

Management's Discussion & Analysis

Period Ended June 30, 2004 as compared to June 30, 2003

*As approved by the Board of Directors
On August 26, 2004*

This Management Discussion and Analysis should be read in conjunction with Terra Energy Corp.'s (the "Corporation") unaudited consolidated financial statements and corresponding notes for the periods ended June 30, 2004 and June 30, 2003. This commentary is based on information available at August 25, 2004. Additional information relating to Terra is available on SEDAR at www.sedar.com.

For the purposes of calculating unit costs, natural gas has been converted to a barrel of oil equivalent ("BOE") using six thousand cubic feet equal to one barrel of oil unless otherwise stated. This conversion conforms to Canadian Securities Regulators National Instrument 51-101 – Standards of Disclosure for Oil and Gas Activities. BOE's are a very approximate comparative measure that, in some cases, could mislead particularly if used in isolation.

Management's Discussion and Analysis contains the term cash flow from operations and funds from operations, which should not be considered alternative to, or more meaningful than cash flows from operating activities as determined in accordance with Canadian generally accepted accounting principles ("GAAP") as an indicator of Terra's performance. Terra's determination of cash flow from operating activities may not be comparable to that reported by other companies. The reconciliation between net earnings and cash flows from operating activities can be found in the statements of cash flows from the unaudited consolidated financial statements.

Corporate History

Terra Energy Corp. ("Terra") is a publicly traded corporation incorporated under the Business Corporations Act of Alberta formed as a result of the amalgamation of Terra Energy Corp., Terrapet Energy Corp., and Rhodes Resources Corp. This Management Discussion and Analysis along with the associated financial statements referenced above include the accounts of the Corporation and its wholly-owned subsidiary Constar Resources Ltd. and Terra Energy, a general partnership between Terra Energy Corp. and Constar Resources Ltd. The comparative information is for Terrapet Energy Corp.

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

Current Production

Average daily production for the three and six month periods ended June 30 in barrel equivalents of oil is as follows:

Period Ended	Six months ended June 30, 2004	Six months ended June 30, 2003	Three months ended June 30, 2004	Three months ended June 30, 2003
Oil	278	238	320	244
Natural Gas	755	628	751	659
Liquids	48	45	66	43
Total	1,081	911	1,137	946

Increased production is due to continued developments and acquisitions.

Results of Operations

	Six months ended June 30, 2004	Six months ended June 30, 2003	Three months ended June 30, 2004	Three months ended June 30, 2003
Revenues, net of royalties	\$6,496,144	\$4,356,120	\$3,581,954	\$2,162,186
Production Expenses	\$1,963,240	\$1,621,930	\$1,226,980	\$942,671
General & administrative and interest expenses	\$1,184,263	\$734,443	\$601,873	\$340,032
Income tax expense	\$610,300	\$490,500	\$274,300	\$210,500
Income before non-cash expenses	\$2,738,341	\$1,509,247	\$1,478,801	\$668,983
Non-cash expenses	\$1,991,500	\$742,070	\$1,083,500	\$331,242
Net Income	\$746,841	\$767,177	\$395,301	\$337,741

The Corporation earned higher revenues as a result of increased production activity. Increased revenues in 2004 were also due to improved commodity prices as compared to 2003. Strong commodity prices continued for the second quarter of 2004.

The reduction in net income for the six months is due to the increase in non-cash charges, specifically increased depletion as a result of adoption National Instrument 51-101 and the requirement to record stock based compensation on the income statement in accordance with CICA Handbook Section 3870 – Stock Based Compensation.

Production expenses per BOE were as follows:

	Six months ended June 30, 2004	Six months ended June 30, 2003	Three months ended June 30, 2004	Three months ended June 30, 2003
Production Expenses	\$1,963,240	\$1,621,930	\$1,226,980	\$942,671
BOE total production	196,622	164,829	103,402	86,116
Production expenses per BOE	\$9.98	\$9.84	\$11.87	\$10.95

The increased production costs per boe are primarily due to workovers being performed on certain recently acquired producing properties. These are one time costs and it is expected that production costs per boe will decrease in future periods.

Net revenues per BOE were as follows:

	Six months ended June 30, 2004	Six months ended June 30, 2003	Three months ended June 30, 2004	Three months ended June 30, 2003
Revenues, net of royalties and production expenses	\$4,532,904	\$2,734,190	\$2,354,974	\$1,219,515
BOE total production	196,622	164,829	103,402	86,116
Net Revenues per BOE	\$23.05	\$16.59	\$22.77	\$14.16

Higher net revenues for the period ending June 30, 2004 are due to improved commodity prices and increased production for the three months ended June 30, 2004.

