



***MANAGEMENT'S DISCUSSION AND ANALYSIS AND
FINANCIAL STATEMENTS***

***FOR THE THREE AND NINE MONTH PERIODS ENDED
SEPTEMBER 30, 2008 AND 2007***

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This Management's Discussion and Analysis ("MD&A") of financial condition, future prospects and results of operations of Petro-Reef Resources Ltd. ("Petro-Reef" or the "Corporation") is dated November 26, 2008. It should be read in conjunction with the audited annual financial statements and corresponding notes for the twelve month period ended December 31, 2007 and for the periods ended March 31, 2008 and June 30, 2008.

The financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles. When alternative accounting methods exist, management has chosen those methods it deems most appropriate in the circumstances. Financial statements are not precise since they include certain amounts based on estimates and judgments. Management has determined such amounts on a reasonable basis in order to ensure that the financial statements are presented fairly, in all material respects. The financial information contained elsewhere in this report has been revised to ensure consistency with the financial statements.

Management has established systems of internal controls, which are designed to provide reasonable assurance that the Corporation's assets are safeguarded from loss or unauthorized use and to produce reliable accounting records for the preparation of financial information.

Petro-Reef's Board of Directors has reviewed and approved the September 30, 2008 interim financial statements and related MD&A.

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. Cash flow from operations and operating netback are not recognized measures under GAAP. Management believes that in addition to net income, cash flow from operations and operating netback are useful supplemental measures that demonstrate the Corporation's ability to generate the cash necessary to repay debt or fund future growth through capital investment. Investors are cautioned, however, that these measures should not be construed as an alternative to net income determined in accordance with GAAP as an indication of Petro-Reef's performance. Petro-Reef's method of calculating these measures may differ from other companies and accordingly, they may not be comparable to measures used by other companies. Operating netback is calculated on a \$/boe basis and is defined as revenue less royalties and operating expenses.

FORWARD LOOKING ADVISORY

Some of the statements contained herein (including without limitation, financial and business prospects and financial outlooks) may be forward-looking statements which reflect management's expectations regarding future plans and intentions, growth, results of operations, performance and business prospects and opportunities. Words such as "may", "will", "should", "could", "anticipate", "believe", "expect", "intend", "plan", "potential", "continue" and similar expressions have been used to identify these forward-looking statements. These statements reflect management's current beliefs and are based on information currently available to management. Forward-looking statements involve significant risk and uncertainties. A number of factors could cause actual results to differ materially from the results discussed in the forward-looking statements including, but not limited to, changes in general economic and market conditions and other risk factors. Although the forward-looking statements contained herein are based upon what management believes to be reasonable assumptions, management cannot assure that actual results will be consistent with these forward-looking statements. Investors should not place undue reliance on forward-looking statements. These forward-looking statements are made as of the date hereof and the Corporation assumes no obligation except as required by law to update or review them to reflect new events or circumstances.

Forward-looking statements and other information contained herein concerning the oil and gas industry and the Corporation's general expectations concerning this industry are based on estimates prepared by management using data from publicly available industry sources as well as from reserve reports, market research and industry analysis and on assumptions based on data and knowledge of this industry which the Corporation believes to be reasonable. However, this data is inherently imprecise, although generally indicative of relative market positions, market shares and performance characteristics. While the Corporation is not aware of any misstatements regarding any industry data presented herein, the industry involves risks and uncertainties and is subject to change based on various factors.

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 within the time periods specified by securities regulations and that information required to be disclosed is accumulated and communicated to management.

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 of 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, 2008, 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. 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. There have been no changes in internal controls from the prior quarter.

BUSINESS RISKS

Petro-Reef is exposed to risks inherent in the oil and gas business. Operationally, the Corporation faces risks associated with finding, developing and producing oil and gas reserves, such as the availability of rigs and inclement weather. The Corporation continues to follow strict exploration criteria on each prospect to ensure high profitability and rate of return on capital investment. Exploration risks are managed by hiring skilled technical staff and by concentrating exploration activity on areas in which Petro-Reef has experience and expertise. Petro-Reef operates most of its production, allowing the Corporation to manage costs, timing and sales of production. Estimates of economically recoverable reserves and the future net cash flow are based on factors such as commodity prices, projected production and future capital and operating costs. These assumptions may differ from actual results. The Corporation has its reserves evaluated annually by an independent engineering firm. Petro-Reef is also exposed to environmental risks and risks associated with the reliance upon relationships with partners. Petro-Reef carries environmental liability, property, drilling and general liability insurance to mitigate its risks. The Corporation is also exposed to financial risks in the form of commodity prices, interest rates, the Canadian to U.S. dollar exchange rate and inflation. Petro-Reef manages

commodity price risk by focusing its capital program on areas that are expected to generate attractive rates of return.

ABBREVIATIONS

bbl	barrel	GJs/d	gigajoules per day
bbls	barrels	M3	cubic meters
bcf	billion cubic feet	Mbbls	thousands of barrels
bhp	brake horsepower	mcf	thousand cubic feet
boe	barrel of oil equivalent (1 boe = 6 mcf)	mcf/d	thousand cubic feet per day
bbls/d	barrels per day	MMbbls	millions of barrels
boe/d	barrels of oil per day	mmcf	million cubic feet
FNR	future net revenue	mmcf/d	million cubic feet per day
GJ	gigajoule	NGLs	natural gas liquids
		NPV	net present value

Reference is made to barrels of oil equivalent. Barrels of oil equivalent may be misleading, particularly if used in isolation. In accordance with National Instrument 51-101, a boe conversion ratio for natural gas of 6 mcf: 1 bbl has been used, which is based on an energy equivalent conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead.

NOTE: In this report all currency values are in Canadian dollars.

Additional information about Petro-Reef is available on SEDAR at www.sedar.com.

SELECTED QUARTERLY INFORMATION

Financial

<i>Three months ended September 30</i>	2008	<i>2007</i>	<i>% Growth</i>
Gross Revenue	\$4,501,683	\$1,795,473	150.7%
Cash Flow From Operations	\$2,411,635	\$951,444	153.5%
Net Income	\$453,787	(\$288,379)	n/a

	September 30, 2008	<i>December 31, 2007</i>	<i>% Growth</i>
Total Assets	\$36,719,035	\$28,603,828	28.4%
Current Financing	\$6,080,763	-	n/a

RESULTS OF OPERATIONS

Production

<i>Three months ended September 30</i>	2008	<i>2007</i>	<i>% Growth</i>
	Average	<i>Average</i>	
Crude Oil and NGL (bbls/d)	136	27	403.5%
Natural Gas (mcf/d)	4,407	3,406	29.4%
Combined (boe/d)	871	595	46.4%

<i>Nine months ended September 30</i>	2008	<i>2007</i>	<i>% Growth</i>
	Average	<i>Average</i>	
Crude Oil and NGL (bbls/d)	124	26	377.1%
Natural Gas (mcf/d)	5,188	3,319	56.3%
Combined (boe/d)	989	579	70.7%

Financial

<i>Three months ended September 30</i>	2008	<i>2007</i>	<i>% Growth</i>	2008	<i>2007</i>
				(\$ / boe)	<i>(\$ / boe)</i>
Gross Revenue	\$4,501,683	\$1,795,473	150.7%	\$56.83	\$32.79
Royalties	\$1,003,340	\$298,392	236.2%	\$12.67	\$5.45
Revenue After Royalties	\$3,498,343	\$1,497,081	133.7%	\$44.16	\$27.34
Operating Expenses	\$756,135	\$418,590	80.6%	\$9.55	\$7.65
Operating Netback	\$2,742,208	\$1,078,491	154.3%	\$34.61	\$19.69
General & Administrative Expenses	\$238,083	\$209,802	13.5%	\$3.01	\$3.83
Interest Expense (Income)	\$92,490	(\$82,755)	n/a	\$1.17	(\$1.51)
Non-cash Expenses	\$1,810,654	\$1,226,155	47.7%	\$22.86	\$22.39
Income (Loss) Before Income Taxes	\$600,981	(\$274,711)	n/a	\$7.59	(\$5.02)
Income Tax Expense	\$147,194	\$13,668	976.9%	\$1.86	\$0.25
Net Income (Loss)	\$453,787	(\$288,379)	n/a	\$5.73	(\$5.27)
Per Share – Basic	\$0.01	(\$0.01)			
Per Share - Diluted	\$0.01	(\$0.01)			

