

KROES ENERGY INC.

REPORT TO THE SHAREHOLDERS REGARDING RESULTS AND ACTIVITIES IN 2006

Before dealing with the results and activities for 2006, it is appropriate to discuss a major new development that occurred early in 2007. On April 2, 2007 Kroes Energy Inc. and Shelton Canada Corp. announced that they had entered into an agreement whereby Shelton will acquire Kroes' wholly owned subsidiary Zhoda 2001 Corporation. Zhoda's only operating asset is a 45% interest in Kashtan Petroleum Ltd., the joint venture oilfield exploitation project in Ukraine. In consideration for this acquisition, Shelton will pay to Kroes a total of \$4,927,753 comprised of \$1,000,000 cash; \$3,498,753 by issuance of 6,997,507 common shares of Shelton; and \$429,000 by way of transfer of Shelton's only remaining western Canadian oil and gas interests.

The completion of the transaction is subject to a number of conditions including approval by the shareholders of Kroes and all relevant regulatory authorities as well as due diligence on the part of both Shelton and Kroes. Subject to the fulfillment of all conditions, this transaction is expected to close on or before May 31, 2007. On closing of the transaction, Kroes intends to distribute the Shelton shares that it receives to its shareholders and will then confine its expansion activities to western Canada.

This transaction signals a major change in Kroes' business strategy. Over the past three years the Company has struggled to achieve its goals in Ukraine with very little progress. While the Kashtan joint venture has significant upside potential, the company has been unable to capture that potential for the benefit of its shareholders. A combination of political, economic and business factors make it unlikely that this upside will be attained by retaining this lone project. Our principal concerns include the high level of royalties recently imposed by the Ukrainian government, unilateral decision making by our State-controlled partner, the loss of our country manager due to illness, and ongoing political turmoil and uncertainty.

Shelton has a significant inventory of offshore exploration and exploitation projects that do not attract the high royalties imposed on onshore production; it has experienced Ukrainian/Canadian senior management; well established political and business contacts in Ukraine; and a long term growth and financing strategy focused on Ukraine.

Accordingly, Kroes' Board of Directors has concluded that the shareholders would be best served by acceptance of the offer from Shelton Canada Corp. for the purchase of the wholly owned subsidiary Zhoda 2001 Corporation that holds the company's 45% interest in the Kashtan Petroleum Ltd. joint venture. A detailed discussion of the transaction and the Board's recommendation is contained in the Company's Information Circular dated April 29, 2007.

Results for 2006

Net Earnings for 2006 amounted to \$150,745, a significant decline from the \$806,414 earned in 2005 and primarily the result of higher royalty payments in Ukraine. In 2006, higher oil prices caused revenues to increase by \$577,930 to \$5,204,851 but royalty payments to the Government of Ukraine rose by \$1,180,239 to a total of \$2,152,942. Operating costs in Ukraine increased by 16% and further eroded earnings. Cash from Operations amounted to \$795,389, a decrease of 38% from the prior year and amounted to 2.3 cents per share.

Production of crude oil averaged 239 barrels per day compared with 246 barrels per day produced in 2005. Production of natural gas in western Canada began in the last quarter with small amounts of test production from two wells. During the first quarter of 2007 another well was placed on stream and the Company's production now averages 300,000 cubic feet per day.

Capital expenditures for the year totaled \$1,384,245 compared with \$1,773,450 spent in 2005. Kroes share of spending in the Kashtan joint venture was \$829,808, about one-half of the spending in 2005 and involved the drilling of one well and improvements to gathering and field facilities. In Canada, the Company spent \$553,203 on its new exploration and development program for shallow gas.

Ukraine

Political uncertainty continues to plague Ukraine as the government struggles with the transition to western style democracy. The higher prices for crude oil prompted the cash-short government to increase its take from the oil industry and for onshore exploitation projects such as the Kashtan Joint Venture where Kroes holds a 45% interest, economics have been severely damaged. The royalty rate on this production is now 47%.

