



International Corporation

Second Quarter 2006

Report to Shareholders

For Quarter Ending June 30, 2006



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Corporate Profile

Sherritt International Corporation is a diversified resource company involved in the production of coal, nickel, cobalt, oil and electricity. Its success is built upon utilizing innovative technologies and the breadth of its financial and operational expertise to increase productivity and profitability. Sherritt continues to explore opportunities to grow its \$2.4 billion asset base through expansion of its existing businesses and strategic acquisitions.

A leader in employee health and safety, Sherritt is also dedicated to ensuring that its operations meet the highest standards in environmental stewardship.

Sherritt's 151 million common shares and \$193 million 7% convertible debentures trade on the Toronto Stock Exchange under the symbols S and S.DB.A respectively. Sherritt's \$274 million of 7.875% senior unsecured debentures trade on the over-the-counter bond market.

Forward-looking Statements

This interim report contains forward-looking statements. Forward-looking statements generally can be identified by the use of statements that include words such as "believe", "expect", "anticipate", "intend", "plan", "likely", "will" or other similar words or phrases. Similarly, statements contained in each of the "Outlook" sections of this interim report including those with respect to expectations concerning assets, prices, foreign exchange rates, earnings, production, market conditions, capital expenditures, commodity demand, risks, availability of regulatory approvals, corporate objectives and plans or goals, are or may be forward-looking statements. These forward-looking statements are not based on historic facts, but rather on current expectations, assumptions and projections about future events. These forward-looking statements are subject to known and unknown risks, uncertainties and other factors that are beyond the Corporation's ability to control or predict. Actual results and developments may differ materially from those contemplated by this interim report depending on, among others, such key factors as business and economic conditions in Canada, Cuba and the principal markets for Sherritt's products.

Key factors that may result in material differences between actual results and developments and those contemplated by this interim report also include the supply, demand and prices for Sherritt's products; dependence on significant customers; deliveries; production levels, production and other anticipated and unanticipated costs and expenses; energy costs; premiums or discounts realized over LME cash and other benchmark prices; interest rates; foreign exchange rates; rates of inflation; changes in tax legislation; the timing, capital costs and financing arrangements associated with development projects; the timing of the receipt of government and other approvals; political unrest or instability in the countries where Sherritt is active; risks related to collecting accounts receivable and repatriating profits and dividends from Cuba; risks related to foreign exchange controls on Cuban government enterprises to transact in foreign currency; risks associated with the United States embargo on Cuba and the Helms-Burton Act; risks associated with mining, processing and exploration activities; potential imprecision of reserve estimates; market competition; developments affecting labour relations; environmental regulation and other risk factors listed from time to time in Sherritt's continuous disclosure documents such as its annual report, annual information form and management information circular.

The Corporation does not intend, and does not assume any obligations, to update these forward-looking statements.

Highlights

- Successful initial public offering of Royal Utilities Income Fund
- Record revenues in Coal, Oil and Gas and Power
- Strong nickel, cobalt and oil pricing environment
- Purchased \$107 million of convertible debentures

Financial Highlights (unaudited)

(millions of dollars, except per share amounts)	Q2 2006	Q1 2006	Q2 2005 (restated) ⁽³⁾	Six months ended June 30	
				2006	2005 (restated) ⁽³⁾
Revenue	\$296.9	\$259.6	\$322.5	\$556.5	\$579.6
EBITDA ⁽¹⁾⁽²⁾	124.8	112.2	146.0	237.0	269.1
Net earnings	57.2	35.7	53.7	92.9	89.1
Basic earnings per share	0.38	0.24	0.35	0.61	0.60
Diluted earnings per share	0.36	0.20	0.29	0.58	0.50
Weighted average number of shares (millions)					
Basic	151.3	151.1	154.2	151.2	146.8
Diluted	179.4	194.3	198.7	179.3	198.7
Total cash, cash equivalents and short-term investments	367.5	437.0	491.8	367.5	491.8

(1) Reference should be made to the Summary Financial Results by Segment later in this interim report for a description of the above financial measures and for a reconciliation of these measures to GAAP measures.

(2) The Corporation discloses EBITDA, which is a non-GAAP measure, in order to provide an indication of revenue less cash operating expenses. EBITDA does not have any standardized meaning prescribed by Canadian generally accepted accounting principles and is, therefore, unlikely to be comparable with similar measures presented by other issuers.

(3) Comparable periods have been restated to reflect a change in the methodology of accounting for income taxes in the Cuban oil and gas business to provide a clearer presentation of income taxes in that business and a reclassification of certain selling expenses in the Metals business, which were previously netted against revenue, to operating, selling, general and administrative costs.

All amounts in this interim report represent Sherritt's 100% interest unless otherwise indicated. Amounts relating to Metals and Coal reflect the Corporation's 50% interest in these operations. Amounts relating to Coal also reflect the Corporation's 50% proportionate interest in Royal Utilities up to June 27, 2006. Subsequent to June 27, 2006, the Corporation changed its accounting for Royal Utilities to equity method. Sherritt's interest is one-third in the Power business and 49% in the soybean-based food processing business. The non-controlling interests are disclosed separately in the consolidated financial statements.

Higher revenues in all four major business units led to a 14% increase in consolidated revenues from the first quarter of 2006. Net earnings of \$57.2 million (\$0.38 basic earnings per share) in the second quarter represented a 60% increase over the \$35.7 million recorded in the previous quarter. Compared to the second quarter of 2005, Coal, Oil and Gas and Power all recorded higher revenue. Metals revenues in the second quarter 2006 were lower than the same period last year due to lower sales volumes of both nickel and cobalt. Earnings before interest, taxes, depreciation and amortization ("EBITDA") were \$124.8 million, an increase of \$12.6 million over the first quarter, but lower than the same period last year, primarily due to higher sales volumes in Metals during in the second quarter of 2005.

Basic earnings per share of \$0.38 included a \$0.07 per share one-time benefit of a tax rate change as a result of the decrease in Alberta and Federal tax rates, including elimination of the Federal large corporations tax. Earnings also included a one-time after tax gain of \$0.03 per share from the disposition of units in Royal Utilities Income Fund ("Royal Utilities"), together with expenses related to restructuring of the Coal business and a loss on purchase of debentures totaling \$0.03 per share. Excluding these one-time items, the basic earnings per share was \$0.31 for the quarter.

Sherritt, together with its partner Ontario Teachers' Pension Plan, completed the initial public offering ("IPO") of Royal Utilities during the quarter. Royal Utilities operates mine mouth thermal coal assets and royalty streams in western Canada and began trading on the Toronto Stock Exchange on June 27, 2006. Sherritt's share of the proceeds from the IPO and restructuring of the Coal operations totalled \$117.2 million. Following the IPO and over-allotment option, Sherritt holds 41.2% of the outstanding units in Royal Utilities.

During the quarter, Sherritt purchased \$107 million principal amount of its outstanding 7% convertible unsecured subordinated debentures due December 15, 2013 by way of two issuer bids. The \$193 million of convertible debentures that remain outstanding are redeemable in whole or in part at the option of the Corporation, starting December 16, 2006. The purchase of convertible debentures reduces the share dilution that will arise upon conversion of the debentures to equity.

Capital expenditures for the quarter totalled \$58.8 million and included \$33.0 million for Oil and Gas drilling activity and facilities construction, \$12.9 million for Metals expansion and maintenance and \$6.6 million in sustaining and expansion capital for Power.

Cash and cash equivalents, restricted cash and short-term investments totalled \$367.5 million at June 30, 2006, a decrease of \$117.7 million since year end. The cash decrease is mainly due to the purchase of convertible debentures at a cost of \$181.6 million (including transaction costs), capital expenditures of \$109.4 million, dividend payments, debt repayments and other advances and payments related to the expansion projects in Power and Metals. This was partly offset by distributions received as a result of the restructuring and IPO of Royal Utilities combined with cash generated from operations.

Outlook for 2006 (see "Forward-looking Statements")

Sherritt anticipates that prices for nickel and oil will continue to be above historical averages and that cobalt prices may increase due to higher demand. Overall high energy, raw materials, and other input costs are also expected to continue in 2006, impacting operations and construction projects underway.

Total capital expenditures for the year are expected to be approximately \$360 million, of which \$130 million will be spent in the third quarter.

Coal – Through completion of the IPO of Royal Utilities, Sherritt should realize the imputed value of its mine-mouth thermal coal assets and royalty streams. Coal assets jointly retained by Sherritt and Ontario Teachers' largely comprise the Coal Valley mine and substantial coal reserves in western Canada. Sherritt's share of cash distributions from Royal Utilities is expected to be \$3.2 million per month.

Sherritt remains committed to a series of long-term initiatives to develop these coal reserves to supply energy, in the form of syngas, hydrogen or steam. The first of these initiatives is the commencement of a pre-feasibility study for a commercial gasification plant at Camrose Riley for the production of syngas, which is expected to be completed by the end of the year.

Production at the Coal Valley mine is expected to be approximately 1.9 million tonnes for the 2006 calendar year. Increased production along with stronger sales prices should result in a positive operating margin in the second half of 2006.

Capital expenditures, excluding Royal Utilities, for the 2006 calendar year are forecast at approximately \$6.4 million, of which \$3.4 million relates to the completion of the wash plant expansion at Coal Valley. In the third quarter, capital expenditures are projected to be approximately \$1.4 million.

Metals – Process bottlenecks experienced during the first quarter have been addressed and production is expected to proceed at an annualized rate of 33,000 tonnes per year (100% basis) of mixed sulphides. Finished nickel production for 2006 is expected to be 30,000 tonnes (100% basis) while finished cobalt production is expected to be similar to 2005 levels.

Construction work for expansion at the Moa mine and processing facilities was initiated during the quarter. Given the brownfield nature of the expansion, it is possible for Sherritt and its partner to increase production in phases, thereby minimizing cost uncertainties in today's inflationary environment for capital projects. While the overall timeline to expand operations by the full 16,000 tonnes (100% basis) may be

extended, the phasing of the expansion could result in up to 4,000 tonnes (100% basis) new production coming online earlier than the originally planned commissioning date in 2008. Evaluation of this approach is currently underway.

Total capital expenditures for the year are expected to be approximately \$142 million, \$20 million below the initial full year guidance of \$162 million. This difference takes into consideration the timing of activities associated with the Metals' expansion. In the third quarter, capital expenditures are forecast to be approximately \$57 million.

Oil and Gas – During the quarter, Sherritt benefited from above average Gulf Coast fuel oil reference prices. Gross working interest oil production in Cuba has stabilized and is expected to remain near current levels, assuming new production from development drilling offsets natural reservoir declines. The recently commercialized Santa Cruz field currently has three development drilling rigs operating in the area. There are four rigs active in other fields, including an exploration well underway at Playa Larga. A multilateral appraisal well on the existing Majaguillar-Corajol deposit (discovered several years ago) is also planned for the second half of 2006. The commercial potential of the San Anton exploration well continues to be evaluated.

The outlook for net oil production for 2006 is dependent on several factors, including gross working interest production volumes, fuel oil reference prices and capital spending. Assuming that these factors remain consistent with expectations, average net oil production for 2006 is expected to be comparable to 2005 levels.

The commercial potential of various enhanced oil recovery technologies continues to be developed. Programs involving CO₂, steam or gas re-injection are being contemplated. These initiatives will require a significant amount of capital.

Capital expenditures for the quarter totalled \$33.0 million and leave the Corporation on track to spend approximately \$140 million for the year. In the third quarter, capital expenditures are expected to be approximately \$44 million.

Power – Production for 2006 is expected to be a record 2 million MWh. Scheduled maintenance outages at the Varadero facilities in the third quarter will impact electricity production by an estimated 40,000 MWh. Additional capacity from the newly commissioned 85MW power production facility is expected to lead to record production and revenue for Power in 2006.

Detailed engineering for the 65 MW expansion at Boca de Jaruco is largely complete. All major components have been ordered and civil work on the site will commence in the third quarter. The expansion is expected to be commissioned in the second quarter of 2007. The total cost of the project is estimated to be \$60 million, with approximately \$52 million being incurred during 2006. This expansion will bring Power's total capacity to 376 MW.

Estimated capital expenditures for the remainder of 2006 include \$39 million for the 65 MW expansion project and \$5 million for other capital projects. Third quarter capital expenditures are expected to be about \$25 million, most of which will relate to the expansion project.

Coal

	Q2 2006	Q1 2006	Q4 2005	Q3 2005	Q2 2005	Six months ended June 30	
						2006	2005
Coal Sales (mm of tonnes)							
Royal Utilities ⁽¹⁾⁽²⁾	4.2	4.9	4.8	4.5	4.3	9.1	9.1
Coal Valley mine	0.4	0.3	0.1	0.2	0.2	0.7	0.4
	<u>4.6</u>	<u>5.2</u>	<u>4.9</u>	<u>4.7</u>	<u>4.5</u>	<u>9.8</u>	<u>9.5</u>
Production (mm of tonnes)							
Royal Utilities ⁽¹⁾⁽²⁾	4.1	5.0	4.9	4.5	4.4	9.1	9.1
Coal Valley mine	0.4	0.4	0.1	0.1	0.2	0.8	0.5
	<u>4.5</u>	<u>5.4</u>	<u>5.0</u>	<u>4.6</u>	<u>4.6</u>	<u>9.9</u>	<u>9.6</u>
EBITDA (mm of \$)	\$ 13.3	\$ 18.8	\$ 15.8	\$ 14.5	\$ 14.0	\$ 32.1	\$ 35.0
Realized Prices (\$ per tonne)							
Royal Utilities ⁽¹⁾⁽²⁾ (excludes royalty income)	\$12.63	\$11.31	\$11.10	\$11.15	\$11.14	\$11.92	\$10.92
Coal Valley mine	47.05	46.45	45.77	50.85	53.08	46.78	51.35
Capital Expenditures (mm of \$)	\$ 5.9	\$ 3.1	\$ 21.5	\$ 17.9	\$ 5.8	\$ 9.0	\$ 7.1

(1) Royal Utilities include the two contract operations, five mine mouth operations, and the Bienfait mine and Char plant.

(2) Realized prices, sales volumes and production volumes for Royal Utilities included up to June 27, 2006.

Higher revenues from both Royal Utilities and Coal Valley resulted in a 12% increase in Coal revenue for the second quarter of 2006 compared to the same period in 2005. Royal Utilities revenues increased as a result of higher royalty income and revenues from the contract mines due to higher recoverable costs. Coal Valley's revenues increased to \$16.8 million in the second quarter of 2006 from \$14.7 million in the second quarter of 2005 as a result of increased sales volumes resulting from the expansion completed during the first quarter of 2006.

EBITDA of \$13.3 million was slightly lower than the \$14.0 million in the second quarter of 2005 as a result of one-time charges for Royal Utilities restructuring. EBITDA decreased from the first quarter of 2006 mainly due to higher scheduled maintenance activities in Royal Utilities, combined with the restructuring costs.

Coal Valley has benefited from positive pricing developments in the thermal coal export market. In June, the Newcastle reference price for Asian export coal prices was settled at U.S. \$52.50/MT, approximately \$5.00 higher than anticipated. Realized prices at Coal Valley were lower than prior year quarter primarily due to a stronger Canadian dollar. As a result of the wash plant expansion in 2005, sales and production volumes from Coal Valley doubled compared to the prior year. Project spending on Coal development opportunities was \$0.5 million in the quarter.

Sherritt proportionally consolidated its Coal business prior to the Royal Utilities IPO. Subsequent to the IPO, Sherritt accounted for its interest in Royal Utilities on an equity accounting basis. The coal assets jointly retained by Sherritt and Ontario Teachers' comprising the Coal Valley mine and non-dedicated coal reserves will continue to be proportionally consolidated.

Capital expenditures in the second quarter were comparable to the prior year quarter.

Metals

	Q2 2006	Q1 2006	Q4 2005	Q3 2005	Q2 2005	Six months ended June 30	
						2006	2005
Production (tonnes)							
Nickel	3,338	3,681	3,854	3,825	4,349	7,019	8,260
Cobalt	370	409	409	417	453	779	870
Sales (thousands of pounds)							
Nickel	7,213	8,283	9,275	7,619	9,715	15,496	18,670
Cobalt	861	923	963	955	984	1,784	1,813
EBITDA (mm of \$)	\$ 46.3	\$ 30.1	\$ 20.5	\$ 34.3	\$ 62.3	\$ 76.4	\$111.6
Realized Prices ⁽¹⁾							
Nickel (\$/lb)	\$10.42	\$ 7.77	\$ 6.91	\$ 8.02	\$ 9.22	\$ 9.00	\$ 8.95
Cobalt (\$/lb)	16.46	14.56	16.08	17.64	19.65	15.48	20.66
Reference Prices							
Nickel (U.S. \$/lb)	\$ 9.09	\$ 6.72	\$ 5.73	\$ 6.61	\$ 7.44	\$ 7.87	\$ 7.20
Cobalt (U.S. \$/lb) ⁽²⁾	14.43	12.43	12.50	13.41	15.03	13.41	16.15
Capital Expenditures (mm of \$)	\$ 12.9	\$ 15.1	\$ 12.8	\$ 10.8	\$ 5.4	\$ 28.0	\$ 13.6

(1) Comparable periods have been restated to reflect the change in accounting for certain selling expenses which were previously netted against revenues and have now been reclassified to operating, selling, general and administrative costs

(2) Average Metal Bulletin: 99.3% cobalt published price

Metals EBITDA increased approximately 54% quarter-over-quarter, primarily due to higher realized prices for both nickel and cobalt. Revenue gains were partially offset by lower production volumes and a strong Canadian dollar. Strong base metal pricing has continued subsequent to quarter end with the London Metals Exchange nickel price surpassing the \$13.50 per pound mark in July, 2006.

During the quarter, Moa management addressed process bottlenecks related to settling characteristics of the ore being processed. Upon completion of this modification, the annualized production rate returned to approximately 33,000 tonnes (100% basis) per year of mixed sulfides.

During the quarter, Fort Saskatchewan undertook unplanned maintenance activities on several autoclaves. Production guidance remains unchanged for the remainder of the year and takes into consideration additional planned maintenance activities scheduled for Fort Saskatchewan facility in the second half of 2006.

Capital expenditures for the second quarter totalled \$12.9 million and included the completion of basic engineering activities related to the Metals expansion.

