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for Growth

Q1

First Quarter Interim Report For the Three Months Ended March 31, 2010

HIGHLIGHTS

Three Months Ended March 31,	**2010**	2009	Change
(000s, except per share amounts)	*($)*	*($)*	*(%)*
Financial			
Oil and gas revenues	**2,293**	1,595	44
Funds from operations (1)	**854**	600	42
Per share – basic and diluted	**0.05**	0.06	(17)
Net loss	**265**	490	46
Per share – basic and diluted	**0.02**	0.05	60
Capital expenditures	**7,165**	671	968
Working capital (deficiency)	**6,601**	(2,781)	337
Shareholders' equity	**35,432**	15,076	135
(000s)	*(#)*	*(#)*	*(%)*
Share Data			
At period-end	**20,981**	10,074	108
Weighted average – basic and diluted	**17,101**	10,154	68
			(%)
Operating			
Production			
Natural gas *(mcf/d)*	**5,211**	3,345	56
Crude oil and NGLs *(bbls/d)*	**16**	18	(11)
Total *(boe/d)*	**885**	576	54
Average wellhead prices			
Natural gas *($/mcf)*	**4.66**	5.03	(7)
Crude oil and NGLs *($/bbl)*	**74.80**	50.69	48
Total *($/boe)*	**28.79**	30.81	(7)
Operating cost *($/boe)*	**7.04**	8.99	(22)
Operating netback *($/boe)*	**15.54**	18.16	(14)
Gross (net) wells drilled			
Gas *(#)*	**2 (2.0)**	– (–)	– (–)
Oil *(#)*	**– (–)**	– (–)	– (–)
Standing *(#)*	**– (–)**	– (–)	– (–)
Dry and abandoned *(#)*	**– (–)**	– (–)	– (–)
Total *(#)*	**2 (2.0)**	– (–)	– (–)
Average working interest *(%)*	**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) For a description of the boe conversion ratio, refer to the commentary at the beginning of the Management's Discussion and Analysis.

DeeThree
Exploration Ltd.

LETTER TO SHAREHOLDERS

DeeThree Exploration Ltd. continued its record of success and had a very active first quarter of 2010 with a focus on its Lethbridge core area.

Financial and Operational Accomplishments

For the three months ended March 31, 2010, our Company recorded numerous financial and operating successes. We posted several record year-over-year results that included:

- Increasing oil and gas revenues 44% to $2.3 million.
- Improving funds from operations 42% to $0.9 million or $0.05 per fully diluted share.
- Growing average production to 885 boe/d, up 54% from the first three months last year and up 42% from the final quarter of 2009.
- Drilling 2 gross (2.0 net) development wells for a 100% success rate.
- Completing construction of an 18-kilometre pipeline that became operational in February 2010.
- Shooting approximately 49 sections of 3-D seismic data.
- Reducing operating costs to $7.04/boe from $8.99/boe in the first quarter of 2009 and from $8.61/boe for the year ended December 31, 2009.
- Exiting the quarter with positive working capital of $6.6 million.
- Increasing the Company's credit facilities to $12.0 million, which is currently unutilized.
- Closing a bought deal public financing for $12.5 million (net of expenses).

Management is extremely pleased with our first quarter operational achievements in the Lethbridge area. Early in the period, the completion of an 18-kilometre pipeline extension allowed DeeThree to bring on-stream approximately 300 boe/d of behind pipe volumes. This pipeline expansion is of additional significance as it ties our Jensen and Warner fields together into a contiguous block. We believe that this will ultimately reduce future development and operational costs in the area as we continue to drill. Presently, over 95% of the Lethbridge production flows through Company owned facilities. Our exploration team was also very active with the completion of two 3-D seismic programs covering approximately 49 sections. Obtaining this data early in the year is a strategic advantage for DeeThree as it allows us to gain more insight into the area's geological makeup as well as assists in identifying additional locations for our 2010 drilling program and beyond.

During the first quarter, the Company successfully drilled two 100% working interest development wells on its Lethbridge property: the first was completed and placed on-stream and the second is awaiting a stimulation operation. The pressure and production information from these wells has substantiated a number of additional drilling locations within our established producing pools.

In April, the Company's 2010 20-well drilling program was strategically managed to be more cost effective as limited service resources and inclement weather increased drilling costs. As a result, only two additional 100% working interest wells were drilled by the Company on the Lethbridge property. The first well successfully targeted an exploratory location that was cased and tested at rates over 850 mcf/d. This well will be tied into the nearby DeeThree gathering system as soon as surface conditions permit. The second, a horizontal well, was ultimately abandoned after providing valuable knowledge for future horizontal operations. The Company's current production is approximately 950 boe/d with an additional 250 boe/d of production awaiting tie-in.

Also subsequent to quarter-end, the Company obtained a two-year extension to its lease of the Lethbridge property, providing us with additional time to further evaluate, develop and explore in excess of 200,000 undeveloped acres where our Company has already identified a number of highly prospective multi-zone targets. Under this extension, we have committed to drill a further 20 wells on the Lethbridge property over the two-year period (ten wells per year) into the Mississippian horizon. The term of the lease now expires November 13, 2013.

In February 2010, DeeThree increased its credit facility with its lender from $8 million to $12 million, and in March, the Company completed a bought deal public financing with a syndicate of underwriters for net proceeds of $12.5 million, issuing 4.2 million common shares at $2.40 per share and 1.2 million flow-through common shares at $2.80 per share. Through the combination of this financing, the available credit facility and this year's annual projected cash flow of $5.0 million to $6.0 million, our Company is very well positioned to carry out its 2010 capital program.

Outlook

DeeThree expects to continue generating solid operating and financial results through successful drilling complemented by a strong financial position despite ongoing economic, industry and commodity price volatility. The Company's 2010 capital budget of $20 million remains largely unchanged at present with 16 of the anticipated 20 wells left to be drilled. Fundamentally, our Company is well positioned to increase or decrease capital spending in response to natural gas prices if necessary. DeeThree has hedged approximately 30% of its current natural gas production at an average price of approximately $4.68/mcf for the summer months, and will continue to monitor opportunities to hedge additional volumes should they arise.

We are excited about the results we have posted to date and we look forward to reporting our progress throughout the balance of the year.

On behalf of the Board of Directors,

Martin Cheyne
President & Chief Executive Officer

May 11, 2010

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 Ltd. ("DeeThree" or the "Company") for the three months ended March 31, 2010 and 2009 and should be read in conjunction with the consolidated financial statements and accompanying notes. All financial measures are expressed in Canadian dollars unless otherwise indicated. This commentary is based on the information available as at, and is dated May 11, 2010.

