



TRAFINA
ENERGY LTD.

Q2 2011 FINANCIAL STATEMENTS

FINANCIAL STATEMENTS

CONDENSED INTERIM STATEMENTS OF FINANCIAL POSITION (UNAUDITED)

	June 30, 2011	December 31, 2010
ASSETS		
Current Assets		
Cash	\$ 294,344	\$ ---
Accounts receivable	1,134,261	1,281,311
Commodity contracts	5,000	---
Prepaid expenses and deposits	164,202	203,110
	1,597,807	1,484,421
Exploration and evaluation assets (note 4)	5,478,483	2,639,240
Property and equipment (note 5)	11,884,033	13,764,140
	\$ 18,960,323	\$ 17,887,801
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current Liabilities		
Accounts payable and accrued liabilities	\$ 2,957,633	\$ 3,970,493
Bank debt (note 6)	---	3,673,466
Commodity contract liability (note 13)	---	119,589
Current portion of liability settlement (note 7)	---	69,444
	2,957,633	7,832,992
Flow through share obligation	---	130,000
Decommissioning obligations (note 8)	4,067,203	5,222,074
	7,024,836	13,185,066
Shareholders' Equity		
Share capital (note 9)	17,059,230	10,461,151
Warrants (note 9)	1,615,429	1,236,023
Contributed surplus (note 10)	2,335,515	870,514
Deficit	(9,074,687)	(7,864,953)
	11,935,487	4,702,735
	\$ 18,960,323	\$ 17,887,801
Commitments (note 14)		
Subsequent event (note 16)		
See accompanying notes to condensed interim financial statements.		

FINANCIAL STATEMENTS

CONDENSED INTERIM STATEMENTS OF LOSS AND COMPREHENSIVE LOSS (UNAUDITED)

	Three months ended		Six months ended	
	2011	June 30 2010 (note 17)	2011	June 30 2010 (note 17)
REVENUE				
Petroleum and natural gas	\$ 1,302,854	\$ 1,275,671	\$ 2,839,963	\$ 2,770,306
Royalties	(117,330)	(129,710)	(257,507)	(334,973)
Realized gain (loss) on commodity contracts (note 13)	(24,564)	66,459	(33,280)	87,352
Unrealized gain (loss) on commodity contracts (note 13)	258,027	(129,000)	124,589	153,000
Other	12,281	36,625	42,626	14,137
	1,431,268	1,120,045	2,716,391	2,689,822
EXPENSES				
Operating	810,128	889,492	1,873,273	2,034,335
General and administrative	494,996	398,980	1,021,909	851,934
Depletion and depreciation	548,661	616,797	1,207,810	1,289,698
Impairment of property and equipment	---	---	---	805,307
Share based compensation	177,135	28,022	200,408	95,989
Gain on property divestment (note 5)	(373,904)	(217,492)	(373,904)	(280,721)
Finance expenses (note 11)	47,749	71,922	126,629	130,575
Loss before income taxes	(273,497)	(667,676)	(1,339,734)	(2,237,295)
Deferred income tax reduction	---	(25,143)	(130,000)	(280,658)
Net loss and comprehensive loss	(273,497)	(642,533)	(1,209,734)	(1,956,637)
Basic and diluted loss per common share	\$ (0.01)	\$ (0.03)	\$ (0.03)	\$ (0.11)
Weighted average number of common shares outstanding	49,748,788	18,425,034	39,899,742	18,359,814

See accompanying notes to condensed interim financial statements.

FINANCIAL STATEMENTS

CONDENSED INTERIM STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY (UNAUDITED)

For the six months ended June 30,

	2011	2010
SHARE CAPITAL		
Balance, beginning of period	\$ 10,461,151	\$ 7,411,451
Issued for cash upon public offering	9,000,250	---
Issued on exercise of warrants	6,435	---
Issued on exercise of stock options	30,000	9,000
Issued as partial consideration for property purchase	---	162,000
Fair value of warrants associated with public offering	(1,615,429)	---
Share issue costs	(823,177)	(11,752)
Balance, end of period	<u>17,059,230</u>	<u>7,570,699</u>
WARRANTS		
Balance, beginning of period	1,236,023	580,782
Exercise of warrants	(37)	---
Expiration of warrants	(1,235,986)	---
Fair value of warrants associated with public offering	1,615,429	---
Balance, end of period	<u>1,615,429</u>	<u>580,782</u>
CONTRIBUTED SURPLUS		
Balance, beginning of period	870,514	650,084
Exercise of warrants	37	---
Expiration of warrants	1,235,986	---
Share based compensation	228,978	95,989
Balance, end of period	<u>2,335,515</u>	<u>746,073</u>
DEFICIT		
Balance, beginning of period	(7,864,953)	(1,246,797)
Net loss	(1,209,734)	(1,956,637)
Balance, end of period	<u>(9,074,687)</u>	<u>(3,203,434)</u>
TOTAL SHAREHOLDERS' EQUITY	<u>\$ 11,935,487</u>	<u>\$ 5,694,120</u>

See accompanying notes to condensed interim financial statements.

