

**INTERIM REPORT  
FOR THE THREE AND SIX MONTHS ENDED  
JUNE 30, 2005**

**PETRO-REEF RESOURCES LTD.**

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**PETRO-REEF RESOURCES LTD.**

**MANAGEMENT'S DISCUSSION AND ANALYSIS**

Management's Discussion and Analysis are part of the Interim Report for the first half of 2005 ended June 30, dated August 26, 2005. They are prepared by management and should be read in conjunction with the unaudited financial statements and notes which also are part of the same Interim Report, as well as in conjunction with the 2004 annual audited financial statements and Management's Discussion and Analysis.

For 2004 Management's Discussion and Analysis for the company was incorporated as part of the annual report for 2004, and are available for review on the SEDAR website ([www.sedar.com](http://www.sedar.com)).

Petro-Reef Resources Ltd. is a Calgary based crude oil and natural gas exploration and production company with producing properties in Alberta, Canada.

**Highlights of Financial and Operations Results for the First Half of 2005 and 2004**

<b>Financial</b>	<b>June 30 2005 \$</b>	<b>June 30 2004 \$</b>	<b>% Change</b>
Crude oil and Natural Gas Revenue net of Royalties and ARTC	1,322,944	885,879	+ 49
Cash flow from operations	823,070	391,364	+ 110
Cash flow from operations per share - basic & diluted	0.05	0.02	-
Net loss for the period	(39,093)	(157,177)	- 75
Net loss per share – basic and diluted	0.00	0.01	-
Capital Expenditures	856,090	644,682	+ 33
Bank Loan	1,000,000	1,425,000	- 30
Shareholder's equity	4,173,767	4,280,289	- 0.2
Common shares outstanding			
Weighted average	17,800,815	17,690,226	+ 0.6
<b>Operations</b>			
<b>Daily Average Production</b>			
Crude Oil and NGLs (Bbls/day)	1	17	- 94
Natural Gas (mcf/day)	1134	654	+ 73
Total BOE/day	190	126	+ 51
<b>Average Selling Price</b>			
Crude Oil (\$per Bbl)	52.38	47.43	+ 10
Natural Gas (\$per mcf)	7.12	6.71	+ 6
NGL (\$per Bbl)	50.78	43.71	+ 6

Notable from the highlights is that the cash flow from operations for the comparable six month period increased by one hundred ten percent (+110 %) and that production increased fifty-one percent (+51 %).

The first half average product price for natural gas per thousand cubic feet was \$6.40 for 2005 and \$6.16 for 2004. The price for July 2005 was \$6.69 per thousand cubic feet.

Production and revenue are compared for the first half of 2005 versus 2004 in the next two tables. They are useful for trend analysis. Average daily production increased from 126 to 190 BOE/day. Column 6 shows “cash flow” after royalties and operating expenses but before Alberta Royalty Tax Credits, general and administrative costs, interest expense, and income taxes. Refer to the Financial Statements for further details.

### 2005 PRODUCTION & REVENUE SUMMARY (Unaudited)

<u>(0)</u> <u>Month</u>	<u>(1)</u> <u>BOE</u>	<u>(2)</u> <u>BOE / Day</u>	<u>(3)</u> <u>REVENUE</u> \$	<u>(4)</u> <u>ROYALTIES</u> \$	<u>(5)</u> <u>EXPENSES</u> \$	<u>(6)</u> <u>(3) – (4) – (5)</u> \$	<u>(7)</u> <u>NET BACK</u> \$ / BOE
JAN	7,367.51	237.66	310,711.42	73,677.99	64,905.41	172,128.02	23.36
FEB	6,768.89	241.75	288,550.33	63,607.96	58,985.61	165,956.76	24.52
MAR	7,144.40	230.46	341,209.02	72,145.99	59,937.19	209,125.84	29.27
APR	5,513.57	183.79	277,682.83	63,387.74	52,999.59	161,295.50	29.25
MAY	4,877.46	157.34	216,391.00	44,276.04	37,449.30	134,665.66	27.61
JUNE	2,831.13	94.37	133,539.72	15,847.04	69,309.99	48,382.69	17.09
<b>Average / Total</b>	<b>34,389.39</b>	<b>190.27</b>	<b>1,568,084.32</b>	<b>332,942.76</b>	<b>343,587.09</b>	<b>891,554.47</b>	<b>26.04</b>

