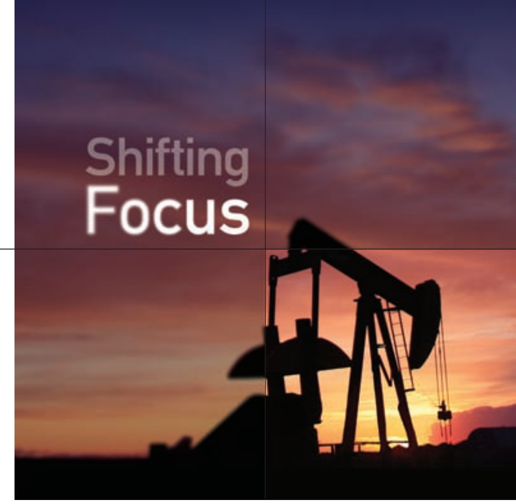
DeeThree Exploration Ltd.

Q1

2011 First Quarter Interim Report
For the Three Months Ended
March 31, 2011



Highlights

Three Months Ended March 31,	**2011**	2010[4]	Change
(000s, except per share amounts)	*($)*	*($)*	*(%)*
Financial			
Oil and natural gas revenues	**1,969**	2,293	(14)
Funds from (used in) operations [1]	**(833)**	847	(198)
Per share – basic and diluted	**(0.02)**	0.05	(140)
Cash flow from (used in) operating activities	**(4,863)**	658	(839)
Net loss	**(1,991)**	(589)	238
Per share – basic and diluted	**(0.05)**	(0.03)	67
Capital expenditures [2]	**129,529**	7,158	1,710
Total assets	**192,682**	44,730	331
Working capital	**20,659**	6,601	213
Shareholders' equity	**175,423**	34,653	406
(000s)	*(#)*	*(#)*	*(%)*
Share Data			
At period-end	**62,752**	20,981	199
Weighted average – basic and diluted	**36,294**	17,101	112
			(%)
Operating [3]			
Production			
Natural gas *(mcf/d)*	**3,744**	5,211	(28)
Crude oil and NGLs *(bbls/d)*	**89**	16	456
Total *(boe/d)*	**713**	885	(19)
Average wellhead prices			
Natural gas *($/mcf)*	**3.77**	4.66	(19)
Crude oil and NGLs *($/bbl)*	**86.98**	74.80	16
Total *($/boe)*	**30.68**	28.79	7
Netbacks *($/boe)*			
Operating *($/boe)*	**14.92**	15.54	(4)
Funds from (used in) operations *($/boe)*	**(12.99)**	10.64	(222)
Gross (net) wells drilled			
Gas *(#)*	**– (–)**	2 (2.0)	–
Oil *(#)*	**2 (2.0)**	– (–)	–
Standing *(#)*	**– (–)**	– (–)	–
Dry and abandoned *(#)*	**– (–)**	– (–)	–
Total *(#)*	**2 (2.0)**	2 (2.0)	–
Average working interest *(%)*	**100**	100	–

(1) Funds from operations and funds from operations per share are not recognized measures under International Financial Reporting Standards ("IFRS"). Refer to the commentary in the Management's Discussion and Analysis under the heading "Non-IFRS Measurements" for further discussion.
(2) Total capital expenditures, including acquisitions.
(3) For a description of the boe conversion ratio, refer to the commentary in the Management's Discussion and Analysis under the heading "Other Measurements".
(4) Amounts presented for the three months ended March 31, 2010 have been restated for the effect of the adoption of IFRS.

Letter to Shareholders

The first three months of 2011 were transformational for DeeThree Exploration Ltd. In late March, we completed the $125 million strategic asset acquisition of approximately 1,830 boe/d of production, positioning our Company for significant future growth in reserves, production and cash flow per share. The acquired assets are located in the Brazeau/West Pembina and Peace River Arch areas of west central and northwestern Alberta, respectively. The addition of these assets has greatly diversified our production mix, taking us from a heavily weighted natural gas company at 98% natural gas and 2% crude oil and NGLs to approximately 30% crude oil and NGLs, prior to any new oil volumes coming on-stream. These assets will materially enhance our cash flow and operating netbacks as well as provide tremendous drilling upside, particularly in the Brazeau area where over 100 potential drilling locations have been identified. This acquisition was funded through a combination of a bought deal equity financing, issuing 26,795,000 common shares at $4.30 per share for net proceeds of $108 million, and existing working capital. In addition, we raised $15.4 million through the issuance of 3,000,000 flow-through shares at a price of $5.15 per share. These funds will be used to conduct exploration activity on our newly acquired properties as well as our existing properties.

In addition, our credit facility was increased to $20 million from $10 million following the completion of the strategic asset acquisition, providing us additional financial flexibility to carry out our 2011 capital program.

Bakken Update

To date, we have successfully drilled and cored 3 gross (3.0 net) horizontal wells on our Bakken acreage in the Lethbridge area of southern Alberta. The first well was fracture stimulated in early May using a 15-stage program, and at the conclusion of a seven-day clean up, the well was flowing at approximately 250 bbls/d crude oil with 250 mcf/d natural gas. This well has been temporarily shut-in awaiting tie-in, which is expected to be completed by July 1, 2011.

An 18-stage frac was completed on the second well. This well is located on the eastern portion of the Bakken fairway approximately 20 miles east of DeeThree's first well in a different geological setting. The first of two tests to be completed on this well resulted in the recovery of a combination of reservoir oil, load oil and water. A second production test will commence within the coming days, following the installation of a pump jack.

The horizontal total depth has been recently reached on the third Bakken well, which we plan to fracture stimulate during the third quarter of 2011.

Subsequent to quarter-end, we entered into a farm-out and joint venture agreement with a major oil and gas company with respect to a small portion of our unexplored Bakken acreage. The farmee has committed to drill four horizontal earning wells on the farm-out lands by December 31, 2011 and is responsible for 100% of the costs through completion to earn a 60% working interest with no payout terms. These exploration activities will provide our Company with additional technical information regarding the Bakken play on our Lethbridge property and should also increase the availability of services in the area for potentially faster service times and lower costs.

Outlook

I believe that DeeThree is in an enviable position with two key oil resource play areas – the southern Alberta Bakken and Brazeau Belly River – which have material potential for increased production and reserves. We have the flexibility to shift capital between areas depending on the success of our drilling results. With very little history or technical data in the new emerging Bakken play, it is difficult to project future production targets and decline rates. As we gain more knowledge, we will be better able to determine production profiles and will provide guidance at that time.

DeeThree continues to maintain a healthy balance sheet, exiting the first quarter with $20.6 million in positive working capital. Our 2011 capital program remains on track and funded at approximately $42 million with plans to drill another 11 horizontal locations throughout the balance of the year.

With the combination of our current working capital, increased cash flow and access to credit, we are well positioned to continue to explore the new and emerging resource Bakken play on our Lethbridge property as well as to develop our Belly River play in the Brazeau area, which we believe holds material low-risk upside.

I am excited about the future prospects for DeeThree and look forward to reporting our progress in our next report.

On behalf of the Board of Directors,

Martin Cheyne
President & Chief Executive Officer

June 8, 2011

4 Management's Discussion and Analysis

The following Management's Discussion and Analysis ("MD&A") of financial condition and results of operations for DeeThree Exploration Ltd. ("DeeThree" or the "Company") is dated June 8, 2011 and should be read in conjunction with the Company's unaudited interim financial statements and related notes for the period ended March 31, 2011 as well as the audited financial statements and MD&A for the year ended December 31, 2010.

Non-IFRS Measurements

This MD&A contains the terms "funds from operations" and "funds from operations per share", which should not be considered an alternative to or more meaningful than cash flow from operating activities as determined in accordance with International Financial Reporting Standards ("IFRS") or Canadian generally accepted accounting principles ("previous GAAP"). These terms do not have any standardized meaning as prescribed by IFRS or previous GAAP. DeeThree's determination of funds from operations and funds from operations per share 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 whereby 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 IFRS:

Three Months Ended March 31,	**2011**	2010
(000s)	*($)*	*($)*
Cash flow from (used in) operating activities	**(4,863)**	658
Changes in non-cash working capital	**4,030**	189
Funds flow from (used in) operations	**(833)**	847

During the first three months of 2011, the Company's funds used in operations totaled $833,000 ($(0.02) per basic and diluted share) versus funds from operations of $847,000 ($0.05 per basic and diluted share) in 2010.

The Company considers corporate netbacks as a key measure as it demonstrates its profitability relative to current commodity prices. Corporate netbacks are comprised of operating, funds flow and net loss netbacks. Operating netback is calculated as the average sales price of its commodities and then subtracts royalties, transportation costs and operating expenses. Funds flow netback starts with the operating netback and further deducts general and administrative costs, interest expense and adds interest income. To calculate the net loss netback, DeeThree takes the funds flow netback and deducts share-based compensation expense as well as depletion and depreciation charges, accretion expense, any impairment expense and deferred income taxes. There is no IFRS measure that is reasonably comparable to netbacks. See the section entitled "Netbacks (per unit)" for the operating netback calculations.

Net debt and working capital deficiency, which terms represent current assets less current liabilities and bank debt, is used to assess efficiency, liquidity and the general financial strength of the Company. There is no IFRS measure that is reasonably comparable to net debt or working capital.

Other Measurements

All dollar amounts are referenced in Canadian dollars. Where amounts are expressed on a barrel of oil equivalent ("boe") basis, natural gas volumes have been converted to oil equivalence at 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.

Forward-Looking Statements

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 junior oil and gas company that commenced operations in 2007 as a private company, and on June 25, 2009, completed a reverse takeover transaction with Royal Capital Corp., a public capital pool company, and began trading on the TSX Venture Exchange under the symbol DTX in June 2009. On October 20, 2010, DeeThree's listing for its common shares was transferred to the Toronto Stock Exchange.

In late 2008, DeeThree completed its first significant acquisition from a major oil and gas producer of properties in the Lethbridge area of southern Alberta (the "Lethbridge property"). The Lethbridge property has been the primary focus of the Company until late in the first quarter of 2011 when DeeThree closed a transformational acquisition of properties in the Brazeau/West Pembina and the Peace River Arch areas of Alberta. See "Acquisition" section for further information.

The unaudited financial statements and comparative information for the three months ended March 31, 2011 have been prepared in accordance with IFRS, specifically IFRS 1 - "First-Time Adoption of International Financial Reporting Standards", and International Accounting Standard ("IAS") 34 - "Interim Financial Reporting". Previously, the Company prepared its financial statements in accordance with previous GAAP. In accordance with IFRS 1, DeeThree's transition date to IFRS was January 1, 2010, and therefore, the comparative information for 2010 has been prepared in accordance with the Company's IFRS accounting policies. The 2009 financial information contained within this MD&A has been prepared following previous GAAP, and as allowed by IFRS 1, has not been restated for the effects of adopting IFRS. Certain amounts in prior years have been reclassified to conform to the current year's IFRS presentation format.

Acquisition

On March 22, 2011 (and effective January 1, 2011), the Company acquired certain oil and gas assets principally located in the Brazeau/West Pembina area of central Alberta and the Peace River Arch area of northern Alberta (together the "property acquisition") for total cash consideration of $122,547,000 after certain adjustments. This acquisition involved the purchase of approximately 1,830 boe/d (40% light crude oil and NGLs) of primarily high working interest, operated crude oil, natural gas and NGLs production and reserves. The property acquisition was accounted for as a business combination under IFRS 3 - "Business Combinations". Acquisition costs of $1,119,000 were charged to general and administrative ("G&A") expense on the statement of income and comprehensive income.

Financial and Operating Results

Sales Volumes

Three Months Ended March 31,	2011	2010
Sales		
Natural gas *(mcf/d)*	**3,744**	5,211
Crude oil *(bbls/d)*	**71**	15
NGLs *(bbls/d)*	**18**	1
Total sales *(boe/d)*	**713**	885
	(%)	*(%)*
Production Split		
Natural gas	**88**	98
Crude oil	**10**	2
NGLs	**2**	–
Total	**100**	100

For the first quarter of 2011, the Company's production averaged 713 boe/d compared to 885 boe/d in the same period of 2010 and 635 boe/d recorded in the fourth quarter of 2010. This represents a 19% year-over-year decrease and a 12% quarter-over-quarter increase. During the three-month period of 2010, the Company brought on-stream two new wells that resulted in increased production due to strong initial production rates. The quarter-over-quarter increase was the result of the property acquisition of approximately 1,830 boe/d that closed on March 22, 2011 offset by natural declines of the Company's existing production. During the three months ended March 31, 2011, DeeThree recorded nine days of production, revenue, royalties and operating costs related to the acquired production. Consequently, approximately 87 boe/d of natural gas, 53 boe/d of crude oil and 11 boe/d of NGLs volumes were added to DeeThree's average production in the quarter, thereby increasing the Company's crude oil and NGLs production to 12% of total corporate production.

Revenue

Three Months Ended March 31,	2011	2010
(000s)	*($)*	*($)*
Revenue		
Natural gas	**1,272**	2,183
Crude oil	**600**	103
NGLs	**97**	7
Total revenue	**1,969**	2,293

During the first three months of 2011, revenue decreased 14% to $1,969,000 from $2,293,000 recorded in the comparative period of 2010 and increased 33% from $1,483,000 in the final quarter of 2010. The year-over-year decrease was primarily due to a 19% drop in average production offset by a 7% improvement in the Company's overall price per boe. The quarter-over-quarter increase was due to an increase in production volumes compounded by an increase in the corporate average price per boe.

Commodity Prices and Foreign Exchange

Three Months Ended March 31,	2011	2010
	($)	*($)*
Benchmark Prices		
Natural Gas		
NYMEX *(mmbtu)* (1)	**4.14**	5.38
AECO *(CDN$/GJ)* (2)	**3.61**	4.72
Crude Oil		
WTI *(US$/bbl)*	**94.10**	78.90
Edmonton light *(CDN$/boe)*	**88.39**	80.44
Average Realized Prices		
Natural gas *($/mcf)*	**3.77**	4.66
Crude oil *($/bbl)*	**94.33**	75.88
NGLs *($/bbl)*	**58.71**	62.06
Total sales price *($/boe)*	**30.68**	28.79
Foreign Exchange		
CDN$/US$	**0.9860**	1.0409
US$/CDN$	**1.0143**	0.9609

(1) Mmbtu is the abbreviation for millions of British thermal units. One mcf of natural gas is approximately 1.02 mmbtu.

(2) GJ is the abbreviation for gigajoule. One mcf of natural gas is approximately equal to 1.05 GJ.

The Company's financial results are significantly influenced by fluctuations in commodity prices, including price differentials and foreign exchange rates. The Company protects itself from fluctuations in prices by maintaining an appropriate hedging strategy. As at the date of this MD&A, DeeThree had two crude oil hedges in place (see "Subsequent Events" section). Most commodity prices are based on U.S. dollar benchmarks, which result in the Company's realized prices being influenced by the Canadian/U.S. exchange rates. The Company does not sell or transact in foreign currency, but may be impacted by foreign currency exchange rate changes related to commodity prices as outlined above. DeeThree does not currently have in place foreign exchange risk management contracts; however, it will consider entering into currency rate forward swap transactions in the future.

