

# MANAGEMENT'S DISCUSSION AND ANALYSIS

August 8, 2006

The following is Management's Discussion and Analysis ("MD&A") of Iteration Energy Ltd. (the "Company" or "Iteration") operating and financial results as at and for the three and six month periods ended June 30, 2006 as well as information and estimates concerning the Company's future outlook based on currently available information. This discussion should be read in conjunction with Iteration's unaudited consolidated financial statements as at and for the three and six months ended June 30, 2006 and the audited consolidated financial statements as at and for the year ended December 31, 2005, together with accompanying notes. Readers should also refer to Iteration's 2005 Annual Information Form and Management's Discussion and Analysis for the year ended December 31, 2005. All financial information is reported in Canadian dollars, unless noted otherwise, and in accordance with Canadian generally accepted accounting principles ("GAAP").

Certain amounts in prior periods have been reclassified to enable comparison with the current period's presentation.

Natural gas is converted to crude oil equivalent at a ratio of six thousand cubic feet to one barrel. Boe's may be misleading, particularly if used in isolation. A boe conversion ratio of 6 mcf:1 bbl is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead.

Additional information about Iteration Energy Ltd. filed with Canadian securities commissions, including periodic quarterly and annual reports and the Annual Information Form (AIF), is available on-line at [www.iterationenergy.com](http://www.iterationenergy.com) and at [www.sedar.com](http://www.sedar.com).

## ITERATION OVERVIEW

Iteration is a Canadian oil and gas company with focus areas in Northeast British Columbia/Northwest Alberta and in East Central Alberta. The most significant currently producing properties are Boundary Lake in Northeast British Columbia and Wild River, East Central, and Granlea in Alberta.

The Company strives to operate its properties whenever possible and to maintain high working interests. Iteration believes this high level of operatorship can translate to controlling costs, timing of capital outlays and projects as well as providing competitive advantages for future opportunities.

### Acquisition of East Central Alberta Assets

Pursuant to a purchase and sale agreement dated June 6, 2006, the Company purchased certain petroleum and natural gas properties and related assets in east central Alberta ("East Central Alberta Assets") from an unrelated oil and gas company. The gross purchase price was \$42,325,000, subject to adjustments. The adjusted purchase price was \$42,048,000. The Company assumed an asset retirement obligation of \$2,510,000 associated with this acquisition. The acquisition was initially funded by bank debt. The Company commenced reporting production from this acquisition July 1, 2006.

### Issuance of 6,200,000 Subscription Receipts

Pursuant to a short form prospectus dated June 22, 2006, the Company issued 6,200,000 subscription receipts for gross proceeds of \$25,110,000 on June 28, 2006. The subscription receipts were converted into common shares after the closing of the acquisition of the East Central Alberta Assets. The East Central Alberta Asset acquisition closed on June 27, 2006. The net proceeds of the offering were applied to reduce bank debt of the Company incurred in connection with the acquisition of the East Central Alberta Assets.

### Acquisition of Iteration Energy Inc.

On March 21, 2005, the Company purchased all of the issued and outstanding shares of Iteration Energy Inc. in exchange for the issuance of 5,750,000 common shares of Iteration and 5,000,000 performance warrants. The 5,750,000 shares of Iteration are subject to an escrow agreement and are being released as to

a third of the issued shares on each of March 20, 2006, 2007 and 2008, respectively. The performance warrants have a term of 42 months and an exercise price of \$2.90 per share. In order for the warrants to vest, the shares of the Company had to trade at an average price of \$4.50/share or more for a period of 45 days. The warrants vested on May 7, 2005. In conjunction with this acquisition, the Company granted 4,610,000 stock options with an exercise price of \$2.90 to the employees of Iteration Energy Inc. that joined Iteration. The stock options vest over a three-year period and expire after five years.

### **Divestiture of Lavoy Area Assets**

Pursuant to two asset sale agreements dated March 21, 2005, the Company sold its Lavoy area assets to two unrelated third parties for cash consideration totaling \$85.0 million, with an effective date of January 1, 2005. The net proceeds received from the asset sale were \$80.8 million after adjustments for operating results and capital expenditures between the effective date and the closing date of March 24, 2005.

