Novus Energy Inc.
Financial Statements
December 31, 2012

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MANAGEMENT'S REPORT

To the Shareholders of Novus Energy Inc.

The accompanying financial statements of Novus Energy Inc. were prepared by and are the responsibility of management. They have been prepared in conformity with International Financial Reporting Standards.

Management maintains systems of internal accounting controls designed to provide reasonable assurance that all transactions are properly recorded in the Company's book of accounts, that procedures and policies are adhered to and that assets are safeguarded from unauthorized use.

Collins Barrow Calgary LLP, the external auditors of the Company, conducts an independent examination of the financial statements in accordance with Canadian generally accepted auditing standards in order to express their opinion on the financial statements. Their examination includes such tests and procedures considered necessary to provide reasonable assurance that the financial statements are presented fairly.

The Audit Committee of Novus Energy Inc., comprised of independent directors, has met with representatives of Collins Barrow Calgary LLP and management in order to determine if management has fulfilled its responsibilities in the preparation of the financial statements. On the recommendation of the Audit Committee, the financial statements have been approved by the Board of Directors.

(signed) *"Hugh G. Ross"*

Hugh G. Ross
President and Chief Executive Officer

(signed) *"Ketan Panchmatia"*

Ketan Panchmatia
VP Finance and Chief Financial Officer

Calgary, Alberta
April 24, 2013

INDEPENDENT AUDITORS' REPORT

To the Shareholders of Novus Energy Inc.

We have audited the accompanying financial statements of Novus Energy Inc., which comprise the statements of financial position as at December 31, 2012 and December 31, 2011, and the statements of income (loss) and comprehensive income (loss), statements of changes in shareholders' equity and statements of cash flows for the years ended December 31, 2012 and December 31, 2011, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

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 comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of Novus Energy Inc. as at December 31, 2012 and December 31, 2011, and its financial performance and its cash flows for the years ended December 31, 2012 and December 31, 2011 in accordance with International Financial Reporting Standards.

(signed) "*Collins Barrow Calgary LLP*"

Chartered Accountants

Calgary, Canada
April 24, 2013

($CAD, thousands)	Notes		**Dec 31, 2012**		Dec 31, 2011
ASSETS					
Current assets					
Accounts receivable	14	**$**	**8,057**	$	8,859
Deposits and prepaid expenses			**667**		410
			8,724		9,269
Exploration and evaluation	6		**11,374**		10,212
Property and equipment	7		**197,797**		137,415
Deferred income taxes	12		**19,493**		23,930
		$	**237,388**	$	180,826
LIABILITIES AND SHAREHOLDERS' EQUITY					
Current liabilities					
Accounts payable and accrued liabilities	14	**$**	**18,458**	$	7,942
Bank debt	8		**69,149**		49,584
			87,607		57,526
Decommissioning liabilities	9		**13,924**		11,655
			101,531		69,181
Shareholders' Equity					
Equity instruments	10		**131,412**		116,089
Contributed surplus			**15,811**		13,645
Deficit			**(11,366)**		(18,089)
			135,857		111,645
		$	**237,388**	$	180,826

Commitments – note 16

See accompanying notes.

Approved on behalf of the Board:

(signed) *"Hugh G. Ross"*

Hugh G. Ross - Director

(signed) *"Larry C. Mah"*

Larry C. Mah - Director

($CAD, thousands, except per share amounts)	Notes		**Year ended Dec 31, 2012**		Year ended Dec 31, 2011
REVENUE					
Production revenue		**$**	**75,952**	$	53,137
Royalties			**(8,757)**		(6,704)
			67,195		46,433
EXPENSES					
Field operations			**11,535**		10,573
Transportation and marketing			**3,706**		1,940
Exploration and evaluation			**384**		129
General and administrative			**6,911**		5,977
Stock-based compensation	10(d)		**2,099**		4,872
Depletion, depreciation and impairment	6, 7		**27,054**		28,251
			51,689		51,742
Income (loss) from operations			**15,506**		(5,309)
Other income (loss)					
Finance costs	11		**(2,023)**		(1,303)
Gain (loss) on sale of property and equipment			**(1,077)**		983
			(3,100)		(320)
Income (loss) before income taxes			**12,406**		(5,629)
Income taxes					
Current	12		**1,204**		754
Deferred (recovery)	12		**4,437**		(5,575)
			5,641		(4,821)
Net income (loss) and comprehensive income (loss) for the year		**$**	**6,765**	$	(808)
Net income (loss) and comprehensive income (loss) per share					
Basic	10(f)	**$**	**0.04**	$	**-**
Diluted	10(f)	**$**	**0.04**	$	**-**

See accompanying notes.

($CAD, thousands)	Notes	**Year ended Dec 31, 2012**	Year ended Dec 31, 2011
Equity instruments	10		
Common Shares			
Balance – beginning of year		**$ 112,208**	$ 108,122
Issued on exercise of stock options		**-**	112
Issued on exercise of warrants		**20,447**	3,425
Normal course issuer bids	10(e)	**(1,243)**	(1,143)
Recognition of tax effect on share issue costs		**-**	1,692
Balance – end of year		**$ 131,412**	$ 112,208
Warrants	10(a)		
Balance – beginning of year		**$ 3,881**	$ 4,520
Exercised		**(3,814)**	(639)
Expired		**(67)**	-
Balance – end of year		**$ -**	$ 3,881
Total equity instruments		**$ 131,412**	$ 116,089
Contributed surplus			
Stock-based compensation	10(d)		
Balance – beginning of year		**$ 9,955**	$ 5,123
Stock-based compensation expense		**2,099**	4,872
Exercise of stock options		**-**	(40)
Balance – end of year		**$ 12,054**	$ 9,955
Warrants			
Balance – beginning of year		**$ 3,690**	$ 3,690
Expiry of warrants		**67**	-
Balance – end of year		**$ 3,757**	$ 3,690
Total contributed surplus		**$ 15,811**	$ 13,645
Deficit			
Balance – beginning of year		**$ (18,089)**	$ (16,831)
Net income (loss) for the year		**6,765**	(808)
Excess cost over stated value on normal course issuer bid purchases	10(e)	**(42)**	(450)
Balance – end of year		**$ (11,366)**	$ (18,089)
Total shareholders' equity		**$ 135,857**	$ 111,645

See accompanying notes.

($CAD, thousands)	Notes		**Year ended Dec 31, 2012**		Year ended Dec 31, 2011
CASH PROVIDED BY (USED IN)					
OPERATING ACTIVITIES					
Net income (loss) for the year		**$**	**6,765**	$	(808)
Non-cash and other items:					
Stock-based compensation			**2,099**		4,872
Depletion, depreciation and impairment			**27,054**		28,251
Loss (gain) on sale of property and equipment			**1,077**		(983)
Finance costs			**305**		347
Deferred income taxes expense (recovery)			**4,437**		(5,575)
Decommissioning expenditures			**(405)**		(676)
Change in non-cash working capital	13		**2,997**		(6,406)
			44,329		19,022
FINANCING ACTIVITIES					
Proceeds from bank debt, net			**19,565**		49,584
Proceeds from issuance of equity instruments, net of issuance costs			**16,633**		2,858
Redemption of share capital			**(1,285)**		(1,593)
			34,913		50,849
INVESTING ACTIVITIES					
Capital expenditures			**(87,536)**		(76,360)
Proceeds from sale of property and equipment			**230**		3,250
Change in non-cash working capital	13		**8,064**		(1,824)
			(79,242)		(74,934)
Decrease in cash			**-**		(5,063)
Cash, beginning of year			**-**		5,063
Cash, end of year		**$**	**-**	$	-

Supplemental cash flows disclosure – note 13.

See accompanying notes.

1. Description of business

Novus Energy Inc. ("Novus" or the "Company") is engaged in the acquisition, exploration, development and production of petroleum and natural gas reserves in Western Canada.

