

**PETRO-REEF RESOURCES LTD.**

**NEWS RELEASE**

TSX Venture Exchange  
Symbol PER  
Common Shares Outstanding 17,705,603

Calgary, Alberta  
August 31, 2004

Petro-Reef Resources Ltd. announces that it has prepared an Interim Report for the Six Months Ended June 30, 2004. It was mailed to shareholders August 27, 2004 and filed with regulators on August 30, 2004. It is available for review on the regulatory filings SEDAR website ([www.sedar.com](http://www.sedar.com)).

**PETRO-REEF RESOURCES LTD.**

**MANAGEMENT'S DISCUSSION AND ANALYSIS**

**INTERIM REPORT FOR THE SIX MONTHS ENDED JUNE 30, 2004**

Management's Discussion and Analysis are part of the Interim Report for the six months of 2004 ended June 30, dated August 31, 2004. 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.

The first Management's Discussion and Analysis for the company was incorporated as part of the annual report for 2003, and is available for review on the SEDAR website ([www.sedar.com](http://www.sedar.com))

### Highlights of Financial and Operations Results for the First Half of 2004 and 2003

Financial	June 30 2004	June 30 2003	% Change
Crude oil and Natural Gas Revenue net of Royalties and ARTC	885,879	388,249	+ 128
Cash flow from operations	391,364	74,872	+ 423
Cash flow from operations per share	0.02	0	-
Net Earnings (loss) from operations	(157,177)	14,355	- 1095
Net loss per share	0.01	0	-
Capital Expenditures	644,682	234,864	+ 175
Bank Loan	1,425,000	750,000	+ 90
Shareholders' equity	4,280,289	4,358,231	-
Common shares outstanding			
Weighted average	17,690,226	17,688,937	-
<b>Operations (by accounting period)</b>			
	<b>Daily Average Production</b>		
Crude Oil and NGLs (Bbls/day)	17.09	5.75	+ 197
Natural Gas (mcf/day)	654	267	+ 145
Total BOE/day	126.04	50.31	+ 150
<b>Average Selling Price</b>			
Crude Oil (\$per Bbl)	47.43	43.67	+ 8
Natural Gas (\$per mcf)	6.71	7.53	- 11
NGL (\$per Bbl)	43.71	39.15	+ 11

Notable from the highlights is that although the average natural gas price for the six month period is eleven percent (11%) less, the cash flow from operations for the comparable period increased by four hundred twenty-three percent (423%).

The following tabulations compares first half natural gas prices per gigajoule for a period of four years, for natural gas sold only by Petro-Reef.

**First Half Product Price for Natural Gas (\$ per Gigajoule)  
Years 2001-2002-2003-2004**

Month of:	2001	2002	2003	2004
January	10.336401	2.910568	6.643443	6.659749
February	7.438433	2.919091	8.516847	5.757239
March	7.324812	4.048778	8.081131	5.881507
April	7.049290	4.193984	6.432713	6.274938
May	5.560984	3.837456	6.497444	6.950898
June	4.442052	2.895572	6.272281	6.564096
Average	7.03	3.53	7.07	6.35

Production and revenue are compared for the first half of 2004 versus 2003 in the next two tables. They are useful for trend analysis. Average BOE/day increased one hundred forty-five percent (145%). 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. Total “cash flow” increased one hundred thirty-seven percent (137%). Refer to the Financial Statements for further details.

**2004 PRODUCTION & REVENUE SUMMARY BY PRODUCTION DATE**

(0) <u>Month</u>	(1) <u>BOE</u>	(2) <u>BOE / Day</u>	(3) <u>REVENUE</u> \$	(4) <u>ROYALTIES</u> \$	(5) <u>EXPENSES</u> \$	(6) <u>(3) – (4) – (5)</u> \$	(7) <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
JUN	3,251.17	108.37	137,528.18	9,637.65	41,665.62	86,224.91	26.52
<b>Average</b>		<b>126.08</b>					<b>25.65</b>
<b>Total</b>	<b>22,898.51</b>		<b>949,519.49</b>	<b>78,205.59</b>	<b>284,005.80</b>	<b>587,308.10</b>	