## **FINANCIAL AND OPERATING HIGHLIGHTS**

### **Operational Overview**

The quarter ended June 30, 2006 was a period of continued growth for the Company. Iteration successfully completed the acquisition of 725 boed from five east central Alberta producing properties for a net purchase price of \$42,048,000 as well as a public offering of 6,200,000 subscription receipts for gross proceeds of \$25,110,000. In the six weeks since acquiring the East Central Alberta properties, the Company has undertaken nine workovers and one recompletion in the southern summer access areas. Average production for early August has been increased to over 900 boed. Total production for the Company averaged over 4,700 boed in early August, with a further 550 boed tested behind pipe which is expected to be brought on production in the next few months.

### Highlights for the Quarter

The major highlights of the three months ended June 30, 2006 were as follows:

- Successfully closed the acquisition of the East Central Alberta Assets for a net purchase price of \$42,048,000 on June 27, 2006.
- Successfully closed the offering of 6,200,000 subscription receipts for gross proceeds of \$25,110,000 on June 28, 2006.
- A 53% year over year production increase for the three month period ended June 30, 2006.
- Average production for the quarter was 3,900 boed. Average production for the six months ended June 30, was 3,850 boed.
- June 30, 2006 production, including the East Central Alberta acquisition was 4,500 boed with an additional 500 boed tested behind pipe.
- Expanded the Company's land base to 245,000 net acres with another 52,000 net acres being earned this summer.
- Production expenses decreased from \$6.85 per boe for the three months ended March 31, 2006 to \$6.55 for the three months ended June 30, 2006. This decrease was less than expected as a result of unscheduled compressor repairs and plant maintenance shut downs.
- General and administrative expenses decreased from \$2.31 per boe for the three months ended March 31, 2006 to \$1.82 per boe for the three months ended June 30, 2006, as a result of increased production during the quarter.

### **Financial Highlights**

The Lavoy property was disposed of on March 24, 2005. Accordingly, the financial statements for the period from January 1 to March 24, 2005 include the results of Lavoy. In order to facilitate an understanding of the Company's operating results on a go forward basis, the Lavoy results have been split out in the following table and the Company's analysis of results in this management discussion and analysis has focused on changes that were not as a result of the Lavoy disposition.

	<b>Three months ended June 30,</b>		<b>Six Months Ended June 30,</b>			
	<b>2006</b>	2005	<b>2006</b>	2005	2005	2005
	<b>Total</b>	Total	<b>Total</b>	Excluding Lavoy	Lavoy	Total
<b>Financial</b>						
(\$thousands, except as noted)						
Production revenue before royalties	<b>\$12,394</b>	\$10,939	<b>\$ 29,711</b>	\$22,716	\$8,380	\$31,096
Funds from operations <sup>(2)</sup>	<b>\$ 6,854</b>	\$ 6,917	<b>\$16,962</b>	\$10,064	\$ 6,023	\$16,807
Per Share (\$) <sup>(1)</sup>						
- basic	<b>\$0.13</b>	\$0.14	<b>\$ 0.34</b>	\$ 0.22	\$0.14	\$0.36
- diluted	<b>\$0.13</b>	\$0.14	<b>\$ 0.32</b>	\$0.22	\$0.14	\$0.36
Net earnings (loss)	<b>\$(1,472)</b>	\$473	<b>\$1,177</b>	\$(2,749)	\$779	\$(1,970)
Per Share (\$) <sup>(1)</sup>						
- basic	<b>\$(0.03)</b>	\$0.01	<b>\$0.02</b>	\$(0.06)	\$0.02	\$(0.04)
- diluted	<b>\$(0.03)</b>	\$0.01	<b>\$0.02</b>	\$(0.06)	\$0.02	\$(0.04)
Royalties	<b>\$2,502</b>	\$2,277	<b>\$6,754</b>	\$5,107	\$1,649	\$6,756
Production expense	<b>2,324</b>	653	<b>4,203</b>	2,905	829	3,734
Depletion	<b>9,503</b>	5,043	<b>17,119</b>	12,315	5,542	17,857
Total assets			<b>\$220,611</b>			\$148,612
Capital expenditures:						
Property acquisition	<b>\$42,171</b>	-	<b>\$51,062</b>			-
Exploration, development and other	<b>\$10,021</b>	\$3,278	<b>\$31,158</b>	\$6,486	\$1,998	\$8,484
<b>Shares outstanding</b>						
Common shares June 30			<b>55,129,847</b>			48,821,681
Weighted average – basic	<b>50,973,803</b>	48,821,681	<b>49,940,317</b>			46,312,012
Weighted average – diluted <sup>(1)</sup>	<b>50,973,803</b>	50,627,848	<b>53,405,949</b>			46,312,012
Warrants June 30			<b>5,000,000</b>			5,000,000
Stock options June 30			<b>5,250,722</b>			4,857,697

