



COSTA ENERGY INC.

Q1

For The Period Ending
March 31, 2006

COSTA ENERGY INC.

First Quarter Report

**For The Period Ending
March 31, 2006**



President's Message to Shareholders

On behalf of the directors and officers of COSTA Energy Inc., it is my pleasure to present the financial and operating results for the three months ended March 31, 2006.

Corporate Developments

On March 1, 2006, COSTA Resources Ltd. ("Resources"), a private oil and gas company based in Calgary, Alberta, acquired Kelso Energy Inc. ("Kelso") by way of a reverse takeover. Approximately 53 million common shares and 9.4 million non-voting shares were issued to the shareholders of Resources and significant changes were made to the management team and board of directors of Kelso. The new management is Ron Newman as President and CEO, Terry Brooker as Vice President and COO, and Bob Johnston as Vice President Exploration; the same positions they held in Resources. The Board of Directors of the Company consists of Curtis Bartlett (Chairman), Terry Brooker, Hugh Gillard, Tim Granger, Terry McCoy, Ron Miller and Ron Newman. The Company was also pleased to add Dave Campbell to management as Chief Financial Officer on April 25, 2006.

The acquisition allows the shareholders of Resources and Kelso to participate in the broad range of opportunities available to both companies. The Company now has five producing areas: Boundary Lake, in British Columbia and Alderson, Schuler, Pembina and Veteran, in Alberta. The merger of the two companies has resulted in an entity that has:

- Combined gross proved plus probable reserves of 338,000 BOEs as evaluated by McDaniel & Associates Consultants Ltd. as of December 31, 2005;
- Total undeveloped land of over 24,000 gross acres (10,000 net);
- A strong balance sheet with total debt consisting of \$1 million of debentures due Dec. 31, 2006.

The first quarter results presented in this report includes three months for Resources and one month for Kelso ended March 31, 2006.

Production in the first quarter of 2006 averaged 108 boepd. The Company enters the final 9 months of 2006 fiscally secure with a strong balance sheet, a good revenue stream, a land base with numerous drilling opportunities and an unused \$2.0 million bank facility.

During the first quarter, the Company spent \$437,000 on land, production facilities, seismic and re-completing two gross (1.8 net) wells. Both wells encountered gas, but at non-commercial rates and are suspended.

Management proposed, and the Board approved, a \$7.3 million capital budget, which is focused on adding significant new production by exit 2006 through a diverse program of opportunities. The Company has a large inventory of low risk infill drilling in Southern Alberta and Saskatchewan, and medium risk drilling in Central Alberta.



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Subsequent Activity

At a Special Meeting of the shareholders on April 12, 2006, the common shareholders approved a special resolution changing the name of the Company from "Kelso Energy Inc." to "COSTA Energy Inc." and approved a special resolution to affect a one (1) for eight (8) share consolidation of both the Company's outstanding common shares and non-voting shares. The Company has approximately 12.78 million common shares and approximately 1.18 million non-voting shares outstanding after the consolidation.

COSTA is poised for growth. The drilling and re-completions planned for the remainder of the year, and potential acquisitions, allows COSTA to look forward to reporting significant production increases at year end.

Respectfully submitted on behalf of the Board,

Ron E. Newman
President and Chief Executive Officer

**Corporate Highlights**

	2006
Production and Prices	
Natural gas sales (Mcf)	552
Oil and NGL sales (bpd)	16
Average daily sales 6:1 (boepd)	108
Average natural gas price (\$/Mcf)	\$7.62
Average oil price (\$/bbl)	\$60.58
Average NGL price (\$/bbl)	\$37.33
Financial (\$)	
Oil and gas revenue	\$460,962
Net loss	\$452,838
Per share, basic and diluted	\$(0.05)
Working capital at period end	\$131,925
Long term bank debt at period end	nil
Shareholders' equity at period end	\$10,723,133
Shares*	
Weighted average during the period	
Basic and Diluted (common and non-voting)	9,967,135
Outstanding common and non-voting shares at period end	13,959,117

