CALVALLEY PETROLEUM INC.

2006
1st Quarter
Interim Report
to Shareholders

1

CAL VALLEY PETROLEUM INC.

CORPORATE PROFILE

Calvalley Petroleum Inc. ("Calvalley" or the "Company") is a Calgary, Alberta-based junior international oil and gas company focused on the exploration and development of the 2,234 km^2 Block 9 in the Republic of Yemen where it is the Operator and a 50% working interest owner. Calvalley's common shares are listed and posted for trading on The Toronto Stock Exchange under the symbol "CVI.A."

Calvalley has made a number of significant oil discoveries in the Republic of Yemen over the past several years and initiated production from Block 9 in the fourth quarter of 2005. The Company is party to a Production Sharing Agreement, dated February 23, 1997, with the Ministry of Oil and Mineral Resources of the Republic of Yemen, which permits the Company to explore for, and produce, oil and natural gas on Block 9. The Company is well financed and debt free and looks forward to anther successful year in the Republic of Yemen.

Web site: calvalleypetroleum.com

FIRST QUARTER 2006 HIGHLIGHTS

- The closing of a $47.7 million (net of commissions) bought deal private placement at CDN$6.50 per share in February, 2006
- Four horizontal wells drilled, with a fifth well currently being drilled
- Tender documents for two additional drilling rigs prepared and issued
- Five additional well proposals for the continued horizontal development at the Hiswah field prepared and presented to the Government of Yemen
- Three exploration well recommendations prepared and presented to the Government of Yemen and partners for approval
- Prepared plan and tender documents for acquiring 760 kilometers of 2D seismic survey data
- Evaluated and awarded bids for tenders associated with various oil and gas services, including wireline logging, mud engineering, drilling, wellsite mudlogging and testing services

Note: Since January 1, 2005, Calvalley has chosen to state all of its financial reporting in U.S. currency so as to better reflect the nature of the Company's business and the functional currency of the Yemen Joint Venture. Amounts in Canadian dollars are specifically noted.

CHAIRMAN AND CHIEF EXECUTIVE OFFICER'S MESSAGE

Commencement of Production in Yemen and Ongoing Construction Projects

In late 2005, Calvalley initiated production from a single well, Hiswah-6. With limited infrastructure in place and by utilizing temporary tankage and truck loading facilities, the oil was transported approximately 280 km away to Safer Exploration receiving facilities on Block 18. Initially, production was constrained by the receipt capacity of the Safer delivery terminal to which the oil was being trucked. However, since that time, Calvalley has been authorized to design and has successfully constructed a new permanent off-loading facility at Block 18, thereby alleviating the bottleneck that had previously limited production.

Other construction projects continued with success in the first quarter of 2006. Temporary production facilities in respect of Hiswah 3 and 6 wells were erected, allowing us to continuing producing oil in the early stages of the production phase while constructing a permanent Central Processing Facility ("CPF") and a field gathering pipeline system. This construction continued throughout the first quarter of 2006.

Calvalley continues to work toward obtaining governmental approval of design for a main pipeline transmission system that will connect Block 9 with Safer's Block 18 facilities. Negotiations continued through the first quarter of 2006 in respect of the final specifications for the pipeline with the applicable governmental authorities in Yemen. At this time, we have made a recommendation to construct a twelve inch diameter pipeline which will ultimately have four pump stations with a maximum capacity of 100,000 barrels a day.

Continued Drilling Success at Hiswah

Calvalley continues to aggressively pursue exploration and development opportunities on Block 9. In the first three months of 2006 alone, four horizontal wells have been drilled in the Hiswah field. Drilling of a fifth well, Hiswah 16, is currently underway, which represents the fourteenth horizontal well to be drilled by Calvalley at the Hiswah field and the twenty-fifth well overall in Block 9. The continued emphasis on such drilling activities illustrates your Company's desire to pursue production growth in addition to its commitment to an aggressive exploration and development strategy going forward, even as production success has been achieved.

Financial Stability

In January and February of 2006, the Company issued 407,143 Class "A" common voting shares, with the exercise of warrants originally issued as part of a 2005 private placement and expiring on March 14, 2006, for cash consideration of CDN$1,587,858.

On February 21, 2006, Calvalley closed a bought deal private placement of 9,000,000 Class "A" common voting shares at a price of CDN$6.50 per share for a net proceeds amount of $46,279,000 dollars. This private placement was underwritten by a syndicate of underwriters led by UBS Securities Canada Inc. and included Jennings Capital Inc., Octagon Capital Corporation and Leede Financial Markets Inc. The Company intends to apply the proceeds of this issue towards its ongoing exploration and development program in Yemen.

As has been the case for a number of years, your Company's share price rose once again during the first quarter of 2006. On March 31, 2006, Calvalley's share price closed at $7.45, up 65% from its December 31, 2005 close of $4.52 and 101% from March 31, 2005 (the share price closed at $3.50 on the TSX Venture Exchange). And the share price continues to rise. As at May 10, Calvalley's shares closed at $8.55, another 15% increase from its share price as at March 31, 2006.

Outlook

The outlook for the remainder of 2006 is very promising. The Company is pleased to report that the Government of Yemen has approved the location and well programs for another five horizontal wells and an additional ten well locations have been proposed for subsequent drilling in 2006. Further, the Government of Yemen has also approved the acquisition of 760 km of 2D seismic data, which will delineate existing leads for the Company that our technical team has identified as well as enabling us to identify additional prospects. In this regard, we have received bids from internationally-respected seismic acquisition firms in respect of the 2D seismic acquisition program and expect this program to be initiated by the summer of 2006.

