



Q3 2005

*Nine months ended
September 30, 2005*

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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 Discussion and Analysis

September 30, 2005

(Unaudited, prepared by Management)

Period Ended September 30, 2005 as compared to September 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 September 30, 2005 and September 30, 2004. This commentary is based on information available at November 2, 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.

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(Unaudited, prepared by Management)

Highlights

<i>Operations for the nine months ended September 30</i>	<i>2005</i>	<i>2004</i>	<i>Percent Growth</i>
Average Daily Production	2,248	1,093	106%
Exit Production (boe/d)	2,256	971	132%
Undeveloped Land (Net Acres)	89,863	11,296	696%

<i>Financial for the nine months ended September 30</i>		<i>2004</i>	<i>Percent Growth</i>
Revenue	\$26,860,101	\$12,263,522	119%
Cashflow From Operations	\$8,105,320	\$4,670,313	73%
Cashflow Per Share - basic	\$0.14	\$0.17	(18%)
Revenue per boe	\$46.17	\$39.55	17%
Operating Netback per boe	\$19.70	\$20.98	(6%)
Cashflow per boe	\$13.93	\$15.77	(12%)

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

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2005 OPERATIONS – YEAR TO DATE

Current Production

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

<i>Nine months ended September 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)	501	419	318	359	58%	17%
Natural Gas (boe/d)	1,599	1,689	720	556	122%	204%
Liquids (bbl/d)	148	148	55	56	169%	164%
Total (boe/d)	2,248	2,256	1,093	971	106%	132%

<i>Three Months Ended September 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)	464	419	390	359	19%	17%
Natural Gas (boe/d)	1,583	1,689	648	556	144%	204%
Liquids (bbl/d)	148	148	25	56	492%	164%
Total (boe/d)	2,195	2,256	1,063	971	106%	132%

The above production amounts are presented for information purposes only. All per boe analysis of operating results are based upon sales amounts and not raw production volumes.

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(Unaudited, prepared by Management)

Results of Operations

<i>Nine Months Ended September 30</i>	2005	2004	2005	2004	Percent Growth
			<i>(\$ / boe)</i>	<i>(\$ / boe)</i>	<i>(\$ / boe)</i>
Revenues	\$26,860,101	\$12,263,522	\$46.17	\$39.55	12%
Royalties	\$5,264,095	\$2,382,685	\$9.04	\$7.98	13%
Production Expenses	\$10,136,673	\$3,602,502	\$17.43	\$12.10	44%
Operating Netback	\$11,459,333	\$6,278,334	\$19.70	\$21.15	(7%)
General & administrative expenses	\$2,673,750	\$1,523,774	\$4.59	\$5.11	(10%)
Interest expense	\$645,716	\$264,247	\$1.11	\$0.89	25%
Non-cash expenses	\$10,635,903	\$3,203,000	\$18.28	\$10.73	70%
Income (loss) before income taxes	(\$2,496,036)	\$1,287,313	(\$4.29)	\$4.42	(197%)
Income tax expense (recovery)	(\$266,119)	\$805,300	(\$0.46)	\$2.70	(117%)
Net Income (loss)	(\$2,229,917)	\$482,013	(\$3.83)	\$1.72	336%

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<i>Three Months Ended September 30</i>	2005	2004	2005	2004	Percent Growth
			(\$ / boe)	(\$ / boe)	(\$ / boe)
Revenues	\$10,514,578	\$3,941,307	\$59.26	\$40.30	47%
Royalties	\$1,732,077	\$884,557	\$9.76	\$9.04	8%
Production Expenses	\$4,130,800	\$1,311,320	\$23.29	\$13.41	74%
Operating Netback	\$4,651,701	\$1,745,430	\$26.22	\$17.84	47%
General & administrative expenses	\$642,144	\$522,012	\$3.62	\$5.34	(32%)
Interest expense	\$78,507	\$81,746	\$0.44	\$0.84	(48%)
Non-cash expenses	\$2,460,441	\$1,211,500	\$13.87	\$12.39	12%
Income (loss) before income taxes	\$1,470,609	(\$69,828)	\$8.29	(\$0.71)	1268%
Income tax expense (recovery)	\$865,612	\$195,000	\$4.88	\$1.99	145%
Net Income (loss)	\$604,997	(\$264,828)	\$3.41	(\$2.70)	227%

The average per BOE price received by Terra for the quarter was \$59.26. Factors affecting this price are as follows:

- Approximately 67% of the Corporation's sales are from natural gas. While oil volume sales have experienced very high price increases, price increases for natural gas sales have been less significant. For the first nine months of 2005 the price of Edmonton Light oil averaged approximately \$69 per barrel. During the same period the average AECO spot price per GJ for natural gas was approximately \$7.47. Using a conversion factor of 6 Mcf: 1 BOE, the average price of natural gas would be approximately \$45 per BOE.
- Increasing natural gas prices over the course of the third quarter has resulted in an increase in revenue per BOE from the second quarter of \$39.54 to \$59.26 in the third quarter resulting in an increased operating netback from \$8.74 to \$26.22.
- In December, 2003 the Corporation 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 for the period from January 1, 2005 to 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.

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- The Dominion Canada asset acquisition at December 31, 2004 required Terra Energy Corp. to assume an established sales contract committing approximately 2MMcf per day of sales gas. 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 was terminated on October 31, 2005 and previously committed volumes will now receive the current spot price.