Oil and Gas

	Q2 2006	Q1 2006	Q4 2005	Q3 2005	Q2 2005	Six months ended June 30	
						2006	2005
Production (boepd)							
Gross working interest production in							
Cuba ⁽¹⁾⁽²⁾	30,330	30,891	29,714	29,600	32,095	30,609	32,099
Net production ⁽¹⁾⁽³⁾							
Cuba							
Cost recovery	6,074	7,303	6,189	5,765	11,357	6,685	9,833
Profit oil	9,535	9,215	9,255	9,408	8,126	9,376	8,675
Total Cuba	15,609	16,518	15,444	15,173	19,483	16,061	18,508
Spain	457	495	592	569	461	476	461
Pakistan ⁽⁴⁾	375	—	—	—	—	188	—
Total net production	16,441	17,013	16,036	15,742	19,944	16,725	18,969
EBITDA (mm of \$)	\$ 54.7	\$ 56.2	\$ 49.1	\$ 52.1	\$ 57.4	\$110.9	\$ 98.1
Realized Prices							
Cuba (per bbl)	\$45.20	\$43.14	\$38.28	\$39.65	\$36.52	\$44.15	\$32.70
Spain (per bbl)	78.09	71.28	65.96	73.49	63.81	74.57	61.37
Reference Prices							
U.S. Gulf Coast Fuel Oil #6							
(U.S. \$ per bbl)	\$48.88	\$45.86	\$40.31	\$39.88	\$35.84	\$47.47	\$31.70
Capital Expenditures	\$ 33.0	\$ 23.7	\$ 28.9	\$ 27.9	\$ 36.8	\$ 56.7	\$ 65.3

(1) Production figures exclude production from wells for which commerciality has not been established.

(2) Gross working interest production in Cuba is allocated to the Corporation and agencies of the Cuban government in accordance with production-sharing arrangements and joint venture agreements.

(3) Net oil production (equivalent to net sales volume) represents the Corporation's share of gross working interest production. Net oil production for each production-sharing contract is comprised of cost recovery oil (based upon the Corporation's recoverable costs within each block) and profit oil (based upon a percentage of gross production less cost recovery oil). Recoverable costs, subject to certification by agencies of the Cuban government, are accumulated in cost recovery pools for each production-sharing contract and reduced by the allocation of cost recovery oil to the Corporation. Cost recovery revenue equals capital and operating costs eligible for recovery under the production-sharing contracts, therefore cost recovery oil volumes increase as a result of higher capital expenditures and decrease when selling prices increase. At higher oil prices, the reduction in cost recovery oil volumes is partially offset by an increase in profit oil barrels, after deducting the Cuban government's share, which is analogous to royalty interests in Canadian hydrocarbon fiscal regimes.

(4) Natural gas production in Pakistan converted into barrels of oil equivalent per day (boepd) using a 6:1 conversion ratio.

Record revenue of \$69.6 million was achieved in the second quarter as a result of higher oil prices, partially offset by the stronger Canadian dollar. Oil and Gas EBITDA in the quarter was \$54.7 million, compared to \$56.2 million last quarter and \$57.4 million in the same quarter last year. Higher equipment, service and operating costs attributed to market conditions led to an increase in operating and administration costs.

Sherritt currently operates seven drill rigs in Cuba. For the full year, Sherritt expects to drill a total of 3 exploration wells and 17 development wells. This compares to 4 exploration and 12 development wells that were completed in 2005.

For the six months ended June 30, 2006, EBITDA of \$110.9 million was 13% higher than the same period last year. This increase was due to record fuel oil reference prices and the retroactive recognition of Santa Cruz production, which was declared commercial in the first quarter of 2006.

Gross working interest production volumes averaged 30,330 boepd during the second quarter of 2006. Factoring in the retroactive production allocated to Santa Cruz, production volumes increased by 1,024 boepd from the preceding quarter. Net production in Cuba of 15,609 boepd in the second quarter of 2006 was comparable with the preceding quarter (after adjusting for Santa Cruz production), but 3,874 boepd

lower than the same quarter last year, due to lower gross working interest production volume, the impact on cost recovery barrels from higher fuel oil reference prices and lower capital spending in commercial blocks. Production from the Badar gas field in Pakistan came on stream in April 2006.

During the second quarter of 2006, six drilling rigs were active, compared with four active rigs during the same period in 2005, and a seventh rig was contracted for one well starting in the third quarter. During the quarter, three development wells were completed in the Yumuri and Varadero West fields, together with the first development well in the Santa Cruz field. In addition, three Santa Cruz development wells and one Seboruco well were drilling at the end of the quarter, with two more rigs preparing to spud development wells in the Seboruco and Canasi fields.

In April, exploration drilling started on the Playa Larga prospect and is expected to be completed in the third quarter. The San Anton exploration well was completed in January 2006, and is currently under evaluation to determine its commercial potential.

During the second quarter of 2006, the Canasi land-based treatment and ocean disposal system was commissioned and construction of the 17 km gas pipeline from the Yumuri production facility was started. The Canasi water system will enable Sherritt to optimize oil production volumes in the future as produced water rates increase, while the tie-in of gas production from the Yumuri battery will enable the Cuban government to eliminate flaring and conserve natural gas production for electricity generation at Energas and domestic uses.

Capital expenditures in the quarter totalled \$33.0 million. Expenditures included funds allocated to development drilling, exploration drilling, completion of the Canasi land-based treatment and ocean disposal system and the construction of the land-based gas pipeline connected to the Yumuri production facility.

Power

	Q2 2006	Q1 2006	Q4 2005	Q3 2005	Q2 2005	Six months ended June 30	
						2006	2005
Electricity Generation (000's of MWh)	549	431	409	377	426	980	845
EBITDA (mm of \$)	\$ 20.7	\$ 15.1	\$ 14.4	\$ 18.7	\$ 15.0	\$ 35.8	\$34.6
Realized price per MWh	\$44.46	\$44.61	\$44.57	\$50.67	\$55.20	\$44.52	\$55.0
Capital Expenditures (mm of \$)	\$ 6.6	\$ 8.1	\$ 9.2	\$ 19.6	\$ 30.9	\$ 14.7	\$49.1

Record second quarter electricity production was almost 30% higher than both the preceding quarter and second quarter of 2005. This increase was attributed to new production from the 85 MW expansion completed in the first quarter of this year.

The tariff for production from the new facility is U.S. \$45 per MWh while capital costs are repaid, and the tariff for production from the existing facilities is U.S. \$38 per MWh. Realized prices also reflect variations in the exchange rate.

Capital expenditures during the quarter totalled \$6.6 million. The majority of capital expenditures were associated with the 65 MW expansion project which is expected to be completed in the second quarter of 2007. Power capital expenditures to date in 2006 relate mainly to the 85MW and 65MW expansion projects.

Other Businesses

Sherritt's soybean-based food processing business generated revenue of \$15.1 million and EBITDA of \$1.2 million in the second quarter of 2006, compared to revenue of \$19.6 million and EBITDA of \$1.8 million for the comparative quarter in 2005. The decrease in revenue and EBITDA were mostly due to lower realized prices. Capital expenditures for the quarter were \$0.4 million and are estimated at \$1 million for 2006.

Summary Financial Results by Segment (unaudited)

The tables below present EBITDA and operating earnings from continuing operations by segment and reconciles these non-GAAP measures to earnings before income taxes. The Corporation discloses EBITDA in order to provide an indication of revenue less cash operating expenses. Operating earnings is a measure used by Sherritt to evaluate the operating performance of its businesses as it excludes interest charges, which are a function of the particular financing structure for the business, and certain other charges. EBITDA and operating earnings do not have any standardized meaning prescribed by Canadian generally accepted accounting principles and are, therefore, unlikely to be comparable with similar measures presented by other issuers.

Three months ended June 30, 2006

(millions of Canadian dollars)	<u>Coal⁽²⁾</u>	<u>Metals</u>	<u>Oil and Gas</u>	<u>Power</u>	<u>Other⁽¹⁾</u>	<u>Corporate</u>	<u>Consolidated</u>
Revenue	\$73.2	\$110.6	\$69.6	\$28.4	\$15.1	\$ -	\$296.9
Operating, selling, general and administrative	59.9	64.3	14.9	7.7	13.9	11.4	172.1
EBITDA	13.3	46.3	54.7	20.7	1.2	(11.4)	124.8
Depletion, amortization and accretion	13.6	5.0	21.3	6.7	0.6	1.2	48.4
Operating earnings (loss)	(0.3)	41.3	33.4	14.0	0.6	(12.6)	76.4
Share of earnings of equity accounted investments							0.3
Net financing expense							(11.5)
Income taxes							(8.0)
Non-controlling interests							(5.0)
Gain on disposition of investments							5.0
Net earnings							<u>57.2</u>
Capital expenditures	<u>\$ 5.9</u>	<u>\$ 12.9</u>	<u>\$33.0</u>	<u>\$ 6.6</u>	<u>\$ 0.4</u>	<u>-</u>	<u>58.8</u>

- (1) Other represents the results of the soybean-based food processing business.
(2) Coal results include Royal Utilities on the proportionate consolidation basis up to June 27, 2006.

Three months ended June 30, 2005 (restated)⁽²⁾

(millions of Canadian dollars)	<u>Coal</u>	<u>Metals</u>	<u>Oil and Gas</u>	<u>Power</u>	<u>Other⁽¹⁾</u>	<u>Corporate</u>	<u>Consolidated</u>
Revenue	\$65.3	\$143.3	\$67.7	\$26.6	\$19.6	\$ -	\$322.5
Operating, selling, general and administrative	51.3	81.0	10.3	11.6	17.8	4.5	176.5
EBITDA	14.0	62.3	57.4	15.0	1.8	(4.5)	146.0
Depletion, amortization and accretion	14.3	5.2	20.1	5.4	0.7	1.0	46.7
Operating earnings (loss)	(0.3)	57.1	37.3	9.6	1.1	(5.5)	99.3
Share of earnings of equity accounted investments							-
Net financing expense							(13.8)
Income taxes							(25.8)
Non-controlling interests							(6.0)
Net earnings							<u>53.7</u>
Capital expenditures	<u>\$ 5.8</u>	<u>\$ 5.4</u>	<u>\$36.8</u>	<u>\$30.9</u>	<u>\$ 0.1</u>	<u>\$ 0.1</u>	<u>\$ 79.1</u>

- (1) Other represents the results of the soybean-based food processing business.
(2) Comparable periods have been restated to reflect a change in the methodology of accounting for income taxes in the Oil and Gas to provide a clearer presentation of income taxes in that business. Certain selling expenses in Metals which were previously netted against revenue were reclassified to operating, selling and administrative costs.

Six months ended June 30, 2006

(millions of Canadian dollars)	<u>Coal⁽³⁾</u>	<u>Metals</u>	<u>Oil and Gas</u>	<u>Power</u>	<u>Other⁽¹⁾</u>	<u>Corporate</u>	<u>Consolidated</u>
Revenue	\$147.0	\$191.7	\$138.3	\$50.6	\$28.9	\$ -	\$556.5
Operating, selling, general and administrative	<u>114.9</u>	<u>115.3</u>	<u>27.4</u>	<u>14.8</u>	<u>26.5</u>	<u>20.6</u>	<u>319.5</u>
EBITDA	32.1	76.4	110.9	35.8	2.4	(20.6)	237.0
Depletion, amortization and accretion	<u>27.6</u>	<u>9.6</u>	<u>41.9</u>	<u>13.0</u>	<u>1.4</u>	<u>2.4</u>	<u>95.9</u>
Operating earnings (loss)	4.5	66.8	69.0	22.8	1.0	(23.0)	141.1
Share of earnings of equity accounted investments							0.9
Net financing expense							(19.8)
Income taxes							(26.0)
Non-controlling interests							(8.3)
Gain on disposition of investments . .							5.0
Net earnings							<u>92.9</u>
Capital expenditures	<u>\$ 9.0</u>	<u>\$ 28.0</u>	<u>\$ 56.7</u>	<u>\$14.7</u>	<u>\$ 0.9</u>	<u>\$ 0.1</u>	<u>\$109.4</u>

Six months ended June 30, 2005 (restated)⁽²⁾

(millions of Canadian dollars)	<u>Coal</u>	<u>Metals</u>	<u>Oil and Gas</u>	<u>Power</u>	<u>Other⁽¹⁾</u>	<u>Corporate</u>	<u>Consolidated</u>
Revenue	\$128.2	\$244.2	\$118.1	\$52.3	\$36.8	\$ -	\$579.6
Operating, selling, general and administrative	<u>93.2</u>	<u>132.6</u>	<u>20.0</u>	<u>17.7</u>	<u>32.3</u>	<u>14.7</u>	<u>310.5</u>
EBITDA	35.0	111.6	98.1	34.6	4.5	(14.7)	269.1
Depletion, amortization and accretion	<u>28.1</u>	<u>10.2</u>	<u>39.0</u>	<u>10.6</u>	<u>1.4</u>	<u>2.1</u>	<u>91.4</u>
Operating earnings (loss)	6.9	101.4	59.1	24.0	3.1	(16.8)	177.7
Share of earnings of equity accounted investments							0.5
Net financing expense							(28.9)
Income taxes							(45.4)
Non-controlling interests							(14.8)
Net earnings							<u>89.1</u>
Capital expenditures	<u>\$ 7.1</u>	<u>\$ 13.6</u>	<u>\$ 65.3</u>	<u>\$49.1</u>	<u>\$ 0.2</u>	<u>\$ 1.5</u>	<u>\$136.8</u>

(1) Other represents the results of the soybean-based food processing business.

(2) Comparable periods have been restated to reflect a change in the methodology of accounting for income taxes in the Oil and Gas to provide a clearer presentation of income taxes in that business. Certain selling expenses in Metals which were previously netted against revenue were reclassified to operating, selling and administrative costs.

(3) Coal results include Royal Utilities on the proportionate consolidation basis up to June 27, 2006.

Three months ended March 31, 2006

(millions of Canadian dollars)	Coal	Metals	Oil and Gas	Power	Other ⁽¹⁾	Corporate	Consolidated
Revenue	\$73.8	\$81.1	\$68.7	\$22.2	\$13.8	\$ –	\$259.6
Operating, selling, general and administrative	55.0	51.0	12.5	7.1	12.6	9.2	147.4
EBITDA	18.8	30.1	56.2	15.1	1.2	(9.2)	112.2
Depletion, amortization and accretion	14.0	4.6	20.6	6.3	0.8	1.2	47.5
Operating earnings (loss)	4.8	25.5	35.6	8.8	0.4	(10.4)	64.7
Share of earnings of equity accounted investments							0.6
Net financing expense							(8.3)
Income taxes							(18.0)
Non-controlling interests							(3.3)
Net earnings							35.7
Capital expenditures	\$ 3.1	\$15.1	\$23.7	\$ 8.1	\$ 0.5	\$ 0.1	\$ 50.6

Three months ended December 31, 2005

(millions of Canadian dollars)	Coal	Metals	Oil and Gas	Power	Other ⁽¹⁾	Corporate	Consolidated
Revenue	\$62.7	\$98.0	\$58.6	\$22.0	\$17.4	\$ –	\$258.7
Operating, selling, general and administrative	46.9	77.5	9.5	7.6	17.2	6.8	165.5
EBITDA	15.8	20.5	49.1	14.4	0.2	(6.8)	93.2
Depletion, amortization and accretion	14.8	5.1	22.5	5.6	0.7	1.3	50.0
Operating earnings (loss)	1.0	15.4	26.6	8.8	(0.5)	(8.1)	43.2
Share of earnings of equity accounted investments							–
Net financing expense							(30.8)
Income taxes							2.6
Non-controlling interests							(5.9)
Net earnings							9.1
Capital expenditures	\$21.5	\$12.8	\$28.9	\$ 9.2	\$ 0.5	\$ 0.3	\$ 73.2

(1) Other represents the results of the soybean-based food processing business.

Three months ended September 30, 2005 (restated)⁽²⁾

(millions of Canadian dollars)	Coal	Metals	Oil and Gas	Power	Other ⁽¹⁾	Corporate	Consolidated
Revenue	\$64.8	\$86.6	\$60.8	\$24.2	\$20.9	\$ –	\$257.3
Operating, selling, general and administrative	50.3	52.3	8.7	5.5	19.4	21.0	157.2
EBITDA	14.5	34.3	52.1	18.7	1.5	(21.0)	100.1
Depletion, amortization and accretion	14.2	4.8	19.8	5.6	0.8	1.0	46.2
Operating earnings (loss)	0.3	29.5	32.3	13.1	0.7	(22.0)	53.9
Share of earnings of equity accounted investments							0.1
Net financing expense							(5.3)
Income taxes							(15.2)
Non-controlling interests							(7.4)
Net earnings							26.1
Capital expenditures	\$17.9	\$10.8	\$27.9	\$19.6	\$ –	\$ 0.3	\$ 76.5

(1) Other represents the results of the soybean-based food processing business.

(2) Comparable periods have been restated to reflect a change in the methodology of accounting for income taxes in the Oil and Gas to provide a clearer presentation of income taxes in that business. Certain selling expenses in Metals which were previously netted against revenue were reclassified to operating, selling and administrative costs.

Management's Discussion and Analysis

(all tabular dollar amounts expressed in millions of Canadian dollars, except per share amounts)

The following Management's Discussion and Analysis of the consolidated financial results of Sherritt International Corporation for the three and six months ended June 30, 2006 should be read in conjunction with the unaudited consolidated financial statements and related notes contained in this interim report and the interim report issued for the first quarter of 2006, as well as the Management's Discussion and Analysis, audited consolidated financial statements and related notes contained in the Corporation's 2005 annual report. Additional information relating to the Corporation, including the Corporation's 2005 Annual Information Form, is on SEDAR at www.sedar.com or on the Corporation's web site at www.sherritt.com. This Management's Discussion and Analysis is as of July 28, 2006.

Significant Transactions

On June 27, 2006, Royal Utilities Income Fund ("Royal Utilities"), an unincorporated open-ended limited purpose trust in which the Corporation held an indirect 50% interest through its partnership in Coal, successfully completed its initial public offering of units ("IPO").

Prior to the IPO, Royal Utilities transferred to certain affiliates certain non-core mining assets composed of the Coal Valley export thermal coal mine, various non-producing coal mines, certain coal and potash resources and other non-mining assets (the "Transferred Assets"). These transfers were recorded at their carrying value.

