

# **Ridgeway Petroleum Corp.**

**FORM 51-102F1**

**MANAGEMENT'S DISCUSSION & ANALYSIS**

**QUARTER ENDED MARCH 31, 2004**

May, 2004

### *Overview*

Ridgeway Petroleum Corp. ("Ridgeway" or the "Company") is principally engaged in the business of development of its helium and carbon dioxide ("CO<sub>2</sub>") project (the "St. Johns Helium/CO<sub>2</sub> Project") in eastern Arizona and western New Mexico. The Company has spent approximately \$38,863,966 to date in acquiring, exploring and developing the St. Johns Helium/CO<sub>2</sub> Project. The Company currently owns a 100% working interest in leases covering approximately 242,000 acres which reflects recent relinquishments following updated geological interpretations.

Pursuant to the normal course issuer bid announced in September 2001, the Company purchased 85,200 of its common shares at a cost of \$168,405 during the following twelve-month period. All shares purchased by the Company are being held by the Company to be dealt with at a later date.

### *General-Financial*

Management's Discussion and Analysis relating to the consolidated financial statements for the quarter ended March 31, 2004 and 2003 follows. All financial data contained herein has been prepared in accordance with Canadian generally accepted accounting principles. The reporting currency is the Canadian dollar.

Since early 1997, the Company has completed a number of financings for gross proceeds of approximately \$32.4 million including proceeds from the subsequent exercise of common share purchase warrants issued in conjunction with such financings. In addition, a further \$2.2 million has raised through the exercise of incentive stock options.

To date, Ridgeway has expended most of the proceeds on the drilling of eighteen exploratory and delineation wells, including coring, casing, drill stem testing, completions and production testing as well as lease acquisition and maintenance and the completion of feasibility studies and resource evaluations regarding development of a commercial project.

The results of these activities have established that the Company's St. Johns Helium/CO<sub>2</sub> Project has significant gas in place and is a world class asset. It is not necessary to incur significant additional expenditures to further establish the value of this asset.

In the first quarter of 2003, the Company signed a fifteen year take or pay contract with Air Liquide for the purchase Ridgeway's helium once in production.

In late 2002, the Company signed an agreement with CIG Resources Company ("CIG"), a subsidiary of El Paso Corporation (NYSE-EP), to continue to explore and evaluate the commercial feasibility of the Company's CO<sub>2</sub> holdings.

With the signing of these two agreements, the Company has now achieved two of the key goals necessary in the development of the Project. The remaining strategic goal is the securing of gas contracts for the purchase of CO<sub>2</sub> in the enhanced oil recovery arena, which the Company is actively pursuing. The Company has held meetings with a number of the key potential users of CO<sub>2</sub> with the objective of discussing their current and long-term needs. While the low oil price

environment experienced in 1998 hampered these discussions, recent meetings have been encouraging reflecting the positive outlook for oil prices.

The Project contemplates the development of the field including the drilling of additional wells, adding any necessary field compression and installing gathering pipelines, the construction and operation of the helium processing plant and related facilities and construction and operation of a CO<sub>2</sub> pipeline to customers in California.

In October 2003, the Company announced that a portion of the net proceeds from its Short Form Offering, which raised gross proceeds of \$1,500,000 before commissions and offering expenses, would be used to fund a proposed three well development/appraisal project. The drilling of the first well commenced May 4, 2004. The drilling had been delayed pending the contracting of an appropriate drilling rig in a very tight service industry market.

The development/appraisal project is to consist of drilling and completing a number of wells to establish more statistically persuasive data for gas composition, average well flow by zone, optimal drilling and completion procedures, and provide additional wells for delivery of crude CO<sub>2</sub> to the Reliant Processing Ltd. liquids plant located within the Project field. This development/appraisal project will also test the recommendations provided by Cambrian Management, Ltd. who were retained by Ridgeway to establish drilling and completion practices for the future development of the Project.

