



Q2 2005

*Six months ended
June 30, 2005*

Table of Contents

| | |
|--------------------------------------|----|
| Management's Discussion and Analysis | 1 |
| Consolidated Financial Statements | 17 |

Abbreviations

| | | | |
|-------|-----------------------------------|--------|------------------------------------|
| AIF | Annual Information Form | mcf/d | thousand cubic feet per day |
| Bbl | barrel | mmcf | million cubic feet |
| bbl/d | barrels per day | mmcf/d | million cubic feet per day |
| boe | barrels of oil equivalent | NGLs | natural gas liquids |
| boe/d | barrels of oil equivalent per day | TSX-V | TSX Venture Exchange |
| C\$ | Canadian dollars | WCSB | Western Canadian Sedimentary Basin |
| mcf | thousand cubic feet | | |

Company Definition

Throughout the annual report, Terra Energy Corp. is referred to as "Terra Energy", the "Company" or the "Corporation".

Volume Reporting Definition

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. Barrels of oil equivalent are a very approximate comparative measure that, in some cases, could mislead particularly if used in isolation.

Forward Looking Statements

Certain information regarding the Company contained herein may constitute forward-looking statements under applicable securities laws. Such statements are subject to known or unknown risks and uncertainties that may cause actual results to differ materially from those anticipated or implied in the forward-looking statements.

Management's Discussion & Analysis

Period Ended June 30, 2005 as compared to June 30, 2004

This Management Discussion and Analysis should be read in conjunction with Terra Energy Corp.'s ("Terra Energy" or the "Corporation") unaudited consolidated financial statements and corresponding notes for the periods ended June 30, 2005 and June 30, 2004. This commentary is based on information available at August 23, 2005. Additional information relating to Terra Energy 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 Energy's performance. Terra Energy'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 is a publicly traded corporation, amalgamated under the Business Corporations Act of Alberta, and formed as a result of the amalgamation of Terra Energy Corp., Terrapet Energy Corp., and Rhodes Resources Corp. on January 30, 2004. This Management Discussion and Analysis along with the associated financial statements referenced above include the accounts of the Corporation and its wholly-owned subsidiary Constar Resources Ltd. and Terra Energy, a general partnership between Terra Energy Corp. and Constar Resources Ltd.

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

Highlights

| <i>Operations for the six months ended June 30</i> | <i>2005</i> | <i>2004</i> | <i>Percent Growth</i> |
|--|-------------|-------------|-----------------------|
| Average Daily Production | 2,342 | 1,081 | 117% |
| Exit Production (boe/d) | 2,078 | 1,109 | 87% |
| Undeveloped Land (Net Hectares) | 85,763 | 11,296 | 659% |

Management's Discussion & Analysis

Period Ended June 30, 2005 as compared to June 30, 2004

| <i>Financial for the six months ended June 30</i> | 2005 | 2004 | <i>Percent Growth</i> |
|---|--------------|-------------|-----------------------|
| Revenue | \$16,345,523 | \$7,994,272 | 104% |
| Cashflow From Operations | \$4,174,270 | \$3,243,141 | 29% |
| Cashflow Per Share - basic | \$0.08 | \$0.12 | (33%) |
| Revenue per boe | \$40.43 | \$45.56 | (11%) |
| Operating Netback per boe | \$16.84 | \$25.39 | (34%) |
| Cashflow per boe | \$10.32 | \$18.17 | (43%) |

The Corporation's reserves were evaluated at December 31, 2004. Information regarding the reserves is available at www.sedar.com.

2005 OPERATIONS – YEAR TO DATE

Current Production

The average daily production rate for the six and three month periods ended June 30, 2005 and 2004 is set out below, and expressed in barrel of oil equivalents.

| <i>Six months ended June 30</i> | 2005 | | 2004 | | <i>Percent Growth</i> | |
|---------------------------------|----------------|-------------|----------------|-------------|-----------------------|-------------|
| | <i>Average</i> | <i>Exit</i> | <i>Average</i> | <i>Exit</i> | <i>Average</i> | <i>Exit</i> |
| Oil (bbl/d) | 520 | 413 | 278 | 379 | 87% | 9% |
| Natural Gas (boe/d) | 1,732 | 1,565 | 755 | 645 | 129% | 143% |
| Liquids (bbl/d) | 90 | 100 | 48 | 85 | 88% | 18% |
| Total (boe/d) | 2,342 | 2,078 | 1,081 | 1,109 | 116% | 87% |

| <i>Three Months Ended June 30</i> | 2005 | | 2004 | | <i>Percent Growth</i> | |
|-----------------------------------|----------------|-------------|----------------|-------------|-----------------------|-------------|
| | <i>Average</i> | <i>Exit</i> | <i>Average</i> | <i>Exit</i> | <i>Average</i> | <i>Exit</i> |
| Oil (bbl/d) | 502 | 413 | 320 | 379 | 57% | 9% |
| Natural Gas (boe/d) | 1,759 | 1,565 | 751 | 593 | 134% | 164% |
| Liquids (bbl/d) | 120 | 100 | 66 | 85 | 82% | 18% |
| Total (boe/d) | 2,381 | 2,078 | 1,137 | 1,057 | 109% | 97% |

Management's Discussion & Analysis

Period Ended June 30, 2005 as compared to June 30, 2004

Terra Energy's average production for April, May, and June was 2,520, 2,649, and 1,975 BOE per day, respectively. June's production was curtailed due to planned gas plant turnarounds at several plants most notably the McMahon Gas Plant at Fort St. John and the Gordondale East gas plant in Northwest Alberta. A significant portion of Terra Energy's natural gas production is in close proximity to Fort St. John and is processed at the McMahon Gas Plant.

The Gordondale East gas plant experienced a 100% shut down for several days in June for plant maintenance. Terra Energy's recently tied in Bilawchuk 10-22-80-9W6 gas well flows through this facility. When the plant commenced processing natural gas, the 10-22 gas well did not come back on production due to high liquid levels in the tubing. The well was swabbed and was returned to production at a reduced rate.

Spring breakup and the typical spring rains limited Terra's drilling operations for the quarter. As a result no new production from drilling operations was added in the second quarter. At Sextet in Northern British Columbia, one well was shut-in due to high water production levels. The well will be returned to production once the surface access conditions have dried up sufficiently to permit access to the well. Due to the volume of water production, natural gas production from Sextet area will be less than previously expected.

The previously announced active drilling program commenced in July with two drilling rigs and one service rig active at month end.