*share amounts are post consolidation

MANAGEMENT'S DISCUSSION AND ANALYSIS

The following is management's discussion and analysis ("MD&A") of financial conditions and results of operations for the three month period ended March 31, 2006. This MD&A, dated May 29, 2006 should be read in conjunction with the unaudited interim consolidated financial statements for the three month period ended March 31, 2006 and the audited financial statements of COSTA Resources Ltd. ("Resources") for the year ended December 31, 2005. The financial information contained herein has been prepared in accordance with Canadian generally accepted accounting principles (GAAP). All comparative percentages are between the three month periods ended March 31, 2006 and 2005 and all dollar amounts are expressed in Canadian currency, unless otherwise noted. Additional information about the Company is available on SEDAR, at www.sedar.com or at the Company's web site at www.costaenergy.com.



Oil Equivalent Conversion (boe)

Barrels of oil equivalent “boe” amounts have been calculated using a conversion rate of six thousand cubic feet of natural gas “Mcf” to one barrel of oil and natural gas liquids (6 Mcf = 1 bbl).

Forward Looking Statements

Statements throughout this quarterly report that are not historical facts may be considered “forward looking statements.” These forward-looking statements sometimes include words to the effect that management believes or expects a stated condition or result. All estimates and statements that describe the Company’s objectives, goals or future plans are forward-looking statements. Since forward-looking statements address future events and conditions, by their nature they involve inherent risks and uncertainties. Actual results could differ materially from those currently anticipated due to any number of factors, including such variables as new information regarding recoverable reserves, changes in demand for, and commodity prices of crude oil and natural gas, legislative, environmental and other regulatory or political changes, competition in areas where the Company operates and other factors discussed in this quarterly report.

Description of Business

COSTA Energy Inc. (“COSTA” or the Company”) is a junior oil and gas company, which explores for, develops, produces, and sells crude oil, natural gas and natural gas liquids in the Provinces of Alberta, British Columbia and Saskatchewan.

COSTA is a public company, whose common shares trade on the TSX-Venture Exchange under the symbol “COE.” The Company has its principal business office in Calgary, Alberta.

On March 1, 2006, Resources acquired COSTA by way of reverse takeover. The acquisition was accounted for using the purchase method. The quoted market price of the shares issued was not considered to representative of their fair value. The cost of the purchase by Resources was determined by assessing Resources’ share of the fair value of the net assets acquired with reference to independent appraisals. The accounts include the results of COSTA effective March 2, 2006. The consolidated financial statements are issued under the name of the legal parent but are a continuation of the financial statements of the legal subsidiary and not of the legal parent. The comparative figures presented in the consolidated financial statements are those of the legal subsidiary.

Quarterly Summary of Results

	March 31, 2006
Sales volume (boe/d)	108
Revenue per boe of production	\$ 47.42
Revenue	\$ 460,962
Net Income (loss)	\$ (452,838)
Capital expenditures	\$ 436,573

Production and Operation

During the quarter the Company produced an average 108 boepd comprised of 16 bbls/d of oil and natural gas liquids and 552 mcf/d of natural gas. March 2006 production was 30 bbls/d of oil and natural gas liquids and 763 mcf/d of natural gas. The Company



spent approximately \$437,000 on land, seismic, production facilities and re-completing two gross (1.8 net) wells. Both wells encountered gas, but at non-commercial rates and are suspended.

Quarterly Production

Area	First Quarter 2006				March 2006			
	Gas (mcf/d)	Oil (bpd)	NGL (Bpd)	Boepd	Gas (mcf/d)	Oil (bpd)	NGL (Bpd)	Boepd
Alderson	392	-	-	65	390	-	-	65
Schuler	38	-	-	6	39	-	-	7
Pembina	9	7	2	11	7	7	2	10
Boundary Lake	113	-	1	20	327	-	4	58
Veteran	-	6	-	6	-	17	-	17
Total	552	13	3	108	763	24	6	157

Revenue

During the quarter ended March 31, 2006, oil and gas sales were \$460,962, (\$47.42 per boe) Revenue increased due to the acquisition of the Southeast Alberta natural gas properties, Central Alberta oil property, and the acquisition of the Kelso producing properties at Boundary Lake, British Columbia and Veteran, Alberta.