FINANCIAL STATEMENTS

CONDENSED INTERIM STATEMENTS OF CASH FLOWS (UNAUDITED)

	Three months ended June 30		Six months ended June 30	
	2011	2010	2011	2010
Cash provided by (used in):				
OPERATING ACTIVITIES				
Net loss	\$ (273,497)	(642,533)	\$ (1,209,734)	\$ (1,956,637)
Add (deduct) non-cash items:				
Depletion and depreciation	548,661	616,797	1,207,810	1,289,698
Accretion on decommissioning obligations	33,608	38,314	66,911	63,974
Impairment of property and equipment	---	---	---	805,307
Gain on property divestment	(373,904)	(217,492)	(373,904)	(280,721)
Deferred income tax reduction	---	(25,143)	(130,000)	(280,658)
Share based compensation	177,135	28,022	200,408	95,989
Unrealized loss (gain) on commodity contracts	(258,027)	129,000	(124,589)	(153,000)
Funds flow used in operations	(146,024)	(73,035)	(363,098)	(416,048)
Decommissioning expenditures	---	---	(14,271)	---
Change in non-cash operating working capital	(329,141)	(7,911)	140,335	(614,343)
	(475,165)	(80,946)	(237,034)	(1,030,391)
FINANCING ACTIVITIES				
Common shares and warrants issued, net of share issue costs	8,183,508	(106)	8,213,508	(2,752)
Increase (decrease) in bank debt	(4,191,241)	202,081	(3,673,466)	1,471,123
	3,992,267	201,975	4,540,042	1,468,371
INVESTING ACTIVITIES				
Acquisition of property and equipment	---	(35,823)	---	(419,483)
Disposition of property and equipment	450,298	1,047,652	450,298	2,581,544
Additions to property and equipment	(1,425,362)	(447,934)	(3,422,281)	(1,454,155)
Change in non-cash investing working capital	(2,247,694)	(684,924)	(1,036,681)	(1,145,886)
	(3,222,758)	(121,029)	(4,008,664)	(437,980)
Change in cash	294,344	---	294,344	---
Cash, beginning of period	---	---	---	---
Cash, end of period	\$ 294,344	\$ ---	\$ 294,344	\$ ---
Cash paid:				
Interest	\$ 14,141	\$ 30,261	\$ 57,850	\$ 59,918

See accompanying notes to condensed interim financial statements.

NOTES TO CONDENSED INTERIM FINANCIAL STATEMENTS (UNAUDITED)

For the three and six months ended June 30, 2011 and 2010.

1. DESCRIPTION OF BUSINESS

Trafina Energy Ltd. (the “Company” or “Trafina”) was incorporated under the *Business Corporations Act* (Alberta) on December 24, 1991. Its principal business activities are petroleum and natural gas exploration, development and production of oil and natural gas in Western Canada.

2. BASIS OF PREPARATION

Statement of compliance:

The interim financial statements for the three and six months ended June 30, 2011 have been prepared in accordance with International Accounting Standard (“IAS”) 34 – Interim Financial Reporting and as a result do not include all information required in the preparation of annual financial statements. These are the Company’s second condensed interim financial statements and have been prepared following the same accounting policies and methods of computation under International Financial Reporting Standards (“IFRS”), as the Company’s first condensed interim financial statements for the three months ended March 31, 2011 and year ended December 31, 2010, and as such, these condensed interim financial statements should be read in conjunction with the Company’s first IFRS condensed interim financial statements. The impact of adoption from Canadian GAAP (“CGAAP”) to IFRS for the period ended June 30, 2010 is presented in note 17.

Functional and presentation currency and basis of measurement:

The interim financial statements are presented in Canadian dollars, which is the Company’s functional currency and have been prepared on an historical cost basis except for certain financial assets and liabilities, which are measured at fair value.

Use of estimates and judgments:

The preparation of the interim financial statements in accordance with IFRS requires management to make judgments, estimates and assumptions in various reported amounts. Actual results may differ from these estimates. Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimates are revised. The estimates and judgments used in these financial statements are within the framework of the same estimates and judgments used in the condensed interim financial statements for the three months ended March 31, 2011.

The interim financial statements of the Company were authorized by the Board of Directors on August 24, 2011.

3. SIGNIFICANT ACCOUNTING POLICIES

The interim financial statements have been prepared following the same accounting policies as the first IFRS unaudited interim financial statements for the three months ended March 31, 2011 and 2010 and are outlined in note 3 of the Company’s first IFRS statements.

4. EXPLORATION AND EVALUATION (“E&E”) ASSETS

Balance, January 1, 2010	\$	1,363,082
Additions		1,061,401
Asset acquisitions		2,290,691
Transfer to property and equipment		(1,960,934)
Impairment		(115,000)
Balance, December 31, 2010		2,639,240
Additions		2,891,358
Dispositions		(52,115)
Balance, June 30, 2011	\$	5,478,483

Exploration and evaluation assets consist of the Company's exploration and evaluation projects which are pending the determination of technical feasibility and commercial viability.