### 2004 PRODUCTION & REVENUE SUMMARY (Unaudited)

<u>(0)</u> <u>Month</u>	<u>(1)</u> <u>BOE</u>	<u>(2)</u> <u>BOE / Day</u>	<u>(3)</u> <u>REVENUE</u> \$	<u>(4)</u> <u>ROYALTIES</u> \$	<u>(5)</u> <u>EXPENSES</u> \$	<u>(6)</u> <u>(3) – (4) – (5)</u> \$	<u>(7)</u> <u>NET BACK</u> \$ / BOE
JAN	2,825.17	91.13	137,355.77	12,652.74	42,247.91	81,455.12	28.83
FEB	3,641.01	125.55	133,298.98	12,261.88	47,978.07	73,059.03	20.07
MAR	3,417.61	110.25	127,525.48	13,443.04	48,266.91	65,815.53	19.26
APR	5,770.79	192.36	233,092.98	15,348.82	60,074.23	157,669.93	27.32
MAY	3,992.75	128.80	180,718.10	14,861.46	42,773.06	123,083.58	30.83
JUNE	3,251.17	108.37	137,528.18	9,637.65	41,665.62	86,244.91	26.52
<b>Average / Total</b>	<b>22,898.51</b>	<b>126.08</b>	<b>949,549.49</b>	<b>78,205.59</b>	<b>284,005.80</b>	<b>587,308.10</b>	<b>25.65</b>

## **PROPERTY REVIEW**

The majority of Petro-Reef's production continues to come from the two core properties at Alexander/Qui Barre and Peavey/Morinville.

For the first half of 2005, ninety-nine percent (99%) of Petro-Reef's production was natural gas. The remaining percent was crude oil and condensate.

The two core areas produced ninety-nine percent (99%) of the production and ninety-nine percent (99%) of the revenue. For the six months the production from Alexander/Qui Barre was seventy-eight percent (78%) of the total production with seventy-seven percent (77%) of the revenue. Peavey/Morinville had twenty-one percent (21%) of the total production and twenty-two percent (22%) respectively. Four minor working interest or royalty properties shared the remainder of the production and revenue.

In the Alexander/ Qui Barre area one new well was drilled in May 2005. This well is about two-thirds of a mile to the east of the well drilled in June 2004. The well was drilled directionally in order to penetrate the Lower Cretaceous zones at the desired location. Natural gas was encountered in several up-hole formations which required the use of progressively heavier drilling fluid to control the natural gas and prevent a potentially dangerous situation. The well was drilled to total depth and was being prepared to run logs when the drill pipe became permanently stuck, even after several days of attempting to break it free. The drill pipe was cut off above the portion that was stuck and cemented in place. It was still possible to complete a drill stem test in the Belly River formation up-hole. The test produced natural gas with inconclusive results. Future plans are to drill a new well from the same surface location. From the information obtained from the directional hole it has been concluded that a vertical hole should encounter the prospective lower zones in a more favorable position. This decision is based on further geological and geophysical evaluation of all the available data.

Spring break-up this year took an abnormally long time. This was followed by a long rainy spell. The combination caused serious shutdown periods during which it was not possible to service the wells when there were problems. Mother Nature dealt another blow to operations and production when lightning struck an oil tank, blew off the top and burned the contents. The location of the tank was lined and surrounded by a berm. The area was promptly cleaned up, the tank was replaced, and production resumed in short order.

On July 19, 2005 - Petro-Reef Resources Ltd. announced that it has agreed to issue by way of a private placement an aggregate of up to 3,500,000 Units for an aggregate consideration of \$1,575,000, with the assistance of a finder. The Units are priced at \$0.45 and consist of one Common Share and one Purchase Warrant. Each Purchase Warrant entitles the holder to purchase one additional Common Share at an exercise price of \$0.70 per Common Share, if exercised within 18 months after the closing of the offering. The Units will be issued pursuant to prospectus exemptions available under applicable securities legislation in Alberta and Ontario. Sinalta Investments Ltd. has undertaken to act as "finder" for which it will be paid a finders fee of \$100,000, and subject to the approval of the TSXV, the finder shall also be granted warrants to acquire up to 500,000 Common Shares of Petro-Reef at an exercise price of \$0.70 per Common Share, if exercised within 18 months after the closing of the offering. The Company will use the proceeds for oil and gas development and exploration expenditures.