General and administrative expenses have increased in 2005 as compared to 2004 as a result of certain one time charges related to conversion in the Corporation's financing arrangements between chartered banks and increased salary expense due to the strengthening of the Corporation's technical team. The Corporation has also accrued approximately \$281,000 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 downward trend in costs to continue as additional production is added to the production base.

Interest charges for the nine month period ended September 30, 2005 as compared to 2004 increased by 144% as a result of the \$10,000,000 subordinated debt drawn December 31, 2004 for the acquisition of the 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 amortizing financing fees of \$2,969,500 based on the value of warrants related to the subordinated debt. Second, the corporation has had increased sales and 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>Nine Months Ended</i>					<i>Percent</i>
<i>September 30</i>	<i>2005</i>	<i>2004</i>	<i>2005</i>	<i>2004</i>	<i>Change</i>
			<i>(\$ / boe)</i>	<i>(\$ / boe)</i>	<i>(\$ / boe)</i>
Production Expenses	\$10,136,673	\$3,602,502	\$17.43	\$12.10	44%

<i>Three Months Ended</i>					<i>Percent</i>
<i>September 30</i>	<i>2005</i>	<i>2004</i>	<i>2005</i>	<i>2004</i>	<i>Change</i>
			<i>(\$ / boe)</i>	<i>(\$ / boe)</i>	<i>(\$ / boe)</i>
Production Expenses	\$4,130,800	\$1,311,320	\$23.29	\$13.41	74%

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(Unaudited, prepared by Management)

High production expenses during the second and third quarters of 2005 occurred substantially as a result of three reasons:

- planned maintenance programs conducted during the second quarter and continuing into the third quarter, which were scheduled in order to coincide with the planned turnarounds for major gas processing facilities, such as the McMahon Gas Plant at Taylor, British Columbia
- a number of major workovers conducted on oil wells during the second quarter at the Red Creek oil field and one at Lousanna, the costs of which were all expensed as Operating Costs
- high operating costs associated with underutilized facilities at each of the Red Creek gas plant and the Wilder gas plant

Of the total \$4,130,800 of production expenses booked in the third quarter, in excess of \$717,000 was an 'under accrual' of production expenses for the second quarter. The total of \$4,005,000 of production expenses that were booked during the second quarter was understated by over \$717,000. In this manner, the \$18.83 per BOE of production expenses reported for the second quarter would have been approximately \$22.20 per BOE had the accrual estimate been more accurate. Similarly, the \$23.29 per BOE production expenses reported for the third quarter were actually closer to \$19.24 per BOE, when the under accrual is taken into consideration. These numbers are high, by industry standards, and reflect a significant effort on the part of Terra Energy to ensure that all of the assets acquired as part of the December, 2004 strategic acquisition meet operational standards.

There were substantial repairs and maintenance work conducted in both the second and third quarters as part of the "planned maintenance programs" across the Company, totaling approximately \$750,000.

The Red Creek oil field was purchased in December, 2004, and it was necessary to carry out these major workovers in order to maintain and improve the performance of this oil field. A total of approximately \$900,000 was spent on the Red Creek oilwell workovers, together with an additional \$300,000 being spent on a major workover on an oilwell at Lousanna. The majority of these workover costs were booked during the second quarter.

In addition, production expenses have been high at the gas processing facilities located at the Red Creek Field and at the Wilder Field. At Red Creek, the gas plant was originally designed and constructed by a predecessor company for a throughput of 20MMcf per day and early in 2005, the throughput was actually less than 500 Mcf per day. The low throughput rates create additional wear and tear on equipment, and result in increased ongoing repair and maintenance costs. With the completion of the construction of the tie-in between the Boudreau Field and the Red Creek gas plant, substantial volumes of gas will once again start flowing through the Red Creek gas plant, thereby allowing the compressors and other equipment to operate more efficiently and at a much lower cost per

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BOE. At the same time, the new production being tied into Red Creek will, apart from the equipping and tie-in costs themselves, not be burdened with high construction costs associated with processing facilities as this production enjoys the benefits of the existing processing infrastructure. In a similar fashion, the gas plant at the Wilder Field was constructed with an original throughput in excess of 7 MMcf per day, and the throughput early in 2005 was less than 2MMcf per day. With the planned construction of the pipeline connecting the Septimus Field to the Wilder plant, the Company will recognize the savings associated with utilizing its existing spare capacity, while experiencing much lower production expenses per BOE for the throughput. The Boudreau/Red Creek pipeline interconnection was completed during the month of October, and the Septimus/Wilder pipeline interconnection is scheduled for completion during the month of December.

The underutilized facilities in place at the Red Creek gas plant and the Wilder gas plant have high fixed operating costs relative to throughput during the first three quarters of 2005, such as property taxes. Upon completion of the pipeline interconnections, the higher throughputs in these two facilities will not reduce fixed operating costs in total, but should substantially reduce the fixed operating costs on a "BOE of throughput" basis.

The costs of the planned maintenance programs and the costs of these major oilwell workovers combined to depress the Company's netbacks and cashflow for the second and third quarters of 2005. The oilwell workovers are, largely, one time expenses and are not reoccurring. As for the repair and maintenance work, the Company did carry out somewhat more repairs and maintenance during the summer of 2005 than it might in typical years, as a result of the strategic acquisition which was completed in December, 2004 and the need for making the acquired assets conform to Company standards. With these costs already incurred and paid for, and with the planned addition of significant volumes of natural gas throughput at each of the Red Creek gas plant and the Wilder gas plant, the production costs per BOE are anticipated to decline somewhat into the fourth quarter and significantly into 2006. Accordingly, the Company's netbacks and cashflows are expected to improve in the fourth quarter of 2005 and significantly into 2006.

