DeeThree Exploration Inc.

HIGHLIGHTS

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	**2009**	2008
(000s, except per share amounts)	*($)*	*($)*	*($)*	*($)*
Financial				
Oil and gas revenues	**1,040**	297	**2,635**	403
Funds from operations (1)	**95**	144	**695**	113
Per share – basic and diluted	**0.01**	0.01	**0.05**	0.01
Net income (loss)	**(1,079)**	66	**(1,569)**	10
Per share – basic and diluted	**(0.08)**	--	**(0.12)**	--
Capital expenditures	**1,823**	2	**2,494**	195
Working capital (deficiency)	**1,511**	(545)	**1,511**	(545)
Shareholders' equity	**20,780**	(63)	**20,780**	(63)
(000s)	*(#)*	*(#)*	*(#)*	*(#)*
Share Data (2)				
At period-end	**13,465**	12,965	**13,465**	12,965
Weighted average				
Basic	**12,992**	12,965	**13,006**	12,965
Diluted	**13,099**	12,965	**13,112**	12,965
Operating				
Production				
Natural gas *(mcf/d)*	**3,150**	321	**3,247**	227
Crude oil & NGLs *(bbls/d)*	**15**	1	**17**	1
Total *(boe/d)*	**541**	55	**558**	39
Average wellhead prices				
Natural gas *($/mcf)*	**3.33**	9.90	**4.20**	9.44
Crude oil & NGLs *($/bbl)*	**58.29**	118.68	**54.30**	108.65
Total *($/boe)*	**21.13**	60.22	**26.09**	57.70
Operating cost *($/boe)*	**7.88**	12.98	**8.45**	20.19
Operating netback *($/boe)*	**9.90**	33.05	**14.13**	25.91
Gross (net) wells drilled *(#)*				
Gas	**2 (2.0)**	-- (--)	**2 (2.0)**	-- (--)
Oil	**-- (--)**	-- (--)	**-- (--)**	-- (--)
Standing	**3 (3.0)**	-- (--)	**3 (3.0)**	-- (--)
Dry and abandoned	**-- (--)**	-- (--)	**-- (--)**	-- (--)
Total	**5 (5.0)**	-- (--)	**5 (5.0)**	-- (--)
Average working interest *(%)*	**100**	--	**100**	--

(1) Funds from operations and funds from operations per share are not recognized measures under Canadian generally accepted accounting principles. Refer to the Management's Discussion and Analysis for further discussion.
(2) Shares outstanding have been adjusted to reflect the reverse takeover as described in note 1 to the consolidated financial statements as if it occurred at the beginning of the period.
(3) For a description of the boe conversion ratio, refer to the commentary at the beginning of the Management's Discussion and Analysis.

MANAGEMENT'S DISCUSSION AND ANALYSIS

The following Management's Discussion and Analysis ("MD&A") reports on the financial condition and the results of operations of DeeThree Exploration Inc. ("DeeThree" or the "Company") for the three and six months ended June 30, 2009 and 2008 and should be read with the accompanying June 30, 2009 unaudited financial statements as well as the audited financial statements for the year ended December 31, 2008 of DeeThree Exploration Ltd. All financial measures are expressed in Canadian dollars unless otherwise indicated. This commentary is based on the information available as at, and is dated August 28, 2009.

Production information is commonly reported in units of barrel of oil equivalent ("boe"). For purposes of computing such units, natural gas is converted to equivalent barrels of crude oil using a conversion factor of six thousand cubic feet of gas to one barrel of oil. This conversion ratio of 6:1 is based on an energy equivalent conversion for the individual products, primarily applicable at the burner tip and does not represent a value equivalency at the wellhead. Such disclosure of boes may be misleading, particularly if used in isolation. Readers should be aware that historical results are not necessarily indicative of future performance.

Non-GAAP Measurements

This MD&A contains the terms "funds from operations", "funds from operations per share", "funds flow netback" and "net income netback", which should not be considered an alternative to or more meaningful than net earnings or cash flow from operating activities as determined in accordance with Canadian generally accepted accounting principles ("GAAP") as an indicator of the Company's performance. These terms do not have any standardized meaning as prescribed by GAAP. DeeThree's determination of funds from operations, funds from operations per share, funds flow netback and net income netback may not be comparable to that reported by other companies. Management uses funds from operations to analyze operating performance and leverage, and considers funds from operations to be a key measure as it demonstrates the Company's ability to generate cash necessary to fund future capital investments and to repay debt. Funds from operations is calculated using cash flow from operating activities as presented in the statement of cash flows before changes in non-cash working capital and settlement of retirement costs. DeeThree presents funds from operations per share, which is prohibited under GAAP. Per share amounts are calculated using weighted average shares outstanding consistent with the calculation of earnings per share. The following table reconciles funds from operations to cash flow from operating activities, which is the most directly comparable measure calculated in accordance with GAAP:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	**2009**	2008
(000s)	*($)*	*($)*	*($)*	*($)*
Cash flow from operating activities	**422**	144	**1,211**	196
Changes in non-cash working capital	**(327)**	--	**(516)**	(83)
Funds from operations	**95**	144	**695**	113

Future Outlook and Forward-Looking Information

Certain statements contained in this MD&A may constitute forward-looking statements. These statements relate to future events or the Company's future performance. All statements other than statements of historical fact may be forward-looking statements. Forward-looking statements are often, but not always, identified by the use of words such as "seek", "anticipate", "plan", "continue", "estimate", "expect", "may", "will", "project", "predict", "potential", "targeting", "intend", "could", "might", "should", "believe" and similar expressions. These statements involve known and unknown risks, uncertainties and other factors that may cause actual results or events to differ materially from those anticipated in such forward-looking statements. The Company believes that the expectations reflected in those forward-looking statements are reasonable, but no assurance can be given that these expectations will prove to be correct and such forward-looking statements included in this MD&A should not be unduly relied upon by investors. These statements speak only as of the date of this MD&A and are expressly qualified, in their entirety, by this cautionary statement.

In particular, this MD&A contains forward-looking statements pertaining to the following: projections of market prices and costs, supply and demand for oil and natural gas, the quantity of reserves, oil and natural gas production levels, capital expenditure programs, treatment under governmental regulatory and taxation regimes, expectations regarding the Company's ability to raise capital and to continually add to reserves through acquisitions and development, and projections of market prices and costs.

With respect to forward-looking statements contained in this MD&A, the Company has made assumptions regarding, among other things: the legislative and regulatory environments of the jurisdictions where the Company carries on business or has operations, the impact of increasing competition, and the Company's ability to obtain additional financing on satisfactory terms.

The Company's actual results could differ materially from those anticipated in these forward-looking statements as a result of the risk factors included in this MD&A such as: volatility in the market prices for oil and natural gas; uncertainties associated with estimating reserves; geological, technical, drilling and processing problems; liabilities and risks, including environmental liabilities and risks inherent in oil and natural gas operations; incorrect assessments of the value of acquisitions; competition for, among other things, capital, acquisitions of reserves, undeveloped lands and skilled personnel.

This forward-looking information represents the Company's views as of the date of this document and such information should not be relied upon as representing its views as of any date subsequent to the date of this document. DeeThree has attempted to identify important factors that could cause actual results, performance or achievements to vary from those current expectations or estimates expressed or implied by the forward-looking information. However, there may be other factors that cause results, performance or achievements not to be as expected or estimated and that could cause actual results, performance or achievements to differ materially from current expectations. There can be no assurance that forward-looking information will prove to be accurate, as results and future events could differ materially from those expected or estimated in such statements. Accordingly, readers should not place undue reliance on forward-looking information.

Basis of Presentation

DeeThree is a Calgary based resource company actively engaged in crude oil and natural gas exploration, development and production in key areas of the Western Canadian Sedimentary Basin. DeeThree was formed as a result of a reverse takeover completed on June 25, 2009 by DeeThree Exploration Ltd. (a private oil and gas company that commenced operations in 2007) of Royal Capital Corp. (a public capital pool company). Common shares of DeeThree are listed for trading on the TSX Venture Exchange under the symbol DTX. This MD&A focuses on the Company's operations for the three and six months ended June 30, 2009 and 2008.

Financial and Operating Results

Sales Volumes

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	**2009**	2008
Natural gas sales *(mcf/d)*	**3,150**	321	**3,247**	227
Crude oil & NGLs sales *(bbls/d)*	**15**	1	**17**	1
Total sales *(boe/d)*	**541**	55	**558**	39
Total sales *(boe)*	**49,223**	4,932	**101,002**	6,984

For the quarter ended June 30, 2009, the Company's production averaged 541 boe/d compared to 55 boe/d in the same quarter of 2008 and 576 boe/d in the first quarter of 2009. This represents an 884% year-over-year increase and a 6% decline from the first quarter. Production in the first three months of 2009 reflected a favourable accounting adjustment relating to the Lethbridge property acquisition completed in November 2008, and as a result, slightly increasing the first quarter's reported numbers. Excluding that adjustment, the first and second quarters were directly comparable. The Company did not tie-in any new wells during the second quarter of 2009.

