# Interim Report

Pine Cliff
Energy Ltd.

For the Nine Months
Ended September 30, 2005

# Highlights

| | Three Months Ended[2] September 30 2005 | Nine Months Ended[2] September 30 2005 |
|---|---|---|
| FINANCIAL | | |
| Revenue – oil and gas | $ 121,141 | $ 261,558 |
| Funds Flow From Operations[1] | $ 68,119 | $ 92,317 |
| Per Share - Basic | $ 0.00 | $ 0.00 |
| Per Share- Diluted | $ 0.00 | $ 0.00 |
| Net Loss | $ (37,092) | $ (105,821) |
| Per Share – Basic | $ (0.00) | $ (0.00) |
| Per Share - Diluted | $ (0.00) | $ (0.00) |
| Capital Expenditures and Acquisitions | $ 321,206 | $ 1,937,121 |
| Total Assets | – | $ 5,609,386 |
| Shareholders' Equity | – | $ 5,305,042 |

[1] Funds flow from operations is not a recognized measure under GAAP. Management believes that in addition to net loss, funds flow from operations is a useful supplemental measure as it demonstrates the Company's ability to generate the cash necessary to fund future growth through capital investment. Investors are cautioned, however, that this measure should not be construed as an indication of the Company's performance. The Company's method of calculating this measure may differ from other issuers and accordingly, it may not be comparable to that used by other issuers. For these purposes, the Company defines funds flow from operations as funds provided by operations before changes in non-cash operating working capital items.

[2] The Company was incorporated in the Province of Alberta on November 10, 2004 and commenced operations on April 8, 2005.

## Management’s Discussion and Analysis

The following report dated November 2, 2005 is a review of the operations and current financial position for the Company and should be read in conjunction with the unaudited financial statements for the three and nine months ended September 30, 2005, including the notes related thereto, and the audited financial statement for the period ended December 31, 2004, together with the notes related thereto.

### General

The Company is continuing to focus on expanding its operations in the following areas:

(a) Assessing various opportunities to purchase producing properties with exploitation potential and non producing properties.

(b) Assessing international opportunities in various countries that provide sound technical prospects and are not high risk from a political and personal safety aspect.

(c) Continuing to add technical people to assist in developing prospects domestically and on an international basis.

A lot of progress has been made in these areas during the past few months and the Company is optimistic with regard to the potential in these areas of focus.

### Financial and Operational

#### Production

On April 8, 2005, with an effective date of January 1, 2005, the Company acquired interests in two natural gas properties for $1,000,000. The first property, the Sundance lands, located in West Central Alberta was the major property acquired. Pine Cliff now has a 14.4 percent working interest (subject to crown royalty) in 4,960 acres in this area. There are two wells (0.308 net) on these lands that have been producing for approximately two years. Two additional multi-zone wells were drilled in 2005 (net 15 and 3.8 percent). Production commenced in the second quarter at one well (net .038). It is anticipated that the other well (net .15) will commence production in the fourth quarter, 2005. Total production from this area is approximately 120 MCF of natural gas and five barrels of natural gas liquids per day.

Pine Cliff also acquired a 100 percent interest in a Crown lease of 256 hectares in the Auburndale area of East Central Alberta. The Company drilled a Devonian well for sweet natural gas during the second quarter. The Company has tested this well and has concluded that the projected production volume is not sufficient to construct a five kilometer pipeline to tie it in and will not produce this well unless additional production is found in this area and pipeline infrastructure is completed.

## Revenue

Revenue from petroleum and natural gas sales was $121,141 during the third quarter. This is a decline of $19,276 from the second quarter. Higher commodity prices partially offset the decline in production volumes. As mentioned the Company commenced its oil and gas operations on April 8. Average price received in 2005 for its natural gas was $8.77 per MCF and $60.96 per barrel for natural gas liquids.

## Royalties

Royalties consist of Crown royalties ($29,386) paid to the Province of Alberta and gross overriding royalties ($8,038). The Company receives a partial rebate (currently 25%) on royalties paid to the Province of Alberta.

## Interest Income

The Company maintains an investment account that pays interest at prime less 2.25 percent as long as the Company maintains a minimum balance of $1,500,000.