- (1) For periods with positive net earnings, per share amounts are based on weighted average basic and diluted common shares outstanding for the period. For periods with a net loss, per share amounts are based on basic common shares outstanding for the period.
- (2) Management uses funds from operations and funds from operations per share (before changes in non-cash working capital and asset retirement expenditures) to analyze operating performance and leverage. Funds from operations and funds per share as presented do not have any standardized meaning prescribed by Canadian GAAP and therefore they may not be comparable with the calculation of similar measures for other entities. Funds from operations as presented is not intended to represent operating cash flow or income from operations for the period nor should it be viewed as an alternative to cash flow from operating activities, net earnings or other measures of financial performance calculated in accordance with Canadian GAAP. All references to funds from operations and funds per share throughout this MD&A are based on cash flow from operating activities before changes in non-cash working capital and asset retirement expenditures.

## Operating Highlights

	Three months ended June 30,		Six Months Ended June 30,			
	2006	2005	2006	2005	2005	2005
	Total	Total	Total	Excluding Lavoy	Lavoy	Total
<b>Operating</b>						
Gas Production						
Total natural gas (bcf)	<b>1.9</b>	1.3	<b>3.8</b>	2.9	1.2	4.1
Daily average natural gas (mcf/d)	<b>21,348</b>	13,967	<b>21,225</b>	15,791	7,041	22,832
Average price (\$/mcf)	<b>\$5.44</b>	\$7.77	<b>\$6.88</b>	\$7.09	\$6.53	\$6.92
Oil and Liquids Production						
Total oil and liquids (Mbbbls)	<b>30.8</b>	19.2	<b>56.9</b>	48.0	.8	48.8
Daily average oil and liquids (bbls/d)	<b>339</b>	211	<b>314</b>	265	4	269
Average price oil and liquids (\$/bbl)	<b>\$59.37</b>	\$51.91	<b>\$57.31</b>	\$49.89		\$49.90
Daily Average Production (boed)	<b>3,897</b>	2,539	<b>3,852</b>	2,897	1,178	4,075
<b>Land</b>						
Net undeveloped land (M acres)			<b>126</b>			68
<b>Drilling</b>						
Wells drilled (net)						
Gas	-	0.2	<b>8.2</b>			2.5
Oil	<b>1.0</b>	-	<b>3.0</b>			-
Dry	-	-	<b>1.6</b>			0.5
Total	<b>1.0</b>	0.2	<b>12.8</b>			3.0
Success rate (%)	<b>100</b>	100	<b>87</b>			83

## Quarterly Financial Data

(\$ thousands except per share data)

Quarter ended	2006			2005			2004	
	June 30	Mar 31	Dec 31	Sept 30	June 30	Mar 31	Dec 31	Sept 30
<b>Including Lavoy</b>								
Revenues	\$12,394	\$17,317	\$20,719	\$13,956	\$10,939	\$20,157	\$20,035	\$18,448
Net earnings (loss)	(1,472)	2,649	4,271	1,519	473	(2,443)	(2,955)	614
Net earnings (loss) per common share – basic and diluted (\$)	(0.03)	0.05	0.09	0.04	0.01	(0.06)	(0.07)	0.01
<b>Excluding Lavoy</b>								
Revenues	\$12,394	\$17,317	\$20,719	\$13,956	\$10,939	\$11,777	\$13,371	\$10,747
Net earnings (loss)	(1,472)	2,649	4,271	1,519	473	(3,222)	(1,936)	110
Net earnings (loss) per common share – basic and diluted (\$)	(0.03)	0.05	0.09	0.04	0.01	(0.06)	(0.04)	(0.01)

### OPERATING RESULTS (EXCLUDING LAVOY)

#### Net Earnings (Loss)

Iteration's net loss for the three months ended June 30, 2006 was \$1.5 million, as compared to net earnings (after adjusting for Lavoy) of \$0.5 million for the three months ended June 30, 2005. Although production was 53% higher during 2006, the financial results were impacted by lower benchmark natural gas prices for the quarter.

