



Q1, 2006

**Three months ended
March 31, 2006**

Management's Discussion & Analysis

This Management's Discussion and Analysis ("MD&A") of financial condition and results of operations of Terra Energy Corp. ("Terra Energy Corp." or the "Corporation") is dated May 16, 2006. It should be read in conjunction with the unaudited interim consolidated financial statements and corresponding notes for the periods ended March 31, 2006 and March 31, 2005 and with the audited year end consolidated financial statements of the Corporation for the years ended December 31, 2005 and December 31, 2004.

Terra Energy's Board of Directors and Audit Committee have reviewed and approved the March 31, 2006 interim consolidated financial statements and related MD&A.

All references to dollar values refer to Canadian dollars unless otherwise stated.

This MD&A provides certain financial measures that do not have a standardized meaning prescribed by Canadian generally accepted accounting principles ("GAAP"). These non-GAAP financial measures may not be comparable to similar measures presented by other issuers.

This MD&A contains the terms "cash flow from operations" and "cash flow from operations per share", which should not be considered an alternative to, or more meaningful than, cash flow from operating activities as determined in accordance with Canadian generally accepted accounting principles as an indicator of the Corporation's performance. Cash flow from operations per share is calculated using the same weighted average basic and diluted number of shares outstanding used in the calculation of net income (loss) per share. All references to cash flow throughout this MD&A are based on cash flow before changes in non-cash working capital.

Petroleum and natural gas volumes are converted to an equivalent measurement basis referred to as a "barrel of oil equivalent" ("boe") using a conversion rate of six thousand cubic feet of natural gas to one barrel of oil ("6:1"). The 6:1 conversion ratio is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead. Readers are cautioned that boe figures may be misleading, particularly if used in isolation.

The continuous disclosure materials of the Corporation, including its annual MD&A and audited financial statements, Information Circular and Proxy Statement, material change reports and press releases issued by the Corporation are available through the SEDAR system at www.sedar.com.

FORWARD LOOKING ADVISORY

Statements in this document may contain forward-looking information. Such information is subject to known and unknown risks, uncertainties and other factors that could influence actual results or events, and cause actual results or events to differ materially from those stated, anticipated or implied in the forward looking information. As such, readers are cautioned not to place undue reliance on the forward- looking information, as no assurances can be provided as to future results, levels of activity or achievements. Terra Energy assumes no obligation to update forward-looking statements should circumstances or management's estimates change. In addition, the read is cautioned that historical results are not necessarily indicative of future performance.

DISCLOSURE CONTROLS AND PROCEDURES

Disclosure controls and procedures are designed to provide reasonable assurance that information required to be disclosed is recorded, processed, summarized and reported with the time periods specified by securities regulations and that information required to be disclosed is accumulated and communicated to management.

The Chief Executive Officer and Chief Financial Officer have evaluated the effectiveness of the Corporation's disclosure controls and procedures as of March 31, 2006 and have concluded that they are adequate and effective to ensure accurate and complete disclosure.

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CORPORATE HISTORY

Terra Energy is a publicly traded corporation, amalgamated under the Business Corporations Act of Alberta, and formed as a result of the amalgamation of Terra Energy Corp., Terrapet Energy Corp., and Rhodes Resources Corp. on January 30, 2004. This Management Discussion and Analysis along with the associated financial statements referenced above include the accounts of the Corporation and its wholly-owned subsidiary Constar Resources Ltd. and Terra Energy, a general partnership between Terra Energy Corp. and Constar Resources Ltd.

The Corporation's principal business is the exploration, development and production of petroleum and natural gas in Western Canada.

SELECTED QUARTERLY INFORMATION

Financial

<i>for the three months ended March 31</i>	2006	2005	% Growth
Revenue	\$ 11,787,550	\$ 7,932,681	48.6%
Cash Flow From Operations	\$ 5,068,870	\$ 3,809,611	33.1%
Earnings	\$ (230,410)	\$ (993,724)	76.8%
Weighted Average Shares – Basic	70,376,376	49,449,711	42.3%
Weighted Average Shares – Diluted	72,551,972	51,284,179	41.5%
Shares at Quarter End – Basic	71,433,708	52,321,172	36.5%
Shares at Quarter End – Diluted	87,329,849	67,532,814	29.3%

Operational

<i>for the three months ended March 31</i>	2006	2005	% Growth
Production			
Average Daily Production (boe/d)	2,486	2,155	15.4%
Exit Production (boe/d)	3, 225	2,591	28.3%
Undeveloped Land			
Undeveloped Land (Net Acres)	108,810	84,458	28.8%
Wells Drilled			
Gross	6.0	5.0	20.0%
Net	5.04	1.69	198.2%

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RESULTS OF OPERATIONS

Production

Three months ended March 31	2006	2005	% Growth
	Average	Average	
Oil (bbl/d)	353	532	(33.6%)
Natural Gas (mcf/d)	10,902	9,384	16.2%
Liquids (bbl/d)	316	59	435.6%
Combined (boe/d)	2,486	2,155	15.4%

Operations

Three months ended March 31	2006	2005	2006	2005	% Growth
			(\$ / boe)	(\$ / boe)	(\$ / boe)
Revenues	\$11,787,550	\$ 7,932,681	\$ 52.68	\$ 40.90	28.8%
Royalties	2,363,529	984,507	10.56	5.08	107.9%
Production Expenses	3,023,642	2,000,190	13.51	10.31	31.0%
Operating Netback	6,400,379	4,947,984	28.61	25.51	12.2%
General & Administrative expenses	1,129,064	786,695	5.05	4.06	24.4%
Interest Expense	418,314	351,678	1.87	1.81	3.3%
Realized Foreign Exchange (gain) loss	(48,498)	-	(0.22)	-	n/a
Non-cash Expenses	4,448,678	5,254,890	19.88	27.09	(26.6%)
Income Before Income taxes	452,821	(1,445,279)	2.02	(7.45)	(127.1%)
Income Tax Expense (recovery)	683,231	(451,555)	3.05	(2.33)	(231.2%)
Net Income (loss)	\$ (230,410)	\$ (993,724)	\$ (1.03)	\$ (5.12)	79.9%
Per Share – Basic	\$ (0.00)	\$ (0.02)			
Per Share - Diluted	\$ (0.00)	\$ (0.02)			

Revenue

Revenue increased 48.6% to \$11,780,550 in Q1 – 2006 compare to \$7,932,681 in Q1 – 2005 through a combination of higher production volumes and higher commodity prices. Terra Energy realized an all in price per unit of production of \$52.68, up 28.8% from 2005.

Three Months Ended March 31	2006	2005	2006	2005	% Change
			(\$ / boe)	(\$ / boe)	(\$ / boe)
Revenue	\$ 11,787,550	\$ 7,932,681	\$ 52.68	\$ 40.90	28.8%

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Below is a breakdown of prices realized by the Corporation:

<i>Three months ended March 31</i>	2006
Crude Oil (\$ / bbl)	\$ 65.79
Natural Gas Liquids (\$ / bbl)	\$ 54.08
Natural Gas (\$ / mcf)	\$ 8.13
Combined (\$ / boe)	\$ 52.68

Factors affecting Terra Energy's realized price in Q1 – 2006 include:

- Assets acquired at December 31, 2004 required Terra Energy to assume an established sales contract committing approximately 2.0 mmcf per day of sales gas. Revenues received by Terra Energy under this assumed contact were significantly lower than market. This contract was terminated in Q4 – 2005. The termination of the contract allowed the contracted natural gas to receive spot prices in Q1 – 2006.
- In December 2003, the Corporation entered into two financial contracts to hedge a total of 200 barrels of crude oil per day at an average price of \$36.00 per barrel for a period from January 1, 2005 to December 31, 2005. With the maturity of these contracts, all crude oil production was sold at market prices in Q1 – 2006.
- In December 2005, Terra Energy divested approximately 150 bbls/d of medium / heavy crude oil production. Medium / heavy crude oil has a price differential from light crude which lowered the realized price for Terra Energy's crude oil production. In Q1 – 2006, the majority of crude oil production was light oil, which increased the realized price for Terra Energy's crude oil sales.

