



2004
ANNUAL REPORT

CORPORATE PROFILE

Canoro Resources Ltd. (“Canoro”) is a junior international upstream oil and gas company that is headquartered in Calgary, Alberta, Canada. Common shares of Canoro trade on the TSX Venture Exchange under the symbol CNS. Canoro is the Operator of the 53 square kilometer Amguri Development Block in north-east India with a 60% interest. Canoro also has a 65% interest in and is the Operator of a 1,934 square kilometer exploration block - referred to as the AA-ON/7 Block - that is also located in north-east India. In addition, Canoro evaluates new business development opportunities both in India and in Russia. Canoro has a strong management team, with extensive international oil and gas experience. As at August 16, 2004, Canoro had 46,490,733 common shares that were issued and outstanding.

ANNUAL AND SPECIAL MEETING

Shareholders of Canoro are invited to attend the Annual and Special Meeting of the shareholders of the Corporation to be held in the Mayfair Room, The Westin, 320 - 4th Avenue SW, Calgary, Alberta, Canada T2P 2S6, on September 28, 2004 at 2:30 p.m., local time.

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All dollar amounts in this Annual Report are reported in Canadian currency, unless otherwise indicated.

MESSAGE TO THE SHAREHOLDERS

On behalf of the Board of Directors of Canoro Resources Ltd. ("Canoro" or the "Company") we are pleased to present the Company's Annual Report for the year ended March 31, 2004.

During the past fiscal year, Canoro has increased its holdings in India, raised equity to finance its work programs for the next fiscal year, and began operations in the field.

The assignment of interest and operatorship of the Amguri field was approved in February 2004. This decision by the Government of India has provided the Company with a 60% participating interest in the Amguri field. This positive development, along with the Government's previous decision of assigning 65% of the participating interest and operatorship of the AA-ON/7 block, makes Canoro one of the largest independent operators in north-east India.

In March 2004, the Company was successful at raising \$12 million of equity in the Canadian markets to fund its programs going forward. As a debt free company with a strong balance sheet and significant cash resources, Canoro is now well positioned to take advantage of its opportunities in India.

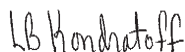
Canoro has also made significant changes to the composition of its Board. On June 29, 2004, B. Vaughan Armstrong, Philip A. Coleman, Kenneth Jones and P. Douglas McArthur resigned from the Board. Canoro would like to acknowledge their contribution to the Company over the past several years.

On June 29, 2004, Douglas R. Martin and D. Nolan Blades were appointed directors of Canoro. The new Board members bring a different set of skills to Canoro and a proven track record of success in the oil and gas business.

The Board of Directors is committed to the task of developing the Company into a significant producer of oil and gas in India and to continue the strategy of seeking additional business opportunities in both India and Russia. Both countries are places where management has significant strengths.

The next fiscal year should see Canoro establish significant cash flow at Amguri through its workovers of three existing wells and the drilling of its first exploratory well on AA-ON/7, where there is an expectation of making a large oil discovery. Canoro also plans a workover of the Dergaon #1 well (located on the AA-ON/7 block) and perform a long term deliverability test.

On Behalf of the Board of Directors.



Les Kondratoff
President and CEO



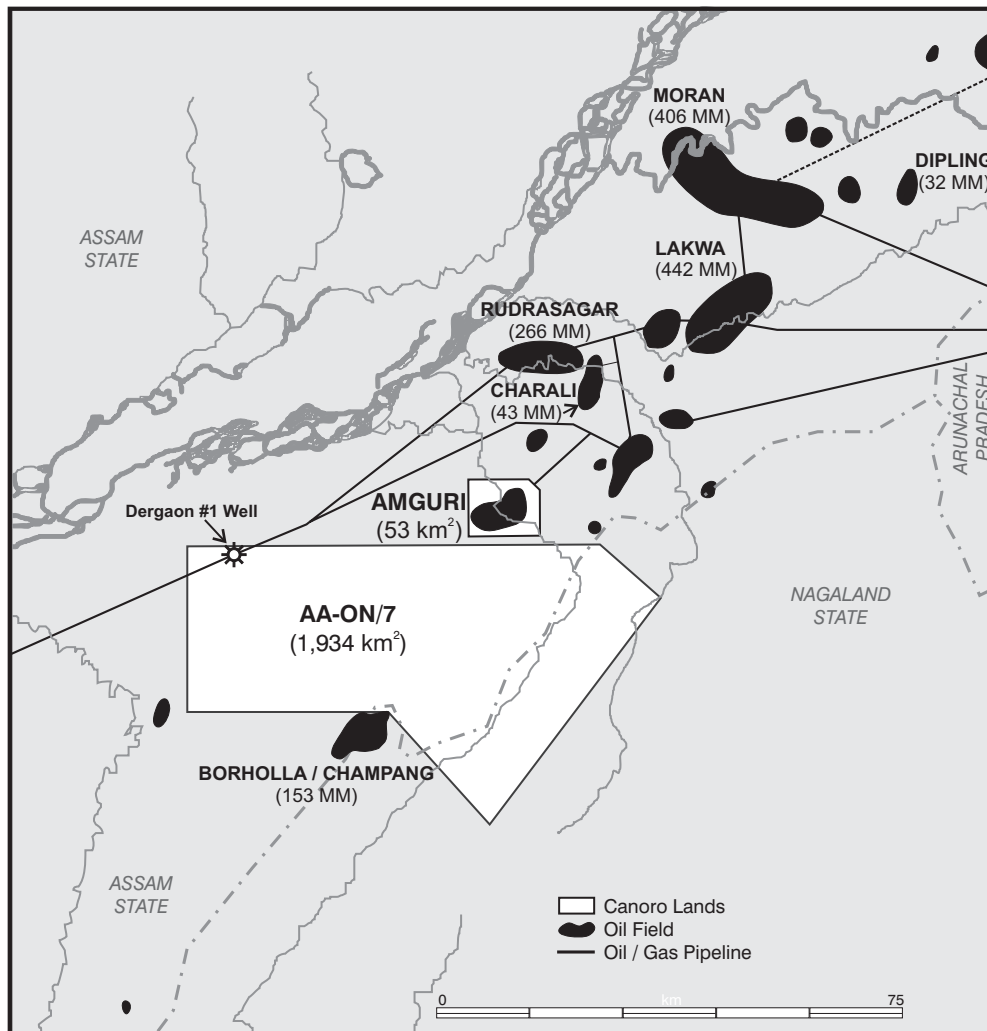
Douglas R. Martin
Chairman of the Board

August 16, 2004

REVIEW OF OPERATIONS

AA-ON/7 EXPLORATORY BLOCK

The AA-ON/7 Exploratory Block covers an area of 1,934 square kilometers (equivalent to about 20 townships) in both the Assam and Nagaland states in north-east India. The block is located in the Assam Basin, which is highly prospective for oil and lies on trend with a number of large (>400 million barrels of oil in place) fields. Only five wells have been drilled on the entire block. One well (Dergaon #1) has evidence of multiple zone hydrocarbon potential. Several of the zones in this well are slated for a long-term production test prior to the end of the fiscal year ending March 31, 2005. This block also contains more than 1,000 kilometers of existing 2-D seismic which is available to the Company and its partner.