#### Production

Average daily production for the three months ended June 30, 2006 increased by 1,358 boed as compared to the three months ended June 30, 2005. This 53% increase resulted primarily from the Company's drilling program undertaken during the last half of 2005 and the first quarter of 2006.

Daily Production (excluding Lavoy) <i>Average for the period</i>	Three months ended June 30,			Six months ended June 30,		
	2006	2005	% Change	2006	2005	% Change
Natural Gas (Mcf/d)	<b>21,348</b>	13,967	53	<b>21,225</b>	15,791	34
Crude oil and natural gas liquids (bbl's/d)	<b>339</b>	211	61	<b>314</b>	265	18
Total (boed)	<b>3,897</b>	2,539	53	<b>3,852</b>	2,897	33

For 2006 guidance purposes, the Company continues to expect to average between 4,400 and 4,600 boed. December 2006 exit production is expected to be between 5,400 and 5,800 boed, as was reported in our guidance of June 8, 2006.

#### Commodity Prices

Industry Benchmarks <i>Average for the period</i>	Three months ended June 30,			Six months ended June 30,		
	2006	2005	% Change	2006	2005	% Change
Natural gas (Alberta Spot) Cdn\$/GJ at AECO	<b>5.82</b>	7.36	(21)	<b>7.27</b>	7.14	2
WTI crude oil US\$/Barrel at Cushing	<b>70.67</b>	53.09	33	<b>67.00</b>	51.44	30

<b>Realized Commodity Prices</b> <i>Average for the period</i>	<b>Three months ended June 30,</b>			<b>Six months ended June 30,</b>		
	<b>2006</b>	2005	% Change	<b>2006</b>	2005	% Change
Natural Gas (\$/Mcf)	<b>5.44</b>	7.77	(30)	<b>6.88</b>	7.09	(3)
Crude oil and natural gas liquids (\$/bbl's)	<b>59.37</b>	51.91	14	<b>57.31</b>	49.89	15
Total (\$/boed)	<b>34.91</b>	47.09	(26)	<b>42.62</b>	43.32	(2)

The realized commodity price for oil and natural gas liquids did not increase to the same extent as the industry benchmarks since incremental oil which was brought on production in the second quarter was heavy. The change in natural gas prices per Mcf varied by an amount different from the change in benchmark pricing as the Company's natural gas is sold at daily spot pricing, versus a monthly price.

### Revenue

Production revenue was \$12.4 million for the three months ended June 30, 2006, compared with \$11.0 million for the three months ended June 30, 2005. The production revenue increase was due to higher production offset by lower commodity prices realized by the Company during the quarter.

<b>Production Revenue before Royalties</b> <i>(\$ thousands)</i>	<b>Three months ended June 30,</b>			<b>Six months ended June 30,</b>		
	<b>2006</b>	2005	% Change	<b>2006</b>	2005	% Change
Production revenue	<b>12,394</b>	10,939	13	<b>29,711</b>	22,716	31

For the three months ended June 30, 2006, 85% of the Company's production revenue was from gas, versus 91% for the three months ended June 30, 2005. For 2006 budget purposes, based on a conversion ratio of 6 mcf gas being taken as equivalent to 1 barrel of oil, the Company projects that 93% of production will be gas and 5% will be from NGL's. Less than 2% of production is projected to be from oil.

### Royalties

Royalty expense, net of Alberta Royalty Tax Credit, was \$2.5 million for the three months ended June 30, 2006, compared with \$2.3 million for the three months ended June 30, 2005. The relatively little change in royalty expense for the quarter is the result of increased production during the quarter, offset by lower commodity prices for natural gas. This was further offset by the lower royalty rate being paid on oil production, as compared to natural gas production.