## Production Costs

Production costs for the nine months ended September 30, 2005 were $31,424 or $6.51 per BOE (Q2 – $20,407 or $7.37 per BOE). BOE's are calculated using a conversion ratio of 6 MCF to 1 barrel of oil. The conversion is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead and as such may be misleading if used in isolation. Lower production costs from the natural gas well that commenced production in the second quarter was the main reason for the decline in costs per BOE from Q2.

## General and Administrative

Pine Cliff does not have any employees at the present time but has engaged the services of a geologist on a consulting basis during the third quarter of 2005. Effective February 1, 2005, Pine Cliff entered into a management agreement with Comstate Resources Ltd. (Comstate), a wholly owned subsidiary of Bonterra Energy Income Trust and a company with common directors and management, to have Comstate provide executive services (President and CEO, CFO and COO), accounting services, oil and gas administration and office administration. The management fee consists of a monthly fee of $12,000, three percent of net earnings before income taxes, plus out of pocket costs. Total fees for the nine months ended September 30, 2005 were $96,000 plus minimal out of pocket costs. The majority of the remaining general and administrative expenses consist of general start up costs of $16,458 and accounting and legal costs of $18,636 associated with continuous disclosure requirements.

**Stock Based Compensation**

The Company has a stock-based compensation plan. The Company records a compensation expense over the vesting period based on the fair value of options granted to employees, directors and consultants. In the second quarter the Company issued 1,732,000 stock options with the fair value estimated using the Black-Scholes option pricing model, assuming a weighted risk free interest rate of 3.6 percent, expected weighted average volatility of 88 percent, expected weighted average life of 3.5 years and no annual dividend rate. The total expense to be amortized over the vesting period of the options is $136,536 of which $29,806 was amortized during the third quarter (Q2 - $28,186).

**Depletion, Depreciation and Amortization**

The Company follows the successful efforts method of accounting for petroleum and natural gas properties and related equipment. Costs of acquiring unproved properties are capitalized. When petroleum and natural gas properties are found to contain proved reserves as determined by Company engineers, the related net book value is depleted on the unit-of-production basis, calculated by field. The costs of dry holes and abandoned properties are charged to operations. Geological costs, lease rentals and carrying costs are charged to income as incurred. Costs of drilling exploratory and development wells that result in additions to proved reserves are capitalized and depleted on the unit-of-production basis. Tangible equipment is depreciated on a straight-line basis over ten years.

## Income Taxes

The Company follows the liability method of accounting for income taxes under which the income tax provision is based on the temporary differences in the accounts calculated using income tax rates expected to apply in the year in which the temporary differences will reverse. The Company has sufficient tax pools such that it is not liable for current income tax.

The Company has the following tax pools which can be used to reduce future taxable income:

| | Rate of Utilization % | | Amount |
|---|---|---|---|
| Undepreciated capital costs | 25 | $ | 119,635 |
| Share issue costs | 20 | | 141,922 |
| Canadian exploration expenses | 100 | | 389,389 |
| Canadian development expenses | 30 | | 400,213 |
| Canadian oil and gas expenses | 10 | | 831,733 |
| Non-capital loss carryforward | 100 | | 127,465 |
| | | $ | 2,010,357 |

## Net Loss

Pine Cliff is in the start up phase and as such anticipates incurring a certain amount of losses during its first months of operations. The net loss in the third quarter of $37,092 declined by $7,461 from $44,553 in the second quarter. The Company is optimistic that current planned activity will result in improved results in the future.

## Liquidity and Capital Resources

As of September 30, 2005, Pine Cliff had positive working capital of approximately $3,450,555. These funds will be used to fund future development of existing properties or to acquire additional oil and gas properties.

The Company is authorized to issue an unlimited number of common shares without nominal or par value. Equity transactions during the past nine months are as follows:

| | Shares | | Amount |
|---|---|---|---|
| Balance, December 31, 2004 | 10 | $ | 1 |
| Issued pursuant to public offering | 36,420,031 | | 5,463,005 |
| Share issue costs | - | | (167,647) |
| Future tax adjustment on share issue costs | - | | 57,069 |
| Balance, September 30, 2005 | 36,420,041 | $ | 5,352,428 |

On April 7, 2005, the Company concluded its initial public offering of 36,420,031 Common Shares at $0.15 per share for gross proceeds of $5,463,005. Total expenses related to the initial public offering were $167,647. The Company granted 930,000 stock options to its directors and officers, and an additional 802,000 stock options to other service providers at an exercise price of $0.15 per share. The Company commenced trading on the TSX Venture Exchange on April 11, 2005.