**2003 PRODUCTION & REVENUE SUMMARY BY PRODUCTION DATE**

(0) <u>Month</u>	(1) <u>BOE</u>	(2) <u>BOE / Day</u>	(3) <u>REVENUE</u> \$	(4) <u>ROYALTIES</u> \$	(5) <u>EXPENSES</u> \$	(6) <u>(3) – (4) – (5)</u> \$	(7) <u>NET BACK</u> \$ / BOE
JAN	1,446.67	46.67	61,120.33	8,415.35	14,010.20	38,694.78	26.75
FEB	1,628.14	58.15	86,808.34	12,609.41	16,382.34	57,816.59	35.51
MAR	1,965.54	63.40	97,834.87	13,850.14	17,076.10	66,908.63	34.04
APR	1,582.68	52.76	64,149.81	9,153.37	19,390.41	35,606.03	22.50
MAY	1,353.92	43.67	54,501.52	6,135.92	18,498.43	29,867.17	22.06
JUN	1,325.16	44.17	52,885.88	7,056.38	26,555.96	19,273.54	14.54
<b>Average</b>		<b>51.47</b>					<b>25.90</b>
<b>Total</b>	<b>9,302.11</b>		<b>417,300.75</b>	<b>57,220.57</b>	<b>111,913.44</b>	<b>248,166.74</b>	

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 2004 ninety-four percent (94%) of Petro-Reef's production was natural gas. The remaining six percent (6%) was crude oil.

The two core areas produced ninety-six percent (96%) of the production and ninety-eight percent (98%) of the revenue. For the six months the production from Alexander/Qui Barre was fifty-four percent (54%) of the total with fifty-five percent (55%) of the revenue. Peavey/Morinville had forty-two percent (42%) and forty-three percent (43%) 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 the last week of June 2004. This well offsets the well drilled in July 2003 about one half a mile away on the same geologic structure. A production test has been completed in the new well in a lower Cretaceous zone and was placed on stream on August 25, 2004 at a rate of four million cubic feet of "sweet" natural gas per day. At this rate the production from this well will be two hundred twenty-seven barrels of oil equivalent per day net to Petro-Reef. To produce this gas it was necessary to lay about one-half mile of pipeline to the existing production and compression facilities at the well drilled in July 2003.

The well drilled on July 2003 had encouraging initial indications of production potential for crude oil and natural gas and was placed on production in November 2003 and by July 2004 was becoming uneconomic. As a result the producing zone was shut in and an up-hole zone completed at a rate of about seven hundred thousand cubic feet of natural gas per day. This is also "sweet" gas.

Another well operated by an industry participant also in the Alexander/Qui Barre area is currently being recompleted for production of lower Cretaceous natural gas at a rate that will be determined upon completion of a production test. This well is scheduled to be producing within about 2 weeks.

For the first six months of 2004 Petro-Reef's average production has been 126 barrels of oil equivalent per day. The additional production from the three wells referred to above should take the average production for Petro-Reef over 300 barrels of oil equivalent per day by September 2004. This will result in a significant increase in natural gas reserves for Petro-Reef. Estimates of increased reserves before several months of production history could be misleading. Calculated reserves will be reported in due time.

The location for the next well to be drilled in the Alexander/Qui Barre area has already been selected based on further interpretation of geological and geophysical data. This well will not be drilled until sufficient reserves have been proven to indicate that a second well in the same reservoir is required. Additional seismic data have been purchased and are currently being reprocessed. With the aid of these data yet another well will be proposed for the area. The timing for the drilling of these wells is dependent on budget consideration, rig availability and regulatory requirements.

As the result of the recompletion of an existing well in the Alexander/Qui Barre area Petro-Reef was able to increase proven reserves by five hundred twenty-seven thousand barrels of oil equivalent of natural gas. Consequently the depletion rate has decreased from 3.46 to 1.67. This has resulted in a significant decrease in depletion expense.

In the Peavey/Morinville area there are three wells that are operated by an industry partner. They have proposed to complete and tie-in two wells, and to recomplete a third well. These operations are pending in the near future.

Petro-Reef's core areas continue to be active and should add to the overall production and revenue for the company.

In June 2004 the board of directors approved the revision to the current stock option plan. The vesting period was changed to one year, rather than three years. Expiry remains at five years. This has resulted in an increase to the compensation expense of \$174,734.

During the second quarter of 2004 Petro-Reef filed three news releases, copies of which are appended hereto.

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 of three zones with hydrocarbon 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 in what has started as an exciting first part of fiscal year 2004.

Dated: August 31, 2004

"Joseph Werner"  
Joseph Werner  
President and  
Chief Executive Officer

## **FORWARD –LOOKING STATEMENTS**

This report contains certain forward-looking statements that involve substantial known and unknown risks and uncertainties, some 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.