<b>Royalties</b> <i>(\$ thousands except where noted)</i>	<b>Three months ended June 30,</b>			<b>Six months ended June 30,</b>		
	<b>2006</b>	2005	% Change	<b>2006</b>	2005	% Change
Royalties	<b>2,502</b>	2,277	10	<b>6,754</b>	5,107	32
Per boe (\$/boe)	<b>7.05</b>	9.80	(28)	<b>9.69</b>	9.74	0
Percentage of revenue (%)	<b>20</b>	21	5	<b>23</b>	22	5

For 2006 **guidance** purposes, the Company **continues to** project that royalties will be in the range of 22 to 24% of production revenue.

### Production Expenses

Production expenses were \$2.3 million for the three months ended June 30, 2006, compared with \$0.7 million for the three months ended June 30, 2005, largely reflecting the 53% increase in production during the quarter.

Production expenses (\$ thousands)	Three months ended June 30,			Six months ended June 30,		
	2006	2005	% Change	2006	2005	% Change
Field operating costs	2,172	558	289	3,942	2,690	46
Allocated general and administrative expense	152	95	60	261	215	21
Total production expense	2,324	653	255	4,203	2,905	45

Production expenses per boe (\$ per boe)	Three months ended June 30,			Six months ended June 30,		
	2006	2005	% Change	2006	2005	% Change
Field operating costs	6.12	2.39	156	5.65	5.13	10
Allocated general and administrative expense	0.43	0.42	2	0.38	0.41	(8)
Total production expense	6.55	2.81	133	6.03	5.54	9

Operating costs for the second quarter of 2006 have been higher than expected for the following reasons:

- a) Two compressors required approximately \$140,000 of repairs and maintenance at Boundary Lake during the second quarter.
- b) Plant facilities at Boundary Lake and Cold Lake were shut down for periods during the second quarter which resulted in actual production for the quarter being approximately 10% less than expected.

Production expenses as reported for the three months ended June 30, 2005 were unusually low reflecting the reduced activity of the Company during this limited period following the corporate restructuring. Production expenses increased in the third quarter of 2005 to \$5.69 per boe and averaged \$7.84 per boe for the year ended December 31, 2005. Management has observed continued upward pressure on the costs of services rendered in the field. In addition, the operating costs associated with the acquisition of the East Central Alberta Assets was \$9.50 per boe when acquired. Although Management expects to be successful in reducing the operating costs associated with these assets, the Company expects average production expenses for the year ended December 31, 2006 to increase from the previous guidance of \$5.50 per boe to \$6.40 per boe.

### Operating Netback

The operating netback (before general and administrative expenses) realized for the three months ended June 30, 2006 was \$20.94/boe versus \$34.03/boe for the three months ended June 30, 2005. The decrease in netback realized was primarily due to the softening of natural gas prices with an additional reduction due to higher per barrel production costs and maintenance shutdowns, as was more fully discussed above.

Operating Netback (\$/boe)	Three months ended June 30,			Six months ended June 30,		
	2006	2005	% Change	2006	2005	% Change
Production revenue	34.91	47.09	(26)	42.62	43.32	(2)
Royalties	(7.05)	(9.80)	(28)	(9.69)	(9.74)	-
Production costs	(6.55)	(2.81)	133	(6.03)	(5.54)	9
Transportation costs	(0.37)	(0.45)	(18)	(0.78)	(1.66)	(53)
Operating netback	20.94	34.03	(38)	26.12	26.38	(1)

For guidance purposes, net backs for 2006, before general and administration expenses, based on 2006 projected average prices of AECO (spot) \$7.43/GJ for gas, and Edmonton Light of \$60 per barrel for oil, are projected to average \$31.20 per boe. Previously, management had projected an average price for AECO (spot) of \$7.00 per GJ for gas, which resulted in a net back of \$28.74 per boe.

### General and Administrative Expenses

General and administrative expenses were \$0.6 million for the three months ended June 30, 2006, compared with \$1.0 million for the three months ended June 30, 2005. General and administrative expense per boe decreased to \$1.81 for the three months ended June 30, 2006 as compared to \$4.35 for the three months ended June 30, 2005. (For purposes of calculating general and administrative expenses per boe, all general and administrative expenses incurred during the period and total production for the period, including Lavoy production has been used.) The reasons for the decrease were:

- a) While the Company was conducting its strategic review in 2004 and 2005, (prior to the new management's group involvement), only limited capital was deployed to maintain the properties. As a result, production declined during this period, without a corresponding reduction in staffing.
- b) Production from the Company's drilling program undertaken during the second half of 2005 and the first quarter of 2006 is coming on stream. Staffing for these activities was done during the later part of 2005. As a result, the incremental production is being produced without the requirement of additional staffing needs.