Following the IPO and exercise of the over-allotment by the underwriters, the Corporation owned 41.2% of the outstanding units of Royal Utilities. For accounting purposes, the Corporation's disposition of its interest in Royal Utilities resulted in a net gain of \$4.7 million.

The results for Coal reflect the Corporation's 50% proportionate interest in Royal Utilities up to June 27, 2006. Subsequent to June 27, 2006, the Corporation prospectively changed its accounting for Royal Utilities to the equity method. The Corporation will continue to proportionately consolidate its 50% interest in the Transferred Assets.

During the second quarter, the Corporation completed two offers to purchase a portion of its outstanding 7% convertible debentures. The first offer expired on April 12, 2006, for which the Corporation purchased \$7.1 million principal amount of debentures at a price of \$1,620 per \$1,000 principal, plus accrued interest. On June 26, 2006, the second offer expired, for which the Corporation purchased \$100 million principal amount at a price of \$1,700 per \$1,000 principal amount, plus accrued interest. These transactions resulted in \$3.1 million being charged to income and \$71.2 million being charged to retained earnings. Given the Corporation's strong earnings and cash flow generation, Sherritt considers the purchase of its outstanding debentures an effective use of its cash while still providing the Corporation with the flexibility to pursue growth opportunities. These purchases reduce the dilution to shareholders which would have occurred if the Corporation elected to give notice of redemption on or after the first call date of December 16, 2006.

Consolidated Earnings

Second Quarter Results

Net earnings for the second quarter of 2006 were \$57.2 million or \$0.38 per share, compared to net earnings of \$53.7 million or \$0.35 per share in the second quarter of 2005. The increase in net earnings was mainly due to a one-time tax rate change benefit, a \$0.07 per share impact, as a result of a decrease in tax rates. In addition, a \$4.7 million gain, \$0.03 per share, was recognized from the Corporation's disposition of its interest in Royal Utilities and \$6.7 million (net of tax \$4.7 million), \$0.03 per share, was charged to earnings related to restructuring costs and the loss on purchase of debentures. These increases in net earnings were partly offset by lower earnings in Metals.

	<u>Q2 2006</u>	<u>Q2 2005</u> (restated)
Revenue	\$296.9	\$322.5

Lower revenues for the second quarter were primarily a result of lower Metals revenue due to decreased nickel and cobalt sales volumes. Sales volumes in Metals have been impacted by process bottlenecks that were rectified during the second quarter. The decrease in Metals revenue was partially offset by increased revenue in Coal due to higher export sales volumes from the Coal Valley mine and higher revenue from Royal Utilities due to higher recoverable costs from the contract mines and increased royalty revenue. Sales volumes from Coal Valley have been increasing as the mine continues to ramp up production following the completion of the mine expansion.

	<u>Q2 2006</u>	<u>Q2 2005</u> (restated)
Operating costs	\$144.0	\$161.4
Selling costs	4.7	4.5
General and administrative costs	23.4	10.6
Operating, selling, general and administrative costs	<u>\$172.1</u>	<u>\$176.5</u>

Lower operating costs for the second quarter were mainly due to a decrease in costs in Metals associated with the lower sales volumes that also resulted in lower revenue for the quarter. This decrease was partially offset by higher operating costs in Coal resulting from increased export sales volumes from Coal Valley and increased operating costs from Royal Utilities. Selling costs were consistent with the comparative quarter. Higher general and administrative costs were mainly due to \$3.6 million of restructuring and other costs, \$3.2 million of increased stock-based compensation costs, and general increases in employee compensation costs. In addition, a \$3.8 million insurance recovery was recorded in the second quarter of 2005.

	<u>Q2 2006</u>	<u>Q2 2005</u>
Depletion, amortization and accretion	\$48.4	\$46.7

The increase in depletion, amortization and accretion expense is mainly due to higher depletion rates in Oil and Gas related to increased capital spending over the past two years, and higher depreciation in Power and Coal, due to the expansion projects completed during the first quarter of 2006.

	<u>Q2 2006</u>	<u>Q2 2005</u> (restated)
Net financing expense	\$11.5	\$13.8

Net financing expense is mainly composed of interest income, interest expense, and foreign exchange losses. The decrease in net financing expense is mainly due to a \$3.0 million decrease in foreign exchange losses, higher interest income, lower interest expense due to the redemption and repurchase of debentures, partially offset by a loss of \$3.1 million on purchase of the convertible debentures.

	<u>Q2 2006</u>	<u>Q2 2005</u>
Share of earnings of equity-accounted investments	<u>\$0.3</u>	<u>\$ -</u>

The Corporation's equity-accounted investments includes the investment in Royal Utilities for the period June 27 to June 30, 2006, and the tourism businesses. Equity earnings from the tourism businesses did not change significantly quarter-over-quarter.

	<u>Q2 2006</u>	<u>Q2 2005</u> (restated)
Effective tax rate	<u>11%</u>	<u>30%</u>

The lower effective tax-rate in the second quarter of 2006 compared to 2005 is mainly the result of significant tax rate reductions by the Alberta and Federal governments, including the elimination of the Federal large corporations tax. The majority of the impact relates to future income tax liabilities in the Corporation's Coal business. Without the reductions in current and future tax rates, the effective tax rate would have been approximately 26% for the quarter. The lower adjusted rate for 2006 as compared to the same period last year reflects the higher proportion of profits in the Metals business recorded in a low tax-rate jurisdiction relative to last year and non-taxable gains on the Coal disposition.

	<u>Q2 2006</u>	<u>Q2 2005</u>
Non-controlling interests	<u>\$5.0</u>	<u>\$6.0</u>

Non-controlling interests reflects the two-thirds outside interest in the net earnings of a variable interest entity in Power. The decrease in non-controlling interest is primarily the result of the variable interest entity becoming taxable in Cuba in respect of profits from the original 226MW facilities.

Six Months Ended June 30 Results

For the six months ended June 30, 2006, net earnings of \$92.9 million or \$0.61 per share were higher than net earnings of \$89.1 million or \$0.60 per share for the comparable period last year. The increase in net earnings was mainly due to a one-time tax rate change benefit, a \$0.07 per share impact. In addition, a \$4.7 million gain, \$0.03 per share, was recognized from the Corporation's disposition of its interest in Royal Utilities and \$6.7 million (net of tax \$4.7 million), \$0.03 per share, was charged to earnings related to restructuring costs and the loss on purchase of debentures. These increases in net earnings were partly offset by lower earnings in Metals.

	<u>Six Months</u> <u>2006</u>	<u>Six Months</u> <u>2005</u> (restated)
Revenue	<u>\$556.5</u>	<u>\$579.6</u>

Lower revenues were primarily the result of decreased revenue in Metals due to lower nickel and cobalt sales volumes as well as lower cobalt prices. This was partially offset by higher revenues in Oil and Gas due to higher realized oil prices and increased revenue in Coal. Coal revenues increased due to higher export sales volumes from Coal Valley and higher revenues associated with Royal Utilities' contract mines mainly due to increased cost recoveries.

	Six Months 2006	Six Months 2005 (restated)
Operating costs	\$273.1	\$276.6
Selling costs	7.4	7.0
General and administrative costs	39.0	26.9
Operating, selling, general and administrative costs	<u>\$319.5</u>	<u>\$310.5</u>

Operating costs did not change significantly between periods. Higher operating costs in Coal were mostly offset by lower operating costs in Metals due to lower nickel and cobalt sales volumes. The operating costs in Coal increased due to higher sales volumes at Coal Valley and higher operating costs associated with Royal Utilities' contract mines. Selling costs were comparable between periods. Higher general and administrative costs were mainly due to \$3.7 million of increased stock-based compensation costs, \$3.6 million of restructuring and other costs, and general increases in employee compensation costs, particularly in Oil and Gas. In addition, a \$3.8 million insurance recovery was recorded in the second quarter of 2005.

	Six Months 2006	Six Months 2005
Depletion, amortization and accretion	<u>\$95.9</u>	<u>\$91.4</u>

The increase in depletion, amortization and accretion expense is mainly due to higher Oil and Gas depletion rates related to increased capital spending over the past two years, and higher depreciation in Power and Coal due to the expansions completed during the first quarter of 2006.

	Six Months 2006	Six Months 2005 (restated)
Net financing expense	<u>\$19.8</u>	<u>\$28.9</u>

Net financing expense is mainly composed of interest income, interest expense, and foreign exchange losses. The decrease in net financing expense is mainly due to a \$6.7 million decrease in foreign exchange losses, lower interest expense due to the redemption and repurchase of debentures, partially offset by a loss of \$3.1 million on purchase of the convertible debentures.

	Six Months 2006	Six Months 2005
Share of earnings of equity-accounted investments	<u>\$0.9</u>	<u>\$0.5</u>

The Corporation's equity-accounted investments includes the investment in Royal Utilities for the period June 27 to June 30, 2006, and the tourism businesses. Equity earnings from the tourism businesses did not change materially between periods.

	Six Months 2006	Six Months 2005 (restated)
Effective tax rate	<u>20%</u>	<u>30%</u>

The lower effective tax rate for the first six months of 2006, as compared to the prior period last year, is mainly the result of significant tax-rate reductions by the Alberta and Federal governments, including the elimination of the Federal large corporations tax. The majority of the impact relates to adjustments to future income tax liabilities in the Corporation's Coal business. Without the reductions in current and future tax rates, the effective tax rate would have been approximately 28% for the six-month period.

	Six Months 2006	Six Months 2005
Non-controlling interests	<u>\$8.3</u>	<u>\$14.8</u>

Non-controlling interests reflects the two-thirds outside interest in the net earnings of a variable interest entity in Power. The decrease in non-controlling interest is the result of the variable interest entity becoming taxable in Cuba in respect of profits from the original 226 MW facilities.

Consolidated Cash Flow

Second Quarter Results

	<u>Q2 2006</u>	<u>Q2 2005</u> (restated)
Cash from operating activities before working capital changes	\$88.1	\$109.1
Decrease in non-cash working capital changes	(1.3)	(25.0)
Cash provided by operating activities	<u>\$86.8</u>	<u>\$ 84.1</u>

Cash provided by operating activities before non-cash working capital decreased mainly as a result of lower earnings in Metals due to lower nickel and cobalt sales volumes, partly offset by higher earnings in Power due to increased production resulting from the expansion.

Cash used for non-cash working capital of \$1.3 million was mainly the result of increased accounts receivable and prepaid expenses due to timing, mostly offset by increased payables associated with third-party feed in Metals and higher taxes payable in Oil and Gas.

	<u>Q2 2006</u>	<u>Q2 2005</u> (restated)
Capital expenditures	\$ 58.8	\$79.1
Cash provided by (used for) other investing activities	200.9	(5.9)
Cash provided by (used for) financing activities	<u>(208.4)</u>	<u>17.6</u>

Capitals expenditures in the second quarter were mainly in support of development and exploration drilling in Oil and Gas and the expansion of facilities in Metals. Second quarter 2005 capital expenditures were higher mainly due to the 85 MW Power expansion.

Cash provided by other investing activities mainly relate to \$117.2 million of proceeds and distributions received as a result of the restructuring of Coal and the disposition of interest in Royal Utilities, coupled with a decrease in short-term investments of \$94.1 million resulting from the timing of maturation of these investments. The Corporation's short-term investments have maturity dates greater than three months but less than one year.

Cash used for financing activities primarily relate to the purchase of \$107 million principal of 7% convertible debentures. The total cost on purchase was \$181.6 million. In addition, dividends of \$22.3 million were paid to the non-controlling interests in Power.

Six Months Ended June 30 Results

	<u>Six Months</u> <u>2006</u>	<u>Six Months</u> <u>2005</u> (restated)
Cash from operating activities before working capital changes	\$169.9	\$195.1
Decrease in non-cash working capital changes	(44.0)	(39.6)
Cash provided by operating activities	<u>\$125.9</u>	<u>\$155.5</u>

Cash provided by operating activities before non-cash working capital decreased mainly as a result of lower earnings in Metals due to lower nickel and cobalt sales volumes, partly offset by higher earnings in Oil and Gas due to higher commodity prices.

Cash used by non-cash working capital of \$44.0 million was a result of several factors. Accounts receivable increased in Metals and Oil and Gas due to higher prices for nickel and oil. In addition, accounts receivable in Power increased due to the timing of collections. Inventory increased mainly at Coal Valley due

to a buildup of coal inventory at port. This was partially offset by increased accounts payable due to higher payables associated with third-party feed in Metals and higher taxes payable in Oil and Gas resulting from increased earnings from the Santa Cruz field.

	<u>Six Months 2006</u>	<u>Six Months 2005 (restated)</u>
Capital expenditures	\$ 109.4	\$136.8
Cash provided by other investing activities	136.3	3.9
Cash provided by (used for) financing activities	<u>(233.7)</u>	<u>31.9</u>

Capitals expenditures for the first half of the year were mainly in support of development and exploration drilling in Oil and Gas, and the expansion of facilities in Metals. Capital expenditures for the first six months of 2005 were higher mainly due to the 85 MW Power expansion.

Cash provided by other investing activities mainly relate to \$117.2 million of proceeds and distributions received as a result of the restructuring of Coal and the disposition of interest in Royal Utilities, coupled with a decrease in short-term investments of \$41.9 million due to the timing in maturation of these investments. Cash used for Other assets related to increase in advances with respect to the Metals expansion and progress payments related to the Power expansion.

Cash used for financing activities primarily relate to the purchase of \$107 million principal of 7% convertible debentures. The total cost on purchase was \$181.6 million. In addition, dividends of \$22.3 million were paid to the non-controlling interests in Power.

Consolidated Financial Position

The consolidated financial position of the Corporation has changed significantly as a result of the reorganization of the Coal business and IPO of Royal Utilities. Previously, Sherritt and Ontario Teachers' exercised joint control of the Coal business and as such, Sherritt proportionately consolidated this business. Subsequent to the Royal Utilities IPO, Sherritt and Ontario Teachers' no longer jointly control Royal Utilities and thus, the Corporation has accounted for its investment in Royal Utilities under the equity method of accounting since June 27, 2006, the date of closing of the IPO. The change to the equity method of accounting resulted in reporting the net investment of Royal Utilities as one-line item on the balance sheet, whereas the proportionate consolidation separately presented the Corporation's proportionate interest in the assets and liabilities of Royal Utilities. The Corporation continues to proportionately consolidate its 50% interest in the Coal Valley mine and other Transferred Assets.

Total assets at June 30, 2006 were \$2.4 billion. Cash and cash equivalents, restricted cash and short-term investments totalled \$367.5 million at June 30, 2006, a decrease of \$117.7 million since year end. The cash decrease is mainly due to the purchase of \$107 million principal of 7% convertible debentures at a cost of \$181.6 million, capital expenditures of \$109.4 million, dividend payments, debt repayments, and other advances and payments related to the expansion projects in Metals and Power. This was partly offset by proceeds received as a result of the restructuring and IPO of Royal Utilities combined with cash generated from operations.

Current advances and loans receivable of \$33.4 million remained relatively unchanged in the second quarter of 2006. Accounts receivable were \$293.2 million as at June 30, 2006 compared with \$278.2 million at year end. Accounts receivable in Metals and Oil and Gas were higher mainly due to higher prices for nickel and oil. In addition, Corporate accounts receivable increased due to the timing of receipt of funds from the Coal restructuring and IPO. These increases were offset by the change in accounting of Coal accounts receivable related to Royal Utilities from proportionate consolidation to the equity method.

Since 2000, Sherritt has had an arrangement to provide extended terms of credit to Cuban government agencies for oil sales in Cuba during periods of high oil prices. Payment terms may be extended under this arrangement up to 180 days and bear interest at 14.0%.

Oil and Gas accounts receivable include amounts due from Cuban government agencies and a joint operating partner. Approximately 30% of the Corporation's Cuban oil and gas revenue is collected from the joint operating partner, and as such, it is exposed to the financial condition of the joint operating partner. As at June 30, 2006, accounts receivable from the joint operating partner were \$55.3 million. Included in this amount was \$26.7 million of cost recovery claims which are subject to approval by the Cuban agency pursuant to the Cuban production sharing contracts.

Metals accounts receivable include receivables from finished nickel and cobalt sales to customers primarily located in Europe and Asia, receivables from fertilizer sales to customers in Canada and receivables from by-product sales. Power and soybean-based food processing receivables include amounts due from Cuban government agencies. Coal Valley accounts receivable arise principally from sales of export coal to Asia and South America.

Inventories were \$104.2 million as at June 30, 2006, a decrease of \$5.8 million since year end. The decrease primarily relates to the change in accounting of Coal's inventory related to Royal Utilities which was partially offset by a \$6.4 million (50% share) increase in Coal Valley inventory due to a buildup of coal inventory at the port.

Capital assets of \$1,006.8 million as at June 30, 2006 decreased by \$642.0 million compared with \$1,648.8 million as at December 31, 2005. The reduction in capital assets was primarily due to the change in accounting in Coal for capital assets related to Royal Utilities. Capital expenditures were mainly in support of development and exploration drilling in Oil and Gas, and the expansion of facilities in Metals.

In December 2005, the Corporation and its joint venture partner entered into funding agreements with companies within the Metals business to finance the Metals expansion. Under these agreements, capital cost up to U.S. \$500 million is to be funded equally by the Corporation and its joint venture partner. As at June 30, 2006, the proportionally consolidated loan from the joint venture partners was \$36.3 million.

The future tax asset (including current portion) of \$68.4 million at June 30, 2006 represented primarily the tax benefit of approximately of \$108.6 million of non-capital losses and \$75.7 million of capital losses. The non-capital losses have been generated primarily through interest on the Corporation's debt. The tax benefit of the losses has been recognized in the financial statements in the expectation that sufficient taxable income will be realized in the future to utilize these losses.

During the second quarter of 2006, the Corporation incurred additional capital losses of \$136 million, of which \$70.6 million relate to the purchase of convertible debentures and \$65.4 million relate to a tax loss on the Coal restructuring and disposition. The benefits of these additional capital losses have not been recognized, however, they are available indefinitely to shelter future capital gains incurred by the Corporation.

Investments of \$369.4 million as at June 30, 2006, are composed of the Corporation's \$347.2 million equity investment in Royal Utilities and \$22.2 million equity investment in the tourism and other businesses.

Other assets were \$95.7 million as at June 30, 2006, compared with \$104.1 million at the end of 2005. The decrease reflects the change in accounting in Coal for Other assets related to Royal Utilities offset by a \$12.8 million increase in advances with respect to the Metals expansion.