The principal and head office of the Company is located at Suite 5200, 150 - 6th Avenue S.W., Calgary, Alberta T2P 3Y7. The registered office of the Company is located at 3500, 855 – 2nd Street S.W., Calgary, Alberta T2P 4J8.

Novus' common shares are listed and posted for trading on the TSX Venture Exchange under the symbol NVS.

These financial statements were approved and authorized for issuance by the Board of Directors on April 24, 2013.

2. Basis of preparation

a) Statement of compliance

These financial statements present the Company's financial results and financial position as at and for the year ended December 31, 2012, including 2011 comparative periods under International Financial Reporting Standards ("IFRS").

A summary of the Company's significant accounting policies under IFRS is presented in note 3. These policies have been consistently applied.

b) Basis of measurement

These financial statements have been prepared on the historical cost basis except for certain financial assets and financial liabilities, which are measured at fair value.

c) Functional and presentation currency

These financial statements are presented in Canadian dollars, which is the Company's functional currency.

d) Function versus nature

Field operations in the statement of income (loss) and comprehensive income (loss) are presented as a combination of function and nature in conformity with industry practice. Depletion and depreciation are presented on a functional basis. Significant expenses, such as benefits and share-based compensation, are presented by their nature in note 17 to these financial statements.

e) Use of estimates and judgments

The preparation of financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, revenues and expenses. Actual results may differ from these estimates.

Estimates and judgments are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Accounting estimates will, by definition, seldom equal the actual results. Revisions to accounting estimates are recognized in the period in which the estimates are revised and in any

future periods affected.

The following discussion sets forth management's most critical estimates and assumptions made in the preparation of these financial statements:

Depletion and valuation of property and equipment and exploration and evaluation assets

The amounts recorded for depletion, depreciation and impairment of property and equipment and the valuation of property and equipment are based on estimates. These estimates include proved and probable reserves, production rates, future petroleum and natural gas prices, future development costs, remaining lives and periods of future benefits of the related assets and other relevant assumptions.

The Company's reserve estimates are evaluated annually pursuant to the parameters and guidelines stipulated under National Instrument 51-101 - Standards of Disclosure for Oil and Gas Activities. Changes in reserve estimates impact the financial results of the Company as reserves and estimated future development costs are used to calculate depletion and are also used in impairment calculations.

The valuation of exploration and evaluation ("E&E") assets is dependent upon the discovery of economically recoverable reserves which in turn is dependent on future petroleum and natural gas prices, future capital expenditures and environmental and regulatory restrictions.

The decision to transfer assets from E&E to property and equipment is based on the estimated proved and probable reserves which are in part used to determine a project's technical feasibility and commercial viability.

For impairment testing, property and equipment and E&E assets are aggregated into Cash Generating Units ("CGUs"), based on management's judgment in defining the smallest identifiable group of assets that generate cash inflows that are largely independent of the cash flows from other assets or groups of assets. CGUs are determined by similar geological structure, shared infrastructure, geographical proximity, commodity type, similar exposure to market risks and materiality.

The discount rate used to calculate the net present value of cash flows for impairment testing is based on estimates of market conditions, recent asset sales and an approximate Company and industry peer group weighted average cost of capital. Changes in the general economic environment could result in significant changes to this estimate.

Decommissioning liabilities

The provision for decommissioning liabilities depends on estimates of current risk-free interest rates, future restoration and reclamation expenditures and the timing of those expenditures.

Valuation of accounts receivable

The valuation of accounts receivable is based on management's best estimate of the provision for doubtful accounts.

Income taxes

The amounts recorded for deferred income taxes are based on estimates as to the timing of the reversal of temporary differences and tax rates currently substantively enacted. They are also based on estimates of the probability of the Company utilizing certain tax pools and assets which, in turn, is dependent on estimates of proved and probable reserves, production rates, future petroleum and

natural gas prices and changes in legislation, tax rates and interpretations by taxation authorities. The availability of tax pools is subject to audit and interpretation by taxation authorities. To the extent assumptions regarding future probability change, there can be a change in the amounts recognized in respect of deferred tax assets as well as the amounts recognized in profit or loss in the period in which the change occurs.

Stock-based compensation

The amounts recorded relating to the fair value of stock options are based on estimates of the future volatility of the Company's share price, expected forfeiture rates, expected lives of the underlying securities, expected dividends and other relevant assumptions.

The amounts recorded relating to the fair value of performance warrants are based on estimates of the future volatility of the Company's share price, expected forfeiture rates, expected lives of the underlying securities, expected dividends and meeting certain performance targets.

3. Significant accounting policies

a) Business combinations

Business combinations are accounted for using the acquisition method. The acquired identifiable net assets are measured at their fair value at the date of acquisition. Any excess of the purchase price over the fair value of the net assets acquired is recognized as goodwill. Following initial recognition, goodwill is recognized at cost less any accumulated impairment losses. Any deficiency of the purchase price below the fair value of the net assets acquired is recorded as a gain in net earnings. Associated transaction costs are expensed when incurred.

b) Jointly controlled operations and jointly controlled assets

Some of the Company's petroleum and natural gas activities involve jointly controlled assets and are conducted under joint operating agreements. The financial statements include the Company's share of these jointly controlled assets, the relevant revenue and related costs.

c) Cash and cash equivalents

Cash and cash equivalents consist of amounts on deposit with banks, term deposits and other similar short-term highly liquid investments with maturities of 90 days or less at the date of issue.

d) Exploration and evaluation and property and equipment

(i) *Exploration and evaluation*

Pre-license expenditures incurred before the Company has obtained legal rights to explore an area are expensed.

E&E costs include the costs of acquiring licenses, exploratory drilling, geological and geophysical activities, acquisition of mineral and surface rights, decommissioning liabilities and technical studies. E&E costs are capitalized as E&E assets when the technical feasibility and commercial viability of extracting petroleum and natural gas reserves have yet to be determined. E&E assets are measured at cost and are not depleted or depreciated. E&E assets, net of any impairment loss, are transferred to property and equipment when proved and/or probable reserves are determined to exist.

The cost of undeveloped land that expires during the period is charged as additional depletion and depreciation expense.

E&E assets are assessed for impairment when facts and circumstances suggest that the carrying amount exceeds the recoverable amount. E&E assets are also assessed for impairment upon their reclassification to property and equipment.

Exchanges or swaps that involve only E&E assets are accounted for at cost. Any gains or losses from the divestiture of E&E assets are recognized in income.

(ii) *Property and equipment*

All costs directly associated with the acquisition and development of petroleum and natural gas interests, including directly attributable overhead, administrative expenses and remuneration of production and supervisory personnel, and are capitalized on an area-by-area basis as property and equipment and are measured at cost less accumulated depletion and depreciation and net of impairment losses. These costs include expenditures for areas where technical feasibility and commercial viability has been determined. These costs include property acquisitions with proved and/or probable reserves, development drilling, completions, gathering and infrastructure, decommissioning liabilities and transfers of exploration and evaluation assets.

Costs of replacing parts of property and equipment are capitalized only when they increase the future economic benefits embodied in the specific asset to which they relate. All other expenditures are recognized in income as incurred. The carrying amount of any replaced or sold component is derecognized. The costs of the day-to-day servicing of property and equipment are recognized in income as incurred.

Exchanges or swaps of property and equipment are measured at fair value unless the transaction lacks commercial substance or neither the fair value of the asset received nor the asset given up can be reliably estimated. The cost of the acquired asset is measured at the fair value of the asset given up, unless the fair value of the asset received is more clearly evident. When fair value is not used, the cost of the acquired asset is measured at the carrying amount of the asset given up. Any gains or losses from the divestiture of property and equipment are recognized in income.