During the three-month period ended March 31, 2011, benchmark natural gas prices in Canada fell 24% from the same period last year. In Canada, the benchmark index is the price set at the AECO hub, a major storage site near the TransCanada Energy pipeline exit point from Alberta at Empress. The benchmark index for United States natural gas prices is the market price as established by the New York Mercantile Exchange at Henry Hub ("NYMEX"), a major point of natural gas pipeline intersection in Louisiana. NYMEX is linked to AECO through transportation tariffs from the respective hubs to common markets and through foreign exchange rates. AECO prices averaged $3.61/GJ throughout the first quarter of 2011 compared to $4.72/GJ a year ago. DeeThree's average realized gas price was $3.77/mcf versus $4.66/mcf last year, which is in line with market prices.

Oil prices continued to recover in the first quarter of 2011 with West Texas Intermediate ("WTI") averaging $94.10/bbl compared to $78.90/bbl in the same period last year. The benchmark for crude oil prices in North America, and substantially globally, is WTI delivered to Cushing, Oklahoma, again as determined by the NYMEX. Canadian crude prices are based on refiner postings in Canadian dollars at Edmonton, Alberta, and as with natural gas, are linked to WTI through transportation tariffs to common markets and the foreign exchange rate. The average realized price of DeeThree's crude oil was $94.33/bbl for the first quarter of 2011 compared to $75.88/bbl a year ago. Information regarding the Company's risk management program can be found in the "Business Risks and Risk Mitigation" section of this MD&A.

Royalties

Three Months Ended March 31,	**2011**	2010
(000s)	*($)*	*($)*
Oil and natural gas revenues	**1,969**	2,293
Royalties		
Crown	**95**	176
Freehold	**153**	200
GORR	**20**	24
Total royalties	**268**	400
Total royalties *($/boe)*	**4.18**	5.02
Percent of revenue *(%)*	**14**	17

Prior to the property acquisition that closed late in the first quarter of 2011, royalty expense consisted primarily of freehold royalties relating to the Lethbridge property. The freehold royalty with respect to the Lethbridge property 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). The acquired properties attract primarily Crown royalties payable to the provincial government.

For the first quarter of 2011, royalties totaled $268,000 or 14% of revenue compared to $400,000 or 17% of revenue for the same quarter in 2010 and $153,000 or 11% of revenue (excluding hedging gains) in the fourth quarter of 2010. The year-over-year royalty rate decreased primarily as a result of lower natural gas prices further compounded by lower natural gas production rates. The quarter-over-quarter royalty rate increase was primarily due to higher production levels compounded by increased commodity prices.

Operating and Transportation Expenses

Three Months Ended March 31,	**2011**	2010
(000s)	*($)*	*($)*
Operating expenses	**659**	561
Transportation expenses	**84**	95
Total operating and transportation expenses	**743**	656
Operating expenses *($/boe)*	**10.27**	7.04
Transportation expenses *($/boe)*	**1.31**	1.19
Total operating and transportation expenses *($/boe)*	**11.58**	8.23

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, lease rentals, property and pipeline taxes, and well maintenance charges.

Operating expenses for the first quarter of 2011 totaled $659,000 or $10.27/boe compared to $561,000 or $7.04/boe in the same period last year and $636,000 or $10.89/boe in the final quarter of 2010. The year-over-year increase in operating costs per barrel was directly attributable to the decrease in production volumes. In the same quarter of 2010, the Company achieved economies of scale whereby production was 19% higher without the equivalent increase in absolute operating costs. Quarter-over-quarter operating expenses remained relatively consistent on both an absolute and per barrel basis.

Transportation expenses for the three months ended March 31, 2011 were $84,000 or $1.31/boe ($0.22/mcf) compared to $95,000 or $1.19/boe ($0.20/mcf) recorded in the first quarter of 2010 and $67,000 or $1.15/boe ($0.19/mcf) in the fourth quarter of 2010. Transportation expenses reflect primarily NOVA and ATCO transportation costs and will fluctuate depending on the proportion of the Company's gas that is flowing on firm service versus interruptible service (interruptible service is slightly more expensive) as well as the proportion of Company volumes on ATCO versus NOVA (ATCO is less expensive).

G&A Expense

Three Months Ended March 31,	**2011**	2010
(000s)	*($)*	*($)*
Gross G&A expense (1)	**2,022**	509
Capitalized G&A (direct) (1)	**(118)**	(109)
Overhead recoveries	**(65)**	(33)
G&A expenses (net)	**1,839**	367
Transaction costs	**(1,119)**	–
G&A expense (net)	**720**	367
G&A expense (net) *($/boe)*	**11.22**	4.61

(1) Gross G&A expense and capitalized G&A for the three months ended March 31, 2010 have been restated for the effect of adopting IFRS.

Gross G&A expenses totaled $2,022,000 for the three-month period ended March 31, 2011, which included $1,119,000 of transaction costs related to the property acquisition that are required to be expensed under IFRS. Year-over-year G&A costs net of transaction costs increased on an absolute and per boe basis primarily due to increased staffing and consulting charges associated with higher activity levels, increased travel and marketing costs, audit and consulting fees relating to the IFRS transition and bank fees associated with the increase of the credit facility. Net G&A costs were $720,000 or $11.22/boe in the first three months of 2011 compared to $367,000 or $4.61/boe a year ago and $643,000 or $10.63/boe recorded in the fourth quarter of 2010.

Throughout the first quarter of 2011, the Company had nine full-time employees and five consultants versus five full-time employees and three consultants in the same period of 2010.

The Company capitalized direct G&A expenses amounting to $118,000 and had overhead recoveries of $65,000 in the first quarter of 2011 versus $109,000 and $33,000, respectively, in the comparative period of 2010 and $128,000 and $31,000, respectively, in the final quarter of 2010, which have been restated for the effect of adopting IFRS.

Share-Based Compensation

Three Months Ended March 31,	**2011**	2010
(000s)	*($)*	*($)*
Gross share-based compensation (1)	**247**	78
Capitalized share-based compensation (1)	**(51)**	(30)
Share-based compensation expense	**196**	48
Share-based compensation expense *($/boe)*	**3.05**	0.60

(1) Gross share-based compensation and capitalized share-based compensation for the three months ended March 31, 2010 have been restated for the effect of adopting IFRS.

Share-based compensation expense is a non-cash expense that reflects the amortization over the vesting period of the fair value of stock options granted to employees, consultants and directors of the Company. Stock options granted under the stock option plan have a term of five years to expiry and a four-year vesting term.

For the quarter ended March 31, 2011, the Company incurred a net expense of $196,000 versus $48,000 in the same period of 2010. This increase was directly attributable to increased staffing.

Depletion and Depreciation ("D&D")

Three Months Ended March 31,	**2011**	2010
(000s)	*($)*	*($)*
D&D provision (1)	**871**	969
D&D provision *($/boe)*	**13.57**	12.17

(1) D&D for the three months ended March 31, 2010 has been restated for the effect of adopting IFRS.

D&D is computed on a unit-of-production basis. Such expense, on a boe basis, fluctuates period to period primarily as a result of changes in the underlying proved plus probable reserves base and in the amount of costs subject to D&D, including future development costs. Such costs are segregated and depleted on an area-by-area basis relative to the respective underlying proved plus probable reserves base.

Depreciation is provided on certain field facilities using the straight-line method over a 20-year useful life and on office assets is provided using the declining balance method at rates between 20% and 30%.

The Company's D&D expense for the three months ended March 31, 2011 was $871,000 or $13.57/boe, which was relatively consistent with the expense of $969,000 or $12.17/boe in the comparable period of 2010.

Under IAS 36 – "Impairment of Assets", impairment testing is performed at the cash-generating unit ("CGU") level and is a one-step process for testing and measuring impairment of assets where each CGU's carrying value is compared to the higher of value in use and fair value less costs to sell. Impairment testing is required when there are indicators of impairment such as a significant drop in commodity prices or a write-down of proved or probable reserves. As at March 31, 2011, no impairment indicators were present, and therefore, no impairment testing was required.

Finance Income

Three Months Ended March 31,	**2011**	2010
(000s)	*($)*	*($)*
Finance income	**(75)**	–
Finance income *($/boe)*	**(1.17)**	–

In the first quarter of 2011, the Company recorded interest income totaling $75,000 as a result of the Company's cash balance, which is currently invested in a flexible guaranteed investment certificate.

Accretion and Finance Expenses

Three Months Ended March 31,	**2011**	2010
(000s)	*($)*	*($)*
Accretion expense on decommissioning liabilities	**25**	20
Finance expense	**27**	23
Total accretion and finance expenses	**52**	43
Accretion expense on decommissioning liabilities *($/boe)*	**0.39**	0.25
Finance expense *($/boe)*	**0.42**	0.29
Total accretion and finance expenses *($/boe)*	**0.81**	0.54

Accretion is the increase for the reporting period in the present value of the Company's decommissioning liabilities. In the first quarter of 2011, the Company recorded accretion expense of $25,000 compared to $20,000 in the same period of 2010. The increase was primarily due to new obligations related to the property acquisition, which closed on March 22, 2011. The underlying liability may increase over time based on new obligations incurred from drilling wells, constructing facilities, acquiring operations or adjusting future estimates of timing or estimated decommissioning costs. The liability can also be reduced as a result of abandonment work actually completed.

During the first quarter of 2011, the Company recorded interest charges of $27,000 compared to $23,000 in the same period of 2010 primarily related to standby charges on the unutilized credit facility of $20,000,000 (2010 – $12,000,000).

Income Taxes

Three Months Ended March 31,	**2011**	2010
(000s)	*($)*	*($)*
Deferred income tax expense	**66**	399
Deferred income tax expense *($/boe)*	**1.03**	5.01

DeeThree does not have current income taxes payable and does not expect to pay current income taxes in 2011 as the Company has estimated tax pools available at March 31, 2011 of $169,000,000.

Funds From (Used in) Operations

Three Months Ended March 31,	**2011**	2010
(000s)	*($)*	*($)*
Net loss	**(1,991)**	(589)
Non-cash items:		
D&D	**871**	969
Accretion	**25**	20
Share-based compensation	**196**	48
Deferred income tax expense	**66**	399
Funds from (used in) operations	**(833)**	847

During the three months ended March 31, 2011, the Company incurred a use of funds from operations totaling $833,000 or $0.02 per basic and diluted share compared to funds from operations of $847,000 or $0.05 per basic and diluted share in the comparative period of 2010. This 198% decrease was primarily due to increased G&A costs, which included transaction costs of $1,119,000 related to the property acquisition recorded in the first quarter of 2011 compounded by increased operating costs and offset by increased interest income.

Net Loss

For the three months ended March 31, 2011, the Company recorded a net loss of $1,991,000 or $0.05 per basic and diluted share compared to $589,000 or $0.03 per basic and diluted share in the same period of 2010. The year-over-year increase in net loss was again primarily due to increased G&A costs as well as share-based compensation.

Netbacks (per unit)

Three Months Ended March 31,	**2011**	2010
	($/boe)	*($/boe)*
Sales prices	**30.68**	28.79
Royalties	**(4.18)**	(5.02)
Operating	**(10.27)**	(7.04)
Transportation	**(1.31)**	(1.19)
Operating netback (1)	**14.92**	15.54
G&A and other (excludes non-cash items) (3) (4)	**(28.66)**	(4.61)
Finance income	**1.17**	–
Finance expenses	**(0.42)**	(0.29)
Funds flow netback (1)	**(12.99)**	10.64
D&D (3)	**(13.57)**	(12.17)
Accretion (3)	**(0.39)**	(0.25)
Share-based compensation (3)	**(3.05)**	(0.60)
Deferred income tax expense (3)	**(1.03)**	(5.01)
Net loss netback (2)	**(31.03)**	(7.39)

(1) Non-IFRS measure: refer to the commentary at the beginning of this MD&A. Operating netback, funds flow netback and net loss netback are calculated by dividing operating income, funds flow from operations and the net loss by the sales volume in boes for the period then ended. For a description of the boe conversion ratio, refer to the "Other Measurements" commentary at the beginning of this MD&A.

(2) For a description of the boe conversion ratio, refer to the commentary at the beginning of this MD&A.

(3) Amounts presented for the three months ended March 31, 2010 have been restated for the effect of the adoption of IFRS.

(4) G&A and other includes transaction costs of $1,119,000 relating to the property acquisition.

The operating netback was $14.92/boe for the three months ended March 31, 2011 compared to $15.54/boe in the same period last year. The Company experienced stronger pricing throughout the first quarter of 2011 offset by higher operating costs.

Investment and Investment Efficiencies

Capital Expenditures and Acquisitions

Three Months Ended March 31,	2011	2010
(000s) (excluding decommissioning liabilities and capitalized share-based compensation)	*($)*	*($)*
Property acquisitions and adjustments	**122,547**	–
Land and lease retention	**1,145**	–
Drilling and completions	**5,710**	1,588
Equipment and facilities	**42**	2,035
Geological and geophysical	**(55)**	3,426
Capitalized G&A and other [(1)]	**140**	109
Total capital expenditures	**129,529**	7,158

(1) Capitalized G&A for the three months ended March 31, 2010 has been restated for the effect of adopting IFRS.

During the first quarter of 2011, the Company incurred $129,529,000 (2010 – $7,158,000) in capital expenditures, excluding the non-cash decommissioning liabilities and capitalized share-based compensation. A significant portion of the 2011 first quarter capital spending was directed towards the property acquisition for a consideration of $122,547,000 after certain adjustments. This acquisition involved the purchase of approximately 1,830 boe/d of primarily high working interest, operating crude oil, natural gas and NGLs production and reserves. Drilling and completion expenditures totaled $5,710,000 (2010 – $1,588,000) that involved the drilling of 2 gross (2.0 net) wells, including the horizontal section of the Company's first Bakken well on its Lethbridge property (the vertical section was completed in 2010) and the drilling of the vertical and horizontal section of the second Bakken location. In the comparative quarter of 2010, the Company drilled 2 gross (2.0 net) wells at Lethbridge as well as incurred recompletion costs related to wells drilled in 2009 and preliminary drilling costs related to wells to be drilled throughout the balance of 2010. For the three months ended March 31, 2011, DeeThree spent $42,000 (2010 – $2,035,000) on equipping and tie-ins, which in 2010 consisted primarily of expenditures related to the 18-kilometre pipeline extension. The Company spent $1,145,000 (2010 – $nil) at land sales and recorded a decrease of $55,000 related to credit adjustments on the Company's two seismic programs shot in 2010 (2010 – increase of $3,426,000). The remaining $140,000 (2010 – $109,000) was invested in capitalized G&A and other corporate assets.

Drilling Activity

	Exploration		Development		Total	
	Gross	Net	Gross	Net	Gross	Net
	(#)	*(#)*	*(#)*	*(#)*	*(#)*	*(#)*
Three Months Ended March 31, 2011						
Natural gas	**–**	**–**	**–**	**–**	**–**	**–**
Crude oil and NGLs	**2**	**2.0**	**–**	**–**	**2**	**2.0**
Standing	**–**	**–**	**–**	**–**	**–**	**–**
Dry and abandoned	**–**	**–**	**–**	**–**	**–**	**–**
Total wells	**2**	**2.0**	**–**	**–**	**2**	**2.0**
Success rate *(%)*		**100**		**–**		**100**
Average working interest *(%)*		**100**		**–**		**100**
Three Months Ended March 31, 2010						
Natural gas	–	–	2	2.0	2	2.0
Crude oil and NGLs	–	–	–	–	–	–
Standing	–	–	–	–	–	–
Dry and abandoned	–	–	–	–	–	–
Total wells	–	–	2	2.0	2	2.0
Success rate *(%)*		–		100		100
Average working interest *(%)*		–		100		100

During the first quarter of 2011, DeeThree drilled 2 gross (2.0 net) wells, which included the horizontal section of its first Bakken location and the vertical and horizontal sections of its second Bakken well located on its Lethbridge property in southern Alberta. The Company achieved a 100% success rate on the first well, which is currently shut-in and awaiting tie-in. The second well is still being tested as of the date of this MD&A.

