



GALLEON ENERGY INC.

SECOND QUARTER REPORT 2004

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Report to Shareholders

The second quarter of 2004 is the third quarter for Galleon as a public company. The business plan remains:

- *Grow reserves and production on a per share basis*
- *Focused exploration, strategic acquisitions and controlled exploitation*
- *Build a high quality asset base*
- *Maintain a strong financial position*
- *Foster strategic partnerships*

In the second quarter of 2004, Galleon:

- *Increased production to 1,414 Boe/d – a 78% increase over first quarter production and a 45% increase on a per share basis*
- *Drilled 9 wells in the quarter with 7 cased for production*
- *Increased the owned and identified drilling locations at Calais and Dawson to 70*
- *Exited the second quarter with production of 1,700 Boe/d*
- *Closed a \$10/share, \$10 million flow through share financing*
- *Increased available bank lines to \$15 million*

Subsequent to the second quarter of 2004, Galleon:

- *Signed a farm-in on July 20, 2004 in the Dawson area increasing the company's working interest to 62.5% in 90,880 gross acres of undeveloped land and adding access to 119,040 gross acres of undeveloped land, bringing total Peace River Arch land access to 421,120 gross acres*
- *Closed a \$20.1 million strategic acquisition of a private oil and gas company on July 28, 2004 purchasing 420 Boe/d and increasing production to over 2,100 Boe/d*
- *Increased available bank lines to \$25 million on July 28, 2004*
- *Closed a \$8/share, \$24 million private placement equity financing on August 4, 2004*
- *Increased the owned and identified drilling locations at Calais, Dawson and Two Rivers to 80*

Good progress was made on all fronts since we last reported to you on May 13, 2004. Drilling has met expectations and the acquisition provides Galleon a third leg on its Peace River Arch strategy. Year round access to the land holdings is now in excess of 90% and an active program of 20-25 wells is planned for the second half. The drilling inventory has increased to over 80 locations. 2004 exit production is currently targeted at 3,000 Boe/d with top decile operating costs and netbacks expected in the fourth quarter.

We thank you for your support and look forward to reporting on the ongoing drilling results.

[signed]

Glenn R. Carley
Chairman and Chief Executive Officer
August 19, 2004

[signed]

Steve Sugianto
President and Chief Operating Officer

Highlights

As at June 30, 2004 *2nd Qtr 2004* *1st Qtr 2004* *4th Qtr 2003* *3rd Qtr 2003* *2nd Qtr 2003* *1st Qtr 2003*

Production

Light oil (Bbl/d)	84	56	–	–	–	–
Heavy/Medium oil (Bbl/d)	274	265	152	–	–	–
Natural Gas (Mcf/d)	6,328	2,841	42	–	–	–
Liquids (Bbl/d)	1	1	–	–	–	–
Boe/d at 6:1 gas	1,414	796	159	–	–	–
Total Boe produced	128,667	72,378	14,615	–	–	–

Daily Boe of production per million Class A shares

80	55	19	–	–	–
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Prices

Light oil (\$/Bbl)	49.40	45.26	–	–	–	–
Heavy/medium oil (\$/Bbl)	29.70	27.56	24.61	–	–	–
Crude oil with hedge (\$/Bbl)	28.57	26.48	23.79	–	–	–
Natural Gas (\$/Mcf)	6.67	5.71	6.41	–	–	–
NGLs (\$/Bbl)	34.78	42.88	–	–	–	–

Per Boe (\$)

Gross revenues (net of hedges and transportation costs)

37.10	31.13	24.43	–	–	–
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Royalties, net of ARTC

(8.10)	(6.56)	(5.41)	–	–	–
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Operating costs

(5.43)	(7.08)	(11.65)	–	–	–
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Operating netback

23.57	17.49	7.37	–	–	–
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Other revenue

0.03	0.13	5.80	–	–	–
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G&A

(4.07)	(4.61)	(14.12)	–	–	–
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Interest - cash

(0.28)	(0.07)	–	–	–	–
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Current tax - cash

(0.58)	–	–	–	–	–
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Cash flow from (used in) operations

18.67	12.94	(0.95)	–	–	–
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2nd Qtr 2004 1st Qtr 2004 4th Qtr 2003 3rd Qtr 2003 2nd Qtr 2003 1st Qtr 2003

Financial (\$)

Gross revenues (net of hedges and transportation costs)	4,773,723	2,253,149	357,090	—	—	—
Royalties, net of ARTC	(1,042,773)	(474,615)	(79,087)	—	—	—
Operating costs	(699,145)	(512,095)	(170,317)	—	—	—
Other revenue	4,706	9,373	84,836	31,181	13,455	—
G&A	(523,263)	(333,500)	(206,481)	(112,842)	(32,787)	—
Interest - cash	(35,681)	(5,599)	—	—	—	—
Current tax - cash	(75,111)	—	—	—	—	—
Cash flow from (used in) operations	2,402,456	936,713	(13,959)	(81,661)	(19,332)	—
Depletion, depreciation & accretion	(1,335,956)	(763,207)	(170,472)	(39,016)	(6,054)	—
Future tax (expense) recovery	(484,515)	37,394	94,008	—	—	—
Stock-based compensation	(122,238)	(87,720)	—	—	—	—
Earnings (loss)	459,747	123,180	(90,423)	(120,677)	(25,386)	—
Total assets	60,289,729	47,059,699	15,727,097	10,471,707	875,571	—
Long term financial liabilities	—	—	—	—	—	—
Weighted average outstanding Class A shares-basic	17,607,394	14,580,107	8,300,001	4,063,610	671,670	1
Cash flow \$ per share-basic	0.14	0.06	—	—	—	—
Earnings (loss) \$ per share-basic	0.03	0.01	(0.01)	(0.03)	(0.04)	—