(iii) *Depletion and depreciation*

Petroleum and natural gas interests are depleted on an area-by-area basis using the unit-of-production method by reference to the ratio of production in the period to the related proved and probable reserves, taking into account estimated future development costs. Production and reserves of natural gas are converted to equivalent barrels of crude oil on the basis of six thousand cubic feet of gas to one barrel of oil. Changes in estimates used in prior periods, such as proved and probable reserves, that affect the unit-of-production calculations do not give rise to prior period adjustments and are dealt with on a prospective basis.

Processing facilities and well equipment are depreciated using the unit-of-production method along with the related reserves when the assets are designed to have a life similar to the reserves of the related wells with little to no residual value. Where facilities and equipment, including major components, have differing useful lives, they are depreciated separately on a straight-line basis over the estimated useful life of the facilities and equipment and other related components.

Other assets, referred to as other corporate assets, are depreciated on a straight line basis at rates approximating their estimated useful lives ranging from two to five years.

e) Impairment of non-financial assets

The carrying amounts of the Company's non-financial assets, other than E&E assets and deferred income tax assets, are reviewed for indicators of impairment at each reporting date. If indicators of impairment exist, the recoverable amount of the asset is estimated.

For the purposes of assessing impairment, property and equipment are grouped into CGUs. Goodwill is allocated to the CGUs that are expected to benefit from the synergies of the business combination creating the goodwill.

The recoverable amount of a CGU is the greater of its fair value less costs to sell and its value in use. Fair value is determined to be the amount for which the asset could be sold in an arm's length transaction between knowledgeable and willing parties. Fair value less costs to sell may be determined using discounted future net cash flows of proved and probable reserves using forecast prices and costs and including future development costs. These cash flows are discounted at an appropriate discount rate which would be applied by a market participant. Value in use is determined by estimating the present value of the future net cash flows to be derived from the continued used of the cash-generating unit in its present form. These cash flows are discounted at a rate based on the time value of money and risks specific to the CGU.

An impairment loss is recognized if the carrying amount of an asset or CGU exceeds its recoverable amount. An impairment loss recognized in respect of a CGU is allocated first to reduce the carrying amount of any goodwill allocated to the CGU and then to reduce the carrying amounts of the other assets in the CGU on a pro rata basis. Impairment losses are recognized in income.

E&E assets are assessed for impairment when they are reclassified to property and equipment or if facts and circumstances suggest that the carrying amount exceeds the recoverable amount. Indicators of impairment may include the decision to longer pursue the evaluation project, an expiry of the rights to explore in an area, or failure to receive regulatory approval for a project. E&E assets are tested for impairment separately from property and equipment. If, at any time, it is determined that the Company has no future exploration plans and commercial production cannot be achieved in relation to an area, the associated costs are written down to the estimated recoverable amount or fully derecognized, and the amount of the write-down is recognized in income.

Impairment losses recognized in prior periods are assessed at each reporting date for any indications that the impairment loss has decreased or no longer exists. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depletion and depreciation, if no impairment loss had been recognized. A goodwill impairment loss is not reversed.

f) Provisions and contingent liabilities

Provisions are recognized by the Company when it has a legal or constructive obligation as a result of past events, it is probable that an outflow of economic resources will be required to settle the obligation and a reliable estimate can be made of the amount of that obligation. Provisions are stated at the present value of the expenditure expected to settle the obligation. The obligation is not recorded and is disclosed as a contingent liability if it is not probable that an outflow will be required, if the amount cannot be estimated reliably or if the existence of the outflow can only be confirmed by the occurrence of a future event.

(i) *Decommissioning liabilities*

Decommissioning liabilities are recognized for decommissioning and restoration obligations associated with the Company's E&E assets and property and equipment. The best estimate of the expenditure required to settle the present obligation at the balance sheet date is

recorded on a discounted basis using the pre-tax risk-free interest rate. The future cash flow estimates are adjusted to reflect the risks specific to the liability. The value of the obligation is added to the carrying amount of the associated E&E or property and equipment asset and is depleted or amortized over the useful life of the asset. The provision is accreted over time through charges to Finance costs with actual expenditures charged against the accumulated obligation. Changes in the future cash flow estimates resulting from revisions to the estimated timing or amount of undiscounted cash flows or the discount rate are recognized as changes in the decommissioning provision and related asset. Actual decommissioning expenditures up to the recorded liability at the time are charged against the provision as the costs are incurred. Any differences between the recorded provision and the actual costs incurred is recorded as a gain or loss on asset derecognition.

The Company recognizes the deferred tax asset regarding the temporary difference on the decommissioning liability and the corresponding deferred tax liability regarding the temporary difference on a decommissioning asset.

g) Flow-through shares

From time to time, the Company finances a portion of its exploration and development activities through the issuance of flow-through shares. Under the terms of the flow-through share agreements, the tax attributes of the related expenditures are renounced to subscribers. The stated capital recorded on flow-through share issuances is equal to the estimated fair value of the common shares, exclusive of the flow-through component, on the date of issue. The difference between the gross proceeds received and the stated capital recorded is a liability ("flow-through share premium") until qualifying expenditures are incurred. When the expenditures are incurred the resulting deferred tax liability is recorded through income tax expense less the reversal of the flow-through share premium previously reported.

h) Income taxes

Income tax expense is comprised of current and deferred income taxes. Income tax expense is recognized in the statement of income except to the extent that it relates to items recognized directly in equity or other comprehensive income.

Current income tax is the expected tax payable on the taxable income for the year and any adjustment to tax payable in respect of previous years.

Deferred income tax is recognized by providing for temporary differences between the carrying amounts of assets and liabilities and the amounts used for taxation purposes. Deferred income tax liabilities are generally recognized for all taxable temporary differences. Deferred income tax assets are generally recognized for all deductible temporary differences and carry-forward of unused tax losses and unused tax credits to the extent that it is probable that taxable profits will be available against which those deductible temporary differences and carry-forward of unused tax losses and unused tax credits can be utilized.

Deferred income tax is not recognized on the initial recognition of assets or liabilities in a transaction that is not a business combination, when, at the time of the transaction, the initial recognition affects neither the accounting nor taxable profit or loss. In addition, deferred income tax is not recognized for taxable temporary differences arising on the initial recognition of goodwill.

Deferred income tax is measured at the tax rates that are expected to be applied to temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date. Deferred income tax assets and liabilities are offset if there is a legally enforceable right to offset, and they relate to income taxes levied by the same taxation authority on the same taxable entity, or on different tax entities, but they intend to settle current tax liabilities and

assets on a net basis or their tax assets and liabilities will be realized simultaneously.

i) Leases

Leases that transfer substantially all of the benefits and risks of ownership to the Company are accounted for at the commencement of the lease term as finance leases and recorded as property and equipment at the fair value of the leased asset, or, if lower, at the present value of the minimum lease payments, together with an offsetting liability. Finance charges are allocated to each period so as to achieve a constant rate of interest on the remaining balance of the liability and are charged directly against income. Capitalized leased assets are depreciated over the shorter of the estimated useful life of the asset or the lease term. All other leases are accounted for as operating leases and the lease costs are expensed as incurred.

j) Revenue

Revenue from the production of petroleum and natural gas is recognized when title passes from the Company to the customer. Revenue represents the Company's share, and is shown separately from the royalty obligations to governments and other mineral interest owners. Transportation and marketing costs are reported as a separate expense and are not netted against revenue.

Royalty income is recognized as it accrues in accordance with the terms of the royalty agreements.

k) Finance income and costs

Finance income, consisting of interest income, is recognized as it accrues in the statement of income, using the effective interest method.

Finance costs are comprised of interest expense on borrowings, costs relating to the Company’s credit facilities, accretion of the discount on decommissioning liabilities and impairment losses recognized on financial assets. Cash flow from interest paid is classified as an operating activity on the statement of cash flows.

Borrowing costs incurred for the acquisition or construction of qualifying assets are capitalized during the period of time that is required to complete and prepare the assets for their intended use or sale. A qualifying asset is one that takes a substantial period of time to get ready for use or sale.