Liquidity and Capital Resources

Working Capital

The following table summarizes the change in working capital during the three months ended March 31, 2011 and the year ended December 31, 2010:

	Three Months Ended March 31, 2011	Year Ended December 31, 2010
(000s)	*($)*	*($)*
Working capital – beginning of period	**28,505**	375
Abandonment and reclamation costs	**–**	(39)
Funds from (used in) operations [(1)]	**(833)**	1,689
Issue of capital stock for cash (net of share issue expenses)	**122,517**	48,755
Capital expenditures [(1)]	**(6,983)**	(22,275)
Acquisition	**(122,547)**	–
Working capital – end of period	**20,659**	28,505

(1) Funds from (used in) operations and capital expenditures for the year ended December 31, 2010 have been restated for the effect of adopting IFRS.

DeeThree entered 2011 with positive working capital of $28,505,000. During the period, the Company incurred a use of funds from operations of $833,000 and invested a total of $129,529,000 in capital expenditures, including the property acquisition. The Company issued 26,795,000 common shares at a price of $4.30 per share for total gross proceeds of $115,219,000 ($108,000,000 net of estimated share issue expenses), including 3,495,000 common shares ($15,029,000) issued on the exercise in full of the underwriters' over-allotment option. In addition, DeeThree issued 3,000,000 flow-through shares at a price of $5.15 per flow-through share for total gross proceeds of $15,450,000 ($14,469,000 net of estimated share issue expenses). The proceeds of the flow-through share offering will be used by the Company to conduct exploration activity on its properties. DeeThree exited the period with working capital of $20,659,000.

On March 24, 2011, the Company's lender increased its revolving demand credit facility to $20,000,000 with interest charged at the bank's prime rate plus a range of 1.0% to1.25% per annum based on the Company's consolidated debt to cash flow ratio. Standby fees associated with this facility range from 0.40% to 0.70% per annum on the undrawn portion of the facility, again based on the Company's consolidated debt to cash flow ratio. As at March 31, 2011, $nil was drawn against the 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 facility is a subject to semi-annual reviews by the Company's lender with the next review scheduled for the fall of 2011.

DeeThree expects to fund future capital expenditures with its current working capital and funds flow from operations.

Related Party Transactions and Off-Balance Sheet Transactions

As at March 31, 2011, 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 period ended March 31, 2011, the Company incurred $177,000 in costs with the firm (period ended March 31, 2010 – $136,000), which have been included in G&A expenses and share issue costs, and $59,000 (2010 – $23,700) remained in accounts payable at March 31, 2011. 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 2011.

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.

There were no off-balance sheet transactions entered into during the period nor were there any outstanding as at the date of this MD&A.

Contractual Obligations and Commitments

Years Ended December 31,	2011	2012	2013	2014	2015+
(000s)	*($)*	*($)*	*($)*	*($)*	*($)*
Operating lease – office	302	884	884	542	677
Operating lease – vehicles	108	125	68	41	–
Exploration expenditures (flow-through)	7,500	15,450	–	–	–
Drilling contracts	2,354	7,391	5,037	–	–
Total	10,264	23,850	5,989	583	677

As at March 31, 2011, the Company had contractual obligations for its office lease totaling approximately $3,289,000 to the end of 2016. The head office lease obligations are comprised of the lease and includes parking and an estimate of occupancy costs of the Company's head office space. The Company also had contractual obligations for several vehicles totaling approximately $342,000 to the end of 2014.

In connection with the issuance of flow-through shares by the Company during the first quarter of 2011, DeeThree is required to spend $15,400,000 of eligible exploration expenditures by December 31, 2012. As at March 31, 2011, $nil of the eligible exploration expenditures had been incurred. These expenditures will be renounced to shareholders in January 2012 effective December 31, 2011.

In connection with the issuance of flow-through shares by the Company during the fourth quarter of 2010, DeeThree is required to spend $16,500,000 of eligible exploration expenditures by December 31, 2011. As at March 31, 2011, approximately $9,000,000 of the eligible exploration expenditures had been incurred. These expenditures were renounced to shareholders in January 2011 effective December 31, 2010.

In connection with the issuance of flow-through shares by the Company during the first quarter of 2010, DeeThree was required to spend $3,500,000 of eligible exploration expenditures by December 31, 2011. As at March 31, 2011, all of the eligible exploration expenditures had been incurred. These expenditures were renounced to shareholders in January 2011 effective December 31, 2010.

During the first quarter of 2011 and subsequent to March 31, 2011, DeeThree entered into contracts for drilling rig services under which the Company is committed to using services totaling $14,782,000 beginning in 2011 and extending into 2013.

In connection with the acquisition of the Lethbridge property in November 2008, the Company has an operational commitment to drill 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 at March 31, 2011, the Company drilled 27 wells and has approximately one-third of a township of 3-D seismic data left to shoot in 2011, thereby satisfying the second year drilling and 93% of the total seismic commitment. 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. 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. At the conclusion of the five-year term of the commitment agreement, the applicable areas of the Lethbridge property, which do not have a well located thereon, revert to the Lethbridge property vendor subject to the right of DeeThree to extend the term in respect of an additional five or ten sections of Lethbridge property land by committing to drill an additional five or ten wells, respectively, on such sections of land. Unless cured within a 45-day period, a default by the Company of its obligations under the commitment agreement may result in the applicable areas of the Lethbridge property, which do not have a well located thereon, reverting to the Lethbridge property vendor.

Share Capital

As at June 8, 2011, the Company had 62,752,000 common shares outstanding and 3,040,500 stock options outstanding.

Selected Quarterly Information (1)(2)

Three Months Ended	**Mar.31, 2011**	Dec.31, 2010	Sep.30, 2010	Jun.30, 2010	Mar.31, 2010	Dec.31, 2009 (2)	Sep.30, 2009 (2)	Jun.30, 2009 (2)
(000s, except per share amounts)	*($)*	*($)*	*($)*	*($)*	*($)*	*($)*	*($)*	*($)*
Oil and natural gas revenues	**1,969**	1,483	1,618	1,679	2,293	1,563	820	1,040
Funds from (used in) operations	**(833)**	(19)	413	359	847	435	(18)	95
Per share – basic and diluted	**(0.02)**	–	0.02	0.02	0.05	0.03	–	0.01
Cash flow from (used in) operating activities	**(4,863)**	(23)	685	407	658	(39)	(108)	422
Net loss	**(1,991)**	(5,738)	(6,664)	(2,079)	(589)	(438)	(830)	(1,079)
Per share – basic and diluted	**(0.05)**	(0.19)	(0.28)	(0.10)	(0.03)	(0.03)	(0.06)	(0.08)
Total assets	**192,682**	65,334	52,634	38,691	44,730	31,329	26,569	26,752
Capital expenditures (3)	**129,529**	7,532	3,572	4,012	7,158	4,601	1,683	1,823
Working capital (deficiency)	**20,659**	28,505	20,670	3,133	6,601	375	(190)	1,511
Shareholders' equity	**175,423**	55,126	47,774	32,880	34,653	24,674	20,106	20,780
Production								
Natural gas *(mcf/d)*	**3,744**	3,691	3,958	4,191	5,211	3,636	2,900	3,150
Crude oil and NGLs *(bbls/d)*	**89**	19	18	15	16	17	10	15
Total *(boe/d)*	**713**	635	678	714	885	623	493	541

(1) The selected quarterly information has been prepared in accordance with the accounting principles as contained in the notes to the unaudited financial statements for the three months ended March 31, 2011 and 2010, except for funds from operations, which is a non-prescribed measure under IFRS and previous GAAP.

(2) DeeThree's IFRS transition date was January 1, 2010, and therefore, the 2009 financial information has been prepared following previous GAAP.

(3) Total capital expenditures, including acquisitions.

Factors That Have Caused Variations over the Quarters

DeeThree's total assets and capital expenditures increased significantly in the first quarter of 2011 due to the property acquisition that closed on March 22, 2011, which also contributed to the substantial change in shareholders' equity as the Company raised a total of $108,000,000 (net of share issue expenses) to fund the acquisition and an additional $14,469,000 (net of share issue expenses) in flow-through shares to fund future exploration activities.

DeeThree's working capital increased significantly in the third and fourth quarters of 2010 due to a $22,000,000 common share private placement that closed on September 8, 2010 and a $17,000,000 flow-through share private placement that closed in November 2010. 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. In the second and third quarters of 2009, the Company experienced natural declines with no additional volumes brought on production. During the final quarter of 2009 and first quarter of 2010, DeeThree began to bring on-stream production from its 2009 drilling successes, thereby recording a significant increase in production volumes. In each of the second, third and fourth quarters of 2010, the Company experienced operational difficulties, including inclement weather, high liquids content in its gas stream that required the Company to shut-in volumes as well as steep natural declines on its new production causing production decreases. 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

In April 2011, the Company entered into a farm-out and joint venture agreement with a major oil and gas company (the "farmee"). The terms of the agreement involve a four-well commitment on a total of 15,815 acres of DeeThree's undeveloped lands that are strategically located in the Lethbridge area. The farmee is committed to drill four horizontal earning wells by December 31, 2011 and is responsible for 100% of the costs through completion to earn a 60% working interest in the farm-out lands with no payout terms.

On May 9, 2011, DeeThree entered into a costless collar for 250 bbls/d of crude oil effective June 1, 2011 to December 31, 2011 at a floor price of US$95.00/bbl and a cap price of US$106.00/bbl.

On May 20, 2011, DeeThree entered into a costless collar for 250 bbls/d of crude oil effective January 1, 2012 to December 31, 2012 at a floor price of US$95.00/bbl and a cap price of US$115.00/bbl, unless the monthly average WTI price per barrel averages over US$115.00/bbl every day for the entire month, in which case the cap becomes US$100.00/bbl.

Controls and Procedures

Disclosure Controls

Disclosure controls and procedures are designed to ensure that information required to be disclosed by the Company is accumulated and communicated to management, including the Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO"), to allow timely decisions regarding required disclosure. DeeThree's CEO and CFO have concluded, based on their evaluation as of the end of the period covered by the Company's annual filings, that the Company's disclosure controls and procedures are effective to provide reasonable assurance that material information related to the issuer is made known to them by others within the Company.

Internal Controls over Financial Reporting

DeeThree is required to comply with Multilateral Instrument 52-109 – "Certification of Disclosure in Issuers' Annual and Interim Filings". The certificate of interim filings for the interim period ended March 31, 2011 requires that DeeThree disclose in the interim MD&A any changes in the Company's internal control over financial reporting that occurred during the period that has materially affected, or is reasonably likely to materially affect DeeThree's internal control over financial reporting. DeeThree confirms that no such changes were made to internal controls over financial reporting during the first three months of 2011.

It should be noted that while DeeThree's CEO and CFO believe that the Company's internal controls and procedures provide a reasonable level of assurance and they are effective, they do not expect that these controls will prevent all errors and fraud. A control system, no matter how well conceived or operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met.

Change in Accounting Policies

The interim financial statements and comparative information have been prepared in accordance with IFRS. The Company adopted IFRS on January 1, 2011. Previously, DeeThree prepared its interim financial statements in accordance with previous GAAP. The Company has provided IFRS accounting policies and prepared reconciliations between previous GAAP and IFRS in notes 3 and 16 of its March 31, 2011 interim financial statements. The following table provides a summary reconciliation of DeeThree's 2010 net income under previous GAAP and IFRS to illustrate the impact on adoption.

	Year Ended	Three Months Ended			
	Dec 31, 2010	Dec.31, 2010	Sep.30, 2010	Jun.30, 2010	Mar.31, 2010
(000s)	*($)*	*($)*	*($)*	*($)*	*($)*
Summary of Net Loss					
Net loss – previous GAAP	(6,714)	(5,233)	(666)	(550)	(265)
(Increase)/Decrease					
G&A	82	27	49	13	(7)
Share-based compensation	185	86	64	40	(5)
D&D	1,214	780	132	153	149
Accretion and finance expenses	61	17	16	15	13
Deferred income taxes	1,453	(417)	2,112	232	(474)
Impairments	(11,351)	(998)	(8,371)	(1,982)	–
Total (increase) decrease to expense	(8,356)	(505)	(5,998)	(1,529)	(324)
Net loss – IFRS	(15,070)	(5,738)	(6,664)	(2,079)	(589)

The following discussion illustrates the significant differences between previous GAAP and the accounting policies applied by the Company under IFRS. IFRS 1 – "First-Time Adoption of International Financial Reporting Standards" allows first-time adopters certain exemptions from retrospective application of certain IFRS. IFRS policies have been retrospectively applied, except where specific IFRS 1 optional and mandatory exemptions permitted an alternative treatment upon transition to IFRS.

IFRS 1 Exemptions

IFRS 1 requires the presentation of comparative information as at the January 1, 2010 transition date and subsequent comparative periods as well as the consistent and retrospective application of IFRS accounting policies. To assist with the transition, the provisions of IFRS 1 allow for certain mandatory and optional exemptions for first-time adopters to alleviate the retrospective application of all IFRS. The Company has applied the following transition exceptions and exemptions:

(i) Full Cost Book Value as Deemed Value

Under previous GAAP, the Company followed full cost accounting in which all costs directly associated with the acquisition and development of oil and gas reserves were capitalized on a country-by-country basis. Costs accumulated within a country cost centre were depleted using the unit-of-production method based on proved reserves determined using escalated future pricing. The Company elected an exemption whereby the Canadian full cost pool was measured at the date of transition to IFRS as follows:

- Exploration and evaluation ("E&E") assets were reclassified from the full cost pool to intangible and tangible E&E assets at the amount recorded under previous GAAP;
- Other components, consisting of the Company's major facilities, were brought into the property and equipment balance at net book value; and
- The remaining full cost pool was allocated to the producing and developed assets pro-rata using proved plus probable reserves values.

This resulted in a $2,915,000 increase to E&E assets with a corresponding decrease in property and equipment upon transition. For the three months ended March 31, 2010, the transfer was $6,732,000 and for the year ended December 31, 2010, the transfer was $11,052,000.

(ii) Business Combinations

IFRS 1 provides the option to apply IFRS 3 – "Business Combinations" retrospectively or prospectively from the date of transition. The Company elected to value business combinations prior to January 1, 2010 at the amounts determined under previous GAAP rather than applying IFRS rules retrospectively. As such, previous GAAP balances relating to business combinations entered into before that date have been carried forward without adjustment.

(iii) Arrangements Containing a Lease

The Company elected to apply IFRS relating to leases as at January 1, 2010. The Company determined that there were no significant arrangements containing a lease at the date of transition to IFRS.