MD & A

Management's Discussion & Analysis ("MD&A") is intended to assist in the understanding of the trends and significant changes in the financial condition and results of operations of Galleon Energy Inc. ("Galleon") for the second quarter of 2004. The following information has been prepared by management in accordance with Canadian generally accepted accounting principles ("GAAP") and should be read in conjunction with the audited financial statements for the year ended December 31, 2003 and the unaudited interim consolidated financial statements as at and for the quarters ended June 30 and March 31, 2004.

Petroleum and natural gas reserves and volumes are converted to a common unit of measure on a basis of six thousand cubic feet (Mcf) of gas to one barrel (Bbl) of oil. This MD&A is dated as of August 19, 2004

NON-GAAP MEASUREMENTS

The MD&A contains the term cash flow from operations which should not be considered an alternative to or more meaningful than, cash flow from operating activities or net earnings as determined in accordance with Canadian GAAP as an indicator of Galleon's performance. Galleon's determination of cash flow from operations may not be comparable to that reported by other companies. The reconciliation between net earnings and cash flow from operations can be found in the Consolidated Statements of Cash Flow. The Corporation also presents cash flow per share where cash flow from operations is divided by the weighted average number of shares outstanding to determine per share amounts.

Galleon uses the term net debt in its MD&A and presents a table showing how it has been determined. This measure does not have any standardized meaning prescribed by Canadian GAAP and therefore may not be comparable to similar measures presented by other companies.

FORWARD LOOKING STATEMENTS

Statements throughout this interim report that are not historical facts may be considered "forward looking statements." These forward looking statements sometimes include words to the effect that management believes or expects a stated condition or result. All estimates and statements that describe the Corporation's objectives, goals or future plans are forward looking statements. Since forward looking statements address future events and conditions, by their very nature they involve inherent risks and uncertainties. Actual results could differ materially from those currently anticipated due to any number of factors, including such variables as new information regarding recoverable reserves, changes in demand for, and commodity prices of crude oil and natural gas, legislative, environmental and other regulatory or political changes, competition in areas where the Corporation operates and other factors discussed in this interim report.

COMPARISON TO SECOND QUARTER 2003

Galleon commenced oil and gas operations at the end of June 2003 and accordingly, no comparative year over year oil and gas data is shown in this MD&A. During second quarter 2003, Galleon issued 3,468,000 founder's shares for gross proceeds of \$867,000, received interest income of \$13,455, incurred general and administrative expenses of \$32,787 and recorded depreciation on a compressor of \$6,054. In addition, the Corporation drilled one natural gas well and purchased a compressor which was sold later in 2004.

SECOND QUARTER 2004 HIGHLIGHTS

- Cash flow from operations of \$2,402,456
- Operating netbacks of \$23.57/Boe
- Average daily production of 1,414 Boe; natural gas – 6.3 Mmcf and liquids – 359 Bbl
- Flow through share financing of \$10 million
- Increase in the bank credit facility to \$15 million
- Drilled 9 gross wells resulting in 7 gross (4.9 net) natural gas wells
- Capital expenditures of \$10.9 million

PETROLEUM AND NATURAL GAS REVENUES

Galleon recorded another quarter of significant revenue growth due to strong commodity prices and the addition of natural gas volumes from Calais and Dawson, Alberta. Natural gas volumes produced from Wymark, Saskatchewan and Princess, Alberta also contributed to the growth during second quarter 2004. Revenue increased by 109% from first quarter 2004 comprised of an increase in revenue from natural gas and liquids of 160% and 25% respectively.

Netbacks	Q2 2004 128,667 Boe		YTD 2004 201,045 Boe	
	\$	\$/Boe	\$	\$/Boe
Gross revenues, net of transportation	4,961,979	38.56	7,337,206	36.50
Hedges	(188,256)	(1.46)	(310,334)	(1.55)
Royalties, net of ARTC	(1,042,773)	(8.10)	(1,517,388)	(7.55)
Subtotal	3,730,950	29.00	5,509,484	27.40
Operating costs	(699,145)	(5.43)	(1,211,240)	(6.02)
Operating netback	3,031,805	23.57	4,298,244	21.38
Other revenue	4,706	0.03	14,079	0.07
G&A	(523,263)	(4.07)	(856,763)	(4.26)
Interest costs	(35,681)	(0.28)	(41,280)	(0.21)
Current taxes	(75,111)	(0.58)	(75,111)	(0.37)
Cash flow from operations	2,402,456	18.67	3,339,169	16.61
Revenue contribution analysis				
		Q2 2004		YTD 2004
	\$	%	\$	%
Oil	1,119,103	23	2,014,680	27
NGLs	2,991	–	7,093	1
Natural gas	3,839,885	77	5,315,433	72
Gross revenues, net of transportation	4,961,979	100	7,337,206	100

Product mix analysis		<i>Q2 2004</i>		<i>YTD 2004</i>
		<i>%</i>		<i>%</i>
Oil (Bbls/d)	358	25	340	31
NGLs (Bbls/d)	1	–	1	–
Natural gas (Mcf/d)	6,328	75	4,585	69
Boe/d (6:1)	1,414	100	1,105	100

Volumes increased by 78% in second quarter 2004 compared to first quarter 2004. This was primarily due to an increase in natural gas volumes – 123% and an increase in liquids volumes – 11%.