### **ABBREVIATIONS**

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

\*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.**

**PRESS RELEASE**

TSX Venture Stock Exchange  
Symbol PER  
Common Shares Outstanding 17,688,937

Calgary, Alberta  
May 18, 2004

**PETRO-REEF ANNOUNCES RESULTS OF 2003 ANNUAL REPORT**

The 2003 Annual Report of Petro-Reef Resources Ltd. was mailed to registered shareholders and to Intermediaries May 14, 2004.

**PETRO-REEF RESOURCES LTD.**

**PRESS RELEASE**

TSX Venture Stock Exchange  
Symbol PER  
Common Shares Outstanding 17,688,937

Calgary, Alberta  
June 7, 2004

**PETRO-REEF ANNOUNCES RESULTS OF FIRST QUARTER 2004**

The first quarter report for Petro-Reef Resources Ltd. was mailed to the Shareholders.

**PETRO-REEF RESOURCES LTD.**

**NEWS RELEASE**

TSX Venture Exchange  
Symbol PER  
Common Shares Outstanding 17,705,603

Calgary, Alberta  
June 17, 2004

The annual general meeting of shareholders of Petro-Reef Resources Ltd. was held June 16, 2004. Five existing directors were re-elected, namely Theodore M. Donhuysen, Robert N. Maertens-Poole, Alan P. Hallman, Dennis K. Ulrich and Joseph Werner. Three additional directors were elected, subject to regulatory approval, namely Gary W. Coleman (a former director) Huba A. Sebo and Jack P. Donhuysen.

PricewaterhouseCoopers LLP, chartered Accountants have been appointed as auditors for the ensuing year.

The new board of directors granted to each of the additional directors a 100,000 share stock option at an exercise price of \$0.70 per share, which was the price of the last trade of Petro-Reef shares on June 16, 2004. The stock options will vest over three years and expire five years from the date of grant.

Immediately prior to this grant Petro-Reef had 1,243,334 stock options outstanding with an average exercise price of \$0.40 per share.

The shareholders were informed that for the next well to be drilled by Petro-Reef et al the plans are to move a drilling rig onto location June 21, 2004. The well is licensed to drill to a depth of seventeen hundred meters (1,700 m) as a test in the Leduc formation. Petro-Reef has a thirty-four percent (34%) working interest in this well.

Petro-Reef Resources Ltd. is a Calgary based oil and natural gas company with producing properties in Western Canada. The company trades on the TSX Venture Exchange under the symbol "PER".

For further information, please contact:

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The TSX Venture Exchange has not reviewed and does not accept responsibility for the adequacy or accuracy of this release. This news release may contain forward-looking information. Actual future results may differ materially from those contemplated. The risks, uncertainties and other factors that could influence actual results are described in documents filed with regulatory authorities.

**PETRO-REEF RESOURCES LTD.**  
**FINANCIAL STATEMENTS (UNAUDITED)**  
**JUNE 30, 2004 AND 2003**

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 financial statements for the period ended June 30, 2004, and have been prepared by management.

**PETRO-REEF RESOURCES LTD.**  
**Balance Sheet**  
**As at June 30, 2004 and December 31, 2003**  
**Unaudited**

	<b>2004</b>	<b>2003</b> (Restated - note 2)
<b>ASSETS</b>		
<b>Current assets</b>		
Accounts receivable	\$ 451,904	\$ 992,523
Prepaid expenses and deposits	18,769	6,977
	<u>470,673</u>	<u>999,500</u>
<b>Property, plant and equipment</b> (note 3)	<u>7,440,790</u>	<u>7,175,224</u>
	<u>\$ 7,911,463</u>	<u>\$ 8,174,724</u>
<b>LIABILITIES</b>		
<b>Current liabilities</b>		
Cheques drawn in excess of bank	\$ 107,180	\$ 409,474
Bank line of credit (note 4)	1,425,000	1,150,000
Accounts payable and accrued charges	1,394,465	1,647,684
	<u>2,926,645</u>	<u>3,207,158</u>
<b>Future income taxes</b>	506,424	529,424
<b>Assets retirement obligation</b> (note 5)	<u>198,105</u>	<u>190,436</u>
	<u>3,631,174</u>	<u>3,927,018</u>
<b>SHAREHOLDERS' EQUITY</b>		
<b>Share capital</b> (note 6)	4,753,072	4,743,176
<b>Contributed surplus</b> (note 7)	273,975	94,111
<b>Deficit</b>	<u>(746,758)</u>	<u>(589,581)</u>
	<u>4,280,289</u>	<u>4,247,706</u>
	<u>\$ 7,911,463</u>	<u>\$ 8,174,724</u>