The additional wells for the liquids plant should enable Reliant Processing to achieve their projected volume target of 500 liquid tons of CO<sub>2</sub> per day over the next eighteen months. At that time, the revenues from the liquids plant are anticipated to be sufficient to fund the annual lease rental payments and general and administrative expenses of Ridgeway on an ongoing basis. The ability of Ridgeway to be self-sustaining is a key step in the process of creating shareholder value.

The ability to achieve the projected volume target in the near term has been hampered by the delay in the undertaking of the development/appraisal project by the Company and by technical issues at the liquids plant related to the processing facilities. The plant has been shut down since July 2003 while Reliant determined how to modify their processing facilities to deal with a non-CO<sub>2</sub> element. The Company is optimistic that the plant will begin operations again in the near future but there can be no assurance until Reliant resolves these issues.

While continuing to develop the Project, the Company's objective is to monetize this asset and thereby create value for our shareholders. As part of this process, the Company retained the investment banking firm of Petrie Parkman & Co. (Houston, Denver, London England) in September 2003 to render financial, valuation and other investment firm services to the Company, as it explores strategic alternatives toward reaching its stated objective of enhancing shareholder value. Since that time, the Company has been working very closely with Petrie Parkman in assessing a number of alternatives. Several potential transaction candidates have been identified and a number of meetings have been held in this regard. This ongoing process is extremely time consuming recognizing both the complexity and size of our Project.

### *Liquidity and Capital Resources*

At March 31, 2004, the Company had working capital of \$1,339,218.

Ridgeway has demonstrated the ability to raise the necessary capital, as it is required. As the Company does not believe its current share price reflects the value of the Company, each recent financing has been relatively modest in order to minimize the impact of the dilution on existing shareholders.

The Company has spent sufficient funds to establish size and value of the St. Johns Helium/CO<sub>2</sub> Project. The Company's financial objective is to have adequate funds available to maintain the lease position and to pay the general and administrative expenses while efforts continue to monetize the asset.

The Company will continue to require additional funds. Ridgeway believes that it has access to sufficient equity capital to maintain the asset during this period. In addition, there are common share purchase warrants and incentive stock options outstanding, which when exercised, could provide funds of approximately \$10.6 million. If the Company is unable to raise sufficient funds, there is a risk of a number of leases expiring with a corresponding reduction in the value of the asset.

To date, all of the Company's fundings have been done in Canadian dollars. However, as the Company's major asset is located in the United States, the majority of its operations are conducted in U.S. dollars. This has resulted in the Company being exposed to the impact of a fluctuating Canadian dollar. Ultimately, it is the Company's objective to obtain U.S. funding and thereby reduce the foreign exchange exposure.

The Company has raised approximately \$4.0 million in 2003 and to date in 2004 through a combination of the exercise of a number of employee stock options and common share purchase warrants, private placements and the Short Form Offering which closed in October 2003.

### *Changes in Accounting Policies including Initial Adoption*

The Company retroactively adopted two new accounting standards on the date of required adoption, January 1, 2004.

The Company retroactively adopted the new accounting standard relating to asset retirement obligations. This new standard requires liability recognition for retirement obligations associated tangible long-lived assets, such as well sites. The obligations within the scope of this standard are those for which the Company faces a legal obligation for settlement (or has made promissory estoppel). The initial measurement of the asset retirement obligation is at fair value, defined as "the price that an entity would have to pay a willing third party of comparable credit rating to assume the liability in a current transaction other than in a forced or liquidation sale." The asset retirement cost, equal to the estimated fair value of the asset retirement obligation, is capitalized as part of the cost of the related long-lived asset. Amortization of asset retirement costs are included in depletion expense on the consolidated statement of operations. Increases in the asset retirement obligation resulting from the passage of time are recorded as accretion of asset retirement obligation in the consolidated statement of operations. Actual expenditures incurred are charged against the accumulated obligation. Upon adoption, all prior periods have been restated for this change in accounting policy. The change results in an increase in the net

loss of \$4,982 for the quarter ended March 31, 2004 (2003--\$4,510). The effect of this change on the December 31, 2003 Consolidated Balance Sheet is an increase in Resource Properties, net of \$130,261 and an increase in the Deficit of \$88,200.