COMMODITY PRICING AND MARKETING

Petroleum products are sold to major Canadian marketers at spot reference prices based on US WTI for crude oil and AECO-C for natural gas. The Corporation had two hedging contracts in place during the second quarter which covered 47% of total liquids sales in the quarter. The cost of the crude oil hedge contracts was \$188,256 in Q2/04 or \$5.76/Bbl based on total liquids sold in the quarter.

The first contract commenced on December 1, 2003 for 100 Bbl/day with a fixed price of \$38.46/Bbl WTI Cdn and expired on May 31, 2004. The second contract commenced on January 1, 2004 for 100 Bbl/day with a fixed price of \$40.80/Bbl WTI Cdn and expires on December 31, 2004.

Prices	<i>Q2 2004</i>	<i>YTD 2004</i>
Light oil (\$/Bbl)	49.40	47.74
Heavy/medium oil (\$/Bbl)	29.70	28.65
Hedge impact (\$/Bbl)	(5.76)	(5.01)
Net crude oil (\$/Bbl)	34.33	32.60
Natural gas (\$/Mcf)	6.67	6.37
NGLs (\$/Bbl)	34.78	39.05

PERFORMANCE BY PROPERTY

	Q2 2004 Production		Operating netbacks/ Boe \$	YTD 2004 Production		Operating netbacks /Boe \$	Operating YTD 2004 cash flow %
	Boe/day	%		Boe/day	%		
Dawson	333	24	22.33	183	17	22.12	17
Wymark	316	22	28.58	288	26	27.04	32
Calais	279	20	27.71	182	17	26.47	20
Lloydminster	147	10	12.95	138	12	12.05	7
Delta West	127	9	13.33	131	12	11.95	6
Progress	91	6	26.50	79	7	22.44	7
Princess	61	4	29.76	49	4	29.21	6
John Lake	21	2	30.02	17	2	28.02	2
Monitor	23	2	24.34	23	2	23.77	2
Bindloss	16	1	20.95	15	1	20.53	1
Boe/day	1,414	100	25.03	1,105	100	22.93	100

ROYALTIES

Royalty expenses were 24.6% of gross revenues (19.6% crown, 3.2% freehold and 1.8% other) for second quarter 2004 compared to 20%, (14% crown, 5% freehold and 1% other) for first quarter 2004. The increase in the royalty rates from first quarter 2004 is due to higher royalty rates on new natural gas production. Royalty rates recorded in second quarter 2004 were 28.7% for Calais and 35.4% for Dawson. Royalty rates at Dawson will decrease in the third quarter 2004 due to a conversion of a gross overriding royalty interest to a working interest. ARTC of \$176,623 was accrued in second quarter 2004. YTD 2004 royalty expenses were 23.1% of gross revenues (17.7% crown, 3.7% freehold and 1.7% other).

OPERATING EXPENSES

Operating expenses averaged \$5.43/Boe in second quarter 2004 compared to \$7.08/Boe in first quarter 2004. Year to date operating expenses were \$6.02/Boe. Due to increased production from the lower operating cost natural gas properties

of Calais and Dawson, operating costs on a unit basis decreased in second quarter 2004. Operating costs averaged \$3.59/Boe at Calais and \$3.13/Boe at Dawson during second quarter 2004. Average operating costs on a unit basis are expected to continue to decrease due to greater volumes added from these properties.

GENERAL AND ADMINISTRATION COSTS

Year to date 2004 G&A costs by category include: salary and employee – 51%, corporate – 13%, audit, engineering and legal – 11%, consulting – 9%, office – 9% and computer – 7%.

	<i>Q2 2004</i>		<i>YTD 2004</i>	
	<i>\$</i>	<i>\$/Boe</i>	<i>\$</i>	<i>\$/Boe</i>
Gross	664,525	5.16	1,173,601	5.84
Overhead recoveries	(141,262)	(1.09)	(316,838)	(1.58)
Subtotal	523,263	4.07	856,763	4.26

INTEREST

Interest expense was \$35,681 in second quarter 2004 due to interest paid on bank debt utilized during the quarter. Interest expense of \$5,599 was recorded in first quarter 2004.

DEPLETION AND DEPRECIATION

Depletion and depreciation rates for oil and gas properties were \$10.21/Boe in Q2/04 compared to \$10.25/Boe in Q1/04. Capital expenditures of \$6.7 million related to undeveloped land and seismic costs have been excluded from the depletion and depreciation calculation and \$0.9 million of future costs have been added. Reserve additions from drilling in 2004 have been estimated internally. Reserve additions for the Venture and property acquisitions were based on independent engineering evaluations. The total depletion and depreciation for the three months ended June 30, 2004 was \$1,314,289. Accretion expense of \$21,667 was recorded in Q2/04.

TAXES

A future tax provision of \$447,121 was recorded in year to date 2004 earnings. Large corporation tax of \$75,111 was recorded in second quarter 2004.