(iv) Borrowing Costs

The Company elected to apply IFRS relating to borrowing costs prospectively from January 1, 2010. Borrowing costs relating to qualifying assets, if any, before that date were expensed as incurred.

(v) *Decommissioning Liabilities*

The Company elected to apply IFRS relating to decommissioning liabilities (previously referred to as asset retirement obligations) as at the date of transition to IFRS. The Company restated its decommissioning liabilities in accordance with IFRS at January 1, 2010 and recognized the difference from the amounts recorded under previous GAAP directly into retained earnings. Refer to "Decommissioning Liabilities" below for further details.

(vi) *Share-Based Compensation*

The Company elected to not apply IFRS relating to share-based payments to awards that vested prior to January 1, 2010. Awards that were unvested at the date of transition to IFRS were restated retroactively. This resulted in a $10,000 adjustment to retained earnings and contributed surplus at the date of transition.

DeeThree determined that the total impact of the conversion to IFRS was a reduction in retained earnings on January 1, 2010 in the amount of $1,092,000. The Company performed impairment tests at the CGU level as of this date and did not have a transitional impairment (write-down) of its property and equipment.

E&E

E&E includes those expenditures for an area or project for which technical feasibility and commercial viability have not yet been determined. Such expenditures include costs of acquiring licences and exploratory drilling and completion costs. E&E assets are not amortized. When technical feasibility and commercial viability are determined, the costs are transferred to property and equipment. At the date of transition, DeeThree determined its E&E balance was $2,915,000 comprised of both seismic and undeveloped land.

E&E will be expensed if technical feasibility and commercial viability cannot be established. For the year ended December 31, 2010, DeeThree had no expenses under IFRS related to land expiries previously capitalized under previous GAAP.

Property and Equipment and Impairment of Assets

Development and production ("D&P") costs include those expenditures for areas or projects where technical feasibility and commercial viability have been determined. Under IFRS, DeeThree will continue to capitalize these costs within property and equipment.

Under previous GAAP, with respect to dispositions, there is no recognition of a gain or loss unless the deduction would result in a change to the depletion rate of 20% or greater, in which case a gain or loss is recorded. Under IFRS, property and equipment dispositions will generally result in recognition of a gain or loss to income, regardless of the amount of the transaction.

Under IFRS, DeeThree is required to recognize and measure an impairment loss if the carrying value of D&P assets exceeds the recoverable amount for any individual CGU. Under IFRS, the recoverable amount is the higher of fair value less cost to sell and value in use. Under previous GAAP, impairment tests are calculated at the country level. As a result of the accounting policy change, an impairment of $16,650,000 was recorded during 2010 due primarily to declining natural gas prices. The impact of this change is illustrated in the reconciliation of net income above.

D&D

Under IFRS, costs in D&P are depleted on a unit-of-production basis at a lower unit of account than the country level utilized under previous GAAP. DeeThree determined the area level to be the appropriate unit of account and has used the unit-of-production basis to calculate D&D on its D&P assets utilizing proved plus probable reserves compared to proved reserves only under previous GAAP. This change has resulted in a lower D&D charge to income during 2010. The impact of this change is illustrated in the reconciliation of net income above.

Decommissioning Liabilities

Under previous GAAP, the decommissioning liabilities were measured as the estimated fair value of the retirement and decommissioning expenditures expected to be incurred. In measuring the fair value, DeeThree used a credit adjusted risk-free discount rate. Under IFRS, the cash flows to abandon and remediate the wells and facilities have been risk adjusted; therefore, DeeThree concluded that it should apply a lower risk-free discount rate to value the decommissioning liabilities. As a result, the Company's decommissioning liabilities increased $619,000 at the date of transition. During the year ended December 31, 2010, DeeThree's decommissioning liabilities increased an additional $676,000. Due to the higher fair values and the reduced discount rate, the accretion recognized in income throughout 2010 decreased. The impact of this change is illustrated in the reconciliation of net income above.

Share-Based Compensation

Under previous GAAP, the Company accounted for options granted to employees and directors by measuring the fair value of the instruments issued and amortized over the vesting periods. The fair value was measured using a Black-Scholes option pricing model using share price, exercise price, expected volatility, weighted average expected life, expected dividends and a risk-free rate. Under IFRS, the Company must apply a forfeiture rate on the grant date and subsequently adjust to reflect the actual number of options that vest. Under previous GAAP, forfeitures were recorded at the time of the expiry or cancellation. Further, under IFRS each tranche of options is required to be treated as a separate contract award with a separate life, which resulted in more expense being recognized in income at the beginning of the contract life. DeeThree did not record an adjustment for a change in forfeiture rate as the forfeiture rate under previous GAAP was zero and remains that way under IFRS. The Company did, however, record an adjustment for the graded vesting, which is illustrated above in the net income reconciliation.

Flow-Through Shares

Flow-through shares are resource expenditure deductions for income tax purposes related to exploratory activities funded by flow-through share arrangements that are renounced to investors in accordance with income tax legislation. Under previous GAAP, the accounting treatment for flow-through shares is to record the full amount of the proceeds in share capital. When expenditures are renounced, the related tax affect is recorded to share capital and the future tax liability. Under IFRS, the amount initially recorded in share capital is limited to the amount of common shares that would have been issued on that date and the difference between the actual proceeds and the amount recorded in share capital is set up as a flow-through share premium liability on the statement of financial position. When the expenditures are incurred, the related flow-through share premium liability is reversed and the related tax effect is recorded to the deferred income tax liability.

On transition to IFRS, the Company recorded an adjustment with respect to flow-through shares that were issued during 2008 and 2009. As a result, the flow-through share premium liability increased $705,000, deferred tax liabilities increased $674,000, share capital decreased $733,000 and opening deficit increased $646,000. The impact of this change to deferred income taxes is illustrated in the reconciliation of net income above.

Income Tax

Deferred income tax has also been adjusted to reflect the tax effect arising from other differences between previous GAAP and IFRS. The Company illustrates the income tax effect above in the net income reconciliation.

Critical Accounting Estimates

The preparation of the Company's financial statements requires management to adopt accounting policies that involve the use of significant estimates and assumptions. These estimates and assumptions are developed based on the best available information and are believed by management to be reasonable under the existing circumstances. New events or additional information may result in the revision of these estimates over time. A summary of the significant accounting policies used by DeeThree can be found in note 2 to the March 31, 2011 financial statements.

Accounting Standards Issued But Not Yet Applied

IFRS 9 – “Financial Instruments” was issued by the International Accounting Standards Board (“IASB”) on November 12, 2009 and is the first step to replace IAS 39 – “Financial Instruments: Recognition and Measurement.” IFRS 9 uses a single approach to determine whether a financial asset is measured at amortized cost or fair value, replacing the multiple rules in IAS 39. The approach in IFRS 9 is based on how an entity manages its financial instruments in the context of its business model and the contractual cash flow characteristics of the financial assets. The new standard also requires a single impairment method to be used, replacing the multiple impairment methods in IAS 39. IFRS 9 is effective for annual periods beginning on or after January 1, 2013. The Company is currently evaluating the impact of IFRS 9 on its financial statements and believes there will be no significant impact to the Company upon implementation of the standard.

IAS 12 – “Income Taxes” was amended on December 20, 2010 to remove subjectivity in determining on which basis an entity measures the deferred tax relating to an asset. The amendment introduces a presumption that an entity will assess whether the carrying value of an asset will be recovered through the sale of the asset. The amendment to IAS 12 is effective for reporting periods beginning on or after January 1, 2012. The Company is currently evaluating the impact of this amendment to IAS 12 on its financial statements.

IFRS 10 – “Consolidated Financial Statements” was issued by the IASB on May 12, 2011. IFRS 10 introduces a single control model to assess whether to consolidate an investee. The standard was issued as part of a new suite of consolidation and related standards replacing existing requirements for joint ventures (now joint arrangements) and making limited amendments in relation to associates. The new requirements are effective in annual periods beginning on or after January 1, 2013. The Company is currently evaluating the impact of IFRS 10 and believes the standard will not be applicable to the preparation of its financial statements.

IFRS 11 and IAS 28 – “Joint Arrangements and Investments in Subsidiaries” was issued by the IASB on May 12, 2011 as part of its new suite of consolidation and related standards, replacing existing requirements for subsidiaries. Under IFRS 11 and IAS 28, classification of the joint arrangement depends on whether parties have rights to and obligations for underlying assets and liabilities and joint ventures are no longer allowed to use proportionate consolidation and must use equity accounting. The new requirements are effective in annual periods beginning on or after January 1, 2013. The Company is currently evaluating the impact of IFRS 9 and IAS 28 and believes the standard will not be applicable to the preparation of its financial statements.

IFRS 12 – “Disclosure of Interests in Other Entities” were issued by the IASB on May 12, 2011 as part of its new suite of consolidation and related standards, replacing requirements for subsidiaries and joint ventures (now joint arrangements). The standard includes expanded disclosures regarding subsidiaries, joint arrangements and associates, and new disclosures regarding unconsolidated entities. The new requirements are effective in annual periods beginning on or after January 1, 2013. The Company is currently evaluating the impact of IFRS 12 and believes the standard will not be applicable to the preparation of its financial statements.

Business Risks and Risk Mitigation

DeeThree’s exploration and production activities are concentrated in the Western Canadian Sedimentary Basin where the industry is very competitive. There are a number of risks facing participants in the oil and gas industry, some of which are common to all businesses, while others are specific to the sector. Such risks include finding and developing oil and natural gas reserves economically, estimating amounts of recoverable reserves, producing the reserves in commercial quantities, finding a suitable market at attractive commodity prices, financial and liquidity risks, and environmental and safety risks.

DeeThree mitigates these risks by utilizing a team of highly qualified professionals with expertise and experience in these areas. DeeThree attempts to maximize drilling success by exploring areas that have multi-zone horizons, targeting deeper horizons with uphole potential, continuously assessing new acquisition opportunities to complement existing activities and strives for a balance between higher risk exploratory drilling and lower risk development drilling.

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, attempting to operate the project along with accessing sales markets through Company owned infrastructure or mid-stream operators.

DeeThree has retained an independent engineering consulting firm that assists the Company in evaluating recoverable amounts of oil and natural gas reserves. Values of recoverable reserves are based on a number of variable factors and assumptions such as commodity prices, projected production, future production costs and governmental regulation. Consequently, estimates could vary from actual results.

DeeThree is exposed to commodity price risk whereby the risk that the fair value of future cash flows will fluctuate as a result of changes in commodity prices. Commodity prices for petroleum and natural gas are impacted by not only the relationship between the Canadian and United States dollars, but also global economic events that dictate the levels of supply and demand. The Company protects itself from fluctuations in prices by maintaining an appropriate hedging strategy. As at the date of this MD&A, DeeThree had two crude oil hedges in place (see "Subsequent Events" section). Most commodity prices are based on U.S. dollar benchmarks, which result in the Company’s realized prices being influenced by the Canadian/U.S. exchange rates. DeeThree does not currently sell or transact in any foreign currency and has no foreign exchange risk management contracts outstanding.

Credit risk arises from the potential loss resulting from a counterparty failing to meet its obligations in accordance with the agreed upon terms. The Company may be exposed to third party credit risk through its contractual arrangements with its current or future joint venture partners, marketers of its commodities and other parties. DeeThree makes every effort to sell its commodities to major companies with excellent credit ratings. DeeThree currently has minimal activity with industry partners; however, to the extent that DeeThree does or will in the future, the Company will require cash calls in advance from its partners on capital projects before they commence and make use of offsets such as offsetting payables to mitigate the risk.

The oil and natural gas industry is a very capital intensive industry, and in order to fully realize the Company’s strategic goals and business plans, DeeThree will rely on equity markets as a source of new capital in addition to bank financing and internally generated cash flow to fund its ongoing capital investments. 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. Internally generated funds will also fluctuate with changing commodity prices. DeeThree anticipates it will continue to have adequate liquidity to fund its financial liabilities through its future funds from operations and available bank debt. DeeThree is committed to maintaining a strong balance sheet along 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. DeeThree has had no defaults or breaches on its bank debt or any of its financial liabilities.

Environmental Regulations

There are numerous environmental risks associated with oil and natural gas exploration and production. Some of these risks can involve pollution of the environment and destruction of natural habitat as well as safety risks such as personal injury. DeeThree has established an Environmental, Health and Safety Program and has 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.

Climate Change

The Government of Canada has made clear its intention to regulate greenhouse gases ("GHG"). As these regulations are under development, DeeThree is uncertain as to the total impact of the potential regulations upon its business. The Government of Alberta has set targets for GHG emission reductions, including maximum emissions of GHG from large industrial facilities. In order to comply with the Alberta regulations, companies can make operating improvements to their facilities, purchase carbon offsets or make a monetary contribution to the Alberta Climate Change and Emissions Management Fund.

Outlook

DeeThree is in an enviable position with two key play areas – the southern Alberta Bakken and Brazeau Belly River– which have material potential for increased production and reserves. The Company has the flexibility to shift capital between areas depending on the success of its drilling results. With very little history or technical data in the new emerging Bakken play, it is difficult to project future production targets and decline rates. As the Company gains more knowledge, it will be better able to determine production profiles and will provide guidance at that time.

DeeThree continues to maintain a healthy balance sheet, exiting the first quarter with $20.6 million in positive working capital. The Company's 2011 capital program remains on track and funded at approximately $42 million with plans to drill another 11 horizontal locations throughout the balance of the year.

Statements of Financial Position

As at	**March 31, 2011**	December 31, 2010	January 1, 2010
(000s)(unaudited)	*($)*	*($)*	*($)*
Assets			
Current assets			
Cash and cash equivalents	**21,430**	32,994	–
Restricted cash	**–**	–	4,000
Accounts receivable	**5,111**	884	1,059
Deposits and prepaid expenses	**242**	271	254
	26,783	34,149	5,313
Non-current assets			
Exploration and evaluation assets *(note 5)*	**26,989**	11,052	2,915
Property and equipment *(note 6)*	**135,390**	17,758	23,101
Deferred tax asset	**3,520**	2,375	–
Total assets	**192,682**	65,334	31,329
Liabilities			
Current liabilities			
Bank debt *(note 7)*	**–**	–	2,436
Accounts payable and accrued liabilities	**6,124**	5,644	2,502
	6,124	5,644	4,938
Non-current liabilities			
Decommissioning liabilities *(note 8)*	**7,385**	2,498	2,255
Flow-through share premium liabilities *(note 9)*	**3,750**	2,066	705
Deferred tax liability	**–**	–	592
Total liabilities	**17,259**	10,208	8,490
Shareholders' equity			
Share capital *(note 9)*	**195,581**	73,530	26,530
Share purchase warrants *(note 9)*	**–**	–	283
Contributed surplus	**1,344**	1,107	467
Deficit	**(21,502)**	(19,511)	(4,441)
Total equity	**175,423**	55,126	22,839
Total liabilities and shareholders' equity	**192,682**	65,334	31,329

Commitments *(note 14)*

Subsequent events *(note 15)*

See accompanying notes to the financial statements.

