

# **Ridgeway Petroleum Corp.**

**FORM 51-102F1**

**MANAGEMENT'S DISCUSSION & ANALYSIS**

**ANNUAL PERIOD ENDED DECEMBER 31, 2005**

April, 2006

### *Overview*

Ridgeway Petroleum Corp. ("Ridgeway" or the "Company") is principally engaged in the business of appraisal and development of its helium and carbon dioxide ("CO<sub>2</sub>") project (the "St. Johns Helium/CO<sub>2</sub> Project" or the "Project") in eastern Arizona and western New Mexico. To date, the Company has spent approximately \$41,500,000 in acquiring, exploring and appraising the St. Johns Helium/CO<sub>2</sub> Project. The Company currently owns a 100% working interest in leases covering approximately 200,000 acres and continuously manages its lease position to optimize its land position within the Project.

### *General*

Management's Discussion and Analysis relating to the consolidated financial statements for the year ended December 31, 2005 and 2004 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 equity financings for gross proceeds of approximately \$36.0 million including proceeds from the subsequent exercise of common share purchase warrants issued in conjunction with such financings. In addition, a further \$2.3 million has been raised through the exercise of incentive stock options.

To date, Ridgeway has expended most of the proceeds on the drilling of nineteen 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 potentially a world class asset.

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

In 2004, the Company completed the drilling of the 11-18 helium/CO<sub>2</sub> well. Initial test results reported that the deepest known productive zone has a helium content of approximately 0.575 percent. These results are significantly higher than the helium composition in either of the two wells previously tested in this zone. Notwithstanding the technical difficulties associated with this well, the initial results were positive. Further testing of the well will be deferred until such time as additional wells are drilled.

In February 2005, the Board of Directors of the Company announced the appointment of Barry D. Lasker as Director, President and CEO. Mr. Lasker is located in Houston, Texas where a new office has been established. Mr. Lasker replaced Walter B. Ruck, who announced his intended resignation as President in December 2004 pending appointment of his successor. Mr. Ruck was the founding shareholder of the Company in 1980 and remained as a Director and Chairman of the Board until his sudden passing in July 2005. In late July, Rodney L. Eson was appointed Chairman of the Company.

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, in September 2003, the Company retained the investment banking firm of Petrie Parkman & Co. to render financial, valuation and other investment firm services to the Company. Since that time, the Company worked very closely with Petrie Parkman in assessing a number of alternatives. Several potential transaction candidates were identified and a number of meetings were held in this regard. This process was extremely time consuming recognizing both the complexity and size of our Project. Over the last few months, the Company has come to the conclusion that in order to maximize the value of the asset, it must go it alone to further define the size and productive capabilities of the Field. As a result of this change in strategy, Petrie Parkman is no longer being retained. The Company will however, continue to selectively explore partnership opportunities which could assist in achieving the longer term objective of full field development described below.

On the development side, the key strategic goal for 2006/2007 is for the Company to become cash flow positive. With this in mind, the Board, in principle, approved the design, construction and implementation of a helium and CO<sub>2</sub> plant with productive capacity of 25 million cubic feet of raw gas per day. The production from this plant will allow the Company to gain extensive data regarding well deliverability, gas composition and pressures and the extent of the field while providing sufficient cash flow to cover expenses and corporate overhead. At the same time, the required drilling program would be expected to establish 2 to 3 trillion cubic feet of recoverable gas that would underpin a resource base capable of providing a minimum of 250 million cubic feet per day of CO<sub>2</sub> to enhanced oil recovery ("EOR") projects in the Permian Basin of West Texas or, potentially, into California.

At the Field level, a technical review of our 2006 proposed well locations and a drilling plan have been completed. In March 2006, the Company announced that it has closed the purchase of an air drilling rig capable of drilling to basement. The rig is currently in Nowata, Oklahoma where it will be upgraded to satisfy the specific drilling requirements of the St. Johns Field. In addition, the Company has also completed the purchase of 90 joints of drill pipe that will be used for the upcoming drilling program. The purchase of this rig is an important step towards accelerating the proposed 15 well drilling program that is expected to begin later this summer. With the current tightness in the drilling and service industries, the purchase of this rig will enable the Company to be more aggressive in the size and timing of this year's drilling program. It will also be a more cost effective operation in the long run due to the lower day rates and mobilization and demobilization charges associated with the direct ownership of the drilling rig.