5. PROPERTY AND EQUIPMENT

Cost or deemed cost	Oil and natural gas properties	Office furniture and equipment	Total
Balance, January 1, 2010	\$ 14,113,185	\$ 318,257	\$ 14,431,442
Additions	4,169,338	10,281	4,179,619
Asset acquisitions	2,262,120	---	2,262,120
Dispositions	(2,838,379)	---	(2,838,379)
Transfer from exploration and evaluation assets	1,960,934	---	1,960,934
Change in decommissioning obligations estimates	53,258	---	53,258
Balance, December 31, 2010	19,720,456	328,538	20,048,994
Additions	736,370	987	737,357
Dispositions	(1,745,589)	---	(1,745,589)
Change in decommissioning obligations estimates	16,146	---	16,146
Balance, June 30, 2011	\$ 18,727,383	\$ 329,525	\$ 19,056,908

Accumulated depletion, depreciation and impairment losses	Oil and natural gas properties	Office furniture and equipment	Total
Balance, January 1, 2010	\$ ---	\$ 277,339	\$ 277,339
Depletion and depreciation	2,677,948	40,820	2,718,768
Impairment	3,389,697	---	3,389,697
Dispositions	(100,950)	---	(100,950)
Balance, December 31, 2010	5,966,695	318,159	6,284,854
Depletion and depreciation	1,196,378	11,366	1,207,744
Dispositions	(319,723)	---	(319,723)
Balance, June 30, 2011	\$ 6,843,350	\$ 329,525	\$ 7,172,875

Net book value	Oil and natural gas properties	Office furniture and equipment	Total
Balance, December 31, 2010	\$ 13,753,761	\$ 10,379	\$ 13,764,140
Balance, June 30, 2011	\$ 11,884,033	\$ ---	\$ 11,884,033

In the six months ended June 30, 2011 the Company disposed of certain non-core assets for net cash proceeds of approximately \$450,000. As a result, the Company was able to eliminate the associated decommissioning obligations with a net present value of approximately \$1.4 million (see note 8). The Company recorded a gain on disposition of properties of approximately \$374,000.

For the six months ended June 30, 2011, \$50,060 (December 31, 2010 – \$156,511) of general and administrative costs and \$28,570 (December 31, 2010 – \$12,590) of share based compensation costs were capitalized as they were directly related to exploration and development activities.

In determining the Company's depletion expense at June 30, 2011, future development and abandonment costs on proved plus probable properties of approximately \$14.3 million (December 31, 2010– \$14.6 million) were included in the calculation.

6. BANK DEBT

At June 30, 2011, the Company had cash of \$294,344 and had no bank debt. The Company's credit facilities consist of a \$4.0 million revolving operating demand facility, with interest charged on advances under the facility at the bank's prime rate plus 1.50% and a \$1.8 million acquisition and development demand facility, with interest charged on advances at the bank's prime rate plus 2.00%. The facilities are secured by a \$50 million fixed and floating charge debenture on all assets. The next review date is scheduled on or before October 1, 2011. The facilities include a working capital ratio covenant,

which is not to fall below 1:1. At June 30, 2011 the Company's working capital deficit (excluding commodity contracts) was \$1.4 million and as a result the Company was compliant with its banking covenant.

As the available credit facilities are based on the bank's assessment of the Company's reserves, development prospects and future commodity prices, there can be no assurance that the amount of available credit facility will not decrease at the next review date.

7. LIABILITY SETTLEMENT

In January 2011 the Company made a final payment of approximately \$69,000 relating to an agreed upon settlement amount owed by the Company as a result of prior years' revenue over-allocations.

8. DECOMMISSIONING OBLIGATIONS

Decommissioning obligations have been estimated by management based on Trafina's working interest in its wells and facilities, estimated costs to remediate, reclaim and abandon the wells and facilities and the estimated timing of the costs to be incurred in future periods. The total undiscounted amount of cash flows required to settle the decommissioning obligations is approximately \$6.5 million (December 31, 2010 - \$6.3 million). It is expected that the majority of the total future liability will be incurred between 2015 and 2038. To calculate the net present value of its decommissioning obligations, the Company used an average risk free rate of 2.59% (December 31, 2010 – 2.59%) and an inflation rate of 1.5% (December 31, 2010 – 1.5%).

	June 30, 2011	December 31, 2010
Balance, beginning of the period	\$ 5,222,074	\$ 3,834,358
Obligations incurred	193,890	1,775,370
Obligations reversed on dispositions	(1,401,587)	(564,884)
Obligations settled	(14,271)	---
Change in estimates	186	53,258
Accretion expense	66,911	123,972
Balance, end of period	\$ 4,067,203	\$ 5,222,074

9. SHARE CAPITAL

Authorized

- Unlimited number of Class A voting common shares;
- Unlimited number of Class B non-voting common shares;and
- Unlimited number of preferred shares issuable in series.