With the maturity of the out of the money financial hedges, Terra Energy sold the majority of its natural gas and crude oil production at spot market prices during the quarter. With commodity prices expected to remain strong Terra Energy expects its realized commodity price to remain high for the balance of 2006.

Royalties

<i>Three Months Ended March 31</i>	2006	<i>2005</i>	2006	<i>2005</i>	% Change
			(\$ / boe)	(\$ / boe)	(\$ / boe)
Royalties	\$ 2,363,529	\$ 984,507	\$ 10.56	\$ 5.08	107.9%

Royalties increased 140.1% to \$2,363,529 in 2006 compared to \$984,507 in Q1 – 2005 as a result of an increase in revenue. On a per unit of production basis, royalties increased 107.9% to \$10.56 in Q1 – 2006 from \$5.08 in Q1 – 2005. The increase in royalties on a per unit of production basis related to a combination of an increase in royalty rates due to the Corporation's new production coming from higher deliverability wells as well as an underaccrual of royalties in Q1 – 2005. Terra Energy's effective royalty rate on revenues was 20.1% in Q1 - 2006. The royalty rate in Q1 - 2006 is consistent with the Corporations royalty rate of 20.6% at December 31, 2005.

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Production Expenses

Three Months Ended March 31	2006	2005	2006	2005	% Change
			(\$ / boe)	(\$ / boe)	(\$ / boe)
Production Expense	\$ 3,023,642	\$ 2,000,190	\$ 13.51	\$ 10.31	31.0%

Production expenses increased 51.2% to \$3,023,642 in Q1 – 2006 as a result of higher production volumes and an overall general increase in operating costs. On a per unit of production basis, Q1 – 2006 production expenses were \$13.51. This is an increase of \$3.20 on a per unit of production basis compared to Q1 – 2005 but is a decrease of \$3.73 from the 2005 average of \$17.24. Production expenses peaked in Q3 – 2005 as a result of workovers, repairs and maintenance expenses associated with the Wilder asset acquisition. Q4 – 2005 saw production expenses decrease to \$14.92 on a per unit of production basis. This trend of lowering production expenses has continued into Q1 – 2006 and is expected to continue throughout the remainder of 2006 as discussed below.

During Q1 – 2006, Terra Energy benefited from having new production processed at the Corporation's underutilized natural gas facilities at Red Creek. Terra Energy added a new compressor at Red Creek in December 2005 which allowed for an increase in throughput capacity from 500 mcf per day to approximately 5,500 mcf per day of capacity at the plant by the end of Q1 – 2006. The incremental production processed at the Corporation's Red Creek facility did not result in a significant increase in operating costs of the plant thus enabling costs to be expensed over a larger production base which in turn reduced operating costs on a per unit of production basis quarter over quarter.

With the increase in production at the end of Q1 – 2006 through the completion of a 17 km natural gas pipeline in Septimus, BC, a short tie-in in Mica BC and the tie-in of natural gas wells in Boudreau, BC, Terra Energy expects operating costs on a per unit of production basis to continue to decrease.

As production volumes continue to increase, Terra Energy expects the continuation of lower production expenses to continue for the balance of 2006.

General and Administrative Expenses

Three Months Ended March 31	2006	2005	2006	2005	% Change
			(\$ / boe)	(\$ / boe)	(\$ / boe)
General & Administrative Expenses	\$ 1,129,064	\$ 786,695	\$ 5.05	\$ 4.06	24.4%

General & administrative expenses increased 43.5% to \$1,129,064 in Q1 – 2006 compared to \$786,695 in Q1 – 2005. On a per unit of production basis general & administrative costs increased 24.4% to \$5.05 in Q1 – 2006 compared to \$4.06 in Q1 – 2005. General & Administrative costs increased year over year as Terra Energy significantly increased its management team late in Q1 – 2005 to manage the increased production from the acquisition which closed in December 2004. As a result of higher production and a larger asset base, Terra Energy's insurance, year end audit, and year end engineering fees increased in 2006 compared to 2005.

Terra Energy expects costs on a per unit of production basis to fall in the coming quarters as production increases and overall General & Administrative are not expected to significantly increase to manage the additional production volumes.

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Interest Expense

Three Months Ended March 31	2006	2005	2006	2005	% Change
			(\$ / boe)	(\$ / boe)	(\$ / boe)
Interest Expenses	\$ 418,314	\$ 351,678	\$ 1.87	\$ 1.81	3.3%

Interest Expenses increased 18.9% to \$418,314 in Q1 – 2006 compared to \$351,678 in Q1 – 2005. On a per unit of production basis Interest Expenses increased 3.3% to \$1.87 compared to \$1.81 in Q1 – 2005.

Interest Expenses increased as a result of higher indebtedness levels during Q1 – 2006 compared to Q1 – 2005. The increase in indebtedness was required to finance the Q1 – 2006 capital expenditure program. The Corporation was required to pay additional interest charges on our indebtedness as a result of higher interest rates.

Non Cash Expenses

Three months ended March 31	2006	2005	2006	2005	% Growth
			(\$ / boe)	(\$ / boe)	(\$ / boe)
Depletion and Amortization	\$ 3,174,836	\$ 2,040,000	\$ 14.19	\$ 10.52	39.4%
Accretion Expense	105,500	90,390	0.47	0.47	0.0%
Stock Based Compensation	1,393,309	155,000	6.23	0.80	678.4%
Unrealized foreign exchange (gain) loss	(224,967)	-	(1.01)	-	n/a
Financing Fee Amortization	-	2,969,500	-	15.31	n/a
Total Non Cash Items	\$ 4,448,678	\$ 5,254,890	\$ 19.88	\$ 27.10	(26.6%)

Non Cash Expenses decreased 15.3% to \$4,448,678 in Q1 – 2006 compared to \$5,254,890 in Q1 – 2005. On a per unit of production basis Non Cash Expenses decreased 26.6% to \$19.88 in Q1 – 2006 compared to \$27.10 in Q1 – 2005.

Non Cash Expenses were higher in 2005 as a result of a \$2,969,500 financing fee required to be expensed by the Corporation in Q1 – 2005 relating to the payback of a standby mezzanine credit facility put in place to assist with the purchase of certain petroleum and natural gas assets.

Depletion and amortization and accretion expenses increased as a result of higher production in Q1 – 2006 compared to Q1 – 2005.

Stock based compensation increased in Q1 – 2006 as a result of Terra Energy granting replacement stock options to employees for options exercised during the quarter. The exercise price of the replacement options reflected the closing price of Terra Energy's shares at the date of issue as in accordance to the Corporation's stock option plan. Although the total number of options granted did not increase due to the issuance of the replacement stock options, Terra Energy is required to expense the total non cash value of the stock options using the Black-Scholes pricing model in the period.

