Terra Energy Corp.

Management's Discussion & Analysis

for the three month periods ended

March 31, 2009 and March 31, 2008

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" or the "Corporation") is dated May 25, 2009. It should be read in conjunction with the unaudited interim consolidated financial statements and the corresponding notes for the three months periods ended March 31, 2009 and March 31, 2008 and with the audited year end consolidated financial statements of the Corporation for the years ended December 31, 2008 and December 31, 2007.

Terra Energy's Board of Directors and Audit Committee have reviewed and approved the March 31, 2009 unaudited consolidated financial statements and related MD&A.

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

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, Annual Information Form, material change reports and press releases issued by the Corporation are available through the SEDAR system at www.sedar.com.

NON-GAAP MEASURES

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. The terms "cash flow from operations", "operating netback", "working capital" and "net debt" are not recognized under Generally Accepted Accounting Principles ("GAAP"). The Corporation uses these measures to help evaluate its performance, leverage, and liquidity as well as to assess potential acquisitions.

Cash flow from operations is an important financial measure as it demonstrates the Corporation's ability to generate funds necessary to repay debt and to fund future growth through capital investment. Cash flow from operations 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. All references to cash flow from operations throughout this MD&A are based on cash flow from operating activities before changes in non-cash working capital. The Corporation also presents cash flow from operations per share whereby the per share amounts are calculated using weighted average shares outstanding consistent with the calculation of net income per share, which per share amount is calculated under GAAP and is more fully described in the notes to the financial statements.

Operating netback is an important financial measure as it demonstrates profitability relative to current commodity prices. Operating netback is calculated as revenues less royalties and operating expenses. There is no GAAP measure that is reasonably comparable to operating netback.

Net debt and working capital are both important financial measures as they are used to assess liquidity and general financial strength. Working capital is calculated as current assets less current liabilities. Net debt is calculated as the sum of working capital and long-term financing excluding the mark to market of financial instruments. There is no GAAP measure that is reasonably comparable to working capital or net debt.

FORWARD LOOKING ADVISORY

This MD&A contains certain statements or disclosures relating to Terra Energy that are based on the expectations of its Management as well as assumptions made by and information currently available to Terra Energy which may constitute forward-looking information under applicable securities laws. All such statements and disclosures, other than those of historical fact, which address activities, events, outcomes, results or developments that the Corporation anticipates or expects may, or will occur in the future (in whole or in part) should be considered forward-looking information presented in such statements or disclosures, may, among other things, relate to: the anticipated benefits and enhanced shareholder value resulting from operations; the success of the Corporation's growth strategy; sources of income; forecasts of capital expenditures and the sources of the financing thereof; expectations regarding the ability of the Corporation to raise capital' movements in currency exchange rates' anticipated income taxes, the Corporation's business outlook' plans and objectives of Management for future operations' forecast business results and anticipated financial performance. Many factors could cause the performance or achievements of Terra Energy to be materially different from any future results, performance or achievements that may be expressed or implied by such forward-looking statements.

In particular such forward-looking statements include:

(a) Under the heading "General and Administrative Expenses" the statement that:

- i. General and administrative expenses on a per unit of production basis are expected to continue to fall as incremental production additions are not expected to add significant overhead expense.

(b) Under the heading "Liquidity and Financial Condition" the statement that:

- i. Terra Energy is able to generate sufficient cash flow to meet existing and future cash requirements.

(c) Under the heading "Capital Expenditures" the statement that:

- i. On January 27, 2009 the corporation provided guidance that 2009 capital expenditures will be approximately $37.0 million.

(d) Under the heading "Capital Resources" the statement that:

- i. Terra Energy is in the financial position to weather the economic storm with $46,974,040 in unutilized credit facility at March 31, 2009 and $6,274,320 in cash flow from operations in the first quarter of 2009.

(e) Under the heading " Commitments and Contingencies" the statement that:

- i. 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 would have a material adverse impact on its financial position, results of operations or liquidity.

(f) Under the heading "Subsequent Events" the statements that:

- i. Closing of the (Tecton) transaction is subject to regulatory approvals and is scheduled to occur in late May 2009.
- ii. The Company's common shares will commence trading on the TSX at market open on June 1, 2009.

(g) Under the heading "Outlook" the Corporation stated its 2009 objectives:

- i. To reach 10,000 boe/d through a combination of organic growth and acquisitions.
- ii. To improve the balance in our commodity mix closer towards a 50/50 gas to oil ratio.
- iii. To maintain a strong balance sheet.

(h) Further under the heading “Outlook” the Corporation stated:

i. Well positioned to face these challenges and to take advantage of opportunities as they arise

ii. Our preliminary 2009 Capital Expenditure Plan and Budget was designed to keep production rates at about 6,000 boe/d.

iii. New wells and additional tie-ins are expected to offset declines and result in average production rates above 5,900 boe/d during the second quarter of 2009.

iv. New wells and additional tie-ins are expected to offset declines and maintain production levels through 2009.

(i) Under the heading “International Financial Reporting Standards” the statements that:

i. Terra will update it's IFRS changeover plan to reflect new and amended accounting standards.

ii. IFRS is expected to change prior to 2011.

(j) Under the heading “Proved Oil and Gas Reserves” the statements that:

i. Estimated future development costs will be funded from the Corporation's unutilized credit facility or from cash flow from operations.

(k) Under the heading “Litigation” the statement that:

i. 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.

(l) Under the heading “Stock Based Compensation and Share Purchase Warrants” the statement that:

i. This calculation is based on estimates which could differ significantly from actual results. This could have a significant impact on the financial statements.

(m) Under the heading “Income Taxes” the statement that:

i. The actual income tax liability may differ significantly from that estimated and recorded.

(n) Under the heading “Global Financial Crises” the statement that:

i. A $70.0 million revolving line of credit, which was drawn by $18.3 million at March 31, 2009 gives Terra the financial flexibility to manage through these uncertain times.

(o) Under the heading “New Alberta Royalty Regime” the statement that:

i. Is not expected to have a material impact on the Corporation.

(p) Under the heading “Capital Markets” the statement that:

i. Terra Energy believes it has sufficient funds available to fund its projected capital expenditures.

The Corporation's actual results could differ materially from those anticipated in these forward-looking statements as a result of the risk factors set forth below and elsewhere in this MD&A:

(a) general economic conditions in Canada, the United States and globally;

(b) industry conditions, including fluctuations in the price of oil and natural gas;

(c) governmental regulation of the oil and gas industry, including environmental regulation;

(d) fluctuation in foreign exchange or interest rates;

(e) liabilities inherent in oil and natural gas operations;

(f) geological, technical, drilling and processing problems;

(g) unanticipated operating events which can reduce production or cause production to be shut in or delayed;

(h) failure to realize the anticipated benefits of acquisitions;

(i) failure to obtain industry partner and other third party consents and approvals, when required;

(j) stock market volatility and market valuations;

(k) competition for, among other things, capital, acquisitions of reserves, undeveloped land and skilled personnel;

(l) competition for and inability to retain drilling rigs and other services;

(m) rights to surface access;

(n) the need to obtain required approvals from regulatory authorities; and the other factors considered under "Risk Factors" in this MD&A and other risk factors identified in other documents incorporated herein by reference.