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.

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 at 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 natural gas and crude oil, the quantity of reserves, natural gas and crude oil 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 natural gas and crude oil; uncertainties associated with estimating reserves; geological, technical, drilling and processing problems; liabilities and risks, including environmental liabilities and risks inherent in natural gas and crude oil operations; incorrect assessments of the value of acquisitions; and, competition for, among other things, capital, acquisitions of reserves, undeveloped lands and skilled personnel.

This forward-looking information represents the Company's views as at the date of this MD&A and such information should not be relied upon as representing its views as of any date subsequent to the date of this MD&A. 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. The Company disclaims any intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, except as expressly required by applicable securities legislation.

Basis of Presentation

DeeThree is a Calgary based resource company actively engaged in natural gas and crude oil exploration, development and production in key areas of the Western Canadian Sedimentary Basin. DeeThree commenced operations in 2007 as a private company, and on June 25, 2009, completed a reverse takeover transaction with Royal Capital Corp. ("Royal"), a public capital pool company. Following the closing of the transaction, Royal changed its name to DeeThree Exploration Inc. ("DeeThree Inc."), and DeeThree became a wholly owned operating subsidiary of DeeThree Inc. The transaction has been accounted for as a reverse takeover of DeeThree Inc. by DeeThree effective June 25, 2009, and as a result, this MD&A and accompanying consolidated financial statements and notes of DeeThree Inc. treat DeeThree as the acquiring company, and therefore, all pre-acquisition date results reflect the operations of DeeThree. On January 1, 2010, DeeThree Inc. changed its name to DeeThree Exploration Ltd. in conjunction with the amalgamation of DeeThree Inc. with DeeThree.

Financial and Operating Results

Sales Volumes

Three Months Ended March 31,	**2010**	2009
Natural gas sales *(mcf/d)*	**5,211**	3,345
Crude oil and NGLs sales *(bbls/d)*	**16**	18
Total sales *(boe/d)*	**885**	576
Total sales *(boe)*	**79,635**	51,780

For the first quarter of 2010, the Company's production averaged 885 boe/d compared to 576 boe/d in the same quarter of 2009 and 623 boe/d recorded in the fourth quarter of 2009. This represents a 54% year-over-year increase and a 42% quarter-over-quarter improvement. These increases were the result of the Company bringing two new wells on-stream throughout the first three months of 2010, thereby adding an incremental 250 boe/d to the quarterly average.

Revenue and Prices

Three Months Ended March 31,	**2010**	2009
(000s)	*($)*	*($)*
Revenue		
Natural gas	**2,183**	1,514
Crude oil and NGLs	**110**	81
Total revenue	**2,293**	1,595
Average Prices		
Natural gas *($/mcf)*	**4.66**	5.03
Crude oil and NGLs *($/bbl)*	**74.80**	50.69
Total sales price *($/boe)*	**28.79**	30.81

For the three months ended March 31, 2010, revenue rose 44% to $2,293,000 from $1,595,000 in the comparative period of 2009 and 47% from $1,563,000 recorded in the final quarter of 2009. These increases were primarily due to growth in production volumes. During the first quarter of 2010, DeeThree realized an average natural gas price of $4.66/mcf and $74.80/bbl for crude oil and NGLs compared to $5.03/mcf and $50.69/bbl, respectively, a year ago and $4.35/mcf and $67.91/bbl, respectively, in the final quarter of 2009.

DeeThree's current production profile is weighted 98% 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, liquefied natural gas imports, North American supply and demand, storage levels in North America and alternative fuel sources. DeeThree's production is sold within Canada and is marketed to one significant North American purchaser.

The Company has fixed the price applicable to future sales through the following contracts:

Daily Quantity	Term of Contract	Fixed Price (AECO)
700 GJ/d	Apr. 1, 2010 – Oct. 31, 2010	$4.67/GJ
700 GJ/d	Apr. 1, 2010 – Oct. 31, 2010	$4.48/GJ
700 GJ/d	Apr. 1, 2010 – Dec. 31, 2010	$4.485/GJ

Royalties

Three Months Ended March 31,	**2010**	2009
(000s)	*($)*	*($)*
Total revenue	**2,293**	1,595
Royalties	**400**	116
Percent of revenue *(%)*	**17**	7

Royalty expenses consist primarily of freehold royalties relating to the Lethbridge property acquisition and royalties paid to provincial governments relating to the Company's non-core areas. The freehold royalty payable to the vendor in connection with the acquisition is a sliding scale royalty determined monthly on a well-by-well basis using a calculation that is based on the Alberta New Royalty Framework as announced on October 25, 2007 with a cap of 30%. The sliding scale varies based on productivity (a higher royalty is payable from wells with higher production rates) and commodity prices (a higher royalty is payable in times of higher natural gas prices).

For the first three months of 2010, royalties totaled $400,000 or 17% of revenue compared to $116,000 or 7% of revenue for the same quarter in 2009 and $303,000 or 19% of revenue in the fourth quarter of 2009. The year-over-year increase in the royalty rate was primarily due to the new wells that came on-stream throughout the quarter, attracting a higher royalty charge due to initial production rates being strong. The quarter-over-quarter decrease in royalties was due to both a decline in natural gas prices throughout the first three months of 2010 and the Company recording the entire annual freehold mineral tax for 2009 in the final quarter of 2009, whereas in 2010, freehold mineral taxes will be estimated and accrued over the entire year.

Operating Expenses

Three Months Ended March 31,	**2010**	2009
(000s)	*($)*	*($)*
Operating expenses	**561**	465
Operating expenses *($/boe)*	**7.04**	8.99

Operating costs include all costs associated with the production of natural gas and crude oil. The major components of operating costs include charges for contract operating, property and pipeline taxes, and well maintenance charges. Operating costs per barrel can vary significantly quarter to quarter depending on such factors as production rates, inclement weather and maintenance requirements.

Operating expenses for the first quarter of 2010 totaled $561,000 or $7.04/boe compared to $465,000 or $8.99/boe for the same period in 2009 and $499,000 or $8.71/boe in the fourth quarter of 2009. Operating costs in the first quarter of 2010 decreased on a per barrel basis from the first three months a year ago due primarily to an increase in sales volumes that resulted in the Company achieving economies of scale.