Short-term debt of \$52.7 million as at June 30, 2006 decreased by \$31.6 million from year end, of which \$29.0 million related to the change in accounting in Coal for short-term debt related to Royal Utilities.

Accounts payable and accrued liabilities were \$167.1 million at the end of the second quarter compared with \$174.3 million at the end of 2005. The decrease mainly relates to the change in accounting in Coal for accounts payable related to Royal Utilities. This decrease was partially offset by increased payables associated with the impact of higher nickel prices on third-party feed costs and taxes payable in Metals and higher taxes payable in Oil and Gas as a result of increased earnings from the Santa Cruz field.

The future income tax liability of \$66.0 million at June 30, 2006 decreased compared with the year-end amount of \$231.2 million. Almost all of the decrease relates to the change in the accounting treatment of the Coal business from proportionate consolidation to the equity method. The majority of the liability relates to the future income tax liability of the Oil business, which is not a current cash tax liability, but is a result of the

temporary differences between the values of capital assets for tax purposes versus accounting purposes. The remainder of the future income tax liability is associated with the repatriation to Canada of untaxed profits in the Power business.

Long-term debt and other liabilities (including current portion) were \$519.9 million at the end of the second quarter compared with \$649.0 million at the end of 2005. The decrease is mainly attributable to the purchase of \$107 million of the 7% convertible debentures during the second quarter and the cash redemption of \$14.4 million on the remaining 9.875% senior unsecured debentures during the first quarter. These decreases were partially offset by a \$12.8 million increase in the Metals expansion loan.

Non-controlling interests reflects third-party interests of a variable interest entity in Power. The decrease in non-controlling interest from \$211.8 million as at December 31, 2005 to \$197.7 million as at June 30, 2006, relates to the payment of dividends to the non-controlling interests.

The cumulative translation account (“CTA”) component of shareholders’ equity relates to the change in the foreign currency translation method of certain foreign operations as described in notes 2 and 16 to the interim consolidated financial statements. The CTA balance of \$70.2 million represents the unrealized foreign exchange loss on the Corporation’s net investment in its self-sustaining foreign operations of which \$47.7 million related to the translation of the opening balances, mostly capital assets, and a decrease of \$22.5 million related to the net foreign exchange change during the six-month period.

During the quarter, the Corporation entered into capital leases for equipment totalling \$2.0 million.

During the quarter, the Board of Directors of the Corporation approved a quarterly dividend of \$0.025 per share payable July 14, 2006 to shareholders of record as at the close of business on June 30, 2006.

Under a normal course issuer bid, which expired July 4, 2006, the Corporation acquired 200,000 shares at an average price of \$10.31 per share during the first quarter of 2006.

Outlook & Review of Operations

Coal

Coal continues to focus on safety and corporate initiatives to create efficiencies and preserve cash generation.

Outlook (refer to “Forward-looking Statements”)

Through completion of the IPO of Royal Utilities, Sherritt should realize the imputed value of its mine-mouth thermal coal assets and royalty streams. Coal assets jointly retained by Sherritt and Ontario Teachers’ largely comprise the Coal Valley mine and substantial coal reserves in western Canada. Sherritt’s share of cash distributions from Royal Utilities is expected to be \$3.2 million per month.

Sherritt remains committed to a series of long-term initiatives to develop these coal reserves to supply energy, in the form of syngas, hydrogen or steam. The first of these initiatives is the commencement of a pre-feasibility study for a commercial gasification plant at Camrose Riley for the production of syngas, which is expected to be completed by the end of the year.

Production at the Coal Valley mine is expected to be approximately 1.9 million tonnes for the 2006 calendar year. Increased production along with the expectation of higher selling prices going forward should result in a positive operating margin in the second half of 2006.

Capital expenditures, excluding Royal Utilities, for 2006 are forecast at approximately \$6.4 million, of which \$3.4 million relates to the completion of the wash-plant expansion at Coal Valley. In the third quarter, capital expenditures are projected to be approximately \$1.4 million.

Second Quarter Results

	Q2 2006 ⁽¹⁾	Q2 2005 (restated)
Revenue	\$ 73.2	\$ 65.3
Operating costs	(54.7)	(50.1)
Selling costs	(0.2)	(0.1)
General and administrative costs	(5.0)	(1.1)
EBITDA	13.3	14.0
Depletion, amortization and accretion	(13.6)	(14.3)
Operating losses	\$ (0.3)	\$ (0.3)

(1) As a result of the restructuring of the Coal business and subsequent initial public offering, the results for Coal reflect the Corporation’s 50% proportionate share of Coal Valley Partnership (“Coal Valley”) and the Transferred Assets up to June 30, 2006 and the Corporation’s 50% proportionate share of Royal Utilities up to June 27, 2006. Subsequent to June 27, 2006, Royal Utilities was equity-accounted for by the Corporation.

Higher revenues for the second quarter were due to increased revenues from both Royal Utilities and Coal Valley. Royal Utilities revenues increased due to increased royalty income and higher revenues from the contract mines due to higher recoverable costs. Coal Valley’s revenues increased from \$14.7 million in the second quarter of 2005 to \$16.8 million in the second quarter of 2006 as a result of increased sales volumes following the ramp up of production since the expansion. Higher tire and fuel costs at the contract mines were the main cause of increased operating costs in Royal Utilities. Operating costs at Coal Valley increased from \$15.1 million in the second quarter of 2005 to \$16.4 million in 2006 due to increased sales volumes. Higher

general and administrative costs were a result of \$1.5 million of restructuring and other costs combined with increased project spending on the development of coal gasification technologies.

	<u>Q2 2006</u>	<u>Q2 2005</u>
Realized prices (\$/tonne)		
Royal Utilities (excluding royalties) ⁽¹⁾⁽³⁾	\$12.63	\$11.14
Coal Valley ⁽²⁾	47.05	53.08
Sales volumes (millions of tonnes)		
Royal Utilities ⁽¹⁾⁽³⁾	4.2	4.3
Coal Valley ⁽²⁾	<u>0.4</u>	<u>0.2</u>
	4.6	4.5
Production volumes (millions of tonnes)		
Royal Utilities ⁽¹⁾⁽³⁾	4.1	4.4
Coal Valley ⁽²⁾	<u>0.4</u>	<u>0.2</u>
	<u>4.5</u>	<u>4.6</u>

(1) Royal Utilities include two contract operations, five mine-mouth operations, and the Bienfait site and Char Plant.

(2) The Coal Valley mine is primarily an export market mine.

(3) Realized prices, sales volumes, and production volumes for Royal Utilities included up to June 27, 2006.

Realized prices for Royal Utilities increased due to higher recoverable costs at the contract mines. Sales and production volumes were comparable between quarters.

Realized prices at Coal Valley were lower due primarily to a stronger Canadian dollar. Although the current U.S. dollar export coal price is strong, this is more than offset by the impact of the high Canadian dollar. As a result of the wash-plant expansion in 2005, sales and production volumes from Coal Valley doubled.

	<u>Q2 2006</u>	<u>Q2 2005</u> (restated)
Capital expenditures	<u>\$5.9</u>	<u>\$5.8</u>

Capital expenditures were comparable to the prior year quarter.

Six Months Ended June 30 Results

	Six Months 2006 ⁽¹⁾	Six Months 2005 (restated)
Revenue	\$ 147.0	\$128.2
Operating costs	(108.5)	(90.6)
Selling costs	(0.4)	(0.3)
General and administrative costs	(6.0)	(2.3)
EBITDA	32.1	35.0
Depletion, amortization and accretion	(27.6)	(28.1)
Operating earnings	<u>\$ 4.5</u>	<u>\$ 6.9</u>

(1) As a result of the restructuring of the Coal business and subsequent initial public offering, the results for Coal reflect the Corporation's 50% proportionate share of Coal Valley Partnership ("Coal Valley") and the Transferred Assets up to June 30, 2006 and the Corporation's 50% proportionate share of Royal Utilities up to June 27, 2006. Subsequent to June 27, 2006, Royal Utilities was equity-accounted for by the Corporation.

Higher revenues for the six-month period were due to increased revenues from both Royal Utilities and Coal Valley. Royal Utilities revenues increased due to increased royalty income and higher revenues from the contract mines due to higher recoverable costs. Coal Valley's revenues increased from \$21.4 million for the first six months of 2005 to \$30.8 million in 2006 as a result of increased sales volumes following the ramp up of production since the expansion. Higher tire and fuel costs at the contract mines were the main cause of increased operating costs in Royal Utilities. Operating costs at Coal Valley increased from \$22.4 million for the first six months of 2005 to \$31.6 million in 2006 due to increased sales volumes. Higher general and administrative costs were a result of \$1.5 million of restructuring and other costs combined with increased project spending on the development of coal gasification technologies.

	Six Months 2006	Six Months 2005
Realized prices (\$/tonne)		
Royal Utilities (excluding royalties) ⁽¹⁾⁽³⁾	\$11.92	\$10.92
Coal Valley ⁽²⁾	46.78	51.35
Sales volumes (millions of tonnes)		
Royal Utilities ⁽¹⁾⁽³⁾	9.1	9.1
Coal Valley ⁽²⁾	0.7	0.4
	<u>9.8</u>	<u>9.5</u>
Production volumes (millions of tonnes)		
Royal Utilities ⁽¹⁾⁽³⁾	9.1	9.1
Coal Valley ⁽²⁾	0.8	0.5
	<u>9.9</u>	<u>9.6</u>

(1) Royal Utilities include two contract operations, five mine-mouth operations, and the Bienfait site and Char Plant.

(2) The Coal Valley mine is primarily an export market mine.

(3) Realized prices, sales volumes, and production volumes for Royal Utilities included up to June 27, 2006.

Realized prices for Royal Utilities increased due to higher recoverable costs at the contract mines. Sales and production volumes were comparable between periods.

Coal Valley experienced a decrease in realized prices per tonne due to the strong Canadian dollar, partly offset by higher U.S. dollar export coal sale prices, when compared to the prior year. Sales and production volumes of 0.7 million and 0.8 million tonnes, respectively, were achieved at Coal Valley, significantly higher than 2005, as a result of the expansion project completed in 2005.

	Six Months 2006	Six Months 2005 (restated)
Capital expenditures	<u>\$9.0</u>	<u>\$7.1</u>

Capital expenditures were higher, mainly in support of the final stages of the Coal Valley expansion.

Metals

Metals continues to focus on maintaining the low-cost production of finished nickel and cobalt from the development of Cuba's extensive nickel resources. The Metals business, conducted through a joint venture with a Cuban company, mines, processes, and refines nickel and cobalt for sale worldwide (except the United States of America) with mining operations and associated processing facilities in Moa, Cuba; refining facilities in Fort Saskatchewan, Alberta; and international marketing and sales operations.

Outlook (refer to "Forward-looking Statements")

Process bottlenecks experienced during the first quarter have been addressed and production is expected to proceed at an annualized rate of 33,000 tonnes (100% basis) per year of mixed sulphides. Finished nickel production for 2006 is expected to be 30,000 tonnes (100% basis) for the year while finished cobalt production is expected to be similar to 2005 levels.

Construction work for expansion at the Moa mine and processing facilities was initiated during the quarter. Given the brownfield nature of the expansion, it is possible for Sherritt and its partner to increase production in phases, thereby minimizing cost uncertainties in today's inflationary environment for capital projects. While the overall timeline to expand operations by the full 16,000 tonnes (100% basis) may be extended, the phasing of the expansion could result in up to 4,000 tonnes (100% basis) of new production coming online earlier than the originally planned commissioning date in 2008. Evaluation of this approach is currently underway.

Total capital expenditures for the year are expected to be approximately \$142 million, \$20 million below the initial full-year guidance of \$162 million. This difference takes into consideration the timing of activities associated with the Metals' expansion. In the third quarter, capital expenditures are forecast to be approximately \$57 million.

Highlights

- Record nickel prices
- Cobalt prices up from first quarter
- Basic engineering for 16,000 tonne expansion completed and construction has commenced

Second Quarter Results

	Q2 2006	Q2 2005 (restated)
Revenue	\$110.6	\$143.3
Operating costs	(58.8)	(75.9)
Selling costs	(4.5)	(4.4)
General and administrative costs	(1.0)	(0.7)
EBITDA	46.3	62.3
Depletion, amortization and accretion	(5.0)	(5.2)
Operating earnings	<u>\$ 41.3</u>	<u>\$ 57.1</u>

Lower revenues reflected a stronger Canadian dollar, lower nickel and cobalt sales volumes and lower cobalt prices, partly offset by higher nickel prices. Lower operating costs reflect the lower nickel and cobalt sales volumes partly offset by higher energy and maintenance costs. Selling costs, general and administrative costs, depletion, amortization and accretion remain essentially unchanged.

<u>Prices</u>	<u>Q2 2006</u>	<u>Q2 2005</u> (restated)
Nickel – realized (\$/lb)	\$10.42	\$ 9.22
Cobalt – realized (\$/lb)	16.46	19.65
Nickel – reference (U.S. \$/lb)	9.09	7.44
Cobalt – reference (U.S. \$/lb)	<u>14.43</u>	<u>15.03</u>

The nickel reference price reached record levels in the quarter, brought about by strong physical demand, uncertain supply, and speculative interest. The average cobalt reference price was lower due to increased global availability and inventory buildup.

<u>Production (tonnes)</u>	<u>Q2 2006</u>	<u>Q2 2005</u>
Mixed sulphides	3,686	4,130
Finished nickel	3,338	4,349
Finished cobalt	<u>370</u>	<u>453</u>

Mixed sulphide production volumes decreased as a result of throughput process limitations at the Moa facility related to settling characteristics of the ore being processed that have now been rectified. Decreased finished nickel and cobalt production volumes reflected the decreased production from Moa and maintenance activities at the refinery relative to the record quarterly production levels established during the second quarter of 2005. An agreement in principle was reached to renew the mixed sulphide supply agreement between the joint venture subsidiary companies on the same financial terms.

<u>Sales (thousands of pounds)</u>	<u>Q2 2006</u>	<u>Q2 2005</u>
Finished nickel	7,213	9,715
Finished cobalt	<u>861</u>	<u>984</u>

Nickel and cobalt sales volumes were lower due to decreased production volumes.

	<u>Q2 2006</u>	<u>Q2 2005</u> (restated)
Capital expenditures	<u>\$12.9</u>	<u>\$5.4</u>

Capital expenditures increased compared to the second quarter of 2005 as a result of increased basic engineering costs associated with the expansion of the facilities at Moa and Fort Saskatchewan. Excluding the expansion, \$1.9 million was spent in the second quarter of 2006 primarily directed towards sustaining, upgrading, compliance and environmental initiatives.

	<u>Q2 2006</u>	<u>Q2 2005</u> (restated)
Fertilizer sales (tonnes)	91,386	108,630
Revenue	\$ 29.0	\$ 33.7
Operating earnings	<u>2.9</u>	<u>4.5</u>

Operating earnings decreased as a result of reduced fertilizer production and sales volumes. The reduced fertilizer sales volumes reflect the impact of lower fertilizer demand in western Canada. Amortization expense was \$0.8 million, which was comparable to the same quarter last year.

Six Months Ended June 30 Results

	<u>Six Months 2006</u>	<u>Six Months 2005 (restated)</u>
Revenue	\$ 191.7	\$ 244.2
Operating costs	(106.8)	(124.1)
Selling costs	(7.0)	(6.7)
General and administrative costs	(1.5)	(1.8)
EBITDA	76.4	111.6
Depletion, amortization and accretion	(9.6)	(10.2)
Operating earnings	<u>\$ 66.8</u>	<u>\$ 101.4</u>

Lower revenues resulted from lower nickel and cobalt sales volumes and lower cobalt prices. The lower operating costs reflect the lower nickel and cobalt sales volumes partly offset by higher energy and maintenance costs. Selling costs, general and administrative costs, and depletion, amortization and accretion costs were similar to prior year levels.

<u>Prices</u>	<u>Six Months 2006</u>	<u>Six Months 2005 (restated)</u>
Nickel – realized (\$/lb)	\$ 9.00	\$ 8.95
Cobalt – realized (\$/lb)	15.48	20.66
Nickel – reference (U.S. \$/lb)	7.87	7.20
Cobalt – reference (U.S. \$/lb)	<u>13.41</u>	<u>16.15</u>

Strong demand and market speculation contributed to an increase in the nickel reference price, while increased global availability and inventory buildup contributed to a decline in the cobalt reference price. Realized prices were affected by the strengthening Canadian dollar.

<u>Production (tonnes)</u>	<u>Six Months 2006</u>	<u>Six Months 2005</u>
Mixed sulphides	7,219	8,340
Finished nickel	7,019	8,260
Finished cobalt	<u>779</u>	<u>870</u>

Current ore characteristics and maintenance activity lowered mixed sulphides production, which combined with maintenance activities at the refinery, contributed to reduced finished nickel and cobalt production.

<u>Sales (thousands of pounds)</u>	<u>Six Months 2006</u>	<u>Six Months 2005</u>
Finished nickel	15,496	18,670
Finished cobalt	<u>1,784</u>	<u>1,813</u>

Reduced sales volumes mainly result from the reduced production volumes.

	<u>Six Months 2006</u>	<u>Six Months 2005 (restated)</u>
Capital expenditures	<u>\$28.0</u>	<u>\$13.6</u>

Capital expenditures increased compared to the prior period as a result of increased basic engineering costs associated with the expansion of the facilities at Moa and Fort Saskatchewan. Capital expenditures, excluding the expansion, were \$11.2 million primarily directed towards sustaining, upgrading, compliance, and environmental initiatives, and were generally equivalent to the same period last year.

	<u>Six Months 2006</u>	<u>Six Months 2005 (restated)</u>
Fertilizer sales (tonnes)	100,216	122,183
Revenue	\$ 32.7	\$ 38.2
Operating earnings	<u>3.0</u>	<u>4.7</u>

Operating earnings decreased as a result of reduced fertilizer production and sales volumes. The reduced fertilizer sales volumes reflect the impact of lower fertilizer demand in western Canada. Amortization expense was \$1.6 million, which was comparable to the same period last year.

Oil and Gas

Oil and Gas continues to focus its operations on exploration, development and production from offshore oil deposits in Cuba which are drilled from nearby onshore locations using specialized skills in fold and thrust belt geology and directional drilling.

