

**Terra Energy Corp.**  
**Consolidated Financial Statements**  
**For the Three Months ended March 31, 2009**

## Consolidated Balance Sheets

As at March 31 and December 31 (unaudited)

2009

2008

### ASSETS

#### Current

Accounts receivable	\$ 11,073,833	\$ 12,842,594
Prepaid expenses	2,303,191	2,089,828
Other assets (Note 5)	756,268	583,538
	<u>14,133,292</u>	<u>15,515,960</u>

#### Oil and gas properties

143,808,114	137,551,824
<u>\$157,941,406</u>	<u>\$ 153,067,784</u>

### LIABILITIES AND SHAREHOLDERS' EQUITY

#### Current

Bank overdraft (Note 6)	\$ 3,594,393	\$ 4,463,264
Accounts payable and accrued liabilities	14,796,211	17,950,307
Asset retirement obligation	448,992	589,190
	<u>18,839,596</u>	<u>23,002,761</u>

#### Deferred credit

99,645	116,250
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#### Long-term financing (Note 6)

18,319,656	6,315,792
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#### Asset retirement obligation

5,501,108	5,356,504
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#### Future income taxes

23,761,802	23,798,937
<u>66,521,807</u>	<u>58,590,244</u>

### SHAREHOLDERS' EQUITY

#### Share capital and warrants (Note 7)

65,753,404	67,880,302
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#### Contributed surplus (Note 8)

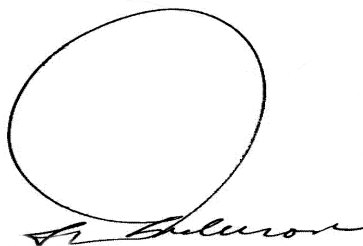
10,455,550	9,680,456
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#### Retained earnings

15,210,645	16,916,782
<u>91,419,599</u>	<u>94,477,540</u>
<u>\$157,941,406</u>	<u>\$ 153,067,784</u>

#### Subsequent event (Note 10)

Approved on behalf of the Board:



Theodore Anderson, Director



Robert Penner, Director

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

## Consolidated Statements of Operations, Comprehensive Loss and Retained Earnings (Deficit)

For the three months ended March 31, (unaudited)

2009

2008

### REVENUE

Petroleum and natural gas	\$ 16,236,381	\$ 20,255,411
Realized loss on financial instruments (Note 3)	-	(254,137)
Unrealized loss on financial instruments (Note 3)	-	(3,035,244)
	16,236,381	16,966,030
Royalties	(3,446,924)	(4,739,441)
	12,789,457	12,226,589

### EXPENSES

Production	5,067,504	4,711,730
General and administrative	1,139,437	1,020,245
Accretion of asset retirement obligation	114,038	118,971
Stock based compensation (Note 7)	837,001	463,173
Depletion and amortization	6,463,698	6,196,653
Interest on long-term debt (Note 6)	128,564	882,532
Unrealized foreign exchange loss	512	336,420
Realized foreign exchange loss	-	6,740
	13,750,754	13,736,464

**Loss before income taxes**

(961,297)      (1,509,875)

### Income tax expense

Current tax	-	3,605
Future tax recovery	(37,135)	(412,577)
	(37,135)	(408,972)

**Net loss and comprehensive loss for the period**

(924,162)      (1,100,903)

**Retained earnings (deficit), beginning of period**

16,916,782      (5,694,045)

**Repurchase of common shares (Note 7)**

(781,975)      (348,683)

**Retained earnings (deficit), end of period**

\$ 15,210,645      \$ (7,143,631)

Loss per share (Note 7)

Basic	\$ (0.01)	\$ (0.01)
Diluted	\$ (0.01)	\$ (0.01)
	\$ (0.01)	\$ (0.01)

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

## Consolidated Statements of Cash Flows

For the three months ended March 31, (unaudited)

