



QUARTERLY REPORT TO THE SHAREHOLDERS FOR THE THREE MONTHS ENDED MARCH 31, 2004

Fairborne reports Q1 results — record activity levels yield strong results

H I G H L I G H T S

		Three Months Ended March 31		Percent
		2004	2003	Change
Financial	<i>(\$ thousands, except per share amounts)</i>		<i>(restated)</i>	
	Gross revenue	18,429	9,531	93
	Funds generated from operations	9,963	5,701	75
	Per share - basic	0.31	0.29	7
	Per share - diluted	0.28	0.29	(3)
	Net Earnings	3,295	2,222	48
	Per share - basic	0.10	0.11	(9)
	Per share - diluted	0.09	0.11	(18)
	Capital expenditures	19,133	4,601	316
	West Pembina/Brazeau acquisition	115,876	—	n/a
	Net debt	90,870	—	n/a
Operating	<i>(Units as noted)</i>			
	Production			
	Crude oil (bbls/d)	1,956	1,497	31
	Natural gas liquids (bbls/d)	139	162	(14)
	Natural gas (mcf/d)	17,853	5,596	219
	Total production (boe/d @ 6:1)	5,071	2,592	96
	Average sales price			
	Crude oil (\$/bbl)	39.92	40.62	(2)
	Natural gas liquids (\$/bbl)	43.35	41.41	5
	Natural gas (\$/mcf)	6.58	6.77	(3)
	Netback per boe (6:1) (\$)			
	Petroleum and natural gas sales	39.98	40.90	(2)
	Royalties	9.15	7.14	28
	Operating expenses	6.38	7.08	(10)
	Operating netback	24.45	26.68	(8)

A C C O M P L I S H M E N T S

- Purchased operated oil, natural gas and NGL properties located in the West Pembina/Brazeau area of west central Alberta for a total consideration of \$115.9 million including asset retirement obligations of \$4.7 million. This acquisition adds approximately 3,600 BOE per day and 96,000 net acres of undeveloped land.
- Closed a private placement of 6,178,000 Subscription Receipts, at a price of \$6.65 each, for net proceeds of \$38.9 million.
- Flow tested an exploratory well at Wild River at various rates up to a maximum of 14.2 Mmcf per day at a flowing wellhead pressure of 3,700 psi.
- Drilled a total of 42 (29.3 net) wells which resulted in 2 (2.0 net) crude oil wells, 36 (24.3 net) natural gas wells and 4 (3.0 net) wells were dry and abandoned for an overall success rate of 90 percent and an average working interest of 70%.
- Established a production base of 41% light crude oil and NGL and 59% natural gas with production averaging 2,095 barrels per day of crude oil and natural gas liquids (“NGL”) and 17.9 million cubic feet (“Mmcf”) per day of natural gas resulting in a total of 5,071 BOE per day. This production base has increased with the acquisition of the West Pembina assets with the percentage of natural gas moving upward.

R E P O R T T O S H A R E H O L D E R S

Fairborne Energy Ltd. (“Fairborne” or “Company”) is pleased to present the results of its operations for the first three months of 2004. The first quarter of 2004 saw significant changes in Fairborne’s size and level of operations. Fairborne focused the majority of its first quarter capital program on drilling and will see the production benefit from these wells begin in the second quarter. In addition, a significant acquisition was completed in the first quarter which provides the Company with the advantage of an increased production base and a large undeveloped land base to aggressively pursue new drilling opportunities.

On February 8, 2004, the Company entered into a purchase and sale agreement to purchase operated oil, natural gas and NGL properties located in the West Pembina/Brazeau area of west central Alberta for a total consideration of \$115.9 million. This acquisition closed on March 31, 2004 and the result of operations from these properties will be included in Fairborne’s operations commencing April 1, 2004.

In conjunction with the purchase, on February 27, 2004 Fairborne closed a private placement of 6,178,000 Subscription Receipts, at a price of \$6.65 each, for net proceeds of \$38.9 million. The Subscription Receipts were converted into

common shares on a one-for-one basis in connection with the acquisition of the West Pembina/Brazeau properties. The proceeds from this issue together with increasing the available bank lines to \$85 million funded the acquisition.

Fairborne originally budgeted \$40 million for its 2004 capital program but available opportunities are substantially in excess of this amount. The capital program has been increased to \$70 million for the year, not including the West Pembina/Brazeau acquisition, and will be funded by additional funds generated from operations from the acquisition. The total capital program for the remaining nine months of the year is \$50 million and will be split approximately \$12 million to land, seismic and exploration, \$30 million to development and exploitation and \$8 million for related facilities.