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Income Taxes

Three Months Ended March 31	2006	2005	2006	2005	% Change
			(\$ / boe)	(\$ / boe)	(\$ / boe)
Current Tax	\$ 10,574	-	\$ 0.05	-	n/a
Future Tax (recovery)	672,657	(451,555)	3.01	(2.33)	n/a
Total Income Taxes	\$ 683,231	\$ (451,555)	\$ 3.05	\$ (2.33)	n/a

Income taxes increased in Q1 – 2006 to \$672,657 from a recovery of \$451,555 in Q1 – 2005. The increase in future taxes relates to the inability of Terra Energy to deduct stock based compensation from income for tax purposes.

With approximately \$107,000,000 in tax pools available to Terra Energy at March 31, 2006, the Corporation does not forecast paying any material cash taxes in 2006.

LIQUIDITY AND FINANCIAL CONDITION

	Mar 31, 2006	Dec 31, 2005
Working Capital	\$ (8,649,825)	\$ (759,450)
Oil and gas properties	\$ 122,859,739	\$ 103,561,874

The working capital deficit at March 31, 2006 was \$8,649,825. The majority of the working capital deficit relates to an accrual of approximately \$10,029,000 in capital expenditures incurred during the first quarter for which invoices had not yet been received by the Corporation. With the slow-down of capital expenditures expected in Q2 – 2006 as a result of spring break-up and road bans, and the approximately \$9,573,000 in warrant proceeds Terra Energy expect to realize upon the expiration of approximately 4,559,000 in warrants in early Q3 – 2006 and higher production volumes, Terra Energy is confident we have sufficient liquidity available to finance our day to day operations and our 2006 CAPEX program.

Terra Energy's bank credit facility is structured as a 364 day revolving credit facility with a one year term out. If the credit facility is not renewed at maturity, the Corporation has the ability to repay any amounts outstanding on the credit facility one year from maturity. As a result of this one year repayment feature, Terra Energy has classified its bank credit facility as a long-term financial obligation.

Capitalized resource properties as at March 31, 2006 are \$122,859,739 net of accumulated depletion, compared with \$103,561,874 as at December 31, 2005. Oil and gas properties increased as a result of continued development of oil and gas properties. In Q1 – 2006, the Corporation incurred \$22,367,990 in net capital expenditures broken down as:

Three Months Ended March 31	2006
Exploration	\$ 2,362,482
Development	9,532,468
Undeveloped Land	3,053,218
Geological / Geotechnical	400,434
Facilities	6,748,064
Net Property Acquisitions	-
Other Assets	271,323
Total Capital Expenditures	\$ 22,367,989

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Terra Energy incurred capital expenditures of \$22,367,989, with the majority of the expenditures focused on development drilling, equipping of new wells and the construction of facilities. During Q1 – 2006, Terra Energy drilled a total of six gross (5.04 net) wells, including two exploration wells (2 net) and four development wells (3.04 net).

In Q1 – 2006, Terra Energy completed a 17 km pipeline connecting the Corporation's Septimus field to the Corporation's Wilder gas plant to the North. This pipeline project accounted for the majority of the facilities expenditures for the quarter. Other facilities expenditures included short tie-ins at the Corporation's Mica and Boudreau fields.

Terra Energy financed the Q1 – 2006 CAPEX program through a combination of cash flow, warrant and option proceeds and bank financing. Terra Energy has announced a 2006 CAPEX program of \$66.1mm. The Corporation is confident the Corporation has sufficient cash flow, bank financing and warrant / option exercises to fully fund the 2006 CAPEX program. Terra Energy may, given strong market conditions, divest non-core assets or issue equity as a means of providing further liquidity.

Cash Flow

For the quarter ended March 31, 2006, the Corporation has generated cash flows from operations of \$5,068,870 (\$3,809,611 for the period ended March 31, 2005).

Cash flow from operations ("Cash Flow"), representing cash generated from operating activities before changes in non-cash working capital items, is a non-GAAP measure. Management utilizes Cash Flow as a key measure to assess the ability of the Corporation to finance operating activities and capital expenditures. Additionally, Cash Flow has been described and presented in order to provide shareholders and potential investors with information regarding the Corporation's liquidity and its ability to generate funds to finance its operations. This performance indicator may not be comparable to similar measures used by other companies.

The following table presents the non-GAAP financial measure "cash flow from operations".

<i>Three Months Ended March 31</i>	2006	<i>2005</i>
Net income (loss) for the period	\$ (230,410)	\$ (993,724)
Future tax provision (recovery)	672,657	(451,555)
Accretion expense	105,500	90,390
Stock based compensation	1,393,309	155,000
Financing fee amortization	-	2,969,500
Unrealized gain on financial instruments	(322,535)	-
Realized gain on financial instruments	275,513	-
Depletion and amortization	3,174,836	2,040,000
Cash flow from operations	\$ 5,068,870	\$ 3,809,611

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Capital Resources

The Corporation's share capital is as follows:

	<i>March 31, 2006</i>		<i>December 31, 2005</i>	
	<i>No. of Shares</i>	<i>Amounts</i>	<i>No. of Shares</i>	<i>Amounts</i>
Common Shares	71,433,708	\$59,316,950	68,093,883	\$57,375,841

During the quarter 1,720,425 employee / agent options and 2,153,900 warrants were exercised generating approximately \$1,906,195 and \$3,012,460 in proceeds, respectively. Terra Energy expects further warrant and option exercises for the balance of 2006 as all existing options and warrants were in the money at March 31, 2006 and 4,558,677 Terra Series F warrants maturing early in Q3 – 2006.

Preferred Shares

<i>Date</i>	<i>Series</i>	<i>Shares Outstanding</i>	<i>Dollar Value</i>
March 31, 2006	Series I to V	1,148,641	\$1,148,641
December 31, 2005	Series I to V	1,148,641	\$1,148,641

The holder of these shares has agreed to waive his right to redeem the shares until April 1, 2007.

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OFF-BALANCE SHEET ARRANGEMENTS

As at March 31, 2006, the Corporation had the following financial commodity contracts outstanding:

<i>Contract Type</i>	<i>Floor Price</i>	<i>Ceiling Price</i>	<i>Volumes Per Day</i>	<i>Contract Term</i>
Financial	Sell \$6.50 per GJ	\$7.50 per GJ	1,000 GJ	April 1, 2006 to April 30, 2006
Financial	Sell \$79.60 per Bbl	N/A	100 Bbls	March 1, 2006 to December 31, 2006
Financial	Buy\$76.20 per Bbl	N/A	100 Bbls	March 1, 2006 to December 31, 2006

The fair market value of these contracts has been recorded as an asset in the amount of \$97,567.

The Corporation has the following forward exchange contracts for the US\$ Banker's Acceptances Notes outstanding as at March 31, 2006.

<i>Contract Type</i>	<i>Value</i>	<i>Maturity Date</i>	<i>Forward Exchange Rate</i>
Financial	US\$ 2,000,000	April 19, 2006	\$ 0.8790
Financial	US\$ 2,000,000	May 19, 2006	\$ 0.8790
Financial	US\$ 2,000,000	June 20, 2006	\$ 0.8790
Financial	US\$ 2,000,000	July 20, 2006	\$ 0.8790

The fair market value of \$224,967 has been recorded as an asset and unrealized foreign exchange gain.