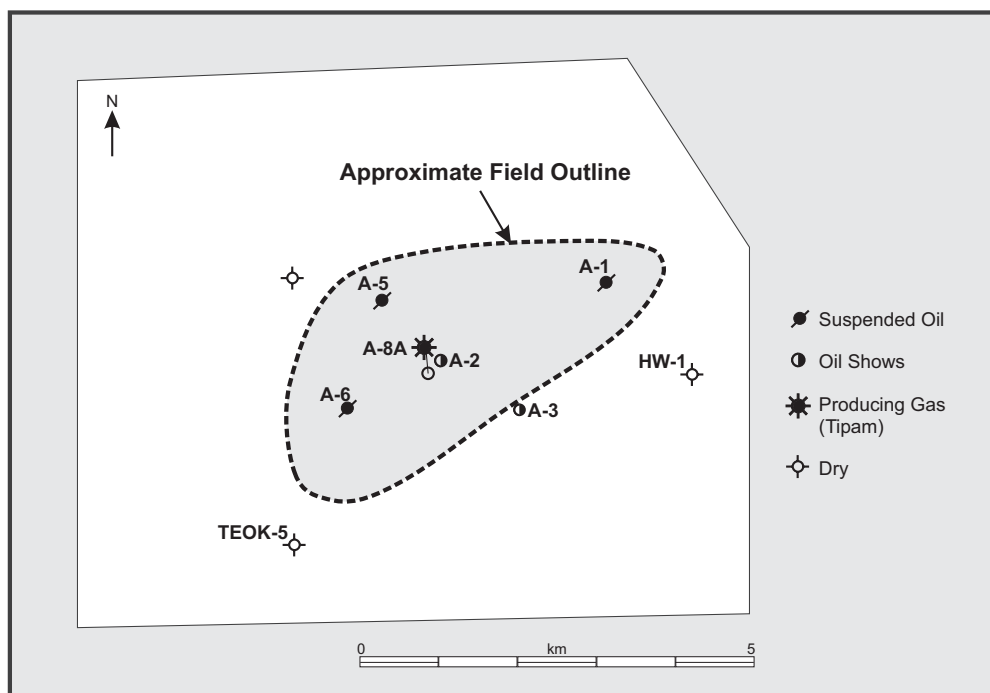
Canoro entered into the AA-ON/7 Production Sharing Contract (PSC) as part of a consortium in partnership with another Canadian company. Part of Canoro's turnaround strategy was to take over the Canadian partner's interest and to assume the role of the Operator of the block after the Canadian partner elected to focus on its more advanced international operations outside India. On February 13, 2003, Canoro announced that the Government of India had approved the assignment of a 30% interest and of operatorship in the AA-ON/7 block to Canoro. This increased Canoro's working interest in the block to 65% from 35% and Canoro assumed the role of Operator of the block. Canoro also received approval to extend the Phase 1 exploration period to September 26, 2004.

During the year ended March 31, 2004 and thereafter, Canoro has significantly exceeded the work program committed to under Phase 1 of the seven year exploration period granted under the PSC. Canoro acquired almost 100 kilometers of new seismic in early 2004 and has reprocessed several hundred kilometers of the existing seismic on the block. The Company has been analyzing and interpreting the seismic and will have one or more well locations selected by the end of September 2004. Preliminary analysis of the seismic data points to several prospective structures with hydrocarbon potential. The process required to be able to drill a well first calls for an environmental impact assessment to be conducted. This study has already been initiated and should be completed during September, 2004 followed by negotiations for land access to the drilling location. In India, land is purchased and is a process that may take some time as negotiations are dependent on the number of land owners affected. Nevertheless, Canoro plans to begin wellsite construction in December 2004 and spud its first well during the first quarter of 2005.

Logs from the Dergaon #1 well, a gas discovery well drilled by the previous Operator of the block in 1973, indicate that there could be as much as 50 meters of net hydrocarbon pay in the well. Short term tests carried out at the time the well was drilled recovered some gas but the potential of the well was not fully evaluated. Canoro has planned a re-entry and test of this well to take place in two parts. The first part, to repair access to the well site and determine the integrity of the well casing, was undertaken during mid 2004 and established that re-entry and testing of the well is possible. Work was then suspended for the monsoon season as the well is located in a low-lying area. The second part of the re-entry and testing program is planned for the latter part of 2004.

AMGURI DEVELOPMENT BLOCK

The Amguri Development Block is located in close proximity to the AA-ON/7 Exploratory Block and encompasses an area of 52.75 square kilometers. The block contains nine previously drilled wells of which one well (#8A) is currently producing gas; three are suspended oil producers and one well (#A-2) discovered oil but was never properly tested.



Canoro acquired a 35% working interest in the Amguri block in 1998 under a farmin agreement with the Indian company, Assam Company Limited, who are also partners with the Company on the AA-ON/7 block. On July 3, 2003 Canoro announced the purchase of an additional 25% interest in the Amguri block and assumption of operatorship from Joshi Technologies International Inc.

The Petroleum Mining Lease was formally issued by the State Government of Assam on November 27, 2003 and the assignment of interest and operatorship to Canoro was approved by the Government of India in February 2004. Canoro closed a financing to raise \$12 million to fund its work programs in March 2004 and is now finalizing its budgets with which to begin implementing its work program on the block.

Canoro's work program consists of re-entering and establishing oil production from three of the existing wells on the Amguri block. The Company has finalized its workover program and has begun the process of tendering for equipment and services to do the work. The State of Assam has been subjected to extreme flooding this year, possibly the worst in 50 years. This has hampered operations in the area for all the operators and thus it is anticipated that Canoro's workover program will not begin until the fourth quarter of 2004.

Preliminary results from the currently producing well #8A indicate that it has considerable potential to produce additional gas. Canoro has begun the process of looking for additional markets for this gas production.

BUSINESS DEVELOPMENT

Canoro continues to look for additional business opportunities in both India and Russia. This is where Canoro's core expertise lies and these are also two areas that have enormous hydrocarbon potential at a reasonable cost.

The Company is planning to evaluate prospective blocks being offered in the NELP 5 licensing round in India and is constantly seeking other opportunities in India and evaluating them as they arise.

Management's approach to business development recognizes the need to grow the Company in a manner that brings projects into the Company which would add significant value, but at the same time not divert critical resources away from its core properties in India.

MANAGEMENT'S DISCUSSION AND ANALYSIS

The following discussion and analysis as provided by the management of Canoro Resources Ltd. should be read in conjunction with the Company's audited consolidated financial statements for the years ended March 31, 2004 and 2003 and is effective August 16, 2004.

Forward Looking Statements

Certain information regarding the Company set forth herein, including management's assessment of the Company's future plans and operations may constitute forward-looking statements under applicable securities laws and regulations. The Company's operations necessarily involve risks associated with exploration, development, production, marketing, and transportation of crude oil and natural gas. Factors such as timing of capital programs, timely access to facilities, equipment and personnel to execute programs, possible insurgency and union interference, volatility of commodity prices, currency fluctuations, impact of political changes, subjectivity of reserve estimates, environmental risks, access to or loss of market, competition from other producers, volatility in stock markets, and ability to access sufficient capital from internal and external sources materially affect the value of the Company and its operations to its shareholders. As a consequence, actual results may vary materially from those anticipated in the forward-looking statements.

OPERATIONS

The Company is an upstream international oil and gas company whose focus is in India and Russia. In India, the Company has interests in and is the Operator of two Production Sharing Contracts – Amguri Discovered Field and AA-ON/7 Exploration Block. Both blocks are located in north-east India. Activities in Russia are confined to business development at the present time.

The Company has a 65% interest in the 25 year Production Sharing Contract with respect to the AA-ON/7 block subject to a 30% back in interest (which, if exercised would reduce the Company's interest to 45.5%) by Oil and Natural Gas Corporation Ltd. ("ONGC", a company majority owned by the Government of India), following declaration of commerciality. The remaining 35% is held by an Indian company, Assam Company Limited, a subsidiary of the Duncan Macneill group. The block comprises of some 1,934 square kilometers of which 1,126 square kilometers is in the State of Assam and the remaining 808 square kilometers are in the State of Nagaland. During the year ended March 31, 2004 and to date, the Company, as Operator, continued with geological and geophysical work and studies on the AA-ON/7 block. Existing seismic that was available on the block was reprocessed. New seismic was acquired with the acquisition completed in early April 2004. Newly acquired seismic has been integrated with the existing seismic data base. Interpretation of the seismic data base is presently being carried out and it is the intention of the Company to select a well location for approval in September 2004. This will enable the Company to enter into Phase II of the exploration period under the Production Sharing Contract on September 26, 2004 which will commit the Company to fund the drilling of one exploration well on the block. It is expected the well will be spudded during north-east India's dry season, which extends from November to March.

In addition, the Company has a 60% interest in the 53 square kilometer Amguri development block, in the State of Assam, India. During the year ended March 31, 2004, the Company increased its interest from 35% to 60% through the acquisition of a further 25% interest. The Company also became the Operator of the block in

February 2004. The Amguri block contains the previously discovered Amguri field in which three previously producing oil wells are currently suspended.