Where funds are borrowed specifically to finance a project, the amount capitalized represents the actual borrowing costs incurred. Where the funds used to finance a project form part of general borrowings, the amount capitalized is calculated using a weighted average of rates applicable to relevant general borrowings of the Company during the period.

All other borrowing costs are recognized in the statement of income in the period in which they are incurred using the effective interest method.

l) Stock-based compensation

The Company has stock options and performance warrants as described in notes 10(b) and 10(c). Stock options granted to directors, officers, employees and consultants of the Company are accounted for using the fair value method under which stock-based compensation expense is recorded based on the estimated fair value of the options at the grant date using the Black-Scholes option pricing model. The Company measures stock-based compensation to non-employees at the fair value of the goods or services received at the date the goods or services are received. If the fair value of the good or services cannot be measured reliably, the value of the options granted is measured using the Black-Scholes option pricing model.

Each tranche in an award is considered a separate award with its own vesting period and grant date fair value. Stock-based compensation costs are expensed over the vesting period with a corresponding increase in contributed surplus. When stock options are exercised, the cash proceeds along with the amount previously recorded as contributed surplus are recorded as share capital. A forfeiture rate is estimated on the grant date and is adjusted to reflect the actual number of options that vest.

Stock-based compensation expense for performance warrants is calculated using the Black-Scholes option pricing model and recorded based on the probable outcome of the vesting requirements, with an expense being recognized over the vesting terms of the performance warrants if those terms are probable to be realized. The estimate of this expense is adjusted for subsequent changes in the expected or actual outcome of the vesting requirements and any changes to this expense are recorded in the period of change. When performance warrants are exercised, the cash proceeds along with the amount previously recorded as contributed surplus are recorded as share capital.

m) Net income (loss) per share

Net income (loss) per share is calculated by dividing net and comprehensive income or loss by the weighted average number of common shares outstanding during the period. The Company computes the dilutive impact of common shares assuming the proceeds received from the pro forma exercise of in-the-money warrants, stock options and performance warrants plus the unamortized portion of stock-based compensation costs are used to purchase common shares at average market prices.

n) Financial instruments

(i) *Classification and measurement*

Financial instruments are measured at fair value on initial recognition of the instrument. Measurement in subsequent periods depends on whether the financial instrument has been classified as “fair value through profit or loss”, “loans and receivables”, “available-for-sale”, “held-to-maturity”, or “financial liabilities measured at amortized cost” as defined by International Accounting Standard (“IAS”) 39, “Financial Instruments: Recognition and Measurement” (“IAS 39”).

Financial assets and financial liabilities at “fair value through profit or loss” are either classified as “held for trading” or “designated at fair value through profit or loss” and are measured at fair value with changes in fair value recognized in the income statement. Transaction costs are expensed when incurred. The Company has designated cash and cash equivalents as “held for trading”.

Financial assets and financial liabilities classified as “loans and receivables”, “held-to-maturity”, or “financial liabilities measured at amortized cost” are measured at amortized cost using the effective interest method of amortization. “Loans and receivables” are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. “Held-to-maturity” financial assets are non-derivative investments that an entity has the positive intention and ability to hold to maturity. “Financial liabilities measured at amortized cost” are those financial liabilities that are not designated as “fair value through the statement of income” and that are not derivatives. The Company has designated accounts receivable and deposits as “loans and receivables” and bank debt and accounts payable and accrued liabilities as “financial liabilities measured at amortized cost”.

Financial assets classified as “available-for-sale” are measured at fair value, with changes in fair value recognized in other comprehensive income. Available-for-sale financial assets are non-derivatives that are either designated in this category or not classified in any of the other

categories. The Company does not have any available-for-sale financial assets.

(ii) *Derivative financial instruments*

The Company may enter into certain financial derivative contracts in order to manage the exposure to market risks from fluctuations in commodity prices. The Company's policy is not to utilize derivative financial instruments for speculative purposes. All financial derivative contracts are classified as "fair value through profit or loss".

Embedded derivatives are separated from the host contract and accounted for separately if the economic characteristics and risks of the host contract and the embedded derivative are not closely related, a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative, and the combined instrument is not measured at fair value through the statement of income. Changes in the fair value of separable embedded derivatives are recognized immediately in the statement of income. The Company has not identified any embedded derivatives.

(iii) *Equity instruments*

The Company's common shares and warrants are classified as equity instruments. Incremental costs directly attributable to the issue of common shares, warrants, stock options and performance warrants are recognized as a deduction from equity, net of any tax effects.

(iv) *Impairment*

The Company assesses at each statement of financial position date whether there is objective evidence that financial assets, other than those designated as "fair value through profit or loss" are impaired. When impairment has occurred, the cumulative loss is recognized in the statement of income. For financial assets carried at amortized cost, the amount of the impairment loss recognized is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the financial asset's original effective interest rate. When an available-for-sale financial asset is considered to be impaired, cumulative gains or losses previously recognized in other comprehensive income are reclassified to the statement of income in the period. Impairment losses may be reversed in subsequent periods.

4. New accounting policies

Future accounting changes

a) Financial Instruments

The International Accounting Standards Board ("IASB") intends to replace IAS 39 with IFRS 9, "Financial Instruments" ("IFRS 9"). IFRS 9 will be published in three phases, of which the first phase has been published.

For financial assets, IFRS 9 uses a single approach to determine whether a financial asset is measured at amortized cost or fair value, and replaces the multiple rules in IAS 39. The approach in IFRS 9 is based on how an entity manages its financial instruments in the context of its business model and the contractual cash flow characteristics of the financial assets. The new standard also requires a single impairment method to be used. For financial liabilities, the approach to the fair value option may require different accounting for changes to the fair value of a financial liability as a result of changes to an entity's own credit risk.

IFRS 9 is currently effective for annual periods beginning on or after January 1, 2015, and the Company will assess the impact of this standard prior to implementation.

b) Fair Value Measurements

In May 2011, the IASB issued IFRS 13, “Fair Value Measurement” which provides a consistent and less complex definition of fair value, establishes a single source of guidance for determining fair value and introduces consistent requirements for disclosures related to fair value measurement. Prospective application of this standard is effective for fiscal periods beginning on or after January 1, 2013, with early adoption permitted.

Adoption of this standard is not expected to have a material impact on the Company’s financial statements.

c) Reporting Entity

In May 2011, The IASB issued IFRS 10, “Consolidated Financial Statements” (“IFRS 10”), IFRS 11, “Joint Arrangements” (“IFRS 11”), IFRS 12, “Disclosure of Interests in Other Entities” (“IFRS 12”) and amendments to both IAS 27, “Consolidated and Separate Financial Statements” and IAS 28 “Investments in Associates”.

IFRS 10 creates a single consolidation model by revising the definition of control in order to apply the same control criteria to all types of entities, including joint arrangements, associates and special purpose vehicles. IFRS 11 establishes a principle-based approach to the accounting for joint arrangement by focusing on the rights and obligations of the arrangement and limits the application of proportionate consolidation to arrangements that meet the definition of a joint operation. IFRS 12 is a comprehensive disclosure standard for all forms of interests in other entities, including joint arrangements, associates and special purpose vehicles.

Retrospective application of these standards with relief for certain transactions is effective for fiscal years beginning on or after January 1, 2013, with earlier adoption permitted if all of the standards are collectively adopted.

Adoption of these standards is not expected to have a material impact on the Company’s financial statements.