Future income tax	\$
Balance at December 31, 2003	3,302,125
Tax effect of share issue costs	(535,816)
Venture acquisition	485,860
Provision for 2004	447,121
Balance at June 30, 2004	3,699,290

In 2003, the Corporation issued \$10.25 million in flow-through shares and had renounced the tax benefit of \$10.25 million to the shareholders. Under the look back provision governing flow-through shares, the Corporation is required to spend the \$10.25 million in eligible capital expenditures in 2004. As of June 30, 2004, the Corporation has spent the required \$10.25 million.

On June 17, 2004, the Corporation issued 1,000,000 Class A shares at \$10.00 each on a flow-through basis for gross proceeds of \$10 million. The shares issued are subject to a hold period under applicable securities laws expiring October 18, 2004. These expenditures will be renounced to the shareholders in 2004. Under the look back provision governing flow-through shares, the Corporation is required to incur eligible expenditures prior to December 31, 2005.

NET EARNINGS

Net earnings of \$582,927 are net of a future tax provision of \$447,121 and non cash expenses for stock-based compensation of \$209,958.

CAPITAL EXPENDITURES

	\$
Property & equipment balance at December 31, 2003	11,277,905
Additions (net)	20,910,718
Acquisition of property and equipment	2,368,924
Asset retirement obligation	250,972
Acquisition of Venture	16,465,764
Depletion and depreciation	(2,056,282)
Property & equipment balance at June 30, 2004	49,218,001

<i>Exploration and development expenditures</i>	\$	YTD 2004 %
Land	3,390,574	16
Geological and geophysical	4,372,783	21
Drilling and completion	10,525,489	50
Plant and facilities	2,549,480	12
Other assets	72,392	1
Total exploration and development	20,910,718	100

An active 9 well drilling program during the second quarter of 2004 resulted in 7 cased natural gas wells; 4 at Calais, 2 at Dawson and 1 at Bindloss, all in Alberta.

LIQUIDITY AND CAPITAL RESOURCES AND SUBSEQUENT EVENTS

For the second quarter of 2004, cash flow from operations of \$2,402,456, an equity issuance of \$10 million and bank credit facilities were used to fund the \$10.9 million capital expenditure program. Cash flow from operations per average weighted basic share was \$0.14 in Q2/04 compared to \$0.06 in Q1/04.

At June 30, 2004, the market value of Galleon's class A shares was approximately \$142 million based on the June 30, 2004 closing price of \$8 per share and 17,824,438 class A shares outstanding (which excludes 500,000 shares owned by Venture).

On August 19, 2004, Galleon had 20,845,771 (excluding 500,000 shares owned by Venture) Class A shares, 922,500 Class B shares and 1,627,667 options outstanding.

Debt and working capital	<i>June 30, 2004</i>	<i>December 31, 2003</i>
	\$	\$
Cash	3,997,031	3,204,663
Working capital (deficiency)	(5,860,743)	(3,755,208)
Total net debt	1,863,712	550,545
<i>Source of funds</i>	<i>Q2 2004</i>	<i>YTD 2004</i>
	\$	\$
Issuance of shares, net of costs	9,354,349	20,524,000
Funds provided by operations	2,402,456	3,339,169
Change in cash and working capital	(852,518)	(583,527)
Net additions to property and equipment	10,904,287	23,279,642

Galleon has no off-balance sheet financing arrangements. The Corporation has lease arrangements for office space to April 30, 2006. The future minimum lease payments total \$602,235 (balance of 2004 – \$164,246; 2005 – \$328,492; and, 2006 – \$109,497).

The Corporation has an extendible revolving credit facility in place with a Canadian chartered bank. The amount of the facility is \$15 million Cdn with interest at the bank's prime rate. In addition, the Corporation has in place a \$3.5 million US swap facility. Collateral for the facilities consists of a demand debenture for \$75 million secured by a first floating charge over all of the property and equipment of the Corporation. At June 30, 2004, no amount was drawn against the credit facility.

On July 28, 2004, the extendible revolving credit facility was increased to \$25 million Cdn.

On July 28, 2004, the Corporation completed the acquisition of a private oil and gas company for total consideration of \$20.1 million. The acquisition was initially funded through an expanded credit facility.

On August 4, 2004, the Corporation issued 3,000,000 Class A shares at \$8.00 each for gross proceeds of \$24 million. The shares issued are subject to a hold period under applicable securities laws expiring December 5, 2004.

CHANGES IN ACCOUNTING POLICIES

Stock-based compensation

Effective January 1, 2004, the Corporation adopted a new accounting standard on stock based compensation as presented in the CICA Handbook section 3870. The standard requires the recognition of stock based compensation expense for all employees and non-employees using the fair value method.

For 2003, options were issued at current market value and had no intrinsic value, therefore no compensation expense was recorded when the options were granted. Consideration paid by employees and non-employees on the exercise of stock options was credited to share capital.

The standard was amended in November 2003 requiring all stock based compensation awards to be expensed. The Corporation adopted the new accounting policy in 2004 on a retroactive basis with no restatement of prior periods as the amount was not material. The Black-Scholes option pricing model has been used to calculate the fair value of the stock options granted. To June 30, 2004 the Corporation has recognized a compensation expense of \$209,958.