For the six months ended June 30, 2009, DeeThree’s production averaged 558 boe/d, which was comprised of 3,247 mcf/d of natural gas, or 97% of the Company’s production, and 17 bbls/d of crude oil and NGLs, or 3% of total corporate production. The year-over-year increase was primarily attributable to the Lethbridge property acquisition.

Revenue and Prices

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	**2009**	2008
(000s)	*($)*	*($)*	*($)*	*($)*
Revenue				
Natural gas	**955**	289	**2,469**	387
Crude oil & NGLs	**85**	8	**166**	16
Total revenue	**1,040**	297	**2,635**	403
Average Prices				
Natural gas sales price *($/mcf)*	**3.33**	9.90	**4.20**	9.44
Crude oil & NGLs sales price *($/bbl)*	**58.29**	118.68	**54.30**	108.65
Total sales price *($/boe)*	**21.13**	60.22	**26.09**	57.70

For the second quarter of 2009, revenue rose 250% to $1,040,000 from $297,000 in the comparative period of 2008 due to an 884% improvement in production volumes offset by a 65% decline in the Company's overall realized price. For the three months ended June 30, 2009, the Company's realized sales price for natural gas was $3.33/mcf while the crude oil and NGLs sales price averaged $58.29/bbl compared to $9.90/mcf and $118.68/bbl, respectively, in the same period last year.

For the first six months of 2009, revenue was $2,635,000 versus $403,000 for the same period of 2008 with an average sales price of $26.09/boe versus $57.70/boe received the prior year.

DeeThree's current production profile is weighted 97% to natural gas, and as a result, revenues are largely reliant on Canadian natural gas prices that are determined by a variety of factors such as weather patterns, LNG imports, North American supply and demand, storage levels in North America and alternative fuel sources.

Royalties

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	**2009**	2008
(000s)	*($)*	*($)*	*($)*	*($)*
Total revenue	**1,040**	297	**2,635**	403
Royalties	**88**	62	**204**	74
Percent of revenue *(%)*	**8**	21	**8**	18

Royalty expenses consist of royalties paid to provincial governments as well as freehold and overriding royalty owners. For the second quarter of 2009, royalties totaled $88,000 or 8% of revenue compared to $62,000 or 21% of revenue for the same quarter in 2008. This year-over-year percent of revenue decline was the direct result of decreased natural gas pricing. The majority of the Company's production is not subject to Crown royalties, rather a freehold royalty burden relating to the Lethbridge property acquisition completed in the final quarter of 2008.

During the first six months of 2009, royalties totaled $204,000 or 8% of revenue versus $74,000 or 18% of revenue a year ago, which was again directly attributable to weaker natural gas prices.

Operating Expenses

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	**2009**	2008
(000s)	*($)*	*($)*	*($)*	*($)*
Operating expenses	**388**	64	**853**	141
Operating expenses *($/boe)*	**7.88**	12.98	**8.45**	20.19

Operating expenses for the 2009 three-month period totaled $388,000 or $7.88/boe compared to $64,000 or $12.98/boe for the same period in 2008 and $8.99/boe in the first quarter of 2009. The year-over-year decrease was primarily attributable to the Lethbridge property acquisition completed in 2008, which has a lower average operating cost structure per boe than the Company's existing production.

For the six months ended June 30, 2009, the Company incurred operating expenses of $853,000 or $8.45/boe compared to $141,000 or $20.19/boe in the corresponding 2008 period. Throughout 2008, the Company's operating cost per boe continually improved as more production volumes were brought on-stream, and as a result, economies of scale were achieved.

Transportation Expenses

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	**2009**	2008
(000s)	*($)*	*($)*	*($)*	*($)*
Transportation expenses	**77**	8	**150**	12
Transportation expenses *($/boe)*	**1.56**	1.62	**1.49**	1.72

Transportation expenses for the three months ended June 30, 2009 were $77,000 or $1.56/boe compared to $8,000 or $1.62/boe recorded in the second quarter of 2008. Transportation expenses reflect primarily NOVA transportation costs, which the Company expects to remain relatively consistent for the remainder of the year.

During the first half of 2009, transportation costs totaled $150,000 or $1.49/boe versus $12,000 or $1.72/boe for the same period in 2008.

General and Administrative ("G&A") Expenses

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	**2009**	2008
(000s)	*($)*	*($)*	*($)*	*($)*
G&A expenses	**365**	23	**686**	66
G&A capitalized (direct)	**(87)**	--	**(128)**	--
G&A recoveries from operations	**(27)**	(5)	**(46)**	(5)
G&A expenses (net)	**251**	18	**512**	61
G&A expenses *($/boe)*	**5.10**	3.65	**5.07**	8.73

For the second quarter of 2009, net G&A expenses totaled $251,000 or $5.10/boe compared to $18,000 or $3.65/boe recorded in the same period of 2008 and $261,000 or $5.05/boe in the first quarter of 2009. The 1,294% year-over-year jump in net expenses reflects increased costs, specifically consulting fees, office rent and business development costs of a new public entity with substantially higher activity levels. During the second quarter of 2009, DeeThree capitalized $87,000 (2008 – $nil) in direct costs relating to its exploration and development efforts and $27,000 (2008 – $5,000) relating to operator recoveries on capital expenditures.

Net G&A expenses increased to $512,000 or $5.07/boe for the first half of 2009 compared to $61,000 or $8.73/boe in the same period a year ago. During the six months ended June 30, 2009, the Company capitalized $128,000 (2008 – $nil) of direct costs and $46,000 (2008 – $5,000) of capital overhead recoveries.

Stock-Based Compensation Expense

Stock-based compensation expense totaled $314,000 for the three-month period ended June 30, 2009 versus $4,000 a year ago. For the first six months of 2009, stock-based compensation expense totaled $321,000 compared to $4,000 in 2008. The year-over-year increases were the result of additional options and warrants being granted during the second quarter of 2009. The warrants that were granted vested immediately, therefore all related stock-based compensation was recorded in the quarter. This provision was calculated using the Black-Scholes option pricing model to determine the estimated fair value for the outstanding stock options and warrants.

The Company capitalizes a portion of its stock-based compensation expense consistent with the treatment of capitalized G&A expenses, and as a result, $264,000 (2008 – $nil) and $271,000 (2008 – $nil) was capitalized for the three and six-month periods ended June 30, 2009, respectively. A future tax liability of $95,000 was booked for the three and six-month periods of 2009 in association with the capitalized stock-based compensation expense.

Stock-based compensation expenses are non-cash charges that reflect an estimate of the cost to the Company for stock options and warrants issued to directors, employees, consultants and agents/brokers. The value is amortized over the vesting period of the award.

Interest Expense

For the three and six months ended June 30, 2009, interest expense was $141,000 and $221,000, respectively, compared to $1,000 and $2,000 recorded in the three and six-month comparative periods of 2008, respectively. These year-over-year increases were directly attributable to the increase in the Company's bank debt throughout 2009 versus 2008. In addition, the Company is subject to Part X11.6 tax in relation to the $4,500,000 flow-through commitment renounced January 1, 2009. To date, the Company has recorded $68,000 in Part X11.6 tax.

Netbacks (per unit)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	**2009**	2008
	($/boe)	*($/boe)*	*($/boe)*	*($/boe)*
Sales prices	**21.13**	60.22	**26.09**	57.70
Royalties	**(1.79)**	(12.57)	**(2.02)**	(10.60)
Operating	**(7.88)**	(12.98)	**(8.45)**	(20.19)
Transportation	**(1.56)**	(1.62)	**(1.49)**	(1.72)
Operating netback	**9.90**	33.05	**14.13**	25.19
G&A and other (excludes non-cash items)	**(5.10)**	(3.65)	**(5.07)**	(8.73)
Interest expense	**(2.86)**	(0.20)	**(2.19)**	(0.29)
Funds flow netback (1)	**1.94**	29.20	**6.87**	16.17
Depletion, depreciation and accretion	**(22.71)**	(13.38)	**(23.37)**	(13.03)
Stock-based compensation	**(6.38)**	(0.81)	**(3.18)**	(0.57)
Future tax recovery (expense)	**5.24**	(1.62)	**4.13**	(1.15)
Net income (loss) netback	**(21.91)**	13.39	**(15.55)**	1.42

(1) Non-GAAP measure: refer to disclosure on non-GAAP measure. Funds flow netback is calculated by dividing funds flow by the sales volume per boe for the period then ended.
(2) For a description of the boe conversion ratio, refer to the commentary at the beginning of this MD&A.

