



Q3 2007

Three and nine months ended
September 30, 2007

Company Definition

Throughout this annual report Terra Energy Corp. is referred to as “Terra Energy” the “Company” or the “Corporation”.

Volume Definition Reporting

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. Please note that the term, boe, may be misleading, particularly if used in isolation. A boe conversion ratio of six thousand cubic feet per barrel is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead.

Directors

Ted S. Anderson ^{(1) (2)}

Ralph G. Evans ^{(3) (4)}

Tony Sabelli ^{(1) (3)}

Colin MacDonald ⁽²⁾

Cas H. Morel ^{(2) (3) (4)}

Robert D. Penner ^{(1) (2)}

1. Member of the Audit Committee of the Board of Directors
2. Member of the Corporate Governance, Compensation and Nominating Committee of the Board of Directors
3. Member of the Engineering Reserves Committee of the Board of Directors
4. Member of the Environmental and Safety Committee of the Board of Directors

Officers

Cas H. Morel	President and Chief Executive Officer
Bud K. Love	Vice President, Finance and Chief Financial Officer
Tim A. Beatty	Vice President, Capital Projects
John M. Behr	Vice President, Exploration
Timothy A. Blair	Vice President, Land
Jan Campbell	Corporate Secretary

Terra Energy Corp.

Management's Discussion & Analysis

for the three and nine months ended September 30, 2007

This Management's Discussion and Analysis ("MD&A") of financial condition and results of operations of Terra Energy Corp. ("Terra Energy Corp." or the "Corporation") is dated November 13, 2007. It should be read in conjunction with the unaudited interim consolidated financial statements and corresponding notes for the three and nine month periods ended September 30, 2007 and September 30, 2006 and with the audited year end consolidated financial statements of the Corporation for the years ended December 31, 2006 and December 31, 2005.

Terra Energy's Board of Directors and Audit Committee have reviewed and approved the September 30, 2007 interim consolidated financial statements and related MD&A.

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

This MD&A provides certain financial measures that do not have a standardized meaning prescribed by Canadian generally accepted accounting principles ("GAAP"). These non-GAAP financial measures may not be comparable to similar measures presented by other issuers.

This MD&A contains the terms "cash flow from operations" and "cash flow from operations per share", which should not be considered an alternative to, or more meaningful than, cash flow from operating activities as determined in accordance with Canadian generally accepted accounting principles as an indicator of the Corporation's performance. Cash flow from operations per share is calculated using the same weighted average basic and diluted number of shares outstanding used in the calculation of net income (loss) per share. All references to cash flow throughout this MD&A are based on cash flow before changes in non-cash working capital.

Petroleum and natural gas volumes are converted to an equivalent measurement basis referred to as a "barrel of oil equivalent" ("boe") using a conversion rate of six thousand cubic feet of natural gas to one barrel of oil ("6:1"). The 6:1 conversion ratio is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead. Readers are cautioned that boe figures may be misleading, particularly if used in isolation.

The continuous disclosure materials of the Corporation, including its annual MD&A and audited financial statements, Information Circular and Proxy Statement, material change reports and press releases issued by the Corporation are available through the SEDAR system at www.sedar.com.

FORWARD LOOKING ADVISORY

Statements in this document may contain forward-looking information. Such information is subject to known and unknown risks, uncertainties and other factors that could influence actual results or events, and cause actual results or events to differ materially from those stated, anticipated or implied in the forward looking information. As such, readers are cautioned not to place undue reliance on the forward-looking information, as no assurances can be provided as to future results, levels of activity or achievements. In addition, the reader is cautioned that historical results are not necessarily indicative of future performance.

DISCLOSURE CONTROLS AND PROCEDURES

Disclosure controls and procedures are designed to provide reasonable assurance that information required to be disclosed is recorded, processed, summarized and reported with the time periods specified by securities regulations and that information required to be disclosed is accumulated and communicated to management.

The Chief Executive Officer and Chief Financial Officer have evaluated the effectiveness of the Corporation's disclosure controls and procedures as of September 30, 2007 and have concluded that they are adequate and effective to ensure accurate and complete disclosure.

DESIGN OF INTERNAL CONTROLS OVER FINANCIAL REPORTING

Effective for the year end 2006, securities regulations state that the Corporation is to design and implement internal controls over financial reporting and disclose in its MD&A any material changes in the Corporation's internal control over financial reporting that occurred during the Corporation's most recent interim period. Internal controls are processes designed and implemented by management to provide reasonable assurance regarding the reliability the Corporation's financial reporting and the preparation of financial statements and other financial information for external purposes in accordance with Canadian GAAP. For the quarter ended September 30, 2007, the Chief Executive Officer and the Chief Financial Officer have designed internal controls over financial reporting, or caused them to be designed under their supervision. Management has concluded that internal controls are adequately designed in this regard, considering the employees involved and the control procedures in place, including management and Audit Committee oversight and quarterly external auditor reviews. Occasionally, the Corporation requires outside assistance and advice on taxation, new accounting pronouncements and complex accounting and reporting issues, which is common with companies of a similar size. It should be noted, that the Corporation's control system, no matter how well designed, can provide only reasonable, but not absolute, assurance of detecting, preventing and deterring errors or fraud.

CORPORATE HISTORY

Terra Energy is a publicly traded corporation, amalgamated under the Business Corporations Act of Alberta, and formed as a result of the amalgamation of Terra Energy Corp., Terrapet Energy Corp., and Rhodes Resources Corp. on January 30, 2004. This 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.

SELECTED QUARTERLY INFORMATION

Financial

<i>Three months ended September 30</i>	2007	<i>2006</i>	<i>%Growth</i>
Gross Revenue	\$12,439,938	\$10,287,259	20.9%
Cash Flow From Operations	\$3,671,403	\$4,601,864	(20.2%)
Earnings	(\$1,161,031)	(\$244,582)	(374.7%)
Dividends	Nil	Nil	
Weighted Average Shares – Basic	74,956,496	69,556,634	7.8%
Weighted Average Shares – Diluted	74,956,496	69,556,634	7.8%
Shares at Quarter End – Basic	74,720,584	70,393,633	6.1%

	September 30, 2007	<i>December 31, 2006</i>	<i>%Growth</i>
Total Assets	\$159,579,186	\$147,561,394	8.1%
Long-term Financing	\$53,315,145	\$35,478,837	50.3%

Operational

<i>Three months ended September 30</i>	2007	<i>2006</i>	<i>%Growth</i>
Production			
Average Daily Production (boe/d)	3,706	2,931	26.4%
Wells Drilled			
Gross	3.0	5.0	(40.0%)
Net	3.0	5.0	(40.0%)

<i>Nine months ended September 30</i>	2007	<i>2006</i>	<i>% Growth</i>
Production			
Average Daily Production (boe/d)	3,067	2,894	6.0%
Wells Drilled			
Gross	4.0	12.0	(66.7%)
Net	4.0	11.0	(63.6%)

RESULTS OF OPERATIONS

Production

<i>Three months ended September 30</i>	2007	2006	%Growth
	Average	Average	%
Oil (bbl/d)	274	396	(30.8)
Natural Gas (mcf/d)	15,728	13,676	15.0
Liquids (bbl/d)	811	256	216.8
Combined (boe/d)	3,706	2,931	26.4

<i>Nine months ended September 30</i>	2007	2006	%Growth
	Average	Average	%
Oil (bbl/d)	289	371	(22.1)
Natural Gas (mcf/d)	13,121	13,329	(1.6)
Liquids (bbl/d)	591	301	96.3
Combined (boe/d)	3,067	2,894	6.0

Operations

<i>Three months ended September 30</i>	2007	2006	2007	2006	%Growth
	\$	\$	(\$/boe)	(\$/boe)	%
Gross Revenues	12,439,938	10,287,259	36.49	38.15	(4.4)
Realized Gain on Financial Instrument	113,746	766,785	0.33	2.84	(88.4)
Unrealized Gain (Loss) on Financial Instrument	(335,659)	(59,549)	(0.98)	(0.22)	345.5
Revenue Before Royalties	12,218,025	10,994,495	35.84	40.77	(12.1)
Royalties	(2,636,840)	(2,027,512)	(7.74)	(7.52)	2.9
Revenue After Royalties	9,581,185	8,966,983	28.10	33.25	(15.5)
Production Expenses	(4,449,862)	(3,123,725)	(13.05)	(11.58)	12.7
Operating Netback	5,131,323	5,843,258	15.05	21.67	(30.5)
General & Administrative Expenses	(757,556)	(730,754)	(2.22)	(2.71)	(18.1)
Interest Expense	(1,021,419)	(666,064)	(3.00)	(2.47)	21.5
Realized Foreign Exchange Gain	-	502,836	-	1.86	(100.0)
Non-cash Expenses	(4,950,901)	(4,918,998)	(14.52)	(18.24)	(20.4)
Income (Loss) Before Income Taxes	(1,598,553)	30,278	(4.69)	0.11	(4,363.6)
Income Tax Recovery (Expense)	437,522	(274,860)	1.28	(1.02)	(225.5)
Net Income (Loss)	(1,161,031)	(244,582)	(3.41)	(0.91)	274.7
Per Share – Basic	(0.02)	0.00			
Per Share - Diluted	(0.02)	0.00			