Asset retirement obligation

Effective January 1, 2004, the Corporation has adopted the new standard for asset retirement obligations as set out in the CICA Handbook section 3110. The new standard requires the recognition and measurement of liabilities related to the legal obligation to abandon and reclaim property, plant and equipment upon acquisition, construction, development and/or normal use of the asset. The initial liability must be measured at fair value and subsequently adjusted for the accretion of discount and changes in the fair value. The asset retirement cost is capitalized as part of property and equipment and depleted into earnings over time.

The adoption of this standard has increased the asset retirement liability by \$644,357 at December 31, 2003, and added an asset retirement cost of \$660,271 to property, plant and equipment which was reduced by depletion on the increased asset retirement cost for 2003 of \$8,796. The comparative balance sheet for

2003 has been restated. To June 30, 2004 in addition to reflecting the effect of the Venture acquisition, \$250,972 of additional asset retirement liability and \$42,882 in accretion expense have been recognized. The accretion expense has been applied to depletion, depreciation and accretion expense on the Consolidated Statement of Operations and Deficit.

Full cost accounting guideline

Effective January 1, 2004, the Corporation adopted the new guidelines for full cost accounting as per CICA accounting guideline 16. Under the new guideline, future net revenues from total proven reserves used in the ceiling test calculation are estimated using expected future escalating product prices and costs, whereas prior to the adoption, constant pricing was used. Future general and administrative, and financing charges, associated with the future net revenues are no longer deducted in arriving at the ceiling value. Where a ceiling test failure occurs, probable reserve values may now be included in determining the impairment amount which is based on the fair value of the associated reserves.

The adoption of the new guideline at December 31, 2003 resulted in no change to net income, fixed assets or any reported amounts in the December 31, 2003 financial statements.

CRITICAL ACCOUNTING ESTIMATES

There are a number of critical estimates underlying the accounting policies employed in preparing the Consolidated Financial Statements.

Revenue estimates

Payment for sales in the oil and gas industry occurs up to two months after the month of production. Sales are estimated based upon information received from field offices regarding production levels and published industry pricing and transportation data.

Cost estimates

Costs for services performed but not yet billed are estimated based on original quotes and historical cost information.

Reserves

The full cost method of accounting, which is used to account for oil and gas activities, relies on estimates of proven reserves that will ultimately be recoverable from the properties. These estimates are utilized in calculating the unit-of-production depletion, potential impairment of asset carrying costs and future site restoration expense. The process of estimating reserves is complex and requires significant judgment, based on available geological, geophysical, engineering and economic data.

Reserves are evaluated at year-end by an independent engineering firm and quarterly updates to those reserves, as well as new reserves from wells drilled in the current year are estimated by the Corporation's engineers.

Although every effort is made to ensure that critical estimates are accurate, changing economic and operational conditions, as well as governmental regulations, can significantly affect those estimates, which may cause significant fluctuation in earnings and cash flows.

BUSINESS RISKS

Galleon is engaged in the exploration, development and production of crude oil and natural gas. The oil and gas business is inherently risky and there is no assurance that hydrocarbon reserves will be discovered and economically produced. Operational risks include competition, reservoir performance uncertainties, environmental factors, and regulatory, environment and safety concerns. Financial risks associated with the petroleum industry include fluctuations in commodity prices, interest rates, currency exchange rates and the cost of goods and services.

Galleon employs highly qualified people, uses sound operating and business practices, and evaluates all potential and existing wells using the latest applicable technology. Galleon complies with government regulations and has in place an up-to-date emergency response test. Environment and safety policies and standards are adhered to. Asset retirement obligations are recognized upon acquisition, construction, development and/or normal use of the assets. Galleon maintains property and liability insurance coverage. The coverage provides a reasonable amount of protection from risk of loss; however, not all risks are foreseeable or insurable.

A commodity hedging program is in place to protect product pricing on 100 Boe/d of production and ensure cash flows are available for reinvestment.

CASH FLOW SENSITIVITIES

	<i>Cash Flow</i> \$	<i>Per Share Basic</i> \$
Natural gas price change of \$0.10/Mcf	157,000	0.01
Natural gas production change of 1 Mmcf/day	1,023,000	0.06
Crude oil and NGLs price change of \$1.00 US WTI per Bbl	67,000	–
Interest rate change of 1%	48,000	–
Foreign exchange rate change of 1% point (\$US - CDN)	90,000	0.01

Cash flow sensitivities are calculated as they relate to the Corporation's 2004 budgeted revenues and expenses, and outstanding shares at June 30, 2004.

Budgeted volumes are 6.7 Mmcf/d of natural gas and 357 Bbl/d of liquids.

Budgeted commodity prices are \$6.00/Mcf and \$29/Bbl WTI US. The Corporation's current hedging contract has not been reflected in these sensitivities.

Outlook

Plans for the second half of 2004 include the drilling of 20-25 wells in the core areas of Calais and Dawson, Alberta and Two Rivers, British Columbia. In addition, at Two Rivers the recompletion of certain wells and the tie-in of one existing well are planned in the fourth quarter of 2004.

Exploration and development capital expenditures for the second half of 2004 are estimated at \$25 million and will be funded from cash flow and available bank credit facilities.

Galleon's current production exceeds 2,100 Boe/d (75% natural gas) and is expected to increase to a 2004 exit production exceeding 3,000 Boe/d (85% natural gas).