Production averaged 234 barrels per day during 2006 compared with 241 barrels per day in 2005. New production from well #303 was offset by loss of production from well #180 where a number of attempts to repair a major break in the casing so far have been unsuccessful.

Development well No. 303 began drilling in October 2005 and was completed and put on production in June of 2006. The well bore was deviated so that it K1 productive zone at a 75-degree angle. This resulted in the exposure of some 15 meters of pay in each of the K1 and the higher P1/P2 zones. The well was completed in the K1 zone and the initial production rate was 80 barrels per day. The well has since declined to about 40 barrels per day. This significant decline appears to be typical of production from the K1 zone. The well also penetrated 15 meters of the shallower and more prolific P1/P2 zone but unfortunately, Ukrainian regulations will not allow production from two zones and the lower zones must be depleted before the wells can be completed in the P1/P2. Kashtan now has four recent wells producing from the K1 zone that could provide significantly more production if the regulations were more realistic.

In April of 2007 development well #306 reached total depth at 1,700 meters and on a 24 hour test produced 150 barrels per day (65 barrels per day net to Kroes). Production facilities will be installed over the next few weeks, after which the stabilized production rate will be determined.

Trinidad

Production from the Company's 25% interest in the Icacos Block onshore Trinidad averaged 5 barrels per day, unchanged from 2005. The new sliding scale royalty imposed in 2005 was levied at the maximum rate of 35% as prices remained above the \$US 49.51 per barrel limit. Cash flow from this interest amounted to \$31,378 in 2006, essentially unchanged from the prior year.

Western Canada

With the reduced netbacks in Ukraine and the political turmoil that continues to frustrate the Company's activities, the Directors of Kroes decided it was appropriate to diversify the Company's operations into western Canada where there is significant activity and opportunity. Early in 2006,

the Company entered into a Joint Venture Agreement with Montane Resources Ltd., a private Alberta company, to explore and develop shallow gas prospects on its significant landholdings in a concentrated area of central Alberta. In general, Kroes will pay 50% of initial land or seismic costs to earn a 25% working interest in a prospect. It will then participate at its working interest in drilling and subsequent development expenditures and production operations.

Activity in the program began late in the second quarter and by year end the Company had interests in three wells that were capable of production, drilled one dry hole and participated in one unsuccessful recompletion of a shut in well. In addition, the Company agreed to participate in two wells that were scheduled for drilling early in 2007, participated in a land sale to acquire contiguous acreage to one of the successful wells, and agreed to participate in another prospect where 3-D seismic is required.

Oil and Gas Reserves

The Company's share of oil and gas reserves was evaluated by PetroGlobe (Canada) Ltd. at December 31, 2006 and the details of this evaluation are provided in the Company's Information Circular dated April 27, 2007. The volume of proved and probable crude oil reserves in Ukraine declined due to poor performance of wells in the northwest quadrant of the field and lower oil saturation in certain producing zones. The net present value of reserves also declined significantly due to the lower volumes, lower crude oil prices and the significant increase in royalty imposed by the Government of Ukraine.

Corporate

The company initiated a financing by way of Short Form Offering Document in May of 2006 with Octagon Capital Corporation as agent and it was closed on June 27, 2006 having raised \$1.2 million. The financing consisted of 1,787,500 units at 65 cents each, with each unit comprising one common share, one flow-through share and one-half warrant. Each whole warrant entitles the holder to acquire a common share at 45 cents per share until December 27, 2007. The funds will be dedicated to exploration and development of shallow gas prospects in central Alberta.

In December of 2006 the Company received a dividend from Kashtan Petroleum Ltd., its 45% owned joint venture in Ukraine. After deducting a 5% withholding tax in Ukraine, Kroes received \$178,000 in its Calgary account. This is the fourth annual dividend the Company has received and brings the total cash return to \$847,000.

On March 22, 2006, stock options for the purchase of 100,000 shares were granted to a Director that had been recently appointed. The options will vest equally over the next 3 years and have a term of five years. Under its option plan, the Company can issue options for a maximum of 10% of the number of shares outstanding and prior to this grant, the number of options available to issue was 360,000.

Fred Callaway, President
April 27, 2007