Results of Operations

| <i>Six Months Ended June 30</i> | <i>2005</i> | <i>2004</i> | <i>2005</i> | <i>2004</i> | <i>Percent Growth</i> |
|-----------------------------------|---------------|-------------|-------------------|-------------------|-----------------------|
| | | | <i>(\$ / boe)</i> | <i>(\$ / boe)</i> | <i>(\$ / boe)</i> |
| Revenues | \$16,345,523 | \$7,994,272 | \$40.43 | \$44.78 | (10%) |
| Royalties | \$3,532,018 | \$1,498,128 | \$8.74 | \$8.39 | 4% |
| Production Expenses | \$6,005,873 | \$1,963,240 | \$14.86 | \$11.00 | 35% |
| Income from Operations | \$6,807,632 | \$4,532,904 | \$16.84 | \$25.39 | (34%) |
| General & administrative expenses | \$2,031,606 | \$1,001,762 | \$5.03 | \$5.61 | (10%) |
| Interest expense | \$567,209 | \$182,501 | \$1.40 | \$1.02 | 37% |
| Non-cash expenses | \$8,175,462 | \$1,991,500 | \$20.22 | \$11.16 | 81% |
| Income (loss) before income taxes | (\$3,966,645) | \$1,357,141 | (\$9.81) | \$7.60 | (229%) |
| Income tax expense (recovery) | (\$1,131,731) | \$610,300 | (\$2.80) | \$3.42 | (182%) |
| Net Income (loss) | (\$2,834,914) | \$746,841 | (\$7.01) | \$4.18 | (267%) |

Management's Discussion & Analysis

Period Ended June 30, 2005 as compared to June 30, 2004

| <i>Three Months Ended June 30</i> | <i>2005</i> | <i>2004</i> | <i>2005</i> <i>(\$ / boe)</i> | <i>2004</i> <i>(\$ / boe)</i> | <i>Percent Growth</i> <i>(\$ / boe)</i> |
|-----------------------------------|---------------|-------------|----------------------------------|----------------------------------|--|
| Revenues | \$8,412,842 | \$4,395,322 | \$39.54 | \$45.56 | (13%) |
| Royalties | \$2,547,511 | \$813,368 | \$11.97 | \$8.43 | 42% |
| Production Expenses | \$4,005,683 | \$1,226,980 | \$18.83 | \$12.72 | 48% |
| Income from Operations | \$1,859,648 | \$2,354,974 | \$8.74 | \$24.41 | (64%) |
| General & administrative expenses | \$1,244,911 | \$492,143 | \$5.85 | \$5.10 | 14% |
| Interest expense | \$215,531 | \$109,730 | \$1.01 | \$1.14 | (11%) |
| Non-cash expenses | \$2,920,572 | \$1,083,500 | \$13.73 | \$11.23 | 22% |
| Income (loss) before income taxes | (\$2,521,366) | \$669,601 | (\$11.85) | \$6.94 | (271%) |
| Income tax expense (recovery) | (\$680,176) | \$274,300 | (\$3.19) | \$2.84 | (212%) |
| Net Income (loss) | (\$1,841,190) | \$395,301 | (\$8.65) | \$4.10 | (311%) |

The average per BOE price received by Terra for the quarter was \$39.54. Factors affecting this price are as follows:

- Approximately 67% of the Corporation's sales are from natural gas. While oil prices have experienced extremely high price increases, price increases for natural gas have been less significant. For the first six months of 2005 the AECO spot average price for natural gas using a conversion factor of six thousand cubic feet equal to one barrel of oil, the average natural gas price would be approximately \$42 per barrel of oil equivalency.
- The Corporation has entered into two financial contracts to hedge a total of 200 barrels of oil per day at an average price of \$36.00 per barrel. These contracts expire on December 31, 2005.
- Approximately 30 percent of the Corporation's oil sales are from medium crude. The revenue differential between light and medium crude was approximately \$10 per boe. The primary source for the medium crude is from a property purchased during April, 2004. Therefore, the prior year's revenues include revenues from medium crude for a two month period.
- The Dominion Canada asset acquisition at December 31, 2004 required Terra Energy Corp. to assume an established sales contract. The contract price is based upon a pooled priced that is calculated using resale pricing received by the purchaser. Revenues received by Terra Energy Corp. under this contract have been significantly lower than market prices. The contract ends November 1, 2005.

General and administrative expenses have increased in 2005 as compared to 2004 as a result of the certain one time charges related to changes in the Corporation's financing arrangements and increased

Management's Discussion & Analysis

Period Ended June 30, 2005 as compared to June 30, 2004

salary expense due to the strengthening of the Corporation's technical team. The Corporation has also accrued approximately \$224,000 for Part XII.6 tax related to flow through shares issued and renounced in 2004. This tax is expected to be accrued for both 2005 and 2006 and the incremental amounts accrued in future periods will decrease as the Corporation meets its flow through share obligations. General and administrative expenses on a per boe basis have decreased by 10% attributable to increased production. The Corporation expects this trend to continue as additional production is added to the production base.

Interest charges for the six month period ended June 30, 2005 as compared to 2004 increased by 211% as a result of the \$10,000,000 subordinated debt drawn December 31, 2004 for a strategic acquisition. The debt was retired March 29, 2005.

The increased non-cash expenses are primarily due to two reasons. First, there is a one-time charge for the amortization of the financing fees related to the subordinated debt. Second, the corporation owns more assets resulting in an increased depletion provision. Also, as a result of issuance of additional employee stock options, there was an increase in the 2005 Stock Based Compensation provision.

Production expenses per boe were as follows:

| <i>Six Months Ended June 30</i> | <i>2005</i> | <i>2004</i> | <i>2005</i> | <i>2004</i> | <i>Percent Change</i> |
|---------------------------------|-------------|-------------|-------------------|-------------------|-----------------------|
| | | | <i>(\$ / boe)</i> | <i>(\$ / boe)</i> | <i>(\$ / boe)</i> |
| Production Expenses | \$6,005,873 | \$1,963,240 | \$14.86 | \$11.00 | 35% |

| <i>Three Months Ended June 30</i> | <i>2005</i> | <i>2004</i> | <i>2005</i> | <i>2004</i> | <i>Percent Change</i> |
|-----------------------------------|-------------|-------------|-------------------|-------------------|-----------------------|
| | | | <i>(\$ / boe)</i> | <i>(\$ / boe)</i> | <i>(\$ / boe)</i> |
| Production Expenses | \$4,005,683 | \$1,226,980 | \$18.83 | \$12.72 | 48% |

Increased production expenses were due to several workovers with a cost of approximately \$1 million that were performed in the second quarter of 2005 in conjunction with the planned gas plant shut downs on properties that were acquired as part of the December, 2004 strategic acquisition.