<i>Nine months ended September 30</i>	2008	<i>2007</i>	<i>% Growth</i>	2008	<i>2007</i>
				(\$ / boe)	<i>(\$ / boe)</i>
Gross Revenue	\$15,527,026	\$6,567,758	136.4%	\$57.31	\$41.56
Royalties	\$3,181,158	\$1,251,542	154.2%	\$11.74	\$7.92
Revenue After Royalties	\$12,345,868	\$5,316,216	132.2%	\$45.57	\$33.64
Operating Expenses	\$2,376,475	\$1,236,657	92.2%	\$8.77	\$7.82
Operating Netback	\$9,969,393	\$4,079,559	144.4%	\$36.80	\$25.81
General & Administrative Expenses	\$1,207,084	\$598,813	101.6%	\$4.46	\$3.79
Interest Expense (Income)	\$324,056	(\$142,558)	n/a	\$1.20	(\$0.90)
Non-cash Expenses	\$6,029,922	\$3,177,374	89.8%	\$22.26	\$20.10
Income Before Income Taxes	\$2,408,331	\$445,930	440.1%	\$8.89	\$2.82
Income Tax Expense	\$667,934	\$270,100	147.3%	\$2.47	\$1.71
Net Income	\$1,740,397	\$175,830	889.8%	\$6.42	\$1.11
Per Share – Basic	\$0.05	\$0.01			
Per Share - Diluted	\$0.05	\$0.01			

Revenue

<i>Three months ended September 30</i>	2008	<i>2007</i>	<i>% Growth</i>	2008	2007
				<i>(\$ / boe)</i>	<i>(\$ / boe)</i>
Gross Revenue	\$4,501,683	\$1,795,473	150.7%	\$56.83	\$32.79

Gross revenue increased 150.7% to \$4,501,683 for the three month period ended September 30, 2008 compared to \$1,795,473 for the same period ended September 30, 2007. Petro-Reef realized an all in price per unit of production for the three month period ended September 30, 2008 of \$56.83 representing a 73.3% increase compared to the realized price per unit of production of \$32.79 for the same period ended September 30, 2007.

Below is a summary of gross prices realized by Petro-Reef for the three month period ended September 30:

<i>Three months ended September 30</i>	2008	<i>2007</i>	<i>% Change</i>
Crude Oil and NGL (\$ / bbl)	\$112.71	\$62.55	80.2%
Natural Gas (\$ / mcf)	\$7.77	\$5.12	51.7%

Revenues increased as a result of a 46.4% increase in production year over year. Revenue also increased as a result of an 80.2% increase in realized crude oil and NGL prices and a 51.7% increase in realized natural gas prices. Petro-Reef's crude oil production increased to 15.6% of total production during the quarter compared to 4.5% in 2007, which allowed the Corporation to benefit from the increase in crude oil prices during the quarter. Crude oil production is expected to increase during the year as more capital is targeted towards crude oil development drilling.

<i>Nine months ended September 30</i>	2008	<i>2007</i>	<i>% Growth</i>	2008	2007
				<i>(\$ / boe)</i>	<i>(\$ / boe)</i>
Gross Revenue	\$15,527,026	\$6,567,758	136.4%	\$57.31	\$41.56

Gross revenue increased 136.4% to \$15,527,026 for the nine month period ended September 30, 2008 compared to \$6,567,758 for the same period ended September 30, 2007. Petro-Reef realized an all in price per unit of production for the nine month period ended September 30, 2008 of \$57.31, representing a 37.9% increase compared to the realized price per unit of production of \$41.56 for the same period ended September 30, 2007.

Below is a summary of gross prices realized by Petro-Reef for the nine month period ended September 30:

<i>Nine months ended September 30</i>	2008	<i>2007</i>	<i>% Change</i>
Crude Oil and NGL (\$ / bbl)	\$105.84	\$57.69	82.9%
Natural Gas (\$ / mcf)	\$8.28	\$6.76	22.5%

Royalties

<i>Three months ended September 30</i>	2008	<i>2007</i>	<i>% Growth</i>	2008	<i>2007</i>
				<i>(\$ / boe)</i>	<i>(\$ / boe)</i>
Royalties	\$1,003,340	\$298,392	236.2%	\$12.67	\$5.45

Royalties increased 236.2% to \$1,003,340 for the three month period ended September 30, 2008 compared to \$298,392 for the same period ended September 30, 2007. Royalties on a per unit of production basis rose 132.4% to \$12.67 for the three month period ended September 30, 2008 compared to \$5.45 for the same period ended September 30, 2007. Royalties paid increased as a result of a 46.4% increase in production and a 73.3% increase in realized prices which resulted in a 150.7% increase in revenues during the quarter.

The effective royalty rate rose to 22.3% for the three month period ended September 30, 2008 from 16.6% for the same period ended September 30, 2007. This increase in the effective royalty rate was a result of accruing for freehold mineral taxes which are payable to the Crown in early 2009.

Effective January 1, 2009, Alberta Crown royalties are expected to increase significantly. While this will result in an increase in overall royalties, Petro-Reef has focused recent drilling activities to lands which do not pay Crown royalties. As a result, it is expected that royalties will increase marginally in 2009 as the proportion of freehold royalties increases as production increases from these areas.

<i>Nine months ended September 30</i>	2008	<i>2007</i>	<i>% Growth</i>	2008	<i>2007</i>
				<i>(\$ / boe)</i>	<i>(\$ / boe)</i>
Royalties	\$3,181,158	\$1,251,542	154.2%	\$11.74	\$7.92

Royalties increased 154.2% to \$3,181,158 for the nine month period ended September 30, 2008 compared to \$1,251,542 for the same period ended September 30, 2007. Royalties on a per unit of production basis rose 48.3% to \$11.74 for the nine month period ended September 30, 2008 compared to \$7.92 for the same period ended September 30, 2007.

The effective royalty rate increased to 20.5% for the nine month period ended September 30, 2008 from 19.1% for the same period ended September 30, 2007.

Operating Expenses

<i>Three months ended September 30</i>	2008	<i>2007</i>	<i>% Growth</i>	2008	<i>2007</i>
				<i>(\$ / boe)</i>	<i>(\$ / boe)</i>
Operating Expenses	\$756,135	\$418,590	80.6%	\$9.55	\$7.65

Operating expenses rose 80.6% to \$756,135 for the three month period ended September 30, 2008 compared to \$418,590 for the same period ended September 30, 2007. Production expenses on a per unit of production basis increased 24.8% to \$9.55 for the three month period ended September 30, 2008 compared to \$7.65 for the same period ended September 30, 2007.

Operating expenses increased 80.6% as a result of a 46.4% increase in production year over year as well as a focus during the quarter on cleaning up leases and repairing several facilities to increase capacity and increase operating time in subsequent quarters. Petro-Reef anticipates operating expenses on a per unit of production

basis to fall as production increases from new wells allows for greater economies of scale to be realized at the Corporation's processing facility.

<i>Nine months ended September 30</i>	2008	<i>2007</i>	<i>% Growth</i>	2008	<i>2007</i>
				(\$ / boe)	<i>(\$ / boe)</i>
Operating Expenses	\$2,376,475	\$1,236,657	92.2%	\$8.77	\$7.82

Operating expenses rose 92.2% to \$2,376,475 for the nine month period ended September 30, 2008 compared to \$1,236,657 for the same period ended September 30, 2007. Production expenses on a per unit of production basis rose 12.2% to \$8.77 for the nine month period ended September 30, 2008 compared to 7.82 for the same period ended September 30, 2007.

General & Administrative Expenses

<i>Three months ended September 30</i>	2008	<i>2007</i>	<i>% Growth</i>	2008	<i>2007</i>
				(\$ / boe)	<i>(\$ / boe)</i>
General & Administrative Expenses	\$238,083	\$209,802	13.5%	\$3.01	\$3.83

General & administrative expenses rose 13.5% to \$238,083 for the three month period ended September 30, 2008 compared to \$209,802 for the same period ended September 30, 2007. General & administrative expenses on a per unit of production basis fell 21.5% to \$3.01 for the three month period ended September 30, 2008 compared to \$3.83 for the same period ended September 30, 2007.

General & administrative increased as a result higher staffing levels as well as higher audit and tax advisory fees. General & administrative expenses also rose as a result of lower overhead recoveries from industry partners as the Corporation's working interest on production wells significantly increased as a result of the acquisition which closed during the first quarter of 2008. Petro-Reef anticipates general and administrative expenses on a per unit of production basis to continue to fall as staffing levels are sufficient to handle the expected increase in production forecasted for subsequent quarters.