Current production is approximately 8,150 BOE per day not including 600 BOE per day at Bassett Lake which is expected to be back on production within seven days following production facilities modifications. At West Pembina, repairs to the sulphur plant are largely completed and 325 BOE per day will return to production over the next several days. The Company also has 900 BOE per day tested and behind pipe and anticipates this production to be on stream within 60 to 90 days.

PROPERTY REVIEW

Central Alberta:

At Clive, there were 10 wells drilled and completed for coal bed methane in the Edmonton (Horseshoe Canyon Zone) group. There are currently five of these wells on production at a total of 540 Mcf/day. The Company is awaiting the processing of the holding applications required to start a larger scale development program. In the summer and early fall the Company plans to license between 25 and 50 wells in the first phase of development as well as pipelines required to connect the wells to our existing shallow gas pipeline system. The Company also plans to drill several infill locations in the Clive Unit during the last half of 2004. Two Nisku exploration tests are licensed and will be drilled after break-up at Wood River.

At Westeros there was one shallow sweet gas well in the Edmonton zone drilled in the first quarter. In February, the first sweet well in this area came on-stream. The well has been brought on-stream at a reduced rate due to temporary processing constraints. In the late spring or early summer the Company plans on drilling an additional 3 wells for sweet gas in the Basal Quartz.

Bassett Lake Area:

Bassett Lake is a winter access only area located in northern Alberta. Fairborne drilled 20 wells in this area this winter, 18 successful gas wells in the Bluesky, one D&A well and one water injection well. Five wells were drilled in the winter of 2003 (four cased gas wells and one dry hole). In the first quarter of 2004, 22 wells were connected for production. Compression and water disposal and pipeline facilities were completed. Production will commence in late May at approximately 5 MMcf per day. The start up date is later than anticipated by approximately six weeks as the Company installs facilities to handle a small amount of hydrocarbon liquids that were not anticipated but were present during the initial production testing.

Peace River Arch Area:

There were 5 sweet gas wells drilled at Rycroft in the first quarter of 2004. Expansion of the Rycroft facility is required and will be completed this summer in order to bring the successful wells on production. The Company drilled a

successful exploration well on a farm-in block just south of Rycroft and will be drilling the first two option wells after break-up.

At Gordondale, a new pool is being developed by the Company that already includes eight wells that will be able to produce approximately 500 BOE per day, net to Fairborne's interest. These wells all contain sour gas and production will likely be delayed for 6 to 9 months as regulatory requirements are fulfilled and pipeline and processing facilities are completed.

Deep Basin Area:

Three larger gas potential, deeper plays were drilled during the quarter and resulted in a gas discovery at Wild River, a suspended Gold Creek well and a potential gas well from uphole targets at Chambers (the primary deep zone was not productive). During the quarter, the Wild River exploration well tested 14 Mmcf/d at 3,700 psi flowing pressure. Fairborne will retain a 50% working interest in this well which is scheduled to commence production in the early fall.

Included in the West Pembina acquisition, numerous exploration opportunities have been identified for drilling during 2004 and into 2005.

West Pembina/Brazeau Area:

The West Pembina acquisition closed March 31, 2004 and includes 3,600 BOE per day of production and significant workover/development opportunities and exploration inventory. The acquisition also included 96,000 net acres of undeveloped land. Numerous workovers have been identified in the Belly River formation and drilling will commence after break-up on several deeper Nisku targets. The Company has purchased approximately 1,900 square kilometers of 3D seismic over these lands and is currently evaluating this data.



Richard A. Walls

May 11, 2004



MANAGEMENT DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following Management Discussion and Analysis of Financial Condition and Results of Operations (“MD&A”) is provided by the management of Fairborne Energy Ltd. (“Fairborne” or the “Company”) to review first quarter 2004 activities and the results as compared to the previous period. This MD&A should be read in conjunction with the unaudited consolidated interim financial statements for the three months ended March 31, 2004 and 2003 and the audited consolidated financial statements for the year ended December 31, 2003.

Fairborne is a publicly traded company with its head office in Calgary and is engaged in the business of acquiring crude oil and natural gas properties and exploring for, developing and producing crude oil and natural gas in Western Canada. The Company uses a strategy to balance risk and reward by focusing on opportunities by geographic area and prospect type using a portfolio approach to exploration and development expenditures. The Company was incorporated as a private company in early 2002 and in June, 2002 commenced active operations.

Per barrel of oil equivalent (“BOE”) amounts may be misleading, particularly if used in isolation. A BOE conversion ratio has been calculated using a conversion rate of six thousand cubic feet of natural gas to one barrel and is based on an energy equivalent conversion method application at the burner tip and does not represent an economic value equivalency at the wellhead.