The Company retroactively adopted the new accounting standard relating to stock-based compensation. Under the new standard, the Company records compensation expense in the Consolidated Financial Statements for stock options granted to directors and employees using the fair value method. Fair values are determined using the Black-Scholes option-pricing model. The Company previously accounted for its stock-based compensation plans using the intrinsic-value method whereby no costs were recognized in the consolidated financial statements. Upon adoption of this new standard, all prior periods have been restated for this change in accounting policy. The effect of the new standard on the December 31, 2002 balance sheet for stock options granted during 2002 was to increase contributed surplus by \$1,034,292 and to increase the deficit by the same amount. The effect of the new standard on the December 31, 2003 balance sheet for stock options granted during 2003 was to increase contributed surplus by an additional 1,282,226 and to increase the deficit by the same amount. The effect of the new standard on the results of operations for the quarter ended March 31, 2004 was to increase the loss and contributed surplus by a further \$310,000.

The fair value of each option granted in 2004 was estimated on the date of grant using the Black-Scholes option-pricing model with the following assumptions: risk free interest rate--2.5%, expected lives (years)--2.0, expected volatility--0.715. The grant-date fair value of the options granted during the period ended March 31, 2004 was \$1.24 per option.

#### *Results of Operations*

##### *Quarter Ended March 31, 2004 and 2003*

The Company incurred a net loss of \$661,774 for the quarter ended March 31, 2004 compared to a net loss of \$352,040 during the same period in 2003.

The primary reason for the increase in the loss in 2004 relates to the stock-based compensation expense of \$310,000 reflecting the grant of stock options in this quarter. See "Changes in Accounting Policies including Initial Adoption" described above.

There are a number of other factors which essentially are offsetting.

Adversely impacting the current quarter is the shut down of the liquids plant described above along with a corresponding reduction in depletion expense. The increase in other professional expense reflects, in part, the retention of Petrie Parkman & Co., an investment banking firm also described above.

On the positive side, there are reductions in the expenses of legal, travel, promotion and wages and salaries. In 2003, the increase in promotion and travel reflected the Company's efforts to raise the profile of the Ridgeway, broaden the shareholder base and facilitate the raising of additional capital. These activities included a number of meetings and presentations to the investment community in both Europe and the United States. In 2003, legal included fees related to contractual negotiations as well as private placements. The decrease in wages and salaries reflected a reduction in staffing levels.

An additional factor influencing the results for both periods is the continued fluctuation of the Canadian dollar relative to the United States dollar. Over one half of the operating expenses and virtually all of the capital expenditures are paid in United States dollars which to date have been funded in Canadian dollars. For the first time in several years, the Canadian dollar has continued to strengthen rather than weaken on a period over period basis.

The level of activity continues to be consistent with the Company having established the size and value of the Project. The Company has sufficient resources to continue the development of the project and will utilize consultants, as required.

Further losses will be incurred during this development stage of the St. Johns Helium/CO<sub>2</sub> Project. Profitability will not occur until the Project is fully developed and Helium and/or CO<sub>2</sub> is flowing to markets.

Resource property expenditures were \$312,930 in the period 2004 compared to \$345,256 in the prior period, all of which were attributable to the St. Johns Helium/CO<sub>2</sub> Project.

#### *Results of Operations*

##### *Quarter Ended March 31, 2003 and 2002*

During the quarter ended March 31, 2003, the Company incurred a net loss of \$352,040 compared to a net loss of \$847,786 during the same period in 2002.

There are number of activities that account for the decrease in the loss for the year. The primary reason for the decrease relates to the stock-based compensation expense in 2002 of \$564,550 reflecting the grant of stock options in that quarter. See "changes in Accounting Policies including Initial Adoption" described above.