The financing was scheduled to close on or about July 28, 2005 or such other date as the finder and Petro-Reef may agree upon, and is conditional upon receiving regulatory approval, including approval of the TSX Venture Exchange and completion of definitive documentation. A first closing took place on August 18, 2005 for 1,277,776 Units for an aggregate consideration of \$575,000. The balance of the offering is expected to be completed on or before September 2, 2005.

It is contemplated that with current cash flow and the addition of the private placement Petro-Reef can embark on an exploration program which will see four new wells drilled and four wells recompleted. Preparatory work is already underway for the drilling of one well along with one recompletion in September.

During the second quarter of 2005 Petro-Reef made the following news releases which are available at [www.sedar.com](http://www.sedar.com).

- May 04 - re the filing of all the required forms and reports for fiscal 2004
- May 06 - re the grant of stock options to two directors
- June 01 - re the filing of the first quarter interim report
- June 16 - re the results of the Annual General Meeting of Shareholders held on June 15.
- June 19 - re the announcement of a private placement of 3,500,000 common shares
- August 19 - re the closing of the first part of the private placement, 1,277,776 units

The company continues to use the following exploration criteria on each prospective area, to assure high profitability and rate of return on capital investment:

- 1) Each exploration prospect must exhibit
  - a) A minimum three hydrocarbon zone potential.
  - b) Each zone must show the potential for:
    - (i) 10:1 profit to capital risk ratio
    - (ii) a minimum of 30% rate of return on capital invested.
    - (iii) minimum life of 15 years.
- 2) The use of 2-D and 3-D seismic to identify and confirm potential drilling locations using state-of-the-art technology.

On behalf of Petro-Reef and the board of directors, I would like to thank the shareholders for their continued support. We will continue to endeavor to meet and hopefully exceed your expectations.

“Joseph Werner”  
Joseph Werner  
President and  
Chief Executive Officer

Dated: August 26, 2005

## **FORWARD-LOOKING STATEMENTS**

This report contains certain forward-looking statements that involve substantial known and unknown risks and uncertainties, certain of which are beyond Petro-Reef's control, including: the impact of general economic conditions in Canada, the United States and worldwide; industry conditions; changes in laws and regulations including the adoption of new environmental laws and regulations and changes in how they are interpreted and enforced; increased competition; fluctuations in foreign exchange or interest rates; stock market volatility and market valuations of companies with respect to announced transactions and final valuations thereof; and obtaining required approvals of regulatory authorities.

Petro-Reef's actual results, performance or achievement could differ materially from those expressed in, or implied by, these forward-looking statements and accordingly, no assurances can be given that any of the events anticipated by the forward-looking statements will transpire or occur, or if any of them do so, what benefits, including the amount of proceeds, that Petro-Reef will derive therefrom.

Management uses cash flow from operations per share to analyze operating performance. Cash flow from operations per share presented does not have any standardized meaning prescribed by Canadian generally accepted accounting principals ("GAAP") and therefore it may not be comparable with the calculation of similar measures for other entities.

## **ABBREVIATIONS**

ARTC	Alberta Royalty Tax Credit	Mbbls	thousands of barrels
Bbl	barrel	Mcf	thousand cubic feet
Bbls	barrels	Mcf/d	thousand cubic feet per day
Bcf	billion cubic feet	MMbbls	millions of barrels
BOE	barrel of oil equivalent (1 BOE = 6 Mcf)	MMcf	million cubic feet
Bopd	Barrels of oil per day	MMcf/d	million cubic feet per day
GJ	Gigajoule	FNR	future net revenue
GJs/d	Gigajoules per day	NGL	natural gas liquids
		NPV	net present value
		RL1	reserve life index

### **NOTE:**

In this report all currency values are in Canadian Dollars.

\* Note that natural gas is converted to a barrel of oil equivalent (BOE) using six thousand cubic feet equal to one BOE unless otherwise stated. This conversion conforms to the Canadian Securities Regulators National Instrument 51-101. A BOE is a very approximate comparative measure that could be misleading in some cases, particularly if used in isolation.