SIGNED ON BEHALF OF THE BOARD

"Joseph Werner"

Director

"Robert N. Maertens-Poole"

Director

**PETRO-REEF RESOURCES LTD.**  
**Statements of Operations and Deficit**  
**Unaudited**

	3 Months Ended June 30, 2004	3 Months Ended June 30, 2003 (Restated note 2)	6 Months Ended June 30, 2004	6 Months Ended June 30, 2003 (Restated note 2)
<b>Revenue</b>				
Oil and gas sales, net of royalties and ARTC	\$ 531,591	\$ 176,756	\$ 885,879	\$ 388,249
<b>Expenses</b>				
Accretion expense	3,361	3,125	6,834	6,194
Depletion and depreciation	125,146	71,925	379,950	140,983
General and administrative	102,035	102,778	165,208	186,640
Interest expense	13,665	16,734	40,878	16,734
Production	149,916	61,999	288,426	110,003
Stock based compensation	180,839	3,921	184,760	7,842
	<u>574,962</u>	<u>260,482</u>	<u>1,066,056</u>	<u>468,396</u>
<b>Earnings (loss) before the following</b>	(43,371)	(83,726)	(180,177)	(80,147)
<b>Future income tax (recovery)</b>	<u>32,000</u>	<u>(98,690)</u>	<u>(23,000)</u>	<u>(94,502)</u>
<b>Net earnings (loss) for the period</b>	(75,371)	14,964	(157,177)	14,355
<b>Deficit - Beginning of period</b>	<u>(671,387)</u>	<u>(441,470)</u>	<u>(589,581)</u>	<u>(440,861)</u>
<b>Deficit - End of period</b>	<u>\$ (746,758)</u>	<u>\$ (426,506)</u>	<u>\$ (746,758)</u>	<u>\$ (426,506)</u>
<b>Basic and diluted earnings (loss) per common share</b>	<u>\$ 0.00</u>	<u>\$ 0.00</u>	<u>\$ (0.01)</u>	<u>\$ 0.00</u>

**PETRO-REEF RESOURCES LTD.**  
**Statement of Cash Flows**  
**Unaudited**

	3 Months Ended June 30, 2004	3 Months Ended June 30, 2003 (Restated note 2)	6 Months Ended June 30, 2004	6 Months Ended June 30, 2003 (Restated note 2)
<b>Cash provided by (used in)</b>				
<b>Operating activities</b>				
Net earnings (loss) for the period	\$ (75,371)	\$ 14,964	\$ (157,177)	\$ 14,355
Items not effecting working capital				
Depletion and depreciation	125,146	71,925	379,950	140,983
Stock based compensation	180,839	3,921	184,760	7,842
Accretion expense	3,361	3,125	6,834	6,194
Future income taxes	32,000	(98,690)	(23,000)	(94,502)
Cash flow from operations	<u>265,975</u>	<u>(4,755)</u>	<u>391,367</u>	<u>74,872</u>
Net change in non-cash operating working capital items (note 9)	<u>19,856</u>	<u>309,008</u>	<u>261,394</u>	<u>(555,070)</u>
	<u>285,831</u>	<u>304,253</u>	<u>652,761</u>	<u>(480,198)</u>
<b>Financial activities</b>				
Bank line of credit	(50,000)	25,000	275,000	750,000
Proceeds from exercise of stock options	<u>5,000</u>	<u>-</u>	<u>5,000</u>	<u>-</u>
	(45,000)	25,000	280,000	750,000
<b>Investing activities</b>				
Expenditures on property, plant and equipment	(306,151)	(104,529)	(644,682)	(234,864)
Net change in non-cash investing working capital items (note 9)	<u>(32,315)</u>	<u>(254,133)</u>	<u>14,215</u>	<u>(328,303)</u>
	<u>(338,466)</u>	<u>(358,662)</u>	<u>(630,467)</u>	<u>(563,167)</u>
<b>Change in cheques drawn in excess     of bank during the period</b>	(97,635)	(29,409)	302,294	(293,365)
<b>Cheques drawn in excess of bank     - Beginning of period</b>	<u>(9,545)</u>	<u>(5,092)</u>	<u>(409,474)</u>	<u>258,864</u>
<b>Cheques drawn in excess of bank     - End of period</b>	<u>\$ (107,180)</u>	<u>\$ (34,501)</u>	<u>\$ (107,180)</u>	<u>\$ (34,501)</u>
<b>Supplemental information</b>				
Interest paid	<u>\$ 13,665</u>	<u>\$ 16,734</u>	<u>\$ 40,878</u>	<u>\$ 16,734</u>