Critical Accounting Estimates

In preparing financial statements in accordance with generally accepted accounting principles, management undertakes certain judgments and estimates. Changes in these judgments and estimates could have a material impact on the financial results and condition. The following discussion outlines accounting policies and practices that are critical to determining the Corporation's financial results.

Proved Oil and Gas Reserves

Under Canadian Securities Regulations National Instrument 51-101 "Standards of Disclosure for Oil and Gas Activities" (NI 51-101), "proved" reserves are those reserves that can be estimated with a high degree of certainty to be recoverable (it is likely that the actual remaining quantities recovered will exceed the estimated proved reserves). In accordance with this definition, the level of certainty targeted by the reporting company should result in at least a 90% probability that the quantities actually recovered will equal or exceed the estimated reserves. There was no such consideration of probability under National Policy 2B (NP 2B). In the case of "probable" reserves, which are obviously less certain to be recovered than proved reserves, NI 51-101 states that it must be equally likely that the actual remaining quantities recovered will be greater or less than the sum of the estimated proved plus probable reserves. With respect to the consideration of certainty, in order to report reserves as proved plus probable, the reporting company must believe that there is at least a 50% probability that the quantities actually recovered will equal or exceed the sum of the estimated proved plus probable reserves. The implementation of NI 51-101 has resulted in a more rigorous and uniform standardization of reserve evaluation.

The oil and gas reserve estimates are made using all available geological, reservoir and historical production data. Estimates are reviewed and revised as appropriate. Revisions may occur as a result of changes in prices, costs, fiscal regimes, reservoir performance or a change in the Corporation's plans.

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Ceiling Test

Under the Canadian Institute of Chartered Accountants (CICA) full cost accounting guidelines, the Corporation calculates a ceiling test annually whereby the carrying value of petroleum and natural gas properties is compared to estimated future cash flow from the production of proved reserves. The Corporation has early adopted the requirement of CICA Accounting Guideline 16 "Oil and Gas Accounting - Full Cost" ("AcG 16"). The requirements of the guideline were to be followed for all fiscal years beginning on or after January 1, 2004. At December 31, 2005, the Corporation calculated the ceiling test using AcG 16 without any material adverse impact on the Corporation's financial position or results of operations.

Asset Retirement Obligation

CICA Handbook Section 3110 "Asset Retirement Obligations" requires accrued reclamation and abandonment obligations be recognized on the balance sheet by increasing oil and gas properties offset by a liability of an equal amount. Estimates are required to determine the future obligation. The asset and liability are initially measured at fair value, being the discounted future value of the liability, and then capitalized as part of the cost of the asset and subsequently amortized over the life of the asset. The liability then accretes until the retirement obligation is settled.

Litigation

The Corporation is involved in various claims and litigation arising from the normal course of business. While the outcome of these matters is uncertain and there can be no assurance that such matters will be resolved in the Corporation's favor, the Corporation does not currently believe that the outcome of adverse decisions in any pending or threatened proceeding related to these and other matters or any amount which it may be required to pay by reason thereof, would have a material adverse effect on its financial position or results of operations.

Depletion and Depreciation Expense

Terra Energy uses the full cost method of accounting for exploration and development activities whereby all costs associated with these activities are capitalized, whether successful or not. The aggregate of capitalized costs, net of certain costs related to unproved properties, and estimated future development costs is amortized using the unit-of-production method based on estimated proved reserves. Changes in estimated proved reserves or future development costs have a direct impact on depletion and depreciation expense. Certain costs related to unproved properties and major development projects may be excluded from costs subject to depletion until proved reserves have been assigned, at which point they would be included in the depletion calculation, or for impairment, for which any write-down would be charged to depletion and depreciation expense.

Stock Based Compensation and Share Purchase Warrants

The Corporation calculates the fair value of the options granted and share purchase warrants issued. This calculation is based on estimates which could differ significantly from actual results. This could have a significant impact on the financial statements.

Income Taxes

The determination of Terra Energy's income and other tax liabilities requires interpretation of complex laws and regulations often involving multiple jurisdictions. All tax filings are subject to audit and potential reassessment after the lapse of considerable time. Accordingly, the actual income tax liability may differ significantly from that estimated and recorded.

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Financial Instruments

The Corporation's results are impacted by external market risks associated with fluctuations in commodity prices, operational and safety and environmental risks. The Corporation partially mitigates its exposure to market risks through the use of various financial instruments and physical contracts. The Corporation does not utilize derivative instruments for speculative purposes.

RISK FACTORS RELATING TO OIL AND GAS EXPLORATION, DEVELOPMENT AND PRODUCTION

Uncertain Discovery of Viable Commercial Prospects

The Corporation's future success may be dependent upon its ability to economically locate commercially viable oil or gas deposits. The Corporation can make no representations, warranties or guaranties that it will be able to consistently identify viable prospects, or that such prospects will be commercially exploitable. An inability of the Corporation to consistently identify and exploit commercially viable hydrocarbon deposits would have a material and adverse effect on the Corporation's business and financial position. Exploratory drilling is subject to numerous risks, including the risk that no commercially productive oil and gas reservoirs will be encountered. The cost of drilling, completing and operating wells is often uncertain, and drilling operations may be curtailed, delayed or canceled as a result of a variety of factors, including unexpected formation and drilling conditions, pressure or other irregularities in formations, blowouts, equipment failures or accidents, as well as weather conditions, compliance with governmental requirements and/or shortages or delays in the delivery of equipment. The inability to successfully locate and drill wells that will economically produce commercial quantities of oil and gas could have a material adverse effect on the Corporation's business and financial position. The Corporation's properties are in various stages of exploration and development. Whether the Corporation ultimately drills a property may depend on a number of factors including funding, the receipt of additional seismic data or reprocessing of existing data, material changes in oil or gas prices, the costs and availability of drilling equipment, success or failure of wells drilled in similar formations or which would use the same production facilities, changes in estimates of costs to drill or complete wells, the Corporation's ability to attract industry partners to acquire a portion of its working interest to reduce exposure to drilling and completion costs, decisions of the Corporation's joint working interest owners, and/or restrictions under provincial regulators.

Volatility of Oil and Natural Gas Contracts

The ultimate profitability, cash flow and future growth of the Corporation will be affected by changes in prevailing oil and gas prices. Oil and gas prices have been subject to wide fluctuations in recent years in response to changes in the supply and demand for oil and natural gas, market uncertainty, competition, regulatory developments and other factors which are beyond the control of the Corporation. It is impossible to predict future oil and natural gas price movements with any certainty. An extended or substantial decline in oil and gas prices would have a material adverse effect on (i) the Corporation's access to capital, and (ii) the Corporation's financial position and results of operations.

Increased Operating Costs

Higher operating costs for our underlying properties will directly decrease the amount of cash flow received by the Corporation. Electricity, chemicals, supplies, reclamation and abandonment, and labour costs are a few of the operating costs that are susceptible to material fluctuation.

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Title of Assets

Although the Corporation conducts title reviews in accordance with industry practice prior to any purchase of resource assets, such reviews do not guarantee that an unforeseen defect in the chain on title will not arise and defeat our title to the purchased assets. If such a defect were to occur, our entitlement to the production from such purchased assets could be jeopardized.

