

**INTERIM REPORT
FOR THE THREE MONTHS ENDED
MARCH 31, 2004**

PETRO-REEF RESOURCES LTD.

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NOTICE TO READER

In accordance with National Instrument 51-102 released by the Canadian Securities Administrators, the Company discloses that its auditors have not reviewed the unaudited interim consolidated financial statements for the period ended March 31, 2004.

PETRO-REEF RESOURCES LTD.
Balance Sheet
As at March 31, 2004 and December 31, 2003
Unaudited

	2004	2003 (Restated - note 2)
ASSETS:		
Current assets		
Accounts receivable	\$ 419,334	\$ 992,523
Prepaid expenses and deposits	<u>39,714</u>	<u>6,977</u>
	459,048	999,500
Property, plant and equipment (note 3)	<u>7,258,951</u>	<u>7,175,224</u>
	<u>\$ 7,717,999</u>	<u>\$ 8,174,724</u>
LIABILITIES:		
Current liabilities		
Cheques drawn in excess of bank	\$ 9,545	\$ 409,474
Bank line of credit (note 4)	1,475,000	1,150,000
Accounts payable and accrued charges	<u>1,395,300</u>	<u>1,647,684</u>
	2,879,845	3,207,158
Future income taxes	474,424	529,424
Asset retirement obligation (note 5)	<u>193,909</u>	<u>190,436</u>
	<u>3,548,178</u>	<u>3,927,018</u>
SHAREHOLDERS' EQUITY:		
Share capital (note 6)	4,743,176	4,743,176
Contributed surplus (note 7)	98,032	94,111
Deficit	<u>(671,387)</u>	<u>(589,581)</u>
	<u>4,169,821</u>	<u>4,247,706</u>
	<u>\$ 7,717,999</u>	<u>\$ 8,174,724</u>

SIGNED ON BEHALF OF THE BOARD
"Joseph Werner"
 Director

"Robert N. Maertens-Poole"
 Director

PETRO-REEF RESOURCES LTD.
Statement of Cash Flows
For the three months ended March 31, 2004 and 2003
Unaudited

	2004	2003 (Restated - note 2)
Cash provided by (used in)		
Operating activities		
Net loss for the period	\$ (81,806)	\$ (609)
Items not effecting working capital		
Depletion and depreciation	254,804	69,058
Stock based compensation	3,921	3,921
Accretion expense	3,473	3,069
Future income taxes	<u>(55,000)</u>	<u>4,188</u>
Cash flow from operations	125,392	79,627
Net change in non-cash operating working capital items (note 8)	<u>30,070</u>	<u>(163,518)</u>
	<u>155,462</u>	<u>(83,891)</u>
Financing activities		
Bank line of credit	<u>325,000</u>	<u>725,000</u>
Investing activities		
Expenditures on property, plant and equipment	(338,531)	(130,335)
Net change in non-cash investing working capital items (note 8)	<u>257,998</u>	<u>(774,731)</u>
	<u>(80,533)</u>	<u>(905,066)</u>
Change in cheques drawn in excess of bank during the period	399,929	(263,957)
Cheques drawn in excess of bank – Beginning of period	<u>(409,474)</u>	<u>258,865</u>
Cheques drawn in excess of bank – End of period	<u>\$ (9,545)</u>	<u>\$ (5,092)</u>
Supplemental information		
Interest paid	\$ 27,214	\$ 3,780

PETRO-REEF RESOURCES LTD.
Statement of Operations and Deficit
For the three months ended March 31, 2004 and 2003
Unaudited

	2004	2003 (Restated – note 2)
Revenue		
Oil and gas sales, net of royalties and ARTC	<u>\$ 354,288</u>	<u>\$ 211,493</u>
Expenses		
Accretion expense	3,473	3,069
Depletion and depreciation	254,804	69,058
General and administrative	63,173	80,082
Interest expense	27,213	3,780
Production	138,510	48,004
Stock based compensation	<u>3,921</u>	<u>3,921</u>
	<u>491,094</u>	<u>207,914</u>
Earnings (loss) before the following	(136,806)	3,579
Future income taxes (recovery)	<u>(55,000)</u>	<u>4,188</u>
Net loss for the period	(81,806)	(609)
Deficit – Beginning of period	<u>(589,581)</u>	<u>(440,861)</u>
Deficit – End of period	<u>\$ (671,387)</u>	<u>\$ (441,470)</u>
Basic and diluted loss per common share	<u>\$ (0.004)</u>	<u>\$ (0.000)</u>