<i>Nine months ended September 30</i>	2008	<i>2007</i>	<i>% Growth</i>	2008	<i>2007</i>
				(\$ / boe)	<i>(\$ / boe)</i>
General & Administrative Expenses	\$1,207,084	\$598,813	101.6%	\$4.46	\$3.79

General & administrative expenses rose 101.6% to \$1,207,084 for the nine month period ended September 30, 2008 compared to \$598,813 for the same period ended September 30, 2007. General & administrative expenses on a per unit of production basis increased 17.6% to \$4.46 for the nine month period ended September 30, 2008 compared to \$3.79 for the same period ended September 30, 2007.

Interest Expense (Income)

<i>Three months ended September 30</i>	2008	<i>2007</i>	<i>% Growth</i>	2008	<i>2007</i>
				(\$ / boe)	<i>(\$ / boe)</i>
Interest Expenses	\$92,490	(\$82,755)	n/a	\$1.17	(\$1.51)

Petro-Reef incurred interest expense of \$92,490 for the three month period ended September 30, 2008 compared to an interest income of \$82,755 for the same period ended September 30, 2007. Net interest

expense on a per unit of production basis was \$1.17, compared to an interest income of \$1.51 per unit of production in 2007.

Net interest expense increased as a result of higher debt levels during the quarter which were required to finance the acquisition of a working interest partner during the first quarter of 2008. Interest expense is expected to increase in subsequent quarters as Petro-Reef capital expenditures are expected to exceed cash flow from operations generated by the Corporation which will require additional debt financing.

<i>Nine months ended September 30</i>	2008	2007	% Growth	2008	2007
				<i>(\$ / boe)</i>	<i>(\$ / boe)</i>
Interest Expenses	\$324,056	(\$142,558)	n/a	\$1.20	(\$0.90)

Petro-Reef incurred interest expenses of \$324,056 for the nine month period ended September 30, 2008 compared to an interest income of \$142,558 for the same period ended September 30, 2007. Net interest expense on a per unit of production basis was \$1.20, compared to an interest income of \$0.90 per unit of production in 2007.

Non Cash Expenses

<i>Three months ended September 30</i>	2008	2007	% Growth	2008	2007
				<i>(\$ / boe)</i>	<i>(\$ / boe)</i>
Depletion and Amortization	\$1,660,495	\$807,741	105.6%	\$20.96	\$14.75
Accretion Expense	\$33,752	\$4,168	709.8%	\$0.43	\$0.08
Stock-Based Compensation	\$116,407	\$414,246	(71.9%)	\$1.47	\$7.57
Total Non Cash Items	\$1,810,654	\$1,226,155	47.7%	\$22.86	\$22.39

Non cash expenses rose 47.7% to \$1,810,654 for the three month period ended September 30, 2008 compared to \$1,226,155 for the same period ended September 30, 2007. On a per unit of production basis, non cash expenses increased 2.1% to \$22.86 for the three month period ended September 30, 2008 compared to \$22.39 for the same period ended September 30, 2007.

Depletion and amortization expense increased 105.6% to \$1,660,495 as a result of a 46.4% increase in production year over year. The increase in production combined with an increase in capital expenditures resulted in higher depletion on an aggregate basis. Stock based compensation fell 71.9% as no new stock options were granted during the quarter.

<i>Nine months ended September 30</i>	2008	2007	% Growth	2008	2007
				<i>(\$ / boe)</i>	<i>(\$ / boe)</i>
Depletion and Amortization	\$5,457,918	\$2,102,734	159.6%	\$20.15	\$13.30
Accretion Expense	\$47,989	\$15,096	217.9%	\$0.18	\$0.10
Stock-Based Compensation	\$524,015	\$1,059,544	(50.5%)	\$1.93	\$6.70
Total Non Cash Items	\$6,029,922	\$3,177,374	89.8%	\$22.26	\$20.10

Non cash expenses rose 89.8% to \$6,029,922 for the nine month period ended September 30, 2008 compared to \$3,177,374 for the same period ended September 30, 2007. On a per unit of production basis, non cash

expenses increased 10.7% to \$22.26 for the nine month period ended September 30, 2008 compared to \$20.10 for the same period ended September 30, 2007.

Income Taxes

<i>Three months ended September 30</i>	2008	<i>2007</i>	<i>% Growth</i>	2008	<i>2007</i>
				(\$ / boe)	<i>(\$ / boe)</i>
Current Tax	-	-	-	-	-
Future Tax	\$147,194	\$13,668	976.9%	\$1.86	\$0.25
Total Income Taxes	\$147,194	\$13,668	976.9%	\$1.86	\$0.25

Non-cash income taxes expenses were \$147,194 for the three month period ended September 30, 2008 compared to an expense of \$13,668 for the same period ended September 30, 2007. On a per unit of production basis, income taxes increased to \$1.86 for the three month period ended September 30, 2008 compared to an expense of \$0.25 for the same period ended September 30, 2007.

<i>Nine months ended September 30</i>	2008	<i>2007</i>	<i>% Growth</i>	2008	<i>2007</i>
				(\$ / boe)	<i>(\$ / boe)</i>
Current Tax	-	-	-	-	-
Future Tax	\$667,934	\$270,100	147.3%	\$2.47	\$1.71
Total Income Taxes	\$667,934	\$270,100	147.3%	\$2.47	\$1.71

Income taxes expenses were \$667,934 for the nine month period ended September 30, 2008 compared to an expense of \$270,100 for the same period ended September 30, 2007. On a per unit of production basis, income taxes rose to \$2.47 for the nine month period ended September 30, 2008 compared to an expense of \$1.71 for the same period ended September 30, 2007.

LIQUIDITY AND FINANCIAL CONDITION

	September 30, 2008	<i>December 31, 2007</i>
Working Capital	(\$9,167,895)	(\$120,357)
Oil and Gas Properties	\$34,129,576	\$20,682,771

Petro-Reef's working capital deficit at September 30, 2008 was \$9,167,895 compared to a deficit of \$120,357 at December 31, 2007. The working capital deficit increased as a result of the \$10,400,000 acquisition which closed during the first quarter, all of which was funded using existing cash holdings and an increased credit facility. Included in the working capital deficit was \$6,080,763 in outstanding bank lines of credit which is included in current liabilities. Petro-Reef's bank credit facility is structured as a \$14,000,000 revolving operating demand loan and a \$4,000,000 non-revolving acquisition / development demand loan. As at September 30, 2008, Petro-Reef Resources Ltd. was in compliance with its bank covenants.

Recent developments in the current financial markets have affected the ability of Petro-Reef to obtain financing outside of available cash flow and bank lines of credit. Although commodity prices have fallen significantly from their highs reached in July 2008, with a low cost structure (royalties, operating and general & administrative expenses), Petro-Reef is confident in its abilities to generate sufficient cash flow to continue with its capital development strategy. Petro-Reef's bank line was reviewed by its senior lender in September and is scheduled

for an annual review in April 2009. With the weakness in the financial markets, access to equity by Petro-Reef at terms which would be reasonable to the Corporation is unavailable. As a result, Petro-Reef's go forward capital expenditures program does not depend on any cash injections from an equity offering.

In the event the current financial crisis deepens, Petro-Reef's capital expenditure program is scalable, allowing for cancellation of projects with no material financial effect on the Corporation. We have met all obligations under the 2007 flow-through equity offering and have no drilling commitments with industry partners.

Based on forecast cash flows from operations and available bank credit financing, Petro-Reef is confident in its ability to fund ongoing capital and operating expenditures. Petro-Reef's debt levels are expected to increase in subsequent quarters as a result of increasing capital expenditures, but will be within the credit lines provided by Petro-Reef's senior lender.

Capitalized resource properties as at September 30, 2008 were \$34,129,576 net of accumulated depletion, compared to \$20,682,771 as at December 31, 2007. 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, 2008 Petro-Reef incurred \$3,391,583 and \$18,307,751 in net capital expenditures, respectively, broken down as follows:

	3-Month Period Ended September 30, 2008	9-Month Period Ended September 30, 2008
Exploration	\$974,017	\$1,502,788
Development	\$1,325,015	\$3,230,234
Property Acquisitions	-	\$9,975,415
Undeveloped Land	\$367,965	\$700,622
Geological / Geotechnical	\$25,539	\$269,786
Facilities	\$634,106	\$2,452,129
Other Assets	\$64,941	\$176,777
Total Capital Expenditures	\$3,391,583	\$18,307,751

Cash Flow From Operations

For the three month period ended September 30, 2008, Petro-Reef generated cash flows from operations of \$2,411,635 (\$0.07 per basic / diluted share), an increase of 153.5% compared to \$951,444 (\$0.03 per basic share) for the three month period ended September 30, 2007. Cash flow from operations increased as a result of higher production volumes and higher realized commodity prices.