Transportation Expenses

Three Months Ended March 31,	**2010**	2009
(000s)	*($)*	*($)*
Transportation expenses	**95**	73
Transportation expenses *($/boe)*	**1.19**	1.42

Transportation expenses for the three months ended March 31, 2010 were $95,000 or $1.19/boe ($0.20/mcf) compared to $73,000 or $1.42/boe ($0.24/mcf) recorded in the first quarter of 2009 and $64,000 or $1.12/boe ($0.19/mcf) in the final three months of 2009. Transportation expenses reflect primarily NOVA and ATCO transportation costs, which the Company expects to remain relatively consistent throughout 2010.

General and Administrative ("G&A") Expenses

Three Months Ended March 31,	**2010**	2009
(000s)	*($)*	*($)*
G&A expenses	**508**	322
G&A capitalized (direct)	**(115)**	(41)
G&A recoveries from operations	**(33)**	(20)
G&A expenses (net)	**360**	261
G&A expenses *($/boe)*	**4.52**	5.05

For the three-month period ended March 31, 2010, G&A net expenses totaled $360,000 compared to $261,000 recorded in the same period of 2009 and $290,000 for the final quarter of 2009. On a per boe basis, G&A expenses improved in 2010 to $4.52/boe from $5.05/boe in the first quarter of 2009 and $5.06/boe in the final three months of 2009 due primarily to increased production volumes. Gross G&A expenses for the first quarter of 2010 were higher than the same period of 2009 due to increased costs, specifically salaries, performance bonuses and consulting fees booked in the 2010 three-month period. The Company capitalizes salaries, bonuses and consulting charges relating to geological and geophysical personnel, which totaled $115,000 (2009 – $41,000).

Stock-Based Compensation Expense

Three Months Ended March 31,	**2010**	2009
(000s)	*($)*	*($)*
Gross stock-based compensation expense	**76**	14
Capitalized stock-based compensation expense	**(33)**	(7)
Stock-based compensation expense	**43**	7
Stock-based compensation expense *($/boe)*	**0.54**	0.14

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.

Stock-based compensation expense totaled $43,000 or $0.54/boe for the three-month period ended March 31, 2010 versus $7,000 or $0.14/boe a year ago. The year-over-year increase was the result of additional options and warrants being granted primarily during the second quarter of 2009.

The Company capitalizes a portion of its stock-based compensation expense consistent with the treatment of capitalized G&A expenses, and as a result, $33,000 (2009 – $7,000) was capitalized for the three months ended March 31, 2010. A future tax liability of $12,000 was booked during the 2010 three-month period in association with the capitalized stock-based compensation expense.

Interest Expense

For the first quarter of 2010, interest expense totaled $23,000 compared to $80,000 in the same period last year. This decrease was directly attributable to the Company's bank debt level throughout the first quarter of 2010 versus the same period in 2009.

Funds From Operations

Three Months Ended March 31,	**2010**	2009
(000s)	*($)*	*($)*
Net loss	**(265)**	(490)
Non-cash items:		
Depletion, depreciation and accretion	**1,151**	1,242
Stock-based compensation	**43**	7
Future income tax recovery	**(75)**	(159)
Funds from operations	**854**	600

During the three months ended March 31, 2010, funds from operations were $854,000 or $0.05 per basic and diluted share compared to $600,000 or $0.06 per basic share in the comparative period of 2009. This 42% increase was primarily due to a 54% year-over-year increase in sales volumes.

Funds from operations is a non-GAAP measure and has been defined by the Company as net losses plus the add back of non-cash items (depletion, depreciation and accretion, stock-based compensation and future income taxes) and exclude the change in non-cash working capital related to operating activities. Management uses funds from operations to analyze performance and considers it a key measure as it demonstrates the Company's ability to generate the cash necessary to fund future capital investments and to repay debt.

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 March 31,	**2010**	2009
(000s)	*($)*	*($)*
Funds flow from operating activities	**854**	600
Changes in non-cash working capital	**(189)**	189
Cash flow from operations	**665**	789

Cash flow from operating activities for the three-month period ended March 31, 2010 was $665,000 ($0.04 per basic and diluted share) compared to $789,000 ($0.08 per basic and diluted share) in the same period of 2009.

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

Three Months Ended March 31,	**2010**	2009
(000s)	*($)*	*($)*
DD&A provision	**1,151**	1,242
DD&A provision *($/boe)*	**14.45**	23.98

DeeThree follows the full cost method of accounting for its depletion calculation whereby all incurred acquisition, exploration and development costs relating to the exploration and development of gas and oil reserves are capitalized. In addition to these capital costs are the estimated future capital expenditures to be incurred in order to develop proved non-producing reserves, which are included in a third party engineering report. This accumulation of costs is then depleted on a unit-of-production basis using estimated proved gas and oil reserves. Depreciation of office assets is provided using the declining balance method at rates between 20% and 30%. Accretion is the increase for the reporting period in the present value of the Company's asset retirement obligation, which is calculated using an interest rate of 8%.

The Company's DD&A expense for the three months ended March 31, 2010 was $1,151,000 or $14.45/boe versus $1,242,000 or $23.98/boe in the comparable period of 2009. The decrease in DD&A was primarily due to positive reserves additions resulting from the Company's 2009 drilling program.

Impairment Expense

Management has determined that there was no impairment of DeeThree's natural gas and crude oil assets as at March 31, 2010.

Income Taxes

A future tax recovery of $75,000 was recognized for the three months ended March 31, 2010 compared to an income tax recovery of $159,000 in the same period of 2009.

Net Loss

For the three months ended March 31, 2010, the Company recorded a net loss of $265,000 or $0.02 per basic and diluted share compared to $490,000 or $0.05 per basic and diluted share in 2009. The loss recorded in 2010 reflects decreased commodity prices offset by a significant decline of depletion expenses.

Netbacks (per unit)

Three Months Ended March 31,	**2010**	2009
	($/boe)	*($/boe)*
Sales prices	**28.79**	30.81
Royalties	**(5.02)**	(2.24)
Operating	**(7.04)**	(8.99)
Transportation	**(1.19)**	(1.42)
Operating netback	**15.54**	18.16
G&A and other (excludes non-cash items)	**(4.52)**	(5.05)
Interest expense	**(0.29)**	(1.55)
Funds flow netback [(1)]	**10.73**	11.56
DD&A	**(14.45)**	(23.98)
Stock-based compensation	**(0.54)**	(0.14)
Future tax recovery	**0.94**	3.08
Net loss netback	**(3.32)**	(9.48)

(1) Non-GAAP measure: refer to disclosure on non-GAAP measurements at the beginning of this MD&A. Funds flow netback is calculated by dividing funds flow by the sales volume in boes 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 was $15.54/boe for the quarter ended March 31, 2010 compared to $18.16/boe in the same period of 2009, reflecting weaker commodity prices in 2010 and increased royalty rates offset by decreased transportation and operating expenses.