5. Determination of Fair Values

A number of the Company’s accounting policies and disclosures require the determination of fair value, for both financial and non-financial assets and liabilities. Fair values have been determined for measurement and/or disclosure purposes based on the following methods. When applicable, further information about the assumptions made in determining fair values is disclosed in the notes specific to that asset or liability.

a) Property and equipment and E&E assets

The fair values of property and equipment and E&E assets recognized in an acquisition are based on market values. The market values of property and equipment and E&E assets are the estimated amounts for which such property and equipment and E&E assets could be exchanged for on the acquisition date between a willing buyer and a willing seller in an arm’s length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently and without compulsion. The market values of petroleum and natural gas interests (included in property and equipment) and E&E assets are estimated with reference to the discounted cash flows expected to be

derived from petroleum and natural gas production based on externally prepared reserve reports. The risk-adjusted discount rate is specific to the asset with reference to general market conditions.

b) Financial instruments

The fair values of accounts receivable, bank debt and accounts payable are estimated as the present value of future cash flows, discounted at the market rate of interest at the reporting date. At December 31, 2012, and December 31, 2011, the fair value of these balances, excluding bank debt, approximated their carrying value due to their short term to maturity. The fair value of bank debt approximated carrying value due to it bearing a floating rate of interest.

The significance of inputs used in making fair value measurements are examined and classified according to a fair value hierarchy. Fair value of assets and liabilities included in Level 1 are determined by reference to quoted prices in active markets for identical assets and liabilities. Assets and liabilities in Level 2 include valuations using inputs other than quoted prices for which all significant outputs are observable, either directly or indirectly, and are based on valuation models and techniques where the inputs are derived from quoted indices. Level 3 valuations are based on inputs that are unobservable and significant to the overall fair value measurement.

The Company does not have any financial instruments measured at fair value using a fair value hierarchy.

c) Stock options and performance warrants

The fair value of stock options and performance warrants are measured using a Black-Scholes option pricing model. Measurement inputs include share price, exercise price, expected volatility (based on historic volatility), weighted average expected life (based on historical experience and general option/performance warrant holder behavior), expected dividends, and the risk-free interest rate (based on government bonds).

6. Exploration and evaluation

Cost		**Dec 31, 2012**		Dec 31, 2011
Balance, beginning of year	**$**	**10,212**	$	11,779
Additions		**3,299**		2,991
Dispositions		**-**		(57)
Transfers to property and equipment		**(1,218)**		(2,777)
Surrendered and expired leases		**(919)**		(1,724)
Balance, end of year	**$**	**11,374**	$	10,212

E&E assets consist of the Company's unproved properties and capitalized exploratory drilling and completion costs which are pending the determination of commercial viability.

7. Property and equipment

Petroleum and natural gas properties		**Dec 31, 2012**		Dec 31, 2011
Balance, beginning of year	**$**	**205,423**	$	127,870
Additions		**86,622**		77,189
Dispositions		**(2,312)**		(2,413)
Transfers from exploration and evaluation		**1,218**		2,777
Balance, end of year	**$**	**290,951**	$	205,423

Other corporate assets		**Dec 31, 2012**		Dec 31, 2011
Balance, beginning of year	**$**	**745**	$	552
Additions		**29**		193
Balance, end of year	**$**	**774**	$	745

Accumulated depletion, depreciation and impairment		**Dec 31, 2012**		Dec 31, 2011
Balance, beginning of year	**$**	**68,753**	$	42,226
Dispositions		**(960)**		-
Depletion, depreciation and impairment expense		**26,135**		26,527
Balance, end of year	**$**	**93,928**	$	68,753

Carrying amounts		**Dec 31, 2012**		Dec 31, 2011
Petroleum and natural gas properties	**$**	**197,630**	$	137,149
Other corporate assets		**167**		266
	$	**197,797**	$	137,415

The depletion, depreciation and impairment of property and equipment, and any reversal thereof, are recognized in depletion, depreciation and impairment expense in the statement of income (loss) and comprehensive income (loss).

Future development costs of $345.9 million (2011 – $183.8 million) were included in depletable costs as these costs are necessary to bring the proved and probable reserves into production.

General and administrative expenditures of $521 thousand for the year ended December 31, 2012 (2011 - $457 thousand) were capitalized as they were directly attributable to drilling, completion and facility construction activities.

During the year ended December 31, 2012, the Company recognized net impairments (recoveries) of $(3) thousand (2011 - $9.9 million) which were recorded in depletion, depreciation and impairment expense. A gross impairment of $2.1 million (2011 - $9.9 million) was recognized in two (2011 – four) CGUs due to a combination of lower commodity prices and a revision of estimated reserves, which resulted in the fair value less costs to sell of the applicable CGU being less than its carrying amount. An impairment reversal of $2.1 million (2011 - $nil) was recognized in two (2011 – nil) CGUs largely as a result of positive technical revisions to reserves in those CGUs.

The fair values of the CGUs were calculated using before tax future net cash flows based on proved and probable reserves and discounted at a rate of 10%. In determining the discount rate, the Company considered acquisition metrics of recent transactions completed on assets similar to those in the specific CGU.

The following table outlines the impairments (recoveries) recognized during the years ended December 31, 2012 and December 31, 2011:

Cash Generating Unit	Year Ended Dec 31, 2012	Year ended Dec 31,2011
Central Alberta	$ (1,292)	$ 112
North Central Alberta	(831)	281
Northwest Alberta	2,019	8,107
Southeast Saskatchewan	101	1,425
	$ (3)	$ 9,925

A 1% increase in the discount rate used in calculating the impairment would result in an additional net impairment of $144 thousand (2011 - $330 thousand).

The following table outlines the benchmark reference prices used in the December 31, 2012 impairment calculations:

	Edmonton Light Crude $Cdn/BBL	Hardisty Bow River Crude $Cdn/BBL	AECO Natural Gas $Cdn/MMBTU
2013	84.55	69.33	3.31
2014	89.84	74.57	3.72
2015	88.21	73.21	3.91
2016	95.43	80.17	4.70
2017	96.87	81.37	5.32
2018	98.32	82.59	5.40
2019	99.79	83.83	5.49
2020	101.29	85.08	5.58
2021	102.81	86.36	5.67
2022	104.35	87.66	5.76
Thereafter		Escalation rate of 1.5% per year	

The following table outlines the benchmark reference prices used in the December 31, 2011 impairment calculations:

	Edmonton Light Crude $Cdn/BBL	Hardisty Bow River Crude $Cdn/BBL	AECO Natural Gas $Cdn/MMBTU
2012	96.87	82.34	3.16
2013	93.75	79.69	3.78
2014	90.89	77.25	4.13
2015	96.23	81.80	5.53
2016	98.16	83.44	5.65
2017	100.12	85.10	5.77
2018	102.12	86.81	5.89
2019	104.17	88.54	6.01
2020	106.25	90.31	6.14
2021	108.38	92.12	6.27
Thereafter		Escalation rate of 2.0% per year	

Adjustments were made to the benchmark prices, for the purposes of the impairment calculations, to reflect varied delivery points and quality differentials in the products delivered.

8. Bank debt

As at December 31, 2012, the Company had drawn $69.1 million against its $95 million revolving operating demand line and $nil against its $10 million acquisition/development demand loan. The loans are available to the Company by way of prime rate based loans, bankers' acceptances and letters of credit/guarantee with interest paid monthly. Interest on the revolving operating demand loan is charged at prime plus 0.75%. Bankers acceptances are charged a stamping fee of 2% per annum and letters of credit/guarantee are charged a fee of 1.5% per annum. Interest on the acquisition/development demand loan is charged at prime plus 1.25%. The credit facilities are secured by a general assignment of book debts and a $150 million debenture with a floating charge over all assets of the Company with a negative pledge and undertaking to provide fixed charges upon request. The credit facilities are subject to a financial covenant that requires the Company to maintain a working capital ratio of at least 1:1, but for the purposes of the covenant, outstanding bank debt and the fair value of any commodity contracts are excluded and the unused portion of the revolving operating demand loan may be added to current assets. As at December 31, 2012, this ratio was 1.9:1.