Issued

Class A common shares:

	June 30, 2011		December 31, 2010	
	Number	Amount	Number	Amount
Balance, beginning of period	29,861,262	\$ 10,461,151	18,273,262	\$ 7,411,451
Issued for cash upon public offering	25,715,000	9,000,250	---	---
Issued on exercise of warrants	14,300	6,435	---	---
Issued for cash upon private placements	---	---	6,484,000	1,945,200
Issued for cash on a flow-through basis upon private placements	---	---	4,750,000	2,000,000
Issued as partial consideration for property acquisition	---	---	324,000	162,000
Exercise of stock options	100,000	30,000	30,000	9,000
Fair value of warrants associated with private placement	---	(1,615,429)	---	(655,241)
Premium on flow-through shares	---	---	---	(322,500)
Share issue costs	---	(823,177)	---	(88,759)
Balance, end of period	55,690,562	\$ 17,059,230	29,861,262	\$ 10,461,151

In April 2011 the Company completed a public offering of units for gross proceeds of \$9.0 million. The Company issued 25,715,000 units (comprised of 25,715,000 Class A common shares and 25,715,000 share purchase warrants) at a price of \$0.35 per unit. Each unit consisted of one Class A common share and one Common Share purchase warrant to acquire an additional Class A common share at an exercise price of \$0.45. The net proceeds from the financing have been used to temporarily reduce the Company's outstanding indebtedness, thus enabling the Company to draw upon its available credit facility to fund the Company's ongoing capital expenditure program.

Warrants:

Details of the outstanding warrants are as follows:

	June 30, 2011		December 31, 2010	
	Number	Amount	Number	Amount
Balance, beginning of the period	8,847,335	\$ 1,236,023	2,513,335	\$ 580,782
Exercise of warrants	(14,300)	(37)	---	---
Expiry of warrants	(8,833,035)	(1,235,986)	---	---
Issued upon private placement	---	---	6,334,000	655,241
Issued upon public offering	25,715,000	1,615,429	---	---
Balance, end of the period	25,715,000	\$ 1,615,429	8,847,335	\$ 1,236,023

The Company recorded fair values for the warrants of \$1,615,429 and \$655,241, respectively and used the following assumptions:

	<u>2011</u>	<u>2010</u>
Weighted average expected volatility	70%	110%
Weighted average risk free interest rate	1.78%	1.69%
Weighted average expected life (years)	1.5	1.0

Each outstanding warrant at June 30, 2011 entitles the holder to exercise one warrant for one Class A common share of the Company at a price of \$0.45 per share on or before October 21, 2012.

Stock Option Plan

The Company has an employee stock option plan under which officers, directors, employees and consultants are eligible to receive grants of options. At June 30, 2011, 3,585,000 common stock options were outstanding, with an average exercise price of \$0.37 per share. For options granted, one third of the options vest on the day following the date of grant, one third on the day following the first anniversary date of the grant and the remaining options vest on the day following the second anniversary date of the grant.

Stock option continuity is as follows:

	June 30, 2011		December 31, 2010	
	Number	Weighted Average Exercise Price	Number	Weighted Average Exercise Price
Balance, beginning of the period	2,195,000	\$ 0.37	1,650,000	\$ 0.36
Granted	1,490,000	0.35	575,000	0.40
Exercised	(100,000)	0.30	(30,000)	0.30
Balance, end of period	3,585,000	\$ 0.37	2,195,000	\$ 0.37

Stock options outstanding and exercisable as at June 30, 2011:

Grant Year	Number Outstanding	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (years)	Number Exercisable at June 30, 2011	Weighted Average Exercise Price
2008	350,000	\$0.37	2.29	350,000	\$0.37
2009	1,170,000	\$0.37	3.34	983,333	\$0.36
2010	575,000	\$0.40	4.04	248,333	\$0.41
2011	1,490,000	\$0.35	5.00	---	\$0.35
	3,585,000	\$0.37	3.49	1,581,666	\$0.37

For stock options granted on June 30, 2011 a third of the stock options are exercisable commencing July 1, 2011.

For the three and six months ended June 30, 2011, the Company recorded share based compensation expense of \$177,135 (2010 – 28,022) and \$200,408 (2010 – 95,989), respectively. The assumptions used in the computation of the fair values of the stock options granted in the six months ended June 30, 2011 and 2010 are as follows:

	2011	2010
Weighted average expected volatility	70%	150%
Weighted average risk free interest rate	1.56%	1.22%
Weighted average expected life (years)	4.0	4.0

Per Share Amounts:

Basic weighted average shares outstanding for the three and six months ended June 30, 2011 were 49,748,788 (2010 – 18,425,034) and 39,899,742 (2010 – 18,359,814), respectively. Since the Company had net losses in the three and six month periods any adjustments for options and warrants would have an anti-dilutive effect and as a result are excluded from diluted per share amounts.