These factors should not be considered exhaustive. Statements relating to "reserves" or "resources" are by their nature forward-looking statements, as they involve the implied assessment, based on certain estimates and assumptions, that the resources and reserves described can be profitably produced in the future. With respect to forward-looking statements contained or incorporated by reference in this MD&A, Terra Energy has made assumptions regarding: future exchange rates; energy markets and the price of oil and natural gas; the impact of increasing competition; condition in general economic and financial markets; availability of drilling and related equipment; availability of skilled labour; availability of prospective drilling rights; current technology; cash flow; commodity prices; production rates; effects of regulation and tax laws by governmental agencies; future operating costs and the Corporation's ability to obtain financing on acceptable terms. In addition, forward-looking statements in documents incorporated by reference herein may be based on additional assumptions as disclosed in such documents. Readers are cautioned that the foregoing list of factors is not exhaustive.

The above summary of assumptions and risks related to forward-looking information has been provided in this MD&A and the documents incorporated by reference herein in order to provide readers with a more complete perspective on Terra Energy's future operations. Readers are cautioned that this information may not be appropriate for other purposes.

The forward-looking statements contained in this MD&A are expressly qualified by this cautionary statement.

DESIGN OF INTERNAL CONTROLS OVER FINANCIAL REPORTING

The CEO and CFO have designed, or caused to be designed under their supervision, internal controls over financial reporting to provide reasonable assurance regarding the reliability of the Corporation's financial reporting and the preparation of financial statements for external purposes in accordance with the Canadian GAAP. Such officers have evaluated, or caused to be evaluated under their supervision, the effectiveness of the Corporation's internal controls over financial reporting at the financial year end of the Corporation and concluded that the Corporation's internal controls over financial reporting is effective, at the financial year end of the Corporation, for the foregoing purpose. The Corporation's CEO and CFO are required to cause the Corporation to disclose any change in the Corporation's internal controls over financial reporting that occurred during the Corporation's most recent interim period that has material affected, or is reasonably likely to materially affect, the Corporation's internal controls over financial reporting. No material changes in the Corporation's internal controls over financial reporting were identified during such period that has materially affected, or are reasonably likely to materially affect, the Corporation's internal controls over financial reporting. It should be noted that a control system, including the Corporation's disclosure and internal controls and procedures, no matter how well conceived, can provide only reasonable, but not absolute, assurance that the objectives of the control system will be met and it should not be expected that the disclosure and internal controls and procedures will prevent all errors or fraud.

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 MD&A 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

Three months ended March 31	**2009** $	2008 $	%Growth
Gross Revenue	**16,236,381**	20,255,411	(19.8)
Cash Flow From Operations	**6,274,320**	8,525,863	(26.4)
Net Loss	**(924,162)**	(1,100,903)	16.1
Weighted Average Shares – Basic	**73,588,055**	74,080,013	(0.7)
Weighted Average Shares – Diluted	**73,588,055**	74,080,013	(0.7)
Shares at Period End – Basic	**72,453,233**	74,240,984	(2.4)

As at	**March 31, 2009** $	December 31, 2008 $	%Growth
Total Assets	**157,941,406**	153,067,784	3.2
Long-term Financing	**18,319,656**	6,315,792	190.1

Operational

Three months ended	**March 31, 2009** $	March 31, 2008 $	%Growth
Production			
Average Daily Production (boe/d)	**5,884**	4,675	25.9
Wells Drilled			
Gross	**4.0**	2.0	100.0
Net	**3.0**	1.5	100.0

2009 FIRST QUARTER HIGHLIGHTS

- Average production per day increased 25.9% to 5,884 barrels per day compared to the same quarter last year.
- Gross revenue decreased 19.8% to $16,236,381 from $20,255,411 compared to the same quarter last year.
- Cash flow from operations decreased 26.4% to $6,274,320 from $8,525,863 compared to the same quarter last year.
- Production expense per unit of production decreased 13.6% to $9.57 from $11.08 compared to the same quarter last year.

Comparative Quarterly Financial Information

	2009 Q1 $	2008 Q4 $	2008 Q3 $	2008 Q2 $
Gross Revenue	16,236,381	19,442,227	21,199,751	20,807,645
Cash Flow from Operations	6,274,320	10,670,333	12,466,109	10,453,069
Net income (loss)	(924,162)	4,515,719	13,773,416	5,778,180
Per Share (Basic)	(0.01)	0.06	0.18	0.08
Per Share (Diluted)	(0.01)	0.06	0.18	0.08
Total Assets	157,941,406	153,067,784	151,754,605	130,657,918
Bank Debt	18,319,656	6,315,762	–	–
Working Capital Deficiency	(4,706,304)	(7,486,801)	(5,590,138)	(2,728,924)

	2008 Q1 $	2007 Q4 $	2007 Q3 $	2007 Q2 $
Gross Revenue	20,255,411	14,242,403	12,439,938	12,268,332
Cash Flow from Operations	8,525,863	5,023,522	3,671,403	4,659,991
Net income (loss)	(1,100,903)	944,913	(1,161,031)	618,865
Per Share (Basic)	(0.01)	0.01	(0.02)	0.01
Per Share (Diluted)	(0.01)	0.01	(0.02)	0.01
Total Assets	167,625,061	166,772,292	159,579,186	151,971,175
Bank Debt	58,173,279	54,631,003	53,315,145	50,904,999
Working Capital Deficiency	(9,905,778)	(15,244,263)	(10,016,746)	(3,209,424)

RESULTS OF OPERATIONS

Production

Three months ended March 31	2009 Average	2008 Average	%Growth
Oil (bbl/d)	**176**	251	(29.9)
Natural Gas (Mcf/d)	**27,900**	19,778	41.1
Liquids (bbl/d)	**1,058**	1,128	(6.2)
Combined (boe/d)	**5,884**	4,675	25.9

Operations

Three months ended March 31	2009 $	2008 $	2009 ($/boe)	2008 ($/boe)	%Growth %
Gross Revenues	**16,236,381**	20,255,411	**30.66**	47.61	(35.6)
Realized Gain (Loss) on Financial Instrument	**–**	(254,137)	**–**	(0.60)	N/A
Unrealized (Loss) on Financial Instrument	**–**	(3,035,244)	**–**	(7.13)	N/A
Revenue Before Royalties	**16,236,381**	16,966,030	**30.66**	39.88	(23.1)
Royalties	**(3,446,924)**	(4,739,441)	**(6.51)**	(11.14)	(41.6)
Revenue After Royalties	**12,789,457**	12,226,589	**24.15**	28.74	(16.0)
Production Expenses	**(5,067,504)**	(4,711,730)	**(9.57)**	(11.08)	(13.6)
Operating Netback	**7,721,953**	7,514,859	**14.58**	17.66	(17.4)
General & Administrative Expenses	**(1,139,437)**	(1,020,245)	**(2.15)**	(2.40)	(10.4)
Interest Expense	**(128,564)**	(882,532)	**(0.24)**	(2.07)	(88.4)
Realized Foreign Exchange Loss	**–**	(6,740)	**–**	(0.02)	N/A
Non-cash Expenses	**(7,415,249)**	(7,115,217)	**(14.01)**	(16.72)	(16.2)
Loss Before Income Taxes	**(961,297)**	(1,509,875)	**(1.82)**	(3.55)	(48.7)
Income Tax Recovery	**37,135**	408,972	**0.07**	0.96	(92.7)
Net Loss	**(924,162)**	(1,100,903)	**(1.75)**	(2.59)	(32.4)
Per Share – Basic	**(0.01)**	(0.01)			
Per Share - Diluted	**(0.01)**	(0.01)			