Outlook (refer to “Forward-looking Statements”)

During the quarter, Sherritt benefited from above-average Gulf Coast fuel oil reference prices. Gross working interest oil production in Cuba has stabilized and is expected to remain near current levels, assuming new production from development drilling offsets natural reservoir declines. The recently commercialized Santa Cruz field currently has three development drilling rigs operating in the area. There are four rigs active in other fields, including an exploration well underway at Playa Larga. A multilateral appraisal well on the existing Majaguillar-Corajol deposit (discovered several years ago) is also planned for the second half of 2006. The commercial potential of the San Anton exploration well continues to be evaluated.

The outlook for net oil production for 2006 is dependent on several factors, including gross working interest production volumes, fuel oil reference prices and capital spending. Assuming that these factors remain consistent with expectations, average net oil production for 2006 is expected to be comparable to 2005 levels.

The commercial potential of various enhanced oil-recovery technologies continues to be developed. Programs involving CO₂, steam or gas re-injection are being contemplated. These initiatives will require a significant amount of capital.

Capital expenditures for the quarter totalled \$33.0 million and leave the Corporation on track to spend approximately \$140 million for the year. In the third quarter, capital expenditures are expected to be approximately \$43.6 million.

Highlights

- Record revenue of \$69.6 million
- EBITDA of \$54.7 million
- Full field development at Santa Cruz underway
- Continuing with exploration and appraisal programs on Blocks 9 and 10
- Excellent safety statistics compared with Alberta industry

Second Quarter Results

	Q2 2006	Q2 2005 (restated)
Revenue	\$ 69.6	\$ 67.7
Operating costs	(9.9)	(7.0)
General and administrative costs	(5.0)	(3.3)
EBITDA	54.7	57.4
Depletion, amortization and accretion	(21.3)	(20.1)
Operating earnings	<u>\$ 33.4</u>	<u>\$ 37.3</u>

Revenue for the second quarter was higher as a result of record fuel oil prices, partly offset by lower production volumes and lower cost-recoverable spending. The increase in operating costs reflects new wells, facilities and equipment, including the Santa Cruz field, price increases for manpower, services and material inputs, and renegotiation of service rates with Cuban agencies retroactive to 2003. General and administrative costs reflect increases in staff and higher compensation costs. Depletion, amortization and accretion costs were comparable to the same period last year, as the impact of lower production volumes was offset by higher depletion rates related to increased capital spending over the past two years.

<u>Prices</u>	<u>Q2 2006</u>	<u>Q2 2005</u> (restated)
Realized prices \$/barrel (Cuba)	\$45.20	\$36.52
Reference price – Fuel Oil No. 6 (U.S. \$/barrel)	<u>48.88</u>	<u>35.84</u>

Currently, Oil and Gas delivers and sells all of its Cuban net oil production to agencies of the Cuban government, generally at selling prices based on 79% to 83% of the Gulf Coast Fuel Oil No. 6 reference price. Prices for Santa Cruz production are still under negotiation and have been estimated based on prices received for production from other fields, after adjusting for the higher quality of the Santa Cruz oil. The average reference price for the second quarter was a record U.S. \$48.88, peaking at U.S. \$53.00 early in the quarter. The impact of higher fuel oil prices was partially reduced by the strengthening of the Canadian dollar.

<u>Production</u>	<u>Q2 2006</u>	<u>Q2 2005</u>
Gross working interest oil production in Cuba (bpd) ⁽¹⁾⁽²⁾⁽⁴⁾	<u>30,330</u>	<u>32,095</u>
Net oil production (boepd) ⁽¹⁾⁽⁴⁾		
Cuba ⁽³⁾		
Cost recovery	6,074	11,357
Profit oil	<u>9,535</u>	<u>8,126</u>
	15,609	19,483
Spain	457	461
Pakistan ⁽⁵⁾	<u>375</u>	–
Total	<u><u>16,441</u></u>	<u><u>19,944</u></u>

- (1) Production figures exclude production from wells for which commerciality has not been established.
- (2) Gross working interest production in Cuba is allocated to the Corporation and agencies of the Cuban government in accordance with production-sharing arrangements and joint venture agreements.
- (3) Net oil production (equivalent to net sales volume) represents the Corporation's share of gross working interest production. Net oil production for each production-sharing contract is composed of cost recovery oil (based upon the Corporation's recoverable costs within each block) and profit oil (based upon a percentage of gross production less cost recovery oil). Recoverable costs, subject to certification by agencies of the Cuban government, are accumulated in cost recovery pools for each production-sharing contract and reduced by the allocation of cost recovery oil to the Corporation. Cost recovery revenue equals capital and operating costs eligible for recovery under the production-sharing contracts; therefore, cost recovery oil volumes increase as a result of higher capital expenditures and decrease when selling prices increase. At higher oil prices, the reduction in cost recovery oil volumes is partially offset by an increase in profit oil barrels, after deducting the Cuban government's share, which is analogous to royalty interests in Canadian hydrocarbon fiscal regimes.
- (4) Barrels per day ("bpd"). Barrels of oil equivalent per day ("boepd").
- (5) Natural gas production in Pakistan converted into boepd using a 6:1 conversion ratio.

During the second quarter, gross working interest production volumes in Cuba decreased from the same period last year due to natural reservoir declines, partially offset by production from new oil wells. The focus on exploration drilling in the second half of 2005 resulted in fewer new development wells coming into production over the past year. The Santa Cruz field was declared commercial in the first quarter of 2006 and retroactive oil production from the appraisal and discovery wells was recognized in results for the first quarter of 2006. During the second quarter, five rigs were engaged in development drilling activities and gross working interest oil production increased by 1,024 boepd from the first quarter, after adjusting out the retroactive Santa Cruz production. On a net basis, Cuban oil production reflects fewer cost recovery barrels due to record fuel oil prices and lower capital spending, which included exploration drilling on Block 10, which is not recoverable until commerciality is declared. Production from the Badar gas field in Pakistan came on stream in April 2006. Production from the Casablanca platform in Spain was comparable to the same period last year, reflecting low decline rates.

	<u>Q2 2006</u>	<u>Q2 2005</u> (restated)
Capital expenditures	\$33.0	\$36.8

During the second quarter of 2006, six drilling rigs were active, compared with four active rigs during the same period in 2005, and a seventh rig was contracted for one well starting in the third quarter. Despite the addition of two rigs, capital expenditures for the second quarter were lower than the same period last year, during which a significant amount of material and supplies were purchased for capital projects completed later in 2005. Since they were activated in August 2005, the two additional rigs have been drilling on Block 7 wells, for which the Corporation pays 45% of the capital costs.

During the quarter, three development wells were completed in the Yumuri and Varadero West fields, together with the first development well in the Santa Cruz field. In addition, three Santa Cruz development wells and one Seboruco well were drilling at the end of the quarter, with two more rigs preparing to spud development wells in the Seboruco and Canasi fields. In April, exploration drilling started on the Playa Larga prospect in Block 10 which is expected to be completed in the third quarter. The San Anton exploration well on Block 9, was completed in January 2006, and is currently under evaluation to determine its commercial potential. During the second quarter of 2006, the Canasi land-based treatment and ocean disposal system was commissioned and construction of the 17 km gas pipeline from the Yumuri production facility has commenced.

Six Months Ended June 30 Results

	<u>Six Months</u> <u>2006</u>	<u>Six Months</u> <u>2005</u> (restated)
Revenue	\$138.3	\$118.1
Operating costs	(18.5)	(13.7)
General and administrative costs	(8.9)	(6.3)
EBITDA	110.9	98.1
Depletion, amortization and accretion	(41.9)	(39.0)
Operating earnings	<u>\$ 69.0</u>	<u>\$ 59.1</u>

Revenue for the first six months was higher as a result of record fuel oil prices, partly offset by lower production volumes and lower cost recoverable spending. The increase in operating costs reflects new wells, facilities and equipment, including the Santa Cruz field, price increases for manpower, services and material inputs, and renegotiation of service rates with Cuban agencies retroactive to 2003. General and administrative costs reflect increases in staff and higher compensation costs. Depletion, amortization and accretion costs were slightly higher than last year due to higher depletion rates related to increased capital spending over the past two years, partially offset by the impact of lower production volumes.

<u>Prices</u>	<u>Six Months</u> <u>2006</u>	<u>Six Months</u> <u>2005</u>
Realized prices \$/barrel (Cuba)	\$44.15	\$32.70
Reference price – Fuel Oil No. 6 (U.S. \$/barrel)	<u>47.47</u>	<u>31.70</u>

Currently, Oil and Gas delivers and sells all of its Cuban net oil production to agencies of the Cuban government, generally at selling prices based on 79% to 83% of the Gulf Coast Fuel Oil No. 6 reference price. Prices for Santa Cruz production are still under negotiation and have been estimated based on prices received for production from other fields, after adjusting for the higher quality of the Santa Cruz oil. The average reference price for the first half was a record U.S. \$47.47, peaking at U.S. \$53.00 early in the quarter. The impact of higher fuel oil prices was partially reduced by the strengthening of the Canadian dollar.

<u>Production</u>	<u>Six Months 2006</u>	<u>Six Months 2005</u>
Gross working interest oil production in Cuba (bpd) ⁽¹⁾⁽²⁾⁽⁴⁾	30,609	32,099
Net oil production (boepd) ⁽¹⁾⁽⁴⁾		
Cuba ⁽³⁾		
Cost recovery	6,685	9,833
Profit oil	9,376	8,675
	<u>16,061</u>	<u>18,508</u>
Spain	476	461
Pakistan ⁽⁵⁾	188	-
Total	<u>16,725</u>	<u>18,969</u>

- (1) Production figures exclude production from wells for which commerciality has not been established.
- (2) Gross working interest production in Cuba is allocated to the Corporation and agencies of the Cuban government in accordance with production-sharing arrangements and joint venture agreements.
- (3) Net oil production (equivalent to net sales volume) represents the Corporation's share of gross working interest production. Net oil production for each production-sharing contract is composed of cost recovery oil (based upon the Corporation's recoverable costs within each block) and profit oil (based upon a percentage of gross production less cost recovery oil). Recoverable costs, subject to certification by agencies of the Cuban government, are accumulated in cost recovery pools for each production-sharing contract and reduced by the allocation of cost recovery oil to the Corporation. Cost recovery revenue equals capital and operating costs eligible for recovery under the production-sharing contracts; therefore, cost recovery oil volumes increase as a result of higher capital expenditures and decrease when selling prices increase. At higher oil prices, the reduction in cost recovery oil volumes is partially offset by an increase in profit oil barrels, after deducting the Cuban government's share, which is analogous to royalty interests in Canadian hydrocarbon fiscal regimes.
- (4) Barrels per day ("bpd"). Barrels of oil equivalent per day ("boepd").
- (5) Natural gas production in Pakistan converted into boepd using a 6:1 conversion ratio.

During the first six months, gross working interest production volumes in Cuba decreased from the same period last year due to natural reservoir declines, partially offset by production from new oil wells. The focus on exploration drilling in the second half of 2005 resulted in fewer new development wells coming on production over the past year. During 2006, there has been renewed focus on development drilling, as the Santa Cruz field was declared commercial in the first quarter of 2006 and only one rig has been assigned to exploration drilling. On a net basis, Cuban oil production reflects fewer cost recovery barrels due to record fuel oil prices and lower capital spending, which included exploration drilling on Blocks 9 and 10, which is not recoverable until commerciality is declared. Production from the Badar gas field in Pakistan came on stream in April 2006, averaging 375 boepd over the second quarter. Production from the Casablanca platform in Spain was slightly higher than the same period last year.

	<u>Six Months 2006</u>	<u>Six Months 2005 (restated)</u>
Capital expenditures	<u>\$56.7</u>	<u>\$65.3</u>

During the first six months of 2006, six drilling rigs were active, compared with four active rigs during the same period in 2005, and a seventh rig was contracted for one well starting in the third quarter. Despite the addition of two rigs, capital expenditures were lower than the same period last year, during which a significant amount of materials and supplies was purchased for capital projects completed later in 2005. Since they were activated in August 2005, the two additional rigs have been drilling on Block 7 wells, for which the Corporation pays 45% of the capital costs. The expansion of the Yumuri battery was completed during the first half of 2005, resulting in higher capital expenditures on facilities and infrastructure than during 2006.

During the first six months of 2006, four development wells were completed in the Yumuri, Seboruco and Varadero West fields, together with the first development well in the Santa Cruz field. In addition, three Santa Cruz development wells and one Seboruco well were drilling at the end of the quarter, with two more rigs preparing to spud development wells in the Seboruco and Canasi fields. In April, exploration drilling started on the Playa Larga prospect in Block 10 which is expected to be completed in the third quarter. The San Anton exploration well on Block 9, was completed in January 2006, and is currently under evaluation to determine its commercial potential. During the second quarter of 2006, the Canasi land-based treatment and ocean disposal system was commissioned and construction of the 17 km gas pipeline from the Yumuri production facility has commenced.

Power

Power continues to focus on the effective utilization of energy resources in the production of electricity. Power has been an advocate of the construction of electric generating facilities that derive both an economic and environmental benefit from processing natural gas produced in Cuba which may otherwise be flared.

Business in Cuba is conducted through Energas S.A. (“Energas”), a Cuban entity in which Power holds a one-third equity interest. The remainder is held by two Cuban agencies, each of which holds a one-third equity interest. Electricity is supplied to a Cuban agency under long-term fixed-price contracts and natural gas is supplied to Energas at no cost. Current production capacity of 311 megawatts (MW) will increase to 376 MW with the completion of a 65 MW expansion in the second quarter of 2007. As with previous facilities, Power is responsible for the financing and construction of this expansion and will also operate the new facility.

Production from the 85 MW expansion completed in the first quarter of 2006, will be sold at a tariff of U.S. \$45 per MWh. Power’s investment in this expansion, as well as the 65 MW expansion currently underway, will generate a reinvestment credit for Power of up to 30% of the amount invested. This reinvestment credit will be paid to Power by the Cuban state at the rate of one-third of Energas taxes paid. This equates to Power’s share of Energas taxes.

Outlook (refer to “Forward-looking Statements”)

Production for 2006 is expected to be a record 2.0 million MWh. Scheduled maintenance outages at the Varadero facilities in the third quarter will impact electricity production by an estimated 40,000 MWh. Additional capacity from the newly commissioned 85MW power production facility is expected to lead to record production and revenue for Power in 2006.

Detailed engineering for the 65 MW expansion at Boca de Jaruco is largely complete. All major components have been ordered and civil work on the site will commence in the third quarter. The expansion is expected to be commissioned in the second quarter of 2007. The total cost of the project is estimated to be \$60 million, with approximately \$52 million being incurred during 2006. This expansion will bring Power’s total capacity to 376 MW.

Estimated capital expenditures for the remainder of 2006 include \$39 million for the 65 MW expansion project and \$5 million for other capital projects. Third-quarter capital expenditures are expected to be about \$25 million, most of which will relate to the expansion project.

Highlights

- Record production for the quarter of over 549,000 MWh

Power’s investment in Energas is a Variable Interest Entity as defined in Accounting Guideline AcG-15. The two-thirds non-controlling interest in Energas is disclosed separately on the consolidated balance sheets and the statements of operations.

Second Quarter Results

	<u>Q2 2006</u>	<u>Q2 2005</u>
Revenue	\$28.4	\$ 26.6
Operating costs	(7.4)	(11.1)
General and administrative costs	<u>(0.3)</u>	<u>(0.5)</u>
EBITDA	20.7	15.0
Depletion, amortization and accretion	<u>(6.7)</u>	<u>(5.4)</u>
Operating earnings	<u>\$14.0</u>	<u>\$ 9.6</u>

Revenue for the second quarter was higher due to production from the 85 MW expansion, partly offset by lower realized electricity prices. Revenue from the sale of by-products was \$4.2 million during the quarter,

compared to \$3.0 million in the comparable quarter. The increase in by-product revenue was due to production from the expansion and higher prices. Operating costs in the quarter were lower than in the prior year quarter as a \$3.8 million reduction in an expected insurance recovery was recorded in the second quarter of 2005. Higher depletion, amortization and accretion was mainly due to the addition of the 85 MW expansion.

	<u>Q2 2006</u>	<u>Q2 2005</u>
Realized prices (\$/MWh)	\$44.46	\$55.20

The tariff for electricity sales is fixed by long-term U.S. dollar contracts. The tariff for electricity sold from the original 226 MW Power facilities was reduced to U.S. \$38 per MWh from U.S. \$45 per MWh on September 1, 2005. The tariff for production from the 85 MW expansion is currently U.S. \$45 per MWh. The decrease in realized prices was due to the reduction in the tariff in September 2005, combined with a stronger Canadian dollar.

	<u>Q2 2006</u>	<u>Q2 2005</u>
Electricity sold ⁽¹⁾ (MWh)	549,289	426,247

(1) Including non-controlling interest's share

Electricity sales for the quarter were higher mainly due to the addition of 85 MW of capacity during the first quarter of 2006.

	<u>Q2 2006</u>	<u>Q2 2005</u> (restated)
Capital expenditures	\$6.6	\$30.9

Capital expenditures for the second quarter of 2006 were primarily directed to the new 65 MW expansion project. In addition, Power incurred \$0.5 million of expenditures in respect of progress payments for the 65 MW expansion, that have been capitalized as Other Assets on the consolidated balance sheet. Prior quarter capital expenditures related mainly to the 85 MW expansion.

Six Months Ended June 30 Results

	<u>Six Months 2006</u>	<u>Six Months 2005</u>
Revenue	\$ 50.6	\$ 52.3
Operating costs	(14.0)	(17.0)
General and administrative costs	(0.8)	(0.7)
EBITDA	35.8	34.6
Depletion, amortization and accretion	(13.0)	(10.6)
Operating earnings	<u>\$ 22.8</u>	<u>\$ 24.0</u>

Lower revenue in the first six months of 2006 is attributable to lower realized electricity prices, partly offset by increased production. Revenue from the sale of by-products was \$7.0 million, compared to \$5.7 million in 2005. The increase in by-product revenue was due to production from the expansion and higher prices. Operating costs were lower than in the prior year period as a \$3.8 million reduction in an expected insurance

recovery was recorded in the second quarter of 2005. Higher depletion, amortization and accretion was mainly due to the addition of the 85 MW expansion.