The operating netback for the six months ended June 30, 2009 was $14.13/boe compared to $25.19/boe for the first half of 2008, reflecting weaker commodity prices in 2009 that were offset by decreased royalty and operating expenses.

Funds from Operations

Funds from operations totaled $95,000 or $0.01 per basic and diluted share during the second quarter of 2009 compared to $144,000 or $0.01 per basic and diluted share in the comparative period of 2008.

For the six months ended June 30, 2009, the Company recorded funds from operations of $695,000 or $0.05 per basic and diluted share compared to $113,000 or $0.01 per basic and diluted share recorded in the 2008 six-month period. Refer to the beginning of this MD&A section for discussion and reconciliation of funds from operations to cash flow from operating activities, which is the most directly comparable measure calculated in accordance with GAAP.

Cash Flow from Operating Activities

Cash flow from operations for the 2009 three-month period totaled $422,000 or $0.03 per basic and diluted share compared to $144,000 or $0.01 per basic and diluted share in the same period of 2008.

During the first half of 2009, the Company's cash flow from operating activities was $1,211,000 or $0.09 per basic and diluted share versus $196,000 or $0.02 per basic and diluted share a year ago.

Depletion, Depreciation and Accretion ("DD&A")

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	**2009**	2008
DD&A provision *($000s)*	**1,118**	66	**2,360**	91
DD&A provision *($/boe)*	**22.71**	13.38	**23.37**	13.03

The DD&A expense is determined by both the success of DeeThree's drilling program and the cost of any acquisitions. These factors, plus the 884% year-over-year increase in production, caused the aggregate DD&A expense for the three months ended June 30, 2009 to increase to $1,118,000 or $22.71/boe from $66,000 or $13.38/boe in the second quarter of 2008. For the six months ended June 30, 2009, the DD&A provision was $2,360,000 or $23.37/boe compared to $91,000 or $13.03/boe recorded in the same period of 2008.

Impairment Expense

Management has determined that there was no impairment of DeeThree's natural gas and crude oil assets at June 30, 2009.

Income Taxes

A future tax recovery of $258,000 was recognized for the three months ended June 30, 2009 compared to an income tax expense of $8,000 in the same period of 2008.

The Company recorded an income tax recovery of $417,000 for the six-month period ended June 30, 2009 compared to $8,000 in the same period last year.

Net Income (Loss)

For the three months ended June 30, 2009, the Company recorded a net loss of $1,079,000 or $0.08 per basic and diluted share compared to net income of $66,000 in 2008. The loss recorded in 2009 reflects the net impact of decreased commodity prices compounded by increased DD&A expenses and non-cash stock-based compensation expense.

The net loss for the six months ended June 30, 2009 was $1,569,000 or $0.12 per basic and diluted share versus net income of $10,000 in the comparative period of 2008.

Capital Expenditures

Net cash capital expenditures totaled $1,823,000 in the three months ended June 30, 2009 compared to $2,000 recorded in 2008. Drilling and completion expenditures totaled $1,554,000 that involved the drilling of 5 gross (5.0 net) wells in the Lethbridge area. The Company also spent $121,000 on equipping and tie-ins, $57,000 on land and seismic, and the remaining $91,000 on capitalized G&A and other corporate assets.

For the first six months of 2009, net cash capital expenditures totaled $2,494,000 versus $195,000 in the comparative period of 2008. Drilling and completion expenditures totaled $1,886,000, equipping and tie-in costs were $298,000, $150,000 was spent on the purchase of 806 acres of freehold land, and the remaining $160,000 was spent on capitalized G&A and other.

Liquidity and Capital Resources

The following table summarizes the change in working capital during the six months ended June 30, 2009 and the year ended December 31, 2008:

	Six Months Ended June 30, 2009	Year Ended December 31, 2008
(000s)	*($)*	*($)*
Working capital (deficiency) – beginning of period	**(2,710)**	(169)
Funds from operations	**695**	367
Capital expenditures	**(2,494)**	(18,773)
Issue of capital stock for cash (net of share issue expenses)	**5,204**	16,175
Repayment of shareholder loans	**--**	(310)
Net working capital acquired on acquisition	**816**	--
Working capital (deficiency) – end of period	**1,511**	(2,710)

DeeThree entered 2009 with a working capital deficiency of $2,710,000. During the six-month period, the Company generated funds from operations of $695,000 and incurred $2,494,000 in capital activities. Throughout the second quarter of 2009, the Company raised $5,204,000 through the issuance of 719,693 flow-through common shares at a price of $2.40 per flow-through common share and 1,976,250 subscription receipts at a price of $2.00 per subscription receipt for total proceeds of $5,679,000 ($5,008,000 net of issue costs). Upon completion of the amalgamation agreement with Royal Capital Corp. on June 25, 2009, all subscription receipts were converted to common shares. In addition, 195,000 warrants were exercised in the second of 2009 at an exercise price of $1.00 per warrant for proceeds of $195,000. At June 30, 2009, the Company had a working capital of $1,511,000.

At June 30, 2009, the Company had a revolving demand credit facility with an authorized borrowing amount of $8,500,000, with interest charged at the bank's prime rate plus 1.5% per annum. Standby fees associated with this facility are 0.25% per annum on the undrawn portion of the facility. At June 30, 2009, $1,878,000 was drawn against the revolving demand credit facility. Subsequent to June 30, 2009, the lender advised the Company that the loan credit facility would be reduced to $8,000,000 effective July 31, 2009 due to market conditions and changes in commodity prices. The next review of the credit facility is scheduled for October 2009.

Collateral for this facility consists of a general security agreement, providing a security interest over all present and after acquired personal property and a floating charge on all present and after acquired land interests of the Company.

DeeThree also has a cash secured letter of credit facility with its lender in the amount of $4,000,000 to facilitate the issuance of a letter of credit by the lender with respect to the Lethbridge property acquisition, which was fully utilized at June 30, 2009. This amount is fully secured by funds on deposit of $4,000,000. This facility is repayable on or before November 14, 2009.

The Company's ability to continue as a going concern is dependent on the ability to raise capital, the continued generation of positive cash flow and the success of its development and exploration program. The accompanying unaudited financial statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts and classification of liabilities that might be necessary should the Company be unable to continue as a going concern. Such adjustments could be material.

Share Capital

In April and May 2009, the Company issued 719,693 flow-through common shares at a price of $2.40 per flow-through common share for total proceeds of $1,727,000.

In April, May and June 2009, the Company issued 1,976,250 subscription receipts at a price of $2.00 per subscription receipt for total proceeds of $3,953,000 ($3,281,000 net of issue costs). Upon completion of the amalgamation agreement with Royal Capital Corp. on June 25, 2009, all subscription receipts were converted to common shares.

On June 23, 2009, 195,000 warrants were exercised at $1.00 per warrant.

Consolidation of DeeThree Exploration Inc. (formerly Royal Capital Corp.)

On June 25, 2009, DeeThree Exploration Inc. (formerly Royal Capital Corp. ("Royal" or the "corporation")) completed the acquisition of DeeThree Exploration Ltd. Immediately prior to the completion of the transaction, Royal shareholders approved a consolidation of the outstanding common shares of the corporation on a 1-for-12 basis and at the same time, changed the name of the corporation to DeeThree Exploration Inc.

As at August 28, 2009, DeeThree Exploration Inc., the resulting issuer following the reverse takeover transaction completed June 25, 2009, had 13,464,943 common shares, 877,500 stock options, 305,000 common share purchase warrants and 110,207 agent compensation options issued and outstanding.

At August 28, 2009, there were 3,208,600 common shares, 150,000 stock options and 228,750 common share purchase warrants held in escrow with respect to the Qualifying Transaction Escrow Agreement and 124,999 common shares with respect to the CPC Escrow Agreement.

Contractual Obligations

In connection with the issuance of flow-through shares by the Company during the year ended December 31, 2008, DeeThree is required to spend $4,500,000 of eligible exploration expenditures by December 31, 2009. The qualifying expenditures were renounced to shareholders in January 2009. As at June 30, 2009, approximately $1,700,000 of eligible exploration expenditures had been incurred.

In connection with the issuance of flow-through shares by the Company during the period ended June 30, 2009, the Company is required to spend $1,727,000 of eligible exploration expenditures by December 31, 2010. The qualifying expenditures will be renounced to shareholders in January 2010.