Investment and Investment Efficiencies

Capital Expenditures

Three Months Ended March 31,	**2010**	2009
(000s) (excluding asset retirement obligations and capitalized stock-based compensation)	*($)*	*($)*
Land and lease retention	**–**	116
Property acquisitions and adjustments	**–**	6
Drilling and completions	**1,588**	331
Equipment and facilities	**2,035**	177
Geological and geophysical	**3,426**	–
Capitalized G&A and other	**116**	41
Total capital expenditures	**7,165**	671

In the first quarter of 2010, the Company incurred $7,165,000 (2009 – $671,000) in capital expenditures, excluding the non-cash asset retirement obligation and capitalized stock-based compensation. Drilling and completion expenditures totaled $1,588,000 (2009 – $331,000) that involved the drilling of 2 gross (2.0 net) wells on the Lethbridge property as well as recompletion costs related to wells drilled in 2009 and preliminary drilling costs related to wells to be drilled throughout the balance of 2010. DeeThree also spent $2,035,000 (2009 – $177,000) on equipping and tie-ins, which consisted primarily of expenditures related to the 18-kilometre pipeline extension, $nil (2009 – $116,000) on land purchases and capitalized lease rentals, and $3,426,000 (2009 – $nil) related to the shooting of two 3-D seismic programs that commenced in the quarter. The remaining $116,000 was invested in capitalized G&A and other corporate assets.

Drilling Activity

During the three months ended March 31, 2010, DeeThree drilled 2 gross (2.0 net) development wells (100% working interest) at Lethbridge for a 100% success rate. In the same period of 2009, no wells were drilled.

Liquidity and Capital Resources

Working Capital

Accounts receivable consist of production revenue receivables from DeeThree's major purchaser as well as joint venture receivables from the Company's partners with respect to operating and capital costs. Prepaid costs primarily include unamortized insurance premiums and prepaid property taxes that are being amortized over the related period.

Accounts payable include capital, operating, royalty and G&A costs as well as accrued or estimated costs for these items. Included in accounts payable are amounts owing to the Company's joint venture partners with respect to non-operated properties and processing, gathering and transportation charges.

The following table summarizes the change in working capital during the three months ended March 31, 2010 and the year ended December 31, 2009:

	Three Months Ended March 31, 2010	Year Ended December 31, 2009
(000s)	*($)*	*($)*
Working capital (deficiency) – beginning of period	**375**	(2,710)
Funds from operations	**854**	1,112
Capital expenditures	**(7,165)**	(8,778)
Issue of capital stock for cash (net of share issue expenses)	**12,537**	9,935
Net working capital acquired on acquisition	**–**	816
Working capital – end of period	**6,601**	375

DeeThree entered 2010 with a working capital of $375,000. During the first quarter, the Company generated funds from operations of $854,000 and invested $7,165,000 in capital expenditures. In addition, on March 5, 2010, the Company closed a bought deal equity financing resulting in the issue of 4,197,500 common shares issued at a price of $2.40 per common share and 1,236,250 flow-through shares issued at a price of $2.80 per flow-through share for total gross proceeds of $13,536,000 ($12,473,000 net of estimated share issue expenses), including 547,500 common shares and 161,250 flow-through shares issued on the exercise in full of the underwriter's over-allotment option. In addition, 29,500 stock options were exercised during the quarter for proceeds of $64,000. DeeThree exited the period with working capital of $6,601,000.

As at March 31, 2010, the Company had a revolving demand credit facility with an authorized borrowing base of $12,000,000, with interest charged at the bank's prime rate plus 1.25% per annum. Standby fees associated with this facility are 0.25% per annum on the undrawn portion of the facility. As at March 31, 2010, $nil was drawn against the facility. On April 30, 2010, the Company's lender completed its review and no change was made to the borrowing base (note 12). The next review of the credit facility is scheduled to take place on or before October 31, 2010. 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's ability to continue as a going concern is dependent on its ability to raise capital, the continued generation of positive cash flow 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.

Share Capital

As at May 11, 2010, the Company had 20,981,000 common shares outstanding, 1,397,557 stock options and 252,500 warrants outstanding.

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

On June 25, 2009, DeeThree Exploration Inc. (formerly Royal Capital Corp. ("Royal")) 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. On January 1, 2010, DeeThree Exploration Inc. changed its name to DeeThree Exploration Ltd. in conjunction with the amalgamation of DeeThree Exploration Inc. with DeeThree Exploration Ltd., its wholly owned operating subsidiary.

As at May 11, 2010, there were 2,165,300 common shares, 100,000 stock options and 126,250 common share purchase warrants held in escrow with respect to the Qualifying Transaction Escrow Agreement and 86,451 common shares with respect to the CPC Escrow Agreement.

Selected Quarterly Information

Three Months Ended	**Mar.31, 2010**	Dec.31, 2009	Sep.30, 2009	Jun.30, 2009	Mar.31, 2009	Dec.31, 2008	Sep.30, 2008	Jun.30, 2008
(000s, except per share amounts)	*($)*	*($)*	*($)*	*($)*	*($)*	*($)*	*($)*	*($)*
Oil and gas revenues	**2,293**	1,563	820	1,040	1,595	859	387	297
Funds from operations	**854**	435	(18)	95	600	71	182	144
Per share – basic and diluted	**0.05**	0.03	–	0.01	0.05	0.01	0.01	0.01
Net income (loss)	**(265)**	(438)	(830)	(1,079)	(490)	(466)	21	66
Per share – basic and diluted	**(0.02)**	(0.03)	(0.06)	(0.08)	(0.05)	(0.04)	–	–
Capital expenditures	**7,165**	4,601	1,683	1,823	671	18,656	(78)	2
Working capital (deficiency)	**6,601**	375	(190)	1,511	2,781	(2,710)	1,871	(545)
Shareholders' equity	**35,432**	24,674	20,106	20,780	15,076	16,676	3,013	(63)
Production								
Natural gas *(mcf/d)*	**5,211**	3,636	2,900	3,150	3,345	1,623	322	321
Crude oil and NGLs *(bbls/d)*	**16**	17	10	15	18	12	15	1
Total *(boe/d)*	**885**	623	493	541	576	282	69	55

Note: The selected quarterly information has been prepared in accordance with the accounting principles as contained in the notes to the consolidated financial statements for the years ended December 31, 2009 and 2008.