Net revenues per boe were as follows:

| <i>Six Months Ended June 30</i> | <i>2005</i> | <i>2004</i> | <i>2005</i> | <i>2004</i> | <i>Percent Change</i> |
|---------------------------------|--------------|-------------|-------------------|-------------------|-----------------------|
| | | | <i>(\$ / boe)</i> | <i>(\$ / boe)</i> | <i>(\$ / boe)</i> |
| Gross Revenue | \$16,345,523 | \$7,994,272 | \$40.43 | \$44.78 | (10%) |
| Royalties | \$3,532,018 | \$1,498,128 | \$8.74 | \$8.39 | 4% |
| Production Expenses | \$6,005,873 | \$1,963,240 | \$14.86 | \$11.00 | 35% |
| Net Revenue | \$6,807,632 | \$4,532,904 | \$16.84 | \$25.39 | (34%) |

Management's Discussion & Analysis

Period Ended June 30, 2005 as compared to June 30, 2004

| <i>Three Months Ended June 30</i> | <i>2005</i> | <i>2004</i> | <i>2005</i> | <i>2004</i> | <i>Percent Change</i> |
|-----------------------------------|-------------|-------------|-------------------|-------------------|-----------------------|
| | | | <i>(\$ / boe)</i> | <i>(\$ / boe)</i> | <i>(\$ / boe)</i> |
| Gross Revenue | \$8,412,842 | \$4,395,322 | \$39.54 | \$45.56 | (13%) |
| Royalties | \$2,547,511 | \$813,368 | \$11.97 | \$8.43 | 42% |
| Production Expenses | \$4,005,683 | \$1,226,980 | \$18.83 | \$12.72 | 48% |
| Net Revenue | \$1,859,648 | \$2,354,974 | \$10.44 | \$24.41 | (57%) |

General and Administrative Expenses

| <i>Six Months Ended June 30</i> | <i>2005</i> | <i>2004</i> | <i>2005</i> | <i>2004</i> | <i>Percent Change</i> |
|-----------------------------------|-------------|-------------|-------------------|-------------------|-----------------------|
| | | | <i>(\$ / boe)</i> | <i>(\$ / boe)</i> | <i>(\$ / boe)</i> |
| General & Administrative Expenses | \$2,031,606 | \$1,001,762 | \$5.03 | \$5.61 | (10%) |

| <i>Three Months Ended June 30</i> | <i>2005</i> | <i>2004</i> | <i>2005</i> | <i>2004</i> | <i>Percent Change</i> |
|-----------------------------------|-------------|-------------|-------------------|-------------------|-----------------------|
| | | | <i>(\$ / boe)</i> | <i>(\$ / boe)</i> | <i>(\$ / boe)</i> |
| General & Administrative Expenses | \$1,244,911 | \$492,148 | \$5.85 | \$5.10 | 14% |

General and administrative expenses have increased in 2005 as compared to 2004 as a result of the certain one time charges related to changes in the Corporation's financing arrangements and increased salary expense due to the strengthening of the Corporation's technical team. The Corporation has also accrued approximately \$224,000 for Part XII.6 tax related to flow through shares issued and renounced in 2004. This tax is expected to be accrued for both 2005 and 2006 and the incremental amounts accrued in future periods will decrease as the Corporation meets its flow through share obligations. General and administrative expenses on a per boe basis have decreased by 10% attributable to increased production. The Corporation expects this trend to continue as additional production is added to the production base.

Interest Expense

| <i>Six Months Ended June 30</i> | <i>2005</i> | <i>2004</i> | <i>2005</i> | <i>2004</i> | <i>Percent Change</i> |
|---------------------------------|-------------|-------------|-------------------|-------------------|-----------------------|
| | | | <i>(\$ / boe)</i> | <i>(\$ / boe)</i> | <i>(\$ / boe)</i> |
| Interest Expenses | \$ 567,209 | \$182,501 | \$1.40 | \$1.02 | 37% |

Management's Discussion & Analysis

Period Ended June 30, 2005 as compared to June 30, 2004

Interest expense for the period ended June 30, 2005 consists of Interest on the revolving line of credit for \$360,174, interest on the Subordinated Debt for \$161,091, and a preferred share dividend for \$45,944. The dividend is considered interest for accounting purposes. The higher interest expense for the period ended June 30, 2005 as compared to the period ended June 30, 2004 is due to higher indebtedness for 2005. On March 29, 2005 the Corporation retired its subordinated debt of \$10,000,000. The retirement is expected to result in a decreased interest expense for future periods.

| <i>Three Months Ended June 30</i> | <i>2005</i> | <i>2004</i> | <i>2005</i> | <i>2004</i> | <i>Percent Change</i> |
|-----------------------------------|-------------|-------------|-------------------|-------------------|-----------------------|
| | | | <i>(\$ / boe)</i> | <i>(\$ / boe)</i> | <i>(\$ / boe)</i> |
| Interest Expenses | \$215,531 | \$109,730 | \$1.01 | \$1.14 | (11%) |

The lower interest expense for the three months ended June 30, 2005 is due to the retirement of the subordinated debt of \$10,000,000 on March 29, 2005. Subsequent to the period end, the Corporation completed a private placement for approximately \$23.3 million. As a result a greater portion of future capital expenditures will be funded by this share issuance resulting in lower future interest charges.

Non Cash Items

| <i>Six Months Ended June 30</i> | <i>2005</i> | <i>2004</i> | <i>2005</i> | <i>2004</i> | <i>Percent Change</i> |
|---------------------------------|-------------|-------------|-------------------|-------------------|-----------------------|
| | | | <i>(\$ / boe)</i> | <i>(\$ / boe)</i> | <i>(\$ / boe)</i> |
| Depletion and Amortization | \$4,400,000 | \$1,617,000 | \$10.88 | \$9.05 | 20% |
| Accretion Expense | \$188,962 | \$43,500 | \$0.47 | \$0.24 | 96% |
| Stock Based Compensation | \$617,000 | \$331,000 | \$1.53 | \$1.85 | (17%) |
| Financing Fee Amortization | \$2,969,500 | \$ - | \$7.35 | \$ - | N/A |
| Total Non Cash Items | \$8,175,462 | \$1,991,500 | \$20.22 | \$11.16 | 81% |

Management's Discussion & Analysis

Period Ended June 30, 2005 as compared to June 30, 2004

| Three Months Ended June 30 | 2005 | 2004 | 2005 | 2004 | Percent |
|----------------------------|-------------|-------------|------------|------------|---------|
| | | | (\$ / boe) | (\$ / boe) | Change |
| Depletion and Amortization | \$2,360,000 | \$944,000 | \$11.09 | \$9.79 | 13% |
| Accretion Expense | \$98,572 | \$23,500 | \$0.46 | \$0.24 | 92% |
| Stock Based Compensation | \$462,000 | \$116,000 | \$2.17 | \$1.20 | 81% |
| Financing Fee Amortization | \$ - | \$ - | \$ - | \$ - | N/A |
| Total Non Cash Items | \$2,920,572 | \$1,083,500 | \$13.73 | \$11.23 | (22%) |

Depletion, amortization, and accretion expense for 2005 has increased over 2004 by approximately \$1,800,000 due to the amortization of deferred financing charges. This one-time charge will not occur in future periods. Also affecting non-cash expenses is the stock based compensation expense. Employee stock options issued in June, 2005 resulted in an additional stock based compensation of approximately \$398,000. In the absence of the deferred financing charge amortization and stock based compensation expense, net income for the six months ended June 30, 2005 would have been approximately \$750,000 or 1 cent per share for both basic and diluted weighted average shares.

Management performed a ceiling test calculation to assess the recoverability of its petroleum and natural gas assets as at June 30, 2005. The calculation supported the Corporation's carrying value. This calculation was a part of the review procedures, reviewed by the Corporation's external auditors.