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

**1. Accounting policies**

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

The Company has a working capital deficit of \$2,455,972 as at June 30, 2004 and \$2,207,658 as at December 31, 2003. The Company's ability to continue as a going concern is dependent upon the continued support of the Company's creditors, which management expects will be received. Without such creditor support, the Company's assets and liabilities may not be realized or discharged in the normal course, with the result that the carrying amounts could be adjusted materially.

**2. Change in accounting policies**

**Asset retirement obligation**

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

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

Balance Sheet		<b><u>December 31, 2003</u></b>
Asset retirement costs, included in property, plant and equipment		\$ 122,861
Accumulated depletion and depreciation on asset retirement costs, included in property, plant and equipment		41,294
Asset retirement obligations		190,436
Accumulated future site restoration liability		(50,575)
Future income tax liability		(16,466)
Deficit		(41,561)
	<b><u>Six months ended</u></b>	<b><u>Three months ended</u></b>
	<b><u>June 30, 2003</u></b>	<b><u>March 31, 2003</u></b>
Statement of Operations		
Accretion expense	\$ 6,194	\$ 3,069
Depletion and depreciation on asset retirement costs	1,837	938
Provision for future site restoration	<u>(3,263)</u>	<u>(1,675)</u>
Net earnings (loss) impact	<u>\$ 5,488</u>	<u>\$ 2,332</u>
Basic and diluted earnings (loss) per share	<u>\$ 0.00</u>	<u>\$ 0.00</u>

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

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

**Stock based compensation**

On October 1, 2003 the Company adopted the new Canadian accounting standards with respect to stock based compensation, prospectively with an effective date of January 1, 2003. As a result, the net loss for the six months ended June 30, 2003 has been adjusted by \$7,842 to reflect the portion of the December 31, 2003 adjustment of stock based compensation related to that period.

**3. Property, plant, and equipment**

	<b>June 30, 2004</b>		
	<b>Cost</b>	<b>Accumulated depletion and depreciation</b>	<b>Net</b>
Petroleum and natural gas	\$ 10,724,825	\$ 3,300,732	\$ 7,424,093
Furniture and fixtures	33,992	17,295	16,697
	<u>\$ 10,758,817</u>	<u>\$ 3,318,027</u>	<u>\$ 7,440,790</u>
	<b>December 31, 2003</b>		
	<b>Cost</b>	<b>Accumulated depletion and depreciation</b>	<b>Net</b>
Petroleum and natural gas	\$ 10,085,109	\$ 2,922,946	\$ 7,162,163
Furniture and fixtures	35,777	22,716	13,061
	<u>\$ 10,120,886</u>	<u>\$ 2,945,662</u>	<u>\$ 7,175,224</u>

No interest or general and administrative expenses were capitalized during the period.

Unproven property costs of \$244,131 (2003 – \$244,131) have been excluded from capitalized costs subject to depletion.

**4. Bank line of credit**

The current line of credit is \$2,000,000, with an additional \$500,000 available for development drilling and acquisition financing. Interest is at prime plus 1.25% per annum for the current loan and 1.5% per annum for the development loan. At June 30, 2004 the balance owing on the current loan was \$1,425,000 (2003 - \$1,150,000).

The line of credit is secured by \$5,000,000 floating charge debenture over all the Company's assets with a negative pledge and undertaking to provide fixed charges on the Company's major producing properties at the request of the bank. The credit facilities are repayable on demand and are reviewed periodically by the bank, the next review being scheduled for 2005.

**5. Asset retirement obligation**

The total future asset retirement obligation was estimated based on the Company's net ownership in all wells and facilities, estimated costs to reclaim and abandon the wells and the estimated timing of costs to be incurred in future periods. The Company has estimated the net present value of its asset retirement obligation to be \$198,105 as at June 30, 2004 based on a total future liability of \$329,133 which will be incurred between

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2004 and 2024. A credit adjusted risk free rate of 7.5 percent and an inflation rate of 2 percent were used to calculate the fair value of the asset retirement obligation.