2009

2008

### CASH FLOWS FROM OPERATING ACTIVITIES

Net loss for the period	\$ (924,162)	\$ (1,100,903)
Items not affecting cash:		
Future income taxes	(37,135)	(412,577)
Accretion	114,038	118,971
Stock based compensation	837,001	463,173
Unrealized loss on financial instruments (Note 3)	-	3,035,244
Unrealized loss on foreign exchange	512	336,420
Asset retirement obligations settled	(163,027)	(94,513)
Amortization of deferred credit	(16,605)	(16,605)
Depletion, depreciation and amortization	6,463,698	6,196,653
	<u>6,274,320</u>	<u>8,525,863</u>
Changes in non-cash working capital from operations (Note 9)	2,534,687	(5,617,996)
	<u>8,809,007</u>	<u>2,907,867</u>

### CASH FLOWS FROM FINANCING ACTIVITIES

Proceeds from long-term financing	12,003,352	3,205,856
Increase (decrease) in bank overdraft	(868,871)	1,193,900
Issuance of common shares, net of issuance costs	180,000	767,048
Repurchase of common shares	(3,150,780)	(1,013,035)
	<u>8,163,701</u>	<u>4,153,769</u>

### CASH FLOWS FROM INVESTING ACTIVITIES

Additions to oil and gas properties	(12,666,593)	(9,269,624)
Disposition of oil and gas properties	-	6,013,086
Additions to other assets	(172,730)	-
Changes in non-cash working capital from investing (Note 9)	(4,133,385)	(3,805,098)
	<u>(16,972,708)</u>	<u>(7,061,636)</u>

Increase (decrease) in cash and cash equivalents

-

Cash and cash equivalents, beginning of period

-

Cash and cash equivalents, end of period

\$ -      \$ -

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

## Notes to Consolidated Financial Statements

### 1. BASIS OF PRESENTATION

The interim financial statements of the Terra Energy Corp. (the "Company") have been prepared by management in accordance with Canadian generally accepted accounting principles ("GAAP") and are consistent with the presentation and disclosure in the audited consolidated financial statements and notes thereto for the year ended December 31, 2008 except for the changes described in note 2. The interim consolidated financial statements do not conform in all respects to the requirements of GAAP for annual financial statements. These interim consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto for the year ended December 31, 2008.

The preparation of interim financial statements in conformity with Canadian GAAP requires management to make estimates and assumptions that affect the amounts reported in the interim financial statements and accompanying notes. Actual results could differ from those estimates. The interim financial statements have, in management's opinion, been properly prepared using careful judgements within reasonable limits of materiality.

### 2. ADOPTION OF NEW POLICIES

#### Goodwill and Intangible Assets

On January 1, 2009, the Company adopted the Canadian Institute of Chartered Accountants (CICA) Section 3064, Goodwill and intangible assets, replacing Section 3062, Goodwill and other intangible assets and Section 3450, Research and development costs. This section clarifies the criteria for the recognition of assets, intangible assets and internally developed intangible assets. No changes were required to these financial statements as a result of this change.

### 3. FINANCIAL INSTRUMENTS AND CAPITAL MANAGEMENT

The Company is exposed to financial risk in a range of financial instruments including accounts receivable, accounts payable, bank overdraft, long term financing and financial derivative contracts. The Company manages its exposure to financial risks by operating in a manner that minimizes its exposure to the extent practical. The main financial risks affecting the Company are discussed below:

#### Credit Risk

Credit risk arises when a failure by counterparties to discharge their obligations could reduce the amount of future cash inflows from financial assets on hand at the balance sheet date. The Company's accounts receivable at the balance sheet date arise from sales of crude oil, natural gas liquids and natural gas. Industry standard dictates that commodity sales are settled on the 25th day of the month following the month of production. The Company markets its oil and natural gas through several marketers so that the exposure to any one entity is minimized.

Joint venture receivables are generated from conducting joint operating or capital operations with joint venture partners. Collections from these operations are usually paid within three months of the joint venture bill being issued to the partner. Circumstances can arise which extend the terms of collection beyond this period as specific items on these joint venture billings may need to be resolved between partners. Smaller partners may be cash called to pay for their share of costs in advance of a project. The Company also has the ability to take measures such as withholding production volumes as recourse for collections on receivables.

