

CO-CHAIRMEN'S LETTER TO SHAREHOLDERS



DAVID R. MARTIN
Executive Co-Chairman



A. ROBERT ABBOUD
Independent Co-Chairman
and Lead Director

As world demand for hydrocarbons grows and light oil reserves dwindle, increasing attention is being focused on technologies that efficiently recover and process heavy oil. The challenge is not finding these deposits, because they exist and many have been discovered, with enormous, well-known deposits throughout the world. The challenge is to find the best way to extract, transport and process the oil.

With significant technological advances in heavy oil development in recent years, there is a new wave of interest in heavy oil. However, even with these technical advances, producers are still faced with expensive options to produce, transport and process heavy oil. As a result, many known heavy oil fields lie untapped, and many fields under development are using costly, inefficient technologies.

Production from these areas requires a combination of technologies and skills. Equipped with our technology and our people, Ivanhoe Energy is prepared to meet these challenges.

THE TECHNOLOGY

Heavy oil is a thick, viscous, tar-like product that does not pump or flow easily. Extraction is a challenge, as is pipeline transportation. Producers burn natural gas to generate steam to heat, soften and propel the oil, and must then mix the heavy oil with costly light oil or other diluents to facilitate transportation.

Ivanhoe has state-of-the-art technology to take advantage of known deposits. Our patented, proprietary HTL technology upgrades heavy oil and bitumen into high quality, high-value lighter crude oil, which flows freely through pipelines. Our processing plants are far smaller than conventional technologies require, and can be located in the field, near the heavy oil reserves. Our process also produces significant by-product energy, which can be used to generate the steam or electricity that is used to recover the heavy oil. These advantages permit production of reserves that presently lie stranded, make for tremendous savings, and facilitate transportation of heavy oil to market cost effectively, efficiently and flexibly.

THE PEOPLE

While our technology provides us with a unique edge, the ability to implement that technology lies in our people. Heavy oil production requires specialized skills in order to bring these resources to market economically. Our talented technical teams have worked with major oil and gas companies around the globe, and can apply proven drilling and development techniques to produce stranded oil in remote areas. Our experience allows this to be done safely, efficiently, and in an environmentally-sensitive manner.

Our management has many years of on-the-ground international experience working effectively and harmoniously with local governments. We place a high priority on creating partnerships that meet the cultural and economic needs of our host populations.

THE STRATEGY

Our strategy is to use our HTL technology to develop major heavy oil reserves. Our technology can reduce the exploration risk normally associated with oil and gas resources.

We believe that we can maximize the value of our technology by using it to create opportunities to acquire interests in, and actively participate in, heavy oil development projects. Our strategy is to build, own and operate commercial HTL facilities, rather than licensing our technology to third parties. We intend to use the technology as a strategic tool to acquire and develop reserves by partnering with resource owners and other partners in production-sharing agreements or other long-term arrangements.

Ivanhoe Energy offers two specialized capabilities ready for field application: we have the technology that allows us to upgrade heavy oil in the field; and our people have extensive experience in the development of oil and gas resources around the world.

Moving forward, our priority is to negotiate appropriate partnership arrangements or contracts to put our technology to work. Initiatives are already underway on four continents.

DAVID R. MARTIN
Executive Co-Chairman

A. ROBERT ABBOUD
Independent Co-Chairman

PRESIDENT'S LETTER TO SHAREHOLDERS



JOE GASCA
President and
Chief Executive Officer

This year has been one of focusing, and of preparing for the projects and partnerships to come. We are very excited about the tremendous potential of our HTL technology, and have confidence in the skills and depth of experience of our people. The company's priority is to execute on this potential – to build on our positive test results and establish the partnerships required to fully commercialize the HTL technology for heavy oil reserve development. We have six main goals:

1 - Build a portfolio of HTL projects. By shifting people and financial resources, we will focus on executing business deals for development projects utilizing our HTL technology.

2 - Advance the technology. Development work will continue as we advance our technology through the first commercial application and beyond.

3 - Enhance our financial position. In preparation for the significant capital outlays required by large projects, we have revised our 2007 capital budget. We anticipate a three-year time frame to design and build the first commercial HTL facility, but expect that the value of transactions will be apparent as soon as agreements are signed.

4 - Reinforce internal capabilities. In advance of major projects, we will expand our HTL and enhanced oil recovery (EOR) technical teams so we can respond quickly and effectively.

5 - Build relationships. Close alignment with partners, suppliers, host governments, and financiers will be essential for future success.

6 - Capture value from our other assets. The goal of our existing operations in the U.S. and China is to generate cash to fund our growth as we transition to a heavy oil-focused company. Our non-heavy oil assets will be leveraged to further support our growth.

SUMMARY OF 2006 FINANCIAL RESULTS

The full year 2006 marks our third consecutive year of positive cash flow from operating activities, which increased 45% generating US\$14.4 million for the year. Capital investments for 2006 were US\$17.8 million. Revenue rose by 61%, or \$18.2 million due to continued high oil prices and increased production; however, this gain was offset by an increase in non-cash depletion and depreciation expenses of \$18.1 million. We also incurred increased business and technology development costs, general and administrative expenses and a non-cash impairment of our China oil and gas properties of \$5.4 million, resulting in a loss of \$25.5 million for the year.

In closing, thank you to our Board of Directors for their guidance and role in realizing the company's vision, our employees for their commitment and our shareholders for their continued support. I look forward to a successful upcoming year.

Sincerely,

JOE GASCA
President and Chief Executive Officer

FINANCIAL HIGHLIGHTS

(thousands of U.S. dollars except per share and production amounts)

	YEAR ENDED		
	2006	2005	2004
Total assets (at year end)	\$ 248,544	\$ 240,877	\$ 118,486
Cash flow from operating activities	\$ 14,352	\$ 9,870	\$ 4,032
Cash and cash equivalents (at year end)	\$ 13,879	\$ 6,724	\$ 9,322
Revenue	\$ 48,100	\$ 29,939	\$ 17,997
Operating expenses	35,622	23,368	14,640
Operating income	\$ 12,478	\$ 6,571	\$ 3,357
% Operating income	25.9%	22.0%	18.7%
Depletion and depreciation	\$ 32,550	\$ 14,447	\$ 7,482
Write-downs and provision for impairment	\$ 5,420	\$ 5,636	\$ 16,600
Net loss	\$ (25,492)	\$ (13,512)	\$ (20,725)
Net loss per share – basic and diluted	\$ (0.11)	\$ (0.07)	\$ (0.12)
Net production (after royalties):			
Barrel of oil equivalent (BOE)	795,061	634,492	503,549
BOE/day for the year	2,178	1,738	1,376