In the first quarter of 2006, the Company reapplied for several leases covering approximately 63,000 acres that had reached their ten year expiry date. While the Company is confident it will be successful in reacquiring most of these leases, there were a number of groups involved in this process. The results of the applications are expected early in the second quarter. While there is a risk of losing some leases, the Company still controls an overwhelming land position within the Field. The Company was the sole applicant for an additional 19,000 acres of leases around a previous well that could contain significant, additional gas in place and will also be a target during our 2006 drilling program.

In October 2005, the Company announced that it had acquired additional leases totaling approximately 17,200 acres within the central field area of the St. Johns Helium and CO<sub>2</sub> Project. This acreage is strategically located along the crestal portion of the field, and, based on offsetting well control, is expected to contain thick sequences of gas bearing reservoirs. The addition of this acreage solidifies the Company's land position and is expected to facilitate future appraisal activity and Unit agreement negotiations

Over the past several months, there have been discussions with pipeline companies regarding the possible construction of a pipeline into California and into the Permian Basin. While nothing definitive has occurred to date, discussions are progressing positively. Also on the pipeline front, a firm of consulting engineers has been retained to provide cost estimates, to design and to identify a suitable route for a 300 mile pipeline to deliver gas to the Permian Basin.

A key long term goal is the securing of gas contracts for the sale of CO<sub>2</sub> in the EOR 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 providing their current and long-term needs. With oil prices well above U.S.\$40 per barrel the incentive for additional CO<sub>2</sub> flooding is increasing and demand for CO<sub>2</sub> is growing by the day. The most recent meetings with several EOR participants have been very encouraging, not only for Ridgeway but for the EOR industry in general.

In the longer term, the full field development plan contemplates the appraisal of the field including the drilling of additional wells, adding any necessary field compression and installing gathering pipelines, the construction and operation of a full scale helium processing plant and related facilities and construction and operation of a CO<sub>2</sub> pipeline to customers in the Permian Basin of West Texas or, potentially, into California.

The Company had previously anticipated that, by now, Reliant Processing would have achieved their projected volume target of 500 liquid tons of CO<sub>2</sub> per day from their liquids plant. However, in July 2003, Reliant shut down production from the plant. In the second quarter of 2005, the Company was notified by Reliant of their intent to arbitrate a contractual dispute between the two organizations pursuant to which Reliant is claiming unliquidated damages. The Company believed this claim was without merit and instructed its U.S. counsel to vigorously defend the matter. During April 2006, Reliant and the Company negotiated a settlement agreement whereby Ridgeway has agreed to drill a new well, at a mutually agreed location, that could potentially be used as a replacement to the original well and be made available to Reliant to process the gas stream through the Reliant plant. The final settlement documents are anticipated to be signed shortly.

### *Liquidity and Capital Resources*

At December 31, 2005, the Company had a working capital deficit of \$621,427.

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 dilution on existing shareholders.

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 \$10.3 million.

To date, all of the Company's equity 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 \$2.0 million in 2005 through a combination of private placements and the exercise of common share purchase warrants.

In the first quarter of 2005, the Company completed a debenture placement of \$500,000. The debenture paid interest at 12% per annum and was for a term of four months. In addition, 125,000 shares of the Company were issued to the lender that were subject to a four-month hold period. In the second quarter, the Company repaid the debenture, prior to its maturity, from the proceeds of a private placement.

In the second quarter of 2005, the Company completed a 1,430,266 unit private placement at \$0.80 per unit for aggregate proceeds of approximately \$1,144,213. Each unit comprised one share of the company and one quarter non-transferable share purchase warrant. Each whole warrant will entitle the holder to purchase one additional share of the Company at a price of \$1.00 per share for one year from the date of the closing of the private placement.

Also in the second quarter of 2005, the Company completed another private placement of 760,872 units at a price of \$1.15 per unit for aggregate proceeds of approximately \$875,000. Each unit comprised one share of the Company and three quarters of one whole non-transferable share purchase warrant. Each whole warrant will entitle the holder to purchase one share of the Company at a price of \$1.30 per share for one year from the date of the closing of the private placement.