<i>Nine months ended September 30</i>	2007	2006	2007	2006	%Growth
	\$	\$	(\$/boe)	(\$/boe)	%
Gross Revenues	35,092,394	34,889,866	41.91	44.16	(5.1)
Realized Gain on Financial Instrument	688,640	768,159	0.82	0.98	(16.3)
Unrealized Gain (Loss) on Financial Instrument	(2,203,398)	29,725	(2.63)	0.04	(6,675.0)
Revenue Before Royalties	33,577,636	35,687,750	40.10	45.18	(11.2)
Royalties	(7,393,487)	(6,837,832)	(8.83)	(8.66)	2.0
Revenue After Royalties	26,184,149	28,849,918	31.27	36.52	(14.4)
Production Expenses	(11,055,705)	(9,671,401)	(13.20)	(12.24)	7.8
Operating Netback	15,128,444	19,178,517	18.07	24.28	(25.6)
General & Administrative Expenses	(2,989,968)	(2,943,947)	(3.57)	(3.73)	(4.3)
Interest Expense	(2,511,520)	(1,621,528)	(3.01)	(2.05)	46.8
Realized Foreign Exchange Gain	-	794,077	-	1.00	(100.0)
Non-cash Expenses	(13,331,976)	(13,106,403)	(15.92)	(16.59)	(4.0)
Income (Loss) Before Income Taxes	(3,705,020)	2,300,716	(4.43)	2.91	(252.2)
Income Tax Recovery (Expense)	994,436	(1,797,158)	1.19	(2.27)	(152.4)
Net Income (Loss)	(2,710,584)	503,558	(3.24)	0.64	(606.3)
Per Share – Basic	(0.04)	0.01			
Per Share - Diluted	(0.04)	0.01			

Revenue

<i>Three months ended September 30</i>	2007	2006	2007	2006	%Change
	\$	\$	(\$/boe)	(\$/boe)	%
Gross Revenue	12,439,938	10,287,259	36.49	38.15	(4.4)
Realized Gain on Financial Instrument	113,746	766,785	0.33	2.84	(88.4)
Unrealized Gain (Loss) on Financial Instrument	(335,659)	(59,549)	(0.98)	(0.22)	345.5
Revenue Before Royalties	12,218,025	10,994,495	35.84	40.77	(12.1)

Revenue Before Royalties increased 20.9% to \$12,439,938 for the three month period ended September 30, 2007 compared to \$10,287,259 for the same period ended September 30, 2006. Terra Energy realized an all in price per unit of production for the three month period ended September 30, 2007 of \$35.84, down 12.1% compared to the realized price per unit of production of \$40.77 per boe for the same period ended September 30, 2006.

<i>Nine months ended September 30</i>	2007	2006	2007	2006	%Change
	\$	\$	(\$/boe)	(\$/boe)	%
Gross Revenue	35,092,394	34,889,866	41.91	44.16	(5.1)
Realized Gain on Financial Instrument	688,640	768,159	0.82	0.98	(16.3)
Unrealized Gain (Loss) on Financial Instrument	(2,203,398)	29,725	(2.63)	0.04	(6,675.0)
Revenue Before Royalties	33,577,636	35,687,750	40.10	45.18	(11.2)

Below is a breakdown of gross revenue prices realized by the Corporation for the three and nine month periods ended September 30, 2007:

Gross Revenue:

<i>Three Months Ended September 30</i>	2007	2006	%Change
Crude Oil (\$ / bbl)	76.27	74.46	2.4
Natural Gas Liquids (\$ / bbl)	40.75	62.28	(34.6)
Natural Gas (\$ / mcf)	5.15	5.71	(9.8)

<i>Nine months Ended September 30</i>	2007	2006	%Change
Crude Oil (\$ / bbl)	70.48	71.69	(1.7)
Natural Gas Liquids (\$ / bbl)	38.58	54.17	(28.8)
Natural Gas (\$ / mcf)	6.49	6.54	(0.8)

At period ends, in accordance with generally accepted accounting principles, the Corporation is required to calculate and reflect a "mark-to-market" value of its financial instruments. At December 31, 2006 this calculation resulted in a \$1,841,861 unrealized gain on financial instruments. Further, during each period, the prior periods "unrealized gains" or losses are reversed and a new mark to market adjustment is calculated as at the period end.

At September 30, 2007, the "mark-to-market" adjustment resulted in an unrealized loss of \$335,659 for the quarter. The majority of this relates to a "mark-to-market" loss on derivative contracts used by the Corporation to manage the foreign exchange exposure on USD denominated LIBOR loans taken during the third quarter of 2007. This is offset by the \$346,634 unrealized foreign exchange gain recognized by the company in the third quarter of 2007 as a result of the strengthening Canadian dollar. The "mark-to-market" loss of \$2,203,398 for the nine month period ending September 30, 2007 is primarily the result of the reversal of the December 31, 2006 unrealized gain on financial instruments, and strengthening forward commodity prices early in 2007 compared to year end 2006. As was noted in the second quarter of 2007 Terra has substantially unwound its natural gas hedge position. The unrealized losses on financial instruments are non-cash items and, as a result, do not affect Terra Energy's cash flow from operations.

Royalties

<i>Three months ended September 30</i>	2007	2006	2007	2006	%Change
	\$	\$	(\$/boe)	(\$/boe)	%
Royalties	2,636,840	2,027,512	7.74	7.52	2.9

Royalties increased 30.1 % to \$2,636,840 for the three month period ended September 30, 2007 compared to \$2,027,512 for the same period ended September 30, 2006 as a result the Company's higher production. Royalties on a per unit of production basis remained relatively static, rising 2.9% to \$7.74 for the three month period ended September 30, 2007 compared to \$7.52 for the same period ended September 30, 2006.

The effective royalty rate rose to 21.2% for the three month period ended September 30, 2007 from 19.7% for the same period ended September 30, 2006. The increase in the effective royalty rate was due to the higher royalty rates associated with the flush production from new wells the Corporation brought onstream during the quarter.

<i>Nine months ended September 30</i>	2007	2006	2007	2006	%Change
	\$	\$	(\$/boe)	(\$/boe)	%
Royalties	7,393,487	6,837,832	8.83	8.66	2.0

Royalties increased 8.1% to \$7,393,487 for the nine month period ended September 30, 2007 compared to \$6,837,832 for the same period ended September 30, 2006. Royalties on a per unit of production basis rose 2.0% to

\$8.83 for the nine month period ended September 30, 2007 compared to \$8.66 for the same period ended September 30, 2006.

The effective royalty rate rose to 21.1% for the nine month period ended September 30, 2007 from 19.6% for the same period ended September 30, 2006.

Production Expenses

<i>Three months ended September 30</i>	2007	2006	2007	2006	<i>%Change</i>
	\$	\$	(\$/boe)	(\$/boe)	%
Production Expenses	4,449,862	3,123,725	13.05	11.58	12.7

Production expenses increased 42.5% to \$4,449,862 for the three month period ended September 30, 2007 compared to \$3,123,725 for the same period ended September 30, 2006 reflecting the higher production levels achieved by the Company. Production expenses on a per unit of production basis rose 12.7% to \$13.05 for the three month period ended September 30, 2007 compared to \$11.58 for the same period ended September 30, 2006. Higher production expenses on a per boe basis are primarily due to higher costs associated with the tie-in of new production. The Company expects that ultimately the higher production levels will lead to a reduction of operating expenses going forward.

<i>Nine months ended September 30</i>	2007	2006	2007	2006	<i>%Change</i>
	\$	\$	(\$/boe)	(\$/boe)	%
Production Expenses	11,055,705	9,671,401	13.20	12.24	7.8

Production expenses increased 14.3% to \$11,055,705 for the nine month period ended September 30, 2007 compared to \$9,671,401 for the same period ended September 30, 2006. Production expenses on a per unit of production basis rose 7.8% to \$13.20 for the nine month period ended September 30, 2007 compared to \$12.24 for the same period ended September 30, 2006.

General and Administrative Expenses

<i>Three months ended September 30</i>	2007	2006	2007	2006	<i>%Change</i>
	\$	\$	(\$/boe)	(\$/boe)	%
General and Administrative Expenses	757,556	730,754	2.22	2.71	(18.1)

General & administrative expenses increased 3.7% to \$757,556 for the three month period ended September 30, 2007 compared to \$730,754 for the same period ended September 30, 2006. General & administrative expenses on a per unit of production basis fell 18.1% to \$2.22 for the three month period ended September 30, 2007 compared to \$2.71 for the same period ended September 30, 2006 again as a result of higher production levels. This trend is expected to continue into the fourth quarter as even more production is added.

General & administrative expenses on a per unit of production basis fell as a result of an increasing production base. General & administrative costs on a per unit of production basis are expected to continue to fall as incremental production additions are not expected to add significant overhead expenses.

<i>Nine months ended September 30</i>	2007	2006	2007	2006	<i>%Change</i>
	\$	\$	(\$/boe)	(\$/boe)	%
General and Administrative Expenses	2,989,968	2,943,947	3.57	3.73	(4.3)

General & administrative expenses rose 1.6% to \$2,989,968 for the nine month period ended September 30, 2007 compared to \$2,943,947 for the same period ended September 30, 2006. General & administrative expenses on a

per unit of production basis decreased 4.3% to \$3.57 for the nine month period ended September 30, 2007 compared to \$3.73 for the same period ended September 30, 2007.

Interest Expense

<i>Three months ended September 30</i>	2007	2006	2007	2006	<i>%Change</i>
	\$	\$	<i>(\$/boe)</i>	<i>(\$/boe)</i>	%
Interest Expense	1,021,419	666,064	3.00	2.47	21.5

Interest expenses increased 53.4% to \$1,021,419 for the three month period ended September 30, 2007 compared to \$666,064 for the same period ended September 30, 2006. On a per unit of production basis interest expenses increased 21.5% to \$3.00 for the three month period ended September 30, 2007 compared to \$2.47 for the same period ended September 30, 2006.

Interest expenses increased as a result of higher indebtedness required during the quarter to finance the Corporation's capital expenditures program and an increase in interest rates payable on the Corporation's outstanding bank indebtedness.

<i>Nine months ended September 30</i>	2007	2006	2007	2006	<i>%Change</i>
	\$	\$	<i>(\$/boe)</i>	<i>(\$/boe)</i>	%
Interest Expense	2,511,520	1,621,528	3.01	2.05	46.8

Interest expenses increased 54.9% to \$2,511,520 for the nine month period ended September 30, 2007 compared to \$1,621,528 for the same period ended September 30, 2006. On a per unit of production basis interest expenses increased 46.8% to \$3.01 for the nine month period ended September 30, 2007 compared to \$2.05 for the same period ended September 30, 2006.