There have been nine wells drilled in the Amguri field over the years. One well, currently operated by ONGC, is producing minor amounts of natural gas which is being sold to several tea gardens located in Assam near the Amguri block. The mining lease for the Amguri block was granted on November 27, 2003 and the Company is in the process of being recognized on title to the mining lease by the State of Assam. Formal handover of the Amguri field from ONGC is imminent. Following handover, the Amguri field will be firmly in control of the Company. Plans provide for a workover program on a minimum of three existing wells in the field. Log analysis has been completed on the existing wells and candidate zones for workovers have been selected. The Company expects the three well workover program to commence with site preparation and related work following the cessation of the monsoons in October 2004. Well workovers are anticipated to be completed during the first quarter of 2005, with the Company anticipating production from the well workover program commencing shortly thereafter. Following handover, the Company will secure control over production from the one gas well on the block that will generate a modest amount of revenue. To date, no information is available with respect to production volumes, revenues, or expense for the producing gas well and the Corporation will record such revenues and expenses at the time the information becomes available.

Over the past several months, the Company has been in the process of obtaining technical data, some of which is expected to be delivered upon or following the handover of the field to Canoro. Consequently, the Company has not yet engaged a third-party engineering firm to establish reserves for the field. The Company has recently completed a detailed petrophysical analysis of the wells in the Amguri field and has commissioned the development of a geological model of the field. This data in conjunction with that obtained during the above mentioned workover program will enable the Company to establish reserves on the block and anticipates reporting on them as at March 31, 2005.

The Company continues to evaluate opportunities in India and Russia on an ongoing basis. Business development effort continues in Russia with a number of opportunities having been evaluated by the Company over the past two years. The Company follows strict acquisition and farmin parameters including rates of return, pool sizes, early production and cash flow and a number of other factors. Such business development effort is continuing.

RESULTS OF OPERATIONS

During the year ended March 31, 2004, the Company continued to focus on geological, geophysical, seismic acquisition, and seismic reprocessing activities on AA-ON/7 as well as acquiring an additional interest in and operatorship of the Amguri block. The Company is essentially in a preproduction stage and has not yet undertaken the drilling any new wells or re-entered any existing wells on the two Production Sharing Contracts that it has interests in. One well on the Amguri block, being operated by ONGC, is currently producing minor amounts of natural gas. The Company anticipates recording production revenues from this well following the handover of the field that is expected shortly. Accordingly, the Company has minimal revenues emanating solely from interest income from cash resources.

The Company recorded expenses of \$1.75 million, of which \$0.6 million are non-cash items. Approximately \$1.2 million was incurred with respect to general and administrative expenses compared to \$0.8 million for the previous year. The increase is principally due to increased operational, corporate and financing activities, significantly higher use of consultants, and higher activity overall. In addition, the Company capitalized \$0.3 million with respect to in-house professional engineering and geophysical work associated with the two blocks in India (2003 - \$0.3 million). Non cash items principally included stock based compensation expense that resulted from the grant of options to directors, officers, employees and consultants. The Company has chosen to adopt the new standards with respect to stock options early.

As a result, the Company has recorded a net loss for the year ended March 31, 2004 of \$1.7 million (\$0.05 per share) compared to a net loss of \$1.1 million (\$0.06 per share) for 2003.

Funds utilized in operations, that exclude non cash items for the year ended March 31, 2004, amounted to \$1.08 million compared to \$0.56 million for 2003. Funds were utilized for general and administrative expenses, offset in part by interest income earned on cash resources.

The MD&A contains the term “funds utilized in operations”, which should not be considered an alternative to, or more meaningful than, cash flow from funds utilized in operating activities as determined in accordance with Canadian Generally Accepted Accounting Principles (GAAP) as an indicator of the Company’s performance. Canoro’s determination of “funds utilized in operations” may not be comparable to that reported by other companies. The reconciliation between net loss and “funds utilized in operations” can be found in the audited statement of cash flows in the 2004 and 2003 audited consolidated financial statements.

LIQUIDITY AND CAPITAL RESOURCES

During the year ended March 31, 2004, the Company significantly improved its financial position, working capital and cash reserves. At March 31, 2004, Canoro had \$12.0 million in cash as compared to cash of \$2.3 million at March 31, 2003. The improvement in the Company’s financial position principally arises as a result of the success of its financing efforts, by way of equity issues of shares and warrants, resulting in gross cash proceeds of \$13.5 million. In particular, the Company was successful in closing two equity financings by way of private placements during February and March 2004.

Of the cash resources available, Canoro utilized \$1.1 million in operations, principally its running expenses. In addition, Canoro’s capital expenditure program for the year ended March 31, 2004 amounted to \$2.6 million. A breakdown of capital expenditures is as follows:

(Thousands of dollars)

	<u>Year Ended March 31,</u>	
	<u>2004</u>	<u>2003</u>
Property acquisitions	\$ 876	\$ –
Exploration	1,344	473
Development	342	–
Total	<u>\$ 2,562</u>	<u>\$ 473</u>

In June 2003, Canoro finalized an agreement to acquire an additional 25% working interest and operatorship in the Amguri field. Scheduled payments were made during the year, and the final payment was made in May 2004. Exploration expenditures involved the reprocessing of existing seismic data, and the acquisition of approximately 100 km of seismic on the AA-ON/7 block, which commenced in March 2004, with field work completed in April 2004. In the prior year, exploration expenditures consisted of professional fees to study and commence reprocessing of existing seismic data. Development expenditures centered on study of well and geological data on the Amguri field, and preparation of well workover programs for three suspended oil wells in the field.

Funds utilized for operations and capital expenditures were funded by several successful equity financings accomplished by the Company during the year ended March 31, 2004. On March 11, 2004, Canoro completed a brokered private placement of 14,118,000 common shares plus half-warrants (aggregating 7,059,000 warrants) at a price of \$0.85 per unit for gross proceeds of \$12.0 million. Each full warrant entitles the holder to purchase one common share of the Company at a price of \$1.15 per share until March 11, 2006. In addition, on February 13, 2004, Canoro completed a private placement of 1,857,000 common shares at a price of \$0.75 per share for gross proceeds of \$1,393,000. As well, Canoro issued 358,000 common shares for gross proceeds of \$125,000 on exercise of options. As a result of its financing efforts, and after deducting costs of issue, the Company realized net proceeds of \$12.65 million from issue of equity.

As a result, the Company increased its cash resources from \$2.3 million to \$12.0 million during the year ended March 31, 2004.

During the year ending March 31, 2005, the Company plans to advance its efforts on the two blocks in north-east India. On the AA-ON/7 block, the geological and geophysical work is centered on the development of the first exploratory drilling location under the Production Sharing Contract. The seismic acquisition program was completed in April 2004. The interpretation of the seismic database is in progress and several potentially drillable structures have been identified. Enough encouragement has been seen on the seismic that has warranted the Company and its partner to enter into Phase II of the exploration period on the expiry of Phase I on September 26, 2004. A firm well location will be determined in September 2004 and plans will be advanced to drill one exploration well on the block. It is estimated that the depth of the well will be approximately 3,800 meters based on regional information to penetrate the main oil prone formations and reach basement. The well is planned to commence drilling before the end of the 2004 – 2005 fiscal year of the Company.

With respect to the Amguri field, the Company has prepared an initial development plan for the block. The plan includes the evaluation of existing well logs, well bore and seismic data to be followed by the re-entry into three of the existing wells on the block for a well workover program. The evaluation of well logs is now complete and work is being undertaken to finalize candidates for the well workover program. In addition, the Company is shortly expected to have control over the group gathering station which is connected by way of pipelines to many of the well locations on the block. The Company will be upgrading the facilities, flow lines and separators to enable the receipt and processing of oil and gas from the workover wells. An existing well is currently producing natural gas that is being sold to surrounding tea gardens. The Company will also be reprocessing all the existing available

seismic data with a view to remapping the field in preparation for further drilling once the well workover program is completed.

The Company's cash resources are sufficient to fund the Company's capital program on the two blocks for 2004 – 2005 as well as to fund ongoing corporate and operating activities. The Company has no long term debt.

As at March 31, 2004 the Company had 45,736,628 issued and outstanding common shares (2003 – 28,682,846). In addition, the Company had 8,047,260 share purchase warrants and 3,126,137 options (including 377,637 agent options) that were outstanding at March 31, 2004.