	<u>Six Months 2006</u>	<u>Six Months 2005</u>
Realized prices (\$/MWh)	<u>\$44.52</u>	<u>\$55.00</u>

The decrease in realized prices compared with 2005 was due to the reduction in the electricity tariff in September 2005, combined with a stronger Canadian dollar.

	<u>Six Months 2006</u>	<u>Six Months 2005</u>
Electricity sold ⁽¹⁾ (MWh)	<u>980,592</u>	<u>845,717</u>

(1) Including non-controlling interest's share

Electricity sales in the first half of 2006 were 16% higher, due mainly to the addition of the 85 MW expansion in the first quarter of 2006.

	<u>Six Months 2006</u>	<u>Six Months 2005 (restated)</u>
Capital expenditures	<u>\$14.7</u>	<u>\$49.1</u>

Current year capital expenditures were primarily directed to the new 65 MW expansion and the 85 MW expansion completed during the first quarter. In addition, Power incurred \$9.3 million of expenditures, mainly in respect of progress payments for the 65 MW expansion, that have been capitalized as Other Assets on the consolidated balance sheet. Prior periods capital expenditures related mainly to the 85 MW expansion.

Other

Other primarily comprises the consolidated results of the Corporation's soybean-based food processing business.

Outlook (refer to "Forward-looking Statements")

The soybean-based food processing business continues to pursue opportunities to maximize consumption of its products in Cuba by continuing to improve production facilities and optimizing the distribution of its products.

Operating results for Other reflect the consolidation of this business as a result of the adoption of Accounting Guideline AcG-15 – Consolidation of Variable Interest Entities.

Second Quarter Results

	<u>Q2 2006</u>	<u>Q2 2005</u> (restated)
Revenue	\$ 15.1	\$ 19.6
Operating costs	(13.2)	(17.3)
General and administrative costs	<u>(0.7)</u>	<u>(0.5)</u>
EBITDA	1.2	1.8
Depletion, amortization and accretion	<u>(0.6)</u>	<u>(0.7)</u>
Operating earnings	<u>\$ 0.6</u>	<u>\$ 1.1</u>

Revenue for the second quarter decreased mainly due to lower realized sales prices, a stronger Canadian dollar, and slightly lower sales volumes. Operating costs decreased mainly due to lower soybean procurement costs. General and administrative costs did not change significantly from the comparable period.

Six Months Ended June 30 Results

	<u>Six Months</u> <u>2006</u>	<u>Six Months</u> <u>2005</u> (restated)
Revenue	\$ 28.9	\$ 36.8
Operating costs	(25.3)	(31.2)
General and administrative costs	<u>(1.2)</u>	<u>(1.1)</u>
EBITDA	2.4	4.5
Depletion, amortization and accretion	<u>(1.4)</u>	<u>(1.4)</u>
Operating earnings	<u>\$ 1.0</u>	<u>\$ 3.1</u>

Revenue decreased mainly due to lower realized sales prices, a stronger Canadian dollar, and slightly lower sales volumes. Operating costs decreased mainly due to lower soybean procurement costs, and lower sales volumes. General and administrative costs did not change significantly between comparable periods.

Summary of Quarterly Results (unaudited)

The following table presents a summary of the segments and consolidated operating results for each of the eight quarters from September 2004 to June 2006.

(millions of dollars, except per share amounts)	Quarter Ended							
	June 2006	March 2006	December 2005	September 2005 ⁽¹⁾	June 2005 ⁽¹⁾	March 2005 ⁽¹⁾	December 2004 ⁽¹⁾	September 2004 ⁽¹⁾
Revenue								
Coal	\$ 73.2	\$ 73.8	\$ 62.7	\$ 64.8	\$ 65.3	\$ 62.9	\$ 65.4	\$ 60.2
Metals	110.6	81.1	98.0	86.6	143.3	100.9	109.5	101.8
Oil and Gas	69.6	68.7	58.6	60.8	67.7	50.4	45.9	52.0
Power	28.4	22.2	22.0	24.2	26.6	25.7	23.5	26.6
Other	15.1	13.8	17.4	20.9	19.6	17.2	20.3	20.8
	\$296.9	\$259.6	\$258.7	\$257.3	\$322.5	\$257.1	\$264.6	\$261.4
Earnings from continuing operations	\$ 57.2	\$ 35.7	\$ 9.1	\$ 26.1	\$ 53.7	\$ 35.4	\$ 25.8	\$ 38.6
Net earnings	57.2	35.7	9.1	26.1	53.7	35.4	27.5	38.6
Earnings from continuing operations per share								
Basic	0.38	0.24	0.06	0.17	0.35	0.25	0.18	0.29
Diluted	0.36	0.20	0.05	0.15	0.29	0.21	0.15	0.22
Earnings per share								
Basic	0.38	0.24	0.06	0.17	0.35	0.25	0.19	0.29
Diluted	0.36	0.20	0.05	0.15	0.29	0.21	0.16	0.22

(1) Restated – see note 2 of the Interim Consolidated Financial Statements.

The analysis of financial results for the last eight quarters is generally consistent with the consolidated financial results and selected interim information presented previously in this document. Further details in respect of historical quarterly results can be found in the Corporation's quarterly reports filed on SEDAR at www.sedar.com or on the Corporation's web site at www.sherritt.com.

Accounting Changes

Investments

The results for Coal reflected the Corporation's 50% proportionate interest in Royal Utilities up to June 27, 2006. Subsequent to June 27, 2006, the Corporation changed its accounting for Royal Utilities to the equity method of accounting. The Corporation will continue to proportionately consolidate its 50% interest in the Coal Valley export thermal coal mine, various non-producing coal mines, certain coal and potash resources and other non-mining assets, that continue to be held jointly by Sherritt and Ontario Teachers'.

Translation of foreign currencies

The method of translation of foreign operations depends on whether the foreign operations are integrated or self-sustaining. Prior to January 1, 2006, all of the Corporation's foreign operations were considered integrated and translated into Canadian dollars using current rates of exchange for monetary assets and liabilities, historical rates of exchange for non-monetary assets and liabilities and average rates of exchange for revenues and expenses, except depletion and amortization which are translated at the rates of exchange applicable to the related assets. Gains and losses resulting from these translation adjustments are included in income.

The ongoing review of the economic factors to be considered in determining whether foreign operations are integrated or self-sustaining has resulted in the determination that the Metals foreign operations and the Oil and Gas foreign operations in Cuba and Spain have changed to self-sustaining. This change was made as a result of the increasing proportion of operating, financing and investing transactions of these foreign operations that are denominated in currencies other than the Canadian dollar. This change in method was effective at January 1, 2006 and was applied prospectively. The self-sustaining operations are translated into Canadian dollars using the current rate method, whereby assets and liabilities are translated at period-end exchange rates while revenues and expenses are converted using average rates for the period. Gains and losses on translation to Canadian dollars relating to self-sustaining operations are deferred and included in a separate component of shareholders' equity described as cumulative translation account.

Future income taxes

On October 1, 2005, the Corporation changed its methodology of accounting for income taxes in its Cuban oil and gas operations to provide a clearer presentation of income taxes in that operation. Prior to this change in accounting policy, the Corporation recorded tax on the Cuban oil and gas operations on the basis that cost recovery revenue and expenses were not subject to or deductible under the Cuban tax regime resulting in no temporary differences between the book value and the tax value of the relevant assets and liabilities. This methodology resulted in significant fluctuations in the effective tax rate for the Oil and Gas operations between reporting periods when the relative percentage of cost recovery revenue changed compared to total oil revenue.

Under the newly adopted accounting policy, temporary differences are recognized for the respective assets and liabilities at the effective Cuban tax rate of approximately 30%. This results in a clearer presentation of the effective tax rate in the Cuban oil operations over the life of the operating oil fields. The Corporation has implemented this change on a retroactive basis with restatement of prior periods. The cumulative effect of the change in policy on retained earnings at January 1, 2005 was \$40.3 million. The accounting change resulted in a decrease in net earnings of \$2.3 million (decrease in EPS – basic and diluted \$0.01) and \$2.4 million (decrease in EPS – basic \$0.02 and diluted \$0.01) for the three and six months ended June 30, 2005.

The Corporation also changed the methodology of accounting for income taxes paid on its behalf by an agency of the government of Cuba for the enhanced oil recovery blocks, to reflect these income taxes on a gross basis. As a result, current income tax expense and revenue have increased. This change was applied on a retroactive basis and resulted in an increase in revenue and current income tax expense of \$0.8 million and \$1.5 million for the three and six months ended June 30, 2005, respectively.

Comparative Amounts

Certain comparative amounts have been restated to correct their classification, with no impact on net earnings, to conform to the presentation in the current period.

In the Metals business, certain selling expenses which were previously netted against revenue, have been reclassified to operating, selling, general and administrative expenses, resulting in an increase in revenue of \$1.6 million with a corresponding increase in operating, selling, general and administrative expenses for the three months ended June 30, 2005. For the six months ended June 30, 2005, the reclassification resulted in an increase of \$2.7 million in revenue and an increase of \$2.7 million in operating, selling, general and administration expenses.

Capital expenditures on the Consolidated Statements of Cash Flow exclude non-cash capital additions of \$5.8 million for the three months ended June 30, 2005 and \$7.5 million for the six months ended June 30, 2005.

Accounting Pronouncements

Financial Instruments – Recognition and Measurement

The Canadian Institute of Chartered Accountants (the “CICA”) issued Handbook Section 3855, Financial Instruments – Recognition and Measurement in April 2005. This pronouncement establishes standards for recognizing and measuring financial assets, financial liabilities and non-financial derivatives. Under this standard, an entity would recognize a financial asset or liability only when the entity becomes party to the contractual provisions of the financial instrument. Financial assets and financial liabilities would, with certain exceptions, be initially measured at fair value. Gains and losses on financial instruments measured at fair value would be recognized in net income in the periods in which they arise, with the exception of certain gains and losses on financial assets classified as available for sale (which are recognized in other comprehensive income) and certain financial instruments that are part of a designated hedging relationship (which qualify for special accounting in accordance with Hedges, CICA Handbook Section 3865).

Hedges

The CICA issued Handbook Section 3865, Hedges in April 2005. This pronouncement establishes standards for when and how hedge accounting may be applied. Hedge accounting is a method for recognizing the gains, losses, revenues and expenses associated with the items in a hedging relationship such that those gains, losses, revenues and expenses are recognized in net income in the same period when they would otherwise be recognized in different periods. The application of hedge accounting is optional.

Comprehensive Income

The CICA issued Handbook Section 1530, Comprehensive Income in April 2005. The pronouncement establishes standards for the reporting and presentation of comprehensive income. Comprehensive income is the change in equity (net assets) of an enterprise during a period from transactions and other events and circumstances from non-owner sources, except those resulting from investments by owners and distributions to owners. Other comprehensive income is revenues, expenses, gains and losses that are recognized in comprehensive income, but excluded from net income. Disclosures required under this section include net income for the period, other comprehensive income for the period classified by its nature, reclassification from other comprehensive income to net income, and the tax impact of each component of other comprehensive income.

Equity

The CICA issued Handbook Section 3251, Equity in January 2005. This pronouncement establishes standards for the presentations of equity and the changes in equity. An enterprise should present separately the following components of equity: retained earnings, accumulated other comprehensive income by component, the total of retained earnings and accumulated other comprehensive income, contributed surplus, share capital, and reserves.

The new standards for financial instruments, hedges, comprehensive income and equity apply to interim and annual financial statements relating to fiscal years beginning on or after October 1, 2006, for which early adoption is permitted. The adoption of these pronouncements must be done concurrently. The Corporation is currently assessing the impact of these standards, which are expected to be adopted by the Corporation on January 1, 2007.

Non-monetary Transactions

In June 2005, the CICA issued Handbook Section 3831, Non-Monetary Transactions, which establishes that all non-monetary transactions be measured at their fair value unless, generally, they lack commercial substance or their fair value is not reliably measurable. This new Section is effective for non-monetary transactions initiated in periods beginning on or after January 1, 2006. The adoption of this standard did not have a material impact on the interim consolidated financial statements.

EIC 156 – Accounting by a Vendor for Consideration Given to a Customer

In September 2005, the Emerging Issues Committee of the CICA issued Abstract EIC-156 “Accounting by a Vendor for Consideration Given to a Customer (Including a Reseller of the Vendor’s Products)”. EIC-156 addresses the classification, in the financial statements of a vendor, of considerations (including sales incentives such as discounts, rebates, “free” product/services and other similar arrangement) given to its customer. Its provisions determine whether a consideration is to be treated as an adjustment of the selling price or as a cost incurred by the vendor to sell goods or services. It also establishes the time at which such an amount should be recorded, and the appropriate evaluation procedure. This EIC is effective for fiscal years beginning on or after January 1, 2006 and must be applied retroactively, with appropriate adjustments to preceding financial statements. The adoption of this abstract did not have a material impact on the interim consolidated financial statements.

EIC 157 – Implicit Variable Interest under AcG-15

In October 2005, the Emerging Issues Committee of the CICA issued Abstract EIC-157, “Implicit Variable Interests under AcG-15”, which must be applied by the Corporation in the first interim period beginning subsequent to October 17, 2005. Under AcG-15, an enterprise holding an interest in a variable interest entity has to consolidate that entity if the interest it holds exposes the enterprise to the majority of the entity’s risks or rewards. EIC 157 clarifies that such interests do not have to be explicit and may be inferred from particular facts and circumstances. Such implicit variable interests must be evaluated in accordance with AcG-15 to determine if consolidation is appropriate. The adoption of this abstract did not have a material impact on the interim consolidated financial statements.

EIC 159 – Conditional Asset Retirement Obligations

In December 2005, the Emerging Issues Committee of the CICA issued Abstract EIC-159, “Conditional Asset Retirement Obligations”. EIC 159 clarifies that the term “conditional asset retirement obligation”, as used in CICA Section 3110 “Asset Retirement Obligations”, refers to a legal obligation to perform an asset retirement activity in which the timing and/or method of settlement are conditional on a future event that may or may not be within the control of the entity. The accounting treatment in this Abstract should be applied retroactively, with restatement of prior periods, to all financial statements for interim and annual reporting periods ending after March 31, 2006, although earlier adoption is encouraged. The adoption of this abstract did not have a material impact on the interim consolidated financial statements.

EIC 160 – Stripping Costs Incurred in the Production Phase of a Mining Operation

In March 2006, the Emerging Issues Committee of the CICA issued Abstract EIC-160, “Stripping Costs Incurred in the Production Phase of a Mining Operation”. EIC 160 clarifies that stripping costs should be accounted for according to the benefit received by the entity. Generally, stripping costs should be accounted for as variable production costs that should be included in the costs of the inventory produced (that is, extracted) during the period that stripping costs are incurred. However, stripping costs should be capitalized if

the stripping activity can be shown to represent a betterment to the mineral property. Capitalized stripping costs should be amortized in a rational and systematic manner over the reserves that directly benefit from the specific stripping activity, such as the unit of production method. The accounting treatment in this Abstract should be applied to stripping costs incurred in fiscal years beginning on or after July 1, 2006, and may be applied retroactively. The adoption of this abstract did not have a material impact on the interim consolidated financial statements.

EIC 161 – Discontinued Operations

In April 2006, the Emerging Issues Committee of the CICA issued Abstract EIC-161, “Discontinued Operations”. EIC 161 addresses the allocation of interest expense to discontinued operations based on the principal amount of debt that will or could be paid with the proceeds from the sale of such operations. EIC 161 also specifies that general corporate overhead expenses may not be allocated to discontinued operations. EIC 161 applies to all disposal transactions initiated after the date of issuance of EIC 161 and may be applied prospectively or retroactively. The adoption of this abstract did not have a material impact on the interim consolidated financial statements.

EIC 162 – Stock-based Compensation for Employees Eligible to Retire Before the Vesting Date

In July 2006, the Emerging Issues Committee of the CICA issued Abstract EIC-162 “Stock-based compensation for employees eligible to retire before the vesting date”. EIC 162 clarifies the accounting of compensation costs relating to a stock-based award granted to employees who either are eligible for retirement at the grant date or will be eligible before the end of the vesting period. EIC 162 specifies that the compensation cost attributable to the first case should be recognized on the grant date and that the compensation cost attributable to the second case should be recognized over the period from the grant date to the date the employee becomes eligible to retire. The accounting treatment in this Abstract is to be applied retroactively, with restatement of prior periods, to all stock-based compensation awards accounted for in accordance with Section 3870 in financial statements issued for interim and annual periods ending on or after December 31, 2006, although earlier adoption is encouraged. The Corporation is currently considering the impact of the adoption of this standard.

Critical Accounting Estimates

The preparation of financial statements requires the Corporation to estimate the effect of various matters that are inherently uncertain as of the date of the financial statements. Each of these required estimates varies with respect to the level of judgment involved and the potential impact on the Corporation’s reported financial results. Estimates are deemed critical when the Corporation’s financial condition, change in financial condition or results of operations would be materially impacted by a different estimate or a change in estimate from period to period. The Corporation’s significant accounting policies, including critical accounting policies that require critical accounting estimates are discussed in note 2 of the 2005 Consolidated Financial Statements.

Off Balance Sheet Arrangements

Financial Instruments

As at June 30, 2006, the Corporation had no outstanding foreign exchange or commodity options, futures or forward contracts.

Transactions with Related Parties

Subsidiaries of the Corporation provide goods, labour, advisory and other administrative services to joint ventures at cost, commercial rates, and other various contractual terms. The Corporation and its subsidiaries also market, pursuant to sales agreements, all of the cobalt, a portion of the nickel, and certain by-products produced by certain jointly-owned entities in the Metals business.

The total value of all goods and services, including labour services, that the Corporation and its subsidiaries provided to joint ventures in the second quarter of 2006 amounted to \$29.0 million (2005 – \$9.4 million) and for the six months ended June 30, 2006 was \$45.7 million (2005 – \$20.0 million). The total value of goods and services purchased from affiliates in the second quarter of 2006 was \$11.3 (2005 – \$nil million) and for the six months ended June 30, 2006 was \$12.9 million (2005 – \$1.5 million).

Accounts receivable from joint ventures at June 30, 2006, totalled \$7.7 million (2005 – \$8.6 million). Accounts payable to joint ventures at June 30, 2006 totalled \$5.6 million (2005 – \$5.4 million).

Contractual Obligations and Commitments

The Corporation is committed to purchases of equipment and services in the amount of \$59.0 million. As the Power and Metals expansions progress, the Corporation expects to enter into additional commitments.