Net revenues per boe were as follows:

<i>Nine Months Ended September 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	\$26,860,101	\$12,263,522	\$46.18	\$41.20	12%
Royalties	\$5,264,095	\$2,382,685	\$9.04	\$7.98	13%
Production Expenses	\$10,136,673	\$3,602,502	\$17.43	\$12.10	44%
Operating Netback	\$11,459,333	\$6,278,334	\$19.70	\$21.15	(7%)

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<i>Three Months Ended September 30</i>	<i>2005</i>	<i>2004</i>	<i>2005</i> <i>(\$ / boe)</i>	<i>2004</i> <i>(\$ / boe)</i>	<i>Percent Change</i> <i>(\$ / boe)</i>
Gross Revenue	\$10,514,578	\$3,941,307	\$59.26	\$40.30	47%
Royalties	\$1,732,077	\$884,557	\$9.76	\$9.04	8%
Production Expenses	\$4,130,800	\$1,311,320	\$23.28	\$11.73	74%
Net Revenue	\$4,651,701	\$1,745,430	\$26.22	\$17.85	47%

General and Administrative Expenses

<i>Nine Months Ended September 30</i>	<i>2005</i>	<i>2004</i>	<i>2005</i> <i>(\$ / boe)</i>	<i>2004</i> <i>(\$ / boe)</i>	<i>Percent Change</i> <i>(\$ / boe)</i>
General & Administrative Expenses	\$2,673,750	\$1,523,774	\$4.59	\$5.11	(10%)

<i>Three Months Ended September 30</i>	<i>2005</i>	<i>2004</i>	<i>2005</i> <i>(\$ / boe)</i>	<i>2004</i> <i>(\$ / boe)</i>	<i>Percent Change</i> <i>(\$ / boe)</i>
General & Administrative Expenses	\$642,144	\$522,012	\$3.62	\$5.34	(32%)

General and administrative expenses have increased in 2005 as compared to 2004 as a result of the certain one time charges related to conversion in the Corporation's financing arrangements between chartered banks and increased salary expense due to the strengthening of the Corporation's technical team. The Corporation has also accrued approximately \$281,000 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 downward trend in costs to continue as additional production is added to the production base.

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Interest Expense

<i>Nine Months Ended September 30</i>	2005	2004	2005	2004	Percent
			<i>(\$ / boe)</i>	<i>(\$ / boe)</i>	<i>Change (\$ / boe)</i>
Interest Expenses	\$645,716	\$264,247	\$1.11	\$0.89	25%

Interest expense for the period ended September 30, 2005 consists of interest on the revolving line of credit for \$415,708, interest on the Subordinated Debt for \$161,091, and a preferred share dividend for \$68,916. The dividend is considered interest for accounting purposes. On March 29, 2005 the Corporation retired its subordinated debt of \$10,000,000 thus reducing the rate of interest expense increase for periods subsequent to March 31, 2005. The higher interest expense for the period ended September 30, 2005 as compared to the period ended September 30, 2004 is due to higher indebtedness required to finance capital expansion during 2005.

<i>Three Months Ended September 30</i>	2005	2004	2005	2004	Percent
			<i>(\$ / boe)</i>	<i>(\$ / boe)</i>	<i>Change (\$ / boe)</i>
Interest Expenses	\$78,507	\$81,746	\$0.44	\$0.84	(48%)

The lower interest expense for the three months ended September 30, 2005 is due to a share placement completed during the quarter. The private placement was for approximately \$23.3 million. As a result, a greater portion of capital expenditures have been funded by this share issuance resulting in lower interest charges.

Non Cash Items

<i>Nine Months Ended September 30</i>	2005	2004	2005	2004	Percent
			<i>(\$ / boe)</i>	<i>(\$ / boe)</i>	<i>Change (\$ / boe)</i>
Depletion and Amortization	\$6,600,000	\$2,700,000	\$11.35	\$9.05	25%
Accretion Expense	\$308,403	\$69,000	\$0.53	\$0.23	130%
Stock Based Compensation	\$758,000	\$434,000	\$1.30	\$1.45	(10%)
Financing Fee Amortization	\$2,969,500	-	\$5.10	\$-	N/A
Total Non Cash Items	\$10,635,903	\$3,203,000	\$18.28	\$10.73	70%

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<i>Three Months Ended September 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	\$2,200,000	\$1,083,000	\$12.40	\$11.04	12%
Accretion Expense	\$119,441	\$25,500	\$0.67	\$0.26	158%
Stock Based Compensation	\$141,000	\$103,000	\$0.79	\$1.05	(25%)
Financing Fee Amortization	-	-	\$-	\$-	N/A
Total Non Cash Items	\$2,460,441	\$1,211,500	\$13.87	\$12.39	12%

Depletion, amortization, and accretion expense for 2005 has increased over 2004 by approximately \$7,400,000 due to several reasons. First, there is the deferred financing fee amortization of \$2,969,500. This is a one-time charge will not occur in future periods. Second, there are increased sales resulting in an increased depletion charge for 2005. 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 \$475,000.

Management performed a ceiling test calculation to assess the recoverability of its petroleum and natural gas assets as at September 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.