Uncertainty of Estimates of Reserves and Future Events

Certain statements included in this report contain estimates of the Corporation's oil and gas reserves and the discounted future net revenues from those reserves, as prepared by independent petroleum engineers. There are numerous uncertainties inherent in such estimates including many factors beyond the control of the Corporation. The estimates are based on a number of assumptions including constant oil and gas prices, and assumptions regarding future production, revenues, taxes, operating expenses, development expenditures and quantities of recoverable oil and gas reserves. Such estimates are inherently imprecise indications of future net revenues, and actual results might vary substantially from the estimates based on these assumptions. Any significant variance in these assumptions could materially affect the estimated quantity and value of reserves. In addition, the Corporation's reserves might be subject to revisions based upon future production, results of future exploration and development, prevailing oil and gas prices and other factors. More over, estimates of the economically recoverable oil and gas reserves, classifications of such reserves and estimates of future net cash flows prepared by independent engineers at different times may vary substantially. Information about reserves constitutes forward-looking statements. Further, the future success of the Corporation depends upon its ability to find, develop and acquire oil and gas reserves that are economically recoverable. As a result, the Corporation must locate, acquire and develop new oil and gas reserves to replace those being depleted by production. Without successful funding for acquisitions and exploration and development activities, the Corporation's reserves will decline. No assurances can be made that the Corporation will be able to find and develop or acquire additional reserves at an acceptable cost.

Competition

The Corporation engages in the highly competitive industry of exploration for and production of oil and gas. The Corporation competes directly and indirectly with major and independent oil and gas companies in its exploration for and development of desirable oil and gas properties. Many companies and individuals are engaged in the business of acquiring interests in and developing oil and gas properties in Canada, and the industry is not dominated by any single competitor or a small number of competitors. Many of such competitors have substantially greater financial, technical, sales, marketing and other resources, as well as greater historical market acceptance than does the Corporation. The Corporation will compete with numerous industry participants for the acquisition of land and rights to prospects, and for the equipment and labor required to operate and develop such prospects. Competition could materially and adversely affect the Corporation's business, operating results and financial condition. Such competitive disadvantages could adversely affect the Corporation's ability to participate in projects with favorable rates of return.

Shortage of Supplies and Equipment

The Corporation's ability to conduct operations in a timely and cost effective manner is subject to the availability of natural gas and crude oil field supplies, rigs, equipment and service crews. Although none are expected currently, any shortage of certain types of supplies and equipment could result in delays in our operations as well as in higher operating and capital costs.

Management's Discussion & Analysis

Interruption From Severe Weather

The Corporation's operations are conducted principally in the central region of Alberta, northeastern British Columbia and Saskatchewan. The weather in these areas can be extreme and can cause interruption or delays in our drilling and construction operations.

Dependence on Third-Party Pipelines

In fiscal 2005, substantially all of Terra Energy's sales of natural gas production were through deliveries to local third-party gathering systems to processing plants. In addition, the Corporation relies on access to interprovincial pipelines for the sale and distribution of substantially all of our gas. As a result, a curtailment of our sale of natural gas by pipelines or by third-party gathering systems, an impairment of our ability to transport natural gas on interprovincial pipelines or a material increase in the rates charged to us for the transportation of natural gas by reason of a change in federal or provincial regulations or for any other reason, could have a material adverse effect upon us. In such event, we would have to obtain other transportation arrangements. There can be no assurance that we would have economical transportation alternatives or that it would be feasible for us to construct pipelines. In the event such circumstances were to occur, our netbacks from the affected wells would be suspended until, and if, such circumstances could be resolved.

Operating Hazards and Uninsured Risks

The oil and gas business involves a variety of operating risks, including fire, explosion, pipe failure, casing collapse, abnormally pressured formations, adverse weather conditions, governmental and political actions, premature reservoir declines and environmental hazards such as oil spills, gas leaks and discharges of toxic gases. The occurrence of any of these events with respect to any property operated or owned (in whole or in part) by us could have a material adverse impact on us. The Corporation and the operators of our properties, maintain insurance in accordance with customary industry practices and in amounts that we believe to be reasonable. However, insurance coverage is not always economically feasible and is not obtained to cover all types of operational risks. The occurrence of a significant event that is not insured or insured fully could have a material adverse effect on our financial condition.

Restoration, Safety and Environmental Risks

Our operations are in Saskatchewan, Alberta and British Columbia. Certain laws and regulations exist that require companies engaged in petroleum activities to obtain necessary safety and environmental permits to operate. Such legislation may restrict or delay us from conducting operations in certain geographical areas. Further, such laws and regulations may impose liabilities on us for remedial and clean-up costs, personal injuries related to safety and environmental damages, such liabilities collectively referred to as "asset retirement obligations".

Expiration of Licenses and Leases

The Corporation's properties are held in the form of licenses and leases and working interests in licenses and leases. If the Corporation or the holder of the license or lease fails to meet the specific requirement of a license or lease, the license or lease may terminate or expire. There can be no assurance that any of the obligations required to maintain each license or lease will be met. The termination or expiration of the Corporation's licenses or leases or the working interests relating to a license or lease may have a material adverse effect on the Corporation's results of operations and business.

Management's Discussion & Analysis

Canadian Government Regulation and Industry Conditions

The Kyoto protocol, ratified by the Canadian federal government in December 2002, came into force on February 16, 2005. The protocol commits Canada to reducing greenhouse gas emissions to six percent below 1990 levels over the period 2008-2012. The Canadian government released a framework outlining its Climate Change action plan on April 13, 2005. The plan contains few technical details regarding the implementation of the government's greenhouse gas reduction strategy. The Climate Change Working Group of the Canadian Association of Petroleum Producers continues to work with the Canadian and Alberta governments to develop an approach for implementing targets and enabling greenhouse gas control legislation, which protects the industry's competitiveness, limits the cost and administrative burden of compliance and supports continued investment in the sector. As the Canadian government has yet to release a detailed Kyoto compliance plan, the Corporation is unable to predict the impact of potential regulations upon its business; however, it is possible that the Corporation would face increases in operating costs in order to comply with the greenhouse gas emissions legislation.

Canadian Government Regulation and Environmental Matters

The oil and natural gas industry is subject to extensive controls and regulations imposed by various levels of the federal and provincial governments of Canada. It is not expected that any of these controls or regulations will affect the operations of the Corporation in a manner materially different than they would affect other oil and gas companies of similar size. All current legislation is a matter of public record and the Corporation is unable to accurately predict what additional legislation or amendments may be enacted. All of the governmental regulations noted below may be changed from time to time in response to economic or political conditions. The Corporation's management believes that the trend of more expansive and stricter environmental laws and regulations will continue. The implementation of new or modified environmental laws or regulations could have a material adverse impact on the Corporation.

The Corporation is subject to various Canadian federal and provincial laws and regulations relating to the environment. The Corporation believes that it is currently in compliance with such laws and regulations. However, such laws and regulations may change in the future in a manner which will increase the burden and cost of compliance. In addition, the Corporation could incur significant liability under such laws for damages, clean-up costs and penalties in the event of certain discharges into the environment. In addition, environmental laws and regulations may impose liability on the Corporation for personal injuries, clean-up costs, environmental damage and property damage as well as administrative, civil and criminal penalties. The Corporation maintains limited insurance coverage for accidental environmental damages, but does not maintain insurance for the full potential liability that could be caused by such environmental damage. Accordingly, the Corporation may be subject to significant liability, or may be required to cease production in the event of the noted liabilities.