Factors That Have Caused Variations Over the Quarters

The fluctuations in DeeThree's revenue and net earnings from quarter to quarter are primarily caused by increases in production volumes, realized commodity prices and the related impact on royalties and operating costs. DeeThree has been successful in the drilling and tie-in of its wells, and has increased sales and related volumes each successive quarter, with the exception of the second and third quarters of 2009 due to natural declines as well as third party restrictions throughout those periods. During those quarters, DeeThree's revenue stream was negatively impacted by the decrease in commodity prices experienced by the industry as a whole. Please refer to the "Financial and Operating Results" section and other sections of this MD&A for detailed discussions on variations during the comparative quarters and to DeeThree's previously issued interim and annual MD&A for changes in prior quarters.

Subsequent Events

On April 13, 2010, the Company executed a two-year extension to its amended lease agreement, which is part of a lease issuance, seismic and drilling commitment agreement with an arm's length senior Canadian oil and gas producer. This extension involves a commitment to drill an additional 20 wells over the two-year period (ten wells per year) into the Mississippian horizon and expires on November 13, 2013.

On April 30, 2010, the Company's lender completed its review of DeeThree and no change was made to the current $12,000,000 credit facility available to the Company.

Subject to regulatory approval, DeeThree has granted a total of 335,000 stock options to the directors, officers and employees of the Company. The options have an exercise price of $2.40 per share and a maximum term of five years.

Contractual Obligations

In connection with the issuance of flow-through shares by the Company during the second quarter of 2009, the Company is required to spend $1,727,000 of eligible exploration expenditures by December 31, 2010. The qualifying expenditures were renounced to shareholders in January 2010. As at March 31, 2010, the entire $1,727,000 of eligible exploration expenditures had been incurred.

In connection with the issuance of flow-through shares by the Company during the fourth quarter of 2009, the Company is required to spend $5,000,000 of eligible exploration expenditures by December 31, 2010. The qualifying expenditures were renounced to shareholders in January 2010. As at March 31, 2010, approximately $4,500,000 of eligible exploration expenditures had been incurred.

In connection with the issuance of flow-through shares by the Company during the first quarter of 2010, DeeThree is required to spend $3,462,000 of eligible exploration expenditures by December 31, 2011. As at March 31, 2010, approximately $nil of eligible exploration expenditures had been incurred. These expenditures will be renounced to shareholders in 2011 effective December 31, 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). As security for the first year's commitment, DeeThree provided the vendor with a letter of credit totaling $6,000,000. The letter of credit was releasable to the Company as to $2,000,000 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. On May 21, 2009, $2,000,000 was released from the letter of credit. As at March 31, 2010, the Company had fulfilled its first year commitment and the remaining $4,000,000 was released.

Related Party Transactions

As at March 31, 2010, the Company had the following related party transactions:

The Company has retained a law firm to provide legal services. The Corporate Secretary of DeeThree is a partner of this firm. During the three months ended March 31, 2010, the Company incurred $136,000 in costs with the firm (2009 – $9,300), which have been included in G&A and share issue costs, and $23,700 (2009 – $7,700) remained in accounts payable at March 31, 2010. Services provided related to advice and counsel primarily in the areas of general legal, corporate governance and banking matters. The Company expects to continue using the services of this firm throughout the balance of 2010.

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.

Critical Estimates

Management is required to make judgements and use estimates in the application of generally accepted accounting principles that have significant impact on the financial results of the Company. The following discussion outlines the accounting policies and practices that are critical to determining DeeThree's financial results.

Full Cost Accounting

DeeThree follows the Canadian Institute of Chartered Accountants' ("CICA") guideline on full cost accounting in the oil and gas industry to account for oil and gas properties. Under this method, all costs associated with the acquisition of, exploration for and development of natural gas and crude oil reserves are capitalized and costs associated with production are expensed. The capitalized costs are depreciated, depleted and amortized using the unit-of-production method based on estimated proved reserves. Reserves estimates can have a significant impact on earnings as they are a key component in the calculation of DD&A. A downward revision in a reserves estimate could result in a higher DD&A charge to earnings. In addition, if capitalized costs are determined to be in excess of the calculated ceiling, which is based largely on reserves estimates, the excess must be written off as an expense charged against earnings. In the event of a property disposition, proceeds are normally deducted from the full cost pool without recognition of a gain or loss unless there is a change in the DD&A rate of 20% or greater.

Asset Retirement Obligations

The Company records a liability for the fair value of its legal obligations associated with the retirement of long-lived assets in the period in which it is incurred, normally when the asset is purchased or developed. On recognition of the liability, there is a corresponding increase in the carrying value of the related asset and the asset retirement obligation. The total amount of the asset retirement obligation is an estimate based on the Company's net ownership in all wells and facilities, the estimated cost to abandon and reclaim the wells and facilities, the estimated timing of those cash flows, changes in environmental regulations and the discount rate used to calculate the present value of those cash flows. These estimates are subject to measurement uncertainty and any change in these estimates would impact the asset retirement liability.

Reserves Determination

The proved natural gas, crude oil and NGLs reserves that are used in determining DeeThree's depletion rates, the magnitude of the borrowing base available to the Company from its lender and the ceiling test are based on management's best estimates, and are subject to uncertainty. Through the use of geological, geophysical and engineering data, the reservoirs and deposits of natural gas, crude oil and NGLs are examined to determine quantities available for future production, given existing operations and economic conditions and technology. The evaluation of recoverable reserves is an ongoing process impacted by current production, continuing development activities and changing economic conditions as reflected in natural gas and crude oil prices. Consequently, the reserves are estimated, which are subject to variability. To assist with the reserves evaluation process, the Company employs the services of independent oil and gas reservoir engineers.

Income Taxes

The determination of DeeThree's income and other tax liability requires interpretation of complex laws and regulations often involving multiple jurisdictions. All tax filings are subject to audit and potential reassessment after lapse of considerable time. Accordingly, the actual income tax liability may differ significantly from the liability estimated or recorded.