The Company monitors receivable accounts and actively pursues collection and payment. If any accounts are considered impaired, they will be charged to an allowance for doubtful accounts. During the period ended March 31, 2009 there was no allowance for doubtful accounts recorded due to historical success of collecting receivables. The Company does not have any significant credit risk exposure with respect to accounts receivable to any single counterparty or any group of counterparties having similar characteristics.

The carrying value of accounts receivable approximates its fair value due to the relatively short periods to maturity on this instrument. The maximum exposure to credit risk is represented by the carrying amount on the balance sheet. There are no material financial assets that the Company considers past due and at risk of collection.

### Interest Rate Risk

Interest rate risk refers to the risk that the value of a financial instrument or cash flows associated with the instrument will fluctuate due to changes in market interest rates. The Company is exposed to interest rate risk as it can borrow funds at floating interest rates as disclosed in Note 6. The Company currently does not use interest rate hedges or fixed interest rate contracts to manage the Company's exposure to interest rate fluctuations.

At March 31, 2009, the increase or decrease in net income before taxes for each 1% change in interest rates on floating rate debt amounts to approximately \$183,000 (2008 – \$63,000) per annum.

### Commodity Price Risk

The Company is exposed to fluctuations in commodity prices for crude oil, natural gas and natural gas liquids. Commodity prices are affected by many factors including supply and demand. The Company monitors these risks and when appropriate, utilizes financial instruments to manage its exposure to these risks.

At March 31, 2009 the Corporation had no outstanding derivative contracts.

### Liquidity Risk

Liquidity risk includes the risk that, as a result of the Company's operational liquidity requirements:

- The Company will not have sufficient funds to settle a transaction on the due date; or
- The Company will be forced to sell financial assets at values which are less than what they are worth.

The Company's operating cash requirements, including amounts projected to complete the Company's existing capital expenditure program, are continuously monitored and adjusted as input variables change. These variables include but are not limited to, available credit, oil and natural gas production from existing wells, results from new wells drilled, commodity prices, cost overruns on capital projects and regulations relating to prices, taxes, royalties, land tenure, allowable production and availability of markets. As these variables change, liquidity risks may necessitate the Company conduct equity issues or obtain project debt financing. The Company also mitigates liquidity risk by maintaining an insurance program to minimize exposure to insurable losses.

Following is a list of the financial liabilities at March 31, 2009 and their due dates:

	Total	Within 1 Year	Current Within 1 to 2 Years
Bank Overdraft	3,594,393	3,594,393	–
Accounts payable and accrued liabilities	14,796,211	14,796,211	–
Long-term financing	18,319,656	–	19,319,656
Total	36,710,260	18,390,604	19,319,656

**Foreign Exchange Risk**

The Company is exposed to fluctuations in foreign exchange rates which will have an impact on commodity prices, foreign denominated cash on hand, foreign denominated payables and foreign denominated long-term financing held by the Company.

Commodities are sold to marketers at prices that are commonly based upon reference prices denominated in a foreign currency. Any changes in the foreign exchanges rates will have a direct impact on petroleum and natural gas revenue received by the Company. Foreign denominated cash held by Company is subject to revaluations at period ends with any changes being reflected as realized foreign exchange gains and losses. Changes in the value of payables and long-term financing denominated in a foreign currency are reflected as unrealized foreign exchange gains and losses. Upon settlement, the unrealized foreign exchange gain or loss is reversed and a realized foreign exchange gain or loss is recorded.

**Fair Value**

The carrying values of the financial assets and financial liabilities approximate their fair value.