Financial Condition

	<i>September 30, 2005</i>	<i>December 31, 2004</i>
Current Assets	\$20,359,968	\$ 3,286,086
Current Liabilities	\$15,372,129	\$ 21,449,670
Oil and gas properties	\$81,365,956	\$ 64,308,278

The increased current assets balance is due to additional revenues as a result of increased production activity in 2005. There is also additional cash as a result of an increase in the Corporation's credit facilities and the July, 2005 share issuance. The decreased current liabilities balance is due to the retirement of the subordinated debt on March 29, 2005.

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The working capital surplus at September 30, 2005 is \$4,987,839 as compared to a working capital deficiency of \$18,163,584 at December 31, 2004.

Capitalized resource properties as at September 30, 2005 are \$81,365,956 net of depletion, compared with \$64,308,278 as at December 31, 2004. Oil and gas properties increased as a result of continued development of oil and gas properties.

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>
September 30, 2005	66,776,847	\$55,424,291
December 31, 2004	42,008,611	\$20,780,818

In January, 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. In January, 2005 the Corporation also issued 6,561,200 common shares for net cash proceeds of \$7,756,501. Of these net proceeds, approximately \$1,595,000 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. In July, 2005 the Corporation issued 3,900,000 flow through shares for net proceeds of \$7,515,644 and issued 9,117,353 common shares for net proceeds of \$14,834,737. Of these proceeds, approximately \$1,515,000 has been recorded as part of contributed surplus as an estimate of the fair market value for warrants granted as part of the share issuance.

There were also 418,667 warrants and 50,550 options exercised during the current three month 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 on or before 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 on or before December 31, 2006 of approximately \$12,531,000.

During the period from April 22, 2004 to April 22, 2005 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 at an average price of \$1.16 per share.

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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 commencing April 24, 2005 to September 30, 2005, 224,900 shares were repurchased at an average price of \$1.54 per share.

Preferred Shares

<i>Date</i>	<i>Series</i>	<i>Shares Outstanding</i>	<i>Dollar Value</i>
September 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 October 1, 2006.

Cash Flow from Operations

For the year ended September 30, 2005, the Corporation has generated cash flows from operations of \$8,105,320 (\$4,670,313 for the period ended September 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 September 30</i>	<i>2005</i>	<i>2004</i>
Net income (loss) for the period	(\$2,229,917)	\$482,013
Future tax provision (recovery)	(300,666)	985,300
Accretion expense	308,403	69,000
Stock based compensation	758,000	434,000
Financing fee amortization	2,969,500	-
Depletion and amortization	6,600,000	2,700,000
Cash flow from operations	\$8,105,320	\$4,670,313

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Off-Balance Sheet Arrangements

In June, 2004 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 (1,000 GJ per day) with a price cap of \$8.95 per GJ and a price floor of \$6.00 per GJ. At September 30, 2005 there are 31,000 GJ remaining for delivery on this contract.

In December, 2003 the Corporation has also entered into various fixed-price financial oil contracts with delivery for 2005 of 73,000 barrels (200 barrels per day) at prices between \$35.35 and \$36.65 per barrel. At September 30, 2005 there are only 18,400 barrels remaining for delivery on this contract.

During the three months ended September 30, 2005 the Corporation entered into a costless collar financial gas contract with delivery between November 1, 2005 and March 31, 2006 of 302,000 GJ (2,000 GJ per day) with a price cap of \$13.00 per GJ and a price floor of \$9.00 per GJ.

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.

Transactions with Related Parties

- (a) The Corporation entered into transactions with the following related parties:
- Terra Capital Corp., significant shareholder
 - Pioneer Land Services Ltd. – a director is an employee of Pioneer
 - Borden Ladner Gervais LLP – a director is a partner with the law firm
 - Fasken Martineau Dumoulin LLP – Corporate Secretary is a partner of the law firm

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(b) Transactions

<i>Nine months ended September 30</i>	<i>2005</i>	<i>2004</i>
Expenses		
Rental and salary reimbursement – Terra Capital Corp. (i) (ii)	\$ 54,000	\$ 385,977
Consulting – Pioneer Land Services Ltd. (i)	15,277	-
Legal consulting – Borden Ladner Gervais LLP (i)	130,048	-
	<u>\$ 199,325</u>	<u>\$ 385,977</u>
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.)	87,007	-
Recorded as part of Share issuance cost – Borden Ladner Gervais LLP (v.)	132,946	-
Recorded as part of Share issuance cost – Fasken Martineau Dumoulin LLP (vi.)	11,052	-
	<u>\$ 291,005</u>	<u>-</u>

- (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) Rentals and salary reimbursements 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 salary reimbursement is approximately \$327,000. Any continuing rental fees will be for vehicle, office furniture, and equipment leasing at the rate of \$6,000 per month. Any such 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 and approximates fair market value.
- (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

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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 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.
- (vi) Amounts paid to Fasken Martineau Dumoulin LLP 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.

At September 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.

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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 \$491,913 for the period ending September 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.

Management Discussion and Analysis

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(Unaudited, prepared by Management)

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 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. 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 has been 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. The Company has experienced considerable success with its summer drilling program. The Company is confident that this will translate into significant reserve additions at year end. As for the 4,000 BOED exit rate which has been targeted, the Company continues to work towards this target. The Company is confident that it will have sufficient gas and oil reserves behind pipe by year end to supply a 4,000 BOED production rate, but rig availability, landowner issues,

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regulatory delays, infrastructure constraints, and weather may still delay the “onstream” dates for such production. The Company intends to disclose its ongoing progress in this regard to shareholders through media releases.