Non Cash Expenses

<i>Three months ended September 30</i>	2007	2006	2007	2006	<i>%Change</i>
	\$	\$	<i>(\$/boe)</i>	<i>(\$/boe)</i>	%
Depletion and Amortization	5,007,212	3,678,673	14.69	13.64	7.7
Accretion Expense	119,548	133,730	0.35	0.49	(28.6)
Stock Based Compensation	170,775	686,778	0.50	2.55	(80.4)
Unrealized Foreign Exchange Loss (Gain)	(346,634)	419,817	(1.02)	1.56	(165.4)
Total Non Cash Items	4,950,901	4,918,998	14.52	18.24	(20.4)

Non cash expenses rose 0.6% to \$4,950,901 for the three month period ended September 30, 2007 compared to \$4,918,998 for the same period ended September 30, 2006. On a per unit of production basis, non cash expenses decreased 20.4% to \$14.52 for the three month period ended September 30, 2007 compared to \$18.24 for the same period ended September 30, 2006.

Depletion and amortization expense increased 36.1% to \$5,007,212 in large part due to a 26.4% increase in production, and to a lesser extent due to the larger depletable asset base arising from Terra Energy's 2006 and 2007 capital expenditure program.

Stock based compensation decreased by 75.1% as a result of the cancellation of 197,000 stock options during the three month period ended September 30, 2007 and more importantly due to the nature of the stock option plan. The stock option plan follows a graded vesting schedule which results in stock based compensation expense being recognized on an accelerated or front end loaded basis, tailing off sharply near the vesting date. Terra Energy's

stock based compensation strategy is consistent with industry practices of compensating key employees, consultants and officers of the Corporation.

<i>Nine months ended September 30</i>	2007	2006	2007	2006	<i>%Change</i>
	\$	\$	(\$/boe)	(\$/boe)	%
Depletion and Amortization	12,295,525	10,181,237	14.68	12.89	13.9
Accretion Expense	342,582	351,250	0.41	0.44	(6.8)
Stock Based Compensation	1,040,503	2,600,080	1.24	3.29	(62.3)
Unrealized Foreign Exchange Loss (Gain)	(346,634)	(26,164)	(0.41)	(0.03)	1,266.7
Total Non Cash Items	13,331,976	13,106,403	15.92	16.59	(4.0)

Non cash expenses rose 1.7% to \$13,331,976 for the nine month period ended September 30, 2007 compared to \$13,106,403 for the same period ended September 30, 2006. On a per unit of production basis, non cash expenses decreased 4.0% to \$15.92 for the nine month period ended September 30, 2007 compared to \$16.59 for the same period ended September 30, 2006.

Income Taxes

<i>Three months ended September 30</i>	2007	2006	2007	2006	<i>%Change</i>
	\$	\$	(\$/boe)	(\$/boe)	%
Current Tax	-	1,391	-	0.01	(100.0)
Future Tax (Recovery)	(437,522)	273,469	(1.28)	1.01	(226.7)
Income Taxes	(437,522)	274,860	(1.28)	1.02	(225.5)

A future income tax recovery of \$437,522 for the three month period ended September 30, 2007 was recorded compared to an expense of \$274,860 for the same period ended September 30, 2006. On a per unit of production basis, the future income tax recovery was \$1.28 for the three month period ended September 30, 2007 compared to an expense of \$1.02 for the same period ended September 30, 2006.

<i>Nine months ended September 30</i>	2007	2006	2007	2006	<i>%Change</i>
	\$	\$	(\$/boe)	(\$/boe)	%
Current Tax	-	32,345	-	0.04	(100.0)
Future Tax (Recovery)	(994,436)	1,764,813	(1.19)	2.23	(153.4)
Income Taxes	(994,436)	1,797,158	(1.19)	2.27	(152.4)

A future income tax recovery of \$994,436 for the three month period ended September 30, 2007 was recorded compared to an expense of \$1,797,158 for the same period ended September 30, 2006. On a per unit of production basis, the future income tax recovery was \$1.19 for the three month period ended September 30, 2007 compared to an expense of \$2.27 for the same period ended September 30, 2006.

LIQUIDITY AND FINANCIAL CONDITION

	September 30, 2007	<i>December 31, 2006</i>	%Growth
	\$	\$	%
Working Capital	(10,016,746)	(10,331,676)	(3.0)
Oil and Gas Properties	151,559,512	138,704,967	9.3

The working capital deficit at September 30, 2007 was \$10,016,746 compared to a deficit of \$10,331,676 at December 31, 2006.

Terra Energy's bank credit facility is structured as a \$65.0mm 364 day revolving credit facility with a one year term-out provision. If the credit facility is not renewed at maturity, the Corporation has the ability to repay any amounts outstanding on the credit facility one year from maturity. As a result of this one year repayment feature, Terra Energy has classified its bank credit facility as a long-term financial obligation. As at September 30, 2007, Terra Energy was in compliance with all of its bank covenants.

Capitalized resource properties as at September 30, 2007 were \$151,559,512 net of accumulated depletion, compared to \$138,704,967 as at December 31, 2006. Oil and gas properties increased as a result of continued developments of oil and gas properties, the construction of infrastructure and the acquisition of undeveloped land. For the three and nine month periods ended September 30, 2007 Terra Energy incurred \$12,506,320 and \$25,074,743 in net capital expenditures broken down as:

<i>Three Months Ended September 30</i>	2007	2006
	\$	\$
Exploration	4,806,623	-
Development	682,274	12,623,861
Undeveloped Land	150,894	263,364
Geological / Geotechnical	377,953	118,150
Facilities	6,282,398	1,273,401
Other Assets	206,178	276,850
Total Capital Expenditures	12,506,320	14,555,626
Net Property Acquisitions	-	(8,973,514)
Net Capital Expenditures	12,506,320	5,582,112

<i>Nine Months Ended September 30</i>	2007	2006
	\$	\$
Exploration	7,342,781	2,624,934
Development	1,677,411	25,602,666
Undeveloped Land	1,127,818	11,112,497
Geological / Geotechnical	1,789,408	628,315
Facilities	12,510,493	9,310,494
Other Assets	626,832	1,053,807
Total Capital Expenditures	25,074,743	50,332,713
Net Property Acquisitions	-	(8,973,514)
Net Capital Expenditures	25,074,743	41,359,199

Terra Energy financed its capital expenditures for the period through a combination of bank debt and cash flow.

Cash Flow from Operations (non-GAAP measure)

Cash flow from operations (“Cash Flow”), representing cash generated from operating activities before changes in non-cash working capital items, is a non-GAAP measure. Management utilizes Cash Flow as a key measure to assess the ability of the Corporation to finance operating activities and capital expenditures. Additionally, Cash Flow has been described and presented in order to provide shareholders and potential investors with information regarding the Corporation’s liquidity and its ability to generate funds to finance its operations. This performance indicator may not be comparable to similar measures used by other companies.

The following table presents the non-GAAP financial measure “cash flow from operations”.

<i>Three months ended June 30</i>	2007	2006
	\$	\$
Net income (loss) for the period	(1,161,031)	(244,582)
Future income tax	(437,522)	273,469
Accretion expense	119,548	133,730
Stock based compensation	170,775	686,778
Unrealized loss on financial instruments	335,659	90,401
Unrealized foreign exchange gain	(346,634)	-
Amortization of deferred credit	(16,604)	(16,605)
Depletion and amortization	5,007,212	3,678,673
Cash flow from operations	3,671,403	4,601,864
<i>Nine months ended September 30</i>	2007	2006
	\$	\$
Net income (loss) for the period	(2,710,584)	503,558
Future income tax	(994,436)	1,764,813
Accretion expense	342,582	351,250
Stock based compensation	1,040,503	2,600,080
Unrealized loss (gain) on financial instruments	2,203,398	(7,389)
Unrealized foreign exchange gain	(346,634)	-
Realized loss on financial instruments	-	275,513
Amortization of deferred credit	(49,815)	(16,605)
Depletion and amortization	12,295,525	10,181,237
Cash flow from operations	11,780,539	15,652,457

Cash Flow from Operating Activities

For the three month period ended September 30, 2007, the Corporation generated cash flows from operating activities of \$5,503,933 (\$0.07 per basic / diluted share), a decrease of 34.1% compared to \$8,347,086 (\$0.12 per basic / diluted share) for the three month period ended September 30, 2006. For the nine month period ended September 30, 2007 the Corporation generated cash flows from operating activities of \$11,175,063 (\$0.15 per basic / diluted share), a decrease of 26.2% compared to \$15,140,685 (\$0.21 per basic / diluted share) for the nine month period ended September 30, 2006. The reduction in cash flows from operations is attributable to, lower natural gas prices, increased operating costs, and higher interest costs compared to 2006.

Capital Resources

The Corporation's share capital is as follows:

	September 30, 2007		December 31, 2006	
	No. of Shares	Amounts	No. of Shares	Amounts
Common Shares	74,720,584	65,566,990	76,900,833	\$72,570,457

During the three month period ended September 30, 2007 470,800 common shares were repurchased by the Corporation for \$515,124 at an average price of \$1.09 per common share. The Corporation recorded \$412,743 as a reduction of share capital and the excess of \$102,381 being charged to deficit. As at September 30, 2007 660,249 repurchased shares were held for cancellation. Shares repurchased under the normal course issuer bid are excluded from the outstanding number of shares.

COMMITMENTS AND CONTINGENCIES

The Corporation had outstanding letters of credit to various parties for a total of \$525,927 (2006- \$395,000). The amounts expire at various dates during 2007.

The Corporation is required to incur exploration and development activities by December 31, 2007 of approximately \$15,713,000 as a result of flow-through shares issued in November 2006. At September 30, 2007, the Corporation has incurred qualifying expenditures of approximately \$9,660,561 towards this obligation.