Respectfully submitted,

Edmund M. Shimoon, P.Eng.
Chairman and Chief Executive Officer
May 12, 2006

Operations Review

Calvalley has a 50% working interest and is the operator of the 2,234 km^2 (552,044 acres) Block 9, in the Sayun-Masila Basin in the Republic of Yemen.

Hiswah-10

The Hiswah-10 horizontal development well was spud January 8, 2006 and reached a total depth at 1,586 meters, with an open hole length in the reservoir of 364 meters. Good oil shows and mud-gas liberation were seen while drilling the horizontal leg and the well is deemed to be a success. It will be tied-in to the field gathering system in the near future.

Hiswah-11

Hiswah-11 was another successful horizontal well, drilled parallel to and 280 meters to the east of Hiswah-10. The Hiswah-11 horizontal development well was spud January 27, 2006 and reached a total depth of 1,654 meters, with an open hole length in the reservoir of 391 meters. Good oil shows were seen throughout the reservoir section and the well will be tied-in to the field gathering system in the near future.

Hiswah-12

The Hiswah-12 horizontal production well was drilled in a parallel direction as wells 10 and 11, and had a total depth of 1,590 meters. Of those 1,590 meters, 347 meters is open reservoir in the horizontal leg. The well will follow the aforementioned wells in being tied-in to the Hiswah field gathering system.

Hiswah-13

Hiswah-13 was drilled in an opposite direction to the Hiswah 10, 11 and 12 wellbores, towards the northern flank of the field. The well was spudded March 6, 2006 and reached a total depth of 1,821 meters after drilling 594 meters of oil-bearing reservoir displaying high-level oil shows.

Hiswah-14

Hiswah-14 was spud March 24, 2006 and is being drilled in a parallel direction as Hiswah-13, towards the northern margin of the field.

MANAGEMENT'S DISCUSSION AND ANALYSIS

The following management discussion and analysis ("MD&A") is dated May 12, 2006 and should be read in conjunction with the unaudited interim consolidated financial statements of Calvalley Petroleum Inc. ("Calvalley" or the "Company") ended March 31, 2006 and the audited annual consolidated financial statements of Calvalley for the twelve months ended December 31, 2005.

Advisory

This MD&A highlights significant business results and statistics from Calvalley's audited financial statements for the three months ended March 31, 2006 (the "First Quarter") and the accompanying notes thereto. In the interest of providing its shareholders and potential investors with information regarding Calvalley, including management's assessment of its future plans and operations, this MD&A contains forward-looking statements that involve risks and uncertainties. Such risks and uncertainties include, but are not limited to, risks associated with conventional oil operations; the volatility in commodity prices and currency exchange rates; general economic, market and business conditions; changes in environmental legislation and regulations; the availability of sufficient capital from internal and external sources and such other risks and uncertainties described from time to time in Calvalley's regulatory reports and filings made with securities regulators.

Forward-Looking Statements

Some of the statements contained herein including, without limitation, financial and business prospects and financial outlooks may be forward-looking statements which reflect management's expectations regarding future plans and intentions, growth, results of operations, performance and business prospects and opportunities. Words such as "may", "will", "should", "could", "anticipate", "believe", "expect", "intend", "plan", "potential", "continue", and similar expressions have been used to identify these forward-looking statements. These statements reflect management's current beliefs and are based on information currently available to management. Forward-looking statements involve significant risk and uncertainties. A number of factors could cause actual results to differ materially from the results discussed in the forward-looking statements including, but not limited to, changes in general economic and market conditions and other risk factors. Although the forward-looking statements contained herein are based upon what management believes to be reasonable assumptions, management cannot assure that actual results will be consistent with these forward-looking statements. Investors should not place undue reliance on forward-looking statements. These forward-looking statements are made as of the date hereof.

Forward-looking statements and other information contained herein concerning the oil industry and Calvalley's general expectations concerning this industry are based on estimates prepared by management using data from publicly available industry sources as well as from reserve reports, market research and industry analysis and on assumptions based on data and knowledge of this industry which Calvalley believes to be reasonable. However, this data is inherently imprecise, although generally indicative of relative market positions, market shares and performance characteristics. While Calvalley is not aware of any misstatements regarding any industry data presented herein, the industry involves risks and uncertainties and is subject to change based on various factors.

Change in Reporting Currency

The Company adopted the United States dollar as its reporting currency in 2005, rather than the Canadian dollar as in previous years. Most of the Company's operations were conducted by its non-Canadian subsidiaries in United States dollars. All numbers reported in these financial statements are reported in United States dollars unless otherwise noted. As substantially all of the operations are conducted in United States dollars, management is of the opinion that the

United States dollar will more accurately reflect the balance sheet and the net exposure to the Canadian dollar will be reflected in the income statement. The net exposure to the Canadian dollar will primarily come from Canadian dollar denominated accounts such as cash and trade payables.

As the Company's financial resources and the majority of its operations are denominated in United States dollars, the main effect of this change in reporting currency has been the elimination of foreign exchange losses that arose on the retranslation of the United States dollar denominated net current assets.

Summary of Quarterly Results

Most of this discussion is focused on the construction and investment activities carried on by the Company as operator and 50% owner of the joint venture that is exploring, developing and building in the Malik Block 9 in Yemen. Although the oil revenue indicated on the consolidated income statement is from a Canadian resource property, the property and this income is relatively insignificant as compared to the Yemen operations. It is anticipated that sales revenues from the Block 9 source will outstrip the Canadian revenue sources in future quarters.