**PETRO-REEF RESOURCES LTD.  
CORPORATE INFORMATION**

**DIRECTORS AND OFFICERS**

**Joseph Werner**

Chief Executive Officer  
President & Director  
Calgary, Alberta

**Theodore M. Donhuysen** <sup>(4) (5)</sup>

Vice-President Exploration and Production  
Chief Operating Officer & Director  
Calgary, Alberta

**Robert N. Maertens-Poole** <sup>(3)</sup>

Chief Financial Officer  
Treasurer and Director  
Calgary, Alberta

**Alan P. Hallman** <sup>(3) (4)</sup>

Director  
Calgary, Alberta

**Dennis K. Ulrich** <sup>(1) (3)</sup>

Director  
Medicine Hat, Alberta

**Gary W. Coleman** <sup>(1) (2) (4)</sup>

Director  
Calgary, Alberta

**Jack P. Donhuysen** <sup>(2) (5)</sup>

Director  
Calgary, Alberta

**Huba A. Sebo** <sup>(1) (2) (5)</sup>

Director  
Calgary, Alberta

**R. Greg Powers** <sup>(6)</sup>

Corporate Secretary  
Legal Counsel  
Calgary, Alberta

**Head Office**

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Facsimile: (403) 264-1348  
E-Mail: petrereef@shawcable.com

**Auditors**

PricewaterhouseCoopers LLP  
Chartered Accountants  
3100 111 5<sup>th</sup> Avenue S.W.  
Calgary, Alberta T2P 5L3

**Bank**

National Bank of Canada  
301 6<sup>th</sup> Avenue S.W.  
Calgary, Alberta T2P 4M9

**Registrar and Transfer Agent**

CIBC Mellon Trust Company  
600 333 7<sup>th</sup> Avenue S.W.  
Calgary, Alberta T2P 2Z1

**Stock Listing**

TSX Venture Exchange  
Trading Symbol PER

- (1) Member of the Audit Committee.
- (2) Member of the Compensation Committee.
- (3) Member of the Executive Committee.
- (4) Member of the Governance Committee.
- (5) Member of the Reserves Committee.
- (6) Baker & McKenzie  
2600 255 5<sup>th</sup> Avenue S.W.  
Calgary, Alberta T2P 3G6

**PETRO-REEF RESOURCES LTD.**  
**FINANCIAL STATEMENTS (UNAUDITED)**  
**JUNE 30, 2005 AND 2004**

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 June 30, 2005

**PETRO-REEF RESOURCES LTD.**  
**Balance Sheet**  
**As at June 30, 2005 and December 31, 2004**  
**Unaudited**

	<b>June 30, 2005</b>	<b>December 31, 2004</b>
<b>ASSETS</b>		
<b>Current assets</b>		
Accounts receivable	\$ 843,708	\$ 1,833,691
Prepaid expenses and deposits	27,106	6,072
	<u>870,814</u>	<u>1,839,763</u>
<b>Property, plant and equipment (note 2)</b>	<u>7,018,366</u>	<u>6,852,087</u>
	<u><u>\$ 7,889,180</u></u>	<u><u>\$ 8,691,850</u></u>
<b>LIABILITIES</b>		
<b>Current liabilities</b>		
Cheques drawn in excess of bank	\$ 28,759	\$ 411,771
Bank line of credit (note 3)	1,000,000	700,000
Accounts payable and accrued charges	2,140,376	3,064,931
	<u>3,169,135</u>	<u>4,176,702</u>
<b>Future income taxes</b>	392,424	338,424
<b>Asset retirement obligation (note 4)</b>	<u>153,854</u>	<u>155,456</u>
	<u>3,715,413</u>	<u>4,670,582</u>
<b>SHAREHOLDERS' EQUITY</b>		
<b>Share capital (note 5)</b>	4,873,936	4,772,876
<b>Contributed surplus (note 6)</b>	470,592	380,060
<b>Deficit</b>	<u>(1,170,761)</u>	<u>(1,131,668)</u>
	<u>4,173,767</u>	<u>4,021,268</u>
	<u><u>\$ 7,889,180</u></u>	<u><u>\$ 8,691,850</u></u>