Cash flow from operations, 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. In addition, 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.

<i>Three months ended September 30</i>	<i>2008</i>	<i>2007</i>
Net Income For The Period	\$453,787	(\$288,379)
Future Income Tax Provision	\$147,194	\$13,668
Accretion Expense	\$33,752	\$4,168
Stock-Based Compensation	\$116,407	\$414,246
Depletion And Amortization	\$1,660,495	\$807,741
Cash Flow From Operations	\$2,411,635	\$951,444

For the nine month period ended September 30, 2008, Petro-Reef generated cash flows from operations of \$8,438,253 (\$0.25 per basic/diluted share), an increase of 132.9% compared to \$3,623,304 (\$0.10 per basic / diluted share) for the nine month period ended September 30, 2007.

<i>Nine months ended September 30</i>	<i>2008</i>	<i>2007</i>
Net Income For The Period	\$1,740,397	\$175,830
Future Income Tax Provision	\$667,934	\$270,100
Accretion Expense	\$47,989	\$15,096
Stock-Based Compensation	\$524,015	\$1,059,544
Depletion And Amortization	\$5,457,918	\$2,102,734
Cash Flow From Operations	\$8,438,253	\$3,623,304

Capital Resources

The Corporation's share capital is as follows:

	<i>September 30, 2008</i>		<i>December 31, 2007</i>	
	<i>No. of Shares</i>	<i>Amount</i>	<i>No. of Shares</i>	<i>Amount</i>
Common Shares	34,589,041	\$18,395,534	33,714,781	\$17,946,983

For the nine month period ended September 30, 2008, 506,000 stock options were exercised generating cash proceeds of \$398,800. During the nine month period ended September 30, 2008, 368,260 warrants were exercised generating cash proceeds of \$423,499. In the second quarter 2007, the Corporation issued 1,500,000 flow - through shares priced at \$2.00. As part of the flow – through share offering, Petro-Reef has renounced to investors and must incur \$3,000,000 in eligible exploration expenditures on or before December 31, 2008. Petro-Reef met its exploration expenditure obligation as of December 31, 2007. The actual renunciation of eligible exploration expenditures was filed with the Federal Government in Q1 – 2008 and, as a result, a tax adjustment of \$765,000 to share capital has been accounted for during this period.

OFF-BALANCE SHEET ARRANGEMENTS

The Corporation does not have any off-balance sheet arrangements.

OUTLOOK

With the current economic crisis affecting all companies' access to financing, Petro-Reef has refocused our capital expenditures towards lower risk, development oil drilling locations. In the fourth quarter of 2008, Petro-

Reef anticipates drilling four wells, each of which targeting oil all of which are on lands which have freehold royalties. Recognizing the large development oil potential Petro-Reef has on our lands, the Corporation has commenced with a downspacing application whereby Petro-Reef anticipates drilling up to 72 development oil wells on five sections of land in the Corporation's core area of Alexander. The application process, along with landowner consultation is expected to take 6 months. As a result, Petro-Reef anticipates having approvals in place by July 2009. In the event the current economic crisis worsens in 2009, Petro-Reef has the ability to scale back the development drilling program should this course of activity be required. In anticipation of the accelerated drilling program, Petro-Reef expects to scale-back capital expenditures during the first half of 2009 to conserve cash and available bank lines of credit. It is not anticipated that any new wells will be drilled in the first half of 2009, unless wells which were scheduled to be drilled in 2008 are unable to be drilled until early 2009.

To assist in the identification of future drilling locations, Petro-Reef recently completed a 15 square mile 100% owned 3-D seismic program over newly acquired freehold and Crown lands adjacent to Petro-Reef's existing core area of Alexander. Data is currently being processed and Petro-Reef anticipates our initial interpretation to occur in early 2009. Depending on the interpretation, Petro-Reef anticipates drilling 1-2 wells on the lands covered by the 3-D seismic during the latter half of 2009, subject to available capital and cash available to spend on the exploration drilling location.

Effective January 1, 2009, the Alberta Government's new royalty regime is expected to be implemented, the result of which is significantly higher royalties on all production from Crown lands. The increase is significant and will have an effect on the cash flow generated by the Corporation, albeit a small effect due to the significant freehold royalties paid by the Corporation. To address the significantly decreased economics of drilling on Crown lands, Petro-Reef intends to focus the overwhelming majority of its drilling budget towards freehold lands which attract a significantly lower royalty rate.

RELATED PARTY TRANSACTIONS

All related party transactions are in the normal course of operations and have been measured at the agreed to exchange amounts, which is the amount of consideration established and agreed to by the related parties. During the period ended September 30, 2008, the Corporation purchased engineering services in the amount of \$1,056,036 (2007 - \$1,124,594) from a Corporation controlled by a Director of the Corporation. The Corporation also purchased professional services in the amount of \$72,922 (2007 - \$212,241) from a law firm which a Director of the Corporation is a partner. At September 30, 2008, Petro-Reef had a payable of \$140,901 owed to the engineering firm in the Corporation's accounts payable.

COMMITMENTS

The present office lease agreement expires on September 30, 2011. Future lease payments to the end of the lease term under the Corporation's office lease are as follows:

2008	\$20,230
2009	\$84,258
2010	\$86,762
2011	\$65,070

CRITICAL ACCOUNTING ESTIMATES

The preparation of financial statements in conformity with GAAP requires the Corporation to make assumptions, judgments and estimates that may have a significant impact on the financial statements.

Estimates are reviewed periodically and as adjustments become necessary they are reported in earnings in the periods in which they become known. The Corporation's significant accounting policies are described in Note 1 of these financial statements and in the Corporation's annual MD&A for the year ended December 31, 2007.

NEW ADOPTED ACCOUNTING STANDARDS

Effective January 1, 2008, the Corporation was required to adopt the CICA Handbook Section 1506 - Accounting Changes that provides expanded disclosures for changes in accounting policies, accounting estimates and corrections of errors. Under the new standard, accounting changes should be applied retroactively unless otherwise permitted or where the effect is impracticable to determine. As well, voluntary changes in accounting policy are made only when required by a primary source of GAAP or the change results in more relevant and reliable information. The adopted accounting standard did not have any effect on the Corporation.

As of January 1, 2008, the Corporation was required to adopt two new CICA standards, Section 3862 – Financial Instruments – Disclosures, and Section 3863 – Financial Instruments – Presentation, which will replace Section 3861 – Financial Instruments – Disclosure and Presentation. The new disclosure standard increases the emphasis on the risks associated with both recognized and unrecognized financial instruments and how those risks are managed. The new presentation standard carries forward the former presentation requirements.

As of January 1, 2008, the Corporation adopted CICA Handbook Section 1535 – Capital Disclosures, which requires entities to disclose objectives, policies and processes for managing capital, and in addition, whether the entity has complied with any externally imposed capital requirements.

SELECTED QUARTERLY INFORMATION

	2008			2007
	Q3	Q2	Q1	Q4
Revenue	\$4,501,683	\$6,294,649	\$4,730,694	\$1,957,256
Cash flow	\$2,411,635	\$3,394,919	\$2,631,699	\$779,831
Net Income (Loss)⁽¹⁾	\$453,787	\$884,916	\$401,694	(\$665,008)
Net Income (Loss) Per Share⁽¹⁾	\$0.01	\$0.02	\$0.01	(\$0.02)
Capital Expenditures	\$3,391,583	\$1,811,045	\$13,110,324	\$3,126,358
Total Assets	\$36,719,035	\$34,682,220	\$35,324,313	\$28,603,828
Shareholders Equity	\$21,805,557	\$20,594,571	\$19,369,032	\$19,483,847
Avg. Daily Production (boe/d)	871	1,098	1,000	771
	2007			2006
	Q3	Q2	Q1	Q4
Revenue	\$1,795,473	\$2,228,590	\$2,543,695	\$1,456,725
Cash flow	\$951,444	\$1,104,425	\$1,567,436	\$604,010
Net Income (Loss)	(\$199,246)	\$62,025	\$444,680	\$54,337
Net Income (Loss) Per share	(\$0.01)	\$0.00	\$0.01	\$0.00
Capital Expenditures	\$2,960,159	\$2,190,597	\$2,427,755	\$2,694,363
Total Assets	\$26,488,367	\$26,691,045	\$25,712,699	\$15,056,446
Shareholders Equity	\$19,473,249	\$19,347,503	\$16,168,187	\$7,919,194
Avg. Daily Production (boe/d)	595	544	594	354