Revenue

Three months ended March 31	2009 $	2008 $	2009 ($/boe)	2008 ($/boe)	%Change %
Gross Revenue	**16,236,381**	20,255,411	**30.66**	47.61	(35.6)
Realized Loss on Financial Instrument	**–**	(254,137)	**–**	(0.60)	N/A
Unrealized Loss on Financial Instrument	**–**	(3,035,244)	**–**	(7.13)	N/A
Revenue Before Royalties	**16,236,381**	16,966,030	**30.66**	39.88	(23.1)

Gross revenue decreased 19.8% to $16,236,381 for the three month period ended March 31, 2009 compared to $20,255,411 for the same period ended March 31, 2008. This was primarily the result of a 35.6% decrease in the average price received per BOE being offset by a 25.9% increase in production. Revenue before royalties only decreased by 4.3% due to the absence of losses on financial instruments recognized in the prior year period.

At period ends, in accordance with generally accepted accounting principles, the Corporation is required to calculate and reflect a “mark-to-market” value of its financial instruments on the balance sheet. Furthermore, during each period end, the prior periods mark to market is reversed and a new mark to market adjustment is calculated with the difference being recorded to unrealized gain (loss) on financial instruments on the statement of operations and comprehensive income. The periodic cash settlement of these various financial instruments is recorded in realized gain (loss) on financial instruments on the statement of operations and comprehensive income.

For the three month period ended March 31, 2009, no realized or unrealized gains or losses were recognized. For the three month period ended March 31, 2008, the Corporation’s financial statements reflect a unrealized loss of $3,035,244 on financial instruments. This is the result of the reversal of the December 31, 2007 mark to market liability of $567,483 on financial instruments and a new market to market liability of $3,602,727 at March 31, 2008.

The unrealized losses on financial instruments are non-cash items and, as a result, do not affect Terra Energy’s cash flow from operations.

Below is a breakdown of gross revenue prices realized by the Corporation:

Three months ended March 31	**2009**	2008	%Growth
Crude Oil ($ / bbl)	**39.37**	93.03	(57.7)
Natural Gas Liquids ($ / bbl)	**25.97**	42.42	(38.8)
Natural Gas ($ / Mcf)	**5.21**	7.64	(31.8)

Royalties

Three months ended March 31	**2009** **$**	2008 $	**2009** **($/boe)**	2008 ($/boe)	%Change %
Royalties	**3,446,924**	4,739,441	**6.51**	11.14	(41.6)

Royalties decreased 27.3% to $3,446,924 for the three month period ended March 31, 2009 compared to $4,739,441 for the same period ended March 31, 2008 primarily as a result the Corporation’s lower revenue. Royalties on a per unit of production decreased by 41.6% to $6.51 for the three month period ended March 31, 2009 compared to $11.14 for the same period ended March 31, 2008. Royalties as a percentage of gross revenues decreased to 21.2% from 23.4% as a result of prior period adjustments being recorded in both periods.

Production Expenses

Three months ended March 31	**2009** **$**	2008 $	**2009** **($/boe)**	2008 ($/boe)	%Change %
Production Expenses	**5,067,504**	4,711,730	**9.57**	11.08	(13.6)

Production expenses increased 7.6% to $5,067,504 for the three month period ended March 31, 2009 compared to $4,711,730 for the same period ended March 31, 2008 reflecting higher production volumes. Production expenses on a per unit of production basis declined 13.6% to $9.57 for the three month period ended March 31, 2009 compared to $11.08 for the same period ended March 31, 2008 primarily due to impact of fixed costs on increased production volumes and an increase in third party processing revenues.

General and Administrative Expenses

Three months ended March 31	2009 $	2008 $	2009 ($/boe)	2008 ($/boe)	%Change %
General and Administrative Expenses	**1,139,437**	1,020,245	**2.15**	2.40	(10.4)

General and administrative increased 11.7% to $1,139,437 for the three month period ended March 31, 2009 compared to $1,020,245 for the same period ended March 31, 2008 primarily due to higher legal expenditures being incurred.

General and administrative expenses on a per unit of production basis fell 10.4% to $2.15 for the three month period ended March 31, 2009 compared to $2.40 for the same period ended March 31, 2008. General and administrative expenses on a per unit of production basis fell as a result of an increasing production base and are expected to continue to fall as incremental production additions are not expected to add significant overhead expenses.

Interest Expense

Three months ended March 31	2009 $	2008 $	2009 ($/boe)	2008 ($/boe)	%Change %
Interest Expense	**128,564**	882,532	**0.24**	2.07	(88.4)

Interest expense decreased 85.4% to $128,564 for the three month period ended March 31, 2009 compared to $882,521 for the same period ended March 31, 2008. Interest expense decreased as a result of lower average debt levels in addition to a lower interest rate environment. On a per unit of production basis, interest expense decreased 88.4% to $0.24 for the three month period ended March 31, 2009 compared to $2.07 for the same period ended March 31, 2008 as a result of higher production.

Non Cash Expenses

Three months ended March 31	2009 $	2008 $	2009 ($/boe)	2008 ($/boe)	%Change %
Depletion and Amortization	**6,463,698**	6,196,653	**12.21**	14.57	(16.2)
Accretion Expense	**114,038**	118,971	**0.22**	0.27	(18.5)
Stock Based Compensation	**837,001**	463,173	**1.58**	1.09	45.0
Unrealized Foreign Exchange Loss	**512**	336,420	**–**	0.79	N/A
Non Cash Items	**7,415,249**	7,115,217	**14.01**	16.72	(16.2)

Non cash expenses rose 4.2% to $7,415,249 for the three month period ended March 31, 2009 compared to $7,115,217 for the same period ended March 31, 2008. The majority of the change in non cash expenses is attributable to stock based compensation, which increased by 80.7% to $837,001 in the current period compared to $463,173 in the prior period. New stock options were granted to replace options previously granted that expired in the first quarter of 2009. On a per unit of production basis, non cash expenses decreased 16.2% to $14.01 for the three month period ended March 31, 2009 compared to $16.72 for the same period ended March 31, 2008 as a result of higher production.

Income Taxes

Three months ended March 31	2009 $	2008 $	2009 ($/boe)	2008 ($/boe)	%Change %
Current Tax	–	3,605	–	0.01	N/A
Future Tax (Recovery)	(37,135)	(412,577)	(0.07)	(0.97)	(92.8)
Income Taxes	(37,135)	(408,972)	(0.07)	(0.96)	(92.7)

A future income tax recovery of $37,135 for the three month period ended March 31, 2009 was recorded compared to a recovery of $412,577 for the same period ended March 31, 2008. The decrease in the future income tax recovery is consistent with the decrease in the loss before income taxes. On a per unit of production basis, the future income tax recovery was $0.07 for the three month period ended March 31, 2009 compared to a recovery of $0.97 for the same period ended March 31, 2008.