SIGNED ON BEHALF OF THE BOARD  
"Joseph Werner"  
Director

"Robert N. Maertens-Poole"  
Director

**PETRO-REEF RESOURCES LTD.**  
**Statements of Operations and Deficit**  
**As at June 30, 2005 and December 31, 2004**  
**Unaudited**

	<b>1onths Ended June 30, 2005</b>	<b>3 Months Ended June 30, 2004</b>	<b>6 Months Ended June 30, 2005</b>	<b>6 Months Ended June 30, 2004</b>
<b>Revenue</b>				
Oil and gas sales, net of royalties and ARTC	\$ 621,790	\$ 531,591	\$ 1,322,944	\$ 885,879
<b>Expenses</b>				
Accretion expense	2,394	3,361	4,602	6,834
Depletion and depreciation	288,483	125,146	689,811	379,950
General and administrative	46,810	102,035	111,465	165,208
Interest expense	12,833	13,665	26,220	40,878
Loss on settlement of asset retirement obligation	873	-	1,159	-
Production	212,984	149,916	362,356	288,426
Stock based compensation	59,804	180,839	112,591	184,760
	<u>624,181</u>	<u>574,962</u>	<u>1,308,204</u>	<u>1,066,056</u>
<b>Earnings (loss) before the following</b>	(2,391)	(43,371)	14,740	(180,177)
<b>Interest income</b>	<u>167</u>	<u>-</u>	<u>167</u>	<u>-</u>
	(2,224)	(43,371)	14,907	(180,177)
<b>Future income tax (recovery)</b>	<u>22,000</u>	<u>32,000</u>	<u>54,000</u>	<u>(23,000)</u>
<b>Net loss for the period</b>	(24,224)	(75,371)	(39,093)	(157,177)
<b>Deficit - Beginning of period</b>	<u>(1,146,537)</u>	<u>(671,387)</u>	<u>(1,131,668)</u>	<u>(589,581)</u>
<b>Deficit - End of period</b>	<u>\$ (1,170,761)</u>	<u>\$ (746,758)</u>	<u>\$ (1,170,761)</u>	<u>\$ (746,758)</u>
<b>Basic and diluted loss per common share</b>	<u>\$ 0.00</u>	<u>\$ (0.01)</u>	<u>\$ 0.00</u>	<u>\$ (0.01)</u>

**PETRO-REEF RESOURCES LTD.**  
**Statements of Cash Flows**  
**As at June 30, 2005 and December 31, 2004**  
**Unaudited**

	<b>3 Months Ended June 30, 2005</b>	<b>3 Months Ended June 30, 2004</b>	<b>6 Months Ended June 30, 2005</b>	<b>6 Months Ended June 30, 2004</b>
<b>Cash provided by (used in)</b>				
<b>Operating activities</b>				
Net loss for the period	\$ (24,224)	\$ (75,371)	\$ (39,093)	\$ (157,177)
Items not effecting working capital				
Accretion expense	2,394	3,361	4,602	6,834
Depletion and depreciation	288,483	125,146	689,811	379,950
Loss on settlement of asset retirement obligation	873	-	1,159	-
Stock based compensation	59,804	180,839	112,591	184,760
Future income taxes	22,000	32,000	54,000	(23,000)
	<u>349,330</u>	<u>265,975</u>	<u>823,070</u>	<u>391,367</u>
Cash flow from operations				
Asset retirement obligations	(4,350)	-	(7,363)	
Net change in non-cash operating working capital items (note 8)	<u>(99,667)</u>	<u>19,856</u>	<u>(78,353)</u>	<u>261,394</u>
	<u>245,313</u>	<u>285,831</u>	<u>737,354</u>	<u>652,761</u>
<b>Financial activities</b>				
Bank line of credit	350,000	(50,000)	300,000	275,000
Proceeds from exercise of stock options	79,000	5,000	79,000	5,000
	<u>429,000</u>	<u>(45,000)</u>	<u>379,000</u>	<u>280,000</u>
<b>Investing activities</b>				
Expenditures on property, plant and equipment	(425,409)	(306,151)	(856,090)	(644,682)
Net change in non-cash investing working capital items (note 8)	<u>(42,652)</u>	<u>(32,315)</u>	<u>122,748</u>	<u>14,215</u>
	<u>(468,061)</u>	<u>(338,466)</u>	<u>(733,342)</u>	<u>(630,467)</u>
<b>Change in cheques drawn in excess of bank during the period</b>	206,252	(97,635)	383,012	302,294
<b>Cheques drawn in excess of bank - Beginning of period</b>	<u>(235,011)</u>	<u>(9,545)</u>	<u>(411,771)</u>	<u>(409,474)</u>
<b>Cheques drawn in excess of bank - End of period</b>	<u><u>\$ (28,759)</u></u>	<u><u>\$ (107,180)</u></u>	<u><u>\$ (28,759)</u></u>	<u><u>\$ (107,180)</u></u>
<b>Supplemental information</b>				
Interest paid	<u><u>\$ 12,833</u></u>	<u><u>\$ 13,665</u></u>	<u><u>\$ 26,220</u></u>	<u><u>\$ 40,878</u></u>