Calvalley's net loss for the First Quarter totals $1,236,000 compared to a net income of $68,000 in 2005 reflecting the items described in a preceding paragraph. The main reasons for the difference are the following:

- Although the Company began to produce oil and ship it to the Safer owned receiving facility in Block 18, approximately 280 kilometers from the Hiswah field, the Company has not recorded any revenue in the first quarter accounts. The Company is negotiating a marketing agreement but had not completed it by March 31, 2006 and accordingly has not recognized any sales revenue.
- Produced oil continues to accumulate at the export point in anticipation of signing the marketing agreement.
- Substantially more activity in the Yemen Block 9 oil fields required greater support and administrative services such that general and administrative expenses (excluding president's bonus) increased to $400,000 as compared to $191,000 for the same period in 2005; and
- The Company paid a management bonus of $500,000 to its chief executive officer in 2006.
- As the Company has entered the commerciality phase of its contract with the Yemen government, certain costs that might otherwise have been capitalized are now deducted as general and administrative costs.
- The Company is now liable for Yemen payroll taxes that commenced with achieving commerciality. These taxes were $70,500 in the first quarter.

Comparative Quarterly Information

($000)		Net Income (loss)		Earnings per basic share		Earnings per diluted share		Total revenue
2006 Q1	$	(1,236)	$	(0.1)	$	-	$	442
2005 Q4	$	(853)	$	-	$	-	$	93
2005 Q3	$	114	$	-	$	-	$	120
2005 Q2	$	(65)	$	-	$	-	$	274
2005 Q1	$	68	$	-	$	-	$	294
2004 Q4	$	(821)	$	-	$	-	$	130
2004 Q3	$	118	$	-	$	-	$	121
2004 Q2	$	1,379	$	0.02	$	0.01	$	151
2004 Q1	$	1,676	$	0.02	$	0.02	$	81

Other items of discussion related to the consolidated income statement are:

Oil Sales

The Block 9 joint venture began to produce oil in the last few weeks of 2005 and through the first quarter of 2006. Average daily production for this period of approximately 1,636 bopd was somewhat lower than expected due to the delays in tying-in additional wells and the shut-in of the Hiswah 6 well for maintenance.

Neither revenues nor inventories have been recognized in the first quarter because, although oil was produced and shipped to a receiving facility, the Company had not signed a marketing or sales agreement. Approximately 180,000 barrels had been produced and shipped to the receiving facility at Safer in Block 18 by March 31, 2006. Calvalley's share of the production under the Production Sharing Agreement between the Company and the Government of Yemen is approximately 56% of this production or approximately 100,000 barrels.

Calvalley accrued oil revenues net of royalties of $43,000 for the first quarter as compared to $199,000 for the twelve months ended December 31, 2005 and $43,000 for the three months ended March 31, 2005. This production is related to a minor interest in a Canadian property that the Company continued to own through these periods. The Company has divested itself of most of its Canadian properties so as to devote its energies to the Yemen Block 9 project.

Other Revenue

Other revenue, comprised primarily of interest revenue, was $399,000 for the first quarter of 2006, $596,000 for the 2005 year and $158,000 for the quarter ended March 31, 2005. The increased interest revenue resulted from holding cash reserves in excess of $66,000,000 for the last six weeks of the first quarter of 2006 following the issuance of 9,000,000 Class "A" common voting shares in February and the exercise of warrants.

Operating Expenses

Operating expenses for the quarter were $914,000 in 2006 as compared to $219,000 in 2005, due to increased general and administrative expenses and a management bonus as has been described above.

General and Administration

General and administration expenses in the first quarter amounted to $900,000 in 2006 as compared to $191,000 for 2005 due to increased support activities expenses and a management bonus as has been described above.

Depletion and Depreciation

Calvalley recorded depletion, depreciation and amortization expenses of $7,000 for the quarter ended March 31, 2006 as compared to $2,000 in 2005. Although the Yemen joint venture commenced production in December 2005 and through the first quarter of 2006, the Company did not record depletion because no revenue was received for that production before year end.

Asset Retirement Obligations

The amount provided in 2006 for asset retirement obligations was $1,000 compared to $nil recorded for the quarter ended March 31, 2005. During 2004 most of the Canadian properties were sold for consideration that included the assumption of the associated asset retirement obligation. No provision has been made for an asset retirement obligation in respect of the Yemen properties because the Company is not under a legal requirement for reclamation expenses and therefore is not required to recognize an asset retirement obligation under GAAP. Provision for reclamation costs has been made in the reserve report because the Company intends to maintain good environmental practices as part of its corporate governance.

Liquidity and Capital Resources

Calvalley's total cash flow for the first quarter of 2006 was $41,731,00 due primarily to a private placement in February 2006 wherein the Company issued 9,000,000 Class "A" common voting shares for CDN$6.50 per share for net proceeds of $47.7 million. In addition, the warrants that were issued as part of a private placement in March 2005 were exercised resulting in an increase to working capital of approximately $1.4 million. The Company also disbursed $6,251,000 for capital expenditures and working capital primarily related to the Block 9 operations.

Working capital

As at March 31, 2006, the Company's working capital was $678,793,000 as compared to $26,600,000 on December 31, 2005 and $23,132,000 on March 31, 2005. Of this, $55,500,000 was in Canadian dollars. The Company has sufficient funds with which to meet its capital budget for 2006.

Share transactions

Capital expenditures and Yemen related working capital of $6,251,000 were made in Yemen for the first quarter of 2006 compared to $7,404,000 in 2005.

On February 21, 2006 the Company issued 9,000,000 Class "A" common voting shares for cash consideration of CDN$53,939,000 (U.S.$46,279,000) net of commissions, legal fees, private placement financing fees to the TSX Venture Exchange. No warrants were issued with this placement.