Management is continuing its efforts to streamline general and administrative functions within the organization. As a result of these efforts, general and administrative costs are now expected to be under \$2.25 per boe for 2006, as opposed to the previous guidance of \$2.35 per boe.

General and administrative expenses (\$ thousands except where noted)	Three months ended June 30,			Six months ended June 30,		
	2006	2005	% Change	2006	2005	% Change
General and administrative expenses before the following	1,524	1,549	(2)	3,189	3,830	(17)
Overhead recoveries	(280)	(85)	229	(641)	(200)	220
Allocation to operating expenses	(152)	(95)	60	(261)	(215)	21
Capitalized overhead	(447)	(363)	23	(865)	(703)	23
Net General and administrative expense	645	1,006	(36)	1,422	2,712	(52)
Per boe (\$ / boe)	1.81	4.35	(58)	2.04	5.17	(61)

### Stock Based Compensation Expense

As approved by the Company's shareholders, the stock option plan was amended effective April 1, 2004 to provide stock option holders the choice, upon exercise, to receive a cash payment in exchange for surrendering the option. The cash payment is equal to the appreciated value of the stock option, as determined by the difference between the option's exercise price and the Company's closing share price the day prior to electing to exercise the option. In July, 2005, the stock option plan was further amended to cap the total number of options that may be outstanding at 10 % of the issued and outstanding Common Shares at that time.

For the three months ended June 30, 2006, a recovery of stock based compensation expense of \$0.1 million was recorded based on the reduction in value of the outstanding stock options as determined using the June 30, 2006 closing share price, as compared to the closing share price at March 31, 2006. Future fluctuations in the stock based compensation expense or recoveries are dependent on the movement of the Company's share price and the number of vested options outstanding. Based on the June 30, 2006 share price of \$4.17, had all 5,250,722 stock options outstanding been vested, stock based compensation expense and a corresponding liability of \$5.7 million would have been recognized. Of this amount, \$2.4 million has been recognized as a current liability, and reported as part of accounts payable, in the June 30, 2006 financial statements.

### Interest Expense

Interest expense on current debt (the Company had no long term debt) for the three months ended June 30, 2006 was \$0.2 million as compared to \$0.04 million for the three months ended June 30, 2005. (For purposes of calculating interest expense per boe, Lavoy production for the period January 1 to March 24, 2005 has been included). Interest expense increased as a result of the Company drawing on its \$50 million credit facility to fund the capital drilling program and the acquisition of the East Central Alberta Assets acquired on June 27, 2006. The \$50 million credit facility was established with a Canadian Chartered bank. It is secured by a general security agreement and a postponement of claims. The facility bears interest at the bank's prime rate on the drawn amount, calculated in arrears. In addition, there is a standby fee of 10 basis points on the undrawn amount.

Interest expense (\$ thousands except where noted)	Three months ended June 30,			Six months ended June 30,		
	2006	2005	% Change	2006	2005	% Change
Interest expense	172	35	391	227	589	(61)
Per boe (\$/boe)	0.49	0.15	227	0.33	0.80	(59)

### Depletion

Depletion and depreciation expense was \$9.5 million for the three months ended June 30, 2006 compared to \$5.0 million for the three months ended June 30, 2005. The increase in the amount of depletion recorded was due to the magnitude of capital spending undertaken by the Company during the fourth quarter of 2005 and the first two quarters of 2006, combined with higher production during the period as compared to 2005.

Depletion (\$ thousands except where noted)	Three months ended June 30,			Six months ended June 30,		
	2006	2005	% Change	2006	2005	% Change
Depletion	9,503	5,043	88	17,119	12,315	39
Per boe (\$/boe)	26.80	21.83	23	24.55	23.48	4

### Capital Expenditures

Exploration and development capital spending for the three months ended June 30, 2006 not including the acquisition of the East Central Alberta Assets were \$10.0 million, (\$52.2 million including the acquisition of the East Central Alberta Assets), versus \$3.3 million for the three months ended June 30, 2005. Capital spending increased dramatically from the same period in 2005 when operations were effectively on hold until the Company's restructuring process was completed in late March 2005.