SELECTED FINANCIAL INFORMATION

(Thousands of dollars except per share amounts)

	Year Ended March 31,		
	2004	2003	2002
Revenue (net of royalty)	55	12	154
Funds utilized in operations	(1,077)	(555)	(591)
Net loss	(1,696)	(1,119)	(795)
Basic and diluted net loss per share	(0.05)	(0.06)	(0.05)
Cash dividends per share	Nil	Nil	Nil
Total assets	17,882	5,590	2,858
Long term debt	Nil	Nil	540

During the three years ended March 31, 2004, the Company has continued to advance its efforts in acquiring majority interests in two Production Sharing Contracts in north-east India and becoming Operator of the two blocks. Canoro has also advanced its efforts in evaluating the two blocks, accessing seismic data, acquiring seismic on AA-ON/7, processing and reprocessing seismic, building relationships in India, setting up presence and operations in India and generally getting ready to commence drilling, workover and facilities operations in India. As well, the Company has been accessing equity capital, through issuance of common shares and warrants, and convertible debentures, by way of private placements, to fund its ongoing operations and capital programs as well as in building significant amount of cash reserves for executing its well workover and drilling programs on the two blocks during 2004 – 2005 fiscal year. The Company essentially is in a pre-production stage thus incurring ongoing general and administrative and ongoing operating expenditures resulting in reported start-up losses and cash flow deficiency in operations which will likely continue for this fiscal year. The completion of the workover program is expected to result in ongoing cash flows for the Company. With the follow-up development programs, such cash flows are anticipated to grow rapidly depending upon the pace of development and the level of oil and gas production that can be attained by the Company. The successful drilling of an exploration well on AA-ON/7 can result in a significant discovery and with follow-up delineation and development, it is possible for the Company to rapidly attain a significant size in terms of production, revenues, cash flows and earnings from India.

SUMMARY OF QUARTERLY RESULTS

	Fiscal Year 2004				Total
	Quarter Ended				
	Mar 31, 2004	Dec 31, 2003	Sept 30, 2003	June 30, 2003	
<i>(Thousands of dollars, except per share amounts)</i>					
Revenue	17	10	12	16	55
Funds utilized in operations	(443)	(165)	(103)	(366)	(1,077)
Net loss	(727)	(692)	(119)	(158)	(1,696)
Basic and diluted loss per share	(0.03)	(0.01)	(0.00)	(0.01)	(0.05)
Capital expenditures	1,587	365	267	343	2,562
Weighted average common shares outstanding (000's)	33,080	29,245	29,126	29,050	

	Fiscal Year 2003				Total
	Quarter Ended				
	Mar 31, 2003	Dec 31, 2002	Sept 30, 2002	June 30, 2002	
<i>(Thousands of dollars, except per share amounts)</i>					
Revenue	–	–	(5)	17	12
Funds utilized in operations	(151)	(180)	(93)	(131)	(555)
Net loss	(233)	(494)	(205)	(187)	(1,119)
Basic and diluted loss per share	(0.01)	(0.03)	(0.01)	(0.01)	(0.06)
Capital expenditures	269	103	48	52	395
Weighted average common shares outstanding (000's)	20,190	17,360	16,368	15,368	
Production (total mcf)	–	–	–	1,526	1,526

As indicated above, the Company is essentially in a preproduction stage with it generating revenues solely from investment income from its cash resources. The Company is reporting ongoing cash deficiency from operations resulting from general and administrative costs, that include corporate and ongoing business development and operating costs. The level of burn rate has increased in the last quarter of 2004 with the Company gearing up for executing its substantial increase in capital programs, by way of well workovers and drilling expenditures as well as ongoing geological and geophysical evaluation expenditures and that trend is expected to continue. The Company anticipates positive cash flow from operations following successful execution of its well workover programs. As well, the weighted average shares outstanding are expected to increase substantially as a result of successfully completing two significant financings during the last fiscal quarter of 2004 and with the ongoing exercise of options and warrants.

FOURTH QUARTER RESULTS

Activities during the quarter ended March 31, 2004 increased substantially. As well, the Company completed two significant equity financings - a private placement of \$1.4 million that was closed in February 2004 and a major private placement of \$12.0 million that was closed in March 2004. The March 2004 financing comprised of a brokered placement and required the development of an offering memorandum, significant due diligence work by our agent, its advisors and legal counsel as well as a large number of investor road shows. Considerable work was undertaken in the development of economic models of the two blocks in India as well as for Russian business development. Legal, accounting, technical and other advisors were retained to assist the Company in its financing efforts. All of these activities resulted in a significant increase in general and administrative expenses.

As well, the Company chose to adopt the new stock based compensation rules early and as a result, the Company recorded \$0.4 million as stock based compensation expense during the quarter.

Canoro has made significant progress with respect to its operations as well. The Company was recognized as the Operator of the Amguri block in February 2004 by the government of India and continues its efforts to be formally recognized on the Petroleum Mining Lease that has been issued by the Government of Assam. With respect to the AA-ON/7 block, the Company commenced the seismic acquisition program in March 2004 which was completed in April 2004. During this period there was also a continuation of the ongoing program to reprocess as much of the available seismic data on the block as possible.

All of the above activities resulted in a higher loss, higher amount of funds utilized from operations, and a higher capital expenditure program for the quarter ended March 31, 2004.

TRANSACTIONS WITH RELATED PARTIES

The Company's transactions with related parties are fully described in note 12 to the consolidated financial statements of the Company, which note is incorporated herein by reference. These related party transactions were principally incurred to conserve cash.

CHANGES IN ACCOUNTING POLICIES

Full Cost Accounting for Oil and Gas Operations

The Company follows the full cost method of accounting for its oil and gas operations. In September 2003, CICA Accounting Guideline 16 "Oil and Gas Accounting – Full Cost" was issued to replace Accounting Guideline 5 effective for years beginning after January 1, 2004. Effective December 31, 2003, the Company adopted the new accounting standards for oil and gas activities as set out in AcG-16, Oil and Gas Accounting – Full Cost. Under the new standard, the ceiling test is a two-part test. The first part determines if impairment exists based upon comparing the carrying value of petroleum and natural gas properties to the undiscounted future cash flows based upon estimated future prices and proved reserves and the lower of cost and market of undeveloped properties. If the first part indicates impairment, the second step is performed to measure the amount of impairment based upon comparing the carrying value of the oil and natural gas properties to the cash flows of proved and probable reserves discounted at a risk-free rate and the lower of cost and market of undeveloped properties. At March 31, 2004, the Corporation was unable to meet the first part of the ceiling test; however, no write-down is required as the sum of the discounted cash flows from the proved and probable reserves exceeded the carrying values of the petroleum and natural gas reserves and the cost of unproved properties at that time.

Stock-Based Compensation

In September 2003, CICA issued an amendment to section 3870, "Stock-based Compensation and Other Stock-based Payments" to be effective for fiscal years beginning on or after January 1, 2004 with earlier adoption encouraged. In the fourth quarter ended March 31, 2004, the Company adopted the amended standard which

requires the use of the fair value method for valuing stock option grants. Under this method, compensation cost, attributable to share options granted to directors, officers, employees or consultants is measured at fair value at the grant date and expensed over the vesting period with a corresponding increase to contributed surplus. Upon the exercise of the stock options, consideration paid together with the amount previously recognized in contributed surplus is recorded as an increase to share capital. Pursuant to the transition rules, the expense recognized applies to stock options granted on or after fiscal years commencing on or after January 1, 2003. The impact of the adoption of this amended standard was a non-cash charge of \$0.35 million to expenses for the year ended March 31, 2004 with a corresponding increase to contributed surplus on the Company's balance sheet.

Asset Retirement Obligations

Effective April 1, 2004 the Company will adopt the new CICA accounting standard, Handbook Section 3110 "Asset Retirement Obligations". This new standard requires that companies recognize the liability associated with future abandonment and site restoration costs in the financial statements at the time the liability is incurred, normally when the related asset is purchased or developed. When incurred, the liability will be measured at its fair value with a corresponding increase to property, plant and equipment and over time, will be accreted up to the actual expected cash outlay to perform the abandonment and reclamation. This accretion to the liability will be expensed through the Company's consolidated statement of earnings. The increase to property, plant and equipment, known as the "asset retirement cost", will result in an increase to depletion expense over the life of the Company's reserves. Canoro is currently assessing this new standard to determine the magnitude and effects it will have on the Company's financial statements.

RISK ASSESSMENT

Canoro is in the business of exploring for, developing and producing oil and natural gas in India and Russia. Along with the competitive nature of the oil and gas industry, risk exposures, some of which are beyond the control of the Company, can be categorized as operational, political, regulatory, environmental and financial.