During the first quarter 120,000 share options were exercised for proceeds of CDN$141,000 (US $121,000) and 407,143 warrants were exercised for proceeds of CDN$1,589,000 (US $1,378,000).

During 2005 the Company issued 8,142,857 Class "A" common voting shares for cash consideration of $24,432,700 on March 24, 2005 (the "March 2005 Private Placement"). The net proceeds from the offering totaled $21,581,057 after deduction of legal fees, private placement financing fees to the TSX Venture Exchange, and cash commissions paid to the syndicate of underwriters. In addition to the cash commission, the syndicate of underwriters received warrants equivalent to 5% of the shares issued, exercisable until March 24, 2006 at a price of CDN$3.90 per common share purchase warrant in connection with the offering; all of these warrants were exercised in 2006. Also during 2005, the Company issued 8,724,513 Class "A" common voting shares for cash consideration of $11,176,873 upon the exercise of warrants, such warrants expiring on June 10, 2005 and originally being issued as part of a private placement which took place in December 2003.

During 2005 a total of 676,700 options were exercised for $833,000. A total of 773,300 options were exercised for $452,000 in 2004.

Share price performance

The trading price of Calvalley's Class "A" common voting shares continued to increase. As at March 31, 2005, the closing price for the Class "A" common voting shares on the TSX Venture Exchange was $3.70. As at December 31, 2005, the closing price for the Class "A" common voting shares on The Toronto Stock Exchange was $4.52. As at March 31, 2006, the closing price had risen to $7.45, a 101% and a 65% increase, respectively.

Other

No operating loans were taken out in either 2006 or 2005.

At December 31, 2005 the Company had Canadian tax pools of approximately $19.5 million of which $4.8 million were non-capital losses, $13.0 were Canadian resource tax pools and $1.7 million were deferred financing costs. The total pools were $19.7 million in 2004. No provision has been made to record these pools as an asset because the Company is not likely to take advantage of them due to the insignificance of its Canadian operations and assets.

The Company has no Canadian long term contractual obligations other than operating leases for office space and parking which total approximately $145,000 for 2006 and 2007. Its long-term commitments regarding its Yemen property include its 50% proportionate share of government allowances and bonuses of $450,000 per year, plus certain other bonus payments of $2,000,000, $3,000,000 and $4,000,000 when an if sustainable production exceeds 25,000, 75,000 and 100,000 barrels of oil per day, respectively. Also, the Company is committed to paying $1.25 per bbl of production from the Block 9 to a maximum of $5,125,000 in connection with a financing arrangement entered into in March 2004.

Off Balance Sheet Arrangements

Calvalley had no off balance sheet arrangements as at December 31, 2005 or at December 31, 2004.

Block 9 Republic of Yemen – Exploration and Development Program

Calvalley is the operator and 50 percent working interest owner of Block 9. Exploration and development expenditures during the First Quarter was $6.125 million as compared to $14.1 million during 2005 and $7.405 million in the first quarter of 2005.

Block 9 Oil Production and Construction of Infrastructure

The Company received approval for commerciality on Block 9 in August 2005 and initiated production within four months of the approval. On December 10, 2005, the Company initiated production in Yemen when the Hiswah-6 well began flowing clean oil at a rate of approximately 1,370 bopd. Combined daily production averaged 1,850 bbls through the quarter.

The Company initiated production at Hiswah-6 and Hiswah-3, using temporary tankage and truck loading facilities, and the construction of an early production facility is expected to be operational by the end of the second quarter of 2006. Further, site preparation and construction of facilities that will expand the Block 18 Safer Facility was almost completed. The Company expects to receive approval to finalize design for a pipeline from Block 9 to Block 18 this year and to commence construction shortly after approval is granted.

Production will likely increase in the second quarter as more wells are tied-in to the production facilities. As at the date of this MD&A and after the quarter end, the joint venture had tied in Hiswah wells 7, 9 and 10 to add to the Hiswah 3 and 6 wells that produced during the first quarter, bringing production levels to 6,500 bbls per day. Although the wells are capable of producing at greater flow rates, production is restricted by the trucking capacity and Yemen government limits.

Critical Accounting Estimates

Because a precise determination of certain assets and liabilities is dependent upon future events, the preparation of financial statements necessarily involves the use of estimates and approximations, which have been made using careful judgment. The financial information provided in this MD&A and in the consolidated financial statements has, in management's opinion, been properly prepared within reasonable limits of materiality and within the framework of the accounting policies summarized below. Financial results incorporate estimates on the following items:

- Depletion, depreciation and accretion are based on estimates of oil reserves.
- Estimated value of future income tax liabilities.
- Estimated value of asset retirement obligations that is dependent upon the future costs and timing of related expenditures.
- Estimated fair value of unit-based compensation.

To estimate the economically recoverable oil reserves and related future net cash flows, we incorporate many factors and assumptions including:

- expected reservoir characteristics based on geological, geophysical and engineering assessments.

- future production rates based on historical performance and expected future operating and investment activities.
- future oil prices and quality differentials.
- assumed effects of regulation by governmental agencies.
- future development and operating costs.

We believe these factors and assumptions are reasonable, based on the information available to us at the time we prepared the estimates. However, actual results could vary considerably, which could cause material variances in:

- estimated quantities of proved oil reserves in aggregate and for any particular group of properties.
- reserve classification based on risk of recovery.
- future net revenues, including production, revenues, taxes and development and operating expenditures.
- financial results including the annual rate of depletion and recognition of property impairments.
- assessing, when necessary, our oil assets for impairment. Estimated future undiscounted cash flows are determined using proved reserves.