**Capital Management**

The Company's objective when managing capital is to safeguard its ability to continue as a going concern so that it can continue to provide returns to shareholders and benefits for other stakeholders. The Company manages the capital structure and makes adjustments to it in light of changes in economic conditions and the risk characteristics of the underlying assets. The Company's objective is met by retaining adequate equity to provide for the possibility that cash flows from assets will not be sufficient to meet future cash flow requirements. The Board of Directors does not establish quantitative return on capital criteria for management. The Company defines capital as the aggregate of total equity, bank overdraft and long-term financing less cash and cash equivalents, which at March 31, 2009 was \$113,333,648 (December 31, 2008 – \$105,256,596).

The Company is subject to covenants on its operating credit facility with its lender. At March 31, 2009 the Company was in compliance with these financial covenants.

**4. RELATED PARTY TRANSACTIONS**

Except as disclosed elsewhere in these consolidated financial statements, the Corporation had the following related party transactions:

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

- Pioneer Land Services Ltd. – a Director is an employee of Pioneer

- Borden Ladner Gervais LLP – a Director is partner with the law firm

- b) Transactions

	2009	2008
Expenses		
Legal Consulting – Borden Ladner Gervais LLP	\$ 145,993	\$ 42,749
	\$ 145,993	\$ 42,749
Other		
Recorded as part of Oil and Gas Properties – Pioneer Professional Services Group Ltd.	\$ –	\$ 8,463
Recorded as part of Oil and Gas Properties – Borden Ladner Gervais LLP	–	4,490
	\$ –	\$ 12,953

- c) These transactions are in the normal course of operations and have been valued in these consolidated financial statements at the exchange amount which is the amount of consideration established and agreed to by the related parties, which approximate fair values.

## 5. OTHER ASSETS

At March 31, 2009, the corporation held 5,069,400 common shares of a publicly traded company representing approximately 7.8% of the outstanding shares of the company. The Corporation has classified the investment as an “available for sale” financial asset with any changes in fair value being recognized in other comprehensive income. At March 31, 2009 there were no material changes in the fair value of the financial asset from the acquisition dates.

## 6. LONG-TERM FINANCING

The Corporation has a revolving line of credit, with a syndicate of chartered banks, of up to \$70 million (2008 - \$70 million), which bears interest at prime plus 0.00% (December 31, 2008 – 0.00%). The facility is secured by a general security agreement, a floating charge debenture in the amount of \$150 million and an unlimited liability guarantee by Terra Energy Corp. and Constar Resources Ltd. At March 31, 2008, the Corporation was indebted on the revolving line of credit in amount of \$18,319,656 (December 31, 2008 - \$6,315,792). The outstanding cheques issued in the amount of \$3,594,393 are shown as bank overdraft until they clear against the revolving line.

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 June 2009. 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.

## 7. SHARE CAPITAL

- a) Authorized
- i) Unlimited number of common voting shares
  - ii) Unlimited number of preferred shares
- b) Issued and outstanding

	March 31, 2009		December 31, 2008	
	Number of Shares	Amounts	Number of Shares	Amounts
<b>Common shares</b>				
Balance, beginning of period	74,886,533	\$ 67,880,302	74,297,484	\$ 65,195,721
Issued on exercise of options	180,000	180,000	2,127,300	2,538,177
Reclassification of contributed surplus (note 8)	–	61,907	–	1,520,517
Shares repurchased for cancellation	(2,613,300)	(2,368,805)	(1,538,251)	(1,374,113)
<b>Total Common Shares, end of period</b>	<b>72,453,233</b>	<b>\$ 65,753,404</b>	<b>74,886,533</b>	<b>\$ 67,880,302</b>

On May 17, 2007, the Corporation obtained permission from the TSX Venture Exchange for a Normal Course Issuer Bid to repurchase for cancellation up to 5,000,000 common shares from May 17, 2007 to May 17, 2008. On June 9, 2008 the Corporation obtained permission from the TSX Venture Exchange for a Normal Course Issuer Bid to repurchase for cancellation up to 3,700,000 common shares from June 9, 2008 to June 9, 2009.