OFF-BALANCE SHEET ARRANGEMENTS

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

At September 30, 2007 the Corporation had entered into derivative contracts, the terms of which are summarized as follows:

Contract Type	Floor Price	Ceiling Price	Volumes Per Day	Contract Term
Financial	Sell US\$77.25 per Bbl	N/A	100 Bbls	January 1, 2007 to December 31, 2007
Financial	Buy US\$76.40 per Bbl	N/A	100 Bbls	January 1, 2007 to December 31, 2007
Financial	Sell \$7.50 per GJ	N/A	1,000 GJ	November 1, 2006 to October 31, 2007
Financial	Sell \$6.50 per GJ	\$8.92 per GJ	1,000 GJ	November 1, 2006 to October 31, 2007
Financial	Sell \$7.50 per GJ	N/A	1,500 GJ	December 1, 2006 to December 31, 2007
Financial	Sell \$7.65 per GJ	N/A	1,000 GJ	December 1, 2006 to October 31, 2007
Financial	Sell \$7.75 per GJ	N/A	1,000 GJ	January 1, 2007 to December 31, 2007
Financial	Buy \$7.41 per GJ	N/A	3,000 GJ	May 1, 2007 to December 31, 2007
Financial	Buy \$7.40 per GJ	N/A	1,500 GJ	June 1, 2007 – November 30, 2007
Financial	Buy \$7.48 per GJ	N/A	1,000 GJ	June 1, 2007 – December 31, 2007
Financial	Buy \$7.45 per GJ	N/A	1,000 GJ	June 1, 2007 – December 31, 2007
Financial	Buy \$7.35 per GJ	N/A	1,000 GJ	June 1, 2007 – November 1, 2007
Financial	Buy \$7.59 per GJ	N/A	3,000 GJ	July 1, 2007 – July 31, 2007
Financial	Buy \$7.59 per GJ	N/A	1,000 GJ	August 1, 2007 – November 30, 2007

Financial	Buy \$7.59 per GJ	N/A	1,500 GJ	December 1, 2007 – December 31, 2007
Financial	Buy \$8.50 per GJ	N/A	2,000 GJ	December 1, 2007 – December 31, 2007
Financial	Buy \$8.70 per GJ	N/A	3,000 GJ	January 1, 2008 – March 31, 2008
Financial	Sell \$6.53 per GJ	N/A	1,000 GJ	April 1, 2007 to October 31, 2007
Financial	Sell \$8.05 per GJ	N/A	1,000 GJ	November 1, 2007 to March 31, 2008
Financial	Sell \$7.45 per GJ	N/A	1,000 GJ	April 1, 2007 to March 31, 2008
Financial	Sell \$8.00 per GJ	\$8.60 per GJ	1,000 GJ	November 1, 2007 to March 31, 2008
Financial	Sell \$7.10 per GJ	N/A	1,000 GJ	April 1, 2007 to October 31, 2007
Financial	Sell \$8.00 per GJ	N/A	2,000 GJ	November 1, 2007 to December 31, 2007
Financial	Sell \$7.95 per GJ	N/A	1,000 GJ	April 1, 2007 to March 31, 2008
Financial	Sell \$8.05 per GJ	N/A	1,000 GJ	December 1, 2007 to December 31, 2007
Financial	Sell \$8.20 per GJ	\$9.21 per GJ	1,000 GJ	November 1, 2007 to March 31, 2008
Financial	Sell \$8.25 per GJ	\$9.40 per GJ	1,000 GJ	November 1, 2007 to March 31, 2008

Contract Type	Contract Amount	CAD/USD Exchange	Settlement Amount	Settlement Date
Financial	\$74,524 USD	\$1.0590	\$78,876 CAD	November 23, 2007
Financial	\$77,008 USD	\$1.0584	\$81,551 CAD	February 22, 2008
Financial	\$4,200,000 USD	\$1.0621	\$4,460,820 CAD	February 22, 2008

The mark to market value of the above commodity products transactions of \$361,537 has been recorded as a liability as at September 30, 2007.

RELATED PARTY TRANSACTIONS

The Corporation entered into transactions with the following related parties:

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

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

Fasken Martineau DuMoulin LLP – in 2006 the Corporate Secretary was a partner with the law firm

	September 30, 2007	September 30, 2006
	\$	\$
Expenses		
Consulting - Pioneer Land Services Ltd.	1,463	5,277
Legal Consulting – Fasken Martineau DuMoulin LLP	375	49,743
Legal Consulting - Borden Ladner Gervais LLP	314,955	128,022
	316,793	183,042
Other		
Recorded as part of Oil and Gas Properties - Pioneer Land Services Ltd	5,685	32,362
Recorded as part of Oil and Gas Properties - Borden Ladner Gervais LLP	29,866	-
Recorded as part of share issuance cost – Borden Ladner Gervais LLP	71,123	-
	106,674	32,362

OUTLOOK

Early this year, Terra Energy announced its Capital Expenditure Plan for 2007, which reflected the two primary objectives set by management and by the Board of Directors for the year. The first objective was the completion of four major infrastructure projects in our Fort St. John Core Operating Area, which were targeted at bringing additional volumes of 'behind-pipe' gas reserves on production. The second objective was for Terra Energy to carry out an exploration program targeted at adding substantial new reserves to the Company's bottom line, and in the process honouring the Company's commitment to expend 'qualifying expenditures' for renunciation to flow-through subscribers.

On May 2, 2007, the Company announced the completion of the first of these four major infrastructure projects, namely the Tower-Septimus Pipeline. This project resulted in incremental production for the Company of approximately 500 BOED.

On September 12, 2007, the Company announced the completion of the second of these four major infrastructure projects, namely the East Boudreau Pipeline. This project involved a combination of 4 inch and 6 inch diameter pipe, stretching approximately 19.5 kilometers from the Company's East Boudreau gas field to the Red Creek gas plant. This project resulted in incremental production for the Company of approximately 500 BOED.

The third major infrastructure project being carried out in 2007 is the completion by the Company of pipelines and well site facilities at our Eight Mile South gas field, in conjunction with the development by a third party midstreamer of a new sour gas processing plant at Doe Creek in British Columbia together with a gathering line to such plant. Terra Energy has committed to 3.25 MMcf per day (approximately 500 BOED) of firm service at this plant commencing upon start-up. The start-up of the plant and connecting gathering line was originally scheduled for late September of 2007, but it is now not anticipated to be operational until December. The construction of the new plant by the midstreamer is well underway, and the Company has commenced the construction of its connecting pipelines and wellsite facilities. The Company has substantially more than the 3.25 MMcf per day of gas awaiting tie-in at Eight Mile South, but it is likely that the Company will be limited to producing at its firm service commitment level as a result of plant capacity limitations.

The fourth major infrastructure project being carried out in 2007 is the construction by Terra Energy of a dehydration and compression facility at the Company's Tower gas field. This new dehydration and compression facility is located right on the Company's Tower-Septimus Pipeline, where it intersects with the new Peace River Crossing. The Company's new facility has a design capacity for 10 to 12 MMcf per day of gas, with expansion potential up to 20 MMcf per day. In connection with this project, the Company currently has 10 MMcf per day of firm service committed through both the Peace River Crossing and the McMahon gas plant, together with an additional 10MMcf per day of interruptible service. The Company has been notified that the Peace River Crossing has now been constructed with the expectation that it will be fully operational on or about December 1, 2007. The Company has received all requisite permits and approvals for the construction of this new facility, and construction work is now almost complete. The Company is currently in the process of completing the mechanical work, with the expectation that electrical work will be completed within the next week or so, for an expected on-stream date co-incident with December 1, 2007. This new facility and the diversion of gas through it will result in the de-bottlenecking of gas production at Tower and the ability by the Company to produce approximately 500 BOED of incremental production from the Tower gas field. An additional benefit to the Company will be the freeing-up of capacity at the Wilder gas plant, making it available for new reserves and production from Wilder and potentially from the Monias area.

Terra Energy is continuing with its 2007 Drilling Program. The Company (at 60% BPO and 76% APO), together with an industry partner (at 40% BPO and 24% APO), are drilling a deep Devonian test well at Monias. This play has been developed with the use of 3D seismic data. The Company owns 100% of the deep rights to a ten (10) section block of lands which completely contains the targeted play. The results of this well are anticipated only upon completion of drilling, logging and testing, expected to occur late in the year.

The Company is proceeding with the drilling of other wells also, including two or three in the Company's Eight Mile gas field. The results of the Company's drilling will be made known at a later date.

CHANGES IN ACCOUNTING POLICIES

On January 1, 2007, the corporation adopted the Canadian Institute of Chartered Accountants ("CICA") Handbook Section 1530 "Comprehensive Income", Section 3855 "Financial Instruments – Recognition and Measurement" Section 3865 "Hedges" and Section 3251 "Equity". The Corporation has adopted these standards retrospectively and the comparatives interim financial statements have not been restated.

Comprehensive Income

The new standards introduce comprehensive income, which consists of net earnings and other comprehensive income ("OCI"). The Corporation's Consolidated Financial Statements now include a Consolidated Statement of Loss, Comprehensive Loss and Deficit. The cumulative changes in OCI are included in accumulated other comprehensive income ("AOCI"), which is presented as a new category within shareholder's equity in the Consolidated Balance Sheet.

Financial Instruments

The financial instruments standard establishes the recognition and measurement criteria for financial assets, financial liabilities and derivatives. All financial instruments are required to be measured at fair value on initial recognition of the instrument, except for certain related party transactions. Measurement in subsequent periods depends on whether the financial instrument has been classified as "held-for-trading", "available-for-sale", "held-to-maturity", "loans and receivables", or "other financial liabilities" as defined by the standard.

Financial assets and financial liabilities "held-for-trading" are measured at fair value with changes in those fair values recognized in net earnings. Financial assets "available-for-sale" are measured at fair value, with changes in those fair values recognized in OCI. Financial assets "held-to-maturity", "loans and receivables" and "other financial liabilities" are measured at amortized cost using the effective interest method of amortization. The methods used by the Corporation in determining fair value of financial instruments are unchanged as a result of implementing the new standard.

Cash and cash equivalents are designated as "held-for-trading" and are measured at carrying value, which approximates fair value due to the short-term nature of these instruments. Accounts receivable is designated as "loans and receivables". Accounts payable and accrued liabilities, bank overdraft and long-term financing are designated as "other liabilities". Risk management assets and liabilities are derivative financial instruments classified as "held-for-trading" unless designated for hedge accounting.