PETRO-REEF RESOURCES LTD.
Notes to Financial Statements
March 31, 2004 and 2003

1. Accounting policies

The interim financial statements of Petro-Reef Resources Ltd. (the "Company") have been prepared following the same accounting policies and methods of computation as for the financial statements of the Company as at December 31, 2003. The interim financial statements contain disclosures, which are supplemental to the Company's annual financial statements. Certain disclosures, which are normally required to be included in the notes to the annual financial statements, have been condensed or omitted except as noted below. The year end financial statements should be read in conjunction with the Company's financial statements and notes thereto for the year ended December 31, 2003.

The Company has a working capital deficit of \$2,420,797 as at March 31, 2004 and \$2,207,658 as at December 31, 2003. The Company's ability to continue as a going concern is dependent upon the continued support of the Company's creditors, which management expects will be received. Without such creditor support, the Company's assets and liabilities may not be realized or discharged in the normal course, with the result that the carrying amounts could be adjusted materially.

2. Change in accounting policies

Asset retirement obligation

Effective January 1, 2004, the Company adopted the new Canadian accounting standard for asset retirement obligations. The new standard requires the Company to record the fair value of an asset retirement obligation as a liability in the period in which it incurs a legal obligation associated with the retirement of tangible long-lived assets that result from the acquisition, construction, development, and/or normal use of the assets. The associated asset retirement costs are capitalized as part of the carrying amount of the property, plant and equipment and depleted and depreciated using a unit of production method over estimated gross proved reserves. Subsequent to the initial measurement of the asset retirement obligation, the obligation is adjusted at the end of each period to reflect the passage of time (accretion), and changes in the estimated future cash flows underlying the obligation. The effect of adoption of the new standard on the financial statements is disclosed below.

The effect of this change in accounting policy has been recorded retroactively with restatement of prior periods. The effect of the adoption is presented below as increases (decreases):

Balance Sheet	<u>December 31, 2003</u>
Asset retirement costs, included in property, plant and equipment	\$ 122,861
Accumulated depletion and depreciation on asset retirement costs, included in property, plant and equipment	41,294
Asset retirement obligations	190,436
Accumulated future site restoration liability	(50,575)
Future income tax liability	(16,466)
Deficit	(41,828)
	<u>Three months ended</u>
Statement of Operations	<u>March 31, 2003</u>
Accretion expense	\$ 3,069
Depletion and depreciation on asset retirement costs	938
Provision for future site restoration	<u>(1,675)</u>
Net loss impact	<u>\$ 2,332</u>
Basic and diluted net loss per share	<u>\$ 0.00</u>

There was no impact on the Company's cash flow as a result of adopting this new policy. See note 5 for additional information on the asset retirement obligation and the impact on the financial statements.

PETRO-REEF RESOURCES LTD.
Notes to Financial Statements
March 31, 2004 and 2003

Stock based compensation

On October 1, 2003 the Company adopted the new Canadian accounting standards with respect to stock based compensation, prospectively with an effective date of January 1, 2003. As a result, the net loss for the three months ended March 31, 2003 has been adjusted by \$3,921 to reflect the portion of the December 31, 2003 adjustment of stock based compensation related to that period.

3. Property, plant, and equipment

	March 31, 2004		
	Cost	Accumulated depletion and depreciation	Net
Petroleum and natural gas	\$ 10,421,590	\$ 3,177,122	\$ 7,244,468
Furniture and fixtures	31,104	16,621	14,483
	<u>\$ 10,452,694</u>	<u>\$ 3,193,743</u>	<u>\$ 7,258,951</u>
	December 31, 2003		
	Cost	Accumulated depletion and depreciation	Net
Petroleum and natural gas	\$ 10,085,109	\$ 2,922,946	\$ 7,162,163
Furniture and fixtures	35,777	22,716	13,061
	<u>\$ 10,120,886</u>	<u>\$ 2,945,662</u>	<u>\$ 7,175,224</u>

No interest on general and administrative expenses were capitalized during the period. Unproven property costs of \$244,131 (2003 – \$244,131) have been excluded from capitalized costs subject to depletion.