The 2006 product mix is about 85% natural gas. The 8% increase in the Canadian dollar against the U.S. dollar over the past year had a negative impact on Canadian dollar price realizations.

The Company sells its natural gas and crude oil into the spot market.

Financial

COSTA recorded a net loss of \$452,838 (\$0.05 per share) in the first quarter, compared to a net loss of \$27,500 (\$nil per share) in the same period in 2005.

Royalties

For the quarter ended March 31 2006, royalty expenses increased to \$81,439 (\$8.38 per boe) from \$nil in 2005. This significant increase is consistent with the production acquisitions by the Company. As a percentage of revenue, the overall royalty rate is 17.7% of revenue.

Other Income

Other income for the three month period ending March 31, 2006 of \$26,408 largely consisted of seismic data sales. The previous year was nil.

Operating Expenses

Operating expenses were \$161,738 (\$16.64 per boe) in the first quarter.



General and Administrative (“G&A”) Costs

G&A costs of \$286,181 in the quarter were up compared to \$24,315 (including stock compensation costs) for the same period in 2005. This increase was primarily due to the additional staff for the production acquisitions and the planned drilling program in the balance of 2006.

Depletion, Depreciation and Accretion

During the quarter, COSTA incurred depletion, depreciation and accretion (“DD&A”) charges of \$402,357 up from \$2,697 in the same period in 2005 due to the production acquisitions in 2005 and 2006.

Capital Expenditures

COSTA’s net capital expenditures for the three month period ended March 31, 2006 are as follows:

	2006
Land	\$51,077
Geological and geophysical	\$49,131
Intangible drilling & completion	\$312,879
Facilities & equipment	\$19,138
Office equipment	\$4,348
	\$436,573

Liquidity and Capital Resources

At March 31, 2005, COSTA had positive working capital of \$131,925, including subordinated debentures of \$1,000,000 maturing December 31, 2006.

The Company’s 2006 budget is based on a program of exploration and development on lands owned by the Company, or has agreements to farm in on the interests of third parties. The Company expects to fund this program using cash from operations, the utilization of cash and bank deposits and the Company’s bank line of credit.

All of the Company’s funds which are not yet required in operations are held in interest bearing accounts with its banker and are immediately available to meet ongoing capital requirements.

The Company is committed to spend \$2,190,000 on qualifying expenditures that can be renounced to flow-through share purchasers under the terms of their share purchase agreements. These costs must be incurred by December 31, 2006. The Company has sufficient cash and access to credit facilities to meet this commitment and has currently identified projects that will generate the majority of the required qualifying expenditures.



Income Tax

The nature of the Company's tax pools are greater than the accounting value and as such there is no future income tax provision on current income tax at March 31, 2006.

Related Party Transactions

During the three months ended March 31, 2006, directors and officers of the Company exercised options to acquire 113,800 common shares at a weighted average exercise price of \$0.461 per share.

In a prior period, Resources had loaned \$15,000 to a shareholder and director to purchase 63,694 common shares of the Company. The loan was unsecured and bore interest at the bank prime rate. The loan was repaid in January 2006, together with interest of \$621.

Outstanding Shares

As of March 31, 2006 the Company has 12,781,692 outstanding common shares and 1,177,425 outstanding non voting shares. Details of COSTA's outstanding shares are provided in note 3 to the financial statements.

Outlook

The Company is still in the early stage of its development and while it has limited proven reserves it does have the financial strength to pursue prospects. COSTA has over 24,000 gross and 10,000 net acres of undeveloped land. On lands controlled by the Company, at least twenty drillable locations have been identified, six of which are expected to be drilled in the summer of 2006. Good drilling successes, combined with cash flow from existing producing properties, should enable COSTA to have positive 2006 results.