A reconciliation of the asset retirement obligation is provided below:

	<b>Six months ended</b>		<b>Year Ended</b>
	<b>June 30</b>	<b>June 30</b>	<b>December 31</b>
	<b>2004</b>	<b>2003</b>	<b>2003</b>
Balance, beginning of period	\$ 190,436	\$ 168,190	\$ 168,190
Liabilities incurred in period	835	-	9,632
Liabilities settled in period	-	-	-
Accretion expense	6,834	6,194	12,614
	<u>6,834</u>	<u>6,194</u>	<u>12,614</u>
Balance, end of period	<u>\$ 198,105</u>	<u>\$ 174,384</u>	<u>\$ 190,436</u>

**6. Share capital**

	<b>Six months ended</b>		<b>Year end</b>	
	<b>June 30, 2004</b>		<b>December 31, 2003</b>	
	<u>Shares</u>	<u>Amount</u>	<u>Shares</u>	<u>Amount</u>
Balance, beginning of period	17,688,937	4,743,176	17,688,937	4,743,176
Exercise of options	<u>16,666</u>	<u>9,896</u>	<u>-</u>	<u>-</u>
Balance, end of period	<u>17,705,603</u>	<u>4,753,072</u>	<u>17,688,937</u>	<u>4,743,176</u>

Basic and diluted loss per common share are calculated using the weighted average number of common shares outstanding during the period of 17,691,043 (2003 – 17,688,937)

**7. Contributed Surplus**

	<b>Six months ended</b>	<b>Year end</b>
	<b>June 30, 2004</b>	<b>December 31, 2003</b>
Balance beginning of period	\$ 94,111	\$ -
Compensation recognized in the period	184,760	94,111
Adjustment for options exercised in the period	<u>(4,896)</u>	<u>-</u>
Balance, end of period	<u>\$ 273,975</u>	<u>\$ 94,111</u>

**8. 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.

During the period, the Company changed the vesting period for all outstanding stock options to be one year from issuance of the option, from previously being vested equally over three years. As a result of this change to the stock option plan, compensation costs for the three month period ending June 30, 2004 increased by \$174,734.

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The 300,000 options granted during the second quarter vest one year after issuance and expire June 16, 2009.

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

	<b>Number of Options</b>	<b>Weighted Average Exercise Price</b>
Outstanding at January 1, 2004	1,310,000	\$ 0.42
Granted	350,000	0.70
Exercised	(16,666)	(0.30)
Expired	(100,000)	-
	<u>1,543,334</u>	<u>0.49</u>
Outstanding at June 30, 2004	<u>1,543,334</u>	<u>0.49</u>
Exercisable at June 30, 2004	<u>493,334</u>	<u>\$ 0.44</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 3.8. The exercisable options have a range of exercise prices between \$.30 and \$.49 per share and have a weighted average number of years to expiry of 2.5.

The fair value of each option granted during the three month period ended June 30, 2004 is estimated on the date of grant using the Black-Scholes options pricing model with the following weighted average assumptions:

	<b>Three months ended June 30, 2004</b>
Fair value of options granted (\$/share)	.61
Risk-free interest rate (%)	4.50
Expected life (years)	5
Expected volatility (%)	132
Expected dividend yield (%)	-

**9. Cash flows**

	<b>3 Months Ended June 30, 2004</b>	<b>3 Months Ended June 30, 2003</b>	<b>6 Months Ended June 30, 2004</b>	<b>6 Months Ended June 30, 2003</b>
Changes in non-cash working capital				
Operating Activities:				
Accounts receivable	\$ (75,969)	\$ 31,421	\$ 427,971	\$ (4,461)
Prepaid deposits	20,946	10,216	(11,792)	(12,760)
Accounts payable and accrued charges	<u>74,879</u>	<u>267,371</u>	<u>(154,785)</u>	<u>(537,849)</u>
	<u>19,856</u>	<u>309,008</u>	<u>261,394</u>	<u>(555,070)</u>
Investing Activities:				
Accounts receivable	43,398	( 304,447)	112,648	(294,224)
Accounts payable and accrued charges	<u>(75,713)</u>	<u>50,314</u>	<u>(98,433)</u>	<u>(34,079)</u>
	<u>(32,315)</u>	<u>(254,133)</u>	<u>14,215</u>	<u>(328,303)</u>
	<u>\$ (12,459)</u>	<u>\$ 54,875</u>	<u>\$ 275,609</u>	<u>\$(883,373)</u>