A summary of the status of the Company's stock option plan as of September 30, 2005 and December 31, 2004, and changes during the nine month and from incorporation periods ending on those dates is presented below:

| | September 30, 2005 | | December 31, 2004 | |
|---|---|---|---|---|
| | Options | Weighted-Average Exercise Price | Options | Weighted-Average Exercise Price |
| Outstanding at beginning of period | - | $0.00 | - | $0.00 |
| Options granted | 1,752,000 | 0.16 | - | 0.00 |
| Options cancelled | (16,000) | 0.15 | - | 0.00 |
| Outstanding at end of period | 1,736,000 | $0.16 | - | $0.00 |
| Options exercisable at end of period | - | $0.00 | - | $0.00 |

Of the 1,736,000 options that are outstanding as of September 30, 2005, 1,716,000 are exercisable 50 percent on April 5, 2006 and the remaining 50 percent on April 5, 2007. The options all expire on January 31, 2010.

Additional information relating to the Company may be found on WWW.SEDAR.COM and by visiting its website at www.pinecliffenergy.com.

**Submitted on behalf of the Board of Directors,**

George F. Fink

President, CEO and Director

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## Management's Responsibility for Financial Statements

The information provided in this report, including the financial statements, is the responsibility of management. In the preparation of these statements, estimates are sometimes necessary to make a determination of future values for certain assets or liabilities. Management believes such estimates have been based on careful judgements and have been properly reflected in the accompanying financial statements.

Management maintains a system of internal controls to provide reasonable assurance that the Company's assets are safeguarded and to facilitate the preparation of relevant and timely information.

The Company's auditors have not performed a review of these interim financial statements. The audit committee has reviewed these financial statements with management and has reported to the Board of Directors. The Board of Directors has approved the financial statements as presented in this interim report.

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Pine Cliff Energy Ltd.

# Statements of Loss and Deficit

For the periods ended September 30
(unaudited) (Note 1)

| | Three Months 2005 | Nine Months 2005 |
|---|---|---|
| **Revenue** | | |
| Oil and gas sales | $ 121,141 | $ 261,558 |
| Royalties | (14,195) | (37,424) |
| Alberta royalty tax credits | 2,484 | 7,346 |
| Interest income | 19,121 | 39,475 |
| | 128,551 | 270,955 |
| **Expenses** | | |
| Production costs | 11,017 | 31,424 |
| General and administrative | 49,415 | 147,214 |
| Stock based compensation | 30,249 | 58,435 |
| Depletion, depreciation and accretion | 76,465 | 168,413 |
| | 167,146 | 405,486 |
| **Loss Before Income Taxes** | (38,595) | (134,531) |
| **Income Taxes (Recovery)** | | |
| Current | – | – |
| Future | (1,503) | (28,710) |
| | (1,503) | (28,710) |
| **Loss for the Period** | (37,092) | (105,821) |
| Deficit, Beginning of Period | (68,729) | – |
| **Deficit, End of Period** | (105,821) | (105,821) |
| **Loss Per Share – Basic** | $ 0.00 | $ 0.00 |
| **Loss Per Share – Diluted** | $ 0.00 | $ 0.00 |