On March 1, 2006, Resources acquired COSTA by way of a reverse takeover. The acquisition, which also involved a change of management and the board of directors, is intended to enhance COSTA's critical mass, balance sheet, production and reserve base, ability to mitigate risk and access capital.

Business Risks

The oil and gas industry is exposed to numerous business risks which can materially affect the Company's performance and financial results.

The Company's operations are exposed to commodity prices. The Company does not hedge its sale prices, but sells into the spot market under short term contracts.

In the oil and gas business, there is no certainty that exploration and production programs will yield positive results or that, if positive results are initially achieved, production levels will continue because of the uncertainty associated with forecasting production. The Company attempts to mitigate risks in several ways including investing in multiple prospects, limiting capital exposure on any one prospect through partnering with third parties and targeting multiple zones.

Like other industry participants, COSTA is subject to numerous environmental regulations. COSTA controls these risks by careful site examinations prior to any acquisition, focusing on light oil and sweet gas and maintaining high operating standards.



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Additional information on the Company can be found on the SEDAR website at www.sedar.com or at the Company's web site at www.costaenergy.com.



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Management's comments on unaudited financial statements

The accompanying unaudited interim consolidated financial statements of COSTA Energy Inc. (the "Company") for the quarter ended March 31, 2006 have been prepared by management and approved by the Audit Committee of the Board of Directors of the Company. These statements have not been reviewed by the Company's external auditors.

Dated May 29, 2006

(signed) Ronald E. Newman

President and Chief Executive Officer

(signed) David F. Campbell

Chief Financial Officer

**COSTA ENERGY INC.**

Consolidated Balance Sheets

	March 31 2006 (Unaudited)	December 31 2005
Assets		
Current assets:		
Cash and cash equivalents	\$ 1,354,144	\$ 1,802,572
Accounts receivable	1,180,497	487,536
Income taxes receivable	66,495	70,822
Prepaid expenses and deposits	120,184	69,030
	<u>2,721,320</u>	<u>2,429,960</u>
Property, plant and equipment	9,827,991	5,084,228
	<u>\$ 12,549,311</u>	<u>\$ 7,514,188</u>
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 1,589,395	\$ 1,109,439
Debentures (note 4)	1,000,000	-
	<u>2,589,395</u>	<u>1,109,439</u>
Asset retirement obligations	350,024	200,873
Future income taxes	-	830,731
	<u>2,939,419</u>	<u>2,141,043</u>
Shareholders' equity:		
Share capital (note 3)	10,723,133	6,073,934
Contributed surplus (note 3)	76,702	36,316
Deficit	(1,189,943)	(737,105)
	<u>9,609,892</u>	<u>5,373,145</u>
Subsequent event (note 3)		
	<u>\$ 12,549,311</u>	<u>\$ 7,514,188</u>

See accompanying notes to consolidated financial statements.

**COSTA ENERGY INC.**Consolidated Statements of Operations and Deficit
(Unaudited)

	For the three months ended March 31	
	2006	2005
Revenues:		
Oil and gas sales	\$ 460,962	\$ -
Royalties, net of Alberta Royalty Tax Credit	(81,439)	-
	<u>379,523</u>	<u>-</u>
Expenses:		
Operating	161,738	-
General and administrative	286,181	24,315
Depletion, depreciation and accretion	402,357	2,697
Interest	8,493	488
Other income	(26,408)	-
	<u>832,361</u>	<u>27,500</u>
Net loss	(452,838)	(27,500)
Deficit, beginning of period	(737,105)	(6,622)
Deficit, end of period	\$ (1,189,943)	\$ (34,122)
Net loss per share – basic and diluted	\$ (0.05)	\$ 0.00
Weighted average number of shares outstanding		
Basic and diluted (common and non-voting)	9,967,135	7,869,653

See accompanying notes to consolidated financial statements.