Net Income (Loss)

The Net Loss for the six month period ended June 30, 2005 was \$2,834,914. This amount can largely be attributed to the "one-time" deferred financing cost in the amount of \$2,969,500, associated with the repayment of the \$10 million mezzanine financing, extraordinary operating costs in the second quarter at Lousana and Red Creek in the approximate amount of \$900,000, and to a lesser extent by commodity price hedging which resulted in unrealized revenues.

Financial Condition

| | June 30, 2005 | December 31, 2004 |
|------------------------|---------------|-------------------|
| Current Assets | \$4,928,628 | \$ 3,286,086 |
| Current Liabilities | \$13,868,858 | \$ 21,449,670 |
| Oil and gas properties | \$68,442,723 | \$ 64,308,278 |

The increased current assets balance is due to additional revenues as a result of increased production activity in 2005. The decreased current liabilities balance is due to the retirement of the subordinated

Management's Discussion & Analysis

Period Ended June 30, 2005 as compared to June 30, 2004

debt on March 29, 2005. The working capital deficiency at June 30, 2005 is \$8,940,230 as compared to \$18,163,584 at December 31, 2004.

Capitalized resource properties as at June 30, 2005 are \$68,442,723 net of depletion, compared with \$64,308,278 as at December 31, 2004. The carrying value of oil and gas properties increased as a result of continued development expenditures.

Liquidity and Capital Resources

The Corporation's share capital is as follows:

Common Shares

| <i>Date</i> | <i>Shares Outstanding</i> | <i>Dollar Value</i> |
|-------------------|---------------------------|---------------------|
| June 30, 2005 | 52,262,589 | \$31,997,621 |
| December 31, 2004 | 42,008,611 | \$20,780,818 |

During the period ended June 30, 2005 the Corporation issued 3,366,361 flow through shares for net cash proceeds of \$4,502,774. Of these net proceeds, approximately \$94,000 has been recorded as part of contributed surplus as an estimate of the fair market value of agent's options granted as part of the share issuance. The Corporation also issued 6,561,200 common shares for net cash proceeds of \$7,756,501. Of these net proceeds, approximately \$1,485,000 has been recorded as part of contributed surplus as an estimate of fair market value for agent's options and warrants granted as part of the share issuance. There were also 418,667 warrants and 50,550 options exercised during the current period for proceeds of \$485,134.

As a result of flow through shares issued during the 2004 year, the Corporation is required to incur exploration and development activities by December 31, 2005 of approximately \$13,915,600. Flow through shares issued during the current year will require the Corporation to incur exploration and development activities by December 31, 2006 of approximately \$4,713,000.

During the prior year 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. 249,400 common shares were purchased by the Corporation.

In April, 2005 the Corporation obtained permission from the TSX Venture Exchange for a Normal Course Issuer Bid to repurchase for cancellation up to 2,500,000 common shares to April 24, 2006. During the period ended June 30, 2005, 142,800 shares were repurchased.

Management's Discussion & Analysis

Period Ended June 30, 2005 as compared to June 30, 2004

Preferred Shares

| Date | Series | Shares Outstanding | Dollar Value |
|-------------------|---------------|--------------------|--------------|
| June 30, 2005 | Series I to V | 1,148,641 | \$1,148,641 |
| December 31, 2004 | Series I to V | 1,148,641 | \$1,148,641 |

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

Cash Flow from Operations

For the year ended June 30, 2005, the Corporation has generated cash flows from operations of \$4,174,270 (\$3,243,141 for the period ended June 30, 2004).

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 reconciles the non-GAAP financial measure "cash flow from operations".

| <i>Period Ended June 30</i> | <i>2005</i> | <i>2004</i> |
|----------------------------------|---------------|-------------|
| Net income (loss) for the period | (\$2,834,914) | \$746,841 |
| Future tax provision (recovery) | (1,166,278) | 504,800 |
| Accretion expense | 188,962 | 43,500 |
| Stock based compensation | 617,000 | 331,000 |
| Financing fee amortization | 2,969,500 | - |
| Depletion and amortization | 4,400,000 | 1,617,000 |
| Cash flow from operations | \$4,174,270 | \$3,243,141 |

Off-Balance Sheet Arrangements

The Corporation has 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 \$6.00 per GJ. At June 30, 2005 there are 123,000 GJ remaining for delivery on this contract. The Corporation has also 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. At June 30, 2005 there are 36,800 barrels remaining for delivery on this contract.

Management's Discussion & Analysis

Period Ended June 30, 2005 as compared to June 30, 2004

The purpose of these contracts is to ensure a minimum level of cash flow for continued operations, and, as such, have been accounted for as hedges in accordance with CICA guidelines.

The Dominion Canada asset acquisition required Terra Energy Corp. to assume an established sales contract. The contract determines sales for 2,084 GJ per day (approximately 300 boed) on a resale pricing received by the purchaser. These revenues are approximately 20% per GJ below the current spot price for natural gas. The contract ends November 1, 2005.

Transactions with Related Parties

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

Terra Capital Corp., parent company

Pioneer Land Services Ltd. – a director is an employee of Pioneer

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

(b) Transactions

| <i>Six months ended June 30</i> | <i>2005</i> | <i>2004</i> |
|---|-------------|-------------|
| Expenses | | |
| Rent and salaries – Terra Capital Corp. (i) (ii) | \$ 36,000 | \$ 370,977 |
| Consulting – Pioneer Land Services Ltd. (i) | 10,924 | - |
| Legal consulting – Borden Ladner Gervais LLP (i) | 96,990 | - |
| | <hr/> | <hr/> |
| | \$ 143,914 | \$ 370,977 |
| Other | | |
| Recorded as part of Oil and Gas Properties – Terra Capital Corp.(iii.) | 60,000 | - |
| Recorded as part of Oil and Gas Properties – Pioneer Land Services Ltd. (iv.) | 84,918 | - |
| Recorded as part of Share issuance cost – Borden Ladner Gervais LLP (v.) | 109,732 | - |
| | <hr/> | <hr/> |
| | \$ 254,650 | - |

(i) 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.

(ii) Rent and salaries 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

Management's Discussion & Analysis

Period Ended June 30, 2005 as compared to June 30, 2004

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.

- (iii) The \$60,000 paid to Terra Capital Corp. consist of a compressor purchase and has been valued at the exchange amount which is the amount of consideration established and agreed to by the related parties.
- (iv) Amounts paid to Pioneer Land Services Ltd. ("Pioneer") are for Pioneer to act as an agent on the Corporation's behalf for landowner negotiations. The amounts have been valued at the exchange amount which is the amount of consideration established and agreed to by the related parties.
- (v) Amounts paid to Borden Ladner Gervais LLP as for legal services provided for both ongoing activities and share issuances. The amounts have been valued at the exchange amount which is the amount of consideration established and agreed to by the related parties.

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 are 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 was encouraged.

At June 30, 2005, the Corporation calculated the ceiling test using AcG 16 without any material adverse impact on the Corporation's financial position or results of operations.