Section 1506 – Accounting Changes

The Corporation also adopted Section 1506 – Accounting Changes the only impact of which is to provide disclosure of when an entity has not applied a new source of GAAP that has been issued but is not yet effective. This is the case with Section 3862 – Financial Instruments Disclosures and Section 3863 Financial Instruments Presentations which are required to be adopted for fiscal years beginning on or after October 1, 2007. This section also prescribes disclosures for voluntary changes and sets requirements for disclosures for the reasons of these changes. The Corporation will adopt these standards on January 1, 2008 and it is expected the only effect on the Corporation will be incremental disclosures regarding the significance of financial instruments for the entity's financial position and performance; and the nature, extent and management of risks arising from financial instruments to which the entity is exposed.

As of January 1, 2008 the company will be required to adopt CICA Handbook Section 1535, "Capital Disclosures", which requires entities to disclose their objectives, policies and processes for managing capital, and in addition, whether the entity has complied with any externally imposed capital requirements. The company is assessing the impact of this new standard on its consolidated financial statements and anticipates that the main impact will be in terms of additional disclosures.

In January 2006, the CICA Accounting Standards Board ("AcSB") adopted a strategic plan for the direction of accounting standards in Canada. As part of that plan, accounting standards in Canada for public companies are expected to converge with International Financial Reporting Standards ("IFRS") by the end of 2011. The Company continues to monitor and assess the impact of convergence of Canadian GAAP and IFRS.

CRITICAL ACCOUNTING ESTIMATES

In preparing financial statements in accordance with generally accepted accounting principles, management undertakes certain judgments and estimates. Changes in these judgments and estimates could have a material impact on the financial results and condition. The following discussion outlines accounting policies and practices that are critical to determining the Corporation's financial results.

Proved Oil and Gas Reserves

Under Canadian Securities Regulations National Instrument 51-101 "Standards of Disclosure for Oil and Gas Activities" (NI 51-101), "proved" reserves are those reserves that can be estimated with a high degree of certainty to be recoverable (it is likely that the actual remaining quantities recovered will exceed the estimated proved reserves). In accordance with this definition, the level of certainty targeted by the reporting company should result in at least a 90% probability that the quantities actually recovered will equal or exceed the estimated reserves. There was no such consideration of probability under National Policy 2B (NP 2B). In the case of "probable" reserves, which are obviously less certain to be recovered than proved reserves, NI 51-101 states that it must be equally likely that the actual remaining quantities recovered will be greater or less than the sum of the estimated proved plus probable reserves. With respect to the consideration of certainty, in order to report reserves as proved plus probable, the reporting company must believe that there is at least a 50% probability that the quantities actually recovered will equal or exceed the sum of the estimated proved plus probable reserves. The implementation of NI 51-101 has resulted in a more rigorous and uniform standardization of reserve evaluation.

The oil and gas reserve estimates are made using all available geological, reservoir and historical production data. Estimates are reviewed and revised as appropriate. Revisions may occur as a result of changes in prices, costs, fiscal regimes, reservoir performance or a change in the Corporation's plans.

Ceiling Test

Under the Canadian Institute of Chartered Accountants (CICA) full cost accounting guidelines, the Corporation calculates a ceiling test annually whereby the carrying value of petroleum and natural gas properties is compared to estimated future cash flow from the production of proved reserves. The Corporation has early adopted the requirement of CICA Accounting Guideline 16 "Oil and Gas Accounting - Full Cost" ("AcG 16"). The requirements of the guideline were to be followed for all fiscal years beginning on or after January 1, 2004. At September 30, 2007, the Corporation calculated the ceiling test using AcG 16 without any material adverse impact on the Corporation's financial position or results of operations.

Asset Retirement Obligation

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.

Depletion and Depreciation Expense

Terra Energy uses the full cost method of accounting for exploration and development activities whereby all costs associated with these activities are capitalized, whether successful or not. The aggregate of capitalized costs, net of certain costs related to unproved properties, and estimated future development costs is amortized using the unit-of-production method based on estimated proved reserves. Changes in estimated proved reserves or future development costs have a direct impact on depletion and depreciation expense. Certain costs related to unproved properties and major development projects may be excluded from costs subject to depletion until proved reserves have been assigned, at which point they would be included in the depletion calculation, or for impairment, for which any write-down would be charged to depletion and depreciation expense.

Stock Based Compensation and Share Purchase Warrants

The Corporation calculates the fair value of the options granted and share purchase warrants issued. This calculation is based on estimates which could differ significantly from actual results. This could have a significant impact on the financial statements.

Income Taxes

The determination of Terra Energy's income and other tax liabilities requires interpretation of complex laws and regulations often involving multiple jurisdictions. All tax filings are subject to audit and potential reassessment after the lapse of considerable time. Accordingly, the actual income tax liability may differ significantly from that estimated and recorded.

Financial Instruments

The Corporation's results are impacted by external market risks associated with fluctuations in commodity prices, operational and safety and environmental risks. The Corporation partially mitigates its exposure to market risks through the use of various financial instruments and physical contracts. The Corporation does not utilize derivative instruments for speculative purposes.

RISK FACTORS RELATING TO OIL AND GAS EXPLORATION, DEVELOPMENT AND PRODUCTION

Uncertain Discovery of Viable Commercial Prospects

The Corporation's future success may be dependent upon its ability to economically locate commercially viable oil or gas deposits. The Corporation can make no representations, warranties or guaranties that it will be able to consistently identify viable prospects, or that such prospects will be commercially exploitable. An inability of the Corporation to consistently identify and exploit commercially viable hydrocarbon deposits would have a material and adverse effect on the Corporation's business and financial position. Exploratory drilling is subject to numerous risks, including the risk that no commercially productive oil and gas reservoirs will be encountered. The cost of drilling, completing and operating wells is often uncertain, and drilling operations may be curtailed, delayed or canceled as a result of a variety of factors, including unexpected formation and drilling conditions, pressure or other irregularities in formations, blowouts, equipment failures or accidents, as well as weather conditions, compliance with governmental requirements and/or shortages or delays in the delivery of equipment. The inability to successfully locate and drill wells that will economically produce commercial quantities of oil and gas could have a material adverse effect on the

Corporation's business and financial position. The Corporation's properties are in various stages of exploration and development. Whether the Corporation ultimately drills a property may depend on a number of factors including funding, the receipt of additional seismic data or reprocessing of existing data, material changes in oil or gas prices, the costs and availability of drilling equipment, success or failure of wells drilled in similar formations or which would use the same production facilities, changes in estimates of costs to drill or complete wells, the Corporation's ability to attract industry partners to acquire a portion of its working interest to reduce exposure to drilling and completion costs, decisions of the Corporation's joint working interest owners, and/or restrictions under provincial regulators.

Volatility of Oil and Natural Gas Contracts

The ultimate profitability, cash flow and future growth of the Corporation will be affected by changes in prevailing oil and gas prices. Oil and gas prices have been subject to wide fluctuations in recent years in response to changes in the supply and demand for oil and natural gas, market uncertainty, competition, regulatory developments and other factors which are beyond the control of the Corporation. It is impossible to predict future oil and natural gas price movements with any certainty. An extended or substantial decline in oil and gas prices would have a material adverse effect on (i) the Corporation's access to capital, and (ii) the Corporation's financial position and results of operations.

Increased Operating Costs

Higher operating costs for our underlying properties will directly decrease the amount of cash flow received by the Corporation. Electricity, chemicals, supplies, reclamation and abandonment, and labour costs are a few of the operating costs that are susceptible to material fluctuation.

Title of Assets

Although the Corporation conducts title reviews in accordance with industry practice prior to any purchase of resource assets, such reviews do not guarantee that an unforeseen defect in the chain on title will not arise and defeat our title to the purchased assets. If such a defect were to occur, our entitlement to the production from such purchased assets could be jeopardized.

Uncertainty of Estimates of Reserves and Future Events

Certain statements included in this report contain estimates of the Corporation's oil and gas reserves and the discounted future net revenues from those reserves, as prepared by independent petroleum engineers. There are numerous uncertainties inherent in such estimates including many factors beyond the control of the Corporation. The estimates are based on a number of assumptions including constant oil and gas prices, and assumptions regarding future production, revenues, taxes, operating expenses, development expenditures and quantities of recoverable oil and gas reserves. Such estimates are inherently imprecise indications of future net revenues, and actual results might vary substantially from the estimates based on these assumptions. Any significant variance in these assumptions could materially affect the estimated quantity and value of reserves. In addition, the Corporation's reserves might be subject to revisions based upon future production, results of future exploration and development, prevailing oil and gas prices and other factors. More over, estimates of the economically recoverable oil and gas reserves, classifications of such reserves and estimates of future net cash flows prepared by independent engineers at different times may vary substantially. Information about reserves constitutes forward-looking statements. Further, the future success of the Corporation depends upon its ability to find, develop and acquire oil and gas reserves that are economically recoverable. As a result, the Corporation must locate, acquire and develop new oil and gas reserves to replace those being depleted by production. Without successful funding for acquisitions and exploration and development activities, the Corporation's reserves will decline. No assurances can be made that the Corporation will be able to find and develop or acquire additional reserves at an acceptable cost.

Competition

The Corporation engages in the highly competitive industry of exploration for and production of oil and gas. The Corporation competes directly and indirectly with major and independent oil and gas companies in its exploration for and development of desirable oil and gas properties. Many companies and individuals are engaged in the business of acquiring interests in and developing oil and gas properties in Canada, and the industry is not dominated by any single competitor or a small number of competitors. Many of such competitors have substantially greater financial, technical, sales, marketing and other resources, as well as greater historical market acceptance than does the Corporation. The Corporation will compete with numerous industry participants for the acquisition of land and rights to prospects, and for the equipment and labor required to operate and develop such prospects. Competition could materially and adversely affect the Corporation's business, operating results and financial condition. Such competitive disadvantages could adversely affect the Corporation's ability to participate in projects with favorable rates of return.