As circumstances change and additional data becomes available, our reserve estimates also change, possibly materially impacting net income. Estimates made by our engineers are reviewed and revised, either upward or downward, as warranted by the new information. Revisions are often required due to changes in well performance, prices, economic conditions and governmental restrictions.

Although we make every reasonable effort to ensure that our reserve estimates are accurate, reserve estimation is an inferential science. As a result, the subjective decisions, new geological or production information and a changing environment may impact these estimates. Revisions to our reserve estimates can arise from changes in year-end oil prices, and reservoir performance. Such revisions can be either positive or negative.

Changes in Accounting Policy

The Company has not adopted any changes in accounting policy for this quarter ended March 31, 2006.

The Company adopted the United States dollar as its reporting currency in 2005 which is discussed above.

Financial Instruments

Financial instruments of the Company consist mainly of cash and cash equivalents, accounts receivable and accounts payable and accrued liabilities. The fair value of these financial instruments approximates their carrying values.

Disclosure of Outstanding Share Data

As at the date of this MD&A the Company had the following outstanding share data:

100,857,165 Class “A” common voting shares were issued and outstanding;

2,770,770 options are outstanding that may be converted into additional Class “A” common voting shares at exercise prices ranging from CDN$0.50 to CDN$4.20 per options. Of these, 1,875,000 are exercisable.

There are no warrants outstanding.

Additional information relating to Calvalley Petroleum Inc., including Calvalley’s Annual Information Form, can be found on SEDAR at www.sedar.com.

AUDITOR REVIEW OF FINANCIAL STATEMENTS

The unaudited interim financial statements for the period ended March 31, 2006 have not been reviewed by the Company's auditors, Deloitte & Touche LLP. The Company did not engage its auditors to provide a Review Engagement Report on the interim financial statements and therefore, no such report was issued by the auditors for the period ended March 31, 2006.

The unaudited interim financial statements for the period ended March 31, 2005 have not been reviewed by the Company's former auditors, Ernst & Young LLP. The Company did not engage its auditors to provide a Review Engagement Report on the interim financial statements and therefore, no such report was issued by the auditors for the period ended March 31, 2005.

Edmund Shimoon	Cameron Dow
Edmund M. Shimoon	**Cameron W. Dow**
Chairman & Chief Executive Officer	Chief Financial Officer

Interim Report

Consolidated Balance Sheets (Unaudited)

(Expressed in U.S. Dollars)

($ 000)	**As at March 31, 2006** $	**As at December 31, 2005** $
ASSETS		
Current		
Cash and cash equivalents	**66,019**	24,288
Accounts receivable	**6,053**	5,274
Prepaid expenses	**50**	69
	72,122	29,631
Property and equipment *[note 3]*	**29,962**	24,095
	102,084	53,726
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current		
Accounts payable and accrued liabilities	**3,322**	2,974
Taxes payable	**7**	7
	3,329	2,981
Asset retirement obligations	**44**	44
	3,373	3,025
Shareholders' equity		
Share capital *[note 5]*	**118,652**	69,388
Contributed surplus *[notes 4 & 5]*	**1,788**	1,806
Cumulative translation adjustment	**3,963**	3,963
Deficit	**(25,692)**	(24,456)
	98,711	50,701
	102,084	53,726

See accompanying notes

ON BEHALF OF THE BOARD OF DIRECTORS

Edmund M. Shimoon
Director and Chief Executive Officer

Gary Robertson
Director

Interim Report

Consolidated Statements of Income & Deficit (Unaudited)

(Expressed in U.S. Dollars)

($ 000)	**Three months ended March 31, 2006** $	**Three months ended March 31, 2005** $
REVENUE		
Oil sales *[note 2(c)]*	**47**	46
Management fee	**-**	9
Royalties (net of Alberta Royalty Credit)	**4**	3
	43	137
Other	**399**	**158**
	442	**295**
EXPENSES		
Operating	**6**	**8**
General and administration	**900**	**192**
Depletion and depreciation	**7**	**2**
Accretion	**1**	**-**
Stock-based compensation	**-**	**18**
	914	**220**
Income (loss) before other	**(472)**	**75**
Foreign exchange loss	**(625)**	
Loss before income tax	**(1,097)**	
Income tax expense – current	**139**	**7**
Net income for the period	**(1,236)**	**68**
Deficit, beginning of period	**(24,456)**	**(23,470)**
Deficit, end of period	**(25,692)**	**(23,402)**
Earnings per share (basic and diluted)	**($0.01)**	**0.00**

See accompanying notes

Interim Report

Consolidated Statements of Cash Flows (Unaudited)

(Expressed in U.S. Dollars)

($ 000)	**Three months ended March 31, 2006**	**Three months ended March 31, 2005**
	$	$
OPERATING ACTIVITIES		
Net income (loss) for the period	**(1,236)**	68
Add (deduct) items not affecting cash		
Depletion and depreciation	**7**	2
Stock based compensation	**-**	18
Accretion	**1**	-
Unrealized foreign exchange loss (gain)		-
Cash flow from operating activities	**(1,228)**	88
Change in non-cash working capital	**(37)**	208
Cash provided by (used in) operating activities	**(1,265)**	297
INVESTING ACTIVITIES		
Additions to property and equipment	**(5,875)**	(7,492)
Change in non-cash working capital	**(376)**	-
Realized foreign exchange loss on investing activities		
Cash used in investing activities	**(6,251)**	(7,492)
FINANCING ACTIVITIES		
Issuance of common shares	**49,249**	23,833
Cash provided by (used in) financing activities	**49,249**	23,833
Effect of exchange rate changes on cash and cash equivalents	**(2)**	(131)
Increase (decrease) in cash	**41,731**	16,507
Cash and cash equivalents beginning of period	**24,288**	6,912
Cash and cash equivalents end of period	**66,019**	23,419

See accompanying notes

1. BASIS OF PRESENTATION

The interim consolidated financial statements of Calvalley Petroleum Inc. have been prepared by management in accordance with Canadian generally accounting principles.