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## Pine Cliff Energy Ltd.
# Statements of Cash Flow

| For the periods ended September 30<br>(unaudited) (Note 1) | Three Months<br>2005 | Nine Months<br>2005 |
|---|---|---|
| **Operating Activities** | | |
| Net loss for the period | $ (37,092) | $ (105,821) |
| Items not affecting cash | | |
| Stock based compensation | 30,249 | 58,435 |
| Depletion, depreciation and accretion | 76,465 | 168,413 |
| Future income taxes | (1,503) | (28,710) |
| | 68,119 | 92,317 |
| Change in non-cash working capital | | |
| Due from related party (Note 5) | (9,440) | (9,440) |
| Accounts receivable | (14,768) | (106,131) |
| Prepaid expenditures | (600) | (600) |
| Accounts payable and accrued liabilities | (6,346) | 24,155 |
| Due to related party (Note 5) | 8,713 | 12,996 |
| | (22,441) | (79,020) |
| **Cash Provided by Operating Activities** | 45,678 | 13,297 |
| **Financing Activities** | | |
| Proceeds received on initial public offering | – | 5,463,005 |
| Issue costs | 3,858 | (88,802) |
| Change in non-cash working capital | | |
| Accounts payable and accrued liabilities | – | (25,000) |
| Due to related party (Note 5) | – | (53,845) |
| **Cash Provided by Financing Activities** | 3,858 | 5,295,358 |
| **Investing Activities** | | |
| Property and equipment expenditures | (321,206) | (1,937,121) |
| Change in non-cash working capital | | |
| Due from related party (Note 5) | (18,130) | (18,130) |
| Accounts payable and accrued liabilities | 249,928 | 249,928 |
| Due to related party (Note 5) | (121,008) | 7,015 |
| **Cash Used in Investing Activities** | (210,416) | (1,698,308) |
| **Net Cash Inflow (Outflow)** | (160,880) | 3,610,347 |
| **Cash, Beginning of Period** | 3,771,228 | 1 |
| **Cash, End of Period** | $ 3,610,348 | $ 3,610,348 |

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**Pine Cliff Energy Ltd.**

# Balance Sheets

| As at September 30, 2005 (unaudited) and December 31, 2004 (Note 1) | 2005 | 2004 |
|---|---|---|
| **Assets** | | |
| **Current** | | |
| Cash | $ 3,610,348 | $ 1 |
| Due from related party (Note 5) | 27,570 | – |
| Accounts receivable | 106,131 | - |
| Prepaid expenditures | 600 | – |
| | 3,744,649 | 1 |
| **Deferred Charges** (Note 3) | - | 78,845 |
| **Future Income Tax Asset** | 85,779 | - |
| **Property and Equipment** (Note 4) | | |
| Property and equipment | 1,947,121 | - |
| Accumulated depletion and depreciation | (168,163) | - |
| | 1,778,958 | - |
| | $ 5,609,386 | $ 78,846 |
| **Liabilities** | | |
| **Current** | | |
| Accounts payable and accrued liabilities | $ 274,083 | $ 25,000 |
| Due to related party (Note 5) | 20,011 | 53,845 |
| | 294,094 | 78,845 |
| **Asset Retirement Obligations** | 10,250 | - |
| | 304,344 | 78,845 |
| **Shareholders' Equity** | | |
| Share capital (Note 2) | 5,352,428 | 1 |
| Contributed surplus | 58,435 | - |
| Deficit | (105,821) | - |
| | 5,305,042 | 1 |
| | $ 5,609,386 | $ 78,846 |

## Notes to the Financial Statements

Period ended June 30, 2005 (Note 1)

### 1. SIGNIFICANT ACCOUNTING POLICIES

The accounting policies and methods of application followed in the preparation of the interim financial statements are the same as those followed in the preparation of the Company's 2004 annual financial statements. Due to the commencement of operations in the second quarter the following additional accounting policies have been established. These interim financial statements do not include all disclosure required for annual financial statements. The interim financial statements as presented should be read in conjunction with the 2004 annual financial statements.

**Commencement of Operations**

The Company was incorporated in the Province of Alberta on November 10, 2004 and commenced operations April 8, 2005 (see Note 4).

**Measurement Uncertainty**

The amounts recorded for depletion and depreciation of petroleum and natural gas property and equipment and for asset retirement obligations are based on estimates of petroleum and natural gas reserves and future costs. By their nature, these estimates are subject to measurement uncertainty, and the impact on the financial statements of future periods could be material.

**Joint Interest Operations**

Significant portions of the Company's oil and gas operations are conducted with other parties and accordingly the financial statements reflect only the Company's proportionate interest in such activities.