10. CONTRIBUTED SURPLUS

The following schedule shows the continuity of contributed surplus:

	June 30, 2011	December 31, 2010
Balance, beginning of the period	\$ 870,514	\$ 650,084
Exercise of warrants	37	---
Expiration of warrants	1,235,986	---
Share based compensation	228,978	220,430
Balance, end of the period	\$ 2,335,515	\$ 870,514

11. FINANCE EXPENSES

	Three months ended June 30, 2011	Three months ended June 30, 2010	Six months ended June 30, 2011	Six months ended June 30, 2010
Interest on bank debt	\$ 14,141	\$ 33,608	\$ 59,718	\$ 66,601
Accretion on decommissioning obligations	33,608	38,314	66,911	63,974
	\$ 47,749	\$ 71,922	\$ 126,629	\$ 130,575

12. SUPPLEMENTAL CASH FLOW DISCLOSURES

Change in non-cash working capital:

	Three months ended June 30, 2011	Three months ended June 30, 2010	Six months ended June 30, 2011	Six months ended June 30, 2010
Accounts receivable	\$ (60,882)	\$ (56,449)	\$ 147,050	\$ (414,688)
Prepaid expenses and deposits	2,145	39,846	38,908	(22,784)
Accounts payable and accrued liabilities	(2,518,098)	(467,894)	(1,012,860)	(906,091)
Current portion of liability settlement ⁽¹⁾	---	(208,338)	(69,444)	(416,666)
	\$ (2,576,835)	\$ (692,835)	\$ (896,346)	\$ (1,760,229)
Change in non-cash working capital				
Operating	(329,141)	(7,911)	140,335	(614,343)
Investing	(2,247,694)	(684,924)	(1,036,681)	(1,145,886)

(1) Current portion of liability settlement is adjusted for \$69,444 to reflect a reduction in a long term liability settlement.

13. FINANCIAL AND CAPITAL RISK MANAGEMENT

The Company has certain financial instruments, including accounts receivable, commodity contracts, accounts payable and accrued liabilities and bank debt, and is exposed to risks such as credit risk, liquidity risk and market risk. The Company manages its exposure to these risks by operating in a manner that minimizes its exposure to the extent practical.

The carrying amount of the Company's accounts receivable, accounts payable and accrued liabilities approximate their fair values due to short terms to maturity. Bank debts bear interest at a floating market rate and accordingly the fair value approximates the carrying value.

The fair value of the Company's commodity contracts are determined based on inputs, including quoted forward prices for commodities, time value and volatility factors, which can be substantially observed or corroborated in the market place. As at June 30, 2011 the fair value of the Company's commodity contracts were an asset of \$5,000 (December 31, 2010 – liability of \$119,589). The commodity contracts are classified as level 2 within the fair value hierarchy.

Credit Risk

Credit risk is generally related to the collection of the Company's accounts receivable from petroleum and natural gas purchasers and joint interest partners. At June 30, 2011, approximately 41 percent of the Company's accounts receivable trade balance was from various petroleum and natural gas purchasers and has subsequently been received. A further 6 percent of the Company's accounts receivables as at June 30, 2011 have been received to date.

	Less than 90 days	More than 90 days	Total
Petroleum and natural gas purchasers	\$ 488,662	\$ ---	\$ 488,662
Joint interest partners	311,599	334,000	645,599
Total accounts receivable at June 30, 2011	\$ 800,261	\$ 334,000	\$ 1,134,261

A joint interest partner is past due with payments as at June 30, 2011. Subsequent to June 30, 2011 the Company settled the amount owing by the joint interest partner by acquiring an additional working interest from the joint interest partner on common joint interest properties (see note 16).

Liquidity Risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they are due. The Company manages liquidity by ensuring, as far as possible, that it will have sufficient liquidity under both normal and stressed conditions. Trafina's management prepares a yearly budgets, cash flow forecasts and monthly sales reconciliations.

The following are the contractual maturities of financial liabilities as at June 30, 2011:

Financial Liability	Less than 1 year
Accounts payable and accrued liabilities	\$ 2,957,633

Market Risk

Market risk is the risk that changes in market prices, such as foreign exchange rates, commodity prices and interest rates will affect the Company's net earnings or the value of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable limits, while maximizing returns.

Foreign currency exchange rate risk

Foreign currency exchange rate risk is the risk that the fair value of future cash flows will fluctuate as a result of changes in foreign exchange rates. Although all of the Company's petroleum and natural gas sales are denominated in Canadian dollars, the underlying market prices in Canada for petroleum and natural gas are impacted by changes in the exchange rate between the Canadian and United States dollar. The Company had no forward exchange rate contracts in place as at or during the six months ended June 30, 2011.

Commodity price risk

Commodity price risk is the risk that the fair value or future cash flows will fluctuate as a result of changes in commodity prices. The following table summarizes the Company's commodity contracts:

Commodity price financial contracts:

Type	Daily Volume	Duration	Price	Estimated fair value at June 30, 2011
Fixed-Gas	300 GJ/day	July 1, 2011 to December 31, 2011	\$3.85/GJ	\$10,600
Fixed-Gas	300 GJ/day	July 1, 2011 to December 31, 2011	\$4.41/GJ	\$46,400
Collar-Oil	50 bbl/day	July 1, 2011 to December 31, 2011	Floor \$75.00 WTI Cdn Ceiling \$90.00 WTI Cdn	\$(62,000)
Collar-Oil	50 bbl/day	July 1, 2011 to December 31, 2011	Floor \$90.00 WTI US Ceiling \$108.90 WTI US	\$10,000