This MD&A contains forward-looking statements. Forward-looking statements are based on current expectation that involve a number of risks and uncertainties which could cause events or results to differ materially from those reflected in the MD&A. Forward-looking statements are based on the estimates and opinions of Fairborne’s management at the time the statements were made. Fairborne assumes no obligation to update forward-looking statements should circumstances or management’s estimates change.

This document contains the term “funds generated from operations”, which should not be considered as an alternative to, or more meaningful than cash flow from operating activities as determined in accordance with Canadian GAAP as an indicator of Fairborne’s performance. Fairborne’s determination of funds generated from operations may not be comparable to that reported by other companies. The reconciliation between net income and funds generated from operations can be found in the statement of cash flows in the financial statements. Fairborne also represents funds generated from operations per share whereby per share amounts are calculated using weighted average shares outstanding consistent with the calculation of income per share.

SIGNIFICANT ACCOUNTING POLICIES

Use of Estimates

The amounts for depletion, depreciation and amortization of petroleum and natural gas properties and equipment and the provision for future site restoration and abandonment costs are based on estimates. The ceiling test is based on estimates of proved reserves, production rates, oil and gas prices, future costs and other relevant assumptions. By their nature, these estimates are subject to measurement uncertainty and the effect on the financial statements of changes in such estimates in future periods could be significant.

Asset Retirement Obligations

The Company retroactively adopted the new accounting standard for asset retirement obligations at January 1, 2004. All existing reclamation and abandonment liabilities were reversed and the new standard was set up with prior years being restated. The asset retirement obligation was measured and recorded at fair market value with a corresponding increase in oil and gas properties. The asset retirement obligation increases over time with a corresponding accretion expense until the obligations are settled.

Full Cost Accounting for Oil and Gas

The Company adopted the revised full cost method of accounting for oil and gas as outlined in Accounting Guideline 16, which includes limiting the carrying value of oil and gas properties to their estimated fair value. The fair value is estimated to be the future cash flow from proved and probable reserves using future price forecasts and costs discounted at a risk-free rate. This differs from the prior ceiling test calculation that used undiscounted cash flows and constant prices, adjusted for general and administrative and financing costs.

SELECTED FINANCIAL INFORMATION

The following table sets forth selected financial information of the company for the period indicated:

	Three Months Ended March 31	
<i>(\$ thousands except per share amounts)</i>	2004	2003 <i>(restated)</i>
Petroleum and natural gas sales, before royalties	18,429	9,531
Funds generated from operations	9,963	5,701
Per share — basic	0.31	0.29
Per share — diluted	0.28	0.29
Net income	3,295	2,222
Per share — basic	0.10	0.11
Per share — diluted	0.09	0.11
Total assets	266,338	55,769
Long term debt including working capital	90,870	Nil

PRODUCTION

Crude oil and NGL production averaged 2,095 bbls/day and natural gas averaged 17.9 million cubic feet (“Mmcf”) per day for a total of 5,071 BOE/day for the quarter ended March 31, 2004. This compares favorably with the 2,592 BOE per day recorded in first three months of 2003 and represents a 96 percent increase in average production. In comparing the average volumes in the two periods, it is important to consider the effect of the acquisition of Pivotal Energy Ltd. (“Pivotal”) completed on July 2, 2003 which resulted in approximately a 50 percent increase in Fairborne’s productive capability at that time. The Pivotal acquisition and Fairborne’s drilling program have been more focused on adding additional volumes of natural gas and, as such, the production mix has moved from being 64 percent crude oil and NGL in the first three months of 2003 to 41 percent crude oil and NGL for the three months ended March 1, 2004. The West Pembina/Brazeau properties presently produce approximately 74 percent natural gas, which further strengthens Fairborne as a natural gas producer.

COMMODITY PRICES

Commodity prices for crude oil and NGL were consistent quarter over quarter. Fairborne’s crude oil and NGL price averaged \$40.15 per barrel during the first three months of 2004 compared to \$40.70 during the first three months of 2003.

Fairborne’s natural gas prices were consistent quarter over quarter. For the three months ended March 31, 2004 the natural gas price was \$6.58 and \$6.77 for the three months ended March 31, 2003. Commodity prices for crude oil and natural gas are both maintaining these high levels and the outlook for future prices is expected to be high by historical standards.

HEDGING ACTIVITIES

When Fairborne hedges oil and gas prices, the hedging strategy is intended to provide certainty to cash flow by fixing the price on a portion of the production portfolio. During the first three months of 2004, Fairborne hedged an average of 700 barrels per day (33 percent of total crude oil production) and 3.8 Mmcf per day (21 percent of natural gas production). Hedging activity in the first quarter reduced the crude oil price by \$2.27 per barrel and increased the natural gas price by \$0.07 per Mcf.