In connection with the acquisition of the Lethbridge property in November 2008, the Company has committed to the drilling of 30 wells in the area covered in the agreement over a three-year period commencing November 14, 2008 (ten wells per year). In addition, DeeThree has committed to shooting four townships of seismic data over the same period (one township in year one, two townships in year two and one township in year three). The total cost to the Company for these commitments, including well completions and tie-ins on a risked basis, is estimated to be $23,200,000. As security for the commitment, DeeThree provided the vendor with a letter of credit totaling $6,000,000. The letter of credit is releasable to the Company as to $2,000,00 on the spud by DeeThree of the first well on the property and on a dollar for dollar basis incurred in carrying out the commitment, following the drilling and either completion, capping or abandonment of the first five wells under the commitment. Five wells were drilled under the commitment in May 2009. On May 21, 2009, $2,000,000 was released from the letter of credit.

Related Party Transactions

As at June 30, 2009, the Company had the following related party transactions:

(a) On July 31, 2008, DeeThree acquired all of the issued and outstanding shares of 1265953 Alberta Inc. ("1265953"). As part of the purchase consideration, the Company issued 586,500 common shares to the shareholders of 1265953. One director and two officers of the Company were shareholders of 1265953 and received 153,000 common shares of the Company in the transaction.

(b) An officer of the Company indirectly holds a 5% working interest in a property owned by DeeThree. During 2009, net revenue attributable to this working interest was $6,100 (2008 – $nil).

(c) The Company has retained the law firm of Davis LLP to provide legal services. Mr. Daniel E. Kenney, the Corporate Secretary of DeeThree, is a partner of this firm. The Company expects to continue using the services of this firm from time to time.

All related party transactions were in the normal course of operations and have been measured at exchange amounts established and agreed to by the related parties and which are similar to those that the Company would expect to have negotiated with third parties in similar circumstances.

Changes in Accounting Disclosures

Except as discussed in this section, please refer to the Company's accounting disclosures as described in the MD&A of DeeThree Exploration Ltd. as at December 31, 2008. The following disclosures to the financial statements are in effect as of January 1, 2009.

Future Accounting Policy Changes

Business Combinations

In December 2008, the Canadian Institute of Chartered Accountants ("CICA") issued Section 1582 "Business Combinations". This section is effective January 1, 2011 and applies prospectively to business combinations for which the acquisition date is during the first annual reporting period beginning on or after January 1, 2011 for the company. Early adoption is permitted. This section replaces Section 1581 "Business Combination" and harmonizes the Canadian standards with International Financial Reporting Standards.

Transition to International Financial Reporting Standards ("IFRS")

In February 2008, the CICA's Accounting Standards Board ("AcSB") confirmed the changeover to IFRS from Canadian GAAP will be required for publicly accountable enterprises for interim and annual financial statements for fiscal years beginning on or after January 1, 2011, including comparative figures for 2010.

The International Accounting Standards Board ("IASB") has also issued an exposure draft relating to certain amendments and exemptions to IFRS 1. It is anticipated that this exposure draft will not result in an amended IFRS 1 standard until late 2009. The amendment, if implemented, will permit the Company to apply IFRS prospectively by utilizing its current reserves at the transition date to allocate the Company's full cost pool, with the provision that a ceiling test, under IFRS standards, be conducted at the transition date. The eventual changeover to IFRS represents a change due to new accounting standards. The transition from current Canadian GAAP to IFRS is a significant undertaking that may materially affect the Company's reported financial position and results of operations.

In response, the Company is in the preliminary stages of developing a high-level IFRS transition plan and establishing a preliminary timeline for its execution and completion. Management will perform a preliminary review of the accounting policies of the Company under Canadian GAAP and compare them to IFRS. In the second half of 2009, the Company will perform the next phase of the project, conducting an in-depth review of the significant areas of difference identified during the preliminary assessment in order to identify all specific Canadian GAAP and IFRS differences and select ongoing IFRS policies. Key areas addressed will also be reviewed to determine any information technology issues, the impact on internal controls over financial reporting and the impact on other business activities, including compensation arrangements. The Company will also continue to monitor standards development as issued by the IASB and AcSB as well as regulatory developments as issued by the Canadian Securities Administrators, which may affect the timing, nature or disclosure of its adoption of IFRS. Additional disclosures of the key elements of the transition plan and progress of the project will be provided as the information becomes available.

Business Risks and Risk Mitigation

There are a number of risks facing participants in the Canadian oil and gas industry. Some of the risks are common to all businesses, while others are specific to the sector. The most important of these risks are set out below, together with the strategies DeeThree employs to mitigate and minimize these risks.

Global Financial Crisis

Recent market events and conditions, including disruptions in the international credit markets and other financial systems and the deterioration of global economic conditions, have caused significant volatility to commodity prices. These conditions worsened in the third quarter of 2008 and are continuing in 2009, causing a loss of confidence in the broader United States and global credit and financial markets. This has created a climate of greater volatility, less liquidity, widening of credit spreads and a lack of price transparency, increased credit losses and tighter credit conditions. These factors have negatively impacted the Company's valuations and will impact the performance of the global economy going forward.

Commodity prices are expected to remain volatile for the near future as a result of market uncertainties over the supply and demand of these commodities due to the current state of the world economies, OPEC actions and the ongoing global credit and liquidity concerns.

Inherent Industry Risks – Risk of Failing to Discover Economic Reserves Additions

The Company's strategies include focusing on gas prone selected areas in Western Canada, utilizing a team of highly qualified professionals with expertise and experience in these areas, expanding operations in core areas, continuously assessing new acquisition opportunities to complement existing activities and striving for a balance between higher risk exploratory drilling, lower risk development drilling and pursuing liquids-rich gas reservoirs.

Beyond exploration risk, there is the potential that the Company's natural gas and crude oil reserves may not be economically produced at prevailing prices. DeeThree minimizes this risk by generating exploration prospects internally, targeting high quality projects and attempting to operate the project along with access to the sales market through Company owned or mid-stream operators.

Financial, Commodity Price, Capital Expenditures, Liquidity and Environmental Risks

Commodity prices are driven by supply, demand and market conditions outside the Company's influence and control. DeeThree manages this risk by constantly monitoring the forecasted price given by aggregators. The Company manages capital expenditures by two separate tracking systems: a historical accounting system that records the actual costs and a perpetual forecasting model that is constantly updated based on real-time information.

DeeThree's capital investment process is based on risk analysis to ensure capital expenditures balance the objectives of immediate cash flow growth in development activities and future cash flow from the discovery of reserves through exploration.

It is likely that in the future, DeeThree will be required to raise additional capital through debt and equity financings in order to fully realize the Company's strategic goals and business plans. DeeThree's ability to raise additional capital will depend on a number of factors, such as general economic and market conditions that are beyond the Company's control. If the Company is unable to obtain additional financing or to obtain it on favourable terms, DeeThree may be required to forego attractive business opportunities. However, as DeeThree is the operator of virtually all of its operations at a high working interest position, the Company is able to be flexible in the timing of operations to ensure a continued strong financial position. The Company is committed to maintaining a strong balance sheet combined with an adaptable capital expenditures program that can be adjusted to capitalize on or reflect acquisition opportunities or a tightening of liquidity sources if necessary.

The Company manages operational risks by employing skilled professionals utilizing leading-edge technology and conducting regular maintenance and training programs. DeeThree has established an Environmental, Health and Safety Program and updated its operational emergency response plan and operational safety manual to address these operational issues. In addition, a comprehensive insurance program is maintained to mitigate risks and protect against significant losses where possible. DeeThree operates in accordance with all applicable environmental legislation and strives to maintain compliance with such regulations.

CONSOLIDATED BALANCE SHEETS

As at	**June 30, 2009**	December 31, 2008
(000s) (unaudited)	*($)*	*($)*
Assets		
Current		
Cash and cash equivalents	**822**	--
Restricted cash *(note 6)*	**4,000**	6,000
Accounts receivable	**742**	1,220
Prepaid expenses and other	**129**	49
	5,693	7,269
Future income taxes	**--**	219
Property and equipment *(note 5)*	**21,059**	20,483
	26,752	27,971
Liabilities		
Current		
Bank debt *(note 6)*	**1,878**	8,346
Accounts payable and accrued liabilities	**2,304**	1,632
	4,182	9,978
Future tax liability	**398**	--
Asset retirement obligations *(note 7)*	**1,392**	1,317
	5,972	11,295
Shareholders' Equity		
Share capital *(note 8)*	**22,386**	17,148
Share purchase warrants *(note 8)*	**342**	--
Contributed surplus *(note 8)*	**133**	40
Deficit	**(2,081)**	(512)
	20,780	16,676
	26,752	27,971

Future operations *(note 2)*

Commitments *(note 12)*

See accompanying notes to the consolidated financial statements.