<b>Capital Expenditures</b> (\$ thousands)	<b>Three months ended June 30,</b>			<b>Six months ended June 30,</b>		
	<b>2006</b>	2005	% Change	<b>2006</b>	2005	% Change
Acquisition of oil and gas properties	<b>42,171</b>	-	N/A	<b>51,062</b>	-	N/A
Exploration and development expenditures	<b>10,021</b>	3,278	206	<b>31,158</b>	8,484	267
<b>Total</b>	<b>52,192</b>	3,278	1,492	<b>82,220</b>	8,484	869

For 2006, the Company's projected capital program, inclusive of acquisitions to date, is \$124 million. The increase from the previous guidance of \$118 million is a result of the following:

- 1) The cost of acquisitions increased \$2 million as our post-closing adjustments were lower than expected (for the period between the effective and the closing date) due to declining gas prices.
- 2) The Company has invested more in landsales and seismic than initially projected.
- 3) The Company has experienced significant upward pressure on prices for all phases of our work.

The revised capital forecast also reflects delaying some drilling until early 2007.

#### **Capital and Liquidity**

The capital program will be financed by a combination of cash on hand, cash flow from operations and the Company's \$50 million credit facility which was established with a Canadian Chartered Bank during the second quarter in connection with the acquisition of the East Central Alberta Assets.

For guidance purposes the Company has used projected average prices for 2006 of \$7.43/GJ AECO (spot) for gas and \$60 per bbl for Edmonton Light oil. Based on projected 2006 projects, the impact on the Company's annualized cash flow of a \$1.00/GJ swing in AECO (spot) is approximately \$8.9 million.

The Company has entered into various operating leases with respect to its premises. The leases expire June 30, 2009 and require the following future minimum lease payments (\$'000's);

2006	\$ 344
2007	687
2008	687
2009	344

#### **Related Party Transactions**

For the three months ended June 30, 2006, there were no related party transactions.

#### **Outstanding Common Shares**

As at August 4, 2006, there were 55,129,847 common shares, 5,000,000 warrants and 5,253,222 stock options outstanding.

#### **Critical Accounting Estimates**

The Company calculates the asset retirement obligation based on estimates of the date of abandonment, abandonment costs, and inflation. These amounts are then discounted to a present value amount. The estimates used are as follows:

Abandonment and reclamation costs:

Well bore and surface reclamation	\$ 35,000 per well
Pipelines	10,000 per pipeline segment
Roads	15,000 per km
Batteries	15,000 per battery
Compressors	200,000 per compressor
Inflation	2 % per annum
Discount rate	6% per annum

The Company also calculates the ceiling test on reserves based upon estimates of future prices for commodities, production rates, royalty rates, operating costs and inflation rates. Future prices for commodities are based on forward curve amounts. Future production rates, decline rates, royalty rates and operating costs are based on historical amounts. Inflation for commodity prices is 2.5% per annum, and, 2% per annum for operating costs.

### **Outlook for 2006**

The foundation work to return the Company to active operations and profitability was completed in 2005. The major focus is now on adding new drilling locations and prospective lands in order to grow production through an ongoing exploitation and exploration program. The Company is aggressively pursuing acquisition and farm-in opportunities in its core areas, and will continue to be active at landsales. The planned 2006 capital program of \$124 million is expected to result in a year over year production growth, net of the Lavoy disposition, of approximately 35% to 40% with average production expected to be in the range of 4,400 to 4,600 boed. Total production averaged over 4,700 boed in early August 2006, with an additional 550 boed tested behind pipe waiting to be brought on production. Of this amount, approximately 900 boed was from the East Central Alberta Assets. The Company continues to expect year end production to be in the range of 5,400 to 5,800 boed.