Effective January 1, 2005 the Company adopted as its reporting currency the U.S. dollar. This change is attributable to the fact that the Company has divested of most of its Canadian operated properties, leaving the Company with substantially all of its assets and operations in Block 9, the Republic of Yemen where all of the Company's activity is conducted in U.S. currency. Refer to note 2 for disclosure of the effect of this change in reporting currency on the financial statements for the prior year and period.

These interim consolidated financial statements have been prepared following the same accounting policies and methods of computation as the consolidated financial statements for the fiscal year ended December 31, 2005. The disclosures included below are incremental to those included with 2005 annual consolidated financial statements. The interim consolidated financial statements should be read in conjunction with the consolidated financial statements and the notes thereto in the Company's annual report for the year ended December 31, 2005.

2. SELECTED ACCOUNTING POLICIES

(a) Changes in Reporting Currency

Effective December 31, 2005, management has decided to change the reporting currency of the Company from Canadian dollars (C$) to United States dollars ($), as this currency is more appropriate for the Company's investors and other users of the financial statements. In making this change in reporting currency, the Company has followed recommendations of the Emerging Issues Committee ("EIC") of the Canadian Institute of Chartered Accountants ("CICA"), set out in EIC-130, "Translation Method when the Reporting Currency Differs from the Measurement Currency or there is a Change in the Reporting Currency".

Financial statements for all periods presented have been translated from Canadian dollars into US dollars using the current rate method, based on EIC-130 recommendations effective January 1, 2004. Using this method, all consolidated assets and liabilities have been translated using the exchange rate at the balance-sheet dates, while shareholders' equity has been translated using the historical rates of exchange in effect on the dates of the corresponding transactions. The consolidated statements of loss and deficit and consolidated cash flow statements have been translated using the prevailing average exchange rates for the periods. Any resulting exchange difference due to this translation has been included in shareholders' equity as cumulative translation adjustment. All comparative financial information being presented has been restated to reflect the Company's financial statements as if they have been historically reported in US dollars and the effect on the consolidated financial statements resulted in cumulative translation adjustment of $3,963.

(b) Foreign currency translation

The activities of the Canadian parent have been translated into United States dollars using the temporal method. Under this method, monetary assets and liabilities are translated at exchange rates in effect at the balance sheet date. Non-monetary assets and liabilities are translated at rates in effect on the dates the assets were acquired or liabilities were incurred. Revenue and expenses are translated at the rates of exchange prevailing at the date of the transaction. Foreign exchange gains and losses are included in net loss in the period in which they arise

(Expressed in U.S. Dollars, unless otherwise stated)

(c) Revenue recognition

Oil and gas sales are recognized when reserves are produced and delivered to the purchaser. Although the Company produced oil from its Yemen properties during the first quarter of 2006, the Company had not yet entered into a selling agreement. As neither the purchaser nor the price was known, no revenue or crude oil inventory related to this production was recognized.

3. PROPERTY AND EQUIPMENT

	March 31, 2006		
	Cost $	**Accumulated Depletion and Depreciation** $	**Net book value** $
Canada			
Oil and gas properties	113	29	84
Other capital assets	96	47	49
	209	76	133
Yemen			
Oil and gas properties	29,829	-	29,829
	30,038	76	29,962

	December 31, 2005		
	Cost $	**Accumulated Depletion and Depreciation** $	**Net Book Value** $
Canada			
Oil and gas properties and equipment	112	26	86
Other capital assets	87	43	44
	199	69	130
Yemen			
Oil and gas properties	23,966	-	23,966
	24,186	69	24,096

Canada

During 2003, the Company commenced a process of disposed of its Canadian oil and gas properties and equipment to enable it to focus its activities on development of its Yemen project. At December 31, 2003 the Canadian cost centre held one remaining property which was disposed of on January 23, 2004, for proceeds of CDN$819,935, comprised of cash of CDN$500,000 and assumption of the site restoration obligation for this property, for which CDN$319,935 had been accrued at December 31, 2003. During 2003 the Company recognized losses of CDN$1,158,195 in connection with the write down of this property. During 2004 the Company recognized a loss of CDN$2,547 in connection with the sale.

Yemen

In early 1997, the Company entered into a Production Sharing Agreement ("PSA") with the Republic of Yemen. Under the terms of the PSA, the Company is entitled to recover the majority of its exploration and development costs out of an approximate 56.5 percent interest in any future production. The Company's expenditures incurred as of March 31, 2005 were $24,230,259. After these costs are recovered, it will continue to share in production at a reduced rate. As the Yemen cost centre is in the pre-development stage, direct expenses to date have been capitalized.

The current exploration period under the PSA commenced on October 4, 2004 and will run to March, 2008. In the current exploration the Company and its partners committed to spend and additional $1,000,000 on seismic and $5,000,000 on exploration drilling. The expenditures by the Company and its partners have exceeded this commitment and therefore and they have no further commitment in this regard.

In 2001 the Company entered into a Participation Agreement ("PA") with HoodOil Limited ("Hoodoil"), an unrelated party, whereby the Company assigned 40% of its interest in the PSA to Hoodoil. In exchange for this assignment the Company received a Letter of Guarantee in the amount of $10,000,000 in relation to the commitment by Hoodoil to finance future exploratory costs under the PSA to a maximum amount of $10,000,000 over both the first and second exploration periods.