Additional Information

Share Capital

As at June 30, 2006 and July 28, 2006, the Corporation had 151,314,602 common shares outstanding.

If all of the 7% convertible unsecured subordinate debentures were converted into shares at the option of the holders, up to 27,535,575 additional shares would be issued on or before December 14, 2013.

Disclosure Controls and Procedures

As of the end of the period covered by this quarterly report, management, with the participation of the certifying officers, has evaluated the effectiveness of the Corporation's disclosure controls and procedures (as defined by the Canadian Securities Administrators). Based on that evaluation, the certifying officers have concluded that such disclosure controls and procedures are effective to provide reasonable assurance that material information relating to the Corporation and its subsidiaries is made known to them by others within those entities.

Consolidated Balance Sheets

(millions of Canadian dollars)	June 30 2006 (unaudited)	December 31 2005 (audited)
ASSETS		
Current assets		
Cash and cash equivalents	\$ 356.4	\$ 437.6
Restricted cash	11.1	5.9
Short-term investments	–	41.7
Advances and loans receivable	33.4	34.4
Accounts receivable	293.2	278.2
Inventories	104.2	110.0
Overburden removal costs	1.1	2.4
Prepaid expenses	14.6	9.9
Future income taxes	10.2	10.9
	<u>824.2</u>	<u>931.0</u>
Capital assets	1,006.8	1,648.8
Investments (note 4)	369.4	21.4
Future income taxes	58.2	85.2
Other assets	95.7	104.1
	<u>\$2,354.3</u>	<u>\$2,790.5</u>
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities		
Short-term debt	\$ 52.7	\$ 84.3
Accounts payable and accrued liabilities	167.1	174.3
Long-term debt and other long-term liabilities (note 6)	9.1	28.2
Asset retirement obligations (note 7)	2.5	8.8
	<u>231.4</u>	<u>295.6</u>
Long-term debt and other long-term liabilities (note 6)	510.8	620.8
Asset retirement obligations (note 7)	51.9	72.8
Future income taxes	66.0	231.2
Non-controlling interests	197.7	211.8
	<u>1,057.8</u>	<u>1,432.2</u>
Shareholders' equity		
Convertible debentures	8.1	12.6
Capital stock (note 8)	781.7	781.7
Contributed surplus (note 10)	191.9	192.3
Cumulative translation account (note 16)	(70.2)	–
Retained earnings	385.0	371.7
	<u>1,296.5</u>	<u>1,358.3</u>
	<u>\$2,354.3</u>	<u>\$2,790.5</u>

Consolidated Statements of Operations

	Three months ended June 30 (unaudited)		Six months ended June 30 (unaudited)	
	2006	2005 (restated – note 2)	2006	2005 (restated – note 2)
(millions of Canadian dollars except per share amounts)				
Revenue	\$296.9	\$322.5	\$556.5	\$579.6
Operating, selling, general and administrative	172.1	176.5	319.5	310.5
Earnings before undernoted items	124.8	146.0	237.0	269.1
Depletion, amortization and accretion	48.4	46.7	95.9	91.4
Net financing expense (note 11)	11.5	13.8	19.8	28.9
Gain on disposition of investments (note 3)	(5.0)	–	(5.0)	–
Share of earnings of equity accounted investments	(0.3)	–	(0.9)	(0.5)
Earnings before income taxes and non-controlling interests . . .	70.2	85.5	127.2	149.3
Income taxes (note 12)	8.0	25.8	26.0	45.4
Non-controlling interests	5.0	6.0	8.3	14.8
Net earnings	\$ 57.2	\$ 53.7	\$ 92.9	\$ 89.1
Earnings per share (note 8)				
Basic	\$ 0.38	\$ 0.35	\$ 0.61	\$ 0.60
Diluted	0.36	0.29	0.58	0.50
Weighted average number of shares (millions of shares)				
Basic	151.3	154.2	151.2	146.8
Diluted	179.4	198.7	179.3	198.7

Consolidated Statements of Retained Earnings

	Three months ended June 30 (unaudited)		Six months ended June 30 (unaudited)	
	2006	2005 (restated – note 2)	2006	2005 (restated – note 2)
(millions of Canadian dollars)				
Beginning of period, as previously reported	\$402.8	\$356.3	\$371.7	\$320.8
Change in accounting policies (note 2)	–	(40.4)	–	(40.3)
Beginning of period, as restated	402.8	315.9	371.7	280.5
Net earnings	57.2	53.7	92.9	89.1
Excess of cost of repurchase of common shares over stated value	–	–	(0.8)	–
Purchase of convertible debentures (note 6)	(71.2)	–	(71.2)	–
Dividends on common shares	(3.8)	(7.8)	(7.6)	(7.8)
End of period	\$385.0	\$361.8	\$385.0	\$361.8

Consolidated Statements of Cash Flow

(millions of Canadian dollars)	Three months ended June 30 (unaudited)		Six months ended June 30 (unaudited)	
	2006	2005 (restated – note 2)	2006	2005 (restated – note 2)
Operating activities				
Net earnings	\$ 57.2	\$ 53.7	\$ 92.9	\$ 89.1
Add (deduct)				
Non-controlling interests	5.0	6.0	8.3	14.8
Accretion of convertible debentures	0.2	0.1	0.3	0.5
Depletion, amortization and accretion	48.4	46.7	95.9	91.4
Amortization of financing costs	0.3	0.1	0.9	0.4
Loss on debt settlement	3.1	–	3.1	–
Share of earnings of equity accounted investments	(0.3)	–	(0.9)	(0.5)
Gain on disposition of investments	(5.0)	–	(5.0)	–
Future income taxes	(21.0)	1.3	(24.7)	(5.4)
Foreign exchange loss	0.5	3.5	0.9	7.6
Asset retirement obligations	(2.0)	(1.3)	(3.5)	(2.3)
Other items	1.7	(1.0)	1.7	(0.5)
	<u>88.1</u>	<u>109.1</u>	<u>169.9</u>	<u>195.1</u>
Decrease (increase) in non-cash working capital				
Accounts receivable	(5.7)	(10.7)	(39.8)	(17.8)
Inventories	(2.0)	23.1	(16.1)	4.4
Overburden removal costs	(1.4)	(1.0)	(0.9)	(1.5)
Prepaid expenses	(7.4)	1.7	(6.4)	(1.4)
Accounts payable and accrued liabilities	15.2	(38.1)	19.2	(23.3)
	<u>(1.3)</u>	<u>(25.0)</u>	<u>(44.0)</u>	<u>(39.6)</u>
Cash provided by operating activities	<u>86.8</u>	<u>84.1</u>	<u>125.9</u>	<u>155.5</u>
Investing activities				
Capital expenditures	(58.8)	(79.1)	(109.4)	(136.8)
Short-term investments	94.1	(0.5)	41.9	5.3
Net proceeds from sale of capital assets	0.2	0.7	0.4	1.6
Restricted cash	(4.4)	0.3	(5.2)	11.0
Other assets	(6.2)	(6.4)	(18.0)	(14.0)
Distribution from investment	117.2	–	117.2	–
Cash provided by (used for) investing activities	<u>142.1</u>	<u>(85.0)</u>	<u>26.9</u>	<u>(132.9)</u>
Financing activities				
Increase (decrease) in short-term debt	(2.4)	19.7	(10.1)	38.0
Increase (decrease) in long-term debt	1.7	(1.5)	(11.0)	(2.6)
Purchase of convertible debentures	(181.6)	–	(181.6)	–
Issuance of common shares	–	3.3	1.0	5.8
Repurchase of common shares	–	–	(2.1)	(5.4)
Dividends paid to non-controlling interests	(22.3)	–	(22.3)	–
Dividends paid	(3.8)	(3.9)	(7.6)	(3.9)
Cash provided by (used for) financing activities	<u>(208.4)</u>	<u>17.6</u>	<u>(233.7)</u>	<u>31.9</u>
Effect of exchange rate changes on cash and cash equivalents	<u>(0.5)</u>	<u>0.4</u>	<u>(0.3)</u>	<u>0.7</u>
Increase (decrease) in cash and cash equivalents	<u>20.0</u>	<u>17.1</u>	<u>(81.2)</u>	<u>55.2</u>
Cash and cash equivalents at beginning of period	<u>336.4</u>	<u>457.7</u>	<u>437.6</u>	<u>419.6</u>
Cash and cash equivalents at end of period	<u>356.4</u>	<u>474.8</u>	<u>356.4</u>	<u>474.8</u>
Supplementary Cash Flow Information				
Cash received for interest	\$ 6.0	\$ 6.4	\$ 9.6	\$ 11.8
Cash paid for interest on debt	12.6	20.3	14.5	26.9
Cash paid for income taxes	7.1	19.3	22.7	34.0
Cash and cash equivalents consist of:				
Cash on hand	\$ 69.3	\$ 83.9	\$ 69.3	\$ 83.9
Cash equivalents	\$ 287.1	\$390.9	\$ 287.1	\$390.9
	<u>356.4</u>	<u>474.8</u>	<u>356.4</u>	<u>474.8</u>

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(All tabular dollar amounts expressed in millions of Canadian dollars, except per share amounts)

1. SUMMARY OF ACCOUNTING POLICIES

These interim consolidated financial statements have been prepared on a basis consistent with those followed in the consolidated financial statements for the year ended December 31, 2005, with the exception of the change in the foreign currency translation method as detailed in note 2(a) below. The disclosures contained in these interim consolidated financial statements do not include all requirements of Canadian generally accepted accounting principles for annual financial statements. Accordingly, the interim consolidated financial statements should be read in conjunction with the consolidated financial statements for the year ended December 31, 2005.

2. ACCOUNTING CHANGES

(a) Translation of foreign currencies

The method of translation of foreign operations depends on whether the foreign operations are integrated or self-sustaining. Prior to January 1, 2006, all of the Corporation's foreign operations were considered integrated and translated into Canadian dollars using current rates of exchange for monetary assets and liabilities, historical rates of exchange for non-monetary assets and liabilities and average rates of exchange for revenues and expenses, except depletion and amortization which were translated at the rates of exchange applicable to the related assets. Gains and losses resulting from these translation adjustments were included in income.

The ongoing review of the economic factors to be considered in determining whether foreign operations are integrated or self-sustaining has resulted in the determination that the Metals foreign operations and the Oil and Gas foreign operations in Cuba and Spain have changed to self-sustaining. This change was made as a result of the increasing proportion of operating, financing and investing transactions of these foreign operations that are denominated in currencies other than the Canadian dollar. This change in method was effective at January 1, 2006 and was applied prospectively. The self-sustaining operations are translated into Canadian dollars using the current rate method, whereby assets and liabilities are translated at period-end exchange rates while revenues and expenses are converted using average rates for the period. Gains and losses on translation to Canadian dollars relating to self-sustaining operations are deferred and included in a separate component of shareholders' equity described as cumulative translation account.

(b) Future income taxes

On October 1, 2005, the Corporation changed its methodology of accounting for income taxes in its Cuban oil and gas operations to provide a clearer presentation of income taxes in that operation. Prior to this change in accounting policy, the Corporation recorded tax on the Cuban oil and gas operations on the basis that cost recovery revenue and expenses were not subject to or deductible under the Cuban tax regime resulting in no temporary differences between the book value and the tax value of the relevant assets and liabilities. This methodology resulted in significant fluctuations in the effective tax rate for the Oil and Gas operations between reporting periods when the relative percentage of cost recovery revenue changed compared to total oil revenue.

Under the adopted accounting policy, temporary differences are recognized for the respective assets and liabilities at the effective Cuban tax rate of approximately 30%. This results in a clearer presentation of the effective tax rate in the Cuban oil operations over the life of the operating oil fields. The Corporation has implemented this change on a retroactive basis with restatement of prior periods. The cumulative effect of the change in policy on retained earnings at January 1, 2005 was \$40.3 million. The accounting change resulted in a decrease in net earnings of \$2.3 million (decrease in EPS – basic \$0.01, diluted \$0.01) in the second quarter of 2005 and a decrease in net earnings of \$2.4 million (decrease in EPS – basic \$0.02, diluted \$0.01) in the six months ended June 30, 2005.

The Corporation also changed the methodology of accounting for income taxes paid on its behalf by an agency of the government of Cuba for the enhanced oil recovery blocks, to reflect these income taxes on a gross basis. As a result, current income tax expense and revenue have increased. This change was applied on a retroactive basis and resulted in an increase in revenue and current income tax expense of \$0.8 million and \$1.5 million for the three months and six months ended June 30, 2005, respectively.

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

(All tabular dollar amounts expressed in millions of Canadian dollars, except per share amounts)

2. ACCOUNTING CHANGES (Continued)

(c) Comparative amounts

Certain comparative amounts have been restated to correct their classification, with no impact on net earnings, to conform to the presentation in the current period.

In the Metals business ("Metals"), certain selling expenses which were previously netted against revenue, have been reclassified to operating, selling, general and administrative expenses, resulting in an increase in revenue of \$1.6 million with a corresponding increase in operating, selling, general and administrative expenses for the three months ended June 30, 2005. For the six months ended June 30, 2005, the reclassification resulted in an increase of \$2.7 million in revenue and an increase of \$2.7 million in operating, selling, general and administration expenses.

Capital expenditures on the Consolidated Statements of Cash Flow in 2005 have been adjusted to exclude non-cash capital additions of \$5.8 million for the three months period ended June 30, 2005 and \$7.5 million for the six-month period ended June 30, 2005.

3. SIGNIFICANT TRANSACTION

On June 27, 2006, Royal Utilities Income Fund ("Royal Utilities"), a trust in which the Corporation held a 50% indirect interest through its partnership in the Coal business ("Coal"), successfully completed an initial public offering of units ("IPO").

Prior to the IPO, Royal Utilities transferred to certain affiliates of the Coal partnership certain non-core mining assets comprised of the Coal Valley export thermal-coal mine, other non-producing coal mines, certain coal and potash resources and other non-mining assets (the "Transferred Assets"). These transfers were recorded at their carrying value.

Following the IPO and the exercise of the over-allotment by the underwriters, the Corporation owned 41.2% of the outstanding units of Royal Utilities as at June 30, 2006. For accounting purposes, the Corporation's dilution of its interest in Royal Utilities resulted in a gain of \$4.7 million.

The results for Coal reflected the Corporation's 50% proportionate interest in Royal Utilities up to June 27, 2006. Subsequent to June 27, 2006, the Corporation prospectively changed its accounting for Royal Utilities to the equity method of accounting. The Corporation continues to proportionately consolidate its 50% interest in the Transferred Assets.

The gain on disposition of investments also includes a \$0.3 million gain on sale of short-term investments.

4. INVESTMENTS

	<u>June 30, 2006</u>	<u>December 31, 2005</u>
Royal Utilities ^(a)	\$347.2	\$ -
Tourism ^(b)	21.8	21.0
Other	0.4	0.4
	<u>\$369.4</u>	<u>\$ 21.4</u>

(a) The Corporation has a 41.2% direct interest in Royal Utilities (note 3).

(b) The Corporation has a 25% indirect interest in a hotel complex in Varadero, Cuba, and a 12.5% indirect interest in a hotel complex in Havana, Cuba.

These investments are accounted for as long-term investments using the equity method of accounting.

5. POST-RETIREMENT BENEFITS

The Corporation's pension expense for the second quarter of 2006 was \$4.2 million (2005 – \$2.2 million). For the six months ended June 30, 2006, pension expense was \$7.1 million (2005 – \$4.4 million).

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

(All tabular dollar amounts expressed in millions of Canadian dollars, except per share amounts)

6. LONG-TERM DEBT AND OTHER LONG-TERM LIABILITIES

	June 30, 2006	December 31, 2005
7% convertible unsecured debentures due 2013	\$189.0	\$293.6
7.875% senior unsecured debentures due 2012	273.6	273.6
9.875% senior unsecured debentures due 2010	–	14.4
Loan from financial institution	22.5	25.0
Other long-term debt	18.5	5.7
	503.6	612.3
Capital lease obligations	15.1	28.5
Other long-term liabilities	1.2	8.2
	519.9	649.0
Current portion of long-term debt and other long-term liabilities	(9.1)	(28.2)
	\$510.8	\$620.8

In the second quarter of 2006, the Corporation completed two offers to purchase portions of the principal amount of its outstanding 7% convertible unsecured subordinated debentures due December 15, 2013. On the first offer, which expired in April 2006, the Corporation purchased \$7.1 million principal amount of the debentures for a total consideration of \$11.7 million, including accrued interest. On the second offer, which expired in June 26, 2006, the Corporation purchased \$100 million principal amount of the debentures for a total consideration of \$170.3 million, including accrued interest. These transactions resulted in \$3.1 million being charged to income and \$71.2 million being charged to retained earnings.

On January 16, 2006, the \$14.4 million of 9.875% debentures were redeemed for cash.

Other long-term debt reflects proportionally consolidated loans to joint ventures.

Interest and accretion on long-term debt for the second quarter of 2006 was \$12.3 million (2005 – \$12.3 million). For the six months ended June 30, 2006, interest and accretion on long-term debt was \$24.5 (2005 – \$26.6 million).

7. ASSET RETIREMENT OBLIGATIONS

Asset retirement obligations have been recognized in respect of the mining operations of Coal and Metals, including associated infrastructure and buildings. Obligations have also been recorded for nickel and cobalt refining facilities, fertilizers and utilities facilities and oil and gas production facilities. Reclamation of coal mining operations is typically carried out on a continuous basis over the life of each mine and is dependent on the rate that mining progresses over the area to be mined. Retirement of refinery, fertilizer and utility facilities, oil and gas production facilities, infrastructure and buildings normally takes place at the end of the assets' useful life.

The following is a reconciliation of the opening and closing asset retirement obligation balances.

	Six months ended June 30, 2006	Year ended December 31, 2005
Balance, beginning of period	\$ 81.6	\$77.2
Additions to liabilities	2.6	7.6
Liabilities settled	(4.1)	(7.3)
Accretion expense	2.8	5.8
Change in foreign exchange rates	(1.3)	(1.7)
Liabilities disposed (note 3)	(27.2)	–
Balance, end of period	54.4	81.6
Current portion	(2.5)	(8.8)
	\$ 51.9	\$72.8

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

(All tabular dollar amounts expressed in millions of Canadian dollars, except per share amounts)

7. ASSET RETIREMENT OBLIGATIONS (Continued)

The Corporation has estimated the undiscounted cash flow required to settle the asset retirement obligation at approximately \$170.6 million. Expenditures will be made on an ongoing basis over several decades and are expected to be funded by cash generated from operations. Credit adjusted discount rates from 3% to 9% were applied to expected future cash flows to determine the carrying value of the asset retirement obligation.