In addition, Fairborne has hedged U.S. \$965,000 of foreign exchange exposure at Cdn. \$1.3230 to U.S. \$1.00 (U.S. \$0.7559 to Cdn. \$1.00) and US\$1,039,000 of foreign exchange exposure at Cdn \$1.3468 to US \$1.00 (US \$0.7425 to Cdn \$1.00). At March 31, 2004 the estimated fair value of the foreign exchange contract is U.S. \$21,000 which represents the amount the Company would pay to terminate the contract at March 31, 2004.

PRODUCTION REVENUE

For the three months ended March 31, 2004, revenues increased 93 percent to \$18,429,000 from \$9,531,000 for the same period in 2003 due mainly to higher production volumes.

(\$ thousands except per unit)	Three Months Ended March 31			
	2004	\$/Unit	2003	\$/Unit
Natural gas	10,686	6.58	3,407	6.77
Oil and NGL	7,743	40.15	6,124	40.70
Total revenue	18,429	39.98	9,531	40.90

EXPENSES

Royalties consist of payments made to the Alberta government, freehold landowners and overriding royalty owners. Some of the Fairborne properties are located on freehold land on which royalty rates tend to be lower. As such, royalties totaled \$4,220,000 which is an overall royalty rate of 22.9 percent for the three months ended March 31, 2004. For the same period in 2003 royalties were \$1,665,000 and the royalty rate was 17.5 percent. The increase in the rate is due to the addition of the Pivotal properties which were not added until the third quarter of 2003. The royalty rate for the remainder of 2004 is expected to average about 23 percent and should remain constant with the addition of the West Pembina properties.

Fairborne operates in excess of 95 percent of its production and consequently maintains a higher degree of control over operating costs. On a BOE basis, operating costs were \$6.38 per BOE or \$2,940,000 in total during the three months ended March 31, 2004. For the same period in 2003 operating costs were \$7.08 per BOE or \$1,651,000. This is a decrease of 10 percent per BOE. For the remainder of 2004 operating costs are expected to average approximately \$6.00 per BOE. The addition of the West Pembina Brazeau properties should not appreciably change this rate.

During the first quarter of 2004, general and administrative expenses were \$1,138,000 or \$2.47 per BOE in comparison to the first quarter of 2003 whereby general and administrative costs were \$431,000 or \$1.85 per BOE. As the company grows and adds staff connected with the additional requirement of operating the West Pembina/Brazeau production, these costs will increase on an absolute basis but Fairborne does anticipate reducing these costs, on a BOE basis.

Interest for the three months ended March 31, 2004 increased to \$160,000 compared to \$65,000 during the same period in 2003. This increase is the result of higher average debt during the period compared to 2003.

Funds Generated from Operations and Net Income

(\$ thousands except per BOE)	Three Months Ended March 31			
	2004	\$/BOE	2003	\$/BOE
			<i>(restated)</i>	
Production revenue	18,429	39.98	9,531	40.90
Royalties	4,220	9.15	1,665	7.14
Net revenue	14,209	30.83	7,866	33.76
Operating expenses	2,940	6.38	1,651	7.08
Net operating income	11,269	24.45	6,215	26.68
General & administrative (Net of non-cash compensation expense)	1,065	2.31	431	1.85
Interest	160	0.35	65	0.28
Capital taxes	81	0.18	18	0.08
Funds generated from operations	9,963	21.61	5,701	24.47
Compensation expense	73	0.16	—	—
Depletion and depreciation	4,983	10.81	2,106	9.04
Accretion	136	0.30	113	0.48
Future income taxes	1,476	3.20	1,260	5.41
Net income	3,295	7.14	2,222	9.54

For the three months ended March 31, 2004, the depletion expense is \$10.81 per BOE and the accretion expense is \$0.30 per BOE. The depletion expense decreased on a BOE basis from the fourth quarter of 2004 due to positive reserve additions in the first quarter mostly related to the Wild River well. The depletion expense will increase, on a BOE basis, with the acquisition of the West Pembina/Brazeau properties. The magnitude of increases will be dependent on Fairborne's ability to efficiently add reserves on its properties.

Effective January 1, 2004, Fairborne retroactively adopted, with restatement of prior periods, a new accounting standard relating to asset retirement obligations. The effect of the adoption on income is presented below as increases (decreases):

Income Statement

<i>(\$ thousands)</i>	Three Month Period Ended March 31, 2004	Three Month Period Ended March 31, 2003	Year Ended December 31, 2003
Accretion expense	136	113	558
Depletion and depreciation on asset retirement costs	158	153	619
Future site restoration expense	(573)	(254)	(1,405)
Future income taxes	101	(5)	82
Net income impact	178	7	146

Fairborne's effective income tax rate is 32 percent consisting primarily of future income taxes. In 2004, Fairborne does not envision paying cash income taxes.