Management's Discussion & Analysis

Period Ended June 30, 2005 as compared to June 30, 2004

Asset Retirement Obligation

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

Litigation

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

Change in Accounting Policy

Transportation Costs - Effective for fiscal years beginning on or after October 1, 2003, the CICA issued Handbook Section 1100 "Generally Accepted Accounting Principles" which defines the sources of GAAP that companies must use and effectively eliminates industry practice as a source of GAAP. In prior years, it had been industry practice for companies to net transportation charges against revenue rather than showing transportation charges as a component of operating expense on the consolidated statement of income. Effective January 1, 2003, the Company has recorded revenue gross of transportation charges and has recorded transportation charges as an operating expense on the consolidated statement of income. This adjustment of \$327,942 for the period ending June 30, 2004 has no impact on net earnings, per common share calculations, or cash flow for the Company.

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.

Business Acquisitions

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 shareholders 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

Management's Discussion & Analysis

Period Ended June 30, 2005 as compared to June 30, 2004

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.

On December 28, 2004 the Corporation purchased all of the outstanding shares of Fossil Bay Resources Ltd. ("Fossil Bay"), through a wholly owned subsidiary, Terra Resources Inc. ("Terra Resources"). Fossil Bay and Terra Resources immediately amalgamated to form Terra Resources Inc. Terra Resources Inc. was then wound up into Terra Energy Corp. The consideration paid consisted of the issuance of 616,113 common shares and cash of \$255,000. The assets of Fossil Bay consisted primarily of certain oil and gas properties and non-capital loss carryforwards that can be utilized by Terra Energy Corp.

On December 31, 2004 the Corporation acquired certain oil and gas properties from another company for consideration of \$31,547,844 in cash. The purchase resulted in additional proven and probable reserves of 2.8 million barrels equivalent. The properties comprise approximately 75 sections of developed and undeveloped lands which complement the Company's existing core properties of Stoddart and Boudreau. These properties are currently producing approximately 840 barrels equivalent comprised of 4,100 Mcf/d of natural gas and 170 bbls/d of oil and condensate. The acquisition includes primarily operated properties with significant facilities and pipeline infrastructure. Most of the properties have year round access. The acquisition also includes a significant amount of 2-D and 3-D seismic information.

OUTLOOK 2005

The primary focus of the Company during 2005 will be on the growth of its reserves base. The Company has targeted an exit rate of 4,000 BOED for 2005 through a combination of development and exploration activities. As some of the development drilling will be directed towards opportunities which will simply change the category of reserves from Non-Producing or Probable into the Proved Producing category, the aggressive exploration program is intended to ensure that our Total Proved + Probable reserves will increase at least in proportion to our overall production rate.

DETAILS

Below is a summary of our forecasted activity for the year. Terra Energy is planning to drill as many as 15 (gross) wells in northeast British Columbia and the remaining 13 (gross) wells in Alberta and Saskatchewan. Some of these locations may be farmed out. This program was based upon the initial \$30 million budget approved by the Board of Directors. Success on any given play and competitive land strategies may result in deviations from the original CAPEX plan. The specific details of our CAPEX Plan cannot be disclosed for competitive reasons, but the general highpoints are as follows:

Management's Discussion & Analysis

Period Ended June 30, 2005 as compared to June 30, 2004

Fort Saint John, British Columbia

Fort Saint John is the Company's Core Area, and it is comprised of several fields. Starting with the Eagle Field, and moving in a counter-clockwise fashion, are the Stoddart Field, the Red Creek Field, the Boudreau Field, the Wilder/Monias Field, the Septimus Field, the Tower Field, the Eight Mile Field and the Mica Field.

Eagle

Terra Energy is planning to drill up to three wells in the Eagle Field in 2005. These wells are predominantly development wells offsetting production from the Halfway and Belloy formations in the area. The Company has working interests ranging from 22% to 100%.

Stoddart

Terra Energy is planning only modest capital expenditures at Stoddart. Work will be carried out to convert an existing suspended well into a water disposal well for use in conjunction with our oil battery and plant site.

Red Creek

At Red Creek, Terra Energy will drill up to two (100%) exploratory wells targeting new horizons which appear to be prospective. If successful, the Company will benefit from already having tremendous infrastructure in place for handling production. In addition, the Company will re-complete two existing wells (100%) to increase current production rates.

Boudreau Field

Terra Energy will drill and/or re-enter as many as four wells in 2005, to pursue Charlie Lake, Belloy, Baldonnel, Halfway, Doig and Kiskatinow potential. Re-completions have been conducted on two wells to further optimize production from this field. The Company has various interests in this field ranging from 50% to 100%.

Monias/Wilder

The Company is targeting two recompletions in the Monias/Wilder area. The field is located on an anticline and has seen production from five different formations, including the Halfway, Charlie Lake and Belloy. The Company plans to shoot a 2D seismic program across two sections which it owns in order to firm up locations for the 2006 winter drilling season. The Company may drill one additional well targeting a new horizon, following a trend which is productive in the region.

Septimus

The secondary target in this play is the Halfway formation. There is current production offsetting our lands and our technical analysis indicates a very favourable chance of encountering the same or similar Halfway reservoir. Our first well in this field, the 15-34-81-19W6M, has been spudded and is located on the apex of a seismically defined anticline, structurally higher than the offsetting producer. Upon success, the Company will proceed with the construction of a new gathering line which will tie the field into the production facilities at Monias/Wilder, and the Company will proceed with two additional development wells into the same reservoir. There will be secondary targets associated with these drilling operations.

Management's Discussion & Analysis

Period Ended June 30, 2005 as compared to June 30, 2004

Tower

Terra Energy has drilled a well in Section 25-81-17W6M with the Halfway formation as its primary target. The results of the well are on confidential status. There is currently offsetting Halfway production both east and west of the Company's lands. As with all of the fields in our Fort St. John core area, there are several secondary targets. Based upon success, as many as three follow up wells may be drilled during 2005. Infrastructure is available in the immediate vicinity.

Eight Mile

Terra Energy has drilled a well in Section 12-25-81-17W6M. The results of the well are on confidential status. The field consists of 30 sections of land (predominantly 100%), with offsetting production in two different horizons. The Company is planning as many as four exploration wells during 2005. With success, there is potential for several development wells in 2006.

Mica Field

The Company has plans to recomplete one well during 2005. Depending upon further investigations an additional well may be drilled targeting a new horizon which is prospective.

Grande Prairie, Alberta

Terra Energy will follow up its 2004 drilling program with up to three additional wells and one re-entry in 2005. The first of these wells 6-7-71-6W6M has been drilled and is on confidential status. The Company has an undeveloped land position of eight sections (60% to 100%) in this area. The Company will license a well for Section 15-71-6W6M, which will target no fewer than three different horizons.

Heathdale, Alberta

At Heathdale, the Company has an undeveloped land position of ten sections of land, in addition to its developed lands and production. The Company has entered into a farmout agreement with an industry partner requiring the drilling of at least one well upon these lands.