Other Estimates

The accrual method of accounting will require management to incorporate certain estimates, including revenues, royalties, production costs and capital expenditures as at a specific reporting date but for which actual revenue and royalties have not yet been received, and estimates on capital projects that are in progress or recently completed where actual costs have not been received at a specific reporting date.

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, 2009. 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 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 has developed a high-level IFRS transition plan and established a preliminary timeline for its execution and completion. Management has performed a preliminary review of the accounting policies of the Company under Canadian GAAP and compared them to IFRS. During the first three months of 2010, the Company was in the process of completing 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.

Financial Instruments Disclosures

In May 2009, the CICA amended Section 3862, "Financial Instruments – Disclosures", to include additional disclosure requirements about fair value measurement for financial instruments and liquidity risk disclosures. These amendments require a three-level hierarchy that reflects the significance of the inputs used in making the fair value measurements. Fair values 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. Level 3 valuations are based on inputs that are unobservable and significant to the overall fair value measurement. These amendments are effective for DeeThree on December 31, 2009.

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 continued in 2009 and the first quarter of 2010, 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 infrastructure 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.

Outlook

DeeThree expects to continue to generate solid operating and financial results through successful drilling complemented by a strong financial position. The Company's capital budget of $20 million remains largely unchanged at present with the anticipated drilling of a total of 20 wells in 2010; however, it is well positioned to increase or decrease capital spending in response to natural gas prices if necessary. DeeThree has hedged approximately 30% of its natural gas production at an average price of approximately $4.68/mcf for the summer months and will continue to monitor opportunities to hedge additional volumes should they arise.

CONSOLIDATED BALANCE SHEETS

As at	**March 31, 2010**	December 31, 2009
(000s) (unaudited)	*($)*	*($)*
Assets		
Current		
Cash	**11,071**	–
Restricted cash *(note 5)*	**–**	4,000
Accounts receivable	**1,230**	1,059
Prepaid expenses and other	**169**	254
	12,470	5,313
Property and equipment *(note 4)*	**32,123**	26,016
	44,593	31,329
Liabilities		
Current		
Bank debt *(note 5)*	**–**	2,436
Accounts payable and accrued liabilities	**5,869**	2,502
	5,869	4,938
Asset retirement obligations *(note 6)*	**1,686**	1,636
	7,555	6,574
Future tax liability	**1,606**	81
Shareholders' equity		
Share capital *(note 7)*	**38,231**	27,263
Share purchase warrants *(note 7)*	**283**	283
Contributed surplus *(note 7)*	**532**	477
Deficit	**(3,614)**	(3,349)
	35,432	24,674
	44,593	31,329

Commitments *(note 11)*

Subsequent events *(note 12)*

See accompanying notes to the consolidated financial statements.

CONSOLIDATED STATEMENTS OF OPERATIONS, OTHER COMPREHENSIVE LOSS AND DEFICIT

Three Months Ended March 31,	**2010**	2009
(000s, except per share amounts) (unaudited)	*($)*	*($)*
Revenue		
Oil and gas revenues	**2,293**	1,595
Royalty expense	**(400)**	(116)
	1,893	1,479
Expenses		
Operating	**561**	465
Transportation	**95**	73
General and administrative	**360**	261
Interest	**23**	80
Stock-based compensation *(note 7)*	**43**	7
Depletion, depreciation and accretion	**1,151**	1,242
	2,233	2,128
Loss before income taxes	**(340)**	(649)
Income taxes		
Future tax recovery	**75**	159
Net loss and comprehensive loss for the period	**(265)**	(490)
Deficit – beginning of period	**(3,349)**	(512)
Deficit – end of period	**(3,614)**	(1,002)
Net loss per share *(note 7)*		
Basic and diluted	**(0.02)**	(0.05)

See accompanying notes to the consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

Three Months Ended March 31	**2010**	2009
(000s) (unaudited)	*($)*	*($)*
Cash provided by (used in):		
Operating activities		
Net loss for the period	**(265)**	(490)
Add back non-cash items:		
Depletion, depreciation and accretion	**1,151**	1,242
Stock-based compensation	**43**	7
Future income tax recovery	**(75)**	(159)
	854	600
Change in non-cash working capital *(note 8)*	**(189)**	189
	665	789
Financing activities		
Increase (decrease) in bank debt	**(2,436)**	18
Issuance of share capital	**13,600**	–
Share issue expenses	**(1,063)**	–
Change in non-cash working capital *(note 8)*	**51**	–
	10,152	18
Investing activities		
Property and equipment additions	**(7,165)**	(671)
Decrease in restricted cash	**4,000**	–
Change in non-cash working capital *(note 8)*	**3,419**	(136)
	254	(807)
Net increase in cash	**11,071**	–
Cash – beginning of period	**–**	–
Cash – end of period	**11,071**	–

See accompanying notes to the consolidated financial statements.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2010

(unaudited)

1. NATURE OF OPERATIONS

DeeThree Exploration Ltd. ("DeeThree") was incorporated under the Business Corporations Act (Alberta) 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. On January 1, 2010, the name of DeeThree Inc. was changed to "DeeThree Exploration Ltd." in conjunction with the amalgamation of DeeThree and DeeThree Inc.

2. BASIS OF PRESENTATION AND SUMMARY OF ACCOUNTING POLICIES

The interim consolidated financial statements of the Company have been prepared following the same accounting policies and methods of computation as the consolidated financial statements for the year ended December 31, 2009. The disclosures provided below are incremental to those included with the annual consolidated financial statements and certain disclosures, which are normally required to be included in the notes to the annual consolidated financial statements, have been condensed or omitted. These interim consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto in the Company's annual filings for the year ended December 31, 2009.

(a) Pending Accounting Pronouncements

(i) 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.

(ii) The Canadian Institute of Chartered Accountants ("CICA") issued Section 1582, "Business Combinations", which replaces former guidance on business combinations. Section 1582 establishes principles and requirements for the acquisition method for business combinations and related disclosures. This statement applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after January 2011 with earlier application permitted. The Company has chosen not to early adopt the new section.

(iii) The CICA issued Section 1601,"Consolidated Financial Statements" and Section 1602, "Non-Controlling Interests", which replace existing guidance. Section 1601 establishes standards for the preparation of consolidated financial statements. Section 1602 provides guidance on accounting for a non-controlling interest in a subsidiary in consolidated financial statements subsequent to a business combination. These standards are effective on or after the beginning of the first annual reporting period beginning on or after January 2011 with earlier application permitted. The Company has chosen not to early adopt the new section.