At June 30, 2011 the Company had a commodity contracts asset of \$5,000 (June 30, 2010 - \$129,000) based on the fair value of the contracts at that time. An unrealized gain on commodity contracts of \$124,589 was recognized in the six months ended June 30, 2011 (June 30, 2010 \$153,000) and a realized loss of \$33,280 was recognized over the same period (June 30, 2010 \$87,352 gain). In the three months ended June 30, 2011 an unrealized gain on commodity contracts of \$258,027 was recognized (June 30, 2010 \$129,000 loss) and a realized loss of \$24,564 was recognized over the same period (June 30, 2010 \$66,459 gain). For the six months ended June 30, 2011, the Company estimated that a \$0.10/mcf change in the natural gas price, while holding all other variables constant would impact loss before income taxes by approximately \$7,000 and a \$1.00/bbl cdn change in the oil price, while holding all other variables constant would impact loss before income taxes by approximately \$6,000.

Interest Rate Risk

Interest rate risk is the risk that future cash flows will fluctuate as a result of changes in market interest rates. At June 30, 2011, the Company had no bank debt. The Company had no interest rate swap or financial contracts in place as at or during the six months ended June 30, 2011. A 1.0% change in the prime rate over the six months ended June 30, 2011 would have impacted net loss by approximately \$11,000.

Capital Management

The Company manages its capital structure and considers adjustments in light of changes in economic conditions and the risk characteristics of its oil and natural gas assets. The Company considers its capital structure to include share capital, bank debt and working capital. The Company's revolving operating demand facility includes a covenant requiring the Company to maintain a working capital ratio of not less than one-to-one. The ratio is defined by the lender as current assets less unrealized hedging gains, plus any undrawn amounts available on its revolving operating demand facility, less current liabilities, less unrealized hedging losses and excluding any current portion drawn on either facility. The Company was in compliance with its covenant at June 30, 2011. There was no change in management of the Company's capital structure during the six months ended June 30, 2011.

The following outlines the Company's capital structure:

	June 30, 2011	December 31, 2010
Working capital deficiency (excluding bank debt)	\$ 1,359,826	\$ 2,675,105
Bank debt	\$ ---	\$ 3,673,466
Shareholders' equity	\$ 11,935,487	\$ 4,702,735

14. COMMITMENTS

The Company has an office lease arrangement terminating August 30, 2014. The Company's total remaining rent obligation is as follows:

2011	\$67,000
2012	\$146,000
2013	\$158,000
2014	\$112,000

15. RELATED PARTY TRANSACTIONS

A law firm of which the corporate secretary of the Company is a partner provides general and corporate legal services to the Company. For the six months ended June 30, 2011, fees for legal services billed from this related party were approximately \$230,000 (June 30, 2010 - \$118,000), of which \$13,000 is included in accounts payable at June 30, 2011 (June 30, 2010 - \$18,500). These services are measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

16. SUBSEQUENT EVENT

The Company acquired an additional 10 percent working interest in the Rangeview/Divide area of southwest Saskatchewan as a result of the settlement of net debt owed to the Company by a joint interest partner in the Rangeview/Divide properties. The Company estimates that the net debt owed by the working interest partner to be approximately \$233,000.

17. IFRS TRANSITION

The accounting policies set out in note 3 of the Company's first IFRS condensed interim financial statements for the three months ended March 31, 2011 have been applied in preparing the reconciliation of the statement of financial position from CGAAP to IFRS at June 30, 2010 and the comparative financial statements for the three and six months ended June 30, 2010. IFRS 1 First-time Adoption of IFRS and International Accounting Standard ("IAS") 34 Interim Financial Reporting have been applied to these interim financial statements.

Reconciliation of statement of financial position from Canadian GAAP ("CGAAP") to IFRS June 30, 2010

	CGAAP	2010 IFRS TRANSITION	IFRS
ASSETS			
Current Assets			
Accounts receivable	\$ 1,815,997	\$ ---	\$ 1,815,997
Commodity contracts asset	129,000	---	129,000
Prepaid expenses and deposits	125,253	---	125,253
	<u>2,070,250</u>	---	<u>2,070,250</u>
Exploration and evaluation assets (note 17 a(i),d)	---	167,115	167,115
Property and equipment (note 17 a(i),d,e,f,g,h)	15,714,812	(1,277,336)	14,437,476
	<u>\$ 17,785,062</u>	<u>\$ (1,110,221)</u>	<u>\$ 16,674,841</u>
LIABILITIES AND SHAREHOLDERS' EQUITY			
Current Liabilities			
Accounts payable and accrued liabilities	\$ 2,511,138	\$ ---	\$ 2,511,138
Bank debt	2,611,819	---	2,611,819
Current portion of liability settlement	486,111	---	486,111
	<u>5,609,068</u>	---	<u>5,609,068</u>
Flow through share obligation (note 17 b,i)	---	25,729	25,729
Decommissioning obligations (note 17 a(ii),f)	3,525,058	1,820,866	5,345,924
Deferred income taxes (note 17 c,k)	648,849	(648,849)	---
	<u>9,782,975</u>	<u>1,197,746</u>	<u>10,980,721</u>
Shareholders' Equity			
Share capital (note 17 b,k)	6,948,914	621,785	7,570,699
Warrants	580,782	---	580,782
Contributed surplus (note 17 a(iii),j)	661,875	84,198	746,073
Deficit	(189,484)	(3,013,950)	(3,203,434)
	<u>8,002,087</u>	<u>(2,307,967)</u>	<u>5,694,120</u>
	<u>\$ 17,785,062</u>	<u>\$ (1,110,221)</u>	<u>\$ 16,674,841</u>