LIQUIDITY AND FINANCIAL CONDITION

The Corporation defines liquidity as it's ability to generate cash and to meet existing known and reasonably likely future cash requirements. Cash flow from operations is a measure of the Corporations ability to generate cash in order to meet these requirements. Cash flow from operations for the three months ended March 31, 2009 has decreased 26.4% to $6,274,320 from $8,525,863 for the same period in 2008. This decrease reflects the decline in petroleum and natural gas commodity prices during the period. Despite the reduction in cash flow from operations Terra Energy is able to generate sufficient cash flow to meet its existing and future cash requirements.

Cash Flow from Operations (non-GAAP measure)

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".

Three months ended March 31	2009 $	2008 $	2009 ($/boe)	2008 ($/boe)	%Change %
Net income (loss) for the period	(924,162)	(1,100,903)	(1.75)	(2.59)	32.4
Future income tax expense (recovery)	(37,135)	(412,577)	(0.07)	(0.97)	(92.8)
Accretion of asset retirement obligation	114,038	118,971	0.22	0.27	(18.5)
Stock based compensation	837,001	463,173	1.58	1.09	45.0
Unrealized loss (gain) on financial instruments	–	3,035,244	–	7.13	N/A
Unrealized foreign exchange loss (gain)	512	336,420	–	0.79	N/A
Amortization of deferred credit	(16,605)	(16,605)	(0.03)	(0.03)	–
Asset retirement obligations settled	(163,027)	(94,513)	(0.31)	(0.22)	(40.9)
Depletion and amortization	6,463,698	6,196,653	12.21	14.57	(16.2)
Cash flow from operations	6,274,320	8,525,863	11.85	20.04	(40.9)

For the three month period ended March 31, 2009, the Corporation generated cash flows from operations of $6,274,320 ($0.09 per basic / diluted share), a decrease of 26.4% compared to $8,525,863 ($0.12 per basic and $0.11 per diluted share) for the three month period ended March 31, 2008.

Capital expenditures, net debt and working capital are measures of the known and reasonably likely future cash requirements.

	March 31, 2009 $	December 31, 2008 $	%Growth %
Working Capital Deficiency	**4,706,304**	7,486,801	(37.1)
Less: Financial Instruments	**–**	–	N/A
Long-Term Financing	**18,319,656**	6,315,792	190.1
Net Debt	**23,025,960**	13,802,593	66.8

The working capital deficiency at March 31, 2009 was $4,706,304 compared to a deficiency of $7,486,801 at December 31, 2008. The reduction in the working capital deficiency was driven by a reduction in accrued liabilities relating to a decrease in exploration and development activity at quarter end. A working capital deficiency is a normal event in the oil and gas industry with liquidity being maintained by drawing from the unutilized credit facility as needed and then repaying it periodically through production revenues.

Net debt at March 31, 2009 was $23,025,960 compared to $13,802,593 at December 31, 2008. The increase in net debt was driven largely by the first quarter 2009 capital program, which ultimately resulted in production volumes of 5,884 boe/d, an increase of 14.7% from 5,132 boe/d in the fourth quarter of 2008.

Terra Energy's long-term financing is a $70.0 million 364 day revolving bank syndicated credit facility with a one year term-out provision. 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. As at March 31, 2009, Terra Energy was in compliance with all of its bank covenants.

At March 31, 2009, the Corporation's unutilized credit facility was $46,974,040 compared to $56,197,407 at December 31, 2008.

Capital Expenditures

Capital expenditures increased by 36.6% to $12,666,593 for the three month period ended March 31, 2009 compared to $9,269,624 for the same period ended last year. Terra Energy financed its capital expenditures for the period through a combination of cash flow from operations, working capital and long-term financing. On January 27, 2009 the corporation provided guidance that 2009 capital expenditures will be approximately $37.0 million. Capital expenditures in the future are largely discretionary and will be contingent upon management's assessment of the financial condition of the Corporation and the current economic climate and it's impact on access to capital and debt markets.

For the three month period ended March 31, 2009, Terra Energy incurred $12,666,593 in capital expenditures before dispositions broken down as:

Three months Ended March 31	2009 $	2008 $
Exploration	**4,725,717**	2,660,757
Development	**1,876,499**	3,432,524
Undeveloped Land	**2,426,833**	160,650
Geological / Geotechnical	**847**	396,476
Facilities	**3,516,591**	2,408,566
Other Assets	**120,106**	210,651
Total Capital Expenditures	**12,666,593**	9,269,624
Net Property Dispositions	**–**	(6,013,086)
Net Capital Expenditures	**12,666,593**	3,256,538

Capital Resources

The Corporation's share capital is as follows:

	March 31, 2009		December 31, 2008	
	No.of Shares	Amounts	No.of Shares	Amounts
Common Shares	72,453,233	$ 65,753,404	74,886,533	$ 67,880,302

During the three month period ended March 31, 2009, 180,000 common shares were issued on the exercise of stock options for cash proceeds received of $180,000.

During the three month period ended March 31, 2009, 2,613,300 common shares were repurchased under normal course issuer bid by the Corporation for $3,150,780 at an average price of $1.21 per common share. The Corporation recorded $2,368,805 as a reduction of share capital and the excess of $781,975 charged to retained earnings.

As at March 31, 2009, 602,500 repurchased shares were held for cancellation. Shares repurchased under the normal course issuer bid held for cancellation are excluded from the outstanding number of shares. At May 25, 2009, the Corporation has 72,163,333 common shares outstanding and 6,491,200 stock options issued.

The current economic environment has made access to debt and equity markets more difficult. The cost of capital has increased while the availability of capital has decreased. Terra Energy is in the financial position to weather the economic storm with $46,974,040 in unutilized credit facility at March 31, 2009 and $6,274,320 in cash flow from operations in the first quarter of 2009. The Corporation has no immediate requirement for additional capital.

COMMITMENTS AND CONTINGENCIES

The Corporation had outstanding letters of credit to various parties for a total of $525,927 (December 31, 2008 - $525,927). The amounts expire at various dates during 2009 and 2010.

The Corporation is involved in various claims 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 would have a material adverse impact on its financial position, results of operations or liquidity.

OFF-BALANCE SHEET ARRANGEMENTS

The Corporation is, from time to time, party to certain derivative instruments, including crude oil and natural gas contracts. The Corporation enters into these contracts to manage commodity price risk in future earnings and cash flow. These contracts reduce the Corporation's exposure to the fluctuations in petroleum and natural gas revenues by locking in fixed forward prices on a portion of the Corporation's crude oil and natural gas production.

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

RELATED PARTY TRANSACTIONS

The Corporation entered into transactions with the following related parties:

Pioneer Professional Services Group Ltd. – a Director is an employee of Pioneer

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

	March 31, 2009 **$**	March 31, 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

The above transactions are in the normal course of operations and have been valued at the exchange amounts agreed by the related parties.

SUBSEQUENT EVENTS

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.