Tableland, Saskatchewan

Terra Energy has four separate Winnipegosis reef structures which have been identified on its lands with the benefit of 3D seismic which was shot during 2004. These four structures are proximal to existing oil pools. In addition, these lands are prospective for oil in both the Bakken and Midale formations.

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.

Consolidated Balance Sheet

As at June 30, 2005

(Unaudited, prepared by Management)

| | <i>June 30, 2005</i> (unaudited) | <i>December 31, 2004</i> (audited) (Note 1) |
|---|-------------------------------------|---|
| Assets | | |
| Current Assets | | |
| Cash | \$ 1,148,469 | \$ - |
| Accounts receivable | 2,849,022 | 2,397,420 |
| Income taxes receivable | 19,815 | 28,801 |
| Prepaid expenses | 911,322 | 859,865 |
| | \$ 4,928,628 | 3,286,086 |
| Non Current Assets | | |
| Oil and gas properties | 68,442,723 | 64,308,278 |
| Deferred financing costs | - | 2,969,500 |
| | \$ 73,371,351 | \$ 70,563,864 |
| Liabilities and Shareholders' Equity | | |
| Current Liabilities | | |
| Bank overdraft | \$ - | \$295,529 |
| Accounts payable and accrued liabilities | 13,868,858 | 11,154,141 |
| Subordinated debt (Note 4) | - | 10,000,000 |
| | 13,868,858 | 21,449,670 |
| Non Current Liabilities | | |
| Revolving line of credit | 17,212,490 | 15,862,373 |
| Asset retirement obligations | 4,299,990 | 4,021,143 |
| Future income taxes | 3,252,398 | 4,816,300 |
| Preferred shares | 1,148,641 | 1,148,641 |
| | 39,782,377 | 47,298,127 |
| Shareholders' Equity | | |
| Share capital (Note 5) | 31,997,621 | 20,780,818 |
| Contributed Surplus (Notes 5(d) and 6) | 6,253,690 | 4,196,192 |
| Deficit | (4,662,337) | (1,711,273) |
| | 33,588,974 | 23,265,737 |
| | \$ 73,371,351 | \$ 70,563,864 |

Commitments and Contingencies (Note 8)

Approved on behalf of the Board:



Robert Penner, Director



Cas H. Morel, Director

Consolidated Statement of Income (Loss)

As at June 30, 2005

(Unaudited, prepared by Management)

| | For the three months ended June 30 | | For the six months ended June 30 | |
|--|---------------------------------------|-------------------|-------------------------------------|-------------------|
| | 2005 | 2004 | 2005 | 2004 |
| Revenue | | | | |
| Petroleum and natural gas | \$ 8,412,842 | \$4,395,322 | \$16,345,523 | \$ 7,994,272 |
| Royalties and production taxes | (2,547,511) | (813,368) | (3,532,018) | (1,498,128) |
| | 5,865,331 | 3,581,954 | 12,813,505 | 6,496,144 |
| Expenses | | | | |
| Production | 4,005,683 | 1,226,980 | 6,005,873 | 1,963,240 |
| Amortization and depletion | 2,360,000 | 944,000 | 4,400,000 | 1,617,000 |
| Financing fee amortization (Note 4) | - | - | 2,969,500 | - |
| General & administrative | 1,244,911 | 492,143 | 2,031,606 | 1,001,762 |
| Stock based compensation | 462,000 | 116,000 | 617,000 | 331,000 |
| Interest charges (Note 7) | 215,531 | 109,730 | 567,209 | 182,501 |
| Accretion | 98,572 | 23,500 | 188,962 | 43,500 |
| | 8,386,697 | 2,912,353 | 16,780,150 | 5,139,033 |
| Income (loss) before income taxes | (2,521,366) | 669,601 | (3,966,645) | 1,357,141 |
| Income taxes (recovery) | | | | |
| Current provision | 34,547 | 4,700 | 34,547 | 105,500 |
| Future provision (recovery) | (714,723) | 269,600 | (1,166,278) | 504,800 |
| | (680,176) | 274,300 | (1,131,731) | 610,300 |
| Net Income (loss) for the period | \$ (1,841,190) | \$ 395,301 | \$(2,834,914) | \$746,841 |
| Earnings (loss) per common share – basic and diluted | \$(0.03) | \$0.02 | \$(0.05) | \$0.03 |
| Weighted average number of shares outstanding - basic | 50,898,551 | 25,974,541 | 50,898,551 | 25,974,541 |
| Weighted average number of shares outstanding - diluted | 52,655,100 | 26,991,451 | 52,655,100 | 26,991,451 |

Consolidated Statement of Deficit

As at June 30, 2005

(Unaudited, prepared by Management)

| | For the three months ended June 30 | | For the six months ended June 30 | |
|---|---------------------------------------|----------------------|-------------------------------------|----------------------|
| | 2005 | 2004 | 2005 | 2004 |
| Deficit, beginning of period | \$(2,704,997) | \$(2,445,822) | \$(1,711,273) | \$(2,026,546) |
| Net Income (loss) for the period | (1,841,190) | 395,301 | (2,834,914) | 746,841 |
| Purchase of common shares exceeding carrying value | (116,150) | (184,360) | (116,150) | (184,360) |
| Dividends | - | - | - | (770,816) |
| Deficit, end of period | \$(4,662,337) | \$(2,234,881) | \$(4,662,337) | \$(2,234,881) |

Consolidated Statement of Cashflows

As at June 30, 2005

(Unaudited, prepared by Management)

| | For the three months ended June 30 | | For the six months ended June 30 | |
|--|---------------------------------------|-------------|-------------------------------------|-------------|
| | 2005 | 2004 | 2005 | 2004 |
| Cash flows from operating activities | | | | |
| Net income (loss) for the period | \$ (1,841,190) | \$ 395,301 | \$ (2,834,914) | \$ 746,841 |
| Items not affecting cash: | | | | |
| Amortization and depletion | 2,360,000 | 944,000 | 4,400,000 | 1,617,000 |
| Future income taxes | (714,723) | 269,600 | (1,166,278) | 504,800 |
| Stock based compensation | 462,000 | 116,000 | 617,000 | 331,000 |
| Accretion | 98,572 | 23,500 | 188,962 | 43,500 |
| Financing fee amortization | - | - | 2,969,500 | - |
| | 364,659 | 1,748,401 | 4,174,270 | 3,243,141 |
| Net change in non-cash working capital balances | 5,847,144 | (137,094) | 2,336,781 | (596,807) |
| | 6,211,803 | 1,611,307 | 6,511,051 | 2,646,334 |
| Cash flows from financing activities | | | | |
| Issuance of share capital, net of share issuance costs | 98,735 | 15,000 | 12,367,670 | 15,000 |
| Repayment of revolving line of credit | 2,495,972 | 329,688 | 1,350,117 | (506,717) |
| Repurchase of share capital | (203,258) | (248,334) | (203,258) | (248,334) |
| Repayment of subordinated debt | - | - | (10,000,000) | - |
| | 2,391,449 | 96,354 | 3,514,529 | (740,051) |
| Cash flows from investing activities | | | | |
| Acquisition of oil and gas properties | (7,385,553) | (2,880,693) | (8,581,582) | (5,353,998) |
| Interest on note receivable | - | - | - | (72,540) |
| Due from related party | - | - | - | 15,000 |
| Cash assumed on acquisition of Rhodes Resources Corp. | - | - | - | 2,502,459 |
| | (7,385,553) | (2,880,693) | (8,581,582) | (2,909,079) |
| Increase (decrease) in cash and cash equivalents | 1,217,699 | (1,173,032) | 1,443,998 | (1,002,796) |
| Cash and cash equivalents (bank overdraft), beginning of period | (69,230) | 682,287 | (295,529) | 512,051 |
| Cash and cash equivalents (bank overdraft), end of period | \$1,148,469 | \$(490,745) | \$1,148,469 | \$(490,745) |