The long-term commercial success of Canoro depends on its ability to find, acquire, develop and commercially produce oil and natural gas reserves. Oil and natural gas exploration involves a high degree of risk and there is no assurance that expenditures made on future exploration by the Company will result in new discoveries of oil or natural gas in commercial quantities. The process of evaluating prospects and estimating oil and natural gas reserves is complex and subject to uncertainty. It is difficult to project the costs of implementing an exploratory drilling program due to the inherent uncertainties of drilling in unknown formations, the costs associated with encountering various drilling conditions and changes in drilling plans and locations as a result of prior exploratory wells or additional data and interpretations thereof. Actual operating results, including production performance, may vary materially from those estimates. Canoro manages these risks by having operational control and working interests commensurate with the assessed risk in each project and by hiring qualified professionals, including independent technical consultants, with appropriate industry experience. The Company's operations and related assets are located in countries which carry a higher degree of political and economic risk. Canoro's management has considerable expertise operating internationally; however, the cost of doing business internationally is higher to comply with regulatory requirements.

MANAGEMENT'S REPORT

The accompanying consolidated financial statements, the notes thereto and other financial information contained in this annual report has been prepared by, and are the responsibility of, the management of Canoro Resources Ltd. These consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles using management's best judgments.

The board of directors is responsible for ensuring that management fulfills its responsibility for financial reporting and internal control. The Audit Committee, comprised of non management directors, meets with management as well as external auditors to satisfy itself that management is properly discharging its financial reporting obligations and to review consolidated financial statements of the Company and the reports of the auditors. It reports its findings to the board of directors who approve the consolidated financial statements.

These consolidated financial statements have been audited by KPMG LLP, the independent auditors, in accordance with Canadian generally accepted auditing standards. The auditors have full and unrestricted access to the Audit Committee.



Les Kondratoff
President and Chief Executive Officer



Dinesh Dattani
Vice President, Finance, Chief
Financial Officer and Secretary

August 16, 2004

AUDITORS' REPORT TO THE SHAREHOLDERS

We have audited the consolidated balance sheets of Canoro Resources Ltd. as at March 31, 2004 and 2003 and the consolidated statements of operations and deficit and cash flows for the years then ended. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Corporation as at March 31, 2004 and 2003 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

KPMG LLP

Chartered Accountants

Calgary, Canada
July 30, 2004

CONSOLIDATED BALANCE SHEETS

March 31, 2004 and 2003

	<u>2004</u>	<u>2003</u>
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 11,968,876	\$ 2,316,535
Accounts receivable	88,043	20,481
Prepaid expenses	9,093	18,244
	<u>12,066,012</u>	<u>2,355,260</u>
Restricted investments (note 4)	467,874	450,583
Goodwill (note 3)	280,000	280,000
Property, plant and equipment (note 5)	5,067,839	2,504,617
	<u>\$ 17,881,725</u>	<u>\$ 5,590,460</u>
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 792,825	\$ 394,589
Current portion of convertible debentures (note 6)	-	87,543
	<u>792,825</u>	<u>482,132</u>
Shareholders' equity:		
Share capital (note 7)	22,325,735	11,650,896
Share purchase warrants (note 7)	2,172,000	-
Contributed surplus (note 8)	1,004,000	151,000
Convertible debentures (note 6)	-	23,449
Deficit	(8,412,835)	(6,717,017)
	<u>17,088,900</u>	<u>5,108,328</u>
Future operations (note 1)		
Commitments (notes 5 and 11)		
Contingencies (note 5 and 14)		
Subsequent event (note 5)		
	<u>\$ 17,881,725</u>	<u>\$ 5,590,460</u>

See accompanying notes to consolidated financial statements.

Approved by the Board:

Director

Director

CONSOLIDATED STATEMENTS OF OPERATIONS AND DEFICIT

Years ended March 31, 2004 and 2003

	<u>2004</u>	<u>2003</u>
Revenues:		
Oil and gas sales, net of royalties	\$ -	\$ 12,277
Interest income	55,183	-
	<u>55,183</u>	<u>12,277</u>
Expenses:		
General and administrative	1,184,255	814,341
Interest and financing	13,937	77,946
Stock-based compensation (note 7)	465,000	82,000
Unrealized foreign exchange loss	56,650	20,033
Depletion, depreciation and site restoration	21,668	21,758
Annual accretion of discount on convertible debentures (note 6)	9,491	103,569
Amortization of deferred financing costs (note 6)	-	32,375
Gain on disposal of property, plant and equipment	-	(24,000)
Operating	-	3,160
	<u>1,751,001</u>	<u>1,131,182</u>
Net loss	<u>(1,695,818)</u>	<u>(1,118,905)</u>
Deficit, beginning of year	(6,717,017)	(5,598,112)
Deficit, end of year	<u>\$ (8,412,835)</u>	<u>\$ (6,717,017)</u>
Net loss per share:		
Basic and diluted (note 7(g))	<u>\$ (0.05)</u>	<u>\$ (0.06)</u>

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

Years ended March 31, 2004 and 2003

	<u>2004</u>	<u>2003</u>
Cash provided by (used in):		
Operations:		
Net loss	\$ (1,695,818)	\$ (1,118,905)
Add items not affecting cash:		
Common shares issued for services performed	65,677	256,500
Stock-based compensation	465,000	82,000
Unrealized foreign exchange loss	56,650	20,033
Depletion, depreciation and site restoration	21,668	21,758
Annual accretion of discount on convertible debentures	9,491	103,569
Common shares issued for interest	-	71,572
Amortization of deferred financing costs	-	32,375
Gain on disposal of property, plant and equipment	-	(24,000)
Funds utilized in operations	(1,077,332)	(555,098)
Net change in non-cash working capital (note 10)	8,825	153,963
	<u>(1,068,507)</u>	<u>(401,135)</u>
Financing:		
Issuance of common shares and warrants for cash	13,518,173	2,999,900
Issuance of convertible debentures	-	300,000
Financing costs	(868,744)	(254,089)
	<u>12,649,429</u>	<u>3,045,811</u>
Investments:		
Additions to property, plant and equipment	(2,185,640)	(395,191)
Restricted investments	(73,941)	(131,840)
Net change in non-cash working capital (note 10)	331,000	(40,000)
	<u>(1,928,581)</u>	<u>(567,031)</u>
Increase in cash and cash equivalents	9,652,341	2,077,645
Cash and cash equivalents, beginning of year	2,316,535	238,890
Cash and cash equivalents, end of year	<u>\$ 11,968,876</u>	<u>\$ 2,316,535</u>

See accompanying notes to consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Years ended March 31, 2004 and 2003

GENERAL:

Canoro Resources Ltd. (the "Corporation") was continued under the Business Corporations Act (Alberta) and is engaged in the acquisition, development and exploration for and production and marketing of petroleum and natural gas in India and Russia.

1. FUTURE OPERATIONS:

These financial statements have been prepared by management on the basis of accounting principles applicable to a going concern, which assumes that the Corporation will continue in operation for the foreseeable future and will be able to realize its assets and discharge its obligations in the normal course of operations.

As at March 31, 2004, the Corporation had working capital of \$11,273,187 (2003 - \$1,873,128) and had incurred a net loss of \$1,695,818 (2003 - \$1,118,905), and utilized funds from operations totaling \$1,077,332 (2003 - \$575,131) for the year then ended. The application of the going concern concept is dependent upon the Corporation's ability to generate future profitable operations and obtain the necessary financing to do so. During the year ended March 31, 2004, the Corporation issued common shares and share purchase warrants for cash totaling approximately \$12,650,000 (see note 7). These funds will be used to continue the Corporation's development of its petroleum and natural gas properties in India (see note 5).

Management believes the going concern assumption to be appropriate for these financial statements. If the going concern assumption were not appropriate for these financial statements, adjustments might be necessary to the carrying values of assets and liabilities, reported revenues and expenses and the balance sheet classifications used.

2. SIGNIFICANT ACCOUNTING POLICIES:

(a) Basis of presentation:

These consolidated financial statements include the accounts of the Corporation and its subsidiaries, all of which are wholly owned. Certain of the comparative figures have been reclassified to conform to the current year's financial statement presentation.