Statements of Operations and Comprehensive Loss

Three Months Ended March 31,	**2011**	2010
(000s, except per share amounts)(unaudited)	*($)*	*($)*
Revenue		
Oil and natural gas revenues	**1,969**	2,293
Royalties	**(268)**	(400)
Oil and natural gas revenues, net of royalties	**1,701**	1,893
Expenses		
Operating and transportation	**743**	656
General and administrative	**1,839**	367
Depletion and depreciation *(note 6)*	**871**	969
Share-based compensation *(note 9)*	**196**	48
	3,649	2,040
Finance income	**(75)**	–
Accretion and finance expenses *(note 8)*	**52**	43
	3,626	2,083
Loss before income tax	**(1,925)**	(190)
Taxes		
Deferred income tax expense	**66**	399
Net loss and comprehensive loss for the period	**(1,991)**	(589)
Net loss per share *(note 9)*		
Basic and diluted	**(0.05)**	(0.03)

See accompanying notes to the financial statements.

Statements of Changes in Shareholders' Equity

(000s)(unaudited)	Share Capital ($)	Share Purchase Warrants ($)	Contributed Surplus ($)	Deficit ($)	Total Equity ($)
Balance – January 1, 2011	**73,530**	**–**	**1,107**	**(19,511)**	**55,126**
Common shares issued	**115,219**	**–**	**–**	**–**	**115,219**
Flow-through shares issued	**15,450**	**–**	**–**	**–**	**15,450**
Share issue costs	**(8,200)**	**–**	**–**	**–**	**(8,200)**
Tax benefit of share issue costs	**2,074**	**–**	**–**	**–**	**2,074**
Premium on flow-through shares	**(2,550)**	**–**	**–**	**–**	**(2,550)**
Share-based compensation	**–**	**–**	**247**	**–**	**247**
Exercise of options	**58**	**–**	**(10)**	**–**	**48**
Net loss	**–**	**–**	**–**	**(1,991)**	**(1,991)**
Balance – March 31, 2011	**195,581**	**–**	**1,344**	**(21,502)**	**175,423**
Balance – January 1, 2010	26,530	283	467	(4,441)	22,839
Common shares issued	10,074	–	–	–	10,074
Flow-through shares issued	3,462	–	–	–	3,462
Share issue costs	(1,063)	–	–	–	(1,063)
Tax benefit of share issue costs	283	–	–	–	283
Premium on flow-through shares	(496)	–	–	–	(496)
Share-based compensation	–	–	79	–	79
Exercise of options	85	–	(21)	–	64
Net loss	–	–	–	(589)	(589)
Balance – March 31, 2010	38,875	283	525	(5,030)	34,653

See accompanying notes to the financial statements.

Statements of Cash Flows

Three Months Ended March 31,	**2011**	2010
(000s)(unaudited)	*($)*	*($)*
Cash flow from (used in):		
Operating activities		
Net loss for the period	**(1,991)**	(589)
Adjustments for:		
Depletion and depreciation	**871**	969
Accretion	**25**	20
Share-based compensation	**196**	48
Deferred income tax expense	**66**	399
Change in non-cash working capital *(note 10)*	**(4,030)**	(189)
	(4,863)	658
Financing activities		
Decrease in bank debt	**–**	(2,436)
Issuance of share capital	**130,717**	13,600
Share issue expenses	**(8,200)**	(1,063)
Changes in non-cash working capital *(note 10)*	**–**	51
	122,517	10,152
Investing activities		
Property and equipment expenditures	**1,326**	(3,230)
Exploration and evaluation expenditures *(note 5)*	**(8,308)**	(3,928)
Decrease in restricted cash	**–**	4,000
Property acquisitions *(note 4)*	**(122,547)**	–
Changes in non-cash working capital *(note 10)*	**311**	3,419
	(129,218)	261
Change in cash and cash equivalents	**(11,564)**	11,071
Cash and cash equivalents – beginning of period	**32,994**	–
Cash and cash equivalents – end of period	**21,430**	11,071

See accompanying notes to the financial statements.

Notes to the Financial Statements

As at and for the period ended March 31, 2011

(unaudited)

1. Reporting Entity

DeeThree Exploration Ltd. ("DeeThree" or the "Company") is a publicly traded company incorporated under the laws of Alberta. The Company is principally engaged in the exploration for and exploitation, development and production of oil and natural gas, and conducts many of its activities jointly with others. These interim financial statements reflect only the Company's interests in such activities. DeeThree is registered and domiciled in Canada. The address of its main office is Suite 700, 520 Fifth Avenue S.W., Calgary, Alberta.

2. Basis of Presentation

(a) Statement of Compliance

This is the first year in which the Company has prepared its financial statements under International Financial Reporting Standards and interpretations (collectively referred to as "IFRS") as issued by the International Accounting Standards Board ("IASB"). The comparative information has been restated from Canadian generally accepted accounting principles ("Canadian GAAP") to comply with IFRS. In these interim financial statements, the term "Canadian GAAP" refers to Canadian GAAP before the adoption of IFRS. Reconciliations to IFRS from the previously published Canadian GAAP financial statements are shown in note 16.

These interim financial statements for the three months ended March 31, 2011 are unaudited and have been prepared in accordance with International Accounting Standard ("IAS") 34 – "Interim Financial Reporting" using accounting policies consistent with IFRS and IFRS 1 – "First-Time Adoption of International Financial Reporting Standards" has been applied.

Subject to certain transition elections disclosed in note 16, the Company has consistently applied the same accounting policies in its opening IFRS statement of financial position at January 1, 2010 ("date of transition") and throughout all periods presented as if these policies had always been in effect. Note 16 discloses the impact of the transition to IFRS on the Company's reported financial position, financial performance and cash flows, including the nature and effect of significant changes in accounting policies from those used in the Company's financial statements for the year ended December 31, 2010. Comparative figures for 2010 in these financial statements have been restated to give effect to these changes.

DeeThree's significant accounting policies are presented in note 3. The interim financial statements should be read in conjunction with the Company's Canadian GAAP annual financial statements for the year ended December 31, 2010. Note 16 discloses IFRS information for the year ended December 31, 2010 that is material to an understanding of these interim financial statements.

The interim financial statements were authorized for issue by the Board of Directors on June 8, 2011.

(b) Basis of Measurement

The financial statements of DeeThree have been prepared on the historical cost basis, except for share-based transactions, which are measured at fair value. The methods used to measure fair values are discussed in note 11.

(c) Functional and Presentation Currency

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

(d) Use of Estimates and Judgements

The preparation of financial statements in conformity with IFRS requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates and affect the results reported in these interim financial statements and could be material. Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the year in which the estimates are revised and in any future years affected.

Estimates

Information about significant areas of estimation uncertainty in applying accounting principles that have the most significant effect on the amounts recognized in the financial statements is included in the following notes:

- Note 4 – acquisition
- Note 6 – valuation of property and equipment
- Note 8 – provisions for decommissioning costs
- Note 9 – measurement of share-based payments

2. Basis of Presentation *(continued)*

(d) Use of Estimates and Judgements (continued)

Judgements

In the process of applying DeeThree's accounting policies, judgements, apart from those involving estimates, have been made, the following which may have the most significant effect on the amounts recognized in the financial statements:

Reserves Base

Oil and gas development and production assets are depleted on a unit-of-production basis at a rate calculated by reference to proved and probable reserves determined in accordance with National Instrument 51-101 – "Standards of Disclosure for Oil and Gas Activities" and incorporating the estimated future cost of developing and extracting those reserves. Proved and probable reserves are estimated using independent reserve engineer reports and represent the estimated quantities of oil, natural gas and NGLs which geological, geophysical and engineering data demonstrate with a specified degree of certainly to be recoverable in future years from known reservoirs and which are considered commercially producible. Proved reserves are those reserves that can be estimated with a high degree of certainty to be recoverable. It is 90% likely that the actual remaining quantities recovered will exceed the estimated proved reserves. Probable reserves are those additional reserves that are less certain to be recovered than proved reserves. It is equally likely that the actual remaining quantities recovered will be greater or less than the sum of the estimated proved and probable reserves. The level of estimated reserves is also a key determinant in assessing whether the carrying value of any of the Company's development and production assets has been impaired.

Impairment Indicators and Discount Rate

The recoverable amounts of cash-generating units ("CGUs") and individual assets have been determined based on the higher of the present value of value-in-use calculations and discounted fair values less costs to sell. These calculations require the use of estimates and assumptions, including the discount rate. It is reasonably possible that the commodity price assumptions may change, which may then impact the estimated life of the field and economical reserves recoverable, and may then require a material adjustment to the carrying value of property and equipment. The Company monitors internal and external indicators of impairment relating to its tangible assets.

Decommissioning Costs

Decommissioning costs will be incurred by the Company at the end of the operating life of the Company's facilities and properties. The ultimate decommissioning costs are uncertain and cost estimates can vary in response to many factors, including changes to relevant legal requirements, the emergence of new restoration techniques, experience at other production sites and changes to the risk-free discount rate. The expected timing and amount of expenditure can also change; for example, in response to changes in reserves or changes in laws and regulations or their interpretation. As a result, there could be significant adjustments to the provisions established, which would affect future financial results.

Share-Based Compensation

Compensation costs recognized for share-based compensation plans are subject to the estimation of what the ultimate payout will be using pricing models such as the Black-Scholes model, which is based on significant assumptions such as volatility, dividend yield and expected term.

Income Taxes

Tax interpretations, regulations and legislation in the various jurisdictions in which the Company operates are subject to change. As such, income taxes are subject to measurement uncertainty. Deferred income tax assets are assessed by management at the end of the reporting period to determine the likelihood that they will be realized from future taxable earnings.

Contingencies

By their nature, contingencies will only be resolved when one or more future events occur or fail to occur. The assessment of contingencies inherently involves the exercise of significant judgement and estimates of the outcome of future events.

3. Significant Accounting Policies

The accounting policies set out below have been applied consistently to all periods presented in these interim financial statements. Certain comparative amounts have been reclassified to conform with the current quarter's presentation as noted below.

(a) Property and Equipment

Capitalization

Items of property and equipment, which include oil and gas development and production assets, are measured at cost less accumulated depletion and depreciation and accumulated impairment losses.

The initial cost of an asset comprises its purchase price or construction cost, any costs directly attributable to bringing the asset into operation, the initial estimate of any decommissioning obligation, if any, and, for qualifying assets, borrowing costs. Costs incurred subsequent to the determination of technical feasibility and commercial viability and the costs of replacing parts of property and equipment are recognized as petroleum and natural gas properties only when they increase the future economic benefits embodied in the specific asset to which they relate. All other expenditures are recognized in profit or loss as incurred. Such capitalized petroleum and natural gas properties generally represent costs incurred in developing proved and/or probable reserves and bringing in or enhancing production from such reserves, and are accumulated on a field or geotechnical area basis.

Depletion and Depreciation

The net carrying value of development and production assets is depleted using the unit-of-production method by reference to the ratio of production in the year to the related proved plus probable reserves, taking into account estimated future development costs necessary to convert those reserves into production. Proved plus probable reserves are estimated annually by independent qualified reserves evaluators and represent the estimated quantities of crude oil, natural gas and NGLs which geological, geophysical and engineering data demonstrate with a specified degree of certainty to be recoverable in future years from known reservoirs and which are considered commercially producible. Future development costs are estimated taking into account the level of development required to produce the reserves. For interim financial statements, internal estimates of changes in reserves and future development costs are used for determining depletion for the period.

For depletion purposes, relative volumes of petroleum and natural gas production and reserves are converted at the energy equivalent conversion rate of six thousand cubic feet of natural gas to one barrel of crude oil.

Other property and equipment are stated in the statement of financial position at cost less accumulated depreciation. Depreciation is calculated over the estimated useful life of the asset based on the original cost less estimated residual value. The methods and useful lives of the Company's other property and equipment are as follows:

- Facilities — 20 years straight-line
- Office equipment — 5 years declining balance
- Computer equipment — 3 years declining balance

Depreciation methods, useful lives and residual values are reviewed at each reporting date.

Impairment

At each reporting date, DeeThree assesses its development and production assets for possible impairment if there are events or changes in circumstances that indicate that carrying values of the assets may not be recoverable. Such indicators include changes in the business plans, significant downward revisions of estimated volumes, significant declines in commodity prices, increases in estimated future development expenditures, changes in regulations, evidence of physical damage and low plant utilization. If any such indicator exists, the asset's recoverable amount is estimated.

The assessment for impairment entails comparing the carrying value of the CGU with its recoverable amount, that is, the higher of fair value less costs to sell and value in use. Each CGU is identified in accordance with IAS 36 – "Impairment of Assets". If necessary, impairment is charged through the statement of income and comprehensive income if the capitalized costs of the CGU exceed the recoverable amount.

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

3. Significant Accounting Policies *(continued)*

(b) Exploration and Evaluation Assets

Capitalization

Oil and gas exploration and evaluation ("E&E") assets are accounted for in accordance with IFRS 6 – "Exploration for and Evaluation of Mineral Resources" whereby costs associated with the exploration for and evaluation of oil and gas reserves are accumulated on an area-by-area basis and are capitalized as either tangible or intangible E&E assets when incurred. Pre-licence costs are recognized in the statement of income and comprehensive income as incurred. E&E costs, including the costs of acquiring licences and drilling and completing wells, initially are capitalized as E&E assets according to the nature of the expenditure. The costs are accumulated in cost centres by well, field or exploration area pending determination of technical feasibility and commercial viability.

When an area is determined to be technically feasible and commercially viable, the accumulated costs are transferred to property and equipment. When an area is determined not to be technically feasible and commercially viable or the Company decides not to continue to work in the area, the unrecoverable costs are charged to profit or loss as E&E expenses.

No depletion or depreciation is provided for E&E assets.

Impairment

E&E assets are assessed for impairment if (i) sufficient data exists to determine technical feasibility and commercial viability, and (ii) facts and circumstances suggest that the carrying amount exceeds the recoverable amount. For purposes of impairment testing, E&E assets are tested at an operating segment level.

(c) Basis of Consolidation

The purchase method of accounting is used to account for corporate acquisitions and assets that meet the definition of a business combination under IFRS. The cost of an acquisition is measured as the fair value of the assets given, equity instruments issued and liabilities incurred or assumed at the date of closing. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date. The excess of the cost of acquisition over the fair value of the identifiable assets, liabilities and contingent liabilities acquired is recorded as goodwill. If the cost of the acquisition is less than the fair value of the net assets acquired, the difference is recognized immediately in the statement of income and comprehensive income.

(d) Leased Assets

Other leases are operating leases, which are not recognized on the Company's statement of financial position. Payments made under operating leases are recognized in profit or loss on a straight-line basis over the term of the lease. Lease incentives received are recognized as an integral part of the total lease expense over the term of the lease.

(e) Joint Interest Activities

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

(f) Revenue Recognition

Oil, natural gas and NGLs sales are recognized when commodities are sold and title passes to the customer. Royalty expense is recognized as it accrues in accordance with the terms of the overriding royalty agreements.

(g) Decommissioning Liabilities

The present value of expected future abandonment and reclamation costs is recorded on the statement of financial position as both a decommissioning liability and a charge to property and equipment at the time the obligation is incurred. The amount recognized is the present value of the estimated future expenditure determined in accordance with local conditions and discounted using a risk-free interest rate. 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 decommissioning liability; this accretion charge is included as a finance cost on the statement of income and comprehensive income. Actual reclamation and abandonment costs incurred are charged against the liability to the extent the liability was established.