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

Notes to Consolidated Financial Statements

June 30, 2005

(Unaudited, prepared by Management)

***note 1* NATURE OF OPERATIONS**

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

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

***note 2* SIGNIFICANT ACCOUNTING POLICIES**

The interim consolidated financial statements of Terra Energy Corp. have been prepared by management in accordance with Canadian generally accepted accounting principles ("GAAP"). The interim consolidated financial statements have been prepared following the same accounting policies and methods of computation as the financial statements for Terra Energy Corp. for the year ended December 31, 2004. The disclosures provided below are incremental to those included in the annual audited financial statements and do not comply with all of the requirements of GAAP for annual financial statements. The interim consolidated financial statements should be read in conjunction with the audited consolidated financial statements of Terra Energy Corp. and the notes thereto for the year ended December 31, 2004.

***note 3* COMPARATIVE PERIOD AMENDMENT**

During the second quarter of the prior year, the Corporation revisited its first quarter calculations related to stock based compensation expense and determined that an adjustment of \$196,200 was required for the first quarter. This resulted in an increase in the first quarter compensation expense for \$18,800 to \$215,000 and a decrease in the first quarter income from \$547,740 to \$351,540.

***note 4* SUBORDINATED DEBT**

During the period, the Corporation had drawn \$10 million against an available standby mezzanine financing credit facility, with an interest rate of 10% per annum. The facility was repaid in full March 29, 2005. As a result of the repayment, related deferred financing fees of \$2,969,500 have been recorded as an expense in the current period.

The subordinated debt proceeds were used to acquire oil and gas properties at December 31, 2004.

Notes to Consolidated Financial Statements

June 30, 2005

(Unaudited, prepared by Management)

note 5 SHARE CAPITAL

a) Authorized

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

b) Common Shares Issued

| | Number | Amount |
|--|-------------------|----------------------|
| Balance, December 31, 2004 | 42,008,611 | \$ 20,780,818 |
| Issued on exercise of warrants | 418,667 | 422,267 |
| Issued on exercise of options | 50,550 | 62,867 |
| Issued pursuant to a flow through share agreement, net of tax effected share issuance costs | 3,366,361 | 4,409,211 |
| Issued pursuant to share placement agreement net of tax effected share issuance costs, at \$1.25 per share | 6,561,200 | 6,161,178 |
| Shares repurchased | (142,800) | (87,109) |
| Reclassification of contributed surplus amounts | - | 248,389 |
| Balance, June 30, 2005 | 52,262,589 | \$ 31,997,621 |

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 April 22, 2005, 249,400 common shares were purchased.

During the period ended June 30, 2005, the Corporation obtained permission from the TSX Venture Exchange for a Normal Course Issuer Bid to repurchase for cancellation up to 2,500,000 common shares to April 24, 2006. During the current period, 142,800 shares were repurchased.

c) Stock Options:

During the current period the Corporation amended its Employee Stock Option Plan whereby officers, directors, employees, and consultants may be granted options of up to 10 percent of the issued and outstanding common shares of the Corporation. These options entitle the holder to purchase common shares of the Corporation subject to various vesting periods and other terms and conditions specified in the stock option plan. At June 30, 2005 employee options have been granted to purchase 4,274,000 common shares (December 31, 2004 – 2,483,000) ranging at prices between \$0.75 and \$1.60 with expiry dates between February 11, 2009 and June 23, 2010.

Notes to Consolidated Financial Statements

June 30, 2005

(Unaudited, prepared by Management)

Details of all options outstanding are as follows:

| | Number | Weighted Average Exercise Price |
|---|------------------|------------------------------------|
| Employee Stock Options | | |
| Balance December 31, 2004 | 2,483,000 | \$ 0.98 |
| Granted under the stock option plan in the current period | 1,953,000 | 1.44 |
| Exercised during the current period | (42,000) | (1.04) |
| Expired during the current period | (120,000) | (1.15) |
| Employee Stock Options Balance, June 30, 2005 | 4,274,000 | 1.18 |
| Agent Options | | |
| Balance December 31, 2004 | 1,054,216 | 1.32 |
| Granted as part of share issuance. These options will expire January 26, 2007 | 694,929 | 1.40 |
| Exercised during the current period | (8,550) | (1.00) |
| Agent Options Balance, June 30, 2005 | 1,740,595 | 1.35 |
| Other Options | | |
| Other Options Balance, June 30, 2005 | 329,730 | 1.21 |
| Total Options Balance June 30, 2005 | 6,344,325 | \$ 1.24 |

| Options Exercise Price | Weighted Average Remaining Contract Life | Outstanding March 31, 2005 | Weighted Average Share Price for Outstanding Options | Exercisable March 31, 2005 | Weighted Average Share Price for Exercisable Options |
|------------------------------|---|----------------------------------|--|----------------------------------|--|
| \$0.75 | 3.63 years | 198,000 | | 198,000 | |
| 1.00 | 3.63 years | 2,123,000 | | 872,000 | |
| 1.00 | 0.50 years | 202,386 | | 202,386 | |
| 1.15 | 4.45 years | 400,000 | | 80,000 | |
| 1.21 | 1.50 years | 329,730 | | 329,730 | |
| 1.40 | 1.17 years | 241,500 | | 241,500 | |
| 1.40 | 1.50 years | 601,780 | | 601,780 | |
| 1.40 | 1.58 years | 694,929 | | 694,929 | |
| 1.51 | 5.00 years | 1,493,000 | | 493,100 | |
| 1.60 | 5.00 years | 60,000 | | 12,000 | |
| | 2.54 years | 6,344,325 | \$1.24 | 3,725,425 | \$1.23 |

Notes to Consolidated Financial Statements

June 30, 2005

(Unaudited, prepared by Management)

During the current period, the Corporation granted options to officers, directors, employees, and consultants to purchase 1,953,000 common shares ranging at prices between \$1.51 and \$1.60. These options expire on between January 26 and June 23, 2010. These options vest as follows:

- (i) 505,100 options vest immediately
- (ii) 305,100 options vest between January 26 and June 23, 2006
- (iii) 247,600 options vest between January 26 and June 23, 2007
- (iv) 247,600 options vest between January 26 and June 23, 2008
- (v) 247,600 options vest between January 26 and June 23, 2009

d) Stock-based compensation

For stock options granted to employees compensation expense of \$617,000 has been recorded for the period ending June 30, 2005 (\$331,000 June 30, 2004) with the offsetting charge to contributed surplus. The fair value of share options was estimated using the Black-Scholes option-pricing model with the following assumptions: Dividend yield (Nil); expected volatility at 50%; risk-free interest rate of 3.5%; weighted average life of 5 years.