**PETRO-REEF RESOURCES LTD.**  
**Notes to Financial Statements**  
**As at June 30, 2005 and 2004**  
**Unaudited**

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**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, 2004. 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, 2004.

The Company has a working capital deficit of \$2,298,321 as at June 30, 2005 and \$2,336,939 as at December 31, 2004. The Company is subject to certain debt covenants pertaining to demand operating facilities (Note 3). At June 30, 2005 the Company was not in compliance with the working capital covenant. 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. Management continues to actively pursue additional financing and strives to obtain and thereafter maintain profitable operations to support the viability of the “going concern” assumption.

**2. Property, plant, and equipment**

	<b>June 30, 2005</b>		
	<b>Cost</b>	<b>Accumulated depletion and depreciation</b>	<b>Net</b>
Petroleum and natural gas	\$ 12,081,049	\$ 5,078,027	\$ 7,003,022
Furniture and fixtures	44,652	29,308	15,344
	<u>\$ 12,125,701</u>	<u>\$ 5,107,335</u>	<u>\$ 7,018,366</u>
	<b>December 31, 2004</b>		
	<b>Cost</b>	<b>Accumulated depletion and depreciation</b>	<b>Net</b>
Petroleum and natural gas	\$ 11,227,089	\$ 4,390,336	\$ 6,836,753
Furniture and fixtures	42,522	27,188	15,334
	<u>\$ 11,269,611</u>	<u>\$ 4,417,524</u>	<u>\$ 6,852,087</u>

No interest or general and administrative expenses were capitalized during the period. Unproven property costs of \$408,953 (2004 – \$305,637) have been excluded from capitalized costs subject to depletion.

**PETRO-REEF RESOURCES LTD.**  
**Notes to Financial Statements**  
**As at June 30, 2005 and 2004**  
**Unaudited**

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**3. Bank line of credit**

Facility A is a revolving operating demand loan with a maximum limit of \$2,000,000. Facility B is a non-revolving acquisition/development demand loan that provides an additional \$500,000 of financing. Interest is at prime plus 1.25% per annum for Facility A and 1.5% per annum for the Facility B. At June 30, 2005 the balance owing on the current loan was \$1,000,000 (2004 - \$700,000).

The facilities are 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 facilities are repayable on demand and are reviewed periodically by the bank, the next review being scheduled for September 2005.

The terms of the Company's bank facility includes certain financial statement covenants. At June 30, 2005, the Company was in violation of the working capital covenant, whereby it must maintain a 1 to 1 working capital ratio (excluding the loan balance and including in working capital the undrawn portion of the facility). The company has obtained waiver from the bank in relation to the violation of the working capital covenant.

**4. 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 \$153,854 (2004 - \$155,456) as at June 30, 2005 based on a total future liability of \$276,988 which will be incurred between 2005 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.