General and Administrative Expenses

	Six months ended June 30, 2004	Six months ended June 30, 2003	Three months ended June 30, 2004	Three months ended June 30, 2003
General & Administrative Expenses	\$1,001,762	\$523,635	\$492,143	\$235,862
BOE total production	196,622	164,829	103,402	86,116
Expense per BOE	\$5.09	\$3.18	\$4.76	\$2.74

Increased general and administrative costs are primarily due to additional technical personnel costs required to manage forward the Corporation's anticipated growth in production volumes and increased exploration and development activity and increased professional fees with respect to the amalgamation.

Depletion, Amortization, & Accretion

Period Ended	Six months ended June 30, 2004	Six months ended June 30, 2003	Three months ended June 30, 2004	Three months ended June 30, 2003
Depletion, Amortization, & Accretion	\$1,660,500	\$969,162	\$967,500	\$445,581
BOE total production	196,622	164,829	103,402	86,116
Expense per BOE	\$8.45	\$5.88	\$9.36	\$5.17

Increased depletion, amortization, and accretion expenses are attributable in part to the early adoption of National Instrument 51-101 which has refocused reserve classification categories and resulted in lower reserves being classified as proven and an increase in the probable classification. Management performed and the external auditors reviewed a ceiling test calculation to assess the recoverability of its petroleum and natural gas assets as at December 31, 2003. The calculation supported the Corporation's carrying value.

Financial Condition

	June 30, 2004	December 31, 2003
Current Assets	\$3,747,791	\$3,381,413
Current Liabilities	\$3,634,552	\$10,570,606
Oil and gas properties	\$18,161,359	\$12,224,115

The increase in current assets is primarily due to increased accounts receivable resulting from a receivable for the sale of certain properties and an increase in Crown royalty security deposits required by the Province of Alberta. The reduction in current liabilities is due to the reclassification of the revolving line of credit to non-current liabilities. The Corporation received notification from its bank to indicate that payment of the revolving line of credit will not be required without one year's notice. The increase in accounts payable and accrued liabilities is primarily due to continued growth in the Corporation's oil and gas properties. As at June 30, 2004 there was approximately \$720,000 in capital asset purchases included in accounts payable. The Corporation had a working capital surplus of \$113,239 at June 30, 2004 compared to surplus of \$381,968 at December 31, 2003 if the revolving line of credit is excluded from current liabilities.

Capitalized resource properties as at June 30, 2004 are \$18,161,359 net of depletion, compared with \$12,224,115 as at December 31, 2003. Oil and gas properties increased as a result of continued acquisitions, such as the amalgamation with Rhodes Resources Corp, as well as continued development of existing properties.

Liquidity and Capital Resources

The Corporation's share capital is as follows:

Common Shares

Date	Shares Outstanding	Dollar Value
June 30, 2004	27,327,600	\$7,352,879
December 31, 2003	22,500,000	\$1

During the period ended June 30, 2004, as part of the amalgamation with Terra Energy Corp. and Rhodes Resources Corp, the 22.5 million common shares of Terrapet Energy Corp. were exchanged for 18,547,304 common shares of Terra Energy Corp. 3,429,752 preferred shares from Terrapet Energy Corp. were converted to 3,429,752 common shares. 5,345,944 common shares were issued to the former shareholders of Rhodes Resources Corp. An additional 220,000 common shares were issued as part of the purchase of certain oil and gas properties and the exercising of options.

During the three month period ended June 30, 2004 the Corporation obtained permission from the TSX Venture Exchange for a Normal Course Issuer Bid to repurchase for cancellation up to 250,000 common shares to April 22, 2005. During the period ended June 30, 2004, 215,400 common shares were purchased.

The Corporation is required to incur exploration and development expenses of approximately \$2,300,000 as a result of flow through shares issued through Rhode Resources Corp. As at June 30, 2004 the Corporation has spent approximately \$1,583,000.

Preferred Shares at June 30, 2004

Series	Shares Outstanding	Dollar Value
Series I to V	1,148,641	\$1,148,641
Series VI	nil	nil

Preferred Shares at December 31, 2003

Series	Shares Outstanding	Dollar Value
Series I to V	1,148,641	\$1,148,641
Series VI	3,429,752	\$3,429,752

During the period ended June 30, 2004, the Series VI preferred shares were converted to common shares as part of the amalgamation between Terra Energy Corp., Terrapet Energy Corp., and Rhodes Resources Corp.

For the period ended June 30, 2004, the Corporation has generated cash flows from operations of \$3,243,141 (\$1,913,147 for the period ended June 30, 2003).