For the options granted during the current period, the estimated fair value expected to be recognized over the option life is approximately \$1,145,000. Of this amount, \$423,000 has been recorded in the current period stock based compensation expense.

e) Warrants

During the period ended June 30, 2005 the Corporation had issued the following warrants:

- i) 3,280,600 warrants exercisable to purchase one-half common share at \$1.40 per share until January 26, 2006 and at \$1.60 per share until January 26, 2007 when these warrants expire.

***note 6* CONTRIBUTED SURPLUS**

Contributed Surplus consists of the fair value of both share warrants issued for various financing agreements and for the stock based compensation on employee stock options. Values were determined using the Black Scholes Model using the assumptions of no dividends being paid; risk free interest rate of 3.5%; and an expected volatility of 50%.

Notes to Consolidated Financial Statements

June 30, 2005

(Unaudited, prepared by Management)

The details of contributed surplus are as follows:

| | Amount |
|---|---------------------|
| Balance, December 31, 2004 | \$ 4,196,192 |
| Stock based compensation provision for the period | 617,000 |
| Deemed issue costs of agent's options granted during the period [Note 5(c)] | 275,924 |
| Deemed issue costs of warrants granted during the period [Note 5(e)] | 1,302,574 |
| Reclassification resulting from exercise of options and warrants | (138,000) |
| Balance, June 30, 2005 | \$ 6,253,690 |

note 7 INTEREST CHARGES

Interest charges consist of the following amounts:

| Period ended June 30 | 2005 | 2004 |
|--------------------------------------|-------------------|-------------|
| Interest on revolving line of credit | \$ 360,174 | \$ 141,725 |
| Interest on preferred share | 45,944 | 40,776 |
| Interest on subordinated debt | 161,091 | - |
| | \$ 567,209 | \$ 182,501 |

note 8 COMMITMENTS AND CONTINGENCIES

- (a) The Corporation had outstanding letters of credit to various parties for a total of \$710,000. Of these amounts \$555,000 will expire at various dates during 2005 and the remaining \$155,000 expire at various dates during 2006.
- (b) The Corporation is currently involved in litigation with an industry participant who is claiming \$685,850 in respect of an alleged breach of contract arising from a failure to pay on account of Authorizations for Expenditures relating to the development of certain lands and pipelines. The Corporation is contesting this claim and has issued a counterclaim in respect of the same subject. It is management's opinion that an adequate provision has been recorded in these consolidated financial statements. Additional amounts, if any, required to resolve these matters, will be recorded in the period of settlement or when management changes its estimate of an adequate provision.

Notes to Consolidated Financial Statements

June 30, 2005

(Unaudited, prepared by Management)

- (c) The Corporation is currently involved in litigation with three registered landowners who are claiming \$85,000 in respect of breach of contract and trespass arising from pipeline construction and related operation and carried on by the Corporation on or near land owned by the plaintiffs. The Corporation is contesting this claim. No provision has been recorded in these consolidated financial statements. Additional amounts, if any, required to resolve these matters, will be recorded in the period of settlement or when management can reasonably assess the likelihood and balance of amounts owing, if any.
- (d) The Corporation is currently involved in litigation brought by an industry participant relating to a claim of ownership or equitable ownership in a natural gas lease covering a one-quarter Section of land. The Corporation is contesting this claim. No provision has been recorded in these consolidated financial statements. Additional amounts, if any, required to resolve these matters will be recorded in the period of settlement or when management changes its estimate of an adequate provision.
- (e) The Corporation has entered into contracts to hedge commodity prices and deliver petroleum and natural gas (physical). The terms of the contracts are summarized as follows:

| Contract Type | Floor Price | Ceiling Price | Remaining Volume | Contract Term |
|---------------|--|---------------|------------------|--------------------------------------|
| Financial | \$6.00 per GJ Floor with Protection of \$1.00 per GJ | \$8.95 per GJ | 123,000 GJ | November 1, 2004 to October 31, 2005 |
| Financial | \$35.35 | N/A | 18,400 bbl | January 1, 2005 to December 31, 2005 |
| Financial | \$36.65 | N/A | 18,400 bbl | January 1, 2005 to December 31, 2005 |

N/A – not applicable

The amount that the Corporation would be required to pay if all the contracts were cancelled at June 30, 2005 would approximate \$1,219,000 (December 31, 2004 - \$833,334).

- (f) The Corporation has available a financial swap facility of up to \$3 million. The Corporation may enter commodity swap contracts with terms of less than one year and may not exceed 2/3 of the Corporation's average daily production, net of royalties, for the fiscal quarter prior to the date the contract is entered into. The facility is secured by a general security agreement; a floating charge debenture in the amount of \$35 million and an unlimited liability guarantee by the Corporation and its subsidiaries. At June 30, 2005 (December 31, 2004 - \$nil) there were no outstanding swap contracts.

Notes to Consolidated Financial Statements

June 30, 2005

(Unaudited, prepared by Management)

- (g) The Corporation is required to incur exploration and development activities by December 31, 2005 of approximately \$13,915,600 as a result of flow through shares issued 2004. As at June 30, 2005, the Corporation has incurred qualifying expenditures of approximately \$3.9 million.
- (h) The Corporation is required to incur exploration and development activities by December 31, 2006 of approximately \$4,713,000 as a result of flow through shares issued 2005. As at June 30, 2005, the Corporation has not incurred any qualifying expenditures.

note 9 SUBSEQUENT EVENT

Subsequent to the period end the Corporation completed a private placement issuing 3,900,000 Flow Through Shares for gross proceeds of \$7,800,000 and 9,117,353 Share Units with each consisting of one common share and one half common share warrant for gross proceeds of \$15,499,500.

Subsequent to the period end the Corporation also renegotiated its credit facility resulting in an increase in the available credit from \$18.0 million to \$25 million. The new facility is secured by a \$75 million Debenture over all the assets of the Corporation.

note 10 COMPARATIVE FIGURES

Prior year comparative figures have been reclassified to conform to the presentation used in the current year.

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BDO Dunwoody LLP, Calgary, Alberta

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Status Engineering Associates Ltd., Calgary, Alberta
Ryder Scott Company, Calgary, Alberta

Banker

CIBC, Calgary, Alberta

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Shareholders are encouraged to contact our Registrar and Transfer Agent for information regarding their securities holdings.

Stock Exchange

TSX-Venture

Stock Symbol

TTR

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