As of November 1, 2001 the Company entered into a Joint Operating Agreement ("JOA") with Hoodoil in relation to the ongoing exploration and development under the PSA. The Company is the designated operator under the terms of the JOA.

During the first quarter ended March 31, 2002, the PA relating to the PSA with the Republic of Yemen was amended. The amendment transferred 50% of the 40% interest in the PSA from Hoodoil to Reliance Industries Limited ("Reliance"). The terms and conditions of the JOA were also amended to take this into consideration.

Expenditures by Hoodoil and Reliance required to meet their $10 million commitment under the PA are not reflected in these financial statements.

In 2004 both of the Company's Joint Venture partners exercised their options granted in 2001 to increase their respective interests by 5% each. The Company received $2,500,000 from Hoodoil during the first quarter of 2004 and $2,500,000 from Reliance during the second quarter of the year, in return for the combined 10% increase in their working interests. As at December 31, 2004 the Company recognized gains of $3,290,350 on the sale of those working interests.

In March, 2004 the Company entered into a financing arrangement with a private fund established for the purpose of financing international oil and gas projects. During the first six months of 2004 the Company received $2.5 million in an unsecured non-equity investment for the drilling of the Al Roidhat 2 and 3 wells. These funds are only repayable from production from Block 9 at a rate of $1.25 per bbl, to a maximum of $5.125 million. Given the nature of this transaction, the value of the Company's Yemen property and equipment ("P&E") was reduced by the full amount of the funds received and future depletion will be correspondingly reduced by the lower P&E.

In October, 2004 the Company entered into the Second Exploration Period, under the PSA. At that time Calvalley relinquished 25% of the original surface area of Block 9 thereby reducing its land holdings to 3,546 km2 (876,236 acres).

(Expressed in U.S. Dollars, unless otherwise stated)

4. SHARE CAPITAL

a) Common shares

Authorized:

Unlimited number of Class "A" Common Voting Shares.

Issued:

	First quarter 2006			Year ended 2005		
	Number	Amount $CDN	Amount $U.S.	Number	Amount $CDN	Amount $U.S.
Class "A" Common Voting Shares						
Shares outstanding, beginning of year	91,330,022	91,569	69,388	73,785,952	50,390	35,757
Issued on exercise of options	120,000	158	137	676,700	1,007	833
Issued for cash	9,000,000	58,500	50,895	8,142,857	28,500	23,427
Issued on the exercise of warrants	407,143	1,588	1,378	8,724,513	13,864	11,173
Share issuance costs		(3,616)	(3,145)		(2,192)	(1,802)
Shares outstanding, end of period	100,857,165	148,199	118,652	91,330,022	91,569	69,388

On February 21, 2006 the Company completed an offering of 9,000,000 Class "A" common voting shares at a price of CDN$6.50 per share, for total proceeds of $53,939,000 net of commissions. 407,143 Class "A" common voting shares were issued on the exercise of warrants at a price of CDN$3.90 per share and an additional 120,000 Class "A" common voting shares were issued upon the exercise of stock options at exercise prices of from CDN$0.50 to CDN$2.00 per share.

On March 24, 2005 the Company closed a private placement of 8,142,857 Class "A" common voting shares at a price of CDN$3.50 per share. In addition, during the first quarter of 2005, 1,317,586 Class "A" common voting shares were issued on the exercise of warrants at an exercise price of CDN$1.66 per share and a further 176,700 shares were issued upon the exercise of stock options.

b) Stock options

The Company's stock option plan, as approved November 6, 1997 and amended effective July 1, 2004 provides for the issue of stock options to directors, officers, employees and consultants. Vesting terms are determined by the Board as they are granted and currently include periods ranging from immediately, to at the time a specific objective is achieved, to evenly over 3 or 5 years. The options maximum term is 5 years (10 years for options granted prior to October 1, 2001).

A total of 3,928,232 shares have been reserved for issue under this plan. Options, which are forfeited, are re-absorbed into options available for issue.

b) Stock options - *continued*

The following is a continuity of stock options outstanding for the three month period ended March 31, 2005. Option exercise prices are expressed in CDN $'s:

	2006		
	Options	Weighted Average Exercise Price	
		$CDN	$U.S.
Balance, December 31, 2005	2,890,000	2.31	1.98
Granted	-		
Exercised	(120,000)	($1.17)	($1.00)
Balance, March 31, 2006	**2,770,770**	**2.43**	**2.08**

Stock options outstanding at March 31, 2006 were as follows:

Number of Options		Exercise Price		Expiry Date
Granted	Exercisable	$CDN	$U.S.	
400,000	400,000	0.50	0.43	2009
400,000	400,000	0.90	0.77	2011
50,000	50,000	1.40	1.20	2009
85,000	50,000	1.60	1.37	2008
500,000	500,000	1.60	1.37	2009
135,000	-	1.60	1.37	2010
200,000	125,000	3.80	3.26	2010
685,000	-	4.05	3.47	2010
350,000	350,000	4.20	3.60	2010
2,770,000	1,875,000			

At December 31, 2005 stock based compensation expense of $998,235 was expensed and credited to contributed surplus. The fair value of the options granted in 2005 was $589,085 using a Black-Scholes Option Pricing model with the following assumptions:

	2005	2004
Risk-free interest rate	4%	4%
Expected hold period to exercise	5 years	5 years
Volatility in the price of the Company's shares	66%	62.8%
Dividend yield	Nil	Nil

(Expressed in U.S. Dollars, unless otherwise stated)

c) Broker's warrants

On December 10, 2003, the Company issued warrants in connection with the sale of investment units that consisted of both Class "A" common voting shares and share purchase warrants. The Company issued 7,396,081 warrants that allowed the holder to purchase one Class "A" common voting share for $1.33 (CDN$1.66) for each warrant tendered and 1,344,742 warrants that allowed the holder to purchase one Class "A" common voting share for $0.99 (CDN$1.20) for each warrant tendered until June 10, 2005. These warrants were exercised in 2005.