CONSOLIDATED STATEMENTS OF OPERATIONS, OTHER COMPREHENSIVE INCOME (LOSS) AND DEFICIT

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	**2009**	2008
(000s, except per share amounts) (unaudited)	*($)*	*($)*	*($)*	*($)*
Revenue				
Oil and gas revenues	**1,040**	297	**2,635**	403
Royalty expense	**(88)**	(62)	**(204)**	(74)
	952	235	**2,431**	329
Expenses				
Operating	**388**	64	**853**	141
Transportation	**77**	8	**150**	12
General and administrative	**251**	18	**512**	61
Interest	**141**	1	**221**	2
Stock-based compensation *(note 8)*	**314**	4	**321**	4
Depletion, depreciation and accretion	**1,118**	66	**2,360**	91
	2,289	161	**4,417**	311
Income (loss) before income taxes	**(1,337)**	74	**(1,986)**	18
Income taxes				
Future tax expense (recovery)	**(258)**	8	**(417)**	8
Net income (loss) and comprehensive income (loss) for the period	**(1,079)**	66	**(1,569)**	10
Deficit – beginning of period	**(1,002)**	(133)	**(512)**	(77)
Deficit – end of period	**(2,081)**	(67)	**(2,081)**	(67)
Net income (loss) per share *(note 7)*				
Basic and diluted	**(0.08)**	--	**(0.12)**	--

See accompanying notes to the consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	**2009**	2008
(000s) (unaudited)	*($)*	*($)*	*($)*	*($)*
Cash provided by (used in):				
Operating activities				
Net income (loss) for the period	**(1,079)**	66	**(1,569)**	10
Add back non-cash items:				
Depletion, depreciation and accretion	**1,118**	66	**2,360**	91
Stock-based compensation	**314**	4	**321**	4
Future income tax expense (recovery)	**(258)**	8	**(417)**	8
	95	144	**695**	113
Change in non-cash working capital *(note 9)*	**327**	--	**516**	83
	422	144	**1,211**	196
Financing activities				
Decrease in bank debt	**(6,486)**	--	**(6,468)**	--
Issuance of share capital	**5,875**	--	**5,875**	--
Share issue expenses	**(671)**	--	**(671)**	--
Change in non-cash working capital *(note 9)*	**(29)**	--	**(29)**	--
	(1,311)	--	**(1,293)**	--
Investing activities				
Property and equipment additions	**(1,823)**	(2)	**(2,494)**	(195)
Decrease in restricted cash	**2,000**	--	**2,000**	--
Net working capital acquired upon acquisition	**816**	--	**816**	--
Change in non-cash working capital *(note 9)*	**718**	--	**582**	--
	1,711	(2)	**904**	(195)
Net increase in cash	**822**	142	**822**	1
Cash – beginning of period	**--**	(110)	**--**	31
Cash – end of period	**822**	32	**822**	32

See accompanying notes to the consolidated financial statements.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2009
(unaudited)

1. Nature of Operations

DeeThree Exploration Ltd. ("DeeThree") was incorporated under the Alberta Business Corporations Act on January 24, 2007 and commenced operations in mid-2007. DeeThree's principal business activity is petroleum and natural gas exploration, development and production in Western Canada. On July 31, 2008, DeeThree acquired all the common shares of 1265953 Alberta Inc., a private company, and on September 30, 2008, both companies were amalgamated. In November 2008, DeeThree significantly increased its scope of operations as a result of acquiring an oil and gas property in the Lethbridge, Alberta area. On June 25, 2009, DeeThree completed a reverse takeover transaction with Royal Capital Corp. ("Royal"), a TSX Venture Exchange listed capital pool company. Following the closing of the transaction, Royal changed its name to DeeThree Exploration Inc. ("DeeThree Inc." or the "Company"), and DeeThree is now a wholly owned subsidiary of the Company, which trades on the TSX Venture Exchange under the symbol DTX.

The acquisition of DeeThree has been accounted for as a reverse takeover of DeeThree Inc. by DeeThree effective June 25, 2009, and as a result, the financial statements of the Company treat DeeThree as the acquiring company, and therefore, all pre-acquisition date results reflect the operations of DeeThree.

2. Future Operations

These consolidated financial statements are stated in Canadian dollars and have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP") applicable to a going concern, which contemplates the realization of assets and the payment of liabilities in the ordinary course of business. Should the Company be unable to continue as a going concern, it may be unable to realize the carrying value of its assets and to meet its liabilities as they become due.

The Company reported a net loss of $1,569,000 and generated cash flow from operating activities before changes in non-cash working capital balances of $695,000 for the six months ended June 30, 2009. The Company is required to spend $4,500,000 of eligible exploration expenditures by December 31, 2009 with respect to the issuance of flow-through shares by the Company during 2008. At June 30, 2009, the Company had net working capital of $1,511,000, $8,500,000 available under its revolving demand loan credit facility and an accumulated deficit of $2,081,000. The next review of this facility is scheduled for October 2009. In connection with the review of the loan credit facility, the lender will consider, among other factors, operating results, cash flows, oil and gas reserves and commodity prices. Subsequent to June 30, 2009, the lender advised the Company that the loan credit facility would be reduced to $8,000,000 effective July 31, 2009 due to market conditions and changes in commodity prices.

The Company’s ability to continue as a going concern is dependent on the generation of positive cash flow, the renewal of its credit facilities, the raising of capital and the success of its development and exploration program.

The accompanying consolidated financial statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts and classification of liabilities that might be necessary should the Company be unable to continue as a going concern. Such adjustments could be material.

3. Basis of Presentation and Summary of Accounting Policies

These consolidated financial statements have been prepared in accordance with Canadian GAAP. The disclosures contained in these interim financial statements do not include all of the requirements of GAAP for annual financial statements. These interim financial statements should be read in conjunction with the audited financial statements of DeeThree for the year ended December 31, 2008. These interim financial statements are based on accounting policies consistent with those used and described below.

3. Basis of Presentation and Summary of Accounting Policies (continued)

(a) Property and Equipment

The Company follows the full cost method of accounting whereby all costs related to the exploration for and development of oil and gas reserves are accumulated in one Canadian cost centre. Costs include lease acquisition, geological and geophysical expenditures, carrying costs of non-productive properties, the drilling of productive and non-productive wells and related plant and production equipment costs, asset retirement costs, and that portion of general and administrative expenses directly attributable to exploration and development activities. Proceeds received from the disposal of properties are normally deducted from the full cost pool without recognition of a gain or loss, unless such sale results in a change in the rate of depletion of 20% or more.

(b) Depletion and Depreciation

Depletion and depreciation of oil and gas properties and equipment is computed using the unit-of-production method where the ratio of production to proved reserves, before royalties, determines the proportion of depletable costs to be expensed in each period. Undeveloped properties are excluded from the depletion calculation until quantities of proved reserves are found or impairment occurs. Volumes are converted to equivalent units using the ratio of six thousand cubic feet of natural gas to one barrel of crude oil. Depreciation of office equipment and computer equipment is provided for on a 10% and 35% per annum straight-line basis, respectively.

(c) Recovery of Capitalized Costs

The Company performs a cost recovery test, which recognizes impairment when the carrying amount of the property and equipment, by cost centre, exceeds its undiscounted future cash flows from proved reserves based on estimated future commodity prices. If impairment is recognized, the amount of impairment is determined as the excess of the carrying amount over the fair value. Fair value is based on the present value of expected cash flows, reflecting discounting at the risk-free rate of interest. Both proved and probable reserves and undeveloped land are used in estimating fair value. This cost centre impairment test is conducted at each balance sheet date, or more frequently if conditions indicating potential impairment are present.

(d) Joint Interest Activities

A portion of the Company's exploration, development and production activities are conducted jointly with other entities, and accordingly, the consolidated financial statements reflect only the Company's proportionate interest in such activities.

(e) Revenue Recognition

Oil and natural gas sales are recognized when commodities are sold and title passes to the customer.

(f) Asset Retirement Obligations

The present value of expected future abandonment and reclamation costs is recorded on the balance sheet as both a liability and a charge to property and equipment at the time the obligation is incurred. The amount included as property and equipment is depleted over the life of the reserves by the unit-of-production method. The liability accretes until the Company settles the retirement obligation. Actual reclamation and abandonment costs incurred are charged against the liability.