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

DIRECTORS AND OFFICERS

Joseph Werner⁽⁵⁾

Chief Executive Officer
President & Director
Calgary, Alberta

Theodore M. Donhuysen^{(4) (5)}

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

John R. Pantazopoulos⁽⁵⁾

Vice President Finance
Chief Financial Officer & Director
Calgary, Alberta

Larry A. Ness

Vice President Engineering
Calgary, Alberta

R. Greg Powers Q.C.⁽²⁾⁽³⁾

Director, Corporate Secretary
Calgary, Alberta

Richard W. DeVries⁽¹⁾⁽²⁾

Director
Freeport, The Bahamas

Jack P. Donhuysen⁽³⁾⁽⁴⁾

Director
Calgary, Alberta

Alan P. Hallman^{(1) (2) (3)}

Director
Calgary, Alberta

Peter A. Lubey^{(1) (4)}

Director
Calgary, Alberta

Huba A. Sebo

Director
Calgary, Alberta

Head Office

970 – 10655 Southport Road S.W.
Calgary, Alberta T2W 4Y1
Telephone: +1 (403) 265-6444
Facsimile: +1 (403) 264-1348
E-mail: info@petro-reef.ca
Website: www.petro-reef.ca

Auditors

PricewaterhouseCoopers LLP
Chartered Accountants
3100, 111 - 5th Avenue S.W.
Calgary, Alberta T2P 5L3

Bank

National Bank of Canada
301 – 6th Avenue S.W.
Calgary, Alberta T2P 4M9

Registrar and Transfer Agent

CIBC Mellon Trust Corporation
600, 333 - 7th 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 Governance Committee
- (4) Member of the Reserves Committee
- (5) Member of the Management Committee

PETRO-REEF RESOURCES LTD.
FINANCIAL STATEMENTS (Unaudited)
FOR THE THREE AND NINE MONTH PERIODS ENDED
SEPTEMBER 30, 2008 AND 2007

PETRO-REEF RESOURCES LTD.
Balance Sheet
As at September 30, 2008 and December 31, 2007
Unaudited

ASSETS	September 30, 2008	December 31, 2007
Current assets		
Cash and cash equivalents	\$97	\$4,921,309
Accounts receivable	\$2,226,945	\$2,833,229
Prepaid expenses and deposits	\$362,417	\$166,519
	<u>\$2,589,459</u>	<u>\$7,921,057</u>
Property, plant and equipment (note 2)	<u>\$34,129,576</u>	<u>\$20,682,771</u>
	<u>\$36,719,035</u>	<u>\$28,603,828</u>
LIABILITIES		
Current liabilities		
Overdraft	\$1,029,850	-
Bank line of credit (note 3)	\$6,080,763	-
Accounts payable and accrued charges	\$4,646,741	\$8,041,414
	<u>\$11,757,354</u>	<u>\$8,041,414</u>
Future income taxes	\$1,910,144	\$538,727
Asset retirement obligation (note 4)	<u>\$1,245,980</u>	<u>\$539,840</u>
	<u>\$14,913,478</u>	<u>\$9,119,981</u>
SHAREHOLDERS' EQUITY		
Share capital (note 5a)	\$18,395,534	\$17,946,983
Warrants (note 5b)	-	\$840,429
Broker warrants (note 5c)	-	\$212,685
Contributed surplus (note 5d)	\$2,845,070	\$1,659,194
Retained Earnings (Deficit)	\$564,953	(\$1,175,444)
	<u>\$21,805,557</u>	<u>\$19,483,847</u>
	<u>\$36,719,035</u>	<u>\$28,603,828</u>
Commitments (note 8) See accompanying notes to the financial statements		
SIGNED ON BEHALF OF THE BOARD		
"Joseph Werner" Director	"Richard DeVries" Director	

PETRO-REEF RESOURCES LTD.**Statement of Operations, Comprehensive Income and Retained Earnings (Deficit)****For the three and nine month periods ended September 30, 2008 and 2007****Unaudited**

	3-months Ended September 30, 2008	3-months Ended September 30, 2007	9-months Ended September 30, 2008	9-months Ended September 30, 2007
Revenue				
Gross Revenue	\$4,501,683	\$1,795,473	\$15,527,026	\$6,567,758
Royalties	\$1,003,340	\$298,392	\$3,181,158	\$1,251,542
Revenue After Royalty	<u>\$3,498,343</u>	<u>\$1,497,081</u>	<u>\$12,345,868</u>	<u>\$5,316,216</u>
Expenses				
Production expenses	\$756,135	\$418,590	\$2,376,475	\$1,236,657
Accretion expense (note 4)	\$33,752	\$4,168	\$47,989	\$15,096
Depletion and depreciation	\$1,660,495	\$807,741	\$5,457,918	\$2,102,734
Stock-based compensation (note 6)	\$116,407	\$414,246	\$524,015	\$1,059,544
General and administrative	\$238,083	\$209,802	\$1,207,084	\$598,813
Net interest expense (income)	\$92,490	(\$82,755)	\$324,056	(\$142,558)
	<u>\$2,897,362</u>	<u>\$1,771,792</u>	<u>\$9,937,537</u>	<u>\$4,870,286</u>
Earnings before taxes	\$600,981	(\$274,711)	\$2,408,331	\$445,930
Future income tax	<u>\$147,194</u>	<u>\$13,668</u>	<u>\$667,934</u>	<u>\$270,100</u>
Net income and comprehensive Income for the period	\$453,787	(\$288,379)	\$1,740,397	\$175,830
Retained Earnings (Deficit) – Beginning of period	<u>\$111,166</u>	<u>(\$353,684)</u>	<u>(\$1,175,444)</u>	<u>(\$817,894)</u>
Retained Earnings (Deficit) – End of period	<u>\$564,953</u>	<u>(\$642,063)</u>	<u>\$564,953</u>	<u>(\$642,064)</u>
Basic and diluted net income per common share	<u>\$0.01</u>	<u>(\$0.01)</u>	<u>\$0.05</u>	<u>\$0.01</u>

See accompanying notes to the financial statements

PETRO-REEF RESOURCES LTD.**Statement of Cash Flow**

For the three and nine month periods ended September 30, 2008 and 2007

Cash provided by (used in)	3-months Ended September 30, 2008	3-months Ended September 30, 2007	9-months Ended September 30, 2008	9-months Ended September 30, 2007
Operating activities				
Net income for the year	\$453,787	(\$288,379)	\$1,740,397	\$175,830
Items not effecting working capital				
Accretion expense	\$33,752	\$4,168	\$47,989	\$15,096
Depletion and depreciation	\$1,660,495	\$807,741	\$5,457,918	\$2,102,734
Stock-based compensation	\$116,407	\$414,246	\$524,015	\$1,059,544
Future income taxes	\$147,194	\$13,668	\$667,934	\$270,100
Cash flow from operations	<u>\$2,411,635</u>	<u>\$951,444</u>	<u>\$8,438,253</u>	<u>\$3,623,304</u>
Net change in non-cash operating working capital items	<u>\$795,945</u>	<u>(\$589,918)</u>	<u>(\$2,351,080)</u>	<u>(\$1,151,177)</u>
	<u>\$3,207,580</u>	<u>\$361,526</u>	<u>\$6,087,173</u>	<u>\$2,472,127</u>
Financing activities				
Bank line of credit	(\$260,117)	\$851,874	\$7,110,613	\$476,874
Proceeds from share issue	-	-	-	\$9,050,000
Share issue costs	-	-	-	(\$827,233)
Proceeds from exercise of stock options and warrants	\$501,479	-	\$822,379	\$2,096,034
	<u>\$241,362</u>	<u>\$851,874</u>	<u>\$7,932,992</u>	<u>\$10,795,675</u>
Investing activities				
Expenditures on property, plant and equipment	(\$3,391,583)	(\$2,960,159)	(\$18,307,751)	(\$7,578,511)
Net change in non-cash investing working capital items	<u>(\$57,663)</u>	<u>(\$507,619)</u>	<u>(\$633,626)</u>	<u>\$147,673</u>
	<u>(\$3,449,246)</u>	<u>(\$3,467,778)</u>	<u>(\$18,941,377)</u>	<u>(\$7,430,838)</u>
Change in cash during the period	<u>(\$303)</u>	<u>(\$2,254,378)</u>	<u>(\$4,921,212)</u>	<u>\$5,836,964</u>
Cash and cash equivalents				
- Beginning of period	<u>\$400</u>	<u>\$8,089,729</u>	<u>\$4,921,309</u>	<u>(\$1,613)</u>
Cash and cash equivalents, End of period	<u>\$97</u>	<u>\$5,835,351</u>	<u>\$97</u>	<u>\$5,835,351</u>

See accompanying notes to the financial statements

1. Accounting policies

Petro-Reef Resources Ltd. (the "Corporation") is engaged in the exploration for and production of crude oil and natural gas in Canada. The financial statements of the Corporation have been prepared in accordance with accounting principles generally accepted in Canada.