On March 24, 2005 the Company issued 407,143 brokers' warrants that allow the purchaser to acquire one Class "A" common voting share for $3.35 (CDN$3.90) for each warrant tendered. The warrants expire on March 24, 2006. All warrants were exercised before their expiry. The warrants were valued at $295,098 using a Black-Scholes Option Pricing model with assumptions similar to those shown above and an expected life of one year. These warrants were exercised in the first quarter of 2006.

The following is a continuity of warrants outstanding:

	Three months ended March 31, 2006			Year ended December 31, 2005		
		Weighted Average Exercise Price			Weighted Average Exercise Price	
	Warrants	$Cdn	$US	Warrants	$Cdn	$US
Opening balance	407,143	3.90	3.24	8,740,823	1.59	1.32
Issued				407,143	3.90	3.35
Forfeited				(16,310)	1.59	1.32
Exercised	(407,143)	3.90	3.24	(8,724,513)	1.59	1.32
Ending balance	-	-	-	407,143	3.90	3.24

5. CONTRIBUTED SURPLUS

	2006	**2005**
Opening balance	**$ 1,806**	**$ 736**
Stock based compensation	**-**	**998**
Stock based compensation associated with exercised options	**(18)**	**(223)**
Amount attributable to broker warrants	**-**	**295**
Closing balance	**$1,788**	**$1,806**

SELECTED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
Three months ended March 31, 2005
(Unaudited)
(Expressed in U.S. Dollars, unless otherwise stated)

6. GEOGRAPHICAL INFORMATION

Balance sheet information for Canada and Yemen at March 31, 2006 and December 31, 2005 is as follows.

	Three months ended March 31, 2006		
	Yemen	Canada	Total
($000)	$	$	$
Sales revenue (net)	-	47	47
Interest and other revenue	2	397	399
Depletion and depreciation	-	7	7
Income and capital tax expense	-	127	127
Net income (loss)	(155)	(1,081)	(1,236)
Capital assets	29,829	133	29,962
Expenditures for segmented capital assets	5,868	7	5,875

	Year ended December 31, 2006		
	Yemen	Canada	Total
($000)	$	$	$
Sales revenue	-	199	199
Interest and other revenue	15	581	596
Depletion and depreciation	-	32	32
Income and capital tax expense	-	12	12
Net income (loss)	(478)	(258)	(736)
Capital assets	23,966	130	24,096
Expenditures for segmented capital assets	14,067	28	14,095

CORPORATE INFORMATION

Corporate Offices

Head Office
#700, 600 – 6th Ave SW
Calgary, AB T2P 0S5
Ph:(403) 297-0490
Fax:(403) 297-0499

Sana'a Office
PO Box 7090,
Hadda, Sana'a
Republic of Yemen
Ph: +9671 41 5555
Fax: +9671 42 3580

Website:
www.calvalleypetroleum.com

Directors
Edmund M. Shimoon
Calgary, Alberta

Thomas H. Skupa*
Calgary, Alberta

Thomas E. Lester
Calgary, Alberta

Gary Robertson*
Montreal, Quebec

David A. Williams*
Toronto, Ontario

Thomas E. Valentine
Calgary, Alberta

Kenneth M. Stephenson
Calgary, Alberta

** Member Audit Committee*

Officers
Edmund M. Shimoon
Chairman & CEO

David Tkachuk
Senior Vice President & Managing Director

Cameron Dow
Chief Financial Officer

Thomas E. Valentine
Corporate Secretary

Stock Listing
Toronto Stock Exchange
Stock Symbol: CVI.A

Bankers
Bank of Nova Scotia
First Calgary Savings & Credit Union Ltd.

Auditors
Deloitte & Touche LLP

Investor Relations
Renmark Financial Communications

Transfer Agent
Computershare Trust Company of Canada

Forward-Looking Statements

Some of the statements contained herein including, without limitation, financial and business prospects and financial outlooks, may be forward-looking statements which reflect management's expectations regarding future plans and intentions, growth, results of operations, performance and business prospects and opportunities. Words such as "may", "will", "should", "could", "anticipate", "believe", "expect", "intend", "plan", "potential", "continue", and similar expressions have been used to identify these forward-looking statements. These statements reflect management's current beliefs and are based on information currently available to management. Forward-looking statements involve significant risk and

uncertainties. A number of factors could cause actual results to differ materially from the results discussed in the forward-looking statements including, but not limited to, changes in general economic and market conditions and other risk factors. Although the forward-looking statements contained herein are based upon what management believes to be reasonable assumptions, management cannot assure that actual results will be consistent with these forward-looking statements. Investors should not place undue reliance on forward-looking statements. These forward-looping statements are made as of the date hereof.

Forward-looking statements and other information contained herein concerning the oil and gas industry and Calvalley's general expectations concerning this industry are based on estimates prepared by management using data from publicly available industry sources as well as from reserve reports, market research and industry analysis and on assumptions based on data and knowledge of this industry which Calvalley believes to be reasonable. However, this data is inherently imprecise, although generally indicative of relative market positions, market shares and performance characteristics. While Calvalley is not aware of any misstatements regarding any industry data presented herein, the industry involves risks and uncertainties and is subject to change based on various factors.

BOWNE
PRINTED IN CANADA
O31574