In the third quarter, the Company arranged interim unsecured debt financing of U.S.\$500,000 due March 31, 2006 and bearing interest at 10% per annum. These funds provided the Company with sufficient liquidity to determine the ultimate capital and financing requirements for attaining the Company's goal of becoming cash flow positive in 2006/2007. By agreement dated March 31, 2006 the U.S.\$500,000 unsecured debt financing has been extended for a period of up to 3 months and will require 3 monthly payments of US\$166,667 by June 30, 2006.

In October 2005, the Company extended the expiry date to May 5, 2006, of 1,009,000 outstanding non-transferable share purchase warrants issued on November 5, 2004. Each warrant entitles the purchase of one common share of the Company at a price of \$1.00 per share.

In November 2005, the Company announced that it has retained the securities brokerage firm of Coker, Palmer, Phillips & Mullen ("CPPM") as the managing dealer of a proposed placement of U.S.\$10 million to U.S.\$20 million of Convertible Preference Shares of the Company.

CPPM was retained on a "best efforts" basis. It is anticipated that the transaction will be done in the form of a private placement for accredited investors only. The terms and conditions of this proposed financing will be finalized upon the placement of these securities.

The proceeds of this placement will be used to implement the Company's strategic goal of becoming cash flow positive in 2006 as described above

In December 2005, the Company announced a senior secured note placement of US\$2,000,000. The note bears interest at 1 1/2% per month, has a twelve month term and will mature on December 23, 2006. The note is secured by a floating charge on the assets of a wholly-owned subsidiary. The Company has the right to repay the note prior to maturity without penalty. 1,000,000 non-transferable warrants of the Company ("Warrants") were granted to the lender. Each Warrant entitles the holder to purchase one share of the Company at a price of Cdn\$0.50 per share until the maturity date of the note. The Company also paid a finder's fee of US\$100,000 and 60,000 Warrants in connection with this financing. It is anticipated that this interim financing will be repaid from the proceeds of the placement described above.

This interim financing will allow the Company to continue with the previously announced US\$20 million financing. To date, the Company has made presentations to various interested parties and several parties have expressed an interest in participating. It is anticipated that the larger financing will now be completed in the second quarter of 2006.

In April 2006, the Company extended the expiry date:

- From April 14, 2006 to April 13, 2007, of 357,566 outstanding non-transferable share purchase warrants issued on April 14, 2005. Each warrant entitles the purchase of one common share of the Company at a price of \$1.00 per share.

- From May 4, 2006 to May 4, 2007, of 570,654 outstanding non-transferable share purchase warrants issued on May 4, 2005. Each warrant entitles the purchase of one common share of the Company at a price of \$1.30 per share.
- From May 5, 2006 to November 3, 2006, of 1,009,000 outstanding non-transferable share purchase warrants issued on November 5, 2004. Each warrant entitles the purchase of one common share of the Company at a price of \$1.00 per share. The expiry of these warrants had been previously extended from November 7, 2005 to May 5, 2006.

### *Results of Operations*

#### *Year Ended December 31, 2005 and 2004*

The Company incurred a net loss of \$2,493,939 for the year ended December 31, 2005 compared to a net loss of \$2,178,541 during the same period in 2004.

The increase in the loss in the current period is the result of a number of factors.

In 2004, the Company received proceeds from the settlement of a lawsuit.

In 2005, there were increases in interest and financing, legal and wages and salaries. There were also reductions in stock-based compensation and consulting fees.

Interest and financing includes the costs related to the debenture financing in the first quarter and the promissory note placed in the third quarter. Legal includes fees related to contractual reviews, assessments, arbitration and other corporate activities. Wages and salaries reflect the addition of the new President and CEO, partially offset by the appointment of a non-salaried Chairman following the passing of Walter B. Ruck in July.

The reduction in consulting fees reflects the termination of the contact with Petrie Parkman following the Company's conclusion that in order to maximize the value of the asset, it must go it alone to further define the size and productive capabilities of the Project. This reduction was partially offset by costs incurred for updated reservoir evaluations and related geological and oil field studies as well as the costs of concluding a contractor arrangement.

An additional factor influencing the results for both periods is the continuing 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 primarily been funded in Canadian dollars. Over the past three years, the Canadian dollar has gradually strengthened.

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 further developed and Helium and/or CO<sub>2</sub> is flowing to markets.