**COSTA ENERGY INC.**Consolidated Statements of Cash Flows
(Unaudited)

	For the three months ended March 31	
	2006	2005
Cash provided by (used in):		
Operating activities:		
Net loss	\$ (452,838)	\$ (27,500)
Items not involving cash:		
Stock-based compensation	49,169	1,166
Depreciation, depletion and accretion	402,357	-
	(1,312)	(23,637)
Change in non-cash working capital:		
Accounts receivable	(293,603)	(13,542)
Prepaid expenses	(7,039)	-
Accounts payable	(250,874)	(153)
	(552,828)	(37,332)
Financing activities:		
Issuance of common shares net of issue costs	15,950	120,000
Investing activities:		
Additions to property, plant and equipment	(436,573)	(224)
Acquisition of Kelso (note 2)	(78,578)	-
Cash acquired at acquisition	477,833	-
Accounts payable	76,324	-
Due to shareholder	-	(39,512)
	39,006	(39,736)
Increase in cash and cash equivalents	(448,428)	42,932
Cash and cash equivalents, beginning of period	1,802,572	12,409
Cash and cash equivalents, end of period	\$ 1,354,144	\$ 55,341
Supplemental cash flow information:		
Interest paid	\$ 9,114	\$ 488
Taxes paid	\$ -	\$ -

See accompanying notes to consolidated financial statements.

COSTA ENERGY INC.

Notes to Consolidated Financial Statements (Unaudited)
Three months ended March 31, 2006 and 2005

On March 1, 2006, Kelso Energy Inc. ("Kelso") acquired 98.9% of the outstanding shares of COSTA Resources Ltd. ("Resources") in exchange for approximately 53 million common shares and 9.4 million non-voting shares. The remaining Resources shares were acquired pursuant to the compulsory acquisition procedures available under corporate legislation. As the directors and management of Resources have significant influence over the direction of Kelso, Resources has been identified as the acquirer for accounting purposes. This transaction has been accounted for as a reverse takeover of Kelso by Resources.

On April 12, 2006, a special resolution was passed by the common shareholders of Kelso at a special shareholders' meeting, changing its name to COSTA Energy Inc. ("COSTA" or the "Company") and approving a one-for-eight share consolidation of both the outstanding common shares and non-voting shares.

The financial statements of the Company for the three months ended March 31, 2006 include the operating results of Resources prior to the acquisition and the results of the consolidated entities after March 1, 2006. The comparative financial statements for the three months ended March 31, 2005 are those of Resources.

1. Significant accounting policies:

The accompanying unaudited consolidated financial statements of COSTA have been prepared in accordance with Canadian generally accepted accounting principles for interim financial information, including all normal recurring adjustments that are, in the opinion of management, necessary for a fair presentation of the financial position, statement of operations and deficit, and cash flows for the interim period. The interim financial statements should be read in conjunction with the audited consolidated financial statements of Resources for the year ended December 31, 2005. The interim financial information included herein is unaudited and, in addition, has not been reviewed by the Company's external auditors and there have been no changes to the accounting policies as detailed in the annual statements.

2. Business acquisition:

On March 1, 2006, Resources acquired Kelso by way of reverse takeover. On the acquisition, Kelso issued 53,537,821 (approximately 6,692,228 post consolidation) common shares and 9,419,402 (approximately 1,177,426 post consolidation) non-voting shares of Kelso to the shareholders of Resources. The quoted market price of the shares issued was not considered to representative of their fair value. The cost of the purchase to Resources was determined by assessing Resources' share of the fair value of the net assets acquired with reference to independent appraisals. The acquisition was accounted for using the purchase method. The accounts include the results of Kelso effective March 2, 2006.

**COSTA ENERGY INC.**

Notes to Consolidated Financial Statements, page 2

(Unaudited)

Three months ended March 31, 2006 and 2005

2. Business acquisition (continued):

The purchase price was allocated as follows:

Purchase price:	
Fair value of net assets acquired	\$ 4,624,288
Acquisition costs	78,759
	\$ 4,703,047
Allocated at estimated fair values:	
Cash and cash equivalents	\$ 477,833
Oil and gas properties	4,695,239
Asset retirement obligations	(134,843)
Non - cash working capital (deficiency)	(165,913)
Debentures	(1,000,000)
Future income tax asset	830,731
	\$ 4,703,047

3. Share capital:

a) Authorized:

Unlimited number of common shares.