The effective interest rate for the bank debt was approximately 3.6% for the year ended December 31, 2012 (2011 – 3.8%).

The credit facilities are subject to periodic review by the bank with the next review scheduled on or before June 1, 2013, but may be set at an earlier or later date at the sole discretion of the bank.

9. Decommissioning liabilities

The Company's decommissioning liabilities are based on the Company's net ownership in wells and facilities along with management's estimate of the timing and expected future costs associated with the plugging and abandonment of wells, facilities dismantlement and site reclamation.

The following table reconciles the changes in the Company's decommissioning liabilities:

		Dec 31, 2012		Dec 31, 2011
Decommissioning liabilities, beginning of year	**$**	**11,655**	$	8,174
Liabilities incurred		**1,651**		2,610
Liabilities acquired on property acquisitions		**249**		463
Liabilities settled		**(405)**		(676)
Liabilities extinguished on property dispositions		**(77)**		(203)
Effect of change in rate and estimates		**546**		940
Accretion expense		**305**		347
Decommissioning liabilities, end of year	**$**	**13,924**	$	11,655

The inflated, undiscounted amount of the future cash flows required to settle the obligations is estimated to be $18.9 million (2011 - $15.9 million). The obligations were calculated using a risk-free interest rate of 2.5% (2011 – 2.5%) and an inflation rate of 2% (2011 – 2%). It is expected that the obligations will be funded from general Company resources at the time the costs are incurred with the majority of costs expected to occur between 2020 and 2032.

10. Equity instruments

Authorized

Unlimited number of common shares

Issued

Common Shares	Shares		Stated Value
Balance - December 31, 2010	166,961	$	108,122
Issued on exercise of stock options	73		112
Issued on exercise of warrants	3,714		3,425
Normal course issuer bid (note 10(e))	(1,758)		(1,143)
Recognition of tax effect on share issue costs (note 12)	-		1,692
Balance - December 31, 2011	168,990	$	112,208
Issued on exercise of warrants	22,177		20,447
Normal course issuer bid (note 10(e))	(1,792)		(1,243)
Balance – December 31, 2012	**189,375**	**$**	**131,412**

Warrants	Number of Warrants and Underlying Shares		Stated Value
Balance – December 31, 2010	26,276	$	4,520
Exercised	(3,714)		(639)
Expired	-		-
Balance – December 31, 2011	22,562		3,881
Exercised	(22,177)		(3,814)
Expired	(385)		(67)
Balance – December 31, 2012	-	$	-
Total Equity Instruments		**$**	**131,412**

a) Warrants

During the year ended December 31, 2012, 22,176,730 warrants (2011 – 3,714,400) were exercised for gross proceeds of $16.6 million (2011 - $2.8 million) and 384,870 warrants (2011 – nil) expired unexercised.

b) Stock options

The Company has a floating stock option plan by which the Company may grant options to directors, officers, employees and consultants for up to 10% of common shares outstanding. Each option permits the holder to purchase one common share of the Company at the stated exercise price. Options vest ¼ every six months, beginning six months from the date of grant.

The following tables summarize the status of the Company's stock option plan and the activity during the years ended December 31, 2012 and December 31, 2011:

	Dec 31, 2012		Dec 31, 2011	
	Number of Options	**Weighted Average Exercise Price**	**Number of Options**	**Weighted Average Exercise Price**
Balance – beginning of year	16,283	$ 0.84	15,375	$ 0.84
Granted	1,955	0.93	1,160	0.84
Exercised	-	-	(73)	0.99
Expired/forfeited	(151)	1.35	(179)	0.95
Balance – end of year	18,087	0.84	16,283	0.84
Exercisable – end of year	16,056	$ 0.84	10,293	$ 0.83

The weighted average price of the Company's common shares on the dates the stock options were exercised in 2011 was $1.32.

Date of Grant	**Number Outstanding at Dec 31, 2012**	**Exercise Price**	**Weighted Average Remaining Contractual Life (Years)**	**Date of Expiry**	**Number Exercisable at Dec 31, 2012**
Jul 16, 2008	**247**	$ 2.00	0.54	Jul 16, 2013	**247**
Sep 4, 2009	**3,000**	0.60	1.68	Sep 4, 2014	**3,000**
Feb 9, 2010	**3,775**	0.88	2.11	Feb 9, 2015	**3,775**
Jun 17, 2010	**295**	1.10	2.46	Jun 17, 2015	**295**
Oct 1, 2010	**550**	0.90	2.75	Oct 1, 2015	**550**
Nov 1, 2010	**6,880**	0.85	2.84	Nov 1, 2015	**6,880**
Nov 23, 2010	**225**	0.90	2.90	Nov 23, 2015	**225**
Feb 10, 2011	**60**	1.23	3.11	Feb 10, 2016	**45**
Dec 8, 2011	**1,100**	0.82	3.94	Dec 8, 2016	**550**
Mar 14, 2012	**105**	1.06	4.20	Mar 14, 2017	**26**
Apr 20,2012	**1,850**	0.92	4.30	Apr 20, 2017	**463**
	18,087	**$ 0.84**	**2.68**		**16,056**

Options vest ¼ every six months, beginning six months from the date of grant.

c) Performance warrants

The following tables summarize the status of the Company's performance warrants and the activity during the years ended December 31, 2012 and December 31, 2011:

	Dec 31, 2012		Dec 31, 2011	
	Number of Performance Warrants	**Exercise Price**	**Number of Performance Warrants**	**Exercise Price**
Balance – beginning of year	4,200	$ 0.56	4,200	$ 0.56
Granted	-	-	-	-
Exercised	-	-	-	-
Balance – end of year	4,200	$ 0.56	4,200	$ 0.56
Exercisable – end of year	4,200	$ 0.56	4,200	$ 0.56

Performance warrants were granted to certain officers and employees on September 4, 2009 for a term of three years, with each performance warrant being exercisable into one common share at a price of $0.56 per performance warrant upon the Company achieving certain targets for growth in net asset value per fully diluted share ("NAV per share") as defined in the performance warrant certificates. On May 24, 2012, the expiry dates of the performance warrants were extended by two years to September 4, 2014. With reference to the initial NAV per share calculated as $1.10, ⅓ of the performance warrants shall vest upon an increase in NAV per share of 25%, ⅔ of the performance warrants shall vest upon an increase of NAV per share of 33 ⅓%, and all of the performance warrants shall vest upon an increase in NAV per share of 50%. As at December 31, 2011, the NAV growth targets had been met and all of the performance warrants vested.

d) Stock-based compensation expense

The fair value of stock options granted during years ended December 31, 2012 and December 31, 2011 were estimated on the date of grant using the Black-Scholes option pricing model with the following assumptions:

	Year ended Dec 31, 2012	Year ended Dec 31, 2011
Risk-free interest rate	**1.5%**	1.4%
Expected volatility	**80%**	83%
Expected life	**4.5 years**	4.0 years
Expected dividend yield	**0%**	0%
Estimated forfeiture rate	**2.4%**	2.4%
Fair value per option	**$0.57**	$0.51

The weighted average price of the Company's common shares on the dates the stock options were granted was $0.93 (2011 - $0.84).

The fair value of the extension to the performance warrants expiry dates during the year ended December 31, 2012 was estimated to be $0.06 using the Black-Scholes option pricing model with the following assumptions:

	Pre-extension	Post-extension
Risk-free interest rate	**1.4%**	1.4%
Expected volatility	**34%**	39%
Expected life	**0.3 years**	2.0 years
Expected dividend yield	**0%**	0%
Estimated forfeiture rate	**0%**	0%
Fair value per performance warrant	**$0.27**	$0.33

The weighted average price of the Company's common shares on the date the performance warrants were extended was $0.83.