Shortage of Supplies and Equipment

The Corporation's ability to conduct operations in a timely and cost effective manner is subject to the availability of natural gas and crude oil field supplies, rigs, equipment and service crews. Although none are expected currently, any shortage of certain types of supplies and equipment could result in delays in our operations as well as in higher operating and capital costs.

Interruption From Severe Weather

The Corporation's operations are conducted principally in the central region of Alberta, northeastern British Columbia and Saskatchewan. The weather in these areas can be extreme and can cause interruption or delays in our drilling and construction operations.

Dependence on Third-Party Pipelines

In fiscal 2006, substantially all of Terra Energy's sales of natural gas production were through deliveries to local third-party gathering systems to processing plants. In addition, the Corporation relies on access to interprovincial pipelines for the sale and distribution of substantially all of our gas. As a result, a curtailment of our sale of natural gas by pipelines or by third-party gathering systems, an impairment of our ability to transport natural gas on interprovincial pipelines or a material increase in the rates charged to us for the transportation of natural gas by reason of a change in federal or provincial regulations or for any other reason, could have a material adverse effect upon us. In such event, we would have to obtain other transportation arrangements. There can be no assurance that we would have economical transportation alternatives or that it would be feasible for us to construct pipelines. In the event such circumstances were to occur, our netbacks from the affected wells would be suspended until, and if, such circumstances could be resolved.

Operating Hazards and Uninsured Risks

The oil and gas business involves a variety of operating risks, including fire, explosion, pipe failure, casing collapse, abnormally pressured formations, adverse weather conditions, governmental and political actions, premature reservoir declines and environmental hazards such as oil spills, gas leaks and discharges of toxic gases. The occurrence of any of these events with respect to any property operated or owned (in whole or in part) by us could have a material adverse impact on us. The Corporation and the operators of our properties, maintain insurance in accordance with customary industry practices and in amounts that we believe to be reasonable. However, insurance coverage is not always economically feasible and is not obtained to cover all types of operational risks. The occurrence of a significant event that is not insured or insured fully could have a material adverse effect on our financial condition.

Restoration, Safety and Environmental Risks

Our operations are in Saskatchewan, Alberta and British Columbia. Certain laws and regulations exist that require companies engaged in petroleum activities to obtain necessary safety and environmental permits to operate. Such legislation may restrict or delay us from conducting operations in certain geographical areas. Further, such laws and regulations may impose liabilities on us for remedial and clean-up costs, personal injuries related to safety and environmental damages, such liabilities collectively referred to as “asset retirement obligations”.

Expiration of Licenses and Leases

The Corporation’s properties are held in the form of licenses and leases and working interests in licenses and leases. If the Corporation or the holder of the license or lease fails to meet the specific requirement of a license or lease, the license or lease may terminate or expire. There can be no assurance that any of the obligations required to maintain each license or lease will be met. The termination or expiration of the Corporation’s licenses or leases or the working interests relating to a license or lease may have a material adverse effect on the Corporation’s results of operations and business.

Canadian Government Regulation and Industry Conditions

The Kyoto protocol, ratified by the Canadian federal government in December 2002, came into force on February 16, 2005. The protocol commits Canada to reducing greenhouse gas emissions to six percent below 1990 levels over the period 2008-2012. The Canadian government released a framework outlining its Climate Change action plan on April 13, 2005. The plan contains few technical details regarding the implementation of the government’s greenhouse gas reduction strategy. The Climate Change Working Group of the Canadian Association of Petroleum Producers continues to work with the Canadian and Alberta governments to develop an approach for implementing targets and enabling greenhouse gas control legislation, which protects the industry’s competitiveness, limits the cost and administrative burden of compliance and supports continued investment in the sector. As the Canadian government has yet to release a detailed Kyoto compliance plan, the Corporation is unable to predict the impact of potential regulations upon its business; however, it is possible that the Corporation would face increases in operating costs in order to comply with the greenhouse gas emissions legislation.

Canadian Government Regulation and Environmental Matters

The oil and natural gas industry is subject to extensive controls and regulations imposed by various levels of the federal and provincial governments of Canada. It is not expected that any of these controls or regulations will affect the operations of the Corporation in a manner materially different than they would affect other oil and gas companies of similar size. All current legislation is a matter of public record and the Corporation is unable to accurately predict what additional legislation or amendments may be enacted. All of the governmental regulations noted below may be changed from time to time in response to economic or political conditions. The Corporation’s management believes that the trend of more expansive and stricter environmental laws and regulations will continue. The implementation of new or modified environmental laws or regulations could have a material adverse impact on the Corporation.

The Corporation is subject to various Canadian federal and provincial laws and regulations relating to the environment. The Corporation believes that it is currently in compliance with such laws and regulations. However, such laws and regulations may change in the future in a manner which will increase the burden and cost of compliance. In addition, the Corporation could incur significant liability under such laws for damages, clean-up costs and penalties in the event of certain discharges into the environment. In addition, environmental laws and regulations may impose liability on the Corporation for personal injuries, clean-up costs, environmental damage and property damage as well as administrative, civil and criminal penalties. The Corporation maintains limited insurance coverage for accidental environmental damages, but does not maintain insurance for the full potential liability that could be caused by such environmental damage. Accordingly, the Corporation may be subject to significant liability, or may be required to cease production in the event of the noted liabilities.

Provincial Regulation – Royalties Incentives and Land Tenures

In addition to federal regulations, each province has regulations which govern land tenure, royalties, production rates, extra-provincial export, environmental protection and other matters. The royalty regime is a significant factor in the profitability of oil and natural gas production. Royalties payable on production from lands other than Crown lands are determined by negotiations between the mineral owner and the lessee. Crown royalties are determined by government regulation and are generally calculated as a percentage of the value of the gross production. The rate of royalties payable generally depends in part on prescribed reference prices, well productivity, geographical location, field discovery date and the type or quality of the petroleum product produced. From time to time the provincial governments of Canada have established incentive programs which have included royalty rate reductions, royalty holidays and tax credits for the purpose of encouraging oil and natural gas exploration or enhanced planning projects. Crude oil and natural gas located in the western provinces is owned predominantly by the respective provincial governments. Provincial governments grant rights to explore for and produce oil and natural gas pursuant to leases, licenses and permits for varying terms from two years and on conditions set forth in provincial legislation including requirements to perform specific work or make payments. Oil and natural gas located in such provinces can also be privately owned and rights to explore for and produce such oil and natural gas are granted by lease on such terms and conditions as may be negotiated.

Terra Energy Corp.
Consolidated Financial Statements
For the Three and Nine Months Ended
September 30, 2007
(Unaudited)

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Terra Energy Corp.
Consolidated Balance Sheets
As at September 30, 2007 and December 31, 2006
(Unaudited)

	September 30 2007	December 31 2006
Assets		
Current		
Accounts receivable	\$ 6,601,628	\$ 5,752,846
Financial instruments (Note 4)	-	1,841,861
Prepaid expenses	1,418,046	1,261,720
	8,019,674	8,856,427
Oil and gas properties	151,559,512	138,704,967
	\$ 159,579,186	\$ 147,561,394
Liabilities and Shareholders' Equity		
Current		
Bank overdraft (Note 3)	\$ 5,221,778	\$ 8,412,852
Accounts payable and accrued liabilities	12,453,105	10,775,251
Financial instruments (Note 4)	361,537	-
	18,036,420	19,188,103
Deferred credit	199,275	249,090
Long-term financing (Note 3)	53,315,145	35,478,837
Asset retirement obligation	5,451,835	5,033,926
Future income taxes	14,355,989	10,245,725
	91,358,664	70,195,681
Shareholders' Equity		
Share capital (Note 8(b))	65,566,990	73,004,715
Contributed surplus (Note 7)	9,223,296	7,838,602
Deficit	(6,569,764)	(3,477,604)
	68,220,522	77,365,713
	\$ 159,579,186	\$ 147,561,394
Commitments and contingencies (Note 9)		

Terra Energy Corp.
Consolidated Statements of Income (Loss), Comprehensive Income (Loss) and Deficit
(Unaudited)

	<i>Three months ended</i>		<i>Nine Months ended</i>	
	<i>September 30</i>		<i>September 30</i>	
	2007	2006	2007	2006
Revenue				
Gross revenues	\$ 12,439,938	\$10,287,259	\$ 35,092,394	\$ 34,889,866
Realized gain on financial instruments	113,746	766,785	688,640	768,159
Unrealized (loss) gain on financial instruments	(335,659)	(59,549)	(2,203,398)	29,725
	12,218,025	10,994,495	33,577,636	35,687,750
Royalties	(2,636,840)	(2,027,512)	(7,393,487)	(6,837,832)
	9,581,185	8,966,983	26,184,149	28,849,918
Expenses				
Production	4,449,862	3,123,725	11,055,705	9,671,401
General and administrative	757,556	730,754	2,989,968	2,943,947
Accretion expense	119,548	133,730	342,582	351,250
Stock-based compensation	170,775	686,778	1,040,503	2,600,080
Depletion, depreciation and amortization	5,007,212	3,678,673	12,295,525	10,181,237
Interest (Note 3)	1,021,419	666,064	2,511,520	1,621,528
Realized foreign exchange gain	-	(502,836)	-	(794,077)
Unrealized foreign exchange gain	(346,634)	419,817	(346,634)	(26,164)
	11,179,738	8,936,705	29,889,169	26,549,202
Income (loss) before income taxes	(1,598,553)	30,278	(3,705,020)	2,300,716
Income tax (recovery) expense				
Current tax	-	1,391	-	32,345
Future tax (recovery)	(437,522)	273,469	(994,436)	1,764,813
	(437,522)	274,860	(994,436)	1,797,158
Net income (loss) and comprehensive income (loss) for the period	(1,161,031)	(244,582)	(2,710,584)	503,558
Deficit, beginning of period	(5,306,352)	(1,513,006)	(3,477,604)	(1,259,194)
Repurchase of common shares (Note 8(b))	(102,381)	(1,062,466)	(381,576)	(2,064,418)
Deficit, end of period	\$ (6,569,764)	\$(2,820,054)	\$ (6,569,764)	\$ (2,820,054)
Earnings (loss) per share - basic and diluted	\$(0.02)	\$0.00	\$(0.04)	\$0.01
Weighted average number of shares outstanding - basic	74,956,496	69,556,634	75,311,353	70,944,634
Weighted average number of shares outstanding - diluted	74,956,496	69,556,634	75,311,353	73,141,560