In view of uncertainties concerning asset retirement obligations, the ultimate costs could be materially different from the amounts estimated. The estimate of the future asset retirement liabilities is subject to change based on amendments to applicable laws and legislation. Future changes in asset retirement liabilities, if any, could have a significant impact and would be reflected prospectively, as a change in accounting estimate.

8. CAPITAL STOCK

The Corporation's authorized share capital consists of an unlimited number of common shares.

The changes in the Corporation's outstanding common shares were as follows:

	Number		Stated Capital	
	June 30, 2006	December 31, 2005	June 30, 2006	December 31, 2005
Balance, beginning of year	151,333,889	131,381,776	\$781.7	\$582.4
Changes during the period:				
Share purchase plan	-	123,200	-	0.5
Repurchase of shares	(200,000)	(5,085,432)	(1.0)	(26.3)
Stock options exercised	180,000	2,164,000	1.0	13.9
6% convertible debenture conversion	-	21,923,924	-	202.4
6% convertible debenture redemption	-	811,137	-	8.7
7% convertible debenture conversion	713	15,284	-	0.1
Balance, end of period	<u>151,314,602</u>	<u>151,333,889</u>	<u>\$781.7</u>	<u>\$781.7</u>

If all of the 7% convertible debentures are converted into shares at the option of the holders, up to 27,535,575 additional common shares may be issued on or before December 14, 2013.

The following table presents the calculation of basic and diluted earnings per common share:

	Three months ended June 30		Six months ended June 30	
	2006	2005 (restated – note 2)	2006	2005 (restated – note 2)
Net earnings	\$ 57.2	\$ 53.7	\$ 92.9	\$ 89.1
Loss on redemption of convertible debentures included in contributed surplus	-	-	-	(0.5)
Net earnings – basic	57.2	53.7	92.9	88.6
Loss on purchase of convertible debentures	3.1	-	3.1	0.9
Interest and accretion on convertible debentures	3.6	3.7	7.2	8.9
Net earnings – diluted	<u>\$ 63.9</u>	<u>\$ 57.4</u>	<u>\$103.2</u>	<u>\$ 98.4</u>
Weighted average number of shares – basic	151.3	154.2	151.2	146.8
Weighted average effect of dilutive securities:				
Employee stock options	0.5	1.6	0.5	1.7
Convertible debentures	27.6	42.9	27.6	50.2
Weighted average number of shares – diluted	<u>179.4</u>	<u>198.7</u>	<u>179.3</u>	<u>198.7</u>
Earnings per share				
Basic	\$ 0.38	\$ 0.35	\$ 0.61	\$ 0.60
Diluted	<u>0.36</u>	<u>0.29</u>	<u>0.58</u>	<u>0.50</u>

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

(All tabular dollar amounts expressed in millions of Canadian dollars, except per share amounts)

9. STOCK COMPENSATION PLANS

The following is a summary of stock option activity during the three months and six months ended June 30, 2006.

	Three months ended June 30, 2006		Three months ended June 30, 2005	
	Options	Weighted average exercise price	Options	Weighted average exercise price
Outstanding at beginning of period	2,970,000	\$ 9.01	5,630,000	\$6.66
Granted	105,000	11.69	–	–
Exercised	–	–	(500,000)	6.57
Outstanding at end of period	<u>3,075,000</u>	<u>\$ 9.10</u>	<u>5,130,000</u>	<u>\$6.66</u>
Options exercisable, end of period	<u>850,000</u>	<u>\$ 5.71</u>	<u>5,130,000</u>	<u>\$6.66</u>

	Six months ended June 30, 2006		Six months ended June 30, 2005	
	Options	Weighted average exercise price	Options	Weighted average exercise price
Outstanding at beginning of period	2,005,000	\$ 7.97	6,040,000	\$6.62
Granted	1,250,000	10.43	–	–
Exercised	(180,000)	5.74	(910,000)	6.38
Outstanding at end of period	<u>3,075,000</u>	<u>\$ 9.10</u>	<u>5,130,000</u>	<u>\$6.66</u>
Options exercisable, end of period	<u>850,000</u>	<u>\$ 5.71</u>	<u>5,130,000</u>	<u>\$6.66</u>

As at June 30, 2006, 2,225,000 options with a share appreciation right attachment remained outstanding for which the Corporation has recognized a compensation expense of \$0.4 million and \$0.5 million for the three and six months ended June 30, 2006, respectively (three and six months ended June 2005 – \$nil).

The Corporation has recorded a compensation expense of \$1.5 million and \$2.9 million for the three and six months ended June 30, 2006, respectively (\$1.3 million recovery and \$0.3 million recovery for the three and six months ended June 30, 2005, respectively).

10. CONTRIBUTED SURPLUS

	Six months ended June 30, 2006	Year ended December 31, 2005
Balance, beginning of period	\$192.3	\$199.2
Redemption of convertible debentures	–	(0.5)
Repurchase of common shares	(0.4)	(6.4)
Balance, end of period	<u>\$191.9</u>	<u>\$192.3</u>

Contributed surplus may be utilized to eliminate or reduce any deficit, which may arise as a result of the future payment or distribution of dividends or other distributions, from time to time, to holders of the common shares.

Contributed surplus was reduced by \$0.4 million for the six month ended June 30, 2006 reflecting the loss on repurchase of shares during the first quarter.

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

(All tabular dollar amounts expressed in millions of Canadian dollars, except per share amounts)

11. NET FINANCING EXPENSE

	Three months ended June 30		Six months ended June 30	
	2006	2005 (restated – note 2)	2006	2005 (restated – note 2)
Interest income on cash, cash equivalents, short-term investments and loans receivable	\$ (4.3)	\$ (3.7)	\$ (8.2)	\$ (8.3)
Interest expense on debt	12.3	14.1	24.5	28.4
Foreign exchange losses	0.5	3.5	0.9	7.6
Other	3.0	(0.1)	2.6	1.2
	\$11.5	\$13.8	\$19.8	\$28.9

12. INCOME TAXES

	Three months ended June 30		Six months ended June 30	
	2006	2005 (restated – note 2)	2006	2005 (restated – note 2)
Current	\$29.0	\$24.5	\$50.7	\$50.8
Future	(21.0)	1.3	(24.7)	(5.4)
	\$ 8.0	\$25.8	\$26.0	\$45.4

13. COMMITMENTS

As at June 30, 2006, the Corporation was committed to purchase equipment and services in the amount of \$59.0 million.

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

(All tabular dollar amounts expressed in millions of Canadian dollars, except per share amounts)

14. SEGMENT INFORMATION

Reference should be made to Sherritt's annual audited consolidated financial statements for a full description of operating segments.

Three months ended June 30, 2006

(millions of Canadian dollars)	<u>Coal⁽²⁾</u>	<u>Metals</u>	<u>Oil and Gas</u>	<u>Power</u>	<u>Other⁽¹⁾</u>	<u>Corporate</u>	<u>Consolidated</u>
Revenue	\$73.2	\$110.6	\$ 69.6	\$ 28.4	\$15.1	\$ -	\$ 296.9
Operating, selling, general and administrative	59.9	64.3	14.9	7.7	13.9	11.4	172.1
Earnings (loss) before undernoted items	13.3	46.3	54.7	20.7	1.2	(11.4)	124.8
Depletion, amortization and accretion	13.6	5.0	21.3	6.7	0.6	1.2	48.4
Operating earnings (loss)	(0.3)	41.3	33.4	14.0	0.6	(12.6)	76.4
Share of earnings of equity accounted investments							0.3
Net financing expense							(11.5)
Income taxes							(8.0)
Non-controlling interests							(5.0)
Gain on disposition of investments							5.0
Net earnings							57.2
Capital expenditures	5.9	12.9	33.0	6.6	0.4	-	58.8
Assets	\$99.4	\$418.4	\$630.7	\$536.7	\$84.9	\$584.2	\$2,354.3

Three months ended June 30, 2005 (restated-note 2)

(millions of Canadian dollars)	<u>Coal</u>	<u>Metals</u>	<u>Oil and Gas</u>	<u>Power</u>	<u>Other⁽¹⁾</u>	<u>Corporate</u>	<u>Consolidated</u>
Revenue	\$ 65.3	\$143.3	\$ 67.7	\$ 26.6	\$19.6	\$ -	\$ 322.5
Operating, selling, general and administrative	51.3	81.0	10.3	11.6	17.8	4.5	176.5
Earnings (loss) before undernoted items	14.0	62.3	57.4	15.0	1.8	(4.5)	146.0
Depletion, amortization and accretion	14.3	5.2	20.1	5.4	0.7	1.0	46.7
Operating earnings (loss)	(0.3)	57.1	37.3	9.6	1.1	(5.5)	99.3
Share of earnings of equity accounted investments							-
Net financing expense							(13.8)
Income taxes							(25.8)
Non-controlling interests							(6.0)
Net earnings							53.7
Capital expenditures	5.8	5.4	36.8	30.9	0.1	0.1	79.1
Assets	\$752.8	\$425.5	\$585.4	\$522.3	\$89.5	\$360.8	\$2,736.3

(1) Other represents the results of the soybean-based food processing business.

(2) Coal results include Royal Utilities on proportionate consolidation basis up to June 27, 2006.

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

(All tabular dollar amounts expressed in millions of Canadian dollars, except per share amounts)

14. SEGMENT INFORMATION (Continued)

Six months ended June 30, 2006

(millions of Canadian dollars)	<u>Coal⁽²⁾</u>	<u>Metals</u>	<u>Oil and Gas</u>	<u>Power</u>	<u>Other⁽¹⁾</u>	<u>Corporate</u>	<u>Consolidated</u>
Revenue	\$147.0	\$191.7	\$138.3	\$ 50.6	\$28.9	\$ -	\$ 556.5
Operating, selling, general and administrative	<u>114.9</u>	<u>115.3</u>	<u>27.4</u>	<u>14.8</u>	<u>26.5</u>	<u>20.6</u>	<u>319.5</u>
Earnings (loss) before undernoted items	32.1	76.4	110.9	35.8	2.4	(20.6)	237.0
Depletion, amortization and accretion	<u>27.6</u>	<u>9.6</u>	<u>41.9</u>	<u>13.0</u>	<u>1.4</u>	<u>2.4</u>	<u>95.9</u>
Operating earnings (loss)	4.5	66.8	69.0	22.8	1.0	(23.0)	141.1
Share of earnings of equity accounted investments							0.9
Net financing expense							(19.8)
Income taxes							(26.0)
Non-controlling interests							(8.3)
Gain on disposition of investments							<u>5.0</u>
Net earnings							<u>92.9</u>
Capital expenditures	<u>9.0</u>	<u>28.0</u>	<u>56.7</u>	<u>14.7</u>	<u>0.9</u>	<u>0.1</u>	<u>109.4</u>
Assets	<u>\$ 99.4</u>	<u>\$418.4</u>	<u>\$630.7</u>	<u>\$536.7</u>	<u>\$84.9</u>	<u>\$584.2</u>	<u>\$2,354.3</u>

Six months ended June 30, 2005 (restated-note 2)

(millions of Canadian dollars)	<u>Coal</u>	<u>Metals</u>	<u>Oil and Gas</u>	<u>Power</u>	<u>Other⁽¹⁾</u>	<u>Corporate</u>	<u>Consolidated</u>
Revenue	\$128.2	\$244.2	\$118.1	\$ 52.3	\$36.8	\$ -	\$ 579.6
Operating, selling, general and administrative	<u>93.2</u>	<u>132.6</u>	<u>20.0</u>	<u>17.7</u>	<u>32.3</u>	<u>14.7</u>	<u>310.5</u>
Earnings (loss) before undernoted items	35.0	111.6	98.1	34.6	4.5	(14.7)	269.1
Depletion, amortization and accretion	<u>28.1</u>	<u>10.2</u>	<u>39.0</u>	<u>10.6</u>	<u>1.4</u>	<u>2.1</u>	<u>91.4</u>
Operating earnings (loss)	6.9	101.4	59.1	24.0	3.1	(16.8)	177.7
Share of earnings of equity accounted investments							0.5
Net financing expense							(28.9)
Income taxes							(45.4)
Non-controlling interests							(14.8)
Net earnings							<u>89.1</u>
Capital expenditures	<u>7.1</u>	<u>13.6</u>	<u>65.3</u>	<u>49.1</u>	<u>0.2</u>	<u>1.5</u>	<u>136.8</u>
Assets	<u>\$752.8</u>	<u>\$425.5</u>	<u>\$585.4</u>	<u>\$522.3</u>	<u>\$89.5</u>	<u>\$360.8</u>	<u>\$2,736.3</u>

(1) Other represents the results of the soybean-based food processing business.

(2) Coal results include Royal Utilities on proportionate consolidation basis up to June 27, 2006.

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

(All tabular dollar amounts expressed in millions of Canadian dollars, except per share amounts)

14. SEGMENT INFORMATION (Continued)

	Three months ended June 30			
	2006		2005 (restated – note 2)	
	Revenue	Capital Assets	Revenue	Capital Assets
Canada	\$ 86.8	\$ 202.4	\$ 92.7	\$ 779.0
Cuba	110.0	795.8	110.0	786.5
Europe	59.9	1.3	74.4	2.7
Asia	29.2	7.3	41.3	7.1
Other foreign countries	11.0	–	4.1	–
	\$296.9	\$1,006.8	\$322.5	\$1,575.3
	Six months ended June 30			
	2006		2005 (restated – note 2)	
	Revenue	Capital Assets	Revenue	Capital Assets
Canada	\$156.9	\$ 202.4	\$160.8	\$ 779.0
Cuba	211.8	795.8	200.0	786.5
Europe	114.7	1.3	136.8	2.7
Asia	56.6	7.3	71.6	7.1
Other foreign countries	16.5	–	10.4	–
	\$556.5	\$1,006.8	\$579.6	\$1,575.3

15. FINANCIAL INSTRUMENTS

Unutilized lines of credit as at June 30, 2006 were \$48.7 million.

16. CUMULATIVE TRANSLATION ACCOUNT

Exchange gains and losses arising from the translation of the financial statements of the Corporation's self-sustaining foreign operations are deferred and included in the cumulative translation account (see note 2 (a)). When there is a reduction in the Corporation's net investment in a self-sustaining foreign operation, a proportionate amount of the cumulative translation account is included in the determination of consolidated net earnings. Significant changes in the cumulative translation account are as follows:

	Six months ended June 30, 2006	Year ended December 31, 2005
Balance, beginning of period	\$ –	\$ –
Effect of change on opening balances	(47.7)	–
Effect of exchange rate changes during the period	(22.5)	–
Balance, end of period	\$(70.2)	\$ –

Schedule of Selected Current Assets and Accounts Payable by Operating Segment

June 30, 2006

(millions of Canadian dollars)	<u>Coal</u>	<u>Metals</u>	<u>Oil and Gas</u>	<u>Power</u>	<u>Other</u>	<u>Corporate</u>	<u>Consolidated</u>
Accounts receivable	\$ 2.1	\$ 56.4	\$175.3	\$25.8	\$12.5	\$21.1	\$293.2
Inventories	16.6	67.8	–	13.8	6.0	–	104.2
Overburden removal costs	1.1	–	–	–	–	–	1.1
Prepaid expenses	1.4	2.8	2.4	1.8	1.4	4.8	14.6
Future income taxes	1.3	8.9	–	–	–	–	10.2
	<u>\$22.5</u>	<u>\$135.9</u>	<u>\$177.7</u>	<u>\$41.4</u>	<u>\$19.9</u>	<u>\$25.9</u>	<u>\$423.3</u>
Accounts payable and accrued liabilities	<u>\$12.1</u>	<u>\$ 61.8</u>	<u>\$ 38.6</u>	<u>\$11.6</u>	<u>\$10.7</u>	<u>\$32.3</u>	<u>\$167.1</u>

March 31, 2006

(millions of Canadian dollars)	<u>Coal</u>	<u>Metals</u>	<u>Oil and Gas</u>	<u>Power</u>	<u>Other</u>	<u>Corporate</u>	<u>Consolidated</u>
Accounts receivable	\$26.2	\$ 42.5	\$197.9	\$23.0	\$10.1	\$12.4	\$312.1
Inventories	33.0	69.5	–	13.1	7.1	–	122.7
Overburden removal costs	1.9	–	–	–	–	–	1.9
Prepaid expenses	1.7	3.9	0.2	0.1	1.6	1.2	8.7
Future income taxes	5.4	5.0	–	–	–	–	10.4
	<u>\$68.2</u>	<u>\$120.9</u>	<u>\$198.1</u>	<u>\$36.2</u>	<u>\$18.8</u>	<u>\$13.6</u>	<u>\$455.8</u>
Accounts payable and accrued liabilities	<u>\$26.5</u>	<u>\$ 50.9</u>	<u>\$ 36.0</u>	<u>\$11.5</u>	<u>\$11.8</u>	<u>\$40.8</u>	<u>\$177.5</u>

December 31, 2005

(millions of Canadian dollars)	<u>Coal</u>	<u>Metals</u>	<u>Oil and Gas</u>	<u>Power</u>	<u>Other</u>	<u>Corporate</u>	<u>Consolidated</u>
Accounts receivable	\$30.5	\$ 46.8	\$161.2	\$20.2	\$ 9.4	\$10.1	\$278.2
Inventories	28.8	64.6	–	13.0	3.6	–	110.0
Overburden removal costs	2.4	–	–	–	–	–	2.4
Prepaid expenses	1.8	4.0	0.9	0.4	1.4	1.4	9.9
Future income taxes	4.2	6.7	–	–	–	–	10.9
	<u>\$67.7</u>	<u>\$122.1</u>	<u>\$162.1</u>	<u>\$33.6</u>	<u>\$14.4</u>	<u>\$11.5</u>	<u>\$411.4</u>
Accounts payable and accrued liabilities	<u>\$30.1</u>	<u>\$ 54.9</u>	<u>\$ 33.1</u>	<u>\$12.2</u>	<u>\$ 7.7</u>	<u>\$36.3</u>	<u>\$174.3</u>



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