Estimates for future abandonment and reclamation costs are based on historical costs to abandon and reclaim similar sites, taking into consideration current costs. The liability is based on the Company's net interest in the respective sites.

3. Basis of Presentation and Summary of Accounting Policies (continued)

(g) Use of Estimates

The amounts recorded for depletion and depreciation of property and equipment, the accretion expense associated with the asset retirement obligation and the cost recovery assessments for property and equipment are based on estimates of proved reserves, production and discount rates, oil and natural gas prices, future costs and other relevant assumptions. The amount recorded for the gain or loss on financial instruments is based on estimates of future commodity prices and volatility. By their nature, these estimates are subject to measurement uncertainty and the effect on the consolidated financial statements of changes in such estimates in future years could be significant.

(h) Income Taxes

Income taxes are recorded using the asset and liability method of accounting. Under this method, future income taxes are recorded for the effect of any difference between the accounting and income tax basis of an asset and liability using substantively enacted income tax rates and laws that will be in effect when the differences are expected to reverse. A valuation allowance is recorded against any future income tax assets if it is more likely than not that the asset will not be realized.

(i) Flow-Through Shares

The Company financed 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. To recognize the foregone tax benefits to the Company, the carrying value of the shares issued is reduced by the tax effect of the tax benefits when renounced to subscribers.

(j) Cash and Cash Equivalents

The Company considers all highly liquid investments with maturities of three months or less at the time of purchase to be cash equivalents, and therefore, classifies them with cash.

(k) Stock-Based Compensation

The Company recognizes compensation expense using the fair value method when stock options with no cash settlement features are granted to employees, directors and consultants under the fixed share option plan. Under this method, compensation expense is measured at the grant date and recognized as a charge to earnings over the vesting period with a corresponding credit to contributed surplus. The fair value of the options is determined using the Black-Scholes option pricing model. Consideration paid on the exercise of the stock option and the associated contributed surplus recorded is credited to share capital.

(l) Financial Instruments

The Canadian Institute of Chartered Accountants' ("CICA") Section 3855, "Financial Instruments – Recognition and Measurement", establishes a framework for classifying and measuring financial instruments. Under this section, financial instruments must be initially recognized at their fair value on the balance sheet date. Each financial instrument must be included in one of five categories set out in the standard: financial assets and liabilities held for trading, financial assets held to maturity, loans and receivables, financial assets available for sale or other financial liabilities. All financial instruments, with the exception of loans and receivables, held to maturity investments and other financial liabilities measured at amortized cost, are reported on the balance sheet at fair value. Subsequent measurement and changes in fair value will depend on their initial classification. Unrealized gains and losses on financial instruments classified as held for trading are recognized in earnings in the period incurred. Gains and losses on assets available for sale are recognized in other comprehensive income and are charged to earnings when the asset is derecognized.

At January 1, 2007, accounts receivable were designated as loans and receivables. Accounts payable and accrued liabilities and the bank loan were designated as other financial liabilities. The Company did not have any available for sale or held to maturity instruments for the period ended June 30, 2009.

3. Basis of Presentation and Summary of Accounting Policies (continued)

(m) Changes in Accounting Policies

(i) Capital Disclosures and Financial Instruments – Disclosures and Presentation

Effective January 1, 2008, the Company adopted the new accounting standards relating to financial instruments. These were Capital Disclosures, Financial Instruments – Disclosure, and Financial Instruments – Presentation.

Capital Disclosures standards require the disclosure of (i) an entity's objectives, policies and processes for managing capital, (ii) quantitative data about what the entity regards as capital, (iii) whether the entity has complied with any capital requirements, and (iv) if it has not complied, the consequences of such non-compliance. The new Financial Instruments standards revise and enhance disclosure requirements. These new standards place increased emphasis on disclosures about the nature and extent of risks arising from financial instruments and how the entity manages those risks (note 10).

(ii) General Standards of Financial Statement Presentation

Effective January 1, 2008, General Standards of Financial Statement Presentation were amended to include requirements to assess and disclose the Company's ability to continue as a going concern. The adoption of this new section has not had an impact on the Company's financial statements and the Company has included information in note 2 as required.

(iii) Section 3064, "Goodwill and Intangible Assets", is effective for the Company for interim and annual periods beginning on or after January 1, 2009. Section 3064, which replaces Section 3062, "Goodwill and Intangible Assets", and Section 3450, "Research and Development Costs", establishes standards for the recognition, measurement and disclosure of goodwill and intangible assets, clarifying that costs can be deferred only when they relate to an item that meets the definition of an asset, and as a result, start-up costs must be expensed as incurred. Section 1000, "Financial Statement Concepts", was also amended to provide consistency with this new standard. The adoption of this new standard has not had a material impact on the Company's financial statements.

(n) Pending Accounting Pronouncements

International Financial Reporting Standards ("IFRS")

Canadian entities will need to begin reporting under IFRS by the first quarter of 2011 with appropriate comparative data from the prior year. Under IFRS, there are significant differences in accounting policy that must be addressed.

These consolidated financial statements reflect all adjustments that are, in the opinion of management, necessary to present fairly the financial position of the Company as at June 30, 2009 and the results of operations and cash flows for the period ended June 30, 2009.

4. Acquisition

Effective June 25, 2009, the Company acquired all of the issued and outstanding shares of DeeThree Exploration Ltd., a private oil and gas company incorporated in Alberta with operations also in that province. As consideration, DeeThree Exploration Inc. issued 12,964,943 common shares on the basis of one DeeThree Exploration Inc. share for every one DeeThree Exploration Ltd. share. Although the legal parent in the acquisition is DeeThree Exploration Inc., the transaction under securities regulations and for accounting purposes deemed control to pass to the legal subsidiary DeeThree Exploration Ltd., and accordingly, reverse takeover accounting applied (note 1).

4. Acquisition (continued)

The transaction was accounted for by the purchase method based on fair values as follows:

(000s)	*($)*
Net assets acquired:	
Cash	822
Other working capital	(6)
	816
Consideration	816
Common shares	816

5. Property and Equipment

	Cost	Accumulated Depletion and Amortization	Net Book Value
(000s)	*($)*	*($)*	*($)*
June 30, 2009			
Petroleum and natural gas properties	**24,291**	**3,246**	**21,045**
Office equipment	**21**	**7**	**14**
	24,312	**3,253**	**21,059**
December 31, 2008			
Petroleum and natural gas properties	21,410	941	20,469
Office equipment	18	4	14
	21,428	945	20,483

The Company capitalized $128,000 (2008 – $nil) of direct general and administrative costs and $270,000 (2008 – $nil) of stock-based compensation expense.

As at June 30, 2009, unevaluated and undeveloped properties with a cost of $542,000 (2008 – $nil), included in petroleum and natural gas properties, have not been subject to depletion as reserves related to these costs had not been evaluated or assigned for the period ended June 30, 2009. Future capital costs required to develop proved reserves in the amount of $2,625,000 (2008 – $nil) were included in amounts subject to depletion and estimated salvage values of $3,059,000 (2008 – $nil) have been excluded from the depletion calculation.

6. Bank Debt

At June 30, 2009, the Company had a revolving demand credit facility with an authorized borrowing amount of $8,500,000, with interest charged at the bank's prime rate plus 1.5% per annum. Standby fees associated with this facility are 0.25% per annum on the undrawn portion of the facility. At June 30, 2009, $1,878,000 was drawn against the revolving demand credit facility. Subsequent to June 30, 2009, the lender advised the Company that the loan credit facility would be reduced to $8,000,000 effective July 31, 2009 due to market conditions and changes in commodity prices. The next review of the credit facility is scheduled for October 2009.

Collateral for this facility consists of a general security agreement, providing a security interest over all present and after acquired personal property and a floating charge on all present and after acquired land interests of the Company.

The Company also has a cash secured letter of credit facility with its lender in the amount of $4,000,000 to facilitate the issuance of a letter of credit by the lender with respect to the Lethbridge property acquisition, which was fully utilized at June 30, 2009. This amount is fully secured by funds on deposit of $4,000,000. This facility is repayable on or before November 14, 2009.

7. Asset Retirement Obligations

The Company recorded an asset retirement obligation associated with the present value of the estimated future cost to abandon its petroleum and natural gas properties. The undiscounted amount of cash flows required over the estimated reserve life of the underlying assets to settle the obligation, adjusted for inflation, is estimated at $2,838,000. The obligation was calculated using a credit adjusted risk-free discount rate of 8%. The majority of expenditures are expected to be incurred in 2013 through 2023.