Terra Energy Corp.
Consolidated Statements of Cash Flows
(Unaudited)

	<i>Three months ended</i>		<i>Nine months ended</i>	
	<i>September 30</i>		<i>September 30</i>	
	2007	2006	2007	2006
Cash flows from operating activities				
Net income (loss) for the period	\$ (1,161,031)	\$ (244,582)	\$ (2,710,584)	\$ 503,558
Items not affecting cash:				
Future tax (recovery)	(437,522)	273,469	(994,436)	1,764,813
Accretion of asset retirement obligations	119,548	133,730	342,582	351,250
Stock-based compensation	170,775	686,778	1,040,503	2,600,080
Unrealized loss (gain) on financial instruments (Note 4)	335,659	90,401	2,203,398	(7,389)
Unrealized foreign exchange gain	(346,634)	-	(346,634)	
Realized gain on financial instruments	-	-	-	275,513
Amortization of deferred credit	(16,604)	(16,605)	(49,815)	(16,605)
Depletion, depreciation and amortization	5,007,212	3,678,673	12,295,525	10,181,237
	<u>3,671,403</u>	<u>4,601,864</u>	<u>11,780,539</u>	<u>15,652,457</u>
Changes in non-cash working capital from operations	1,832,530	3,745,222	(605,476)	(511,772)
Cash flows from operating activities	<u>5,503,933</u>	<u>8,347,086</u>	<u>11,175,063</u>	<u>15,140,685</u>
Cash flows from (used in) financing activities				
Proceeds from long-term financing	2,756,780	(3,705,376)	18,182,942	10,600,358
Increase (decrease) in bank overdraft	310,692	-	(3,191,074)	-
Issuance of common shares, net of issuance costs	121,601	107,905	211,356	5,753,730
Repurchase of common shares	(515,123)	(2,066,182)	(2,581,766)	(3,816,888)
Cash flows from financing activities	<u>2,673,950</u>	<u>(5,663,653)</u>	<u>12,621,458</u>	<u>12,537,200</u>
Cash flows (used in) from investing activities				
Additions to oil and gas properties	(12,506,321)	(14,565,285)	(25,074,743)	(50,342,372)
Disposition of oil and gas properties	-	8,983,173	-	8,983,173
Changes in non-cash working capital from investing	4,328,438	4,103,305	1,278,222	(3,603,793)
Reimbursement for leasehold improvements	-	-	-	282,299
Cash flows used in investing activities	<u>(8,177,883)</u>	<u>(1,478,807)</u>	<u>(23,796,521)</u>	<u>(44,680,693)</u>
Decrease in cash and cash equivalents	-	1,204,626	-	(17,002,808)
Cash and cash equivalents, beginning of period	-	(5,080,118)	-	13,127,316
Cash and cash equivalents, end of period	<u>\$ -</u>	<u>\$ (3,875,492)</u>	<u>\$ -</u>	<u>\$ (3,875,492)</u>

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, Terrapet Energy Corp., and Terra Energy Corp. 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 in Western Canada.

2. CHANGES IN ACCOUNTING POLICIES AND PRACTICES

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 consolidated financial statements for Terra Energy Corp. for the year ended December 31, 2006 except as noted below. Certain disclosures, which are normally required to be included in the notes to the financial statements, have been condensed or omitted. 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, 2006.

On January 1, 2007, the Corporation adopted the Canadian Institute of Chartered Accountants ("CICA") Handbook Section 1530 "Comprehensive Income", Section 3855 "Financial Instruments - Recognition and Measurement", Section 3865 "Hedges" and Section 3251 "Equity". The Corporation has adopted these standards retrospectively and the comparative interim financial statements have not been restated.

Comprehensive Income

The new standards introduce comprehensive income, which consists of net earnings and other comprehensive income ("OCI"). The Corporation's consolidated financial statements now include a Consolidated Statement of Loss, Comprehensive Loss and Deficit. The cumulative changes in OCI are included in accumulated other comprehensive income ("AOCI"), which is presented as a new category within shareholder's equity in the Consolidated Balance Sheet.

Financial Instruments

The financial instruments standard establishes the recognition and measurement criteria for financial assets, financial liabilities and derivatives. All financial instruments are required to be measured at fair value on initial recognition of the instrument, except for certain related party transactions. Measurement in subsequent periods depends on whether the financial instrument has been classified as "held-for-trading", "available-for-sale", "held-to-maturity", "loans and receivables", or "other financial liabilities" as defined by the standard.

Financial assets and financial liabilities "held-for-trading" are measured at fair value with changes in those fair values recognized in net earnings. Financial assets "available-for-sale" are measured at fair value, with changes in those fair values recognized in OCI. Financial assets "held-to-maturity", "loans and receivables" and "other financial liabilities" are measured at amortized cost using the effective interest method of amortization. The methods used by the Corporation in determining fair value of financial instruments are unchanged as a result of implementing the new standard.

2. CHANGES IN ACCOUNTING POLICIES AND PRACTICES (continued)

Cash and cash equivalents are designated as “held-for-trading” and are measured at carrying value, which approximates fair value due to the short-term nature of these instruments. Accounts receivable is designated as “loans and receivables”. Accounts payable and accrued liabilities, bank overdraft and long-term financing are designated as “other liabilities”. Risk management assets and liabilities are derivative financial instruments classified as “held-for-trading” unless designated for hedge accounting.

The Corporation also adopted Section 1506 “Accounting Changes”, the only impact of which is to provide disclosure of when an entity has not applied a new source of GAAP that has been issued but is not yet effective. This is the case with Section 3862 “Financial Instruments Disclosures” and Section 3863 “Financial Instruments Presentations” which are required to be adopted for fiscal years beginning on or after October 1, 2007. This section also prescribes disclosures for voluntary changes and sets requirements for disclosures for the reasons of these changes. The Corporation will adopt these standards on January 1, 2008 and it is expected the only effect on the Corporation will be incremental disclosures regarding the significance of financial instruments for the entity’s financial position and performance; and the nature, extent and management of risks arising from financial instruments to which the entity is exposed.

As of January 1, 2008 the company will be required to adopt CICA Handbook Section 1535, “Capital Disclosures”, which requires entities to disclose their objectives, policies and processes for managing capital, and in addition, whether the entity has complied with any externally imposed capital requirements. The company is assessing the impact of this new standard on its consolidated financial statements and anticipates that the main impact will be in terms of additional disclosures.

In January 2006, the CICA Accounting Standards Board (“AcSB”) adopted a strategic plan for the direction of accounting standards in Canada. As part of that plan, accounting standards in Canada for public companies are expected to converge with International Financial Reporting Standards (“IFRS”) by the end of 2011. The Company continues to monitor and assess the impact of convergence of Canadian GAAP and IFRS.

3. LONG-TERM FINANCING

The Corporation has a revolving line of credit, with a syndicate of chartered banks, of up to \$65 million (December 31, 2006 - \$55 million), which bears interest at prime plus 0.50% (2006 - prime plus 0.25%). The facility is secured by a general security agreement, a floating charge debenture in the amount of \$150 million and an unlimited liability guarantee by Terra Energy Corp. and Constar Resources Ltd. At September 30, 2007, the Corporation was indebted on the revolving line of credit in the amount of \$53,315,145 (December 31, 2006 - \$35,478,837) and was in compliance with all loan covenants. The outstanding cheques issued in the amount of \$5,221,778 (December 31, 2006 - \$8,412,852) are shown as bank overdraft until they clear against the revolving line.

The Corporation's bank credit facility is structured as a 364 day revolving credit facility with a one-year term out. If the credit facility is not renewed at maturity, the corporation is required to pay the outstanding balance one year from the maturity. The credit facility is subject to a renewal in September 2008. As a result the liability has been classified as a non-current liability. In addition, the credit facility includes a change of control clause whereby in the event of any change of control, the creditor, at their discretion, may terminate the credit facility and therefore the entire amount outstanding will be due and payable upon demand.

	September 30 2007	September 30 2006
Interest on long term debt	\$ 2,204,055	\$ 1,621,528
Other interest	307,465	-
	\$ 2,511,520	\$ 1,621,528

Terra Energy Corp.
Notes to Consolidated Financial Statements
For the Three and Nine Months Ended September 30, 2007
(Unaudited)

4. FINANCIAL INSTRUMENTS

At September 30, 2007, the Corporation had entered into derivative contracts, the terms of which are summarized as follows:

Contract Type	Floor Price	Ceiling Price	Volumes Per Day	Contract Term
Financial	Sell US\$77.25 per Bbl	N/A	100 Bbls	January 1, 2007 to December 31, 2007
Financial	Buy US\$76.40 per Bbl	N/A	100 Bbls	January 1, 2007 to December 31, 2007
Financial	Sell \$7.50 per GJ	N/A	1,000 GJ	November 1, 2006 to October 31, 2007
Financial	Sell \$6.50 per GJ	\$8.92 per GJ	1,000 GJ	November 1, 2006 to October 31, 2007
Financial	Sell \$7.50 per GJ	N/A	1,500 GJ	December 1, 2006 to December 31, 2007
Financial	Sell \$7.65 per GJ	N/A	1,000 GJ	December 1, 2006 to October 31, 2007
Financial	Sell \$7.75 per GJ	N/A	1,000 GJ	January 1, 2007 to December 31, 2007
Financial	Buy \$7.41 per GJ	N/A	3,000 GJ	May 1, 2007 to December 31, 2007
Financial	Buy \$7.40 per GJ	N/A	1,500 GJ	September 1, 2007 – November 30, 2007
Financial	Buy \$7.48 per GJ	N/A	1,000 GJ	September 1, 2007 – December 31, 2007
Financial	Buy \$7.45 per GJ	N/A	1,000 GJ	September 1, 2007 – December 31, 2007
Financial	Buy \$7.35 per GJ	N/A	1,000 GJ	September 1, 2007 – November 1, 2007
Financial	Buy \$7.59 per GJ	N/A	3,000 GJ	July 1, 2007 – July 31, 2007
Financial	Buy \$7.59 per GJ	N/A	1,000 GJ	August 1, 2007 – November 30, 2007
Financial	Buy \$7.59 per GJ	N/A	1,500 GJ	December 1, 2007 – December 31, 2007
Financial	Buy \$8.50 per GJ	N/A	2,000 GJ	December 1, 2007 – December 31, 2007
Financial	Buy \$8.70 per GJ	N/A	3,000 GJ	January 1, 2008 – March 31, 2008
Financial	Sell \$6.53 per GJ	N/A	1,000 GJ	April 1, 2007 to October 31, 2007
Financial	Sell \$8.05 per GJ	N/A	1,000 GJ	November 1, 2007 to March 31, 2008
Financial	Sell \$7.45 per GJ	N/A	1,000 GJ	April 1, 2007 to March 31, 2008
Financial	Sell \$8.00 per GJ	\$8.60 per GJ	1,000 GJ	November 1, 2007 to March 31, 2008
Financial	Sell \$7.10 per GJ	N/A	1,000 GJ	April 1, 2007 to October 31, 2007
Financial	Sell \$8.00 per GJ	N/A	2,000 GJ	November 1, 2007 to December 31, 2007
Financial	Sell \$7.95 per GJ	N/A	1,000 GJ	April 1, 2007 to March 31, 2008
Financial	Sell \$8.05 per GJ	N/A	1,000 GJ	December 1, 2007 to December 31, 2007
Financial	Sell \$8.20 per GJ	\$9.21 per GJ	1,000 GJ	November 1, 2007 to March 31, 2008
Financial	Sell \$8.25 per GJ	\$9.40 per GJ	1,000 GJ	November 1, 2007 to March 31, 2008
Financial	Sell \$8.50 per GJ	\$9.00 per GJ	1,000 GJ	November 1, 2007 to March 31, 2008

Contract Type	Contract Amount	CAD/USD Exchange	Settlement Amount	Settlement Date
Financial	\$74,524 USD	\$1.0590	\$78,876 CAD	November 23, 2007
Financial	\$77,008 USD	\$1.0584	\$81,551 CAD	February 22, 2008
Financial	\$4,200,000 USD	\$1.0621	\$4,460,820 CAD	February 22, 2008

The mark to market adjustment of these contracts has been recognized as a liability in the amount of \$361,537 at September 30, 2007 (December 31, 2006 - asset of \$1,841,861).

5. RELATED PARTY TRANSACTIONS

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

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

Pioneer Land Services Ltd. - a Director is an employee of Pioneer
Borden Ladner Gervais LLP - a Director is partner with the law firm
Fasken Martineau DuMoulin LLP – in 2006 the Corporate Secretary was a partner with the law firm

- b) Transactions

	September 30 2007	September 30 2006
Expenses		
Consulting - Pioneer Land Services Ltd.	\$ 1,463	\$ 5,277
Legal consulting - Fasken Martineau DuMoulin LLP	375	49,743
Legal consulting - Borden Ladner Gervais LLP	314,955	128,022
	\$ 316,793	\$ 183,042
Other		
Recorded as part of oil and gas properties - Pioneer Land Services Ltd.	\$ 5,685	\$ 32,362
Recorded as part of oil and gas properties - Borden Ladner Gervais LLP	29,866	-
Recorded as part of share issuance cost - Borden Ladner Gervais LLP	71,123	-
	\$ 106,674	\$ 32,362

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 and represents actual values charged to the related parties.

6. STATEMENT OF CASH FLOWS

Other information:

	September 30 2007	September 30 2006
Interest paid	\$ 2,329,055	\$ 1,621,528
Taxes received	-	-
Taxes paid	-	32,345
	\$ 2,329,055	\$ 1,653,873

7. 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 stock options.

The details of contributed surplus are as follows:

	September 30 2007	December 31 2006
Balance, beginning of period	\$ 7,838,602	\$ 3,809,311
Stock-based compensation	1,040,503	2,743,436
Warrants expired	434,258	2,300,356
Exercise of options and warrants to common shares	(90,067)	(1,014,501)
Balance, end of period	\$ 9,223,296	\$ 7,838,602

8. SHARE CAPITAL

a) Authorized

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

b) Issued and outstanding

	September 30, 2007		December 31, 2006	
	Number of Shares	Amounts	Number of Shares	Amounts
Common shares				
Balance, beginning of period	76,900,833	\$ 72,570,457	68,093,883	\$ 57,375,841
Issued on exercise of warrants	-	-	2,286,650	3,269,485
Issued on exercise of options	206,000	214,480	2,102,000	2,484,245
	<u>77,106,833</u>	<u>72,784,937</u>	<u>72,482,533</u>	<u>63,129,571</u>
Flow-through shares issued				
November 21, 2006 at \$1.90	-	-	8,270,000	15,713,000
	<u>77,106,833</u>	<u>72,784,937</u>	<u>8,270,000</u>	<u>15,713,000</u>
Tax effect of flow-through share renouncement	-	(5,106,725)	-	(4,254,388)
Transfer from contributed surplus	-	90,067	-	1,014,501
Carrying value of warrants exercised	-	-	-	873,757
Shares repurchased for cancellation	(2,386,249)	(2,200,190)	(3,851,700)	(3,233,222)
Cash share issue costs, net of tax recovery of \$2,025 (2006 - \$329,857 expense)	-	(1,099)	-	(672,762)
	<u>74,720,584</u>	<u>65,566,990</u>	<u>76,900,833</u>	<u>72,570,457</u>
Share purchase warrants				
Balance, beginning of period	1,093,700	434,258	7,752,277	3,608,371
Expired	(1,093,700)	(434,258)	(4,469,427)	(2,300,356)
Exercised	-	-	(2,189,150)	(873,757)
Balance, end of period	<u>-</u>	<u>-</u>	<u>1,093,700</u>	<u>434,258</u>
Total common shares and warrants	<u>74,720,584</u>	<u>\$ 65,566,990</u>	<u>77,994,533</u>	<u>\$ 73,004,715</u>

Terra Energy Corp.
Notes to Consolidated Financial Statements
For the Three and Nine Months Ended September 30, 2007
(Unaudited)

During 2006 and 2007, the Corporation obtained permission from the TSX Venture Exchange for Normal Course Issuer Bid (NCIB) to repurchase for cancellation up to 10,000,000 common shares (5.0 million and 5.0 million respectively).

During the nine month period ended September 30, 2007, the Corporation repurchased 2,386,249 shares for \$2,581,766 at an average price of \$1.08 per common share and recorded \$2,200,190 as a reduction of share capital and the excess of \$381,576 was charged to deficit.

Of the repurchased shares 660,249 are being held for cancellation. Shares repurchased under the NCIB are excluded from the outstanding number of shares.

c) Stock options

Details of all options outstanding are as follows:

	Number of Options	Weighted Average Exercise Price
Employee stock options		
Balance, beginning of period	5,802,000	\$ 1.58
Granted	1,561,000	\$ 1.35
Exercised	(206,000)	\$ (1.04)
Expired	(211,000)	\$ (1.16)
Total options, balance, end of period	6,946,000	\$ 1.37

In January 2007, the Corporation re-priced certain stock options held by non-officer employees. The exercise prices of 2,107,000 employee stock options previously granted ranging from \$1.15 to \$2.27 were re-priced to \$1.08. The options held by the directors and senior officers were excluded from the re-pricing. The differences between fair values of the re-priced options issued as compared to the old options are expensed over the vesting periods of options.

For stock options granted to employees, stock-based compensation expense of \$1,040,503 has been recorded for the period ended September 30, 2007 (2006 - \$2,600,080) with the offsetting credit to contributed surplus. The fair value of share options granted during the first nine months was \$813,307 estimated using the Black-Scholes option-pricing model with the following assumptions: Dividend yield nil (2006-Nil); expected volatility at 50% (2006 – 66%); risk-free interest rate of 4% (2006 – 4.0%); weighted average life of 3.34 years (2006 – 2.96 years).

Terra Energy Corp.
Notes to Consolidated Financial Statements
For the Three and Nine Months Ended September 30, 2007
(Unaudited)

d) Warrants

During 2004, the Corporation issued the following warrants:

2004 Terra Series B

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 September 30, 2007 at which time these warrants will expire.

Balance, December 31,2006	Exercised	Expired	Balance, September 30,2007
1,250,000	-	1,250,000	-

2004 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	-	-	2,500,000
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Subtotal 2004 warrants

3,750,000	-	1,250,000	2,500,000
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During 2005, the Corporation issued the following warrants:

2005 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.

1,093,700	-	1,093,700	-
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Subtotal 2005 warrants

1,093,700	-	1,093,700	-
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Total warrants

4,843,700	-	2,343,700	2,500,000
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9. COMMITMENTS AND CONTINGENCIES

- a) The Corporation had outstanding letters of credit to various parties for a total of \$525,927 (2006 - \$395,000), which expire at various dates during 2007.
- b) The Corporation is required to incur exploration and development activities by December 31, 2007 of approximately \$15,713,000 as a result of flow-through shares issued in November 2006. At September 30, 2007, the Corporation has incurred qualifying expenditures of approximately \$9,660,561 towards this obligation.

CORPORATE INFORMATION

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Auditor

Deloitte & Touche, LLP, Calgary, Alberta

Evaluation Engineers

GLJ Petroleum Consultants Ltd.

Bankers

TD Canada Trust, Calgary, Alberta
National Bank of Canada, Calgary, Alberta

Transfer Agent

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

Computershare Trust Company
Suite 600 530 8th Avenue SW
Calgary, Alberta T2P 3S8
Tel: 1.800.564.6253
Fax: 1.888.453.0330
email: caregistryinfo@computershare.com

Stock Exchange

TSX-Venture

Stock Symbol

TTR

Investor Contact

Bud K. Love
Vice President, Finance & Chief Financial Officer
Tel: 403.699.7777; Fax: (403) 264.7189



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