(b) Petroleum and natural gas properties:

(i) Capitalized costs:

The Corporation follows the full cost method of accounting for its petroleum and natural gas properties. Under this method all costs related to the exploration for and development of petroleum and natural gas reserves are capitalized in cost centers on a country-by-country basis. Costs include lease acquisition costs, geological and geophysical expenses, overhead directly related to exploration and development activities and costs of drilling both productive and non-productive wells. Proceeds from the sale of properties are applied against capitalized costs, without any gain or loss being realized, unless such sale would significantly alter the rate of depletion and depreciation by 20% or more.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

Years ended March 31, 2004 and 2003

2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED):

(b) Petroleum and natural gas properties (continued):

(ii) Depletion and depreciation:

Depletion of petroleum and natural gas properties and depreciation of production equipment is provided using the unit-of-production method based upon estimated proven petroleum and natural gas reserves, before royalties, on a cost centre basis. The costs of significant unevaluated properties and major development projects are excluded from costs subject to depletion. For depletion and depreciation purposes, relative volumes, before royalties, of petroleum and natural gas production and reserves are converted at the energy equivalent conversion rate of six thousand cubic feet of natural gas to one barrel of crude oil.

(iii) Ceiling tests:

In following the full cost method, effective December 31, 2003, the Corporation has prospectively adopted the new accounting standards with respect to applying a ceiling test under Canadian generally accepted accounting principles. Under the new standards, an impairment loss should be recognized when the carrying amount of a cost centre is not recoverable and exceeds its fair value. The carrying amounts are assessed to be unrecoverable 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 are less than the carrying amount of the cost centre. In determining the amount of impairment, the carrying amount of oil and gas properties capitalized in a cost centre is compared to the fair value of the associated proved and probable reserves and the costs of any unproved properties that have been subject to a separate test for impairment and contain no probable reserves. In determining the fair value of the proved and probable reserves, the Corporation uses cash flows based upon oil and gas prices as quoted in the futures market where obtainable, adjusted for quality differences, transportation, foreign exchange and other relevant factors.

These cash flows are then discounted using a risk-free interest rate adjusted for political, reserve volume and type, regulatory and other applicable risks and uncertainties. If the carrying value of the oil and gas properties is in excess of its fair value, the excess is charged against earnings as additional depletion and depreciation.

Prior to December 31, 2003, the ceiling test amount was 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 estimated future costs for administration, financing, site restoration and income taxes. The cash flows were estimated using period end prices and costs. Had the Corporation applied the old method of determining the ceiling test, a write down totaling \$286,000 would have been required at March 31, 2004.

(iv) Joint venture activities:

The Corporation conducts substantially all of its oil and gas exploration and production activities on a joint venture basis. These financial statements reflect only the Corporation's proportionate interest in such activities.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

Years ended March 31, 2004 and 2003

2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED):

(c) Site restoration:

Estimated future site restoration costs for each cost center are provided for over the life of the proven reserves on a unit-of-production basis. Costs for each cost center are estimated by management based on current regulations, costs, technology, and industry standards. The annual charge is included in the provision for depletion and depreciation and actual site restoration expenditures are charged against the accumulated provision account as incurred.

(d) Office furniture and equipment:

Depreciation of office furniture and equipment is based on estimates of useful lives and is calculated using the declining balance method at rates ranging from 20% to 100% per annum.

(e) Foreign currency translation:

The financial statements are stated in Canadian dollars. Foreign currency denominated assets and liabilities are translated at the exchange rate prevailing at the balance sheet date for monetary items and at the transaction date for non-monetary items. Revenues and expenses, except depletion and depreciation, are translated at average exchange rates for the year. Depletion and depreciation are translated at the same rate as the related assets.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

Years ended March 31, 2004 and 2003

2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED):

(f) Convertible debentures and deferred financing costs:

Convertible debentures were recorded as the amount of proceeds received less the amount attributed to the conversion feature which was included as part of shareholders' equity. The difference between the recorded amount and the face value of the convertible debentures was charged to income and included in annual accretion of discount of convertible debentures on an effective yield basis.

Financing costs associated with the issue of convertible debentures were deferred and amortized over the term of the debentures.

(g) Revenue recognition:

Revenues associated with the sale of crude oil and natural gas will be recorded when title passes to the customer. Revenues from crude oil and natural gas production from properties from which the Corporation has an interest with other producers will be recognized on the basis of the Corporation's net working interest.

(h) Income taxes:

The Corporation follows the liability method of accounting for income taxes. Under this method, temporary differences arising from the difference between the tax basis of an asset or liability and its carrying amount on the balance sheet are used to calculate future income tax liabilities or assets. Future income tax liabilities or assets are calculated using substantively enacted tax rates anticipated to apply in the periods that the temporary differences are expected to reverse. A valuation allowance is recorded against any future income tax assets if it is more likely that the assets will not be realized.

(i) Per share data:

Basic net loss per common share is computed by dividing net loss from operations by the weighted average number of common shares outstanding for the period. Diluted per share amounts reflect the potential dilution that could occur if securities or other contracts to issue common shares were exercised or converted to common shares. The treasury stock method is used to determine the dilutive effect of stock options and other dilutive instruments. Under the treasury stock method, only options for which the exercise price is less than the market value impact the dilution calculations.

(j) Cash equivalents:

Cash equivalents are comprised of term deposits and other highly liquid investments with an original maturity of three months or less at the time of purchase and as such, are classified with cash.

(k) Stock-based compensation:

Effective March 31, 2004 the Corporation adopted the amended standard with respect to stock-based compensation, which requires the use of the fair value method for valuing all stock options granted whether they be to employees, directors or non-employees. As such and pursuant to the transition rules, the Corporation recognized an expense for all options granted during the year ended March 31, 2004 (see note 7). Previously and commencing April 1, 2002, the Corporation had followed the fair value method for valuing stock options granted to non-employees but had continued to follow the settlement method of accounting for options issued to employees and directors.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

Years ended March 31, 2004 and 2003

2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED):

(k) Stock-based compensation (continued):

Under the fair value method, a compensation cost is measured at fair value for stock options granted at the grant date and expensed over the vesting period with a corresponding increase to contributed surplus. Upon the exercise of the stock options, consideration paid together with the amount previously recognized to contributed surplus is recorded as an increase to share capital.

(l) Goodwill:

Goodwill represents the excess of the purchase price over the value attributed to the net tangible and intangible assets acquired. Goodwill is not subject to amortization but is subject to an annual review for impairment (or more frequently if events or changes in circumstances indicate that goodwill is impaired), which consists of a comparison of fair value of the assets to their carrying value. The net carrying value of goodwill would be written down if the value is permanently impaired.

(m) Use of estimates:

The preparation of the financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates. The most significant estimates relate to determining the cost recoverability of the Corporation's capital assets and the provisions for depletion, depreciation and site restoration, which are based upon such estimates as proven reserves and future development costs.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

Years ended March 31, 2004 and 2003

3. BUSINESS COMBINATION:

On August 28, 2002, the Corporation acquired all of the issued and outstanding shares of a private company for consideration consisting of 800,000 shares of the Corporation at an ascribed value of \$0.35 per share for consideration totaling \$280,000. The acquisition was accounted for by the purchase method whereby the assets and liabilities of the private company were recorded at fair market values, and the operating results were included in the Corporation's financial statements from August 28, 2002. As the private company had no assets or liabilities, all of the purchase price was allocated to goodwill.

4. RESTRICTED INVESTMENTS:

Restricted investments are represented by guaranteed investment certificates amounting to U.S. \$358,300 bearing interest at rates ranging from 0.35% to 0.77% per annum, and maturing on dates ranging from April 30, 2004 to December 17, 2004.

The guaranteed investment certificates have been provided as a guarantee, which has been issued to the government of India pursuant to the terms of a production-sharing contract for the performance of certain seismic activities expected to be completed by September 30, 2004 and certain operational activities to be completed by March 31, 2005. As such, the guaranteed investment certificates are restricted until the completion of the seismic and operational activities to the satisfaction of the government of India.