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 March 31, 2010 and the results of operations and cash flows for the three months ended March 31, 2010.

3. ACQUISITION

Effective June 25, 2009, DeeThree Inc. (formerly Royal Capital Corp.) 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 7).

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

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

4. PROPERTY AND EQUIPMENT

	Cost	Accumulated Depletion and Amortization	Net Book Value
(000s)	*($)*	*($)*	*($)*
March 31, 2010			
Petroleum and natural gas properties	**38,152**	**6,051**	**32,101**
Office equipment	**37**	**15**	**22**
	38,189	**6,066**	**32,123**
December 31, 2009			
Petroleum and natural gas properties	30,928	4,936	25,992
Office equipment	37	13	24
	30,965	4,949	26,016

The Company capitalized $115,000 (2009 – $41,000) of direct general and administrative costs and $33,000 (2009 – $7,000) of stock-based compensation expense.

As at March 31, 2010, unevaluated and undeveloped properties with a cost of $6,600,000 (2009 – $116,000), 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 March 31, 2010. Future capital costs required to develop proved reserves in the amount of $530,000 (2009 – $1,335,000) were included in amounts subject to depletion and estimated salvage values of $2,300,000 (2009 – $nil) have been excluded from the depletion calculation.

5. BANK DEBT

At March 31, 2010, the Company had a revolving demand credit facility with an authorized borrowing base of $12,000,000, with interest charged at the bank's prime rate plus 1.25% per annum. Standby fees associated with this facility are 0.25% per annum on the undrawn portion of the facility. At March 31, 2010, $nil was drawn against the revolving demand credit facility. On April 30, 2010, the Company's lender completed its review and no change was made to the borrowing base (note 12). The next review of the credit facility is scheduled to take place on or before October 31, 2010. The amount of the facility is subject to a borrowing base test performed on a periodic basis by the lenders, based primarily on reserves and using commodity prices estimated by the lenders as well as other factors. A decrease in the borrowing base could result in a reduction to the credit facility. 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 had 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 and DeeThree's commitment to drill ten wells and shoot one township of seismic during the first year following the completion of the transaction. As at December 31, 2009, the Company had fulfilled the first year commitment, and in January 2010, the vendor released the letter of credit.

6. 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 $3,000,000. 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.

	Three Months Ended March 31, 2010	Year Ended December 31, 2009
(000s)	*($)*	*($)*
Balance – beginning of period	**1,636**	1,317
Liabilities incurred	**16**	67
Revisions	**–**	144
Accretion of asset retirement obligation	**34**	108
Balance – end of period	**1,686**	1,636

7. 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

	Three Months Ended March 31, 2010		Year Ended December 31, 2009	
	Shares	Amount	Shares	Amount
	(#)	*($000s)*	*(#)*	*($000s)*
Balance – beginning of period	**15,518,093**	**27,263**	6,000,000	816
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
Common shares issued *(ii)*	**4,197,500**	**10,074**	–	–
Flow-through shares issued *(ii)*	**1,236,250**	**3,462**	2,000,000	5,000
Tax effect of flow-through shares *(iii)*	**–**	**(1,873)**	–	–
Exercise of warrants	**–**	**–**	52,500	112
Exercise of options *(iv)*	**29,500**	**85**	650	2
Share issue costs	**–**	**(1,063)**	–	(323)
Tax benefit of share issue costs	**–**	**283**	–	86
Balance – end of period	**20,981,343**	**38,231**	15,518,093	27,263

(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 3).

(ii) Private Placements

In March 2010, DeeThree issued 4,197,500 common shares at a price of $2.40 per common share and 1,236,250 flow-through common shares at a price of $2.80 per flow-through common share for total gross proceeds of $13,536,000 ($12,473,000 net of share issue expenses), including 547,500 common shares and 161,250 flow-through shares issued on the exercise in full of the underwriter's over-allotment option.

(iii) Flow-Through Shares

In January 2010, DeeThree renounced the $6,727,000 in qualified exploration expenditures for the 2,719,693 flow-through common shares issued in April, May and October of 2009, and the related tax effect of the transaction was booked at that time.

(iv) On February 2, 2010, 12,500 options were exercised at $2.40 per share, and on March 5, 2010, 17,000 options were exercised at $2.00 per share.

7. SHARE CAPITAL (CONTINUED)

(c) Issued – Share Purchase Warrants

	Three Months Ended March 31, 2010	Year Ended December 31, 2009
(000s)	*($)*	*($)*
Balance – beginning of period	**283**	–
Stock-based compensation expense – warrants	**–**	560
Reduction due to exercise of warrants	**–**	(277)
Balance – end of period	**283**	283

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 March 31, 2010:

	Warrants	Weighted Average Exercise Price
	(#)	*($)*
Outstanding at December 31, 2009	252,500	1.00
Issued	**–**	–
Exercised	**–**	–
Balance – March 31, 2010	**252,500**	**1.00**

Exercise Price	Outstanding and Exercisable	Weighted Average Remaining Contractual Life	Weighted Average Exercise Outstanding and Exercisable Price
($)	*(#)*	*(years)*	*($)*
As at March 31, 2010			
1.00	**252,500**	**0.5**	**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	March 31, 2010	December 31, 2009
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

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. All related compensation expense was recorded in 2009.

7. SHARE CAPITAL (CONTINUED)

(d) Contributed Surplus

	Three Months Ended March 31, 2010	Year Ended December 31, 2009
(000s)	*($)*	*($)*
Balance – beginning of period	**477**	40
Stock-based compensation expense – options	**76**	377
Reduction due to exercise of options	**(21)**	–
Share issue costs – agent/broker options	**–**	60
Balance – end of period	**532**	477

(e) Per Share Amounts

Per share amounts have been calculated on the weighted average number of shares outstanding. The basic and diluted shares outstanding for the three months ended March 31, 2010 were 17,100,671 basic and diluted (2009 – 10,074,000 basic and diluted).