OUTLOOK

The oil and gas sector in Canada continues to experience a period of both challenges and opportunities. The current period is characterized by low commodity prices, a high cost structure, tightening credit markets and capital markets which have become increasingly selective. The market perception of both junior and intermediate companies has changed dramatically over the past 12 months, as reflected in the relative stock market performance of most companies. "Debt" is a consideration of growing importance going forward, particularly in our current environment of low netbacks on both oil and gas sales. The current Canadian/US dollar exchange rate is buffering the full impact of low commodity prices. Future exchange rates will have a significant impact on the competitiveness of our Canadian industry.

Terra Energy is well positioned to face these challenges and to take advantage of opportunities as they arise. Our strong balance sheet and increased production levels provide Terra Energy with a stable platform from which we can achieve our objectives for 2009, including:

- To reach 10,000 boe/d through a combination of organic growth and acquisitions
- To improve the balance in our commodity mix closer towards a 50/50 gas to oil ratio
- To maintain a strong balance sheet

Terra Energy's recently announced agreement to acquire Tecton is the first step along this path. The Tecton assets are immediately adjacent to Terra Energy's existing lands and infrastructure in our Fort St. John core area. This acquisition will provide Terra Energy with continued growth opportunities now and into the future.

During the last quarter of 2008 and the first quarter of 2009, Terra Energy has continued with its development projects in the Fort St. John core area, with a view towards increasing production levels to the 6000 boe/d level. Recent wells drilled and tie-ins are expected to offset production declines through the balance of the 2009. The Corporation has added significantly to its undeveloped land position during the past two quarters and has also repurchased some of its own shares under the normal course issuer bid process.

Our preliminary 2009 Capital Expenditure Plan and Budget was designed to maintain production rates at about 6,000 boe/d, while the Corporation explores other opportunities for growth through asset acquisitions and through M&A opportunities. The Corporation's capital expenditures will be focusing more towards oil assets as the year unfolds.

CHANGES IN ACCOUNTING POLICIES

Goodwill and Intangible Assets

On January 1, 2009, the Corporation 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.

International Financial Reporting Standards ("IFRS")

In February 2008, the CICA's Accounting Standards Board confirmed that IFRS will replace Canadian GAAP in 2011 for profit oriented Canadian publicly accountable enterprises. Terra Energy will be required to report its results in accordance with IFRS beginning in 2011. The Corporation has developed a changeover plan to complete the transition to IFRS by January 1, 2011, including the preparation of required comparative information.

The key elements of Terra Energy's changeover plan include:

- determine appropriate changes to accounting policies and required amendments to financial disclosures;
- identify and implement changes in associated processes and information systems;
- comply with internal control requirements;
- communicate collateral impacts to internal business groups; and
- educate and train internal and external stakeholders.

The Corporation is currently analyzing accounting policy alternatives and identifying implementation options for the corresponding process changes. Terra Energy will update its IFRS changeover plan to reflect new and amended accounting standards issued by the International Accounting Standards Board. As IFRS is expected to change prior to 2011, the impact of IFRS on the Corporation's Consolidated Financial Statements is not reasonably determinable at this time.

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 Corporation 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 Corporation 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.

The most recently completed oil and gas reserve estimate was completed as at December 31, 2008 and on that basis, the undiscounted future development costs associated with proved reserves is approximately $22.8 million compared to $332.2 million in expected cash flow. Estimated future development costs for probable reserves is $24.5 million compared to $197.8 million in expected cash flow. In either event, estimated future development costs will be funded from the Corporation's unutilized credit facility or from cash flow from operations. The cost of funding estimated future development costs will not make the development of a property uneconomic or have an impact on disclosed reserves or future cash flow from the production of proved reserves.

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. For the purposes of interim financial statements the Corporation has reviewed the carrying amount of its assets relative to their recoverable amount, and whether there are indications that events or circumstances may have caused an impairment since the end of the most recently completed fiscal year.

At March 31, 2009, the Corporation calculated the ceiling test using AcG 16 and the April 1, 2009 GLJ price forecast without any material adverse impact on the Corporation's financial position or results of operations. The following table outlines benchmark prices used in the impairment test at March 31, 2009:

	WTI Crude Oil US$/Bbl	Exchange Rate US$/CDN$	Edm Light Crude CDN$/bbl	AECO Natural Gas CDN $/GJ
2009	55.00	0.830	66.79	4.94
2010	62.00	0.850	73.61	6.93
2011	70.00	0.885	81.29	7.71
2012	77.00	0.925	85.99	7.97
2013	85.00	0.950	90.92	8.16
2014	93.85	0.950	97.84	8.47
After 2019 (inflation %)	2%/yr	0%/yr	2%/yr	2%/yr

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 favour, 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.

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. Terra Energy 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. Terra Energy'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.

Global Financial Crisis

Recent market events and conditions, including disruptions in the international credit markets and other financial systems and the deterioration of global economic conditions, have caused significant volatility to commodity prices. These conditions became evident in the latter part of 2008 and are continuing in 2009, causing a loss of confidence in the broader U.S. and global credit and financial markets. This resulted in the collapse of and government intervention in, major banks, financial institutions and insurers and creating a climate of greater volatility, less liquidity, widening of credit spreads, a lack of price transparency, increased credit losses and tighter credit conditions. Notwithstanding various actions by governments, concerns about the general condition of the capital markets, financial instruments, banks, investment banks, insurers and other financial institutions caused the broader credit markets to further deteriorate and stock markets to decline substantially. These factors have negatively impacted company valuations and will impact the performance of the global economy going forward. Petroleum prices are expected to remain volatile for the near future as a result of market uncertainties over the supply and demand of these commodities due to the current state of the world economies.

However, in 2008 and continuing into 2009 Terra Energy significantly increased production volumes and maintained cash flows from operations. This in combination with a $70.0 million revolving line of credit, which was drawn by $18.3 million at March 31, 2009 gives Terra the financial flexibility to manage through these uncertain times.

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.

Exploration, Development and Production Risks

Oil and natural gas exploration involves a high degree of risk and there is no assurance that expenditures made on exploration by Terra Energy will result in new discoveries of oil or natural gas in commercial quantities. It is difficult to project the costs of implementing an exploratory drilling program due to the inherent uncertainties of drilling in unknown formations, the costs associated with encountering various drilling conditions such as over pressured zones and tools lost in the hole, and changes in drilling plans and locations as a result of prior exploratory wells or additional seismic data and interpretations thereof.

Future oil and gas exploration may involve unprofitable efforts, not only from dry wells, but from wells that are productive but do not produce sufficient net revenues to return a profit after drilling, operating and other costs. Completion of a well does not assure a profit on the investment or recovery of drilling, completion and operating costs. In addition, drilling hazards or environmental damage could greatly increase the cost of operations, and various field operating conditions may adversely affect the production from successful wells. These conditions include delays in obtaining governmental approvals or consents, shut-ins of connected wells resulting from extreme weather conditions, insufficient storage or transportation capacity or other geological and mechanical conditions. While close well supervision and effective maintenance operations can contribute to maximizing production rates over time, production delays and declines from normal field operating conditions cannot be eliminated and can be expected to adversely affect revenue and cash flow levels to varying degrees.