With the addition of new production and with the expiry of certain forward sale hedging contracts, the Company’s performance, as measured by netbacks per BOE, operating costs per BOE, and General and Administrative costs per BOE, are expected to improve in the fourth quarter and into 2006.

Management confirms that as at November 2, 2005 the corporation has incurred sufficient development and exploration expenditures to meet its 2005 flow through share obligations.

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 September 30, 2005
(Unaudited, prepared by Management)

	September 30, 2005	December 31, 2004
	(unaudited)	(audited) (Note 1)
Assets		
Current Assets		
Cash	\$14,702,900	\$ -
Accounts receivable	4,739,888	2,397,420
Income taxes receivable	-	28,801
Prepaid expenses	917,180	859,865
	20,359,968	3,286,086
Non Current Assets		
Oil and gas properties	81,365,956	64,308,278
Deferred financing costs	-	2,969,500
	\$101,725,924	\$ 70,563,864
Liabilities and Shareholders' Equity		
Current Liabilities		
Bank overdraft	\$ -	\$295,529
Accounts payable and accrued liabilities	15,372,129	11,154,141
Subordinated debt (Note 3)	-	10,000,000
	15,372,129	21,449,670
Non Current Liabilities		
Revolving line of credit (Note 4)	18,296,782	15,862,373
Asset retirement obligations	4,877,329	4,021,143
Future income taxes	3,584,130	4,816,300
Preferred shares	1,148,641	1,148,641
	43,279,011	47,298,127
Shareholders' Equity		
Share capital (Note 5)	55,424,291	20,780,818
Contributed Surplus (Notes 5(d) and 6)	7,172,971	4,196,192
Deficit	(4,150,349)	(1,711,273)
	58,446,913	23,265,737
	\$ 101,725,924	\$ 70,563,864
Commitments and Contingencies (Note 8)		

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

Consolidated Statement of Income (Loss)

As at September 30, 2005
(Unaudited, prepared by Management)

	For the three months ended September 30		For the nine months ended September 30	
	2005	2004	2005	2004
Revenue				
Petroleum and natural gas	\$10,514,578	\$3,941,307	\$26,860,101	\$12,263,522
Royalties and production taxes	(1,732,077)	(884,557)	(5,264,095)	(2,382,685)
	8,782,501	3,056,750	21,596,006	9,880,837
Expenses				
Production	4,130,800	1,311,320	10,136,673	3,602,502
Amortization and depletion	2,200,000	1,083,000	6,600,000	2,700,000
Financing fee amortization (Note 3)	-	-	2,969,500	-
General & administrative	642,144	522,012	2,673,750	1,523,774
Stock based compensation	141,000	103,000	758,000	434,000
Interest charges (Note 6)	78,507	81,746	645,716	264,247
Accretion	119,441	25,500	308,403	69,000
	7,311,892	3,090,578	24,092,042	8,593,523
Income (loss) before income taxes	1,470,609	(69,828)	(2,496,036)	1,287,313
Income taxes (recovery)				
Current provision	-	(285,500)	34,547	(180,000)
Future provision (recovery)	865,612	480,500	(300,666)	985,300
	865,612	195,000	(266,119)	805,300
Net Income (loss) for the period	\$604,997	\$(264,828)	\$(2,229,917)	\$482,013
Earnings (loss) per common share – basic and diluted	\$0.01	\$(0.01)	\$(0.04)	\$0.02
Weighted average number of shares outstanding - basic	62,579,599	26,897,337	56,224,711	26,897,337
Weighted average number of shares outstanding - diluted	67,278,966	27,478,343	59,773,857	27,478,343

Consolidated Statement of Deficit

As at September 30, 2005
(Unaudited, prepared by Management)

	For the three months ended September 30		For the nine months ended September 30	
	2005	2004	2005	2004
Deficit, beginning of period	\$(4,662,337)	\$(2,234,881)	\$(1,711,273)	\$(2,026,546)
Net Income (loss) for the period	604,997	(264,828)	(2,229,917)	482,013
Purchase of common shares exceeding carrying value	(93,009)	(31,429)	(209,159)	(215,789)
Dividends	-	-	-	(770,816)
Deficit, end of period	\$(4,150,349)	\$(2,531,138)	\$(4,150,349)	\$(2,531,138)

Consolidated Statement of Cashflows

As at September 30, 2005
(Unaudited, prepared by Management)