(f) Options Outstanding

The following summarizes information about stock options outstanding as at March 31, 2010:

	Options	Weighted Average Exercise Price
	(#)	*($)*
Outstanding at December 31, 2009	1,047,057	1.88
Issued	**45,000**	**2.45**
Exercised	**(29,500)**	**2.17**
Balance – March 31, 2010	**1,062,557**	**1.90**

Exercise Price	Outstanding	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Exercisable	Weighted Average Price Outstanding and Exercisable
($)	*(#)*	*(years)*	*($)*	*(#)*	*($)*
As at March 31, 2010					
1.20	**200,000**	**3.2**	**1.20**	**50,000**	**1.20**
2.00	**687,374**	**3.5**	**2.00**	**198,974**	**2.00**
2.13	**85,000**	**4.7**	**2.13**	**–**	**2.13**
2.40	**45,183**	**1.7**	**2.40**	**45,183**	**2.40**
2.45	**45,000**	**4.9**	**2.45**	**–**	**2.45**
	1,062,557	**3.5**	**1.90**	**294,157**	**1.93**

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 weighted average assumptions:

As at	**March 31, 2010**	December 31, 2009
Risk-free interest rate *(%)*	**1.28**	1.28
Expected life *(years)*	**5.0**	4.7
Expected volatility *(%)*	**70**	70
Expected dividend yield *(%)*	**–**	–
Fair value of options granted during the period *($/share)*	**1.15**	1.02

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 $76,000 (2009 – $15,000) for non-cash stock-based compensation expense, of which $33,000 (2009 – $7,000) was capitalized to the full cost pool with a corresponding increase to contributed surplus of $76,000 (2009 – $15,000).

7. SHARE CAPITAL (CONTINUED)

(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, 2009.

8. CHANGES IN NON-CASH WORKING CAPITAL

Three Months Ended March 31,	**2010**	2009
(000s)	*($)*	*($)*
Accounts receivable	**(171)**	354
Prepaid expenses and other	**85**	17
Accounts payable and accrued liabilities	**3,367**	(318)
	3,281	53

The following is a summary of the interest and taxes paid:

Three Months Ended March 31,	**2010**	2009
(000s)	*($)*	*($)*
Interest paid	**10**	90
Income and other taxes paid	**59**	–

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

Three Months Ended March 31,	**2010**	2009
(000s)	*($)*	*($)*
Operating	**(189)**	189
Financing	**51**	–
Investing	**3,419**	(136)
	3,281	53

9. 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) 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, but also global economic events that dictate the levels of supply and demand.

9. FINANCIAL INSTRUMENTS (CONTINUED)

(a) Market Risk (continued)

(i) Commodity Price Risk (continued)

As at March 31, 2010, the Company had the following fixed price physical contracts:

Daily Quantity	Term of Contract	Fixed Price (AECO)
700 GJ/d	Apr. 1, 2010 – Oct. 31, 2010	$4.67/GJ
700 GJ/d	Apr. 1, 2010 – Oct. 31, 2010	$4.48/GJ
700 GJ/d	Apr. 1, 2010 – Dec. 31, 2010	$4.485/GJ

10. RELATED PARTIES

The following summarizes the Company's related party transactions as at March 31, 2010:

The Company has retained a law firm to provide legal services. The Corporate Secretary of DeeThree is a partner of this firm. During the three months ended March 31, 2010, the Company incurred $136,000 in costs with the firm (2009 – $9,300), which have been included in G&A expenses and share issue costs, and $23,700 (2009 – $7,700) remained in accounts payable at March 31, 2010. Services provided related to advice and counsel primarily in the areas of general legal, corporate governance and banking matters. The Company expects to continue using the services of this firm throughout the balance of 2010.

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.

11. COMMITMENTS

In connection with the issuance of flow-through shares by the Company during the second quarter of 2009, the Company is required to spend $1,727,000 of eligible exploration expenditures by December 31, 2010. As at March 31, 2010, all eligible exploration expenditures had been incurred. These expenditures were renounced to shareholders in January 2010 effective December 31, 2009.

In connection with the issuance of flow-through shares by the Company during the fourth quarter of 2009, the Company is required to spend $5,000,000 of eligible exploration expenditures by December 31, 2010. As at March 31, 2010, $4,500,000 of eligible exploration expenditures had been incurred. These expenditures were renounced to shareholders in January 2010 effective December 31, 2009.

In connection with the issuance of flow-through shares by the Company during the first quarter of 2010, the Company is required to spend $3,462,000 of eligible exploration expenditures by December 31, 2011. As at March 31, 2010, $nil of eligible exploration expenditures had been incurred. These expenditures will be renounced to shareholders in 2011 effective December 31, 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). As security for the commitment, DeeThree provided the vendor with a letter of credit totaling $6,000,000. The letter of credit was 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. As at March 31, 2010, the Company had fulfilled the first year commitment and the vendor released the letter of credit.

12. SUBSEQUENT EVENTS

On April 13, 2010, the Company executed a two-year extension to its amended lease agreement, which is part of a lease issuance, seismic and drilling commitment agreement with an arm's length senior Canadian oil and gas producer. This extension involves a commitment to drill an additional 20 wells over the two-year period (ten wells per year) into the Mississippian horizon and expires on November 13, 2013.

On April 30, 2010, the Company's lender completed its review of DeeThree and no change was made to the current $12,000,000 credit facility available to the Company.

Subject to regulatory approval, DeeThree has granted a total of 335,000 stock options to the directors, officers and employees of the Company. The options have an exercise price of $2.40 per share and a maximum term of five years.

CORPORATE INFORMATION

Board of Directors

Michael Kabanuk
Executive Chairman
DeeThree Exploration Ltd.

Brendan Carrigy
Vice President, Exploration
DeeThree Exploration Ltd.

Martin Cheyne
President & Chief Executive Officer
DeeThree Exploration Ltd.

Henry Hamm (1)(2)(3)
Independent Businessman

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

Brad Porter (1)(2)(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

Trevor Murray
Vice President, Land

Daniel Kenney
Corporate Secretary

Head Office

Suite 700
520 Fifth Avenue S.W.
Calgary, Alberta T2P 3R7
Telephone: (403) 760-3060
Facsimile: (403) 263-9710
Website: www.deethree.ca

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
GJ	gigajoules
/d	per day
mcf	thousand cubic feet
mm	million
NGLs	natural gas liquids
3-D	three dimensional

Conversion of Units

1.0 acre	=	0.40 hectares
2.5 acres	=	1.0 hectare
1.0 bbl	=	0.159 cubic metres
6.29 bbls	=	1.0 cubic metre
1.0 foot	=	0.3048 metres
3.281 feet	=	1.0 metre
1.0 mcf	=	28.2 cubic metres
0.035 mcf	=	1.0 cubic metre
1.0 mile	=	1.61 kilometres
0.62 miles	=	1.0 kilometre

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

DeeThree
Exploration Ltd.