FUNDS GENERATED FROM OPERATIONS

The combination of production levels, commodity prices and expenses detailed above resulted in funds generated from operations of \$9,963,000 (\$0.31 per share) for the three months ended March 31, 2004. With present production levels at approximately 8,150 BOE per day and additional production of 1,825 BOE per day to be connected in the next 60 to 90 days, the level of funds generated should increase in the remaining nine months of 2004 with the inclusion of the West Pembina/Brazeau properties.

LIQUIDITY AND CAPITAL RESOURCES

Fairborne's capital program for the first three month of 2004 totaled \$130,345,000 including the acquisition of assets connected with the West Pembina/Brazeau acquisition as detailed in the following table:

Capital Expenditures

<i>(\$ thousands)</i>	Three Months Ended March 31	
	2004	2003
Exploration and development expenditures		
Land and lease acquisitions	1,596	186
Geological and geophysical	1,374	1,147
Drilling, completions and workovers	10,561	2,406
Well equipment and facilities	5,553	857
Corporate assets	49	5
	19,133	4,601
Acquisitions, net of dispositions		
Acquisitions	111,212	-
Dispositions	-	-
	111,212	4,601
	130,345	4,601

Expenditures for land and leases during the first quarter combined with the West Pembina/Brazeau acquisition resulted in Fairborne holding, at March 31, 2004, 239,102 net acres of undeveloped land with an average working interest of 65 percent. Drilling expenditures resulted in a total of 42 (29.3 net) wells drilled resulting in 2 (2.0 net) crude oil wells, 36 (24.3 net) natural gas wells and 4 (3.0 net) wells were dry and abandoned for an overall success rate of 90 percent. Fairborne operated all but one well in this program. The capital program was financed by funds generated from operations of \$9,963,000 and additional bank debt .

Fairborne has a revolving demand loan based on a borrowing base determined by the Company's bankers. In connection with the acquisition of West Pembina/Brazeau properties, the bankers have increased the line to \$85 million. The amount of the line drawn at March 31, 2004 is \$73,674,000.

The capital budget for the remainder of 2004 totals \$50 million not including the disposition of minor properties. Fairborne typically utilizes three sources of funding to finance its capital expenditures: funds generated from operations, bank borrowings and new equity issued, if available on favorable terms.

SHARE CAPITAL

Equity Outstanding:

During the first quarter of 2004, Fairborne issued a total of 6,198,000 common shares, of these, 6,178,000 were issued in connection with the West Pembina/Brazeau acquisition and 20,000 were issued on exercise of share options. The following chart shows the common share equity outstanding:

<i>(thousands)</i>	March 31 2004
Common shares	38,526
Warrants	1,960
Stock options	3,028
Weighted average shares outstanding for the period	
Basic	32,401
Diluted	35,161

BUSINESS ENVIRONMENT AND RISK

The business risks the Company are exposed to are those inherent in the oil and gas industry as well as those governed by the individual nature of Fairborne's operations. Geological and engineering risks, the uncertainty of discovering commercial quantities of new reserves, commodity prices, interest rate and foreign exchange risks, competition and government regulations – all of these govern the businesses and influence the controls and management at the Company. Fairborne manages these risks by:

- attracting and retaining a team of highly qualified and motivated professionals who have a vested interest in the success of the Company;
- operating properties in order to ensure efficient and cost effective operations;
- employing risk management instruments to minimize exposure to volatility of commodity prices, interest rate and foreign exchange rates;
- maintaining a strong financial position; and
- maintaining strict environmental, safety and health practices.




INTERIM CONSOLIDATED FINANCIAL STATEMENTS

INTERIM CONSOLIDATED BALANCE SHEETS

<i>(\$ thousands)</i>	March 31, 2004 <i>(unaudited)</i>	December 31, 2003 <i>(restated, see Note 1)</i>
Assets		
Current assets		
Cash and cash equivalents	\$ 135	\$ 6,152
Accounts receivable	16,873	14,126
Prepaid expenses and deposits	1,441	1,997
	18,449	22,275
Fixed assets <i>(Note 3)</i>		
Petroleum and natural gas properties and equipment	262,839	127,666
Office furniture and equipment	892	843
Accumulated depletion and depreciation	(22,202)	(17,219)
	241,529	111,290
Goodwill	6,360	6,360
	\$ 266,338	\$ 139,925
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities	\$ 33,105	\$ 21,132
Equipment lease <i>(Note 4)</i>	2,540	2,573
Bank indebtedness <i>(Note 5)</i>	73,674	7,941
	109,319	31,646
Asset retirement obligations <i>(Note 6)</i>	11,161	6,165
Future income taxes	16,610	15,913
Shareholders' Equity		
Capital stock <i>(Note 7)</i>	112,728	73,040
Contributed surplus <i>(Note 7)</i>	395	331
Retained earnings	16,125	12,830
	129,248	86,201
	\$ 266,338	\$ 139,925

See accompanying notes to the interim consolidated financial statements.