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. Significant Accounting Policies *(continued)*

(h) Income Taxes

Income tax expense comprises current and deferred tax. Income tax expense is recognized in profit or loss, except to the extent that it relates to items recognized directly in equity, in which case it is recognized in equity.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous years.

Deferred tax is recognized on the temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is not recognized on the initial recognition of assets or liabilities in a transaction that is not a business combination.

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

A deferred tax asset is recognized to the extent that it is probable that future taxable profits will be available against which the temporary difference can be utilized. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realized.

(i) Flow-Through Shares

The Company finances a portion of its exploration and development activities through the issuance of flow-through shares. Under the terms of the flow-through share agreements, the resource expenditure deductions for income tax purposes related to exploratory development activities are renounced to subscribers in accordance with tax legislation. Flow-through shares issued are recorded in share capital at the fair value of common shares on the date of issue. The premium received on issuing flow-through shares is initially recorded as a long-term premium liability. As qualifying expenditures are incurred, the premium is reversed and a deferred income tax liability is recorded. The net amount is then recognized as deferred income tax expense.

(j) Cash and Cash Equivalents

Cash and cash equivalents comprise cash on hand, term deposits held with banks and other short-term highly liquid investments with maturities of three months or less at the time of purchase.

(k) Share-Based Compensation

The fair value of the options is determined using the Black-Scholes option pricing model and each tranche in an award is considered a separate award with its own vesting period and grant date fair value. The grant date fair value of options granted to officers, directors, employees and certain consultants is recognized as compensation expense with a corresponding increase in contributed surplus over the vesting period. A forfeiture rate is estimated on the grant date and is adjusted to reflect the actual number of options that vest.

Upon the exercise of the stock options, consideration paid together with the amount previously recognized in contributed surplus is recorded as an increase in share capital. In the event that vested options expire, previously recognized compensation expense associated with such stock options is not reversed. In the event that options are forfeited, previously recognized compensation expense associated with the unvested portion of such stock options is reversed.

(l) Financial Instruments

(i) Non-Derivative Financial Instruments

Non-derivative financial instruments comprise cash and cash equivalents, accounts receivable, and accounts payable and accrued liabilities. Non-derivative financial instruments are recognized initially at fair value plus, for instruments not at fair value through profit or loss, any directly attributable transaction costs. Subsequent to initial recognition, non-derivative financial instruments are measured as described below.

Financial Assets at Fair Value through Profit or Loss

An instrument is classified as fair value through profit or loss if it is held for trading or is designated as such upon initial recognition. Financial instruments are designated as fair value through profit or loss if the Company manages such investments and makes purchase and sale decisions based on their fair value in accordance with the Company's risk management or investment strategy. Upon initial recognition, attributable transaction costs are recognized in profit or loss when incurred. Financial instruments at fair value through profit or loss are measured at fair value, and changes therein are recognized in profit or loss. The Company has designated cash and cash equivalents at fair value.

3. Significant Accounting Policies *(continued)*

(l) Financial Instruments (continued)

(i) Non-Derivative Financial Instruments (continued)

Other

Other non-derivative financial instruments, which may include accounts receivable, accounts payable and accrued liabilities, and bank debt, are measured at amortized cost using the effective interest method less any impairment losses.

(ii) Derivative Financial Instruments

The Company may enter into certain financial derivative contracts in order to manage the exposure to market risks from fluctuations in commodity prices. These instruments are not used for trading or speculative purposes. The Company has not designated its financial derivative contracts as effective accounting hedges, and therefore, has not applied hedge accounting, even though the Company considers all commodity contracts to be economic hedges. As a result, all financial derivative contracts are classified as fair value through profit or loss and are recorded on the statement of financial position at fair value. Transaction costs are recognized in profit or loss when incurred. As at March 31, 2011, the Company did not have any financial derivative contracts.

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

(m) Share Capital

Common shares are classified as equity. Incremental costs directly attributable to the issue of common shares and stock options are recognized as a deduction from equity, net of deferred income taxes.

(n) Per Share Amounts

Basic net income or loss per share is calculated by dividing the profit or loss attributable to common shareholders of the Company by the weighted average number of common shares outstanding during the period. Diluted per share amounts are determined by adjusting the profit or loss attributable to common shareholders and the weighted average number of common shares outstanding for the effects of dilutive instruments, such as stock options and warrants granted using the treasury stock method. Should the Company have a loss for the period, options and warrants would be anti-dilutive, and therefore, will have no effect on the determination of loss per share.

4. Acquisition

In 2011, the Company acquired oil and gas assets principally located in the Brazeau/West Pembina area of central Alberta and the Peace River Arch area of northern Alberta for total cash consideration of $122,547,000. The property acquisition closed on March 22, 2011 and was accounted for as a business combination under IFRS 3 – “Business Combinations”. Acquisition costs of $1,119,000 were charged to general and administrative expense on the statement of income and comprehensive income. Had the acquisition closed January 1, 2011, an additional $5,800,000 in net operating revenue, $1,500,000 in operating and transportation expenses, and $1,846,000 in other expenses would have been recognized in the statement of income and comprehensive income rather than as an adjustment to the purchase price. Net income is not readily determinable.

4. Acquisition *(continued)*

(000s)	($)
Net assets acquired	
Petroleum and natural gas assets	122,081
Amounts reclassified to E&E activities	7,773
Adjustments related to January 1 to March 22, 2011 period	(2,454)
Decommissioning liabilities	(4,853)
	122,547
Consideration	
Total cash consideration	122,547

5. Exploration and Evaluation Assets

(000s)	**Three Months Ended March 31, 2011** ($)	Year Ended December 31, 2010 ($)
Balance – beginning of period	**11,052**	2,915
Additions	**8,308**	10,213
Acquisitions through business combinations	**7,773**	–
Transfers to property and equipment	**(144)**	(2,076)
Balance – end of period	**26,989**	11,052

E&E assets consist of the Company's exploration projects that are pending the determination of proved or probable reserves. Additions represent the Company's share of costs acquired or incurred on E&E assets during the period.

6. Property and Equipment

(000s)	Oil and Natural Gas Properties ($)	Office Equipment ($)	Total ($)
Cost or deemed cost			
Balance – January 1, 2010	23,077	37	23,114
Additions	12,539	22	12,561
Transfers from E&E assets	2,076	–	2,076
Balance – December 31, 2010	37,692	59	37,751
Acquisitions through business combinations	**119,628**	**–**	**119,628**
Additions	**(1,291)**	**22**	**(1,269)**
Transfers from E&E assets	**144**	**–**	**144**
Balance – March 31, 2011	**156,173**	**81**	**156,254**
Accumulated depletion and depreciation			
Balance – January 1, 2010	–	13	13
Depletion and depreciation for the year	3,320	10	3,330
Impairment loss	16,650	–	16,650
Balance – December 31, 2010	19,970	23	19,993
Depletion and depreciation for the period	**868**	**3**	**871**
Balance – March 31, 2011	**20,838**	**26**	**20,864**
Net book value			
January 1, 2010	23,077	24	23,101
December 31, 2010	17,722	36	17,758
March 31, 2011	**135,335**	**55**	**135,390**

(a) Capitalization of General and Administrative and Share-Based Compensation Expenses

During the three months ended March 31, 2011, approximately $118,000 of directly attributable general and administrative expense and $51,000 of directly attributable share-based compensation expense were capitalized as expenditures on property and equipment (year ended December 31, 2010 – $530,000 and $300,000, respectively).

6. Property and Equipment *(continued)*

(b) Amortization and Impairment Charges

During 2010, as a result of decreasing natural gas prices, DeeThree recognized a $16,650,000 impairment relating to the Company's petroleum and natural gas properties. The impairment charge was recorded as an impairment loss with the offset recorded to accumulated depletion and depreciation. The impairment was based on the difference between the period-end net book value of the assets and the recoverable amount. The recoverable amount was determined using fair value less costs to sell based on discounted cash flows of proved and probable reserves using forecast prices and costs.

No impairment indicators existed as of March 31, 2011.

(c) Future Development Costs and Salvage Value

During the three months ended March 31, 2011, an estimated $24,138,000 of future development costs associated with proved plus probable undeveloped reserves was included in the calculation of depletion and depreciation expense and an estimated $6,500,000 of salvage value of production equipment was excluded (December 31, 2010 – $610,000 and $2,400,000, respectively).

7. Bank Debt

At March 31, 2011, the Company had a revolving demand credit facility with an authorized borrowing base of $20,000,000. Standby fees associated with this facility range from 1.0% to 1.25% per annum on the undrawn portion of the facility based on the Company's consolidated debt to cash flow ratio. At March 31, 2011, $nil (2010 – $nil) was drawn against the revolving demand credit facility. The next semi-annual review of the credit facility is scheduled for the fall of 2011. 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.

8. Decommissioning Liabilities

The Company's decommissioning liabilities result from its ownership interest in oil and natural gas assets. The total decommissioning liabilities are estimated based on the Company's net ownership interest in all wells and facilities, estimated costs to reclaim and abandon these wells and facilities, and the estimated timing of the costs to be incurred in future years. The Company has estimated the net present value of decommissioning obligations to be $7,385,000 as at March 31, 2011 (December 31, 2010 – $2,498,000) based on an undiscounted total future liability of $10,900,000 (December 31, 2010 – $3,200,000). These payments are expected to be incurred over a period of one to 20 years with the majority of costs to be incurred between 2013 and 2026. At March 31, 2011, a risk-free rate of 3.5% (December 31, 2010 – 3.5%) and an inflation rate of 2% (December 31, 2010 – 2%) were used to calculate the net present value of the decommissioning liabilities.

	Three Months Ended March 31, 2011	Year Ended December 31, 2010
(000s)	*($)*	*($)*
Balance – beginning of period	**2,498**	2,255
Liabilities incurred	**80**	200
Liabilities acquired	**4,854**	–
Revisions/settlements	**(72)**	(40)
Accretion of decommissioning liabilities	**25**	83
Balance – end of period	**7,385**	2,498

9. 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, 2011		Year Ended December 31, 2010	
	Shares	Amount	Shares	Amount
	(#)	*($000s)*	*(#)*	*($000s)*
Balance – beginning of period	**32,937,091**	**73,530**	15,518,093	26,530
Common shares issued *(i)*	**26,795,000**	**115,219**	12,197,500	32,074
Flow-through shares issued *(ii)*	**3,000,000**	**15,450**	4,862,624	19,962
Premium on flow-through shares *(ii)*	**–**	**(2,550)**	–	(3,117)
Exercise of warrants *(iii)*	**–**	**–**	252,500	535
Exercise of options *(iv)*	**20,000**	**58**	106,374	297
Share issue costs	**–**	**(8,200)**	–	(3,751)
Tax benefit of share issue costs	**–**	**2,074**	–	1,000
Balance – end of period	**62,752,091**	**195,581**	32,937,091	73,530

(i) *Private Placements*

In March 2011, DeeThree issued 26,795,000 common shares at a price of $4.30 per common share for total gross proceeds of $115,219,000 ($108,000,000 net of share issue expenses), including 3,495,000 common shares ($15,029,000) issued on the exercise in full of the underwriters' over-allotment option.

In March 2010, DeeThree issued 4,197,500 common shares at a price of $2.40 per common share for total gross proceeds of $10,074,000 ($9,281,000 net of share issue expenses), including 547,500 common shares ($1,314,000) issued on the exercise in full of the underwriters' over-allotment option.

In September 2010, DeeThree issued 8,000,000 common shares at a price of $2.75 per common share for total gross proceeds of $22,000,000 ($20,441,000 net of share issue expenses), including 1,043,478 ($2,870,000) common shares issued on the exercise in full of the underwriters' over-allotment option.

(ii) *Flow-Through Shares*

In March 2011, DeeThree issued 3,000,000 flow-through shares at a price of $5.15 per flow-through share for total gross proceeds of $15,450,000 ($14,469,000 net of share issue expenses) and $0.85 per share or $2,550,000 was determined to be the implied premium on the flow-through shares. As at March 31, 2011, the Company is committed to spending an additional $15,450,000 on qualified exploration and development expenditures by December 31, 2012.

In March 2010, DeeThree issued 1,236,250 flow-through common shares at a price of $2.80 per flow-through common share for total gross proceeds of $3,461,500 ($3,183,500 net of share issue expenses), including 161,250 flow-through shares ($415,000) issued on the exercise in full of the underwriters' over-allotment option, and approximately $0.40 per share or $494,000 was determined to be the implied premium on the flow-through shares. As at March 31, 2011, the Company had met its obligation for qualified expenditures related to this issuance.

In November 2010, DeeThree issued 3,626,374 flow-through common shares at a price of $4.55 per flow-through common share for total gross proceeds of $16,500,000 ($15,378,000 net of share issue expenses) and approximately $0.723 per share or $2,622,000 was determined to be the implied premium on the flow-through shares. As at March 31, 2011, the Company was committed to spending an additional $7,500,000 on qualified exploration and development expenditures by December 31, 2011.

(iii) On May 19, 2010 and September 14, 2010, 200,000 and 52,500 warrants were exercised at $1.00 per share, respectively.

9. Share Capital *(continued)*

(b) Issued – Common Shares (continued)

(iv) On February 2, 2010, 12,500 options were exercised at $2.40 per share, on March 5, 2010, 17,000 options were exercised at $2.00 per share, and on September 14, 2010, 76,874 agent options were exercised at $2.00 per share.

On January 6, 2011, 10,000 options were exercised at a weighted average price of $2.45 per share and on March 16, 2011, 10,000 options were exercised at a weighted average price of $2.29 per share for total cash proceeds of $48,000 and previously recognized share-based compensation expense of $10,000.

(c) Per Share Amounts

Per share amounts have been calculated on the weighted average number of shares outstanding. The basic and diluted shares outstanding were as follows:

Three Months Ended March 31,	**2011**	2010
(000s)	*($)*	*($)*
Loss for the period	**(1,991)**	(589)
	(#)	*(#)*
Weighted average number of common shares – basic and diluted	**36,294,258**	17,100,671
	($)	*($)*
Net income per weighted average common share – basic and diluted	**(0.05)**	(0.03)

(d) Options Outstanding

The Company has an option program that entitles officers, directors, employees and certain consultants to purchase shares in the Company. Options are granted based on the five-day volume weighted average prior to the date of grant and vest 20% after six months and then 20% on the first, second and third anniversaries from the option grants and expire in five years.