**Loss Per Share**

Basic loss per share is computed by dividing the loss by the weighted average number of shares outstanding during the period. Diluted per share amounts reflect the potential dilution that could occur if options to purchase common shares were exercised. The treasury stock method is used to determine the dilutive effect of common share options, whereby proceeds from the exercise of common share options or other dilutive instruments are assumed to be used to purchase common shares at the average market price during the period.

The number of common shares used to calculate diluted loss per share for the period ended September 30, 2005 of 24,147,545 included the weighted average number of common shares outstanding of 23,346,184 plus 801,361 common shares related to the dilutive effect of common share options.

## 2 SHARE CAPITAL

<u>Authorized</u>

Unlimited number of Common Shares without nominal or par value.

Unlimited number of Class B Preferred Shares without nominal or par value which may be issued in one or more series.

| Issued | Number | Amount |
|---|---|---|
| Common Shares | | |
| Balance, December 31, 2004 | 10 | $ 1 |
| Issued pursuant to public offering | 36,420,031 | 5,463,005 |
| Share issue costs | – | (167,647) |
| Future tax adjustment on share issue costs | – | 57,069 |
| Balance, September 30, 2005 | 36,420,041 | $ 5,352,428 |

On April 7, 2005, the Company concluded its initial public offering of 36,420,031 Common Shares at $0.15 per share for gross proceeds of $5,463,005. The Company granted 930,000 stock options to its directors and officers, and an additional 802,000 stock options to other service providers at an exercise price of $0.15 per share. The Company commenced trading on the TSX Venture Exchange on April 11, 2005.

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| | September 30, 2005 | | December 31, 2004 | |
|---|---|---|---|---|
| | Options | Weighted-Average Exercise Price | Options | Weighted-Average Exercise Price |
| Outstanding at beginning of period | - | $0.00 | – | $0.00 |
| Options granted | 1,752,000 | 0.16 | - | 0.00 |
| Options cancelled | (16,000) | 0.15 | - | 0.00 |
| Outstanding at end of period | 1,736,000 | $0.16 | - | $0.00 |
| Options exercisable at end of period | - | $0.00 | - | $0.00 |

Of the 1,736,000 options that are outstanding as of September 30, 2005, 1,716,000 are exercisable 50 percent on April 5, 2006 and the remaining 50 percent on April 5, 2007. The options all expire on January 31, 2010.

The Company records a compensation expense over the vesting period based on the fair value of options granted to employees, directors and consultants. On April 5, 2005, the Company issued 1,732,000 stock options with the fair value of $136,536 ($0.08 per option) estimated using the Black-Scholes option pricing model, assuming a weighted risk free interest rate of 3.6 percent, expected weighted average volatility of 88 percent, expected weighted average life of 3.5 years and no annual dividend rate.

## 3. DEFERRED CHARGES

The Company incurred costs in respect of its initial public offering prior to both March 31, 2005 and December 31, 2004 reporting periods. These costs were originally recorded as deferred charges and then charged to share capital upon completion of the public offering.

## 4. PROPERTY AND EQUIPMENT

On April 8, 2005, the Company purchased its original properties from Bonterra Energy Income Trust ("Bonterra") (see Note 5), with an effective date of January 1, 2005. The properties included one producing property and some exploration lands formally held by Novitas Energy Ltd. ("Novitas") (see Note 5) for proceeds of approximately $1,000,000.

## 5. RELATED PARTY TRANSACTIONS

Bonterra, an organization with common directors and management and former parent of the Company, through its wholly owned subsidiaries Comstate Resources Ltd. ("Comstate"), Bonterra Energy Corp. and Novitas has provided working capital, management services and natural gas properties to the Company. As of September 30, 2005, the Company owed $20,011 to Bonterra and its wholly owned subsidiaries for these items. The Company has an accounts receivable from Novitas of $27,570 relating to post closing adjustments in relation to the natural gas properties acquired.

## 6. COMMITMENTS

Commencing February 1, 2005, the Company entered into a management agreement with Comstate to provide executive services (President and CEO, CFO, and COO), accounting services, oil and gas administration and office administration. The management fee consists of a monthly fee of $12,000 plus out of pocket costs, a fee of three percent of net earnings before income taxes, $250 per month per operated producing well and $150 per month per water injector well.

Pine Cliff
Energy Ltd.

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