Significant accounting policies are summarized as follows:

Oil and gas operations

The Corporation follows the full cost method of accounting for crude oil and gas operations whereby all costs related to the acquisition of, exploration for and development of crude oil and natural gas reserves are capitalized. Such costs include leasehold acquisition costs, geological and geophysical costs, lease rentals, drilling, plant and equipment costs and related overhead. Proceeds from the disposal of properties are applied as a reduction of the cost of the remaining assets with no gain or loss recognized, unless such a sale would result in a change of more than twenty percent depletion rate.

The Corporation places a limit on the carrying value of property, plant and equipment and other assets, which may be depleted against revenues of future periods (the "ceiling test"). The carrying value is assessed to be recoverable when the sum of the undiscounted cash flows expected from the production of proved reserves using forward pricing, the lower of cost and market of unproved properties and the cost of major development projects exceed the carrying value. When the carrying value is not assessed to be recoverable, an impairment loss is recognized to the extent that the carrying value of assets exceeds the fair value of proved and probable reserves, and the cost, less any impairment, of unproved properties that contain no probable reserves.

Depletion is computed using the unit-of-production method based on gross estimated proved oil and gas reserves (converted to equivalent units on the basis of estimated relative energy content). In determining the appropriate depletion rate, the Corporation includes the net book value of its oil and gas properties, as well as the estimated future costs to be incurred in developing proved reserves and excludes the unimpaired cost attributable to unproved properties.

Depreciation

Depreciation of furniture and fixtures is calculated using the declining balance method at an annual rate of 20%. Depreciation of computer equipment is calculated using the declining balance method at an annual rate of 45%. Leasehold improvements are amortized over the useful life of 5 years using the straight-line method.

Asset retirement obligation

The Corporation records a liability for the fair value of legal obligations associated with the retirement of long lived tangible assets in the period in which they are incurred, normally when the asset is purchased or developed. On recognition of the liability there is a corresponding increase in the carrying amount of the related asset known as the asset retirement cost, which is depleted on a unit-of-production basis over the life of the reserves. The liability is adjusted each reporting period to reflect the passage of time, with the accretion charged to earnings, and for revisions to the estimated future cash flows. Actual costs incurred upon settlement of the obligations are charged against the liability.

Stock options

The Corporation has an incentive stock option plan for employees, officers, directors and consultants as described in note 6. The Corporation records stock based compensation expense using the fair value method. The fair value of an option is calculated at the grant date, and expensed on a straight line basis over the vesting term of the option. The Corporation records the cumulative stock based compensation as a contributed surplus. When options are exercised, contributed surplus is reduced and share capital is increased by the amount of accumulated stock based compensation for the exercised option. Any consideration received on the exercise of stock options is credited to share capital.

Revenue recognition

Revenue associated with the sale of crude oil, natural gas and natural gas liquids owned by the Corporation are recognized when title passes from the Corporation to its customers.

Income taxes

The Corporation follows the liability method of accounting for income taxes. Under this method, the Corporation records future income taxes for the effect of any differences between the accounting and the income tax basis of an asset or liability using income tax rates substantively enacted on the balance sheet date. The effect of a change in income tax rates on the future income tax assets and liabilities is recognized as income in the period of the change.

Earnings per share

The Corporation uses the treasury stock method to determine the dilutive effect of stock options and other dilutive instruments. This method assumes that any proceeds from the exercise of in-the-money stock options or other dilutive instruments are assumed to be used to purchase common shares at the average market price during the period.

Joint ventures

Substantially all of the Corporation's activities are conducted jointly with other industry partners and accordingly, these financial statements reflect only the Corporation's proportionate interest in such activities.

Cash and Cash equivalents

Cash and cash equivalents consist of all cash on hand and balances with banks, as well as all highly liquid short-term investments. The Corporation considers all highly liquid short-term investments with original terms to maturity of three months or less to be cash equivalents.

Flow Through Share Issuance

The Corporation finances a portion of its exploration program through the issuance of flow-through shares. Under the terms of the flow-through share agreements, and as provided for under the Income Tax Act, the tax attributes of qualifying exploration costs incurred by the Corporation are renounced to subscribers. To recognize the foregone tax benefits to the Corporation, the amount for which the shares are issued is reduced by the tax effect of the tax benefits renounced to subscribers at the time the renunciation documents are filed with the tax authorities.

Measurement uncertainty

The preparation of consolidated financial statements in accordance with Canadian GAAP requires management to make estimates and assumptions and to use judgment regarding assets, liabilities, revenues and expenses. Accordingly, actual results may differ from those estimated amounts.

Recorded amounts for depletion and depreciation, asset retirement obligations and amounts used for the ceiling test and impairment calculations are based on estimates of oil and natural gas reserves and future costs required to develop those reserves. By their nature, these estimates of reserves and the related future cash flows and costs are subject to measurement uncertainty, and the effect on the financial statements of future periods could be significant.

Share Purchase Warrants

The Corporation estimated the fair value of share purchase warrants that were issued. Fair value is estimated using the Black-Scholes method. When exercised the fair value is added to share capital to represent the cost to the Corporation of issuing the warrants.

New Adopted Accounting Standards

Effective January 1, 2008, the Corporation was required to adopt the CICA Handbook Section 1506 - Accounting Changes that provides expanded disclosures for changes in accounting policies, accounting estimates and corrections of errors. Under the new standard, accounting changes should be applied retroactively unless otherwise permitted or where the effect is impracticable to determine. As well, voluntary changes in accounting policy are made only when required by a primary source of GAAP or the change results in more relevant and reliable information. The adopted accounting standard did not have any effect on the Corporation.

As of January 1, 2008, the Corporation was required to adopt two new CICA standards, Section 3862 – Financial Instruments – Disclosures, and Section 3863 – Financial Instruments – Presentation, which will replace Section 3861 – Financial Instruments – Disclosure and Presentation. The new disclosure standard increases the emphasis on the risks associated with both recognized and unrecognized financial instruments and how those risks are managed. The new presentation standard carries forward the former presentation requirements.

As of January 1, 2008, the Corporation adopted CICA Handbook Section 1535 – Capital Disclosures, which requires entities to disclose objectives, policies and processes for managing capital, and in addition, whether the entity has complied with any externally imposed capital requirements.

2. Property, plant, and equipment

	September 30, 2008		
	Cost	Accumulated Depletion and Depreciation	Net
Petroleum and Natural Gas	\$51,333,026	(\$17,307,893)	\$34,025,133
Furniture and Fixtures	\$176,709	(\$72,266)	\$104,443
Total	<u>\$51,509,735</u>	<u>(\$17,380,159)</u>	<u>\$34,129,576</u>

PETRO-REEF RESOURCES LTD.
Notes to Financial Statements
As at September 30, 2008 and September 30, 2007

	December 31, 2007		
	Cost	Accumulated Depletion and Depreciation	Net
Petroleum and Natural Gas	\$32,501,687	(\$11,866,980)	\$20,634,707
Furniture and Fixtures	\$103,325	(\$55,261)	\$48,064
Total	\$32,605,012	(\$11,922,241)	\$20,682,771

At September 30, 2008, unproven oil and gas properties with a cost of \$5,734,536 (December 31, 2007 - \$2,329,277) have been excluded from the depletion and depreciation calculation. Future capital costs required to developed proved reserves in the amount of \$4,165,000 (December 31, 2007 - \$2,708,000) are included in the depletion and depreciation calculation.

During the nine month period ended September 30, 2008, the Corporation capitalized \$152,043 (September 30, 2007 - \$197,083) with respect to overhead expenditures relating to the exploration and development of the Corporation's properties.

3. Demand operating facilities

Facility A is a revolving operating demand loan with a maximum limit of \$14,000,000. Facility B is a non-revolving acquisition/development demand loan that provides an additional \$4,000,000 of financing. Interest is at prime plus 0.375% per annum for Facility A and prime plus 0.5% per annum for the Facility B. Petro-Reef also has the ability to borrow by way of Bankers Acceptances. At September 30, 2008 the balance owing on both facilities was \$6,080,763 (December 31, 2007 - \$0).