	Six Months Ended June 30, 2009	Year Ended December 31, 2008
(000s)	*($)*	*($)*
Balance – beginning of period	**1,317**	32
Liabilities incurred	**50**	1,270
Revisions	**(26)**	--
Accretion of asset retirement obligation	**51**	15
Balance – end of period	**1,392**	1,317

8. Share Capital

(a) Authorized

Unlimited number of common voting shares, no par value.
Unlimited number of preferred shares, no par value, issuable in series.

(b) Issued – Common Shares

Share Capital of DeeThree Exploration Inc.

	Six Months Ended June 30, 2009		Year Ended January 31, 2009	
	Shares	**Amount**	Shares	Amount
	(#)	*($000s)*	*(#)*	*($000s)*
Balance – beginning of period *(i)*	**6,000,000**	**816**	2,000,000	200
Issued for cash (net of share issue costs)	**--**	**--**	4,000,000	591
Consolidation of outstanding common shares 1-for-12 basis	**(5,500,000)**	**--**	--	--
Shares issued to acquire outstanding shares of DeeThree *(i)*	**12,964,943**	**21,570**	--	--
Balance – end of period	**13,464,943**	**22,386**	6,000,000	791

(i) Under reverse takeover accounting, the authorized and issued share capital is that of DeeThree Exploration Inc., while the stated value is that of DeeThree Exploration Ltd. (note 4).

8. Share Capital (continued)

(b) Issued – Common Shares (continued)

Share Capital of DeeThree Exploration Ltd.

	Six Months Ended June 30, 2009		Year Ended December 31, 2008	
	Shares	**Amount**	Shares	Amount
	(#)	*($000s)*	*(#)*	*($000s)*
Balance – beginning of period	**10,074,000**	**17,148**	1	1
Cancelled	**--**	**--**	(1)	(1)
Common shares issued *(ii)*	**1,976,250**	**3,953**	8,199,000	12,927
Flow-through shares issued *(ii)*	**719,693**	**1,727**	1,875,000	4,500
Exercise of warrants *(iii)*	**195,000**	**413**	--	--
Tax effect of flow-through shares *(i)*	**--**	**(1,125)**	--	--
Share issue costs *(ii)*	**--**	**(671)**	--	(372)
Share issue costs – agent/broker options *(iv)*	**--**	**(60)**	--	--
Tax benefit of share issue costs	**--**	**185**	--	93
Balance – end of period	**12,964,943**	**21,570**	10,074,000	17,148

Under reverse takeover accounting, the authorized and issued share capital is that of DeeThree Exploration Inc., while the stated value is that of DeeThree Exploration Ltd.

(i) Flow-Through Shares

In January 2009, DeeThree renounced the $4,500,000 in qualified exploration expenditures for the 1,875,000 flow-through common shares issued in November 2008, and the related tax effect of the transaction was booked at that time.

(ii) Private Placements

In April and May 2009, DeeThree issued 719,693 flow-through common shares at a price of $2.40 per flow-through common share for total proceeds of $1,727,000.

In April, May and June 2009, DeeThree issued 1,976,250 subscription receipts at a price of $2.00 per subscription receipt for total proceeds of $3,953,000 ($3,282,000 net of issue costs). Upon completion of the amalgamation agreement with Royal Capital Corp. on June 25, 2009, all subscription receipts were converted to common shares.

(iii) Warrants

On June 23, 2009, 195,000 warrants were exercised at $1.00 per warrant.

(iv) Share issue costs: fair value of the agent/broker options.

8. Share Capital (continued)

(c) Issued – Share Purchase Warrants

(000s)	Six Months Ended June 30, 2009 ($)	Year Ended December 31, 2008 ($)
Balance – beginning of period	**--**	--
Stock-based compensation expense – warrants	**560**	--
Reduction due to exercise of warrants	**(218)**	--
Balance – end of period	**342**	--

On June 19, 2009, the Company issued 500,000 share purchase warrants with an exercise price of $1.00 per share purchase warrant. These warrants vested immediately and expire on September 16, 2010. The fair value of the warrants was estimated using the Black-Scholes pricing model and the assumptions are outlined below.

Warrants Outstanding

The following summarizes information about common share purchase warrants as at June 30, 2009:

	Warrants (#)	Weighted Average Exercise Price ($)
Outstanding at December 31, 2008	--	--
Issued	**500,000**	**1.00**
Exercised	**(195,000)**	**1.00**
Balance – June 30, 2009	**305,000**	**1.00**

Exercise Price ($)	Outstanding (#)	Weighted Average Remaining Contractual Life (years)	Weighted Average Exercise Price ($)	Exercisable (#)	Weighted Average Exercise Price ($)
As at June 30, 2009					
1.00	**305,000**	**1.2**	**1.00**	**305,000**	**1.00**

The fair value of the common share purchase warrants granted was estimated as at the date of grant using the Black-Scholes option pricing model and the following assumptions:

As at	June 30, 2009	December 31, 2008
Risk-free interest rate *(%)*	**1.28**	--
Expected life *(years)*	**1.2**	--
Expected volatility *(%)*	**70**	--
Expected dividend yield *(%)*	**--**	--
Fair value of options granted during the period *($/share)*	**1.12**	--

8. Share Capital (continued)

(c) Issued – Share Purchase Warrants (continued)

Compensation expense for warrants granted is based on the estimated fair value at the time of the grant and is amortized to expense over the warrants' vesting period. As a result, the Company has recognized $560,000 (2008 – $nil) for non-cash stock-based compensation expense, which includes $255,000 (2008 – $nil) that was capitalized to the full cost pool for the period ended June 30, 2009, with a corresponding increase to share purchase warrants of $560,000 (2008 – $nil).

(d) Contributed Surplus

	Six Months Ended June 30, 2009	Year Ended December 31, 2008
(000s)	*($)*	*($)*
Balance – beginning of period	**40**	--
Stock-based compensation expense – options	**33**	40
Share issue costs – agent/broker options	**60**	--
Balance – end of period	**133**	40

(e) Per Share Amounts

Shares outstanding have been adjusted to reflect the reverse takeover as described in note 1 as if it occurred at the beginning of the period.

Per share amounts have been calculated on the weighted average number of shares outstanding. The basic and diluted shares outstanding for the six months ended June 30, 2009 were 13,005,927 basic and 13,112,398 diluted (2008 – 12,964,943 basic and diluted).

For the three months ended June 30, 2009, the weighted average number of shares outstanding were 12,992,416 basic and 13,098,887 diluted (2008 – 12,964,943 basic and diluted).

(f) Options Outstanding

The following summarizes information about stock options outstanding as at June 30, 2009:

	Options	Weighted Average Exercise Price
	(#)	*($)*
Outstanding at December 31, 2008	200,000	1.20
Issued – agents/brokers	**76,874**	**2.00**
Issued – employees and directors	**627,500**	**2.00**
Acquired through amalgamation	**83,333**	**2.40**
Balance – June 30, 2009	**987,707**	**1.87**

8. Share Capital (continued)

(f) Options Outstanding (continued)

Exercise Price	Outstanding	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Exercisable	Weighted Average Exercise Price
($)	*(#)*	*(years)*	*($)*	*(#)*	*($)*
As at June 30, 2009					
1.20	**200,000**	**3.9**	**1.20**	**50,000**	**1.20**
2.00	**704,374**	**4.7**	**2.00**	**76,874**	**2.00**
2.40	**83,333**	**3.1**	**2.40**	**83,333**	**2.40**
	987,707	**4.4**	**1.87**	**210,207**	**1.97**

The fair value of the common share purchase options granted was estimated as at the date of grant using the Black-Scholes option pricing model and the following assumptions:

As at	**June 30, 2009**	December 31, 2008
Risk-free interest rate *(%)*	**1.28**	1.69
Expected life *(years)*	**2.0 – 5.0**	4.4
Expected volatility *(%)*	**70**	70
Expected dividend yield *(%)*	**--**	--
Fair value of options granted during the period *($/share)*	**0.77 – 1.16**	1.38

Compensation expense for options granted is based on the estimated fair value at the time of the grant and is amortized to expense over the options' vesting period. As a result, the Company has recognized $93,000 (2008 – $4,000) for non-cash stock-based compensation expense, of which $60,000 was recorded as non-cash share issue expenses, $15,000 (2008 – $nil) was capitalized to the full cost pool with a corresponding increase to contributed surplus of $33,000 (2008 – $nil).

(g) Management of Capital

The Company manages its capital to maintain its ability to continue as a going concern and to provide returns to shareholders and benefits to other stakeholders. The capital structure of the Company consists of cash, bank debt and equity comprising of issued share capital, contributed surplus and deficit.