	For the three months ended September 30		For the nine months ended September 30	
	2005	2004	2005	2004
Cash flows from operating activities				
Net income (loss) for the period	\$604,997	\$(264,828)	\$(2,229,917)	\$482,013
Items not affecting cash:				
Amortization and depletion	2,200,000	1,083,000	6,600,000	2,700,000
Future income taxes	865,612	480,500	(300,666)	985,300
Stock based compensation	141,000	103,000	758,000	434,000
Accretion	119,441	25,500	308,403	69,000
Financing fee amortization	-	-	2,969,500	-
	3,931,050	1,427,172	8,105,320	4,670,313
Net change in non-cash working capital balances	(3,247,889)	(1,734,847)	(911,108)	(2,331,654)
	683,161	(307,675)	7,194,212	2,338,659
Cash flows from financing activities				
Issuance of share capital, net of share issuance costs	23,719,152	4,541,881	36,086,822	4,556,881
Repayment of revolving line of credit	18,697,539	(127,141)	20,047,656	(633,858)
Advances on revolving line of credit	(17,613,247)	-	(17,613,247)	-
Repurchase of share capital	(143,090)	(41,524)	(346,348)	(289,858)
Repayment of subordinated debt	-	-	(10,000,000)	-
Payments of dividends	-	(105,000)	-	(105,000)
	24,660,354	4,268,216	28,174,883	3,528,165
Cash flows from investing activities				
Acquisition of oil and gas properties	(14,663,335)	(4,864,550)	(23,128,830)	(10,493,172)
Net change in working capital balance	2,874,251	238,745	2,758,164	513,369
Proceeds from disposal of oil and gas properties	-	1,276,678	-	1,276,678
Interest on note receivable	-	-	-	(72,540)
Due from related party	-	-	-	15,000
Payments to related parties	-	(106,092)	-	(106,092)
Cash assumed on acquisition of Rhodes Resources Corp.	-	-	-	2,502,459
	(11,789,084)	(3,455,219)	(20,370,666)	(6,364,298)
Increase (decrease) in cash and cash equivalents	13,554,431	505,322	14,998,429	(497,474)
Cash and cash equivalents (bank overdraft), beginning of period	1,148,469	(490,745)	(295,529)	512,051
Cash and cash equivalents (bank overdraft), end of period	\$14,702,900	\$14,577	\$14,702,900	\$14,577

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

Notes to Consolidated Financial Statements

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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. 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 disclosure provided below are incremental to those included in the annual audited 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 SUBORDINATED DEBT

During the period, the Corporation had available a standby mezzanine financing credit facility of up to \$10.0 million, with an interest rate of 10% per annum.

At September 30, 2005, the facility was repaid in full. 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 purchase certain properties.

note 4 REVOLVING LINE OF CREDIT

During the current period the Corporation renegotiated its credit facility. The Corporation now has a revolving line of credit of up to \$25 million (\$18 million at December 31, 2004) which bears interest at a variable rate between the prime rate plus 0% and prime plus 0.25%. There is also a quarterly commitment fee between 0.15% and 0.25% of the undrawn portion of the credit facility. The interest rate and commitment fee charged are both dependent upon the ratio of funded debt to annualized cash flow.

Included with the facility is a spot foreign exchange facility of up to \$1 million US dollars. At September 30, 2005 (December 31, 2004 - \$nil) there were no outstanding contracts.

The facility is secured by a floating charge debenture of \$75 million and an unlimited liability guarantee by the Corporation and its subsidiaries. Repayment is required with one year's notice from the bank. As a result, the liability has been classified as a non-current liability.

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note 5 **SHARE CAPITAL**

- a) **Authorized**
 i) Unlimited number of common voting shares
 ii) Unlimited number of preferred shares
- b) **Common Shares Issued**

	<i>Number</i>	<i>Amount</i>
Balance, December 31, 2003	22,500,000	\$ 1
Share reduction as a result of amalgamation	(3,952,696)	-
	18,547,304	1
Issued for preferred Series VI share conversion	3,429,752	3,429,752
Issued on acquisition (amalgamation) of Rhodes Resources Corp.	5,417,374	4,495,100
Issued on acquisition (amalgamation) of Fossil Bay Resources Ltd.	616,113	790,000
Issued as consideration for certain oil and gas properties	200,000	250,000
Issued on exercise of warrants	807,150	685,302
Issued on exercise of options	118,464	100,714
Issued pursuant to flow through share agreement at \$1.40 per share, net of cash issuance costs of \$453,577, tax effected for \$163,288, and non-cash issuance costs of \$412,030	3,450,000	4,127,681
Issued pursuant to flow through share agreement at \$1.40 per share, net of cash issuance costs of \$582,988, tax effected for \$209,876, and non-cash issuance costs of \$220,365	5,596,854	7,242,119
Issued pursuant to flow through share agreement at \$1.40 per share, net of cash issuance costs of \$135,078, tax effected for \$48,628.	1,075,000	1,418,550
Issued pursuant to share placement agreements net of tax effected at \$1.25 per share, net of cash issuance costs of \$312,490, tax effected for \$112,496, and non-cash issuance costs of \$575,635	3,000,000	2,974,371
Income tax effect of flow through share renouncement related to flow shares issued through the Corporation and its predecessors		(4,977,200)
Reclassification of contributed surplus amounts		318,500
Shares repurchased	(249,400)	(74,072)
Balance, December 31, 2004	42,008,611	20,780,818

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	<i>Number</i>	<i>Amount</i>
Issued on exercise of warrants	1,870,217	2,212,734
Issued on exercise of options	178,000	177,050
Issued pursuant to a flow through share agreement at \$1.40 per share, net of cash issuance costs of \$356,744, tax effected for \$128,428, and non-cash issuance costs of \$75,386	3,366,366	4,409,211
Issued pursuant to share placement agreement at \$1.25 per share, net of cash issuance costs of \$695,311, tax effected for \$250,312, and non-cash issuance costs of \$1,484,934	6,561,200	6,271,567
Issued pursuant to a flow through share agreement at \$2.00 per share, net of cash issuance costs of \$444,306, tax effected for \$159,950	3,900,000	7,515,644
Issued pursuant to share placement agreement at \$1.70 per share, net of cash issuance cost of \$1,038,692, tax effected for \$373,929, and non-cash issuance costs of \$1,515,281	9,117,353	13,319,456
Shares repurchased	(224,900)	(137,189)
Reclassification of contributed surplus amounts	-	875,000
Balance, September 30, 2005	66,776,847	\$ 55,424,291

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 at an average price of \$1.16.