Provincial Regulation – Royalties Incentives and Land Tenures

In addition to federal regulations, each province has regulations which govern land tenure, royalties, production rates, extra-provincial export, environmental protection and other matters. The royalty regime is a significant factor in the profitability of oil and natural gas production. Royalties payable on production from lands other than Crown lands are determined by negotiations between the mineral owner and the lessee. Crown royalties are determined by government regulation and are generally calculated as a percentage of the value of the gross production. The rate of royalties payable generally depends in part on prescribed reference prices, well productivity, geographical location, field discovery date and the type or quality of the petroleum product produced. From time to time the provincial governments of Canada have established incentive programs which have included royalty rate reductions, royalty holidays and tax credits for the purpose of encouraging oil and natural gas exploration or enhanced planning projects. Crude oil and natural gas located in the western provinces is owned predominantly by the respective provincial governments. Provincial governments grant rights to explore for and produce oil and natural gas pursuant to leases, licenses and permits for varying terms from two years and on conditions set forth in provincial legislation including requirements to perform specific work or make payments. Oil and natural gas located in such provinces can also be privately owned and rights to explore for and produce such oil and natural gas are granted by lease on such terms and conditions as may be negotiated.

Terra Energy Corp.
Consolidated Interim Financial Statements
For the period ended March 31, 2006
(Unaudited)

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Consolidated Balance Sheet

(Unaudited)

	March 31, 2006	December 31, 2005
ASSETS		
Current		
Cash and cash equivalents	\$ 3,877,157	\$ 13,127,316
Accounts receivable	7,736,472	7,972,458
Financial instruments (Note 10)	322,535	275,513
Prepaid expenses	1,765,887	810,347
	13,702,051	22,185,634
Oil and gas properties	122,859,739	103,561,874
	\$ 136,561,790	\$ 125,747,508
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current		
Accounts payable and accrued liabilities	\$ 22,351,876	\$ 22,942,084
Long-term financing (Note 3)	35,105,320	29,610,391
Asset retirement obligations (Note 7)	4,787,585	4,577,373
Future income taxes	8,861,735	3,934,690
Preferred shares	1,148,641	1,148,641
	72,255,157	62,213,179
SHAREHOLDERS' EQUITY		
Share capital (Note 5)	62,100,279	60,984,212
Contributed surplus (Note 6)	4,300,451	3,809,311
Deficit	(2,094,097)	(1,259,194)
	64,306,633	63,534,329
	\$ 136,561,790	\$ 125,747,508

Commitments and Contingencies (Note 12)

Approved on behalf of the Board:



Robert Penner, Director



Theodore Anderson, Director

The accompanying notes are an integral part of these consolidated financial statements.

Consolidated Statements of Operations and Deficit (Unaudited)

<i>For the three months ended March 31</i>	2006	2005
REVENUE		
Petroleum and natural gas revenues (Note 9)	\$ 11,787,550	\$ 7,932,681
Royalties	(2,363,529)	(984,507)
	9,424,021	6,948,174
EXPENSES		
Production	3,023,642	2,000,190
Depletion, depreciation and amortization	3,174,836	2,040,000
Financing fee amortization (Note 4)	-	2,969,500
General and administrative	1,129,064	786,695
Stock based compensation	1,393,309	155,000
Interest charges (Note 8)	418,314	351,678
Accretion of asset retirement obligation	105,500	90,390
Realized foreign exchange gain	(48,498)	-
Unrealized foreign exchange gain	(224,967)	-
	8,971,200	8,393,453
Income (loss) before income taxes	452,821	(1,445,279)
Income taxes (recovery)		
Current tax	10,574	-
Future tax (recovery)	672,657	(451,555)
	683,231	(451,555)
Net loss for the period	(230,410)	(993,724)
Deficit, beginning of period	(1,259,194)	(1,711,273)
Repurchase of common shares	(604,493)	-
Deficit, end of period	\$ (2,094,097)	\$ (2,704,997)
Earnings (loss) per common share – basic and diluted	\$ -	\$ (0.02)
Weighted average number of shares outstanding - basic	70,376,376	49,499,711
Weighted average number of shares outstanding - diluted	72,551,972	51,284,179

The accompanying notes are an integral part of these consolidated financial statements.

Consolidated Statements of Cash Flows (Unaudited)

<i>For the three months ended March 31</i>	2006	2005
CASH FLOWS FROM OPERATING ACTIVITIES		
Net loss for the period	\$ (230,410)	\$ (993,724)
Items not affecting cash:		
Depletion, depreciation and amortization	3,174,836	2,040,000
Future income taxes (recovery)	672,657	(451,555)
Stock based compensation	1,393,309	155,000
Accretion of asset retirement obligations	105,500	90,390
Unrealized gain on financial instruments	(322,535)	-
Realized gain on financial instruments	275,513	-
Financing fee amortization	-	2,969,500
Cash flow from operations	5,068,870	3,809,611
Changes in non-cash working capital from operations	1,339,502	(3,510,363)
	6,408,372	299,248
CASH FLOWS FROM FINANCING ACTIVITIES		
Issuance of share capital, net of share issuance costs	4,918,655	12,268,935
Proceeds from (repayment of) revolving line of credit	5,494,929	(1,145,855)
Repayment of subordinated debt	-	(10,000,000)
Repurchase of common shares	(1,054,862)	-
	9,358,722	1,123,080
CASH FLOWS FROM INVESTING ACTIVITIES		
Additions to oil and gas properties	(22,367,989)	(1,196,029)
Changes in non-cash working capital from investing	(2,649,264)	-
	(25,017,253)	(1,196,029)
Increase (decrease) in cash and cash equivalents	(9,250,159)	226,299
Cash and cash equivalents (bank overdraft), beginning of period	13,127,316	(295,529)
Cash and cash equivalents (bank overdraft), end of period	\$ 3,877,157	\$ (69,230)

The accompanying notes are an integral part of these consolidated financial statements.

Notes to Consolidated Financial Statements

Note 1 NATURE OF OPERATIONS

Terra Energy Corp. (the "Corporation") was formed on January 30, 2004 as a result of the amalgamation of Rhodes Resources Corp. ("Rhodes"), Terrapet Energy Corp. ("Terrapet"), and Terra Energy Corp ("Terra") pursuant to the Business Corporations Act of Alberta. The amalgamated Corporation operates under the name Terra Energy Corp. The Corporation's principal business is the exploration, development, and production of oil and natural gas in Western Canada.

The amalgamation has been recorded as a reverse takeover by Terrapet and the comparative financial statements represent a continuation, for accounting purposes, of the financial statements of Terrapet and its subsidiaries ("Terrapet Consolidated").

Note 2 SIGNIFICANT ACCOUNTING POLICIES

The interim consolidated financial statements of Terra Energy Corp. have been prepared by management in accordance with Canadian generally accepted accounting principles. The interim consolidated financial statements have been prepared following the same accounting policies and methods of computation as the consolidated financial statements for Terra Energy Corp. for the year ended December 31, 2005. The interim consolidated financial statements should be read in conjunction with the audited consolidated financial statements of Terra Energy Corp. and the notes thereto for the year ended December 31, 2005.

Note 3 LONG-TERM FINANCING

At March 31, 2006, the Corporation was indebted on the revolving line of credit in amount of \$35,105,320.