5. PROPERTY, PLANT AND EQUIPMENT:

2004	Cost	Accumulated depletion and depreciation	Net book value
Petroleum and natural gas properties – India	\$ 5,016,173	\$ –	\$ 5,016,173
Office furniture and equipment	121,101	69,435	51,666
	<u>\$ 5,137,274</u>	<u>\$ 69,435</u>	<u>\$ 5,067,839</u>
2003			
Petroleum and natural gas properties – India	\$ 2,454,266	\$ –	\$ 2,454,266
Office furniture and equipment	99,485	49,134	50,351
	<u>\$ 2,553,751</u>	<u>\$ 49,134</u>	<u>\$ 2,504,617</u>

(i) Activities in India:

At March 31, 2004 the carrying value of the Corporation's undeveloped land associated with the India cost center totaled \$4,730,000 (2003 - \$2,434,000). During the year ended March 31, 2004, direct overhead costs totaling approximately \$300,000 (2003 – approximately \$300,000) were capitalized relating to the Corporation's exploration, development and property acquisition programs in India.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

Years ended March 31, 2004 and 2003

5. PROPERTY, PLANT AND EQUIPMENT (CONTINUED):

(i) Activities in India (continued):

Effective May 25, 1998, the Corporation acquired an interest in an oil and gas field in India for approximately \$300,000. As part of the acquisition agreement, the Corporation is committed to fund certain seismic costs by October 31, 2004 totaling approximately \$1,500,000. In addition, the Corporation is committed to drill an exploratory well by March 31, 2006, which is expected to cost approximately \$3,500,000. During the year ended and subsequent to March 31, 2004, the Corporation has substantially completed its work obligations with respect to funding its seismic obligations. To date the Corporation has not incurred any costs with respect to the drilling of the exploratory well.

On July 3, 2003 the Corporation entered into an agreement to purchase a 25% interest in an oil and gas property in India for total consideration of U.S. \$475,000. As at March 31, 2004 the Corporation had paid U.S. \$425,000 towards the purchase. On May 3, 2004 the Corporation completed the final payment of U.S. \$50,000 due to the vendor under the agreement.

Pursuant to Purchase and Sale and Assignment and Transfer Agreements, the Corporation secured a 60% Participation Interest in the Production Sharing Contract ("PSC") for the Amguri Discovered Field in Assam, India. Under the terms of the PSC, the Effective Date was established to be November 27, 2003, being the date of grant of the Petroleum Mining Lease. The Corporation is in the process of securing the custody of the field from the operator of the field. To date, no information is available with respect to production volumes, revenues, or expenses and the Corporation will record such revenues and expenses at the time the information becomes available. Any net cash flow or operating income from the one producing gas well on the field for the period to March 31, 2004 is not anticipated to be material.

The Corporation performed a ceiling test calculation at March 31, 2004 to assess the recoverable value of the property, plant and equipment. The gas 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 the Corporation. 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 the Corporation's proved plus probable reserves exceeded the carrying value of property, plant and equipment at March 31, 2004.

Year ended March 31	(US\$ to Canadian \$)	(US\$/mcf)
2005	1.35	2.50
2006	1.35	2.55
2007	1.35	2.60
2008	1.35	2.65
2009	1.35	2.71
2010	1.35	2.76
Escalate thereafter	1.35	2.0% per year

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

Years ended March 31, 2004 and 2003

5. PROPERTY, PLANT AND EQUIPMENT (CONTINUED):

(ii) Activities in Russia:

During the year ended March 31, 2004, the Corporation incurred approximately \$110,000 (2003 - \$40,000) relating to establishing its exploration and development activities in Russia. This amount was expensed and is included as part of general and administrative expenses.

6. CONVERTIBLE DEBENTURES:

	<u>2004</u>	<u>2003</u>
Convertible debentures:		
Balance, beginning of year	\$ 110,992	\$ 539,805
Issued during the year	-	300,000
Less: equity component	<u>(23,449)</u>	<u>(70,346)</u>
	87,543	769,459
Add: accretion of discount on conversion feature	9,491	103,569
Less: amount converted to share capital	<u>(97,034)</u>	<u>(785,485)</u>
	-	87,543
Less: classified as current	-	(87,543)
Balance, end of year	<u>\$ -</u>	<u>\$ -</u>
Deferred financing costs:		
Deferred financing costs	\$ -	\$ 34,125
Less accumulated amortization	-	(34,125)
	<u>\$ -</u>	<u>\$ -</u>

At March 31, 2004, convertible debentures with a principal balance of \$nil (March 31, 2003 - \$100,000) were outstanding. These debentures bore interest at the rate of 10% per annum payable annually, were repayable in full on February 11, 2004, and were secured by a floating charge and general security interest on all of the Corporation's assets. In addition, the debentures were convertible, at the option of the holder, at a conversion price of \$0.35 per common share until February 2002, and \$0.60 per common share until February 11, 2004.

During the year ended March 31, 2004, the debenture holders converted debentures with a principal balance of \$100,000 into 166,668 common shares (see note 7) at \$0.60 per common share, leaving a principal balance outstanding of \$nil. As such, both the liability component totaling \$785,485 and the equity component totaling \$231,932 of the convertible debentures, which were converted, have been reclassified to share capital.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

Years ended March 31, 2004 and 2003

7. SHARE CAPITAL:

(a) Authorized:

Unlimited voting common shares, without nominal or par value; and
Unlimited non-voting preferred shares without nominal or par value.

(b) Common shares issued:

	2004		2003	
	Number	Amount	Number	Amount
Balance, beginning of year	28,682,846	\$ 11,650,896	15,268,275	\$ 7,237,471
Issued for cash	16,332,787	11,199,173	8,571,143	2,999,900
Issued for services performed	554,327	464,927	1,050,000	361,500
Issued on conversion of debenture (note 6)	166,668	120,483	2,571,434	1,017,417
Issued on acquisition of private company (note 3)	-	-	800,000	280,000
Issued for share issue cost	-	-	200,000	70,000
Issued on settlement of interest	-	-	204,494	71,572
Issued on convertible debenture financing	-	-	17,500	6,125
	45,736,628	23,435,479	28,682,846	12,043,985
Financing costs	-	(1,109,744)	-	(393,089)
Balance, end of year	45,736,628	\$ 22,325,735	28,682,846	\$ 11,650,896

(c) Share purchase warrants issued:

	2004		2003	
Balance, beginning of year	\$	-	\$	-
Issued for cash		2,319,000		-
Financing costs		(147,000)		-
Balance, end of year	\$	2,172,000	\$	-

As part of the equity financing completed March 12, 2004, the Corporation issued 7,059,000 share purchase warrants to investors and 988,260 share purchase warrants to the financing agent, exercisable at \$1.15 per common share until March 11, 2006.

	2004		2003	
	Number	Weighted average exercise price	Number	Weighted average exercise price
Warrants, beginning of year	-	\$ -	-	\$ -
Granted	8,047,260	1.15	-	-
Exercised	-	-	-	-
Expired / cancelled	-	-	-	-
Warrants, end of year	8,047,260	\$ 1.15	-	\$ -

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

Years ended March 31, 2004 and 2003

7. SHARE CAPITAL (CONTINUED):

(d) Stock options:

The Corporation has a stock option plan whereby officers, directors, employees and consultants may be granted options to purchase common shares of the Corporation. At March 31, 2004, options have been granted to purchase 2,748,500 (2003 - 1,933,500) common shares at prices ranging from \$0.35 to \$0.87 until expiry on dates ranging from February 13, 2005 to January 12, 2009.

Details of the options outstanding under the stock option plan are as follows:

	2004		2003	
	Number	Weighted average exercise price	Number	Weighted average exercise price
Outstanding options, beginning of year	1,933,500	\$ 0.44	1,198,500	\$ 0.44
Granted	1,125,000	0.75	1,300,000	0.35
Exercised	(50,000)	—	—	—
Expired / cancelled	(260,000)	0.40	(565,000)	0.40
Outstanding options, end of year	2,748,500	\$ 0.52	1,933,500	\$ 0.39
Options exercisable, end of year	1,628,502	\$ 0.45	1,066,834	\$ 0.43

Options Range of Exercise Price	Outstanding at March 31, 2004	Weighted Average Remaining Contractual Life	Exercisable at March 31, 2004	Weighted Average Remaining Contractual Life
\$ 0.35	1,623,500	3.0 years	1,220,168	3.0 years
\$ 0.75 - \$0.87	1,125,000	4.6 years	408,334	4.6 years
	2,748,500	3.7 years	1,628,502	3.7 years

(e) Agent options:

During the year ended March 31, 2003, the Corporation granted 685,680 agent's options exercisable at \$0.35 per common share to certain financial institutions in conjunction with a private placement of common shares. These options expire on February 20, 2005 and were exercisable when granted. There were no agent options issued during the current year.