Consolidated Balance Sheets

<i>(unaudited)</i>	<i>June 30 2004 \$</i>	<i>December 31 2003 \$</i>
ASSETS		<i>(Restated - Note 1)</i>
Current		
Cash	3,997,031	3,204,663
Accounts receivable	3,949,929	1,230,087
Deposits and prepaid expenses	486,579	14,442
	<u>8,433,539</u>	<u>4,449,192</u>
Goodwill (note 3)	2,638,189	-
Property and equipment (notes 1, 4 and 5)	49,218,001	11,277,905
	<u>60,289,729</u>	<u>15,727,097</u>
LIABILITIES		
Current		
Accounts payable and accrued liabilities	10,297,251	4,999,737
	<u>10,297,251</u>	<u>4,999,737</u>
Asset retirement obligation (note 1)	1,405,213	660,271
Future tax liability (note 7)	3,699,290	3,302,125
	<u>15,401,754</u>	<u>8,962,133</u>
Commitments (notes 8 and 9)		
SHAREHOLDERS' EQUITY		
Share capital (note 6)	45,706,576	7,001,450
Contributed surplus (notes 1 and 6)	209,958	-
Deficit	(1,028,559)	(236,486)
	<u>44,887,975</u>	<u>6,764,964</u>
	<u>60,289,729</u>	<u>15,727,097</u>

See accompanying notes

Consolidated Statements of Operations & Deficit

(unaudited)

	2004 \$	Three months ended June 30 2003 \$	Six months ended June 30 2004 \$	Period March 27 to June 30 2003 \$
REVENUE				
Petroleum and natural gas	4,961,979	–	7,337,206	–
Crude oil hedge cost	(188,256)	–	(310,334)	–
Royalties, net of ARTC	(1,042,773)	–	(1,517,388)	–
Other income	4,706	13,455	14,079	13,455
	3,735,656	13,455	5,523,563	13,455
EXPENSES				
Operating	699,145	–	1,211,240	–
General and administration	523,263	32,787	856,763	32,787
Stock-based compensation	122,238	–	209,958	–
Interest	35,681	–	41,280	–
Depletion, depreciation & accretion	1,335,956	6,054	2,099,163	6,054
	2,716,283	38,841	4,418,404	38,841
Earnings (loss) before taxes	1,019,373	(25,386)	1,105,159	(25,386)
Current taxes	75,111	–	75,111	–
Future income taxes (note 7)	484,515	–	447,121	–
NET EARNINGS (LOSS)	459,747	(25,386)	582,927	(25,386)
DEFICIT, BEGINNING OF PERIOD	(1,488,306)	–	(236,486)	–
Repurchase of class A shares (notes 4 and 6)	–	–	(1,375,000)	–
DEFICIT, END OF PERIOD	(1,028,559)	(25,386)	(1,028,559)	(25,386)
NET EARNINGS (LOSS) PER SHARE				
Basic	\$0.03	\$(0.04)	\$0.04	\$(0.08)
Diluted	\$0.02	\$(0.04)	\$0.03	\$(0.08)
Weighted average shares – basic	17,607,394	671,670	16,093,751	337,691

See accompanying notes

Consolidated Statements of Cash Flow

(unaudited)

	<i>Three months ended June 30 2004</i>	<i>Three months ended June 30 2003</i>	<i>Six months ended June 30 2004</i>	<i>Period March 27 to June 30 2003</i>
	2004	2003	2004	2003
	\$	\$	\$	\$
Cash provided by (used in):				
OPERATING ACTIVITIES				
Net earnings (loss)	459,747	(25,386)	582,927	(25,386)
Add items not requiring cash:				
Depletion, depreciation and accretion	1,335,956	6,054	2,099,163	6,054
Future income taxes	484,515	-	447,121	-
Stock-based compensation (note 1)	122,238	-	209,958	-
CASH FLOW FROM (USED IN) OPERATIONS				
	2,402,456	(19,332)	3,339,169	(19,332)
Change in non-cash working capital relating to operating activities	2,074,871	(68,299)	2,105,535	(68,299)
	4,477,327	(87,631)	5,444,704	(87,631)
FINANCING ACTIVITIES				
Issue of common shares	10,044,400	867,000	22,054,900	867,000
Share issue costs	(690,051)	(12,400)	(1,530,900)	(12,400)
Repayment of bank debt assumed in Venture acquisition (note 4)	(111,948)	-	(1,896,694)	-
	9,242,401	854,600	18,627,306	854,600
INVESTING ACTIVITIES				
Additions to oil and gas properties	(10,904,287)	(541,103)	(20,910,718)	(541,103)
Acquisition of oil and gas properties (note 5)	-	-	(2,368,924)	-
	(10,904,287)	(541,103)	(23,279,642)	(541,103)
INCREASE IN CASH	2,815,441	225,866	792,368	225,866
CASH, BEGINNING OF PERIOD	1,181,590	-	3,204,663	-
CASH, END OF PERIOD	3,997,031	225,866	3,997,031	225,866
SUPPLEMENTARY INFORMATION				
Cash interest paid	35,681	-	41,280	-
Cash taxes paid	75,111	-	75,111	-

See accompanying notes

Notes to the Consolidated Financial Statements

1. ACCOUNTING POLICIES

These unaudited interim consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP"), and follow the same accounting policies as for the financial statements for the fiscal year ended December 31, 2003, except as noted below. These notes are incremental to, and should be read in conjunction with, the audited financial statements for the fiscal year ended December 31, 2003. These consolidated financial statements include the operations of Venture Energy Inc. ("Venture").