The Corporation's bank credit facility is structured as a 364 day revolving credit facility with a one year term out. If the credit facility is not renewed at maturity, the Corporation is required to pay the outstanding balance one year from the maturity. The credit facility is subject to a renewal in July 2006. As a result the liability has been classified as a non-current liability. In addition, the credit facility includes a change of control clause whereby in the event of any change of control, the creditor, at their discretion, may terminate the credit facility and therefore the entire amount outstanding will be due and payable upon demand. As at March 31, 2006 the Corporation was not in compliance with its current ratio financial covenant with respect to its long term financing agreement. Subsequent to March 31, 2006, the Corporation has entered into an agreement with its lender to increase its revolving credit facility from \$40 million to \$55 million. As the result of this agreement the Corporation is now in compliance with all covenants.

Note 4 SUBORDINATED DEBT

The facility charged a standby fee of 5% on the unadvanced portion of \$5.0 million and a closing fee of 0.75% on the advanced portion of \$10.0 million. The Corporation also issued 5 million warrants to the creditor, with each warrant to purchase one common share, at prices between \$1.20 and \$1.60. These warrants were valued at \$2,307,000. These amounts were fully amortized when the facility was repaid in the first quarter of 2005. The facility was secured by a floating charge debenture on the Corporation's assets, subordinated to the Corporation's existing security issued in relation to the Revolving Loan.

Notes to Consolidated Financial Statements

Note 5 SHARE CAPITAL

a) Authorized

- i) Unlimited number of common voting shares
- ii) Unlimited number of preferred shares

b) Issued and Outstanding

	2006	
	Number of Shares	Amounts
Opening balance, beginning of period	68,093,883	\$ 57,375,841
Issued on exercise of warrants	2,153,900	3,012,460
Issued on exercise of options	1,720,425	1,906,195
Tax effect of flow-through share renouncement	-	(4,254,388)
Reclassification of warrants	-	825,042
Reclassification of contributed surplus	-	902,169
Shares repurchased for cancellation	(534,500)	(450,369)
Closing balance, common shares	71,433,708	59,316,950
Share purchase warrants		
Opening balance, beginning of period	7,752,277	3,608,371
Exercised	(2,092,900)	(825,042)
Closing balance, warrants	5,659,377	2,783,329
Closing balance, common shares and warrants	77,093,085	\$ 62,100,279

During the three months ended March 31, 2006, 534,500 shares were repurchased for \$1,054,862 at an average price of \$1.97 per common share. The Corporation recorded \$450,369 as a reduction of share capital and the excess of \$604,493 being charged to deficit.

As at March 31, 2006, 1,427,900 repurchased shares are held for cancellation. Subsequent to March 31, 2006, 644,000 repurchased shares were cancelled.

c) Stock Options

During 2005, the Corporation amended its Employee Stock Option Plan whereby officers, directors, employees, and consultants may be granted options of up to 10 percent of the issued and outstanding common shares of the Corporation. These options entitle the holder to purchase common shares of the Corporation subject to various vesting periods and other terms and conditions specified in the stock option plan.

Notes to Consolidated Financial Statements

Note 5 SHARE CAPITAL (continued)

c) Stock Options (continued)

Details of all options outstanding are as follows:

	2006	
	Number of Options	Weighted Average Exercise Price
EMPLOYEE STOCK OPTIONS		
Balance, beginning of period	4,201,000	\$ 1.24
Granted	1,786,000	1.81
Exercised	(1,306,000)	(1.02)
Balance, end of period	4,681,000	1.52
AGENT OPTIONS		
Balance, beginning of period	1,383,209	1.40
Exercised	(414,425)	(1.40)
Balance, end of period	968,784	1.40
OTHER OPTIONS		
Balance, beginning and end of period	329,730	1.21
Total Options, balance, end of period	5,979,514	\$ 1.48

Notes to Consolidated Financial Statements

Note 5 SHARE CAPITAL (Continued)

c) Stock Options (continued)

Options Exercise Price	Weighted Average Remaining Contract Life	Outstanding March 31, 2006	Weighted Average Share Price for Outstanding Options	Exercisable March 31, 2006	Weighted Average Share Price for Exercisable Options
\$1.00	2.83 years	768,000		314,000	
\$1.00	3.30 years	222,000		62,000	
\$1.15	3.82 years	312,000		72,000	
\$1.21	0.75 years	329,730		329,730	
\$1.40	0.41 years	77,075		77,075	
\$1.40	0.75 years	236,780		236,780	
\$1.40	0.83 years	654,929		654,929	
\$1.51	4.22 years	1,248,000		422,100	
\$1.60	4.23 years	60,000		12,000	
\$1.66	2.88 years	668,000		668,000	
\$1.66	3.88 years	32,000		32,000	
\$1.70	4.71 years	18,000		3,600	
\$1.82	2.86 years	25,000		25,000	
\$1.89	4.51 years	222,000		44,400	
\$1.89	4.86 years	210,000		42,000	
\$1.90	4.82 years	300,000		60,000	
\$1.90	2.87 years	300,000		300,000	
\$1.94	4.22 years	106,000		106,000	
\$1.94	2.87 years	120,000		120,000	
\$2.01	4.78 years	25,000		5,000	
\$2.02	4.63 years	10,000		2,000	
\$2.10	4.65 years	35,000		7,000	
	3.06 years	5,979,514	\$ 1.48	3,595,614	\$ 1.50

d) Stock -based Compensation

For stock options granted compensation expense of \$1,393,309 has been recorded for the period ended March 31, 2006 (\$155,000 – March 31, 2005) with the offsetting amount recorded in contributed surplus. The fair value of share options issued during first quarter of 2006 was estimated using the Black-Scholes option-pricing model with the following assumptions: Dividend yield (Nil); expected volatility at 66%; risk-free interest rate of 4.0%; weighted average life of 3.06 years.

Notes to Consolidated Financial Statements

Note 5 SHARE CAPITAL (continued)

e) Warrants

	<i>Balance Dec 31, 2005</i>	<i>Issued</i>	<i>Exercised</i>	<i>Expired</i>	<i>Balance Mar 31, 2006</i>
The Corporation issued in exchange for warrants previously granted by Rhodes Resources Corp., the following warrants:					
RHODES SERIES C WARRANTS					
These warrants are exercisable at \$1.10 per common share until January 29, 2005 and at \$1.20 per share until January 29, 2006 at which time these warrants expire.	43,000	-	33,000	10,000	-
Total Rhodes warrants	43,000	-	33,000	10,000	-
During 2004, the Corporation issued the following warrants:					
2004 TERRA SERIES B					
These warrants were issued in conjunction with the Subordinated Debt issued on December 30, 2004 and are exercisable at \$1.40 per common share until June 30, 2007 at which time these warrants will expire.	1,250,000	-	-	-	1,250,000
2004 TERRA SERIES C					
These warrants were issued in conjunction with the Subordinated Debt issued on December 30, 2004 and are exercisable at \$1.40 per common share until December 31, 2006 and at \$1.60 per common share until December 31, 2007 at which time these warrants will expire.	2,500,000	-	-	-	2,500,000
2004 TERRA SERIES D					
Two warrants are required for exercise to purchase one common share at \$1.40 until December 30, 2005 and one common share at \$1.60 until December 30, 2006 at which time these warrants will expire 2005 Terra Series E.	535,250	-	28,000	-	507,250
During 2005, the Corporation issued the following warrants:					
2005 TERRA SERIES E					
These warrants are exercisable at \$1.40 to purchase one common share until January 26, 2006 and at \$1.60 per one common share until January 26, 2007 at which time these warrants will expire.	3,193,600	-	2,092,900	-	1,100,700
2005 TERRA SERIES F					
One warrant is required to purchase one common share at \$2.10 until July 27, 2006 at which time these warrants will expire.	4,558,677	-	-	-	4,558,677
Total Terra Energy warrants	12,037,527	-	2,120,900	-	9,916,627
Total warrants	12,080,527	-	2,153,900	10,000	9,916,627

Notes to Consolidated Financial Statements

Note 6 CONTRIBUTED SURPLUS

Contributed surplus consists of the fair value of both share warrants issued for various financing agreements and for the stock based compensation on employee stock options.