### **Directors, Officers and Auditors**

Current Officers and Directors of the Company are as follows;

#### Officers

Brian Illing	President and CEO
Mark Ariss	VP Exploration East
Sean Johnson	CFO
Jane Mactaggart	VP Exploitation
Carmen McKay-Illing	VP Corporate Affairs
Kevin Stromquist	VP Exploration West

#### Directors

Pat Breen P. Eng.	President- Foremost Income Trust Fund
Dallas Droppo Q.C.	Partner- Blake, Cassels and Graydon LLP
Jim Grenon	President- TOM Capital Associates
Michael Hibberd	President- MJH Services Inc.
Brian Illing P. Geol	President and CEO- Iteration Energy Ltd.
Robert Waters CA	Senior VP and CFO- Enerplus Resource Fund

#### Corporate Secretary

Tony Grenon	Managing Director- TOM Capital Associates
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#### Auditors

Ernst & Young LLP
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### **Advisory – Forward-Looking Information**

This MD&A was prepared on August 4, 2006 and is management's assessment of Iteration's historical financial and operating results. The reader should be aware that historical results are not necessarily indicative of future performance. This MD&A contains forward-looking statements relating to future events or future performance. In some cases, forward-looking statements can be identified by terminology such as "may", "will", "should", "expects", "projects", "plans", "anticipates" and similar expressions. These statements represent management's expectations or beliefs concerning, among other things, future operating results and various components thereof affecting the economic performance of Iteration. Undue reliance should not be placed on these forward-looking statements which are based upon management's assumptions and are subject to known and unknown risks and uncertainties, including the business risks discussed below, which may cause actual performance and financial results in future periods to differ materially from any projections of future performance or results expressed or implied by such forward-looking statements. Accordingly, readers are cautioned that events or circumstances could cause results to differ materially from those predicted. The Company undertakes no obligation, except as required by applicable securities legislation, to update publicly or to revise any of the included forward looking statements, whether as a result of new information, future events or otherwise.

The forward looking statements contained herein are expressly qualified by this cautionary statement. Readers are cautioned that the following list of risk factors is not exhaustive.

In particular, this discussion contains forward-looking statements and information pertaining to the following:

- The quantity and recoverability of our reserves;
- The timing and amount of future production;
- Prices for natural gas produced;
- Operating and other costs;
- Business strategies and plans of Management;
- Supply and demand of natural gas;
- Expectations regarding our ability to raise capital and to add to our reserves through acquisitions as well as exploration and development;
- The focus of capital expenditures on development activity rather than exploration;
- The sale, farming in, farming out or development of certain exploration properties using third party resources;
- The use of development activity and acquisitions to replace and add to reserves;
- The impact of changes in natural gas prices on cash flow after hedging;
- Drilling plans;
- The existence, operations and strategy of the commodity price risk management program;
- The approximate and maximum amount of forward sales and hedging to be employed;
- The Company's acquisition strategy, and the criteria to be considered and the benefits to be derived;
- The impact of Canadian federal and provincial governmental regulation on the Company relative to other issuers of similar size;
- Our treatment under governmental regulatory regimes;
- The goal to sustain or grow production and reserves through prudent management and acquisition;
- The emergence of accretive growth opportunities; and
- The Company's ability to benefit from the combination of growth opportunities and the means to grow through the capital markets.

Iteration's actual results could differ materially from those anticipated in our forward-looking statements as a result of the risk factors set forth below and elsewhere in this MD&A which include but are not limited to:

- Volatility in market prices for natural gas;
- Risks inherent in our operations;

- Uncertainties associated with estimating reserves;
- Competition for, among other things: capital, acquisitions of reserves, undeveloped lands and skilled personnel;
- Incorrect assessments of the value of acquisitions;
- Geological, technical, drilling and process problems;
- General economic conditions including fluctuations in the price of natural gas;
- Royalties payable in respect of Iteration's production;
- Governmental regulation of the oil and gas industry, including environmental regulation;
- Fluctuation in foreign exchange or interest rates;
- Unanticipated operational events that can reduce production or cause production to be shut-in or delayed;
- Stock market volatility and market valuations; and
- The need to obtain required approvals from regulatory authorities.

#### **Additional Information on the Company**

Other information about the Company, including the Management's Discussion and Analysis and the revised Annual Information Form for the year ended December 31, 2005, and Managements discussion and analysis for the quarter ended March 31, 2006, which is available through the internet on the Company's SEDAR profile at [www.sedar.com](http://www.sedar.com).