On the positive side, the results for the year include the revenues from the initial production and sale of crude CO<sub>2</sub> to the Reliant Processing liquids plant, which commenced operations in early July of 2002. The related depletion expense is based on the unit of production method, using the estimated volumes of gas to be produced during the twenty-year contract to provide crude CO<sub>2</sub> to the liquids plant.

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The increase in legal in 2003 includes fees related to contractual negotiations as well as the private placements.

An additional factor influencing the results for both periods is the continued fluctuation of the Canadian dollar relative to the United States dollar. Over one half of the operating expenses and virtually all of the capital expenditures are paid in United States dollars which to date have been funded in Canadian dollars. For the first time in several years, the Canadian dollar has strengthened rather than weakened on a period over period basis.

Resource property expenditures were \$345,256 in the first quarter of 2003 compared to \$344,769 in the first quarter of 2002, all of which were attributable to the St. Johns Helium/CO<sub>2</sub> Project.

Quarterly financial data for each of the eight most recently completed quarters is provided below. Variations from quarter to quarter primarily reflect the retroactive adoption of accounting policies described above, particularly "stock-based compensation".

	2004 First	2003 First	2003 Second	2003 Third	2003 Fourth	2002 First	2002 Second	2002 Third
Revenues	\$957	\$45,854	\$45,642	\$1,917	\$893	\$519	\$664	\$69,963
Loss before discontinued items	\$661,774	\$352,040	\$389,014	\$1,611,006	\$390,135	\$847,786	\$949,329	\$291,925
Loss per common share	\$0.02	\$0.01	\$0.01	\$0.04	\$0.01	\$0.02	\$0.03	\$0.01
Loss per fully diluted common share	\$0.02	\$0.01	\$0.01	\$0.04	\$0.01	\$0.02	\$0.03	\$0.01
Net loss	\$661,774	\$352,040	\$389,014	\$1,611,006	\$390,135	\$847,786	\$949,329	\$291,925
Net loss per common share	\$0.02	\$0.01	\$0.01	\$0.04	\$0.01	\$0.02	\$0.03	\$0.01
Net loss per fully diluted common share	\$0.02	\$0.01	\$0.01	\$0.04	\$0.01	\$0.02	\$0.03	\$0.01

Additional information related to Ridgeway, including its Annual Information Form, is on SEDAR at [www.sedar.com](http://www.sedar.com).

#### *Outstanding Share Data*

The following outstanding share data is as of April 30, 2004.

#### Share Capital

Authorized capital	
Preference Shares	25,000,000
Common Shares	100,000,000

Issued and outstanding  
 Preference Shares  
 Common Shares

1,000  
 39,639,901

Warrants Outstanding

Number of Share Purchase Warrants	Exercise Price	Expiry Date
105,500	\$2.25	May 16, 2005
89,500	\$2.25	June 17, 2005
403,332	\$2.45	September 5, 2005
280,000	\$2.35	October 31, 2004

Options Outstanding

Number of Shares	Exercise Price	Expiry Date
1,185,000	\$1.80	November 1, 2004
100,000	\$2.90	January 23, 2005
200,000	\$2.95	May 23, 2005
75,000	\$3.00	June 25, 2005
250,000	\$3.30	February 9, 2006
1,745,000	\$2.45	August 11, 2006

*Potential Risks and Uncertainties*

The resource industry is highly competitive and, in addition, exposes the Company to a number of risks. Resource exploration and development involves a high degree of risk, which even a combination of experience, knowledge and careful evaluation may not be able to overcome. It is also highly capital intensive and the ability to complete a development project may be dependent on the Company's ability to raise additional capital. In certain cases, this may be achieved only through joint ventures or other relationships, which would reduce the Company's ownership interest in the project. There is no assurance that development operations will prove successful.

In addition to the risks and uncertainties identified above, this Management's Discussion and Analysis contains several forward-looking statements, which are also subject to unknown and uncertain risks, uncertainties and other factors that could cause actual results to differ materially from any future results expressed or implied by such forward-looking statements. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date hereof, and should be aware the Company is under no obligation to publicly release any revisions to these forward-looking statements to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events.