INTERIM CONSOLIDATED FINANCIAL STATEMENTS

INTERIM CONSOLIDATED STATEMENTS OF OPERATIONS AND RETAINED EARNINGS

(\$ thousands, except per share amounts)	Three Months Ended March 31 (unaudited)	
	2004	2003 (restated, see Note 1)
Revenue		
Petroleum and natural gas sales	\$ 18,429	\$ 9,531
Royalties	(4,220)	(1,665)
	14,209	7,866
Expenses		
Production	2,940	1,651
General and administrative	1,138	431
Interest	160	65
Accretion	136	113
Depletion and depreciation	4,983	2,106
	9,357	4,366
Income before taxes	4,852	3,500
Taxes		
Future income taxes	1,476	1,260
Capital taxes	81	18
	1,557	1,278
Net Income	3,295	2,222
Retained earnings beginning of period, as previously reported	12,613	2,439
Retained earnings adjustment, asset retirement obligation (Note 6)	217	69
Retained earnings beginning of period, Adjusted	12,830	2,508
Retained earnings, end of period	\$ 16,125	\$ 4,730
Net income per share (Note 6)		
Basic	\$ 0.10	\$ 0.11
Diluted	\$ 0.09	\$ 0.11

See accompanying notes to the interim consolidated financial statements



INTERIM CONSOLIDATED FINANCIAL STATEMENTS

INTERIM CONSOLIDATED STATEMENTS OF CASH FLOWS

<i>(\$ thousands, except per share amounts)</i>	Three Months Ended March 31 <i>(unaudited)</i>	
	2004	2003 <i>(restated, see Note 1)</i>
Operating activities		
Net income	\$ 3,295	\$ 2,222
Items not involving cash		
Depletion and depreciation	4,983	2,106
Accretion	136	113
Compensation expense	73	–
Future income taxes	1,476	1,260
	9,963	5,701
Asset retirement expenditures	(17)	–
Change in non-cash working capital	(11,013)	(465)
	(1,067)	5,236
Financing activities		
Issuance of common shares net of costs	38,901	–
Equipment lease payments	(33)	(31)
Bank indebtedness	65,733	–
	104,601	(31)
Investing activities		
Capital expenditures	(19,134)	(4,601)
Acquisition of petroleum and natural gas properties <i>(Note 2)</i>	(111,212)	–
Change in non-cash working capital	20,795	(285)
	(109,551)	(4,886)
Change in cash and cash equivalents	(6,017)	319
Cash and cash equivalents, beginning of period	6,152	3,587
Cash and cash equivalents, end of period	\$ 135	\$ 3,906
Cash interest paid	\$ 160	\$ 65
Capital taxes paid	\$ 81	\$ 18

See accompanying notes to the interim consolidated financial statements.



SELECTED NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS

*For the three months ended March 31, 2004 (unaudited)
(tabular amounts are stated in thousands of dollars except per share amounts)*

The interim financial statements of Fairborne Energy Ltd. (the “Company” or “Fairborne”), have been prepared by management in accordance with accounting principles generally accepted in Canada. The interim financial statements have been prepared following the same accounting policies and methods of computation as the financial statements for the year ended December 31, 2003, except as noted below. The disclosure, which follows, is incremental to the disclosure included with the annual financial statements. These interim financial statements should be read in conjunction with the financial statements and notes thereto for the year ended December 31, 2003.

NOTE 1: CHANGE IN ACCOUNTING POLICIES

Full Cost Accounting guideline

Effective January 1, 2004, Fairborne adopted a new Canadian accounting standard relating to full cost accounting for oil and gas entities. Fairborne places a limit on the carrying value of petroleum and natural gas properties and equipment, which may be depleted against revenues of future periods (the “ceiling test”). The carrying value is assessed to be recoverable when the sum of the undiscounted cash flows expected from the production of proved reserves, the lower of cost and market of unproved properties and the cost of major development projects exceeds the carrying value. When the carrying value is not assessed to be recoverable, an impairment loss is recognized to the extent that the carrying value of assets exceeds the sum of the discounted cash flows expected from the production of proved and probable reserves, the lower of cost and market of unproved properties and the cost of major development projects. The cash flows are estimated using expected future product prices and costs and are discounted using a risk-free interest rate.