During the period ended September 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 period ended September 30, 2005, 224,900 shares were repurchased at an average price of \$1.54

Pursuant to an escrow agreement and the policies of the TSX Venture Exchange, 19,731,522 common shares of the Corporation were deposited in escrow at the amalgamation date to form Terra Energy Corp. The shares have been released as follows:

- | | |
|-----------------------------------|-------------------------------------|
| i) 4,636,826 on February 12, 2004 | v) 4,636,826 on February 12, 2005 |
| ii) 236,844 on March 20, 2004 | vi) 236,844 on March 20, 2005 |
| iii) 4,636,826 on August 12, 2004 | vii) 4,636,826 on August 12, 2005 |
| iv) 236,844 on September 20, 2004 | viii) 236,844 on September 20, 2005 |
- The remaining 236,842 common shares will be released on March 20, 2006.

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

Notes to Consolidated Financial Statements

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(Unaudited, prepared by Management)

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 September 30, 2005 options have been granted to purchase 4,068,000 common shares (December 31, 2004 – 2,483,000) ranging at prices between \$0.75 and \$1.60 with an expiry dates between February 11, 2009 and June 23, 2010.

Details of all options outstanding are as follows:

	<i>Number</i>	<i>Weighted Average Exercise Price</i>
Employee Stock Options		
Balance December 31, 2003	-	\$ -
Granted on acquisition (amalgamation) of Rhodes Resources Corp. under stock option plan	312,000	0.75
Granted under the stock option plan during the year	2,797,000	1.00
Exercised during the current period	(105,000)	(0.76)
Expired during the current period	(521,000)	(0.99)
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	(178,000)	(0.99)
Expired during the current period	(190,000)	(1.28)
Employee Stock Options Balance, September 30, 2005	4,068,000	1.18
Agent Options		
Balance December 31, 2003	-	-
Granted on acquisition (amalgamation) of Rhodes Resources Corp. These options expire between December, 2005 and January, 2006.	224,400	1.00
Granted as part of flow through share issuance. These options will expire August 29, 2006	241,500	1.40
Granted as part of share issuance. These options will expire December 31, 2006	601,780	1.40
Exercised during the current period	(13,464)	(1.00)
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, September 30, 2005	1,740,595	1.35
Other Options		
Other Options Balance, September 30, 2005	329,730	1.21
Total Options Balance September 30, 2005	6,138,325	\$ 1.39

Notes to Consolidated Financial Statements

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<i>Options Exercise Price</i>	<i>Weighted Average Remaining Contract Life</i>	<i>Outstanding September 30, 2005</i>	<i>Weighted Average Share Price for Outstanding Options</i>	<i>Exercisable September 30, 2005</i>	<i>Weighted Average Share Price for Exercisable Options</i>
\$0.75	3.38 years	187,000		187,000	
1.00	3.38 years	1,998,000		824,000	
1.00	0.25 years	202,386		202,386	
1.15	4.20 years	400,000		80,000	
1.21	1.25 years	329,730		329,730	
1.40	0.92 years	241,500		241,500	
1.40	1.50 years	601,780		601,780	
1.40	1.33 years	694,929		694,929	
1.51	4.65 years	1,423,000		479,100	
1.60	4.65 years	60,000		12,000	
	2.30 years	6,138,325	\$1.39	3,652,425	\$1.25

During the current period, the Corporation issued granted options to officers, directors, employees, and consultants to purchase 1,953,000 common shares ranging at prices between \$1.51 and \$1.60. Of these options 70,000 have since expired. These options expire on June 22 and 23, 2010. These options vest as follows:

- (i) 491,100 options vest immediately
- (ii) 291,100 options vest between January 26 and June 23, 2006
- (iii) 233,600 options vest between January 26 and June 23, 2007
- (iv) 233,600 options vest between January 26 and June 23, 2008
- (v) 233,600 options vest between January 26 and June 23, 2009

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(Unaudited, prepared by Management)

d) Warrants

	<i>Number</i>	<i>Weighted Average Exercise Price</i>
The Corporation issued in exchange for warrants previously granted by Rhodes Resources Corp., the following warrants:		
Rhodes Series A warrants		
These warrants are exercisable at \$1.00 per common share until October 28, 2005 when these warrants expire	1,066,667	\$ 1.00
Exercised during 2004	(424,000)	(1.00)
Balance December 31, 2004	642,667	1.00
Exercised during the year	(550,667)	(1.00)
Balance September 30, 2005	92,000	\$ 1.00
Rhodes Series B warrants		
These warrants are exercisable at 1.10 per common share until December 31, 2004 and at \$1.20 per common share until December 31, 2005 at which time these warrants expire.	687,500	\$ 1.10
Exercised during 2004	(321,000)	(1.10)
Balance December 31, 2004	366,500	1.10
Exercised during 2005	(12,000)	(1.20)
Balance September 30, 2005	354,500	\$ 1.20
Rhodes Series C		
These warrants are exercisable at \$1.10 per common share until January 29, 2005 and \$1.20 until January 29, 2006 at which time these warrants expire	70,000	\$ 1.10
Exercised during 2004	-	-
Balance December 31, 2004	70,000	1.10
Exercised during 2005	(12,000)	(1.20)
Balance September 30, 2005	58,000	\$ 1.20

Notes to Consolidated Financial Statements

September 30, 2005
(Unaudited, prepared by Management)