Resource property expenditures were \$710,761 in 2005 compared to \$1,959,247 in the prior period, all of which were attributable to the St. Johns Helium/CO<sub>2</sub> Project. The drilling and testing of the 11-18 helium/CO<sub>2</sub> well described above accounts for the higher costs in 2004.

#### *Results of Operations*

*Year Ended December 31, 2004 and 2003*

The Company incurred a net loss of \$2,178,541 for the year ended December 31, 2004 compared to a net loss of \$2,742,195 during the same period in 2003.

Excluding the stock-based compensation expense of \$798,100 in 2004 and \$1,282,226 in 2003, the respective losses are comparable. The stock-based compensation expense reflects the grant of stock options in each period.

While the loss for each period is essentially the same, there are a number of other factors which essentially are offsetting.

On the positive side, there are reductions in the expenses of legal, travel and wages and salaries as well as proceeds received in the settlement of a lawsuit. In 2003, legal included fees related to contractual negotiations as well as private placements. Also in 2003, travel reflected the costs of the Company's effort to raise the profile of the Company, 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. The decrease in wages and salaries resulted from a reduction in staffing levels partially offset by an assessment for employee benefits and other deductions related to a prior period in the U.S. operations.

Adversely impacting the current period is the shut down of the liquids plant described above partially offset by a reduction in the related depletion expense. The increase in other professional expense reflects, in part, the retention of Petrie Parkman & Co., an investment-banking firm also described above as well as the costs of engineering design work related to the project.

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. After strengthening for several prior quarters, the Canadian dollar weakened in the first two quarters of 2004 and then rebounded in the third quarter.

Resource property expenditures were \$2,368,446 in 2004 compared to \$734,928 in the prior year, all of which were attributable to the St. Johns Helium/CO<sub>2</sub> Project. The drilling and testing of the 11-18 helium/CO<sub>2</sub> well described above accounts for the increase in expenditures in 2004.

Quarterly financial data for each of the eight most recently completed quarters is provided below. Variations from quarter to quarter reflect the timing of the revenues and expenses noted above with the largest variable being stock-based compensation.

	2005 Fourth	2005 Third	2005 Second	2005 First	2004 Fourth	2004 Third	2004 Second	2004 First
Revenues	\$1,619	\$4,416	\$1,068	\$145	\$8,969	\$599	\$100,351	\$957
Loss before discontinued items	\$525,748	\$460,871	\$904,095	\$603,225	\$818,362	\$391,781	\$306,624	\$661,774
Loss per common share	\$0.01	\$0.01	\$0.03	\$0.01	\$0.01	\$0.01	\$0.01	\$0.02
Loss per fully diluted common share	\$0.01	\$0.01	\$0.03	\$0.01	\$0.01	\$0.01	\$0.01	\$0.02
Net loss	\$525,748	\$460,871	\$904,095	\$603,225	\$818,362	\$391,781	\$306,624	\$661,774
Net loss per common share	\$0.01	\$0.01	\$0.03	\$0.01	\$0.01	\$0.01	\$0.01	\$0.02
Net loss per fully diluted common share	\$0.01	\$0.01	\$0.03	\$0.01	\$0.01	\$0.01	\$0.01	\$0.02

Additional information related to Ridgeway is on SEDAR at [www.sedar.com](http://www.sedar.com).

#### *Outstanding Share Data*

The following outstanding share data is as of April 25, 2006.

#### Share Capital

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

Issued and outstanding	
Preference Shares	1,000
Common Shares	43,501,993

#### Warrants Outstanding

Number of Share Purchase Warrants	Exercise Price	Expiry Date
357,566	\$1.00	April 13, 2007
570,654	\$1.30	May 4, 2007
1,009,000	\$1.00	November 3, 2006
480,954	\$2.00	July 24, 2006
1,060,000	\$0.50	December 23, 2006

#### Options Outstanding

Number of Options	Exercise Price	Expiry Date
1,500,000	\$2.45	August 11, 2006
1,465,000	\$1.00	November 2, 2007
300,000	\$1.00	February 21, 2010
400,000	\$1.05	April 21, 2010
50,000	\$1.03	June 1, 2010
100,000	\$0.95	July 26, 2010
260,000	\$0.60	December 28, 2010

#### ***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.