For the three month period June 30, 2004, the Corporation renegotiated its credit facility resulting in an increase in available credit from \$8.0 million to \$10.0 million. The swap facility was increased from \$2.5 million to \$3.0 million. An additional condition of the credit facility is that the facility is payable upon one year's notice by the bank. As a result the credit facility payable balance of \$7,060,437 has been presented as part of non-current liabilities.

Off-Balance Sheet Arrangements

The Corporation has entered into various fixed-price physical natural gas contracts with delivery for 2004 of 184,500 GJ at prices between \$5.80 and \$5.87 per GJ. The Corporation has agreed for 2004 to purchase 123,000 GJ natural gas at a price of \$5.55 per GJ. The Corporation has also entered into various fixed-price financial gas contracts with delivery for 2004 of 184,500 GJ at prices between \$6.05 and \$6.15 per GJ. The Corporation has also entered into a 3 way collar financial gas contract with delivery between November, 2004 and October, 2005 of 365,000 GJ with a price cap of \$8.95 per GJ and a price floor of \$5.00 per GJ.

The Corporation has entered into various fixed-price physical oil contracts with delivery for 2004 of 18,000 barrels at prices between \$33.38 and \$36.89 per barrel. The Corporation has entered into various fixed-price financial oil contracts with delivery for 2005 of 73,000 barrels at prices between \$35.35 and \$36.65 per barrel.

The purpose of these contracts is to ensure a minimum cash flow level for continued operations.

Transactions with Related Parties

During the period January 1 through to June 30 of each 2003 and 2004, Terrapet and/or the Corporation entered into the following related party transactions:

(a) Related Parties:

Capital Strategies Canada Corp., controlled by officers of the Corporation
Rhodes Resources Corp., related due to common ownership
Terra Capital Corp., parent company
Forterra Properties Inc., related due to common control
Rhodes Petroleum Corp., related due to common control

(b) Transactions:

	<u>Period Ended June 30, 2004</u>	<u>Period Ended June 30, 2003</u>
Interest revenue – Rhodes Resources Inc.	\$ -	\$ 11,454
Expenses		
Management fee – Terra Capital Corp.	<u>370,977</u>	<u>463,349</u>

Revenue and expense 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.

Management fees have been paid to Terra Capital Corp. for management personnel services, vehicles, office furniture and equipment leasing. Prior to the amalgamation and up to March 31, 2004 all personnel were employees of Terra Capital Corp. Subsequent to amalgamation, new employment contracts were implemented with all employees and effective April 1, 2004 employees were paid by The Corporation. The amount of management fees relating personnel services is approximately \$327,000. Any continuing management fees will be for vehicle, office furniture, and equipment leasing at the rate of \$6,000 per month. All management fees are determined on a cost recovery basis.

During 2003, the Corporation purchased all the outstanding shares of Rhodes Resources Inc., a corporation under common control with Terrapet. The assets consisted of oil and gas properties with a net book value of \$100,000. A note payable for \$100,000 was issued by Terrapet to Rhodes

Petroleum Corp for consideration of this transaction. Rhodes Resources Inc. was immediately wound up into Terrapet.

Prior to the amalgamation with Rhodes Resources Corp., and Terra Energy Corp., Terrapet paid a dividend of \$770,816 to Terra Capital Corp. The dividend resulted in the elimination of a promissory note receivable at December 31, 2003.

During the period ended June 30, 2004 dividends of \$40,776 on the Series I to V preferred shares were accrued. These amounts have been recorded as part of interest on long term debt. No amounts were accrued for the period ending June 30, 2003.

(c) Due from (to) related parties

	June 30, 2004	December 31, 2003
Terra Capital Corp.	\$ (82,150)	\$ 15,000

Included in accounts payable and accrued liabilities at December 31, 2003 are \$39,456 owing to Rhodes Resources Corp. This amount is due for the working interest share of expenses related to wells operated by the Corporation prior to amalgamation. Included in accounts receivable at December 31, 2003 is \$228,497 due from Rhodes Resources Corp to Terrapet in connection with a farm-in arrangement between the two companies prior to amalgamation.

As a result of the amalgamation with Rhodes Resources Corp, no amount is owed or owing at June 30, 2004.

Included in accounts payable and accrued liabilities is \$146,868 (December 31, 2003 - \$nil) owing to Terra Capital Corp. consisting of \$106,092 for prior year management fees and \$40,776 for the dividend on the Series I to V preferred shares.

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.

Reserves are critical to several accounting estimates, affecting net income through depletion and the ceiling test calculation. Estimating reserves is very complex, requiring many judgments based on available geological, geophysical, engineering, and economic data. Estimated reserves also utilized by the Corporation's bank in determining credit facilities. Changes in these judgments could have a material impact on the estimated reserves, and subsequently the Corporation's financial results and financial condition.