New Alberta Royalty Regime

On February 16, 2007, the Government of Alberta announced that a review of the province's royalty and tax regime (including income tax and freehold mineral rights tax) pertaining to oil and gas resources, including oil sands, conventional oil and gas and coal bed methane, would be conducted by a panel of experts with the assistance of individual Albertans and key stakeholders. The review panel produced its report and recommendations on September 18, 2007. The Government of Alberta considered these recommendations and obtained input from the public and the oil and gas sector on the recommendations and on October 25, 2008 released a report entitled "The New Royalty Framework" (the "NRF") on the direction of royalties in the province effective January 1, 2009.

On November 19, 2008, in response the significant reduction in activity and the global economic crisis, the Government of Alberta announced that for wells that commenced drilling after this date companies can elect, on a well by well basis to either have the NRF apply to the production from that well or have the old, pre-NRF rates apply for new wells between 1,000 and 3,500 meters in depth. This five-year transitional royalty system is designed to help stimulate drilling in Alberta.

On March 3, 2009, the Government of Alberta announced a three-point incentive program to stimulate new and continued economic activity in Alberta which included a drilling royalty credit for new conventional oil and natural gas wells and a new well royalty incentive program.

Terra Energy's assets are primarily located in British Columbia and the new Alberta royalty regime is not expected to have a material impact on the Corporation. The royalty regime in British Columbia in which Terra Energy's assets are primarily located may be subject to further review and changes which could adversely impact the Corporations financial condition and operations.

Prices, Markets and Marketing of Crude Oil and Natural Gas

Oil and natural gas are commodities whose prices are determined based on world demand, supply and other factors, all of which are beyond the control of Terra Energy. World prices for oil and natural gas have fluctuated widely in recent years. Any material decline in prices will result in a reduction of net production revenue. Certain wells or other projects may become uneconomic as a result of a decline in world oil prices and natural gas prices, leading to a reduction in the future volume of Terra Energy's oil and gas production. Terra Energy might also elect not to produce from certain wells at lower prices. All these factors could result in a material decrease in Terra Energy's future net production revenue, causing a reduction in its oil and gas acquisition and development activities. In addition, bank borrowings available to Terra Energy will be in part determined by the borrowing base of Terra Energy. A sustained material decline in prices from historical average prices could reduce Terra Energy's future borrowing base, therefore reducing the bank credit available to Terra Energy, and could require that a portion of any existing bank debt of Terra Energy be repaid.

In addition to establishing markets for its oil and natural gas, Terra Energy must also successfully market its oil and natural gas to prospective buyers. The marketability and price of oil and natural gas which may be acquired or discovered by Terra Energy will be affected by numerous factors beyond its control. Terra Energy will be affected by the differential between the price paid by refiners for light quality oil and the grades of oil produced by Terra Energy. The ability of Terra Energy to market natural gas may depend upon its ability to acquire space on pipelines which deliver natural gas to commercial markets. Terra Energy will also likely be affected by deliverability uncertainties related to the proximity of its reserves to pipelines and processing facilities and related to operational problems with such pipelines and facilities and extensive government regulation relating to price, taxes, royalties, land tenure, allowable production, the export of oil and natural gas and the management of other aspects of the oil and natural gas business. Terra Energy has limited direct experience in the marketing of oil and natural gas.

Substantial Capital Requirements; Liquidity

Terra Energy anticipates that it will make substantial capital expenditures for the acquisition, exploration, development and production of oil and natural gas reserves in the future. If Terra Energy's future revenues or reserves decline, Terra Energy may have limited ability to expend the capital necessary to undertake or complete future drilling programs. There can be no assurance that debt or equity financing, or cash generated by operations will be available or sufficient to meet these requirements or for other corporate purposes or, if debt or equity financing is available, that it will be on terms acceptable to Terra Energy. Moreover, future activities may require Terra Energy to alter its capitalization significantly. The inability of Terra Energy to access sufficient capital for its operations could have material adverse effect on Terra Energy's financial condition, results of operations or prospects.

Capital Markets

As a result of the weakened global economic situation, Terra Energy, along with all other oil and gas entities, may have restricted access to capital, bank debt and equity, and is likely to face increased borrowing costs. Although Terra's business and asset base have not changed, the lending capacity of all financial institutions has diminished and risk premiums have increased. As future capital expenditures will be financed out of funds generated from operations, borrowings and possible future equity sales, Terra's ability to do so is dependent on, among other factors, the overall state of capital markets and investor appetite for investments in the energy industry and Terra's securities in particular.

To the extent that external sources of capital become limited or unavailable or available on onerous terms, Terra Energy's ability to make capital investments and maintain existing assets may be impaired, and its assets, liabilities, business, financial condition and results of operations may be materially and adversely affected as a result.

Based on current funds available and expected funds generated from operations, Terra Energy believes it has sufficient funds available to fund its projected capital expenditures. However, if funds generated from operations are lower than expected or capital costs for these projects exceed current estimates, or if Terra Energy incurs major unanticipated expense related to development or maintenance of its existing properties, it may be required to seek additional capital to maintain its capital expenditures at planned levels. Failure to obtain any financing necessary for Terra Energy's capital expenditure plans may result in a delay in development or production on Terra Energy's properties.

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.

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

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 Alberta, British Columbia and Saskatchewan. 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.

Title

Title to oil and natural gas interests is often not capable of conclusive determination without incurring substantial expense. In accordance with industry practice, Terra Energy will conduct such title reviews in connection with its principal properties as it believes are commensurate with the value of such properties. However, no absolute assurances can be given that title defects do not exist. If title defects do exist, it is possible that Terra Energy may lose all or a portion of its right title and interest in and to the properties to which the title defects relate.

Environmental Risks

All phases of the oil and natural gas business present environmental risks and hazards and are subject to environmental regulation pursuant to a variety of international conventions and federal, provincial and municipal laws and regulations. Environmental legislation provides for, among other things, restrictions and prohibitions on spills, releases or emissions of various substances produced in association with oil and gas operations. The legislation also requires that wells and facility sites be operated, maintained, abandoned and reclaimed to the satisfaction of applicable regulatory authorities. Compliance with such legislation can require significant expenditures and a breach may result in the imposition of fines and penalties, some of which may be material. Environmental legislation is evolving in a manner expected to result in stricter standards and enforcement, larger fines and liability and potentially increased capital expenditures and operating costs. The discharge of oil, natural gas or other pollutants into the air, soil or water may give rise to liabilities to governments and third parties and may require Terra Energy to incur costs to remedy such discharge. Implementation of strategies with respect to climate change and reducing greenhouse gases whether to meet the limits required by the Kyoto Protocol or as otherwise determined by federal or provincial governments could have a material impact on the nature of oil and natural gas operations, including those of Terra Energy. See “Environmental Regulation”. Terra Energy is in material compliance with environmental laws. No assurance can be given that the application of environmental laws to the business and operations of Terra Energy will not result in a curtailment of production or a material increase in the costs of production, development or exploration activities or otherwise adversely affect Terra Energy’s financial condition, results of operations or prospects.