CONSOLIDATED FINANCIAL STATEMENTS

In the three month period ended March 31, 2009, the Corporation purchased 2,613,300 common shares for total costs of \$3,150,780, at an average price of \$1.21 per common share. Share capital was reduced by \$2,368,805 and the excess of \$781,975 was charged to deficit.

Of the repurchased shares, 602,500 were being held for cancellation at March 31, 2009 (December 31, 2008 – 783,000).

c) Stock Options

The Corporation's Employee Stock Option Plan provides for officers, directors, employees, and consultants to 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.

Details of all options outstanding at March 31, 2009 are as follows:

	Number of Options	Weighted average exercise price
<b>Employee Stock Options</b>		
Balance, beginning of period	6,655,000	1.53
Granted	1,600,000	1.33
Exercised	(180,000)	(1.00)
Expired	(1,475,800)	(1.60)
<b>Total Options, balance, end of period</b>	<b>6,599,200</b>	<b>1.48</b>

For stock options granted to employees, compensation expense of \$837,001 has been recorded for the three months ended March 31, 2009 (2008 - \$463,173) with the offsetting credit to contributed surplus. The fair value of stock options granted in the period was estimated using the Black Scholes option-pricing model with the following assumptions: Dividend yield Nil; expected volatility of 72% to 73%; risk-free interest rate of 2.0%; weighted average term of 4.6 years.

For the options granted during 2009, the estimated fair value expected to be recognized over the vesting period is approximately \$1,240,379.

d) Per share amounts

The following table summarizes the calculation of basic and diluted net loss per share.

	2009	2008
Net loss	\$ (924,162)	\$ (1,100,903)
Weighted-average number of common shares outstanding – basic	73,588,055	74,080,013
Dilutive effect of stock options	–	–
Weighted-average number of common shares outstanding– diluted	73,588,055	74,080,013
Net loss per share (\$/share)		
Basic	\$ (0.01)	\$ (0.01)
Diluted	\$ (0.01)	\$ (0.01)

For 2009, 6,599,200 stock options (2008 – 6,708,000) were anti-dilutive and have been excluded from the calculation of the dilutive effect of stock options.

**8. CONTRIBUTED SURPLUS**

The details of contributed surplus are as follows:

	2009	2008
Balance, beginning of period	\$ 9,680,456	\$ 9,365,272
Stock based compensation	837,001	1,835,701
Reclassification resulting from exercise of options and warrants to common shares	(61,907)	(1,520,517)
Balance, end of period	<u>\$ 10,455,550</u>	<u>\$ 9,680,456</u>

**9. STATEMENT OF CASH FLOWS****Change in non-cash working capital**

	2009	2008
Accounts receivable	\$ 1,768,761	\$ (3,660,648)
Prepaid expenses	(213,363)	(42,691)
Accounts payable and accrued liabilities	(3,154,096)	(5,719,755)
	<u>(1,598,698)</u>	<u>(9,423,094)</u>
Change in non-cash working capital from investing	(4,133,385)	(3,805,098)
Change in non-cash working capital from operations	2,534,687	(5,617,996)
	<u>\$ (1,598,698)</u>	<u>\$ (9,423,094)</u>

**Other information**

	2009	2008
Interest paid	\$ 96,165	\$ 781,206
Taxes paid	\$ -	\$ 3,605

**10. SUBSEQUENT EVENT**

On April 20, 2009, the Corporation announced that it has agreed to acquire all of the shares of Tecton Energy Canada ULC ("Tecton") in a cash and share exchange transaction valued at \$8 million. The Corporation has agreed to pay \$4 million in cash and issue 2,580,645 common shares at a price of \$1.55 per share. Closing of the transaction is subject to regulatory approvals and is scheduled to occur in late May 2009, following due diligence reviews to be performed on Tecton.

Terra Energy has received approval to list its common shares on the Toronto Stock Exchange (the "TSX"). The Corporation's common shares will commence trading on the TSX at market open on June 1, 2009 under the symbol "TT". The Corporation's common shares will be delisted from the TSX Venture Exchange in conjunction with the TSX listing.