Ceiling Test

Under the Canadian Institute of Chartered Accountants (CICA) full cost accounting guidelines, the Company 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 but early adoption were encouraged.

At December 31, 2003, the Corporation calculated the ceiling test using AcG 16 without any material adverse impact on the Corporation's financial position or results of operations.

Asset Retirement Obligation

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

Litigation

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

Changes in Accounting Policies

In 2002 the Canadian Institute of Chartered Accountants ("CICA") approved Section 3063, "Impairment of Long-Lived Assets" (S. 3063), establishing standards for the recognition, measurement, and disclosure of the impairment of long-lived assets, and applies to long-lived assets held for use. An impairment loss is recognized when the carrying value exceeds its fair value and is not recoverable. This standard is effective for fiscal years beginning on or after April 1, 2003 with early adoption being encouraged. Accounting Guideline 16, "Oil and Gas Accounting Full Cost" (AcG-16), issued in September, 2003 includes this section in the application of the impairment test for oil and gas companies using the full cost method of accounting. The carrying value for oil and gas properties is limited to their fair value, which is equal to estimated future cash flows from proved and probable reserves, calculated future price forecasts and costs discounted at the risk-free rate. AcG-16 is required for all fiscal years beginning on or after January 1, 2004 with early adoption being encouraged. Terra has early adopted the requirements of AcG-16 at December 31, 2003. There has been no material adverse impact on the Company's financial position or results of operations.

For fiscal years commencing on or after July 1, 2003 the CICA's new accounting pronouncement Accounting Guideline 13 "Hedging Relationships" (AcG-13) is in effect. This guideline sets out certain conditions when hedge accounting may be applied; otherwise the fair values of derivative financial instruments are recorded as an asset or liability on the balance sheet. It is management's opinion that all financial contracts satisfy the necessary criteria to be designated hedges. The purpose of the hedges is to ensure a minimum level of cash flow.

The Corporation has early adopted the CICA's section on "Asset Retirement Obligations" (S. 3110). The section is required to be adopted for fiscal years beginning on or after January 1, 2004 with early adoption being encouraged. S. 3110 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. 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. Comparative amounts for 2003 have been restated with an immaterial impact on the results of operations.

Financial Instruments

The Corporation 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.

Business Acquisitions

On November 25, 2003 Terrapet Energy Corp. purchased all the outstanding shares of Constar Resources Ltd. in exchange for the issuance of 929,752 Series VI preferred shares. The purchase has resulted in increased proven and probable reserves of approximately 231,000 barrels equivalent.

On January 30, 2004, Terrapet amalgamated with Rhodes Resources Corp. ("Rhodes") and Terra Energy Corp. to form a new company Terra Energy Corp ("Terra"). The common shareholder of Terrapet Energy Corp. received 18,547,304 common shares of Terra, with the Series VI preferred shareholders of Terrapet receiving 3,429,752 common shares of Terra. The shareholders of Rhodes received 5,345,944 common shares of Terra. The share allocation has been based upon the relative valuations for oil and gas properties as determined by independent evidence adjusted for various other assets and liabilities. The purchase increased oil and gas properties by approximately \$2.4 million. Oil and gas reserves have increased by approximately 271,000 barrels equivalent as compared to Terrapet's reserves. The amalgamation constitutes a reverse takeover as defined by Policy 5.2 of the TSX-V and is subject to Policy 5.9 of the TSX-V regarding related party transactions. The transaction will be recorded at the exchange value of the assets received from Rhodes as there is sufficient independent evidence available and there is a substantive change in the ownership interests.

Outlook 2004

Terra Energy Corp's capital expenditure budget for 2004 is approximately \$12.9 million comprised of development and tie-in projects. Management anticipates that these projects will add an additional 1,000 BOE per day of production by year-end. The capital expenditures will be funded by a combination of operating cash flow, bank financing, and capital issuance. In anticipation of increased future exploration opportunities, Terra will be adding to its technical staff, throughout the remainder of 2004.

Terra continues to seek growth opportunities through increased production and acquisition strategies. Terra's management expects to exit 2004 with 2,000 BOE per day production and be positioned to enter 2005 with a more ambitious exploration posture.

Certain statements contained in the above Management's Discussion and Analysis, including, without limitation, statements containing the words believes, anticipates, estimates, expects, and words of similar import, constitute forward-looking statements. Forward looking statements are not guarantees of future performance and involve risks and uncertainties, which could cause actual results to differ materially from those anticipated in these forward-looking statements. Among the key factors that could cause such differences are: fluctuations in petroleum and natural gas prices, and/or changes in petroleum and natural gas reservoir performance.

We disclaim any intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, unless required to do so by applicable securities law.