Reserve Estimates

There are numerous uncertainties inherent in estimating quantities in oil, natural gas and natural gas liquids reserves and cash flows to be derived therefrom, including many factors beyond the Corporation's control. The reserve and associated cash flow information set forth herein represents estimates only. In general, estimates of economically recoverable oil and natural gas reserves and the future net cash flows therefrom are based upon a number of variable factors and assumptions, such as historical production from the properties, production rates, ultimate reserve recovery, timing and amount of capital expenditures, marketability of oil and gas, royalty rates, the assumed effects of regulation by governmental agencies and future operating costs, all of which may vary from actual results. All such estimates are to some degree speculative, and classifications of reserves are only attempts to define the degree of speculation involved. For those reasons, estimates of the economically recoverable oil and natural gas reserves attributable to any particular group of properties, classification of such reserves based on risk of recovery and estimates of future net revenues expected therefrom prepared by different engineers, or by the same engineers at different times, may vary. The Corporation's actual production, revenues, taxes and development and operating expenditures with respect to its reserves will vary from estimates thereof and such variations could be material. Further, the evaluations are based in part on the assumed success of exploitation activities intended to be undertaken in future years. The reserves and estimated cash flows to be derived therefrom contained in such evaluations will be reduced to the extent that such exploitation activities do not achieve the level of success assumed in the evaluation.

Estimates of proved reserves that may be developed and produced in the future are often based upon volumetric calculations and upon analogy to similar types of reserves rather than actual production history. Estimates based on these methods are generally less reliable than those based on actual production history. Subsequent evaluation of the same reserves based upon production history and production practices will result in variations in the estimated reserves and such variations could be material.

In accordance with applicable securities laws, GLJ Petroleum Consultants Ltd. ("GLJ"), the independent reserves evaluator, has used forecast price and cost estimates in calculating reserve quantities included herein. Actual future net revenue will be affected by other factors such as actual production levels, supply and demand for oil and natural gas, curtailments or increases in consumption by oil and natural gas purchasers, changes in governmental regulation or taxation and the impact of inflation on costs. Actual production and revenues derived therefrom will vary from the estimates contained in the GLJ Report, and such variations could be material. The GLJ Report is based in part on the assumed success of activities the Corporation intends to undertake in future years. The reserves and estimated cash flows to be derived therefrom contained in the GLJ Report will be reduced to the extent that such activities do not achieve the level of success assumed in the GLJ Report. The GLJ Report is effective as of a specific effective date and has not been updated and thus does not reflect changes in the Corporation's resources since that date.

Reserve Replacement

Terra Energy's future oil and natural gas reserves, production, and cash flows to be derived therefrom are highly dependent on Terra Energy successfully acquiring or discovering new reserves. Without the continual addition of new reserves, any existing reserves Terra Energy may have at any particular time and the production therefrom will decline over time as such existing reserves are exploited. A future increase in Terra Energy's reserves will depend not only on Terra Energy's ability to develop any properties it may have from time to time, but also on its ability to select and acquire suitable producing properties or prospects. There can be no assurance that Terra Energy's future exploration and development efforts will result in the discovery and development of additional commercial accumulations of oil and natural gas.

Reliance on Operators and Key Employees

To the extent Terra Energy is not the operator of all of its oil and gas properties, Terra Energy will be dependent on such operators for the timing of activities related to such properties and will largely be unable to direct or control the activities of the operators. In addition, the success of Terra Energy will be largely dependent upon the performance of its management and key employees. Terra Energy does not have any key man insurance policies, and therefore there is a risk that the death or departure of any member of management or any key employee could have a material adverse effect on Terra Energy.

Corporate Matters

To date, Terra Energy has not paid any dividends on its outstanding common shares and does not anticipate the payment of any dividends on its common shares for the foreseeable future. Certain of the directors and officers of Terra Energy are also directors and officers of other oil and gas companies involved in oil and gas exploration and development, and conflicts of interest may arise between their duties as officers and directors of Terra Energy and as officers and directors of such other companies. Such conflicts must be disclosed in accordance with, and are subject to such other procedures and remedies as apply under the Alberta Business Corporations Act.

Management of Growth

The Corporation may be subject to growth-related risks including capacity constraints and pressure on its internal systems and controls. The ability of the Corporation to manage growth effectively will require it to continue to implement and improve its operational and financial systems and to expand, train and manage its employee base. The inability of the Corporation to deal with this growth could have a material adverse impact on its business, operations and prospects.

Permits and Licenses

The operations of Terra Energy may require licenses and permits from various governmental authorities. There can be no assurance that Terra Energy will be able to obtain all necessary licenses and permits that may be required to carry out exploration and development at its properties.

Additional Funding Requirements

Terra Energy's cash flow from its reserves may not be sufficient to fund its ongoing activities at all times. From time to time, Terra Energy may require additional financing in order to carry out its oil and gas acquisition, exploration and development activities. Failure to obtain such financing on a timely basis could cause Terra Energy to forfeit its interest in certain properties, miss certain acquisition opportunities and reduce or terminate its operations. If Terra Energy's revenues from its reserves decrease as a result of lower oil and natural gas prices or otherwise, it will affect Terra Energy's ability to expend the necessary capital to replace its reserves or to maintain its production. If Terra Energy's cash flow from operations is not sufficient to satisfy its capital expenditure requirements, there can be no assurance that additional debt or equity financing will be available to meet these requirements or available on favourable terms. Any equity financing may result in a change of control of Terra Energy or holders of its common shares suffering further dilution.

Variations in Foreign Exchange Rates

World oil and gas prices are quoted in United States dollars and the price received by Canadian producers is therefore effected by the Canadian/U.S. dollar exchange rate, which will fluctuate over time. In recent years, the Canadian dollar has fluctuated materially in value against the United States dollar. Such fluctuations in the value of the Canadian dollar have materially impacted Terra Energy's operating entities production revenues. Further material fluctuations in the value of the Canadian dollar would exacerbate this impact. This fluctuation in the exchange rate for the Canadian dollar and future Canadian/United States exchange rates could accordingly impact the future value of Terra Energy's reserves as determined by independent evaluators.

Issuance of Debt

From time to time Terra Energy may enter into transactions to acquire assets or the shares of other corporations. These transactions may be financed partially or wholly with debt, which may increase Terra Energy's debt levels above industry standards. Neither Terra Energy's articles nor its bylaws limit the amount of indebtedness that Terra Energy may incur. The level of Terra Energy's indebtedness from time to time could impair Terra Energy's ability to obtain additional financing in the future on a timely basis to take advantage of business opportunities that may arise. Terra Energy's ability to meet its debt service obligations will depend on Terra Energy's future operations which are subject to prevailing industry conditions and other factors, many of which are beyond the control of Terra Energy. As certain of the indebtedness of Terra Energy bears interest at rates which fluctuate with prevailing interest rates, increases in such rates would increase Terra Energy's interest payment obligations and could have a material adverse effect on Terra Energy's financial condition and results of operations. Further, Terra Energy's indebtedness is secured by substantially all of Terra Energy's assets. In the event of a violation by Terra Energy of any of its loan covenants or any other default by Terra Energy on its obligations relating to its indebtedness, the lender could declare such indebtedness to be immediately due and payable and, in certain cases, foreclose on Terra Energy's assets. In addition, oil and gas operations are subject to the risks of exploration, development and production of oil and natural gas properties, including encountering unexpected formations or pressures, premature declines of reservoirs, blow-outs, cratering, sour gas releases, fires and spills. Losses resulting from the occurrence of any of these risks could have a materially adverse effect on future results of operations, liquidity and financial condition.