The details of contributed surplus are as follows:

	2006	2005
Balance, beginning of period	\$ 3,809,311	\$ 4,196,192
Stock based compensation	1,393,309	940,000
Agent's options granted	-	275,924
Reclassification resulting from exercise of options and warrants	(902,169)	(1,602,805)
Balance, end of period	\$ 4,300,451	\$ 3,809,311

Note 7 ASSET RETIREMENT

The liability for the expected cash flows required to settle the asset retirement obligations, as reflected in the consolidated financial statements, has been discounted at 9% (2005 – 9%) and the inflation rate used is 2%.

The schedule below is a reconciliation of the Corporation's liability for the period ended March 31, 2006:

	2006	2005
Balance, beginning of period	\$ 4,577,373	\$ 4,021,143
Liabilities disposed	-	(923,126)
Revisions to estimates	(31,208)	(810,062)
Liabilities incurred	135,920	1,911,470
Accretion expenses	105,500	377,948
Balance, end of period	\$ 4,787,585	\$ 4,577,373

Note 8 INTEREST CHARGES

Interest charges consist of the following amounts:

<i>Period ended March 31</i>	2006	2005
Interest on revolving line of credit	\$ 58,131	\$ 167,615
Interest on banker's acceptances	337,210	-
Interest on preferred shares	22,973	22,972
Interest on subordinated debt	-	161,091
	\$ 418,314	\$ 351,678

Notes to Consolidated Financial Statements

Note 9 REVENUE

As at March 31, 2006 petroleum and natural gas revenues include realized gain on financial instruments of \$557,306 of which \$275,513 related to 2005 and unrealized gain on financial instruments of \$97,567.

Note 10 FINANCIAL INSTRUMENTS

As at March 31, 2006, the Corporation had the following financial commodity contracts outstanding:

<i>Contract Type</i>	<i>Floor Price</i>	<i>Ceiling Price</i>	<i>Volumes Per Day</i>	<i>Contract Term</i>
Financial	Sell \$6.50 per GJ	\$7.50 per GJ	1,000 GJ	April 1, 2006 to April 30, 2006
Financial	Sell \$79.60 per Bbl	N/A	100 Bbls	March 1, 2006 to December 31, 2006
Financial	Buy \$76.20 per Bbl	N/A	100 Bbls	March 1, 2006 to December 31, 2006

The fair market value of these contracts has been recorded as an asset in the amount of \$97,567.

The Corporation has the following forward foreign exchange contracts for the US dollar Banker's Acceptances Notes outstanding as at March 31, 2006.

<i>Contract Type</i>	<i>Value</i>	<i>Maturity Date</i>	<i>Forward Exchange Rate</i>
Financial	US\$ 2,000,000	April 19, 2006	\$ 0.8790
Financial	US\$ 2,000,000	May 19, 2006	\$ 0.8790
Financial	US\$ 2,000,000	June 20, 2006	\$ 0.8790
Financial	US\$ 2,000,000	July 20, 2006	\$ 0.8790

The fair market value of \$224,967 has been recorded as an asset and unrealized foreign exchange gain.

Note 11 RELATED PARTY TRANSACTIONS

The Corporation had the following related party transactions:

a) The Corporation entered into transactions with the following related parties:

Capital Strategies Group (Canada) Corp., controlled by two officers of the Corporation
Rhodes Petroleum Corp., controlled by an officer of the Corporation
Terra Capital Corp., a significant shareholder (32%)
Pioneer Land Services Ltd. – a Director is an employee of Pioneer
Borden Ladner Gervais LLP – a Director is partner with the law firm
Fasken Martineau DuMoulin LLP – the Corporate Secretary is partner with the law firm

Notes to Consolidated Financial Statements

Note 11 RELATED PARTY TRANSACTIONS *(continued)*

b) Transactions

	2006	2005
EXPENSES		
Service fees – Terra Capital Corp	\$ -	\$ 18,000
Consulting – Pioneer Land Services Ltd.	4,859	9,642
Legal Consulting – Borden Ladner Gervais LLP	53,520	55,287
	58,379	82,929
OTHER		
Acquisition of P&NG equipment recorded as oil and gas properties	-	60,000
Recorded as part of share issuance cost – Borden Ladner Gervais LLP	-	109,732
Recorded as part of oil and gas properties – Pioneer Land Services Ltd.,	22,440	62,491
	\$ 22,440	\$ 232,223

Note 12 COMMITMENTS AND CONTINGENCIES

- a) The Corporation had outstanding letters of credit to various parties for a total of \$611,155 (2005- \$561,155) which expire at various dates during 2006.
- b) The Corporation is involved in various claims and litigations arising in the normal course of business. While the outcome of these matters is uncertain and there can be no assurance that such matters will be resolved in the Corporation's favour, the Corporation does not currently believe that the outcome of adverse decisions in any proceedings related to these matters or any amount which it may be required to pay of would have a material adverse impact on its financial position, results of operations or liquidity.
- c) The Corporation is required to incur exploration and development activities by December 31, 2006 of approximately \$12,512,905 as a result of flow through shares issued in 2005. At March 31, 2006, the Corporation has incurred qualifying expenditures of approximately \$11,047,000 towards this obligation.
- d) The Corporation has firm transportation and processing contracts expiring between October 31, 2006 and 2009. The monthly transportation and processing fees pursuant to the contacts are approximately \$238,600.

Notes to Consolidated Financial Statements

Note 13 SUBSEQUENT EVENT

On April 19, 2006, the Corporation entered into the following forward foreign exchange contracts for the US dollar Banker's Acceptances Notes.

<i>Contract Type</i>	<i>Value</i>	<i>Maturity Date</i>	<i>Forward Exchange Rate</i>
Financial	US\$ 2,000,000	June 20, 2006	\$ 0.8813
Financial	US\$ 3,000,000	July 7, 2006	\$ 0.8813
Financial	US\$ 2,000,000	July 20, 2006	\$ 0.8813
Financial	US\$ 4,000,000	July 20, 2006	\$ 0.8813
Financial	US\$ 2,000,000	August 21, 2006	\$ 0.8813
Financial	US\$ 3,000,000	September 8, 2006	\$ 0.8813

On April 24, 2006, the Corporation entered into the following financial commodity contract:

<i>Contract Type</i>	<i>Floor Price</i>	<i>Ceiling Price</i>	<i>Volumes Per Day</i>	<i>Contract Term</i>
Financial	\$ 86.00	n/a	200 bbl	June 1, 2006 to May 31, 2007

In April 2006, The Corporation cancelled 644,000 repurchased shares.

Subsequent to March 31, 2006, the Corporation has entered into an agreement with its lender to increase its revolving credit facility from \$40 million to \$55 million.