The Company manages its capital structure and makes adjustments to it in light of economic conditions. The Company, upon approval from its Board of Directors, will balance its overall capital structure through new share issues, the issue of debt or by undertaking other activities as deemed appropriate under the specific circumstances.

There are no financial ratio covenants in the amended and restated financing commitment agreement entered into in November 2008; however, there are certain covenants in the agreement with respect to restrictions in significantly altering the Company's capital structure without the approval of the lender.

The Company's overall strategy with respect to capital risk management remains unchanged from the year ended December 31, 2008.

9. Changes in Non-Cash Working Capital

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	**2009**	2008
(000s)	*($)*	*($)*	*($)*	*($)*
Accounts receivable	**123**	123	**477**	51
Prepaid expenses and other	**(97)**	(11)	**(80)**	(11)
Accounts payable and accrued liabilities	**990**	(112)	**672**	43
	1,016	--	**1,069**	83

The change in non-cash working capital has been allocated to the following activities:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	**2009**	2008
(000s)	*($)*	*($)*	*($)*	*($)*
Operating	**327**	--	**516**	83
Financing	**(29)**	--	**(29)**	--
Investing	**718**	--	**582**	--
	1,016	--	**1,069**	83

10. Financial Instruments

The Company has exposure to credit, liquidity and market risk.

The Company's risk management policies are established to identify and analyze the risks faced by the Company, set appropriate limits and controls, and to monitor risks and adherence to market conditions and the Company's activities.

(a) Credit Risk

Substantially all of the Company's petroleum and natural gas production is marketed under standard industry terms. The industry has a pre-arranged monthly settlement day for payment of revenues from all buyers of crude oil and natural gas. This occurs on the 25th day following the month in which the production is sold. As a result, the Company collects sales revenues in an organized manner. Management monitors purchaser credit positions to mitigate any potential credit losses. To the extent the Company has joint interest activities with industry partners, the Company must collect, on a monthly basis, partners' share of capital and operating expenses.

These collections are subject to normal industry credit risk. The Company attempts to mitigate risk from joint venture receivables by obtaining partner approval of capital projects prior to expenditure and collects in advance for significant amounts related to its partners' share of capital expenditures in accordance with the industry operating procedures. The Company does not typically obtain collateral from petroleum and natural gas marketers or joint venture partners; however, the Company does have the ability to withhold production from joint venture partners in the event of non-payment. At June 30, 2009, of the accounts receivable balance of $742,000, $487,000 relates to the sale of petroleum and natural gas, substantially all of which was collected as at the date of this report. The remainder relates to goods and services tax collectible, which was collected as at the date of this report. DeeThree had no material accounts receivable deemed uncollectible. The Company's credit risk is limited to the carrying amount of its accounts receivable, which are due primarily from other entities involved in the oil and gas industry. These amounts are subject to the same risks as the industry as a whole.

10. Financial Instruments (continued)

(b) Liquidity Risk

Liquidity risk relates to the risk the Company will encounter should it have difficulty in meeting obligations associated with the financial liabilities. The financial liabilities on its balance sheet consist of accounts payable and bank debt. Accounts payable consists of invoices payable to trade suppliers relating to the office and field operating activities and its capital spending program. The Company processes invoices within a normal payment period. The Company anticipates it will continue to have adequate liquidity to fund its financial liabilities through its future funds from operations and available bank debt. The Company had no defaults or breaches on its bank debt or any of its financial liabilities.

(c) Market Risk

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

(i) Commodity Price Risk

Commodity price risk is the risk that the fair value of future cash flows will fluctuate as a result of changes in the commodity prices. Commodity prices for petroleum and natural gas are impacted by not only the relationship between the Canadian and United States dollar, as outlined below, but also global economic events that dictate the levels of supply and demand. The Company had no financial derivative contracts in place at June 30, 2009.

(ii) Interest Rate Risk

Interest rate risk is the risk that future cash flows will fluctuate as a result of changes in market interest rates. The Company is exposed to interest rate risk to the extent the changes in market interest rates will impact the Company's debts that have a floating interest rate. The Company had no interest rate swaps or hedges at June 30, 2009. With regards to interest rate risk, a change of 1% in the effective interest rate would have impacted the Company's net earnings by approximately $6,000 for the first six months of 2009, based on average debt outstanding during the period.

(d) Fair Value of Financial Assets and Liabilities

Financial instruments of the Company consist primarily of cash, accounts receivable, accounts payable and bank debt. As at June 30, 2009, there were no significant differences between the carrying amounts reported on the balance sheet and their estimated fair values due to the short-term nature of these instruments and the floating rate of interest of the bank debt.

11. Related Parties

The following summarizes the Company's related party transactions as at June 30, 2009**:**

(a) On July 31, 2008, DeeThree acquired all of the issued and outstanding shares of 1265953 Alberta Inc. ("1265953"). As the purchase consideration, DeeThree issued 586,500 common shares to the shareholders of 1265953. One director and two officers of DeeThree were shareholders of 1265953 and received 153,000 common shares of DeeThree in the transaction.

(b) An officer of the Company indirectly holds a 5% working interest in a property owned by the Company. During 2009, net revenue attributable to this working interest was $6,100 (2008 – $nil).

(c) The Company has retained the law firm of Davis LLP to provide legal services. Mr. Daniel E. Kenney, the Corporate Secretary of DeeThree, is a partner of this firm. The Company expects to continue using the services of this firm from time to time.

All related party transactions were in the normal course of operations and have been measured at exchange amounts established and agreed to by the related parties and which are similar to those that the Company would expect to have negotiated with third parties in similar circumstances.

12. Commitments

In connection with the issuance of flow-through shares by the Company during the year ended December 31, 2008, the Company is required to spend $4,500,000 of eligible exploration expenditures by December 31, 2009. The qualifying expenditures were renounced to shareholders in January 2009. As at June 30, 2009, approximately $1,700,000 of eligible exploration expenditures had been incurred.

In connection with the issuance of flow-through shares by the Company during the period ended June 30, 2009, the Company is required to spend $1,727,000 of eligible exploration expenditures by December 31, 2010. The qualifying expenditures will be renounced to shareholders in January 2010.

In connection with the acquisition of the Lethbridge property in November 2008, the Company has committed to the drilling of 30 wells in the area covered in the agreement over a three-year period commencing November 14, 2008 (ten wells per year). In addition, DeeThree has committed to shooting four townships of seismic data over the same period (one township in year one, two townships in year two and one township in year three). The total cost to DeeThree for these commitments, including well completions and tie-ins on a risked basis, is estimated to be $23,200,000. As security for the commitment, DeeThree provided the vendor with a letter of credit totaling $6,000,000. The letter of credit is releasable to DeeThree as to $2,000,00 on the spud by DeeThree of the first well on the property and on a dollar for dollar basis incurred in carrying out the commitment, following the drilling and either completion, capping or abandonment of the first five wells under the commitment. Five wells were drilled under the commitment in May 2009. On May 21, 2009, $2,000,000 was released from the letter of credit.

CORPORATE INFORMATION

Board of Directors

Martin Cheyne – Chairman [(2)]
President & Chief Executive Officer
DeeThree Exploration Inc.

Brendan Carrigy [(2)]
Vice President, Exploration
DeeThree Exploration Inc.

Michael Kabanuk [(1)(2)(3)]
Independent Businessman

Dennis Nerland [(1)(2)(3)]
Partner
Shea Nerland Calnan LLP

Brad Porter [(1)(3)]
Independent Businessman

(1) Audit Committee Member
(2) Reserves Committee Member
(3) Corporate Governance & Compensation Committee Member

Officers

Martin Cheyne
President & Chief Executive Officer

Gail Hannon
Chief Financial Officer

Brendan Carrigy
Vice President, Exploration

Daniel Gundersen
Vice President, Engineering

Trevor Murray
Vice President, Land

Daniel Kenney
Corporate Secretary

Head Office

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520 Fifth Avenue S.W.
Calgary, Alberta T2P 3R7
Telephone: (403) 263-0260
Facsimile: (403) 263-9710

Auditors

KPMG LLP
Calgary, Alberta

Banker

Canadian Imperial Bank of Commerce
Calgary, Alberta

Evaluation Engineers

Sproule Associates Limited
Calgary, Alberta

Legal Counsel

Davis LLP
Calgary, Alberta

Registrar and Transfer Agent

Olympia Trust Company
Calgary, Alberta

Stock Trading

TSX Venture Exchange
Trading Symbol: DTX

Abbreviations

bbls	barrels
boe	barrels of oil equivalent
/d	per day
mcf	thousand cubic feet
NGLs	natural gas liquids

Natural gas is equated to oil on the basis of 6 mcf : 1 bbl

DeeThree Exploration Inc.