Financial Instruments

From time to time the Corporation may enter into agreements to receive fixed prices on its oil and natural gas production to offset the risk of revenue losses if commodity prices decline; however, if commodity prices increase beyond the levels set in such agreements, the Corporation will not benefit from such increases. Similarly, from time to time the Corporation may enter into agreements to fix the exchange rate of Canadian to United States dollars in order to offset the risk of revenue losses if the Canadian dollar increases in value compared to the United States dollar; however, if the Canadian dollar declines in value compared to the United States dollar, the Corporation will not benefit from its fluctuating exchange rate.

Availability of Drilling Equipment and Access Restrictions

Oil and natural gas exploration and development activities are dependent on the availability of drilling and related equipment in the particular areas where such activities will be conducted. Demand for such limited equipment or access restrictions may affect the availability of such equipment to Terra Energy and may delay exploration and development activities.

Aboriginal Claims

Aboriginal peoples have claimed aboriginal title and rights to portions of western Canada. The Corporation is not aware that any claims have been made in respect of its property and assets; however, if a claim arose and was successful this could have an adverse effect on the Corporation and its operations.

Seasonality

The level of activity in the Canadian oil and gas industry is influenced by seasonal weather patterns. Wet weather and spring thaw may make the ground unstable. Consequently, municipalities and provincial transportation departments enforce road bans that restrict the movement of rigs and other heavy equipment, thereby reducing activity levels. Also, certain oil and gas producing areas are located in areas that are inaccessible other than during the winter months because the ground surrounding the sites in these areas consists of swampy terrain. There can be no assurance that these seasonal factors will not adversely affect the timing and scope of the Corporation's exploration and development activities, which could in turn have a material adverse impact on the Corporation's business, operations and prospects.

Third Party Credit Risk

The Corporation is, or may be exposed to, third party credit risk through its contractual arrangements with its current or future joint venture partners, marketers of its petroleum and natural gas production and other parties. In the event such entities fail to meet their contractual obligations to the Corporation, such failures could have a material adverse effect on the Corporation and its cash flow from operations. In addition, poor credit conditions in the industry and of joint venture partners may impact a joint venture partner's willingness to participate in the Corporation's ongoing capital program, potentially delaying the program and the results of such program until the Corporation finds a suitable alternative partner.

Alternatives to and Changing Demand for Petroleum Products

Fuel conservation measures, alternative fuel requirements, increasing consumer demand for alternatives to oil and natural gas, and technological advances in fuel economy and energy generation devices could reduce the demand for crude oil and other liquid hydrocarbons. The Corporation cannot predict the impact of changing demand for oil and natural gas products, and any major changes may have a material adverse effect on the Corporation's business, financial condition, results of operations and cash flows.

Kyoto Protocol

Canada is a signatory to the United Nations Framework Convention on Climate Change and has ratified the Kyoto Protocol established thereunder to set legally binding targets to reduce nationwide emissions of carbon dioxide, methane, nitrous oxide and other so-called "greenhouse gases". Terra Energy's exploration and production facilities and other operations and activities emit a small amount of greenhouse gases which will likely subject Terra Energy to legislation regulating emissions of greenhouse gases. The Government of Canada has developed a "Turning the Corner" climate change plan, which outlines future regulatory requirements that will set greenhouse gas emission reduction requirements for various industrial activities, including oil and gas exploration and production. Future federal legislation, together with provincial emission reduction requirements, such as those contained in Alberta's Climate Change and Emissions Management Act and in British Columbia's Bill 18: Greenhouse Gas Reduction (Cap and Trade) Act, may require the reduction of emissions or emissions intensity with Terra Energy's operations and facilities. The direct or indirect costs of these regulations may adversely affect the business of Terra Energy.

Environmental Regulation

The oil and natural gas industry is currently subject to environmental regulations pursuant to provincial and federal legislation. Environmental legislation provides for restrictions and prohibitions on releases or emissions and regulation on the storage and transportation of various substances produced or utilized in association with certain oil and gas industry operations and can affect the location and operation of wells and facilities and the extent to which exploration and development is permitted. In addition, legislation requires that well and facility sites be abandoned and reclaimed to the satisfaction of provincial authorities. As well, applicable environmental laws may impose remediation obligations with respect to property designated as a contaminated site upon certain responsible persons, which include persons responsible for the substance causing the contamination, persons who caused the release of the substance and any past or present owner, tenant or other person in possession of the site. Compliance with such legislation can require significant expenditures and a breach of such legislation may result in the suspension or revocation of necessary licences and authorizations, civil liability for pollution damage, the imposition of fines and penalties or the issuance of clean-up orders.

Applicable environmental laws in Alberta are consolidated in the Environmental Protection and Enhancement Act (the "EPEA"). In British Columbia, environmental laws are primarily found in the Environmental Management Act (the "EMA"). Under the EPEA and the EMA, environmental standards and compliance for releases, clean-up and reporting are stricter and more onerous than in previous legislation. Also, the range of enforcement actions available and the severity of penalties have been significantly increased. These changes will have an incremental effect on the cost of conducting operations in both provinces. Both Alberta and British Columbia review energy projects through an environmental assessment process, which may be held in conjunction with a federal assessment. These review processes involve public participation.

Climate change is an issue that is increasingly subject to government regulation. Although Canada has ratified the Kyoto Protocol and despite legislation to this end introduced by opposition parties in Parliament, it remains uncertain whether the targets in the Kyoto Protocol will be enforced in Canada. Alberta, British Columbia and the federal Government have all introduced climate change action plans that include various means of achieving emissions or emissions intensity reductions, including direct reductions, emissions trading, carbon capture and storage, technology fund contributions and credit for early action. Coordination between these plans has not yet been developed and remains a source of uncertainty. Given the evolving regulatory schemes related to climate change and the control of greenhouse gases and resulting requirements, it is not currently possibly to predict the final form these requirements will take or the impact on Terra Energy and its operations and financial condition at this time.

Conflicts of Interest

Directors and officers of Terra Energy may also be directors and officers of other oil and gas companies involved in oil and gas exploration and development, and conflicts of interest may arise between their duties as officers and directors of Terra Energy and as officers and directors of such other companies. Such conflicts must be disclosed in accordance with, and are subject to such other procedures and remedies as apply under the ABCA.

Dilution

Terra Energy may make future acquisitions or enter into financings or other transactions involving the issuance of securities of Terra Energy which may be dilutive.

Project Risks

Terra Energy will manage a variety of small and large projects in the conduct of its business. Project delays may delay expected revenues from operations. Significant project cost over-runs could make a project uneconomic. Terra's ability to execute projects and market oil and natural gas will depend upon numerous factors beyond Terra's control, including:

- AECO Natural Gas the availability of processing capacity;
- the availability and proximity of pipeline capacity;
- the availability of storage capacity;
- the supply of and demand for oil and natural gas;
- the availability of alternative fuel sources;
- the effects of inclement weather;
- the availability of drilling and related equipment;
- unexpected cost increases;
- accidental events;
- currency fluctuations;
- changes in regulations;
- the availability and productivity of skilled labour; and
- the regulation of the oil and natural gas industry by various levels of government and governmental agencies.

Because of these factors, Terra Energy could be unable to execute projects on time, on budget or at all, and may not be able to effectively market the oil and natural gas that it produces.