During 2004 the Corporation issued the following warrants:

Terra Series A	1,250,000	\$ 1.20
These warrants were issued in conjunction with the Subordinated Debt issued on December 30, 2004 and are exercisable at \$1.20 per common share until December 31, 2006 at which time these warrants will expire		
Balance December 31, 2004	1,250,000	1.20
Exercised during 2005	(1,250,000)	(1.20)
Balance September 30, 2005	-	\$ -

Terra Series B

These warrants were issued in conjunction with the Subordinated Debt issued on December 30, 2004 and are exercisable at \$1.70 per common share until June 30, 2007 at which time these warrants will expire. The exercise price has been determined pursuant to the agreement using the common share price for the July, 2005 share placement agreement	1,250,000	\$ 1.70
Exercised during 2004	-	-
Balance December 31, 2004	1,250,000	1.70
Exercised during 2005	-	-
Balance September 30, 2005	1,250,000	\$ 1.70

Terra Series C

These warrants were issued in conjunction with the Subordinated Debt issued on December 30, 2004 and are exercisable at \$1.40 per common share until December 31, 2006 and at \$1.60 per common share until December 31, 2007 at which time these warrants will expire	2,500,000	\$ 1.40
Exercised during 2004	-	-
Balance December 31, 2004	2,500,000	1.40
Exercised during 2005	-	-
Balance September 30, 2005	2,500,000	\$ 1.40

Notes to Consolidated Financial Statements

September 30, 2005
(Unaudited, prepared by Management)

Terra Series D

Two warrants are required for exercise to purchase one common share at \$1.40 until December 30, 2005 and one common share at \$1.60 until December 30, 2006 at which time these warrants will expire	1,500,000	\$ 1.40
Exercised during 2004	-	-
Balance December 31, 2004	1,500,000	1.40
Exercised during 2005	-	-
Balance September 30, 2005	1,500,000	\$ 1.40

During 2005 the Corporation issued the following warrants:

Terra Series E

These warrants are exercisable at \$1.40 to purchase one common share until January 26, 2006 and at \$1.60 per one common share until January 26, 2007 at which time these warrants will expire	3,280,600	\$ 1.40
Exercised during 2005	(46,000)	(1.40)
Balance September 30, 2005	3,234,600	\$ 1.40

Terra Series F

Two warrants are required for exercise to purchase one common share at \$2.10 until July 27, 2007 at which time these warrants will expire	4,558,677	\$ 2.10
Exercised during 2005	-	-
Balance September 30, 2005	4,558,667	2.10
Total Warrants September 30, 2005	13,547,767	\$ 1.63

e) Stock-based compensation

For stock options granted to employees compensation expense of \$758,000 has been recorded for the period ending September 30, 2005 (\$434,000 September 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, \$598,000 has been recorded in the current period stock based compensation expense.

Notes to Consolidated Financial Statements

September 30, 2005
(Unaudited, prepared by Management)

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 4%; and an expected volatility of 50%.

The details of contributed surplus are as follows:

	Amount
Balance, December 31, 2004	\$ 4,196,192
Stock based compensation provision for the period	758,000
Deemed fair value of agent's options granted during the period [Note 5(c)]	275,924
Deemed fair value of warrants granted during the period [Note 5(e)]	2,817,855
Reclassification resulting from exercise of options and warrants	(875,000)
Balance, September 30, 2005	\$ 7,172,971

note 7 INTEREST CHARGES

Interest charges consist of the following amounts:

Period ended September 30, 2005	2005	2004
Interest on revolving line of credit	\$ 415,708	\$ 203,083
Interest on preferred share (Note 7)	68,916	61,164
Interest on subordinated debt	161,091	-
	\$ 645,716	\$ 264,247

note 8 COMMITMENTS AND CONTINGENCIES

- (a) The Corporation had outstanding letters of credit to various parties for a total of \$408,000. Of these amounts \$408,000 will 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

September 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:

<i>Contract Type</i>	<i>Floor Price</i>	<i>Ceiling Price</i>	<i>Remaining Volume</i>	<i>Contract Term</i>
Financial	\$6.00 per GJ Floor with Protection of \$1.00 per GJ	\$8.95 per GJ	31,000 GJ	November 1, 2004 to October 31, 2005
Financial	\$9.00 per GJ Floor	\$13.00 per GJ	302,000 GJ	November 1, 2005 to March 31, 2006
Financial	\$35.35	N/A	9,200 bbl	January 1, 2005 to December 31, 2005
Financial	\$36.65	N/A	9,200 bbl	January 1, 2005 to December 31, 2005

N/A – not applicable

The Corporation also has commitment to deliver approximately 2,130 GJ per day of gas at a variable price that is set at approximately 20 percent below the daily floating price. The contract expires on October 31, 2005.

The amount that the Corporation would be required to pay if all the contracts were cancelled at September 30, 2005 would approximate \$1,318,000 (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 \$75 million and an unlimited liability guarantee by the Corporation and its subsidiaries. At September 30, 2005 (December 31, 2004 - \$nil) there were no outstanding swap contracts.

Notes to Consolidated Financial Statements

September 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 September 30, 2005, the Corporation has incurred qualifying expenditures of approximately \$5.8 million.
- (i) The Corporation is required to incur exploration and development activities by December 31, 2006 of approximately \$12,513,000 as a result of flow through shares issued 2005. As at September 30, 2005, the Corporation has not incurred any qualifying expenditures.

note 9 **COMPARATIVE FIGURES**

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

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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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