Reconciliation of statements of loss and comprehensive loss from Canadian GAAP (“CGAAP”) to IFRS for the three months ended June 30, 2010

	CGAAP	IFRS adjustments	IFRS
REVENUE			
Petroleum and natural gas	\$ 1,275,671	\$ ---	\$ 1,275,671
Royalties	(129,710)	---	(129,710)
Realized gain on commodity contracts	66,459	---	66,459
Unrealized loss on commodity contracts	(129,000)	---	(129,000)
Other	36,625	---	36,625
	1,120,045	---	1,120,045
EXPENSES			
Operating	889,492	---	889,492
General and administrative	398,980	---	398,980
Depletion and depreciation (note 17 e)	919,782	(302,985)	616,797
Share based compensation (note 17 j)	47,285	(19,263)	28,022
Gain on property divestment (note 17 g)	---	(217,492)	(217,492)
Finance expenses (note 17 f)	105,557	(33,635)	71,922
Loss before income taxes	(1,241,051)	573,375	(667,676)
Deferred income tax reduction (provision) (note k)	305,943	(280,800)	25,143
Net loss and comprehensive loss	\$ (935,108)	\$ 292,575	\$ (642,533)
Basic and diluted loss per common share	\$(0.05)		\$(0.03)

Reconciliation of statements of loss and comprehensive loss from Canadian GAAP (“CGAAP”) to IFRS for the six months ended June 30, 2010.

	CGAAP	IFRS adjustments	IFRS
REVENUE			
Petroleum and natural gas	\$ 2,770,306	\$ ---	\$ 2,770,306
Royalties	(334,973)	---	(334,973)
Realized gain on commodity contracts	87,352	---	87,352
Unrealized gain on commodity contracts	153,000	---	153,000
Other	14,137	---	14,137
	2,689,822	---	2,689,822
EXPENSES			
Operating	2,034,335	---	2,034,335
General and administrative	851,934	---	851,934
Depletion and depreciation (note 17 e)	1,914,230	(624,532)	1,289,698
Impairment of property and equipment	---	805,307	805,307
Share based compensation (note 17 j)	113,127	(17,138)	95,989
Gain on property divestment (note 17 g)	---	(280,721)	(280,721)
Finance expenses (note 17 f)	192,576	(62,001)	130,575
Loss before income taxes	(2,416,380)	179,085	(2,237,295)
Deferred income tax reduction (provision) (note 17 k)	576,332	(295,674)	280,658
Net loss and comprehensive loss	\$ (1,840,048)	\$ (116,589)	\$ (1,956,637)
Basic and diluted loss per common share	\$(0.10)		\$(0.11)

- a. IFRS1 is a standard under IFRS that includes mandatory and optional exemptions that the Company may elect to help in its transition to IFRS. The elections are only available to companies that are transitioning to IFRS for the first time and are only applicable to the opening balance sheet of the Company on the transition date of January 1, 2010. The following includes the significant IFRS1 exemptions taken by the Company at January 1, 2010:

i. Deemed cost exemption:

Under CGAAP the Company followed the full cost method of accounting for its oil and gas properties, whereby, costs incurred to acquire, evaluate, develop assets net of any amounts received from dispositions are pooled together under property and equipment (“P&E”) and depleted, depreciated and/or accreted as one unit. P&E under IFRS requires certain capital projects to be separated into different categories.

The Company elected to use the deemed cost full cost exemption. This election enabled the Company to use the balance sheet carrying amount of its P&E under CGAAP as at January 1, 2010 and separate the P&E into three categories; pre-exploration costs, exploration and evaluation (“E&E”) assets and development and production (“D&P”) assets. The result of this election is as follows:

The Company did not identify any pre-exploration costs. The Company identified and reclassified \$1,363,082 that fit the definition of E&E assets and also removed expenditures relating to office furniture and equipment. The remaining amount was allocated to D&P assets on a pro rata basis using reserve value metrics from its proved plus probable Company interest reserves. The resulting D&P assets were rolled down into CGUs and tested for impairment. The test resulted in the recognition of \$1,990,225 of impairments as at January 1 2010. The Company used the greater of its value in use and its fair value less costs to sell. The impairment amount was recorded to the January 1, 2010 deficit.

ii. Decommissioning obligations:

The Company elected to use an exemption that allowed it to use IAS 37 *Decommissioning Liabilities* to record an abandonment liability and any changes to the CGAAP amount at January 1, 2010 will be recorded to opening deficit. An increase in the decommissioning obligation at January 1, 2010 was primarily a result of using a risk free rate, compared to using a credit adjusted risk free rate under CGAAP. As a result of applying this exemption, the Company's decommissioning obligation increased by \$1,102,809.