Prior to adopting the new standards, the limit on aggregate carrying value of the petroleum and natural gas properties and equipment that may be carried forward for depletion against future revenues was based on the sum of the undiscounted cash flows expected from the production of proved reserves, the lower of cost or market of unproved properties and the cost of major development projects less the estimated future costs for administration, financing, asset retirement obligations and income taxes.

There were no changes to net income, petroleum and natural gas properties and equipment or any other reported amounts in the financial statements as a result of adopting the standard.

Asset Retirement Obligations (“ARO”)

Effective January 1, 2004, Fairborne retroactively adopted, with restatement of prior periods, a new accounting standard relating to asset retirement obligations.

Fairborne recognizes the fair value of ARO in the period in which it is incurred when a reasonable estimate of the fair value can be made. The fair value of the estimated ARO is recorded as a liability, with a corresponding increase in the carrying amount of the related asset. The capitalized amount is depleted on the unit-of-production method based on proved reserves. The liability amount is increased each reporting period due to the passage of time and the amount of accretion is expensed to income in the period. Actual costs incurred upon the settlement of the ARO are charged against the ARO.

Prior to adopting the standard, Fairborne recognized a provision for future site restoration costs over the life of the oil and gas properties and facilities using a unit of production method.

The effect of the adoption is presented below as increases (decreases):

	As at December 31, 2003	As at December 31, 2002
BALANCE SHEET (\$ thousands)		
Net asset retirement costs, included in fixed assets	3,740	3,158
Asset retirement obligations	6,165	4,135
Accumulated provision for future site restoration	(2,764)	(1,086)
Future income taxes	122	40
Retained earnings	217	69

	Period Ended March 31, 2004	Period Ended March 31, 2003	Year Ended December 31, 2003
INCOME STATEMENT (\$ thousands)			
Accretion expense	136	113	558
Depletion and depreciation on asset retirement costs	158	153	619
Future site restoration expense	(573)	(254)	(1,405)
Future income taxes	101	(5)	82
Net earnings impact	178	7	146

NOTE 2: ACQUISITION OF PETROLEUM AND NATURAL GAS PROPERTIES

On March 31, 2004, the Company acquired certain petroleum and natural gas assets located in the West Pembina/Brazeau area of West Central Alberta. The acquisition has been accounted for by the purchase method. Details of the acquisition are as follows:

Net assets acquired: (\$ thousands)	
Petroleum and natural gas properties and equipment	115,876
Asset retirement obligation	(4,664)
	111,212
Consideration: (\$ thousands)	
Cash	71,879
Cash from private placement of common shares	38,859
Transaction costs	474
	111,212

NOTE 3: PETROLEUM AND NATURAL GAS PROPERTIES AND EQUIPMENT

Fairborne performed a ceiling test calculation at January 1, 2004 and March 31, 2004 to assess the recoverable value of petroleum and natural gas properties and equipment. The oil and gas future prices are based on the April 1, 2004 commodity price forecast of our independent reserve evaluators. These prices have been adjusted for commodity price differentials specific to Fairborne. The following table summarizes the benchmark prices used in the ceiling test calculation. Based on these assumptions, the undiscounted value of future net revenues from Fairborne's proved reserves exceeded the carrying value of petroleum and natural gas properties and equipment at January 1, 2004 and March 31, 2004.

Year	WTI	Foreign	Edmonton	AECO
	Oil	Exchange	Light	Gas
	(\$US/bbl)	Rate	Crude Oil	(\$Cdn/mmBtu)
2004	34.25	0.75	40.86	6.62
2005	28.50	0.75	34.62	5.50
2006	26.25	0.75	32.26	5.14
2007	24.00	0.75	29.45	4.93
2008	23.50	0.75	29.41	4.93
2009-14	23.25	0.75	29.40	4.92
Escalate thereafter 1.5% per year				

As at March 31, 2004, Fairborne has to incur \$4.8 million of exploration expenditures to meet its flow through share commitment.

NOTE 4: EQUIPMENT LEASE

The Company repaid the equipment lease in April 2004.

NOTE 5: BANK INDEBTEDNESS

At March 31, 2004 the Company has available \$85 million of demand operating credit facilities from two Canadian chartered banks subject to the bank's valuation of the petroleum and natural gas properties owned by the Company. The facilities bear interest at the bank's prime rate. At March 31, 2004 \$73,674,000 was drawn under the facilities. The scheduled review date of the facility is May 31, 2004. The facilities are secured by a first ranking floating charge on all real property of the Company and a general security agreement.