4. Bank line of credit

The current line of credit is \$2,000,000, with an additional \$500,000 available for development drilling and acquisition financing. Interest is at prime plus 1.25% per annum for the current loan and 1.5% per annum for the development loan. At March 31, 2004 the balance owing on the current loan was \$1,475,000 (2003 - \$1,150,000)

The line of credit is secured by \$5,000,000 floating charge debenture over all the Company's assets with a negative pledge and undertaking to provide fixed charges on the Company's major producing properties at the request of the bank. The credit facilities are repayable on demand and are reviewed periodically by the bank, the next review being scheduled August 2004.

5. Asset retirement obligation

The total future asset retirement obligation was estimated based on the Company's net ownership in all wells and facilities, estimated costs to reclaim and abandon the wells and the estimated timing of costs to be incurred in future periods. The Company has estimated the net present value of its asset retirement obligation to be \$193,909 as at March 31, 2004 based on a total future liability of \$312,504 which will be incurred between 2004 and 2024. A credit adjusted risk free rate of 7.5 percent and an inflation rate of 2 percent were used to calculate the fair value of the asset retirement obligation.

PETRO-REEF RESOURCES LTD.
Notes to Financial Statements
March 31, 2004 and 2003

A reconciliation of the asset retirement obligation is provided below:

	Three months ended	Three months ended	Year Ended
	March 31	March 31	December 31
	2004	2003	2003
Balance, beginning of period	\$ 190,436	\$ 168,190	\$ 168,190
Liabilities incurred in period	-	-	9,632
Liabilities settled in period	-	-	-
Accretion expense	<u>3,473</u>	<u>3,069</u>	<u>12,614</u>
Balance, end of period	<u>\$ 193,909</u>	<u>\$ 171,259</u>	<u>\$ 190,436</u>

6. Share capital

The authorized share capital of the company is composed of an unlimited number of preferred shares and an unlimited number of common shares.

Issued and outstanding common shares

	<u>Shares</u>	<u>Amount</u>
March 31, 2004 and December 31, 2003	<u>17,688,937</u>	<u>\$ 4,743,176</u>

Basic and diluted loss per common share are calculated using the weighted average number of common shares outstanding during the period of 17,688,937 (2003 – 17,688,937)

7. Stock based compensation

The Company has a stock option plan for directors, officers and key employees. The exercise price of each option equals the market price of the Company's stock on the date of grant. Options vest equally over three years and expire after a maximum exercise period of five years from the date of issue. Compensation costs attributable to share options granted is measured at fair value at the grant date and expensed over the expected exercise time frame with a corresponding increase to contributed surplus. Upon exercise of the stock options, consideration paid by the option holder together with the amount previously recognized in contributed surplus is recorded as an increase to share capital.

The 50,000 shares granted during the first quarter, vest over three years and expire March 16, 2009

As at March 31, 2004, the following options were issued:

	<u>Number of</u>	<u>Weighted Average</u>
	<u>Options</u>	<u>Exercise Price</u>
Outstanding at January 1, 2004	1,310,000	\$ 0.42
Granted	50,000	0.71
Expired	-	-
Outstanding at March 31, 2004	<u>1,360,000</u>	<u>0.43</u>
Exercisable at March 31, 2004	<u>403,333</u>	<u>\$ 0.47</u>

PETRO-REEF RESOURCES LTD.
Notes to Financial Statements
March 31, 2004 and 2003

The outstanding options have a range of exercise prices between \$.30 and \$.71 per share and a weighted average number of years to expiry of 3.1. The exercisable options have a range of exercise prices between \$.30 and \$.49 per share and have a weighted average number of years to expiry of .89.

The fair value of each option granted is estimated on the date of grant using the Black-Scholes options pricing model with the following weighted average assumptions:

	Three months ended March 31, 2004
Fair value of options granted (\$/share)	.55
Risk-free interest rate (%)	3.02
Expected life (years)	3
Expected volatility (%)	136
Expected dividend yield (%)	-

8. Cash flows

	<u>2004</u>	<u>2003</u>
Changes in non-cash working capital		
Operating Activities:		
Accounts receivable	\$ 503,940	\$ 10,214
Prepaid deposits	(32,737)	(22,976)
Accounts payable and accrued charges	<u>(441,133)</u>	<u>(150,756)</u>
	<u>30,070</u>	<u>(163,518)</u>
Investing Activities:		
Accounts receivable	69,249	(35,883)
Accounts payable and accrual charges	<u>188,749</u>	<u>(738,846)</u>
	<u>257,998</u>	<u>(774,729)</u>
	<u>\$ 288,068</u>	<u>\$ (938,247)</u>