Stock-based compensation

Effective January 1, 2004, the Corporation adopted a new accounting standard on stock based compensation as presented in the CICA Handbook section 3870. The standard requires the recognition of stock-based compensation expense for all employees and non-employees using the fair value method.

In 2003, options were issued at current market value and had no intrinsic value, therefore no compensation expense was recorded when the options were granted. Consideration paid by employees and non-employees on the exercise of stock options was credited to share capital.

The amended standard requires all stock based compensation awards to be expensed. The Corporation adopted the new accounting policy in 2004 on a retroactive basis with no restatement of prior periods as the amount was not material. The Black-Scholes option pricing model has been used to calculate the fair value of the stock options granted. To June 30, 2004 the Corporation has recognized a compensation expense of \$209,958.

Asset retirement obligation

Effective January 1, 2004, the Corporation adopted, on a retroactive basis with restatement, the new standard for asset retirement obligations as set out in the CICA Handbook section 3110. The new standard requires the recognition and measurement of liabilities related to the legal obligation to abandon and reclaim property, plant and equipment upon acquisition,

construction, development and/or normal use of the asset. The initial liability must be measured at fair value and subsequently adjusted for the accretion of discount and changes in the fair value. The asset retirement cost is capitalized as part of property and equipment and depleted into earnings over time. A credit adjusted risk free rate of 5% and an inflation rate of 1.5% were used to calculate the fair value of the asset retirement obligation.

The adoption of this standard increased the asset retirement liability by \$644,357 at December 31, 2003 and added a gross asset retirement cost of \$660,271 to property, plant and equipment which was reduced by depletion on the increased asset retirement cost for 2003 of \$8,796. The comparative balance sheet for 2003 has been restated. To June 30, 2004, in addition to reflecting the effect of the Venture acquisition, \$250,972 of additional asset retirement liability and \$42,882 in accretion expense has been recognized. The accretion expense has been recorded in depletion, depreciation and accretion expense on the Consolidated Statement of Operations and Deficit.

Full cost accounting guideline

Effective January 1, 2004, the Corporation has adopted the new guideline for full cost accounting as per CICA accounting guideline 16. Under the new guideline, future net revenues from total proven reserves used in the ceiling test calculation are estimated using expected future escalating product prices and costs, whereas prior to the adoption, constant pricing was used. Future general and administrative, and financing charges, associated with the future net revenues are no longer deducted in arriving at the ceiling value. Where a ceiling test failure occurs, probable reserve values may now be included in determining the impairment amount which is based on the fair value of the associated reserves.

The adoption of the new guideline resulted in no change to net income, fixed assets or other reported amounts in the December 31, 2003 financial statements.

Transportation

Clean oil trucking charges and transportation charges related to the delivery of natural gas are deducted from gross prices received for these products. To June 30, 2004 these charges were \$224,289 in aggregate.

2. AVAILABLE CREDIT FACILITY

The Corporation has an extendible revolving credit facility in place with a Canadian chartered bank. During the quarter, the amount of the facility was increased from \$10 million Cdn with interest at the bank's prime rate plus 0.25% to \$15 million Cdn with interest at the bank's prime rate. In addition, the Corporation has in place a \$3.5 million US swap facility which increased from \$2.5 million US during the quarter. Collateral for the facilities consists of a demand debenture for \$75 million secured by a first floating charge over all of the property and equipment of the Corporation. At June 30, 2004, no amount was drawn against the credit facility.

On July 28, 2004, the extendible revolving credit facility was increased to \$25 million Cdn.

3. GOODWILL

Goodwill, which represents the excess of purchase price over fair value of net assets acquired, is not amortized and is assessed by the Corporation for impairment at least annually. Impairment is assessed based on a comparison of the fair value of the net assets acquired to the carrying value of the net assets, including goodwill. Any excess of carrying value over and above fair value is the impairment amount, and is charged to earnings in the period identified.

4. ACQUISITION OF VENTURE ENERGY INC.

On January 15, 2004, the Corporation acquired all of the issued and outstanding shares of Venture. The Venture acquisition was accounted for by the purchase method and shares were acquired for an aggregate of \$17,770,311 by the issuance of 5,923,437 Class A shares of Galleon at a deemed value of \$3.00 per share plus the assumption of \$1.897 million of net debt. Prior to the acquisition, Venture owned 500,000 of the Class A shares of the Corporation. At the time of the acquisition, the fair value of the 500,000 Class A shares was \$1,500,000. An adjustment of \$1,375,000 being the difference between cost and fair value was made to retained earnings. During the quarter ended June 30, 2004 the allocation of the purchase price was adjusted to reflect an increase in obligations assumed with corresponding adjustments, primarily to goodwill.

<i>Calculation of Purchase Price</i>		\$
Fair value of shares issued		17,770,311
Transaction costs		34,236
		<u>17,804,547</u>

Allocation of Purchase Price

Goodwill		2,638,189
Property and equipment		16,500,000
Fair value of Galleon class A shares		1,500,000
Bank debt assumed		(1,896,694)
Asset retirement obligation		(451,088)
Future income tax		(485,860)
		<u>17,804,547</u>

5. PROPERTY AND EQUIPMENT

On January 30, 2004, the Corporation completed the purchase of interests in certain oil and gas properties and a gas plant for cash of \$2.4 million net of adjustments.