The number and weighted average exercise prices of stock options are as follows:

	Three Months Ended March 31, 2011		Year Ended December 31, 2010	
	Options	Weighted Average Exercise Price	Options	Weighted Average Exercise Price
	(#)	*($)*	*(#)*	*($)*
Outstanding – January 1	**1,885,000**	**2.26**	1,047,057	1.88
Issued	**185,500**	**4.34**	1,045,000	2.60
Exercised	**(20,000)**	**2.37**	(106,374)	2.05
Forfeited	**(60,000)**	**2.62**	(100,683)	2.13
Outstanding – end of period	**1,990,500**	**2.44**	1,885,000	2.26
Exercisable – end of period	**555,500**	**2.08**	466,500	1.80

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:

Weighted Average Exercise Price	Options Outstanding	Contractual Life	Weighted Average Options Exercisable
($)	*(#)*	*(years)*	*(#)*
As at March 31, 2011			
1.20	**200,000**	**2.2**	**100,000**
2.00 – 2.89	**1,605,000**	**3.9**	**455,500**
4.22 – 4.39	**185,500**	**5.0**	**–**
	1,990,500	**3.8**	**555,500**

9. Share Capital *(continued)*

(d) Options Outstanding (continued)

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, 2011**	December 31, 2010
Risk-free interest rate *(%)*	**1.84**	2.28
Expected life *(years)*	**2.1**	2.1
Expected volatility *(%)*	**77**	123
Expected dividend yield *(%)*	**0**	0
Fair value of options granted during the period *($/share)*	**1.84**	1.77

A forfeiture rate of 0% for those options granted during the three months ended March 31, 2011 (year ended December 31, 2010 – 0%) was used when recording share-based compensation expense. This estimate is adjusted to the actual forfeiture rate. Share-based compensation cost of $196,000 was expensed during the three months ended March 31, 2011 (three months ended March 31, 2010 – $48,000 and year ended December 31, 2010 – $420,000).

10. Supplemented Cash Flow Information

Changes in non-cash working capital is comprised of:

Three Months Ended March 31,	**2011**	2010
(000s)	*($)*	*($)*
Accounts receivable	**(4,227)**	(171)
Prepaid expenses and other	**28**	84
Accounts payable and accrued liabilities	**480**	3,367
	(3,719)	3,280
Related to operating activities	**(4,030)**	(189)
Related to financing activities	**–**	50
Related to investing activities	**311**	3,419
	(3,719)	3,280

11. Determination of Fair Values

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

(a) Property and Equipment and E&E Assets

The fair value of property and equipment recognized in a business combination is based on market values. The market value of property and equipment is the estimated amount for which property and equipment could be exchanged on the acquisition date between a willing buyer and a willing seller in an arm's length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently and without compulsion. The market value of petroleum and natural gas properties (included in property and equipment) and E&E assets is estimated with reference to the discounted cash flows expected to be derived from oil and natural gas production based on externally prepared reserve reports. The risk-adjusted discount rate is specific to the asset with reference to general market conditions.

The market value of other items of property and equipment is based on the quoted market prices for similar items.

(b) Cash and Cash Equivalents, Accounts Receivable, Accounts Payable and Accrued Liabilities

The fair value of cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities is estimated as the present value of future cash flows, discounted at the market rate of interest at the reporting date. The fair value of these balances approximated their carrying value due to their short-term to maturity.

11. Determination of Fair Values *(continued)*

(c) Stock Options

The fair value of stock options is measured using a Black-Scholes option pricing model. Measurement inputs include share price on measurement date, exercise price of the instrument, expected volatility (based on weighted average historic volatility adjusted for changes expected due to publicly available information), weighted average expected life of the instruments (based on historical experience and general option holder behaviour) and the risk-free interest rate (based on government bonds).

DeeThree classifies the fair value of these transactions according to the following hierarchy based on the amount of observable inputs used to value the instrument.

- Level 1 – Quoted prices are available in active markets for identical assets or liabilities as of the reporting date. Active markets are those in which transactions occur in sufficient frequency and volume to provide pricing information on an ongoing basis.
- Level 2 – Pricing inputs are other than quoted prices in active markets included in Level 1. Prices are either directly or indirectly observable as of the reporting date. Level 2 valuations are based on inputs, including quoted forward prices for commodities, time value and volatility factors, which can be substantially observed or corroborated in the marketplace.
- Level 3 – Valuations in this level are those with inputs for the asset or liability that are not based on observable market data.

The carrying value of cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities included in the statement of financial position approximate fair value due to the short-term nature of those instruments.

12. Financial Risk Management

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 natural gas and crude oil. This occurs on the 25th day following the month in which the production is sold. DeeThree partially mitigates associated credit risk by limiting transactions to credit-worthy counterparties.

DeeThree has minimal activity with industry partners; however, to the extent that DeeThree does, the Company must collect, on a monthly basis, partners' share of capital and operating expenses. These collections are subject to normal industry credit risk. DeeThree had no material accounts receivable deemed uncollectible.

(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 the statement of financial position consist of accounts payable and accrued liabilities. This amount consists of invoices payable to trade suppliers relating to the office and field operating activities, and the Company's capital spending program. DeeThree processes invoices within a normal payment period. DeeThree anticipates it will continue to have adequate liquidity to fund its financial liabilities through its current working capital, its future funds flow from operations and available bank debt. The Company had no defaults or breaches on its bank debt or any of its financial liabilities as at or for the period ended March 31, 2011.

The following table details the Company's financial liabilities as at March 31, 2011:

As at March 31, 2011	Total	Within 1 Year	Over 1 Year
(000s)	*($)*	*($)*	*($)*
Accounts payable and accrued liabilities	**6,124**	**6,124**	**–**
Total financial liabilities	**6,124**	**6,124**	**–**

12. Financial Risk Management *(continued)*

(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.

The Company currently has no financial derivative contracts to manage market risk. The Company will enter into such transactions in accordance with the risk management policy that has been approved by the Board of Directors.

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 commodity prices. Commodity prices for petroleum and natural gas are impacted by not only the relationship between the Canadian and United States dollars, as outlined below, but also global economic events that dictate the levels of supply and demand. The Company has attempted to mitigate commodity price risk through the use of physical fixed priced contracts for its natural gas production. As at March 31, 2011, the Company had no fixed priced contracts in place.

Foreign Currency Exchange Rate Risk

Foreign currency exchange rate risk is the risk that the fair value of future cash flows will fluctuate as a result of changes in foreign exchange rates. The Company does not sell or transact in any foreign currency, but may be impacted by foreign currency exchange rate changes related to commodity prices as outlined above.

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. As at March 31, 2011, the Company had no debt and no interest rate swaps or hedges. Due to the Company's positive cash position at March 31, 2011, a drop in interest rates would decrease future interest income.

(d) Capital Management

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 and cash equivalents, bank debt and equity comprising of issued share capital, contributed surplus and deficit.

The following is a breakdown of the Company's capital structure:

As at	**March 31, 2011**	December 31, 2010
(000s)	*($)*	*($)*
Cash and cash equivalents	**21,430**	32,994
Bank debt	**–**	–
Shareholders' equity	**175,423**	55,126

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.

DeeThree does not have any externally imposed financial covenants governing its capital structure. The current credit facility has no financial ratio covenants; 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, 2010.

13. Related Parties

The following summarizes the Company's related party transactions as at March 31, 2011:

The Company has retained a law firm to provide legal services. The Corporate Secretary of DeeThree is a partner of this firm. During the period ended March 31, 2011, the Company incurred $177,000 in costs with the firm (period ended March 31, 2010 – $136,000), which have been included in general and administrative expenses and share issue costs, and $59,000 remained in accounts payable at March 31, 2011 (March 31, 2010 – $23,700). 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 2011.

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.

14. Commitments

Years Ended December 31,	2011	2012	2013	2014	2015+
(000s)	*($)*	*($)*	*($)*	*($)*	*($)*
Operating lease – office	302	884	884	542	677
Operating lease – vehicles	108	125	68	41	–
Exploration expenditures (flow-through)	7,500	15,450	–	–	–
Drilling contracts	2,354	7,391	5,037	–	–
Total	10,264	23,850	5,989	583	677

As at March 31, 2011, the Company had contractual obligations for its office lease totaling approximately $3,289,000 to the end of 2016. The head office lease obligations are comprised of the lease and includes parking and an estimate of occupancy costs of the Company's head office space. The Company also had contractual obligations for several vehicles totaling approximately $342,000 to the end of 2014.

In connection with the issuance of flow-through shares by the Company during the first quarter of 2011, DeeThree is required to spend $15,400,000 of eligible exploration expenditures by December 31, 2012. As at March 31, 2011, $nil of the eligible exploration expenditures had been incurred. These expenditures will be renounced to shareholders in January 2012 effective December 31, 2011.

In connection with the issuance of flow-through shares by the Company during the fourth quarter of 2010, DeeThree is required to spend $16,500,000 of eligible exploration expenditures by December 31, 2011. As at March 31, 2011, approximately $9,000,000 of the eligible exploration expenditures had been incurred. These expenditures were renounced to shareholders in January 2011 effective December 31, 2010.

In connection with the issuance of flow-through shares by the Company during the first quarter of 2010, DeeThree was required to spend $3,500,000 of eligible exploration expenditures by December 31, 2011. As at March 31, 2011, all of the eligible exploration expenditures had been incurred. These expenditures were renounced to shareholders in January 2011 effective December 31, 2010.

During the first quarter of 2011 and subsequent to March 31, 2011, DeeThree entered into contracts for drilling rig services under which the Company is committed to using services totaling $14,782,000 beginning in 2011 and extending into 2013.

In connection with the acquisition of the Lethbridge property in November 2008, the Company has an operational commitment to drill 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 at March 31, 2011, the Company drilled 27 wells and has approximately one-third of a township of 3-D seismic data left to shoot in 2011, thereby satisfying the second year drilling and 93% of the total seismic commitment. 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. 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. At the conclusion of the five-year term of the commitment agreement, the applicable areas of the Lethbridge property, which do not have a well located thereon, revert to the Lethbridge property vendor subject to the right of DeeThree to extend the term in respect of an additional five or ten sections of Lethbridge property land by committing to drill an additional five or ten wells, respectively, on such sections of land. Unless cured within a 45-day period, a default by the Company of its obligations under the commitment agreement may result in the applicable areas of the Lethbridge property, which do not have a well located thereon, reverting to the Lethbridge property vendor.

15. Subsequent Events

In April 2011, the Company entered into a farm-out and joint venture agreement with a major oil and gas company (the "farmee"). The terms of the agreement involve a four-well commitment on a total of 15,815 acres of DeeThree's undeveloped lands that are strategically located in the Lethbridge area. The farmee is committed to drill four horizontal earning wells by December 31, 2011 and is responsible for 100% of the costs through completion to earn a 60% working interest in the farm-out lands with no payout terms.

On May 9, 2011, DeeThree entered into a costless collar for 250 bbls/d of crude oil effective June 1, 2011 to December 31, 2011 at a floor price of US$95.00/bbl and a cap price of US$106.00/bbl.

On May 20, 2011, DeeThree entered into a costless collar for 250 bbls/d of crude oil effective January 1, 2012 to December 31, 2012 at a floor price of US$95.00/bbl and a cap price of US$115.00/bbl, unless the monthly average WTI price per barrel averages over US$115.00/bbl every day for the entire month, in which case the cap becomes US$100.00/bbl.

16. Transition to IFRS

As stated in note 2(a), these are the Company's first financial statements prepared in accordance with IFRS.

The policies set out in the significant accounting policies section of this report have been applied in preparing the financial statements for the three months ended March 31, 2011, the comparative information presented in these financial statements for the period ended March 31, 2010 and for the year ended December 31, 2010, and in the preparation of an opening IFRS statement of financial position at January 1, 2010 (the Company's date of transition).

The following reconciliations present the adjustments made to the Company's Canadian GAAP financial results of operations and financial position to comply with IFRS 1. A summary of the significant accounting policy changes and applicable exemptions are discussed following the reconciliations. Reconciliations include the Company's Statement of Financial Position as at January 1, 2010, March 31, 2010 and December 31, 2010, Statements of Income (Loss) and Comprehensive Income (Loss) for the three months ended March 31, 2010 and year ended December 31, 2010, and Statements of Cash Flow for the three months ended March 31, 2010 and year ended December 31, 2010.

Reconciliation of the Statement of Financial Position as at the Date of Transition – January 1, 2010

	Previous GAAP	Effect of Transition to IFRS	IFRS
(000s)	*($)*	*($)*	*($)*
Assets			
Current			
Restricted cash	4,000	–	4,000
Accounts receivable	1,059	–	1,059
Deposits and prepaid expenses	254	–	254
	5,313	–	5,313
Exploration and evaluation assets *(note a)*	–	2,915	2,915
Property and equipment *(note a)*	26,016	(2,915)	23,101
Total assets	31,329	–	31,329
Liabilities			
Current			
Bank debt	2,436	–	2,436
Accounts payable and accrued liabilities	2,502	–	2,502
	4,938	–	4,938
Decommissioning liabilities *(note b)*	1,636	619	2,255
Flow-through share premium liabilities *(note g)*	–	705	705
Deferred tax liability *(note f)*	81	511	592
Total liabilities	6,655	1,835	8,490
Shareholders' Equity			
Share capital *(note g)*	27,263	(733)	26,530
Share purchase warrants	283	–	283
Contributed surplus *(note c)*	477	(10)	467
Deficit	(3,349)	(1,092)	(4,441)
Total equity	24,674	(1,835)	22,839
Total liablities and shareholders' equity	31,329	–	31,329

16. Transition to IFRS *(continued)*

Reconciliation of the Statement of Financial Position as at March 31, 2010

(000s)	Previous GAAP ($)	Effect of Transition to IFRS ($)	IFRS ($)
Assets			
Current			
Cash and cash equivalents	11,071	–	11,071
Accounts receivable	1,230	–	1,230
Deposits and prepaid expenses	169	–	169
	12,470	–	12,470
Exploration and evaluation assets *(note a)*	–	6,732	6,732
Property and equipment *(notes a,d)*	32,123	(6,595)	25,528
Total assets	44,593	137	44,730
Liabilities			
Current			
Accounts payable and accrued liabilities	5,869	–	5,869
	5,869	–	5,869
Decommissioning liabilities *(note b)*	1,686	614	2,300
Flow-through share premium liabilities *(note g)*	–	577	577
Deferred tax liability *(note f)*	1,606	(275)	1,331
Total liabilities	9,161	916	10,077
Shareholders' Equity			
Share capital *(note g)*	38,231	644	38,875
Share purchase warrants	283	–	283
Contributed surplus *(note c)*	532	(7)	525
Deficit	(3,614)	(1,416)	(5,030)
Total equity	35,432	(779)	34,653
Total liabilities and shareholders' equity	44,593	137	44,730

16. Transition to IFRS *(continued)*

Reconciliation of the Statement of Financial Position as at December 31, 2010

(000s)	Previous GAAP ($)	Effect of Transition to IFRS ($)	IFRS ($)
Assets			
Current			
Cash and cash equivalents	32,994	–	32,994
Accounts receivable	884	–	884
Deposits and prepaid expenses	271	–	271
	34,149	–	34,149
Exploration and evaluation assets *(note a)*	–	11,052	11,052
Property and equipment *(notes a,d)*	38,888	(21,130)	17,758
Deferred tax asset *(note f)*	1,196	1,179	2,375
Total assets	74,233	(8,899)	65,334
Liabilities			
Current			
Accounts payable and accrued liabilities	5,644	–	5,644
	5,644	–	5,644
Decommissioning liabilities *(note b)*	1,822	676	2,498
Flow-through share premium liabilities *(note g)*	–	2,066	2,066
Total liabilities	7,466	2,742	10,208
Shareholders' Equity			
Share capital *(note g)*	75,508	(1,978)	73,530
Contributed surplus *(note c)*	1,322	(215)	1,107
Deficit	(10,063)	(9,448)	(19,511)
Total equity	66,767	(11,641)	55,126
Total liabilities and shareholders' equity	74,233	(8,899)	65,334