	2004		2003	
	Number	Weighted average exercise price	Number	Weighted average exercise price
Outstanding agent options, beginning of year	685,680	\$ 0.35	—	\$ —
Granted	—	—	685,680	0.35
Exercised	(308,043)	0.35	—	—
Expired / cancelled	—	—	—	—
Outstanding agent options, end of year	377,637	\$ 0.35	685,680	\$ 0.35

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

Years ended March 31, 2004 and 2003

7. SHARE CAPITAL (CONTINUED):

(f) Stock-based compensation:

As described in note 2(k), the Corporation followed the settlement method of accounting for stock options granted to employees prior to fiscal 2004. Had the Corporation used the fair value method of accounting for options and warrants granted to employees during the year ended March 31, 2003, the stock-based compensation expense, pro forma net loss and pro forma net loss per share would have been as follows:

	2004	2003
Increase to stock-based compensation expense	\$ 66,000	\$ 300,000
Net loss for the year:		
As reported	(1,695,818)	(1,118,905)
Pro forma	(1,761,818)	(1,418,905)
Net loss per share:		
Basic and diluted:		
As reported	(0.05)	(0.06)
Pro forma	(0.05)	(0.07)

The weighted-average fair value of stock options was estimated at \$0.35 (2003 - \$0.26) per option using the Black-Scholes option-pricing model with the following assumptions:

	2004	2003
Dividend yield	0%	0%
Expected volatility (range)	85% to 93%	97% to 170%
Risk free rate of return	3.5%	5%
Expected option life (range)	1 - 5 years	1 - 5 years
Forfeiture rate	0%	0%

(g) Per share amounts:

The weighted average number of common shares outstanding during the year ended March 31, 2004 was approximately 33,080,000 (2003 - approximately 20,191,000 shares).

8. CONTRIBUTED SURPLUS:

The Corporation recognized compensation expense of \$118,000 for stock options granted to consultants and non-employees and \$347,000 for stock options granted to employees, officers and directors for the year ended March 31, 2004 (2003 - \$82,000 and \$nil, respectively). In addition, the Corporation recognized \$388,000 of share issue costs representing the fair value of the investors' agent's options and warrants (see note 7(c)) granted during the year ended March 31, 2004 (2003 - \$69,000).

	2004	2003
Balance, beginning of year	\$ 151,000	\$ -
Stock-based compensation:		
Employees' and directors' options	347,000	-
Consultants' options	118,000	82,000
	465,000	82,000
Agent options and warrants:		
Financing agent's options (note 7(e))	63,000	69,000
Financing agent's warrants (note 7(c))	325,000	-
	388,000	69,000
Balance, end of year	\$ 1,004,000	\$ 151,000

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

Years ended March 31, 2004 and 2003

8. CONTRIBUTED SURPLUS (CONTINUED):

The above weighted-average fair value of stock options and warrants was estimated using the Black-Scholes option-pricing model assumptions described in note 7(f).

9. INCOME TAXES:

The provision for income taxes differs from the result, which would have been obtained by applying the combined federal and provincial income tax rates to the Corporation's loss before income taxes. This difference results from the following items:

	<u>2004</u>	<u>2003</u>
Combined federal and provincial income tax rate	40.62%	42.12%
Expected tax recovery	\$ (689,000)	\$ (471,000)
Increase (decrease) resulting from:		
Net increase in valuation allowance	689,000	471,000
	<u>\$ -</u>	<u>\$ -</u>

The components comprising the future income taxes are as follows:

	<u>2004</u>	<u>2003</u>
Tax assets:		
Non-capital loss carry forwards	\$ 1,747,000	\$ 1,913,000
Share issue costs	539,000	302,000
Capital assets	1,224,000	1,492,000
	<u>3,510,000</u>	<u>3,707,000</u>
Less valuation allowance	(3,510,000)	(3,707,000)
Future income tax liability	<u>\$ -</u>	<u>\$ -</u>

At March 31, 2004, the Corporation had approximately \$5,100,000 (2003 - \$4,500,000) of losses available to reduce future taxable income in Canada expiring in the years 2004 to 2010. In addition, the Corporation has cumulative income tax deductions in excess of net book values totaling approximately \$3,600,000 (2003 - \$3,500,000), some of which may be restricted to operations in other countries. The related benefit of these losses and deductions has not been recognized in these financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

Years ended March 31, 2004 and 2003

10. SUPPLEMENTAL CASH FLOW DISCLOSURE:

(a) Changes in non-cash working capital:

	<u>2004</u>	<u>2003</u>
Accounts receivable	\$ (67,562)	\$ 34,036
Prepaid expenses	9,151	12,835
Accounts payable and accrued liabilities	<u>398,236</u>	<u>67,092</u>
	<u>339,825</u>	113,963
Less: changes in non-cash working capital related to investing activities	331,000	(40,000)
Changes in non-cash working capital related to operating activities	<u>\$ 8,825</u>	<u>\$ 153,963</u>

(b) Cash receipts (payments):

	<u>2004</u>	<u>2003</u>
Interest receipts	\$ 41,652	\$ 747
Interest payments	<u>\$ (8,972)</u>	<u>\$ (2,000)</u>

11. COMMITMENT:

The Corporation is committed to making the following approximate payments for leased premises and equipment:

2005	\$ 64,000
2006	64,000
2007	<u>63,000</u>

12. RELATED PARTY TRANSACTIONS:

During the year ended March 31, 2004, the Corporation issued 150,000 common shares with an ascribed value of \$0.91 per share to two executive officers of the Corporation for services rendered. In addition, the Corporation issued 38,675 common shares with an ascribed value of \$0.83 per share to a director of the Corporation for services rendered. The aggregate consideration for these two transactions was \$168,600 (2003 - \$431,500). Of this amount, \$136,500 (2003 - \$105,000) related to direct overhead costs associated with the Corporation's exploration and development activities in India and was recorded as a capital asset and \$32,100 (2003 - \$256,500) related to general and administrative expenses. The above 2003 total of \$431,500 includes \$70,000 related to share issue costs.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

Years ended March 31, 2004 and 2003

13. FINANCIAL INSTRUMENTS:

(a) Interest rate risk:

As at March 31, 2004 and 2003, the Corporation was exposed to changes in interest rates with respect to its outstanding convertible debentures and its restricted investments.

(b) Foreign currency exchange risk:

The Corporation is exposed to foreign currency fluctuations as crude oil and natural gas revenues as well as many of the Corporation's expenditures are referenced to the U.S. dollar.

(c) Credit risk:

The Corporation's accounts receivable are primarily with customers in the oil and gas industry and government agencies and are subject to normal industry credit risks.

(d) Fair value of financial instruments:

The carrying value of the Corporation's financial assets and liabilities approximated their fair values as at March 31, 2004 and 2003.

14. CONTINGENCIES:

The Corporation is subject to legal proceedings and actions arising in the normal course of business. Management believes that any assets or liabilities, which might arise pertaining to such matters, would not be expected to have a material effect on the Corporation's consolidated financial position.

CORPORATE INFORMATION

BOARD OF DIRECTORS

Douglas R. Martin⁽¹⁾

Calgary, Alberta, Canada

D. Nolan Blades⁽²⁾

Calgary, Alberta, Canada

Les Kondratoff, B.Sc., M.B.A.

Bragg Creek, Alberta, Canada

Stephen B. Nerland⁽³⁾

Red Deer, Alberta, Canada

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OFFICERS

Les Kondratoff, B.Sc., M.B.A.

President and Chief Executive Officer

Geoffrey A. Carrington, Ph.D., P.Geoph.

Executive Vice President

Dinesh Dattani, C.A.

Vice President, Finance, Chief Financial
Officer and Corporate Secretary

BANKERS

Bank of Nova Scotia

Calgary, Alberta, Canada

AUDITORS

KPMG LLP

Calgary, Alberta, Canada

LEGAL COUNSEL

Heenan Blaikie LLP

Calgary, Alberta, Canada

REGISTRAR AND TRANSFER AGENT

Computershare Trust Company of Canada

Calgary, Alberta, Canada

STOCK EXCHANGE LISTING

TSX Venture Exchange

Symbol "CNS"

(1) Board Chair;
Chair, Compensation and Governance Committee;
Member, Audit and Reserves Committee

(2) Chair, Audit and Reserves Committee;
Member, Compensation and Governance Committee

(3) Member, Audit and Reserves Committee

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