The facilities are secured by \$40,000,000 floating charge debenture over all the Corporation's assets with a negative pledge and undertaking to provide fixed charges on the Corporation's major producing properties at the request of the bank. The facilities are repayable on demand.

4. Asset retirement obligation

The total future asset retirement obligation was estimated based on the Corporation'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 Corporation has estimated the net present value of its asset retirement obligation to be \$1,245,980 (December 31, 2007 - \$539,840) as at September 30, 2008. A credit adjusted risk free rate of 5.74 percent (2007 - 5.36 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:

	Period Ended September 30, 2008	Year Ended December 31, 2007
Balance, beginning of period	\$539,840	\$391,648
Liabilities incurred in period	\$189,906	\$128,708
Liabilities incurred – revisions	\$468,245	
Accretion Expense	\$47,989	\$19,484
Balance, end of period	\$1,245,980	\$539,840

The estimated undiscounted amount of asset retirement obligation of \$1,431,684 (December 31, 2007 - \$981,014).

PETRO-REEF RESOURCES LTD.
Notes to Financial Statements
As at September 30, 2008 and September 30, 2007

5. Share capital

a) Class A common shares

	Period Ended September 30, 2008		Year Ended December 31, 2007	
	Shares	Amount	Shares	Amount
Balance, beginning of period	33,714,781	\$17,946,983	23,685,291	\$7,559,760
Exercise of options (iii)	506,000	\$670,936	510,000	\$444,714
Exercise of warrants (iv)	368,260	\$552,763	2,758,620	\$2,495,758
Unit private placement (i)	-	-	5,260,870	\$5,209,568
Flow through shares (ii)	-	(\$765,000)	1,500,000	\$3,000,000
Share issue costs (net of tax effect) (i) (ii)	-	(\$10,148)	-	(\$762,817)
Balance, end of period	34,589,041	\$18,395,534	33,714,781	\$17,946,983

- (i) In the first quarter 2007, the Corporation issued 5,260,870 units priced at \$1.15 per unit. Each unit consisted of one Common Share and one-half of one common share Purchase Warrant. Each whole common share Purchase Warrant entitles the holder to purchase one additional Common Share at an exercise price of \$1.75 per Common Share until July 25, 2008. The warrants have been ascribed a fair value of \$0.32 using the Black-Scholes pricing model assuming a risk-free interest rate of 4.01%; weighted average life of 1.5 years; dividend yield of nil; and expected volatility rate of 70%. Primary Capital Inc., the agent, was paid a cash commission of \$423,500, and was granted non transferable Broker Warrants to acquire 368,260 Common Shares at an exercise price of \$1.15 until July 25, 2008 and to acquire one half of one common share Purchase Warrant. Each whole common share Purchase Warrant entitles the holder to purchase one additional Common Share at an exercise price of \$1.75 per Common Share until July 25, 2008. These Broker Warrants have been recorded as share issue costs estimated at \$129,264 using the Black-Scholes pricing model assuming a risk-free interest rate of 4.01%; weighted average life of 1.5 years; dividend yield of nil; and expected volatility rate of 70%. Legal and other costs incurred, related to this private placement, were \$116,779.
- (ii) In the second quarter 2007, the Corporation issued 1,500,000 flow - through shares priced at \$2.00. Primary Capital Inc. was paid a cash commission of \$225,000, and was granted non transferable Broker Warrants to acquire 97,500 Common Shares at an exercise price of \$2.00 until July 25, 2008. These Broker Warrants have been recorded as share issue costs estimated at \$36,198 using the Black-Scholes pricing model assuming a risk-free interest rate of 4.047%; weighted average life of 1.25 years; dividend yield of nil; and expected volatility rate of 58%. Legal and other costs incurred, related to the issuance of these flow - through shares, were \$61,935. As part of the flow – through share offering, Petro-Reef has renounced to investors and must incur \$3,000,000 in eligible exploration expenditures on or before December 31, 2008. Petro-Reef met its obligations as of December 31, 2007. The actual renunciation was filed with the government in early Q1 – 2008 and, as a result, a tax adjustment to share capital has been accounted for during this period.
- (iii) During the nine month period ended September 30, 2008, 506,000 stock options were exercised at an average exercise price of \$0.79 and compensation expense previously of \$272,136 was included in share capital.
- (iv) The increase in share capital in 2007 was a result of the exercise of warrants is comprised of the amount of cash received of \$1,931,038 and the reclassification to share capital of the ascribed value related to the warrants exercised of \$564,720. These warrants were issued by the
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Corporation under financings that closed in August and September of 2005. During the second quarter of 2008, 150,000 broker warrants were exercised at a price of \$1.15 per warrant. During the third quarter of 2008, 218,260 broker warrants were exercised at a price of \$1.15. All remaining warrants expired unexercised and Petro-Reef currently has no warrants outstanding.

b) Warrants

	Period Ended September 30, 2008		
	Exercise Price	Number	Amount
Balance, beginning of period	\$1.75	2,630,435	\$840,429
Granted by way of exercise of Broker Warrants	\$1.75	150,000	\$10,148
Expiry of warrants	\$1.75	2,780,435	(\$850,577)
Balance, end of period	-	-	-

	Year Ended December 31, 2007		
	Exercise Price	Number	Amount
Balance, beginning of period	\$0.70	2,933,620	\$606,719
Exercise of warrants	\$0.70	(2,758,620)	(\$564,719)
Expiry of warrants	\$0.70	(175,000)	(\$42,000)
Unit private placement ((note 5(a)(i))	\$1.75	2,630,435	\$840,429
Balance, end of period	\$1.75	2,630,435	\$840,429

c) Broker warrants

	Period Ended September 30, 2008		
	Exercise Price	Number	Amount
Balance, beginning of period	\$1.33	465,760	\$212,685
Expiry of warrants	\$2.00	(97,500)	(\$83,421)
Exercise of Warrants	\$1.15	(368,260)	(\$129,264)
Balance, end of period	-	-	-

	Year Ended December 31, 2007		
	Exercise Price	Number	Amount
Balance, beginning of period	-	-	-
Unit private placement (note 5(a)(i))	1.15	368,260	129,264
Flow through shares (note 5(a)(ii))	2.00	97,500	83,421
Balance, end of period	\$1.33	465,760	\$212,685

d) Contributed surplus

	Period Ended September 30, 2008	Year Ended December 31, 2007
Balance, beginning of period	\$1,659,194	\$570,609
Stock-based compensation recognized in the period	\$524,015	\$1,236,299
Adjustments for stock options exercised in the period	(\$272,137)	(\$189,714)
Expiry of warrants	\$933,998	\$42,000
Balance, end of period	\$2,845,070	\$1,659,194

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e) Per share amounts

Earnings per common share are calculated using the weighted average number of common shares outstanding during the period. A reconciliation of the denominators used in the per share calculation is outlined below:

	3-Month Period Ended September 30, 2008	3-Month Period Ended September 30, 2007
Basic weighted average common shares	34,529,544	31,714,113
Effect of diluted options and warrants	287,405	3,107,863
Diluted weighted average common shares	<u>34,816,949</u>	<u>34,821,976</u>
	9-Month Period Ended September 30, 2008	9-Month Period Ended September 30, 2007
Basic weighted average common shares	34,036,088	33,574,781
Effect of diluted options and warrants	69,145	917,912
Diluted weighted average common shares	<u>34,105,233</u>	<u>34,492,693</u>

6. Stock based compensation

The Corporation has a stock option plan for directors, officers and key employees. The exercise price of each option equals the market price of the Corporation's stock on the date of grant. Options vest after one year and expire after a maximum period of five years from the date of issue.

A summary of the status of the Corporation's stock option plan as of September 30, 2008 and December 31, 2007 and changes during the period are presented below:

	Period Ended September 30, 2008		Year Ended December 31, 2007	
	Weighted Number of Options	Weighted Average Exercise Price	Weighted Number of Options	Weighted Average Exercise Price
Balance beginning of Period	3,050,000	\$1.18	1,980,000	\$0.89
Granted	390,000	\$1.43	1,580,000	\$1.48
Exercised	(506,000)	\$0.79	(510,000)	\$0.50
Expired	(634,000)	\$1.33	-	-
Balance end of period	<u>2,300,000</u>	<u>\$1.36</u>	<u>3,050,000</u>	<u>\$1.18</u>
Exercisable end of period	<u>1,585,000</u>	<u>\$1.39</u>	<u>1,470,000</u>	<u>\$1.02</u>

Compensation costs of \$524,015 (September 30, 2007 - \$1,059,544) has been recognized for stock options granted during the period. Assumptions used in the calculation of the Corporation's stock based compensation costs include a risk free rate of 3.05% - 3.49%, volatility of approximately 75%, 0% dividend yield and an expected life of 3 years. No stock options were granted by the Corporation during the third quarter.

