.

Note 11 – Management Disclosure

These financial statements have been prepared by management and have not been reviewed by an external auditor.

Corporate Information

Corporate Office:
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Calgary, Alberta, Canada
T2P 2T8
Telephone: (403) 265-7711
Fax: (403) 265-7733
E-mail: admin@kroesenergy.com
Internet: www.kroesenergy.com

Listing: TSX, Trading Symbol: KRS
Bank: Bank of Nova Scotia
Auditor: Grant Thornton LLP
Solicitors: ProVenture Law LLP
Transfer Agent: Computershare Trust
Company of Canada