NOTE 6: ASSET RETIREMENT OBLIGATIONS

The Company's asset retirement obligations result from net ownership interests in petroleum and natural gas assets including well site, gathering systems and processing facilities. The Company estimated the total undiscounted amount of cash flows required to settle its asset retirement obligations is approximately \$16.3 million which will be incurred between 2014 and 2034. The majority of the costs will be incurred between 2014 and 2020. A credit-adjusted risk-free rate of 8.5 percent and an inflation rate of 1.5 percent was used to calculate the fair value of the asset retirement obligations.

A reconciliation of the asset retirement obligations is provided below:

<i>ASSET RETIREMENT OBLIGATIONS (\$ thousands)</i>	Three Month Period Ended March 31, 2004	Year Ended December 31, 2003
Balance, beginning of period	6,165	4,135
Acquisition in the period	4,664	-
Liabilities incurred in period	213	2,255
Liabilities settled in period	(17)	(783)
Accretion expense	136	558
Balance, end of period	11,161	6,165

NOTE 7: CAPITAL STOCK

a) Common Shares

COMMON SHARES, ISSUED AND OUTSTANDING

<i>(thousands)</i>	Number	Amount
Balance, December 31, 2003	32,328	\$ 73,040
Shares issued on exercise of options	20	50
Private placement of common shares for cash	6,178	41,084
Share issue costs	-	(2,224)
Future tax benefit of issue costs	-	778
Balance, March 31, 2004	38,526	112,728

b) Contributed Surplus

<i>(thousands)</i>	2003
Balance, beginning of period	\$ 331
Options granted	73
Options exercised	(9)
Balance, end of period	\$ 395

The weighted average fair value of stock options granted in 2004 was \$1.98 per option using the Black-Scholes option pricing model with the following weighted average assumptions: risk free rate of 4 percent, expected volatility of 30 percent and expected life of 3 years.

c) Per Share Amounts

The following table summarizes the weighted average common shares used in calculating net income per share:

	For the Three Months Ended March 31, 2004	For the Three Months Ended March 31, 2003
Basic	32,400,561	19,750,000
Diluted	35,161,311	19,750,000

The reconciling items between the basic and diluted average common shares are outstanding stock options and outstanding warrants.

d) Stock Options

There are 3,027,783 stock options outstanding at March 31, 2004 with a weighted average exercise price of \$3.20 per option. The options expire between January 23, 2006 and May 26, 2009.

The following table sets forth a reconciliation of the stock option plan activity through to March 31, 2004:

	Number of Options	Weighted average exercise price
Balance December 31, 2003	2,861,049	\$ 2.90
Granted	186,500	\$ 7.74
Exercised	(19,766)	\$ 2.08
Balance March 31, 2004	3,027,783	\$ 3.20

The following table summarizes stock options outstanding under the plan at March 31, 2004:

Exercise Price	Options Outstanding	Remaining Term (years)	Options Exercisable
\$ 1.75 – \$ 1.84	45,729	1.8	45,729
\$ 2.40 – \$ 3.09	2,099,753	3.3	791,412
\$ 3.42 – \$ 4.76	388,912	4.1	10,912
\$ 5.20 – \$ 7.40	379,389	3.6	5,889
\$ 8.00 – \$ 9.15	114,000	5.0	–
	3,027,783	3.6	853,942

e) *Warrants*

There are 1,960,000 warrants to purchase common shares at \$3.50 per share exercisable at any time prior to close of business on May 31, 2006.

NOTE 8: FINANCIAL INSTRUMENTS

The Company has a price risk management program whereby the Company sells forward a portion of its future production through fixed price physical sales contracts with customers.

The following table summarizes the hedges outstanding at March 31, 2004:

Commodity	Period	Volume	Price	
Crude Oil	April 1 to June 30, 2004	350 bbls/day	CDN	\$37.90
Crude Oil	April 1 to June 30, 2004	350 bbls/day	WTI US	\$30.32
Crude Oil	July 1 to September 30, 2004	350 bbls/day	WTI US	\$32.25

The Company has sold forward US\$965,000 of foreign exchange exposure at Cdn \$1.3230 to US \$1.00 (US \$0.7559 to Cdn \$1.00) to June 30, 2004 and US\$1,039,000 of foreign exchange exposure at Cdn \$1.3468 to US \$1.00 (US \$0.7425 to Cdn \$1.00) from July 1, 2004 to September 30, 2004. At March 31, 2004 the estimated fair value of the foreign exchange contract is U.S. \$21,000 which represents the amount the Company would pay to terminate the contracts at March 31, 2004.

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Shareholders and interested investors are encouraged to visit our web site: <http://www.fairborne-energy.com>. Historical public documents, corporate information, latest presentation material and press releases are all available. Filings also available at: www.sedar.com