Unlimited number of special shares issuable in series.

Unlimited number of Series A special shares issuable in series.

Unlimited number of Series B special shares issuable in series.

Unlimited number of Series C special shares (the "Non-voting Shares) issuable in series.

Unlimited number of preferred shares issuable in series.

b) Issued:

	Number of common shares	Amount
Balance, December 31, 2004	330,000	\$ 30,300
Issued for cash on private placements	16,016,573	5,179,500
Issued for cash on private placement of flow-through shares	1,922,500	965,000
Share issue costs		(100,866)
Balance, December 31, 2005	18,269,073	6,073,934
Stock options exercised	268,000	38,733
Issued for cash on private placements	63,694	15,000
Balance at March 1, 2006	18,600,767	6,127,667
Shares cancelled	(18,600,767)	-

COSTA ENERGY INC.

Notes to Consolidated Financial Statements, page 3
(Unaudited)
Three months ended March 31, 2006 and 2005

3. Share capital (continued):

	Number of common shares		Amount
Shares issued to Resources shareholders on reverse takeover of Kelso	53,537,821	\$	3,932,572
Common shares of Kelso at date of acquisition	48,715,648		-
Share issue costs			(29,000)
Balance at March 31, 2006 before share consolidation	102,253,469		10,031,239
One-for-eight share consolidation	(89,471,777)		-
Balance, March 31, 2006	12,781,692		10,031,239

	Number of Non-voting Shares		Amount
Balance, December 31, 2005	-	\$	-
Shares issued to Resources shareholders on on reverse takeover of Kelso	1,177,425		691,894
Balance, March 31, 2006	1,177,425	\$	691,894

On April 12, 2006, a special resolution was passed by the common shareholders of Kelso at a special shareholders' meeting, changing its name to COSTA Energy Inc. and approving a one-for-eight share consolidation of both the outstanding common shares and non-voting shares.

The Company's share capital at March 31, 2006 comprises 12,781,692 common shares (\$10,031,239) and 1,177,425 Non-voting Shares (\$691,894).

- c) The Company has a stock option plan for its directors, officers, employees and consultants and those of its subsidiaries. The Company is authorized to issue options under the plan to acquire up to 10% of the outstanding common shares of the Company. The plan contains restrictions which limit the number of options that may be issued. All option amounts referred to herein are post consolidation. All of the Company's options vested on the reverse take-over. During the three months ended March 31, 2006, the Company granted 125,264 (2005 – nil) options at a weighted average exercise price of \$1.218, to replace Resources options. These options had been originally issued with a 5-year term and vesting as to one third on the date of grant and one third on

**COSTA ENERGY INC.**

Notes to Consolidated Financial Statements, page 4

(Unaudited)

Three months ended March 31, 2006 and 2005

3. Share capital (continued):

each of the first and second anniversaries of the date of grant. They also vested on the acquisition and maintained the original expiry date.

The Company had the following options outstanding at March 31, 2006:

	Number of options outstanding	Weighted average exerciseprice
Outstanding at Dec. 31, 2004	-	\$ -
Granted	534,181	0.730
Outstanding at Dec. 31, 2005	534,181	0.730
Granted	125,264	1.218
Exercised	(113,800)	0.461
Kelso options	462,500	1.520
Outstanding at March 31, 2006	1,008,145	\$ 1.198
Exercisable at March 31, 2006	972,759	\$ 1.195

**COSTA ENERGY INC.**

Notes to Consolidated Financial Statements, page 5

(Unaudited)