iii. Share base compensation:

The Company elected an exemption that allowed it to apply IFRS2 (share-based payments) to any unvested options outstanding as at December 31, 2009. Differences to CGAAP include the fact that each award is treated as a separate award under IFRS and IFRS uses a graded vesting method in the calculation instead of each award treated as a single award and calculated using a straight-line method as under CGAAP. Recalculating share based compensation on outstanding options as at December 31, 2009 resulted in an increase in contributed surplus of \$101,336 and a corresponding increase to the opening deficit.

b. Flow-through share obligation / share capital:

Under CGAAP proceeds received from the issuance of flow-through shares were credited to share capital and the associated deferred tax liability was recognized when the Company renounced the eligible tax pools. Under IFRS a liability is set up to account for a premium between the underlying share price at the time an agreement is entered into, compared to the flow-through share price. The liability is reduced as qualifying flow-through expenditures are made. An analysis was made of all of the Company's flow-through issuances to December 31, 2009. For flow-through issuances completed in 2009 a liability of \$58,474 was recorded with a corresponding entry to share capital. For flow-through share issuances completed prior to 2009, an entry was made to reduce share capital for \$489,982 and reduce the opening deficit to adjust for previous flow-through tax adjustments.

c. Deferred income tax:

As a result of adjustments to P&E and decommissioning obligations the Company's deferred income tax liability was reduced by \$786,991.

d. Transfers:

During the six months ended June 30, 2010 the Company classified various costs as E&E and moved costs out of E&E to property and equipment ("P&E") once it had been determined that there is technical feasibility and commercial viability.

The following table presents the E&E continuity:

	June 30, 2010
Balance, beginning of period	\$ 1,363,082
Additions	101,430
Transfer to property and equipment	(1,297,397)
Balance, end of period	\$ 167,115

e. Depletion:

Under CGAAP depletion was calculated using total proved reserves and used a full cost pool concept. Under IFRS a company has a choice regarding its depletion methodology and depletion is calculated based on individual components and not a full cost pool. The Company has adopted the policy of depleting its development and producing assets using a proved plus probable reserves base and calculates depletion at an area or commodity level. As a result of using a proved plus probable reserve base and depleting at an area level, accumulated depletion decreased by \$302,985 for the three months ended June 30, 2010 and decreased by \$624,532 for the six months ended June 30, 2010.

f. Decommissioning obligation:

As a result of using a risk free rate to calculate the net present value of decommissioning obligations instead of a credit adjust risk free rate the Company's decommissioning obligation at June 30, 2010 increased by \$1,150,454. The resultant increase in the Company's decommissioning obligation also increased property and equipment for the six months ended June 30, 2010. The increase was partially offset by \$432,397 associated with asset dispositions for the six months ended

June 30, 2010. The change in the discount rates used also had an effect on accretion expense resulting in accretion expense decreasing by \$33,635 and \$62,001 for the three and six months ended June 30, 2010, respectively.

g. Gain on property divestment:

Under CGAAP dispositions were recorded to the full cost pool and no gains or losses were reported unless the resulting disposition changed the depletion rate by 20 percent or greater. Under IFRS, proceeds from a divestiture are deducted from the carrying value of the asset and a gain or loss is recognized in earnings. All CGAAP divestitures in 2010 did not result in a gain or loss and P&E was adjusted for proceeds from the sale, with an additional adjustment for a reduction in related decommissioning obligations. Under IFRS the Company adjusted for proceeds from sales by reversing the carrying value in P&E and the associated reduction in decommissioning obligations. This decreased P&E for the carrying value for the six months ended June 30, 2010 of \$2,733,218, offset by the associated decommissioning obligation of \$432,397 and net cash proceeds of \$2,581,544, resulting in a gain of \$280,721. In the three months ending June 30, 2010 as a result of a property sale the Company decreased the carrying value of the P&E by \$1,118,551, offset by the associated decommissioning obligation of \$288,390 and net cash proceeds of \$1,047,653, resulting in a gain of \$217,492.

h. Impairment:

The Company evaluates its CGUs for impairment when indicators of impairment are present. For the six months ended June 30, 2010 the Company recorded impairments of \$805,307 on certain gas properties due to a decline in gas prices and production.

i. Flow-through shares:

The Company's flow-through obligation at January 1, 2010 was reduced by \$32,745 for the six months ended June 30, 2010 as the Company incurred qualifying flow-through expenditures.

j. Share based compensation:

Using a graded method for calculating share based compensation under IFRS resulted in a decrease to contributed surplus for the three and six months ended June 30, 2010 of \$19,263 and \$17,138, respectively, with corresponding entries to share based compensation.

k. Income tax:

As a result of temporary differences between CGAAP and IFRS relating to flow-through shares and the recording of an entry to remove a deferred tax asset as it was determined that it wasn't probable that future taxable profits will be available against which the temporary difference can be utilized, in the six months ended June 30, 2010 deferred income taxes were reduced by \$138,142 to nil, resulting in share capital increasing by \$190,277, flow through obligation decreasing by \$32,745 cumulating in a decrease in deferred income tax reduction of \$295,674.