A reconciliation of the asset retirement obligation is provided below:

	<b>Six Months Ended</b>	<b>Year Ended</b>
	<b>June 30, 2005</b>	<b>December 31, 2004</b>
Balance, beginning of period	\$ 155,456	\$ 190,436
Liabilities incurred in period	-	-
Liabilities settled in period	(6,204)	(48,583)
Accretion expense	4,602	13,603
	<hr/>	<hr/>
Balance, end of period	<u>\$ 153,854</u>	<u>\$ 155,456</u>

**5. Share capital**

	<b>Six months ended</b>		<b>Year ended</b>	
	<b>June 30, 2005</b>		<b>December 31, 2004</b>	
	<b>Shares</b>	<b>Amount</b>	<b>Shares</b>	<b>Amount</b>
Balance, beginning of period	17,738,937	4,772,876	17,688,937	4,743,176
Exercise of options	200,000	101,060	50,000	29,700
	<hr/>	<hr/>	<hr/>	<hr/>
Balance, end of period	<u>17,938,93</u>	<u>4,873,936</u>	<u>17,738,937</u>	<u>4,772,876</u>

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Basic and diluted loss per common share are calculated using the weighted average number of common shares outstanding during the period of 17,938,937 (2004 – 17,701,129) for basic. The effect of any conversion of options would be anti-dilutive.

The increase in share capital as a result of the exercise of stock options is comprised of the amount of cash received of \$79,000 and the compensation expensed previously of \$22,060.

<b>6. Contributed surplus</b>	<b>Six months ended June 30, 2005</b>	<b>Year ended December 31, 2004</b>
Balance beginning of period	\$ 380,061	\$ 94,111
Compensation recognized in the period	112,591	300,649
Adjustment for options exercised in the period	<u>(22,060)</u>	<u>(14,700)</u>
Balance, end of period	<u>\$ 470,592</u>	<u>\$ 380,060</u>

**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 after one year 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.

As at June 30, 2005, the following options were issued:

	<b>Number of Options</b>	<b>Weighted Average Exercise Price</b>
Outstanding at January 1, 2005	1,510,000	\$ 0.49
Granted	200,000	0.53
Exercised	(200,000)	0.20
Expired	-	-
Outstanding at June 30, 2005	<u>1,510,000</u>	<u>0.52</u>
Exercisable at June 30, 2005	<u>1,310,000</u>	<u>\$ 0.51</u>

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 3.15. The exercisable options have a range of exercise prices between \$.30 and \$.71 and have a weighted average number of years to expiry of 2.89.

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The weighted average fair value of each option granted during the period April 1 to June 30, 2005 is estimated on the date of grant using the Black-Scholes options pricing model with the following weighted average assumptions:

	<b>Three months ended</b>
	<b><u>June 30, 2005</u></b>
Fair value of options granted (\$/share)	\$ 0.42
Risk-free interest (%)	3.50
Expected life (years)	5
Expected volatility (%)	119
Expected dividend yield (%)	-

**8. Cash flows**

	<b>Three Months</b>	<b>Three Months</b>	<b>Six Months</b>	<b>Six Months</b>
	<b>Ended</b>	<b>Ended</b>	<b>Ended</b>	<b>Ended</b>
	<b><u>June 30, 2005</u></b>	<b><u>June 30, 2004</u></b>	<b><u>June 30, 2005</u></b>	<b><u>June 30, 2004</u></b>
Changes in non-cash working capital				
Operating Activities:				
Accounts receivable	526,792	(75,969)	568,597	427,970
Prepaid deposits	7,007	20,946	(21,034)	(11,791)
Accounts payable and accrued charges	<u>(633,466)</u>	<u>74,879</u>	<u>(625,916)</u>	<u>(154,785)</u>
	(99,667)	19,856	(78,353)	261,394
Investing Activities:				
Accounts receivable	281,511	43,398	421,387	112,648
Accounts payable and accrued charges	<u>(324,163)</u>	<u>(75,713)</u>	<u>(298,639)</u>	<u>(98,433)</u>
	<u>(42,652)</u>	<u>(32,315)</u>	<u>122,748</u>	<u>14,215</u>
	<b><u>\$ (142,319)</u></b>	<b><u>\$ (12,459)</u></b>	<b><u>\$ 44,395</u></b>	<b><u>\$ 275,609</u></b>

**9. Subsequent events**

The Company has entered into a private placement of 3,500,000 common shares \$0.45 per share for an aggregate consideration of \$1,575,000. Each share comes with one purchase warrant which entitles the holder to purchase one common share at \$0.70. This warrant must be exercised within 18 months after the closing of this offer.