7. Related party transactions

All related party transactions are in the normal course of operations and have been measured at the agreed to exchange amounts, which is the amount of consideration established and agreed to by the related parties. During the period ended September 30, 2008, the Corporation purchased engineering services in the amount of \$1,056,036 (September 30, 2007 - \$1,124,594) from a Corporation

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controlled by a Director of the Corporation. The Corporation also purchased professional services in the amount of \$72,922 (September 30, 2007 - \$212,241) from a law firm which a Director of the Corporation is a partner of. At September 30, 2008, Petro-Reef had a payable of \$140,901 owed to both parties included in the Corporation's accounts payable.

8. Commitments

The present office lease agreement expires on September 30, 2011. Future lease payments to the end of the lease term under the Corporation's office lease are as follows:

2008	\$20,230
2009	\$84,258
2010	\$86,762
2011	\$65,070

9. Financial instruments

The Corporation holds various forms of financial instruments which by nature expose the Corporation to market risk, credit risk and liquidity risks. The Corporation manages these risks by operating in a manner that minimizes these risks. Management monitors and administers these risks while the Board of Directors has overall responsibility for overseeing the Corporation's risk management process.

Fair value

The Corporation is exposed to financial risk in a range of financial instruments including cash and cash equivalents, accounts receivable, deposits, accounts payable, bank overdraft and bank line of credit. The Corporation manages its exposure to financial risks by operating in a manner that minimizes its exposure to the extent practical.

The main financial risks affecting the Corporation are discussed below:

Credit Risk

Credit risk arises when a failure by counterparties to discharge their obligations could reduce the amount of future cash inflows from financial assets on hand at the balance sheet date. The Corporation's accounts receivable at the balance sheet date arise from crude oil, natural gas liquids and natural gas sales.

Industry standard dictates that commodity sales are settled on the 25th day of the month following the month of production. The Corporation markets its oil and natural gas to several marketers so that the exposure to any one entity is minimized. In addition, when joint operations are conducted on behalf of a joint venture partner relating to capital expenditures, costs of such operations are paid for in advance to the Corporation by way of a cash call by the partner of the operation being conducted.

Joint venture receivables are generated from conducting joint operating or capital operations with joint venture partners. Collections from these operations are usually paid within three months of the joint venture bill being issued to the partner. Circumstances can arise which extend the terms of collection beyond this period as specific items on these joint venture billings need to be resolved between partners. Smaller partners may be cash called to pay for their share of costs in advance of a project. The Corporation has the ability to take measures such as withholding production volumes as recourse for collections on receivables as well. The Corporation monitors receivables accounts and actively pursues collection and payment. If any accounts are considered impaired they will be charged to an allowance for doubtful accounts. At September 30, 2008 no allowance for doubtful accounts was recorded.

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The Corporation assesses quarterly if there should be any impairment of the financial assets of the Corporation. During the three and six month periods ended September 30, 2008 there was no impairment required on any of the financial assets of the Corporation due to historical success of collecting receivables. The Corporation does not have any significant credit risk exposure with respect to accounts receivable to any single counterparty or any group of counterparties having similar characteristics. The credit risk on cash and cash equivalents is considered by management to be limited because the counterparties are financial institutions with high credit ratings assigned by international credit rating agencies. The carrying value of accounts receivable approximates its fair value due to the relatively short periods to maturity on this instrument. The maximum exposure to credit risk is represented by the carrying amount on the balance sheet. There are no material financial assets that the Corporation considers past due and at risk of collection.

Financial Assets	Carrying Value	Fair Value
Prepaid Expenses	\$362,417	\$362,417
Accounts Receivable	\$2,226,945	\$2,226,945

Financial Liabilities	Carrying Value	Fair Value
Accounts Payable	\$4,646,741	\$4,646,741
Credit Facility	\$6,080,763	\$6,080,763
Overdraft	\$1,029,850	\$1,029,850

Liquidity Risk

Liquidity risk includes the risk that, as a result of the Corporation's operational liquidity requirements:

- The Corporation will not have sufficient funds to settle a transaction on the due date; or
- The Corporation will be forced to sell financial assets at a value which is less than what they are worth.

The Corporation's operating cash requirements, including amounts projected to complete the Corporation's existing capital expenditure program, are continuously monitored and adjusted as input variables change. These variables include but are not limited to, available credit, oil and natural gas production from existing wells, results from new wells drilled, commodity prices, cost overruns on capital projects and regulations relating to prices, taxes, royalties, land tenure, allowable production and availability of markets. As these variables change, liquidity risks may necessitate the Corporation to conduct equity issues or obtain project debt financing. The Corporation also mitigates liquidity risk by maintaining an insurance program to minimize exposure to insurable losses.

Interest rate risk

The Corporation is exposed to interest rate cash flow risk to the extent that its bank loans are at a floating rate of interest. The related disclosure regarding these debt instruments is included in note 3 of these financial statements.

Market risk

Market risk is the risk that changes in market prices, such as foreign exchange rates, commodity prices, and interest rates will affect the Corporation's net earnings. These risks are generally outside the control of the Corporation. The objective of market risk management is to minimize market risk exposures within acceptable limits, while maximizing returns. The Corporation may utilize commodity contracts to manage market risk and all such contracts are approved by the Board of Directors.

Foreign currency exchange rate risk

Foreign currency exchange rate risk is the risk that the fair value or future cash flows will fluctuate as a result of changes in foreign exchange risks. Although substantially all of the Company's petroleum and natural gas sales are denominated in Canadian dollars, the underlying market prices in Canada for

petroleum and natural gas are impacted by changes in the exchange rate between the Canadian and United States dollar.

Commodity price risk

Commodity price risk is the risk that the fair value of future cash flows will fluctuate as a result of changes in commodity prices. Commodity prices for petroleum and natural gas are impacted by not only the relationship between the Canadian and United States dollar, as outlined above, but also world economic events that dictate the levels of supply and demand. The Corporation may utilize commodity price contracts to manage commodity price risk and all such contracts are approved by the Board of Directors.

10. Capital Management

The Corporation's objectives when managing capital is to safeguard its ability to continue as a going concern, so that it can continue to provide returns to shareholders and benefits for other stakeholders. The Corporation manages the capital structure and makes adjustments to it in light of changes in economic conditions and the risk characteristics of the underlying assets. The Corporation's objective is met by retaining adequate equity to provide for the possibility that cash flows from assets will not be sufficient to meet future cash flow requirements. The Board of Directors does not establish quantitative return on capital criteria for management. The Corporation defines capital as the aggregate of total equity, cash and debt. The Corporation is not subject to any externally imposed cash flow requirements other than covenants on its operating credit facility with its lender. At September 30, 2008 the Corporation was in compliance with its financial covenants.

Recent developments in the current financial markets have affected the ability of Petro-Reef to obtain financing outside of available cash flow and bank lines of credit. Although commodity prices have fallen significantly from their highs reached in July 2008, with a low cost structure (royalties, operating and general & administrative expenses), Petro-Reef is confident in its abilities to generate sufficient cash flow to continue with its capital development strategy. Petro-Reef's bank line was reviewed by its senior lender in September and is scheduled for an annual review in April 2009. With the weakness in the financial markets, access to equity by Petro-Reef at terms which would be reasonable to the Corporation is unavailable. As a result, Petro-Reef's go forward capital expenditures program does not depend on any cash injections from an equity offering.

In the event the current financial crisis deepens, Petro-Reef's capital expenditure program is scalable, allowing for cancellation of projects with no material financial effect on the Corporation. We have met all obligations under the 2007 flow-through equity offering and have no drilling commitments with industry partners.

Based on forecast cash flows from operations and available bank credit financing, Petro-Reef is confident in its ability to fund ongoing capital and operating expenditures. Petro-Reef's debt levels are expected to increase in subsequent quarters as a result of increasing capital expenditures, but will be within the credit lines provided by Petro-Reef's senior lender.

11. Subsequent Events

On October 9, 2008 the Corporation received approval from the TSX Venture Exchange for a normal course issuer bid whereby the Corporation can repurchase for cancellation up to 1,729,452 common shares in its own capital stock. The purchases are to be made through the facilities of the TSX Venture Exchange during the period October 14, 2008 to October 12, 2009.