16. Transition to IFRS *(continued)*

Reconciliation of the Statement of Income (Loss) and Comprehensive Income (Loss) for the Three Months Ended March 31, 2010

(000s, except per share amounts)	Previous GAAP ($)	Effect of Transition to IFRS ($)	IFRS ($)
Revenue			
Oil and natural gas revenues	2,293	–	2,293
Royalties	(400)	–	(400)
Oil and natural gas revenues, net of royalties	1,893	–	1,893
Expenses			
Operating and transportation	656	–	656
General and administrative	360	7	367
Depletion and depreciation *(note d)*	1,118	(149)	969
Share-based compensation *(note c)*	43	5	48
	2,177	(137)	2,040
Accretion and finance expenses *(note b)*	56	(13)	43
	2,233	150	2,083
Loss before income taxes	(340)	150	(190)
Taxes			
Deferred income expense (recovery) *(note f)*	(75)	474	399
Net loss and comprehensive loss for the period	(265)	(324)	(589)
Net loss per share			
Basic and diluted	(0.02)	(0.01)	(0.03)

Reconciliation of the Statement of Income (Loss) and Comprehensive Income (Loss) for the Year Ended December 31, 2010

(000s, except per share amounts)	Previous GAAP ($)	Effect of Transition to IFRS ($)	IFRS ($)
Revenue			
Oil and natural gas revenues	7,073	–	7,073
Royalties	(1,024)	–	(1,024)
Oil and natural gas revenues, net of royalties	6,049	–	6,049
Expenses			
Operating and transportation	2,663	–	2,663
General and administrative	1,822	(82)	1,740
Depletion and depreciation *(note d)*	4,544	(1,214)	3,330
Impairment *(note e)*	5,299	11,351	16,650
Share-based compensation *(note c)*	605	(185)	420
	14,933	9,870	24,803
Finance income	(105)	–	(105)
Accretion and finance expenses *(note b)*	204	(61)	143
	15,032	9,809	24,841
Loss before income taxes	(8,983)	(9,809)	(18,792)
Taxes			
Deferred income tax expense *(note f)*	(2,269)	(1,453)	(3,722)
Net loss and comprehensive loss for the period	(6,714)	(8,356)	(15,070)
Net loss per share			
Basic and diluted	(0.29)	(0.36)	(0.65)

16. Transition to IFRS *(continued)*

Reconciliation of the Statement of Cash Flows for the Three Months Ended March 31, 2010

(000s)	Previous GAAP ($)	Effect of Transition to IFRS ($)	IFRS ($)
Cash flow from (used in):			
Operating activities			
Net loss for the period	(265)	(324)	(589)
Add back non-cash items:			
Depletion and depreciation	1,118	(149)	969
Accretion	33	(13)	20
Share-based compensation	43	5	48
Deferred income tax expense (recovery)	(75)	474	399
	854	(7)	847
Change in non-cash working capital	(189)	–	(189)
	665	(7)	658
Financing activities			
Decrease in bank debt	(2,436)	–	(2,436)
Issuance of share capital	13,600	–	13,600
Share issue expenses	(1,063)	–	(1,063)
Change in non-cash working capital	51	–	51
	10,152	–	10,152
Investing activities			
Property and equipment additions	(7,165)	3,935	(3,230)
Exploration and evaluation expenditures	–	(3,928)	(3,928)
Decrease in restricted cash	4,000	–	4,000
Change in non-cash working capital	3,419	–	3,419
	254	7	261
Change in cash and cash equivalents	11,071	–	11,071
Cash and cash equivalents – beginning of period	–	–	–
Cash and cash equivalents – end of period	11,071	–	11,071

16. Transition to IFRS *(continued)*

Reconciliation of the Statement of Cash Flows for the Year Ended December 31, 2010

	Previous GAAP	Effect of Transition to IFRS	IFRS
(000s)	*($)*	*($)*	*($)*
Cash flow from (used in):			
Operating activities			
Net loss for the year	(6,714)	(8,356)	(15,070)
Add back non-cash items:			
Depletion and depreciation	4,544	(1,214)	3,330
Impairment	5,299	11,351	16,650
Accretion	142	(61)	81
Share-based compensation	605	(185)	420
Deferred income tax recovery	(2,269)	(1,453)	(3,722)
	1,607	82	1,689
Abandonment and reclamation costs	(39)	–	(39)
Change in non-cash working capital	79	–	79
	1,647	82	1,729
Financing activities			
Decrease in bank debt	(2,436)	–	(2,436)
Issuance of share capital	52,506	–	52,506
Share issue expenses	(3,751)	–	(3,751)
	46,319	–	46,319
Investing activities			
Property and equipment additions	(22,193)	8,055	(14,138)
Exploration and evaluation expenditures	–	(8,137)	(8,137)
Decrease in restricted cash	4,000	–	4,000
Change in non-cash working capital	3,221	–	3,221
	(14,972)	(82)	(15,054)
Change in cash and cash equivalents	32,994	–	32,994
Cash and cash equivalents – beginning of year	–	–	–
Cash and cash equivalents – end of year	32,994	–	32,994

Notes to Reconciliations

(a) IFRS 1 – "First-Time Adoption of International Financial Reporting Standards"

IFRS 1 requires the presentation of comparative information as at the January 1, 2010 transition date, and subsequent comparative periods, as well as the consistent and retrospective application of IFRS accounting policies. To assist with the transition, the provisions of IFRS 1 allow for certain mandatory and optional exemptions for first-time adopters to alleviate the retrospective application of all IFRSs. The Company has applied the following transition exceptions and exemptions:

(i) Full Cost Book Value as Deemed Value

Under Canadian GAAP, the Company followed full cost accounting in which all costs directly associated with the acquisition of, and the development of oil and gas reserves were capitalized on a country-by-country basis. Costs accumulated within a country cost centre were depleted using the unit-of-production method based on proved reserves determined using escalated future pricing. The Company elected an exemption whereby the Canadian full cost pool was measured at the date of transition to IFRS as follows:

- E&E assets were reclassified from the full cost pool to intangible and tangible E&E assets at the amount recorded under Canadian GAAP;
- Other components, consisting of the Company's major facilities, were brought into the property and equipment balance at net book value; and
- The remaining full cost pool was allocated to the producing and developed assets pro-rata using proved plus probable reserves values.

16. Transition to IFRS *(continued)*

Notes to Reconciliations (continued)

(a) IFRS 1 – "First-Time Adoption of International Financial Reporting Standards" (continued)

(i) Full Cost Book Value as Deemed Value (continued)

This resulted in a $2,915,000 increase to E&E assets with a corresponding decrease in property and equipment upon transition. For the three months ended March 31, 2010, the transfer was $6,732,000 and for the year ended December 31, 2010, the transfer was $11,052,000.

(ii) Business Combinations

IFRS 1 provides the option to apply IFRS 3 – "Business Combinations" retrospectively or prospectively from the date of transition. The Company elected to value business combinations prior to January 1, 2010 at the amounts determined under Canadian GAAP rather than applying IFRS rules retrospectively. As such, Canadian GAAP balances relating to business combinations entered into before that date have been carried forward without adjustment.

(iii) Arrangements Containing a Lease

The Company elected to apply IFRS relating to leases as at January 1, 2010. The Company determined that there were no significant arrangements containing a lease at the date of transition to IFRS.

(iv) Borrowing Costs

The Company elected to apply IFRS relating to borrowing costs prospectively from January 1, 2010. Borrowing costs relating to qualifying assets, if any, before that date were expensed as incurred.

(v) Decommissioning Liabilities

The Company elected to apply IFRS relating to decommissioning liabilities (previously referred to as asset retirement obligations) as at the date of transition to IFRS. The Company restated its decommissioning liabilities in accordance with IFRS at January 1, 2010 and recognized the difference from the amounts recorded under Canadian GAAP directly into retained earnings. Refer to "Decommissioning Liabilities" below for further details.

(vi) Share-Based Compensation

The Company elected to not apply IFRS relating to share-based payments to awards that vested prior to January 1, 2010. Awards that were unvested at the date of transition to IFRS were restated retroactively. This resulted in a $10,000 adjustment to retained earnings and contributed surplus at the date of transition.

(b) Decommissioning Liabilities

Under Canadian GAAP, decommissioning liabilities (previously referred to as asset retirement obligations) were discounted at a credit adjusted risk-free rate of 8.06%. Under IFRS, the estimated cash flows to abandon and remediate the wells and facilities have been risk adjusted; therefore, the provision is discounted at a risk-free rate of 3.5%. Upon transition to IFRS, this resulted in an increase of $619,000 in decommissioning liabilities with a corresponding increase to the deficit in the statement of financial position. As a result of the adjustment to the deficit on adoption of IFRS, accretion expense decreased $13,000 for the three months ended March 31, 2010 and decreased $61,000 for the year ended December 31, 2010 under IFRS compared to Canadian GAAP.

Under Canadian GAAP, accretion of the discount was included in depletion, depreciation and accretion. Under IFRS, accretion is included in accretion and finance expenses.

Under Canadian GAAP, expenditures on abandonment and remediation were not included in changes in non-cash working capital, as has been done under IFRS.

(c) Share-Based Compensation

Under Canadian GAAP, the Company recognized an expense related to their share-based payments on a straight-line basis through the date of full vesting and did not incorporate a forfeiture multiple. Under IFRS, the Company is required to recognize the expense over the individual vesting periods for the graded vesting awards and estimate a forfeiture rate.

The impact on transition was a decrease to contributed surplus of $10,000 with an offsetting increase to opening deficit. For the three months ended March 31, 2010 and year ended December 31, 2010, contributed surplus decreased $7,000 and $215,000, respectively, with an offsetting increase to opening deficit.

16. Transition to IFRS *(continued)*

Notes to Reconciliations (continued)

(d) Depletion and Depreciation Policy

On transition to IFRS, the Company adopted a policy of depleting its oil and natural gas reserves on a unit-of-production basis by field, using proved plus probable reserves. Under Canadian GAAP, there was only one depletion calculation at a country level using only proved reserves. The Company's major facilities under IFRS are depreciated based on the life span of the facilities.

There was no impact on adoption of IFRS at January 1, 2010 as a result of the IFRS 1 election discussed in note (a) above.

For the three months ended March 31, 2010, depletion and depreciation under IFRS was $149,000 less than the Canadian GAAP primarily due to the depreciation of major facilities over 20 years. For the year ended December 31, 2010, depletion and depreciation under IFRS was $1,214,000 less than under Canadian GAAP because of impairments recognized at June 30, 2010, September 30, 2010 and December 31, 2010 as discussed in (e) below.

(e) Impairment of Property, Plant and Equipment

Under Canadian GAAP, impairment was calculated using only proved reserves at a country level, whereas under IFRS, impairment tests are done at a CGU level using proved plus probable reserves. An impairment is recognized under IFRS if the carrying amount or net book value is higher than the recoverable amount of the CGU. Recoverable amount is defined as the higher of fair value less costs to sell and value in use. For oil and gas companies, the recoverable amount can be determined from the reserves report using the present value of future cash flows at an appropriate discount rate.

On transition to IFRS, there was no impairment for the Company; however, as natural gas prices declined, DeeThree recorded impairments of $2,000,000 at June 30, 2010, $8,500,000 at September 30, 2010 and $6,200,000 at December 31, 2010. These amounts were included in impairment expense. Impairments can be reversed in the future if the recoverable amount increases.

(f) Deferred Income Taxes

The IFRS adjustments made to the carrying values of assets and liabilities in (b), (d) and (e) above and (g) below have resulted in changes to the temporary differences recorded under Canadian GAAP.

Deferred Tax Asset (Liability) As at	January 1, 2010	March 31, 2010	December 31, 2010
(000s)	*($)*	*($)*	*($)*
Canadian GAAP – balance	(81)	(1,606)	1,196
Adjustment related to:			
Temporary differences	163	134	3,113
Reversal of GAAP flow-through share provision *(note g)*	–	1,871	1,871
Flow-through shares *(note g)*	(674)	(1,730)	(3,805)
	(511)	275	1,179
IFRS – balance	(592)	(1,331)	2,375

These adjustments resulted in a deferred tax expense adjustment of $474,000 for the three months ended March 31, 2010 and a deferred tax recovery adjustment of $1,453,000 for the year ended December 31, 2010.

Under IFRS, there is no requirement to separate the portion of deferred income taxes related to current assets or liabilities. All deferred income tax amounts have been classified to long-term.

Adjustments to deferred income taxes have been made in regards to the adjustments noted above that resulted in a change to the temporary difference between tax and accounting values.

(g) Flow-Through Shares

Under IFRS, flow-through shares issued are recorded in share capital at the fair value of common shares on the date of issue. The premium received on issuing flow-through shares is initially recorded as a deferred premium liability and as qualifying expenditures are incurred, the premium is reversed and a deferred tax liability is recorded. The net amount is then recognized as deferred income tax expense.

On transition to IFRS, the Company recorded an adjustment with respect to flow-through shares that were issued during 2008 and 2009. As a result, the flow-through share premium liability increased $705,000, deferred tax liabilities increased $674,000, share capital decreased $733,000 and opening deficit increased $646,000.

16. Transition to IFRS *(continued)*

Notes to Reconciliations (continued)

(g) Flow-Through Shares (continued)

During the three months ended March 31, 2010, expenditures relating to the 2008 and 2009 flow-through shares accounting for approximately 88% of the total flow-through commitment that was set up on transition were incurred. As a result, the premium liability decreased $622,000, deferred income tax liabilities increased $1,056,000 and the net amount of $434,000 was recognized as deferred income tax. Due to the difference between the treatment of flow-through shares between Canadian GAAP and IFRS, the Company also reversed a 2010 first quarter Canadian GAAP amount, which decreased deferred tax liabilities $1,871,000 and increased share capital $1,871,000.

During the remainder of the year ended December 31, 2010, expenditures accounting for the outstanding 12% of this total flow-through commitment were incurred, and as a result, the premium liability decreased $83,000, deferred tax liabilities increased $140,000 and the net amount of $57,000 was recognized as deferred income tax expense.

In March 2010, the Company issued flow-through shares, and under IFRS, recorded a premium liability of $494,500 with an offsetting decrease to share capital. Expenditures incurred during the periods ended June 30, 2010, September 30, 2010 and December 31, 2010 accounted for 100% of the total flow-through commitment, and as a result, the premium liability decreased $494,000, deferred income tax liabilities increased $963,000 and the net amount of $469,000 was recognized as deferred income tax expense.

In November 2010, the Company issued flow-through share, and under IFRS, recorded a premium liability of $2,622,000 with an offsetting decrease to share capital. Expenditures incurred during 2010 accounted for approximately 21% of the total flow-through commitment, and as a result, the premium liability decreased $556,000, deferred income tax liabilities increased $972,000 and the net amount of $416,000 was recognized as deferred income tax expense.

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

Clayton Thatcher
Vice President, Geophysics

Daniel Kenney
Corporate Secretary

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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

Toronto Stock Exchange
Trading Symbol: DTX

Abbreviations

bbls	barrels
boe	barrels of oil equivalent
GJ	gigajoules
/d	per day
mcf	thousand cubic feet
mm	million
mmbtu	million British thermal units
NGLs	natural gas liquids
3-D	three dimensional

Conversion of Units

1,0 mcf	=	1.02 mmbtu
1.0 mcf	=	1.05 GJ
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.