6. SHARE CAPITAL

Authorized

Unlimited number of preferred shares with no par value

Unlimited number of voting Class A shares with no par value

Unlimited number of voting Class B shares with no par value, convertible (at the option of the Corporation) at any time after December 31, 2006 and before December 31, 2008, into Class A shares. The fraction is calculated by dividing \$10 by the greater of \$1 and the then current market price of Class A shares. If conversion has not occurred by the close of business on December 31, 2008, the Class B shares become convertible (at the option of the shareholder) into Class A shares on the same basis. Effective February 1, 2009, all remaining Class B shares will be deemed to be converted to Class A shares.

<i>Issued and outstanding</i>	<i>Number of Shares</i>	<i>Amount \$</i>
Class A shares		
Balance at December 31, 2003	8,300,001	1,633,985
Issued on acquisition of Venture (note 4)	5,923,437	17,770,311
Repurchase of shares held by Venture (note 4)	(500,000)	(125,000)
Issue of Special Warrants for cash (a)	3,000,000	12,000,000
Issue of Flow Through shares for cash (b)	1,000,000	10,000,000
Share issue costs, net of tax of \$535,816 (a)(b)	–	(995,084)
Issued for cash on exercise of stock options (c)	101,000	54,900
Balance at June 30, 2004	17,824,438	40,339,112
Class B shares		
Balance at December 31, 2003, March 31 and June 30, 2004	922,500	5,367,464
Total share capital - June 30, 2004	18,746,938	45,706,576

- a) On February 10, 2004, the Corporation issued 3,000,000 Special Warrants at \$4.00 each for gross proceeds of \$12 million. Each Special Warrant entitled the holder to receive one Class A share without payment of any additional consideration, subject to adjustment in certain events. The resale of the Special Warrants and the Class A shares issuable on exercise thereof was initially subject to a hold period expiring February 11, 2005. On March 30, 2004 certain amendments to securities legislation came into effect which changed the hold period to June 11, 2004. Also as a result of the amendment, the Special Warrants were deemed to be exercised into Class A shares.
- b) The Corporation renounced \$10,250,000 of expenditures to the shareholders in 2003 in connection with a flow through offering on September 30, 2003, and under the look back provision governing flow-through shares is required to expend the amount in 2004. By June 30, 2004 these expenditures had been incurred.

On June 17, 2004, the Corporation issued 1,000,000 Class A shares at \$10.00 each on a flow-through basis for gross proceeds of \$10 million. The shares issued are subject to a hold period under applicable securities laws expiring October 18, 2004. These expenditures will be renounced to the shareholders in 2004. Under the look back provision governing flow-through shares, the Corporation is required to incur eligible expenditures prior to December 31, 2005.

- c) As described in note 1, the Corporation has adopted a new accounting policy with respect to stock based compensation in 2004. Options granted vest 1/3 immediately upon grant, 1/3 on the first anniversary date of the grant and 1/3 on the second anniversary date of the grant.

To June 30, 2004, the Corporation granted an additional 590,000 options at a weighted average exercise price of \$4.35 per share. In accordance with the Corporation's accounting policy, an expense of \$209,958 has been recognized. The fair value of options granted during the quarter was estimated at the date of grant using a Black-Scholes Option Pricing Model with the following assumptions: risk-free interest rate of 3%; dividend yield of 0%; volatility factor of the market price of the Corporation's common shares of 46%; and, an average expected life of the options of 3 years.

	<i>Number of Shares</i>	<i>Weighted Average Exercise Price \$</i>
Outstanding, December 31, 2003	900,000	0.35
Granted	590,000	4.35
Exercised	(101,000)	(0.54)
Outstanding, June 30, 2004	1,389,000	2.03

7. FUTURE INCOME TAXES

A provision to the Corporation's future income tax of \$447,121 was recognized to June 30, 2004. This was primarily due to earnings in the current period.

8. FINANCIAL INSTRUMENTS

The Corporation has one crude oil fixed price commodity hedge in place for 100 barrels of oil per day commencing on January 1, 2004 for a 12 month period. The fixed price for the hedge is \$40.80 WTI Cdn.

At June 30, 2004, the unrealized cost of the commodity hedge on a mark to market basis was \$188,968.

9. SUBSEQUENT EVENTS

On July 28, 2004, the Corporation completed the acquisition of a private oil and gas company for total consideration of \$20.1 million. The acquisition was initially funded through an expanded bank credit facility. (note 2)

On August 4, 2004, the Corporation issued 3,000,000 Class A shares at \$8.00 each for gross proceeds of \$24 million. The shares issued are subject to a hold period under applicable securities laws expiring December 5, 2004.

Corporate Information

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Fred C. Coles ^{1 2}

William L. Cooke ¹

Brad Munro ¹

Steve Sugianto

¹ Member of the Audit and Reserves Committee

² Member of the Compensation Committee

Officers

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Chairman and Chief Executive Officer

Steve Sugianto,
President and Chief Operating Officer

Shivon M. Crabtree,
VP Finance & Chief Financial Officer

C. Steve Cohen,
Secretary

Auditor

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Stock Exchange Listing

TSX Venture Exchange,
Trading Symbols GO.A and GO.B



GALLEON
ENERGY INC.

GO.A