Stock-based compensation costs of $2.1 million for the year ended December 31, 2012 (2011 - $4.9 million) have been expensed and have resulted in corresponding increases in contributed surplus in the respective periods. Stock-based compensation consists of $1.9 million for stock options (2011 - $3.5 million) and $244 thousand for the performance warrants (2011 - $1.4 million).

e) Normal course issuer bids

The Company instituted a normal course issuer bid for the period September 20, 2012 to September 19, 2013, pursuant to which a maximum of 5,000,000 common shares may be acquired during the period. The Company also had normal course issuer bids for the periods September 13, 2010 to September 12, 2011, and September 15, 2011 to September 14, 2012, pursuant to which a maximum of 5,000,000 commons shares could be acquired during each of the periods.

For the year ended December 31, 2012, the Company acquired and cancelled 1,792,000 (2011 – 1,757,500) common shares at an average cost of $0.72 (2011 - $0.91) per share. The excess cost over stated value of $42 thousand (2011 - $450 thousand) was charged to the deficit account.

At December 31, 2012, a maximum of 5,000,000 common shares may be acquired by the Company under the present normal course issuer bid.

f) Per share amounts

The following table reconciles the denominators used for the basic and diluted net income (loss) per share calculations:

	Year ended Dec 31, 2012	Year ended Dec 31, 2011
Basic weighted average shares	**186,838**	169,238
Effect of dilutive instruments	**4,110**	-
Diluted weighted average shares	**190,948**	169,238

The calculation of diluted net income (loss) per share for the year ended December 31, 2012 excludes 707 thousand stock options as the inclusion of these options would have been anti-dilutive.

The calculation of diluted net loss per share for the year ended December 31, 2011 excludes all outstanding options, performance warrants and warrants as they were anti-dilutive.

11. Finance costs

		Year ended Dec 31, 2012		Year ended Dec 31, 2011
Interest and borrowing costs	**$**	**1,718**	$	956
Accretion of decommissioning liabilities		**305**		347
	$	**2,023**	$	1,303

12. Income taxes

a) Current income tax and deferred income tax recovery

The provision for income taxes in the financial statements differs from the result which would have been obtained by applying the combined federal and provincial corporate income tax rate to the income (loss) before income taxes. The difference results from the following items:

		Year ended Dec 31, 2012		Year ended Dec 31, 2011
Income (loss) before income taxes	**$**	**12,406**	$	(5,629)
Statutory tax rate		**25.94%**		27.50%
Expected tax expense (recovery)	**$**	**3,218**	$	(1,548)
Change in enacted tax rates		**(81)**		383
Non-deductible stock-based compensation expense		**544**		1,340
Non-deductible expenses		**21**		13
Deductible capital taxes		**(312)**		(207)
Change in estimated tax pools		**624**		-
Tax assets not recognized		**423**		(5,556)
Deferred income tax (recovery)		**4,437**		(5,575)
Current income tax expense		**1,204**		754
Income tax expense (recovery)	**$**	**5,641**	$	(4,821)

The decrease in the statutory rate from 2011 to 2012 was due to a reduction in the 2012 federal corporate tax rate as part of a series of corporate rate reductions previously enacted by the Canadian federal government. The Alberta provincial tax rate was unchanged between 2011 and 2012 at 10%. The Saskatchewan provincial tax rate was unchanged between 2011 and 2012 at 12%.

The current income tax expense of $1.2 million for the year ended December 31, 2012 (2011 - $754 thousand) relates to the Saskatchewan Resource Surcharge on the Company's Saskatchewan production revenue.

b) Deferred income tax assets (liabilities)

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and amounts for income tax purposes. The Company has recognized a net deferred tax asset based on the independently evaluated reserve report as future cash flows are expected to be sufficient to realize the deferred tax asset. The components of the deferred income tax asset and associated movement are as follows:

	Dec 31, 2011	**Recognized in Profit and Loss**	**Recognized in Equity**	**Dec 31, 2012**
Property and equipment and E&E assets	$ 1,355	$ (4,731)	$ -	$ (3,376)
Decommissioning liabilities	3,013	599	-	3,612
Non-capital losses	17,780	1,407	-	19,187
Share issuance costs	1,692	(1,292)	-	400
Scientific research and development	4,885	17	-	4,902
Tax assets not recognized	(4,795)	(437)	-	(5,232)
Deferred income tax asset (net)	$ 23,930	$ (4,437)	$ -	$ 19,493

	Dec 31, 2010	**Recognized in Profit and Loss**	**Recognized in Equity**	**Dec 31, 2011**
Property and equipment and E&E assets	$ 5,212	$ (3,857)	$ -	$ 1,355
Decommissioning liabilities	2,160	853	-	3,013
Non-capital losses	14,878	2,902	-	17,780
Share issuance costs	1,729	-	(37)	1,692
Scientific research and development	4,993	(108)	-	4,885
Tax assets not recognized	(12,309)	5,785	1,729	(4,795)
Deferred income tax asset (net)	$ 16,663	$ 5,575	$ 1,692	$ 23,930

The amount and timing of reversals of temporary differences will be dependent upon a number of factors, including the Company's future operating results.

The following is a summary of the Company's estimated tax pools as at December 31, 2012:

Classification		**Amount**
Canadian development expenditures	**$**	**91,016**
Non-capital loss carry-forwards		**73,970**
Capital cost allowance		**38,714**
Canadian oil and gas property expenditures		**33,757**
Scientific research and development		**18,899**
Canadian exploration expenditures		**10,797**
Share issue costs		**1,540**
Other		**218**
	$	**268,911**

The estimated non-capital loss carry-forwards available to reduce future year's income for tax purposes expire as follows:

Year		**Amount**
2014		**1,898**
2022 – 2032		**72,072**
Total non-capital loss carry-forwards	**$**	**73,970**

13. Supplemental cash flow information

		Year ended Dec 31, 2012		Year ended Dec 31, 2011
Changes in non-cash working capital related to:				
Accounts receivable	**$**	**802**	$	(3,725)
Deposits and prepaid expenses		**(257)**		143
Accounts payable and accrued liabilities		**10,516**		(4,648)
	$	**11,061**	$	(8,230)
Changes in non-cash working capital related to:				
Operating activities	**$**	**2,997**	$	(6,406)
Financing activities		**-**		-
Investing activities		**8,064**		(1,824)
	$	**11,061**	$	(8,230)
Finance costs paid	**$**	**1,718**	$	956
Income taxes paid	**$**	**1,736**	$	268

14. Financial instruments and risk management

The nature of the Company's financial instruments and operations expose the Company to certain risks. The Board of Directors has overall responsibility for the establishment and oversight of the Company's risk management framework, and senior management employs various strategies to ensure that the exposure to risk is in compliance with the Company's business objectives and tolerance levels.

Credit Risk

Credit risk is the risk of financial loss to the Company if a counterparty to a financial instrument fails to meet its contractual obligation. The Company is exposed to credit risk with respect to accounts receivable.

Substantially all of the Company's accounts receivable are with customers and joint interest partners in the oil and natural gas industry and are subject to normal industry credit risks. The Company markets its petroleum and natural gas to several marketers so that the exposure to any one entity is minimized. Receivables from petroleum and natural gas marketers are normally collected on the 25th day of the month following production. Two of these marketers owed the Company $6.0 million at December 31, 2012, which was subsequently received. Receivables from joint venture partners are typically collected within one to three months of the joint venture billing being issued, however collection is dependent on industry factors such as commodity price fluctuations, escalating costs, the risk of unsuccessful drilling, and disputes amongst partners. The Company attempts to mitigate credit risk from joint venture partners by obtaining partner approval of significant capital costs prior to expenditure. While the Company does not typically obtain collateral from joint venture partners, it may cash call a partner in advance of the work being done. In addition, the Company has the ability to withhold production from partners in the event of non-payment. Should any of the Company's customers or partners be unable to settle amounts due, the impact on the Company could be significant. The maximum exposure to losses arising from accounts receivable is equal to their total carrying amounts on the balance sheet. During the year ended December 31, 2012, the Company has a provision for doubtful accounts in the amount of $175 thousand (2011 – $175 thousand). Although allowances may be provided, the Company will continue to pursue collection of outstanding balances. Allowances may be adjusted if circumstances or events change. When determining whether past due accounts are collectible, the Company factors in the past credit history of the counter parties.