Three months ended March 31, 2006 and 2005

Exercise price	Options outstanding			Options exercisable	
	Number outstanding	Weighted average remaining contractual life (months)	Number exercisable	Weighted average Exercise price	
\$ 0.592	112,527	49	112,527	\$ 0.592	
0.824	116,772	53	116,772	0.824	
0.944	201,698	55	201,698	0.944	
1.176	61,570	58	61,570	1.176	
1.200	150,625	54	150,625	1.200	
1.272	53,078	59	17,692	1.272	
1.280	108,750	30	108,750	1.280	
1.440	11,250	34	11,250	1.440	
1.520	37,500	31	37,500	1.520	
2.080	154,375	39	154,375	2.080	
	1,008,145	48	972,759	1.195	

The fair value of the stock options granted during the three months ended March 31, 2006 was estimated on the date of grant using the Black-Scholes option pricing model with the following assumptions: risk-free interest rate of 3.81 – 4.05%, dividend yield of 0%, expected life of 5 years and volatility of 0%. The weighted average grant-date fair value of options granted during the period is \$0.22 per share.

For stock options granted, the Company records compensation expense using the fair value method. Compensation costs are recognized over the vesting period as an increase to stock-based compensation and contributed surplus.

COSTA ENERGY INC.

Notes to Consolidated Financial Statements, page 6

(Unaudited)

Three months ended March 31, 2006 and 2005

3. Share capital (continued):

The December 31, 2005 contributed surplus balance is as follows:

Contributed surplus, December 31, 2004	\$	-
Stock-based compensation expense		36,316
Contributed surplus, December 31, 2005		36,316
Stock-based compensation expense		49,169
Exercise of options		(8,783)
Contributed surplus, March 31, 2006	\$	76,702

d) Warrants

The following table summarizes the Company's warrants outstanding at March 31, 2006 and changes made during the period then ended.

	Number of warrants Outstanding	Weighted average exercise price
Outstanding at Dec. 31, 2004	6,379,000	\$ 0.26
Expired	(3,700,000)	0.30
Issued	669,436	0.18
One-for-eight share consolidation	(2,929,881)	
Outstanding at Dec. 31, 2005 and March 31, 2006	418,555	1.68

At March 31, 2006 there are: 83,680 warrants outstanding at an exercise price of \$1.44 and a remaining life of seven months; and 334,875 warrants outstanding at an exercise price of \$1.76 and a remaining life of three months.

4. Debentures:

On June 30, 2003, the Company issued \$1,000,000 principal amount of units ("Units"), of which \$332,000 was purchased by officers and directors of the Company. Each Unit consisted of \$1.00 principal amount

COSTA ENERGY INC.

Notes to Consolidated Financial Statements, page 7
(Unaudited)

Three months ended March 31, 2006 and 2005

4. Debentures (continued):

of secured debentures bearing interest at 8% per annum and three (3) share purchase warrants, each warrant entitling the holder to purchase one common share for a period of three years at a price of \$0.18 per share in the first year, \$0.20 per share in the second year and \$0.22 per share in the third year. The debentures initially matured on June 30, 2006.

Subsequently, the Company agreed with the holders of the debentures to extend the maturity of the debentures to June 30, 2007 and to increase the interest rate paid on the debentures from July 1, 2005 to maturity to 10% per annum.

As a result of the reverse takeover of Kelso by Resources, the maturity date of the debentures is amended from June 30, 2007 to December 31, 2006. Included as part of the maturity date change, is the provision for a bonus to debenture holders of 3% of the debenture principal if redeemed prior to September 30, 2006 and an additional bonus of 3% if redeemed after September 30, 2006.

As a result of the share consolidation, the warrant exercise prices are now \$1.44 per share in the first year, \$1.60 per share in the second year and \$1.76 in the third year.

5. Credit facility:

At March 31, 2006, the Company had access to two \$1,000,000 revolving operating demand lines of credit with Canadian chartered banks. The first facility bears interest at bank prime rate plus .75% and is secured against the current and after acquired assets of the Company. The second facility bears interest at bank prime rate plus 1% and is secured against the current and after acquired assets of the Company. At March 31, 2006, either credit facility had been utilized.