As at December 31, 2012, the Company's accounts receivable were comprised of the following:

Sales revenue receivable	$	6,503
Joint interest receivable		926
GST receivable		628
Accrued and other receivable		-
Total accounts receivable	$	8,057

As at December 31, 2012, the Company estimates its accounts receivables to be aged as follows:

Total accounts receivable	0 to 30 days	31 to 60 days	61 to 90 days	Greater than 90 days
$ 8,057	$ 7,374	$ 43	$ 18	$ 622

The Company considers all amounts greater than 90 days as past due and collectible.

Liquidity risk

This is the risk that the Company will not be able to meet its financial obligations as they become due. The Company's objective in managing liquidity risk is to ensure that it has sufficient resources available to meet its liabilities when due. The Company's ongoing liquidity is impacted by various external events and conditions, including commodity price fluctuations and the global economic downturn. At December 31, 2012, the Company's accounts payable and accrued liabilities were $18.5 million, all of which are due for payment within normal terms of trade, which are generally between 30 and 60 days. The Company has a $95 million revolving operating demand loan to help manage its liquidity and settlement of liabilities, of which $69.1 million has been drawn as at December 31, 2012.

The Company's financial liabilities at December 31, 2012 are aged as follows:

Total accounts payable and accrued liabilities	0 to 30 days	31 to 60 days	61 to 90 days	Greater than 90 days
$ 18,458	$ 13,609	$ 2,632	$ 273	$ 1,944

The Company expects to satisfy its obligations under accounts payable and accrued liabilities within the next year. As well, the Company is required to meet certain financial commitments as described in notes 8, 15 and 16.

The Company's credit facilities are demand loans and as such the bank could demand repayment at any time. However, management is not aware of any indications that the bank would demand repayment within the next 12 months. Indications considered include the Company has not had any breach or default of bank covenants during the year and had a recent credit facility review in November, 2012. The Company further ensures that it will have sufficient cash on hand to meet short-term obligations by actively monitoring its credit facilities and coordinating payment cycles with revenue cycles.

Foreign currency exchange risk

This is the risk that the fair value or future cash flows will fluctuate as a result of changes in foreign exchange rates. Although the Company's petroleum and natural gas sales are denominated in Canadian dollars, the underlying market prices in Canada are impacted by changes in the exchange rate between the Canadian and United States dollar and the impact of such exchange rate fluctuations cannot be accurately quantified. The Company had no forward exchange rate contracts in place, nor any working capital items denominated in foreign currencies, as at or during the year ended December 31, 2012.

Commodity price risk

This is the risk that the fair value or future cash flows will fluctuate as a result of changes in commodity prices. Commodity prices for petroleum and natural gas are not only impacted by the relationship between the Canadian and United States dollar as outlined above, but also by world economic events that dictate the levels of supply and demand. The Company had no commodity contracts locking in petroleum or natural gas prices as at or during the year ended December 31, 2012.

Interest rate risk

This is the risk that the fair value or future cash flows will fluctuate as a result of changes in market interest rates. The Company is exposed to interest rate fluctuations on its bank debt which bears a floating rate of interest. From time to time, the Company attempts to mitigate this risk by utilizing short-term bankers' acceptances to lock in a portion of its bank debt at fixed rates.

The average bank debt outstanding during the year ended December 31, 2012 was $46.0 million (2011 - $21.5 million). A 100 basis points change to the effective interest rate would have an impact of $340 thousand on net income (2011 - $156 thousand).

15. Capital disclosures

The Company considers its capital structure to consist of working capital, including bank debt. The Company manages its capital structure in order to meet its financial obligations and sustain the future development of the Company. The Company's Officers are responsible for managing the Company's capital and do so through quarterly meetings and regular reviews of financial information including budgets and forecasts. The Company's Directors are responsible for overseeing this process. Methods used by the Company to manage its capital include the issuance of new share capital to raise additional funds and adjusting its capital spending to manage current and projected debt levels. The Company continually

monitors business conditions including: changes in economic conditions; the risk of its drilling programs; forecasted commodity prices; and potential corporate or asset acquisitions. There was no change in the Company's approach to Capital management during the year ended December 31, 2012.

The Company monitors its capital structure using primarily the non-IFRS measurement ratio of net debt to funds flow from operations, annualized from the most recent quarter. This ratio is calculated as net debt, defined as outstanding bank debt plus or minus net working capital, divided by annualized funds flow from operations. Annualized funds flow is calculated as cash flow from operations before changes in non-cash working capital and decommissioning expenditures from the Company's most recent quarter, multiplied by four. The objective is to maintain this ratio below 1.5:1, although this ratio may temporarily increase at certain times as a result of acquisitions or other significant capital expenditures for which the full quarterly effect of funds flow has not yet been accounted for. As at December 31, 2012 the ratio of net debt to funds flow from operations was 1.7:1 calculated as follows:

		As at Dec 31, 2012
Current assets	$	8,724
Current liabilities		(87,607)
Net debt	$	(78,883)

		Three months ended Dec 31, 2012
Cash flow from operations	$	10,834
Changes in non-cash working capital items		624
Decommissioning expenditures		197
Funds flow from operations		11,655
Annualized funds flow from operations	$	46,620
Net debt to annualized funds flow from operations		1.7:1

At December 31, 2012, this ratio temporarily exceeded the 1.5:1 objective due to the intensive capital program in the last quarter of 2012, resulting in an increased debt load being carried in advance of the full quarterly effect of funds flow from new production coming on stream. The ratio is expected to return to targeted levels at the end of the first quarter of 2013 as the pace of capital activity slows and funds flow is realized from new production.

The Company's share capital is not subject to any external restrictions; however its credit facility is subject to periodic reviews (note 8). The credit facility also contains certain covenants such that the Company cannot, without prior approval of the bank, hedge or contract petroleum or natural gas volumes, on a fixed price basis, exceeding 50% of production volumes, nor can it monetize or settle any fixed price financial hedge or contract. The credit facility also contains a financial covenant that requires the Company to maintain a working capital ratio of at least 1:1, but for the purposes of the covenant, bank debt and the fair value of any commodity contracts are excluded and the unused portion of the revolving operating demand loan may be added to current assets. As at December 31, 2012, this working capital ratio was 1.9:1.

16. Commitments

As at December 31, 2012, the Company had commitments as follows:

		2013		2014		2015		Thereafter
Office lease	$	592	$	-	$	-	$	-

17. Personnel expenses

The following table summarizes the personnel expenses of the Company during the years ended December 31, 2012 and December 31, 2011:

		Year ended Dec 31, 2012		Year ended Dec 31, 2011
Short-term benefits	**$**	**4,440**	$	3,841
Stock-based compensation		**2,099**		4,872
	$	**6,539**	$	8,713

Short-term benefits are comprised of salaries, bonuses, benefits, and director fees and are inclusive of $521 thousand for the year ended December 31, 2012 (2011 - $457 thousand) which was capitalized and included as property and equipment expenditures.

The Company considers its key management personnel to be its executive officers and directors. Short-term benefits for executive officers include salaries, bonuses and benefits. Short-term benefits for directors consist of director fees. Stock-based compensation for executive officers consist of incentive stock options and performance warrants while stock-based compensation for directors consist of incentive stock options. The total compensation relating to key management personnel is as follows:

		Year ended Dec 31, 2012		Year ended Dec 31, 2011
Short-term benefits	**$**	**2,047**	$	1,643
Stock-based compensation		**1,449**		3,937
	$	**3,496**	$	5,580