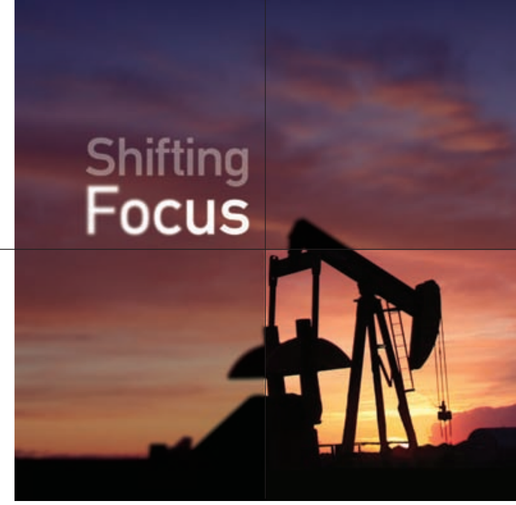
DeeThree Exploration Ltd.

Q3

2011 Third Quarter Interim Report
For the Three and Nine Months Ended
September 30, 2011



Highlights

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2011	2010[5]	Change	**2011**	2010[5]	Change
(000s, except per share amounts)	*($)*	*($)*	*(%)*	*($)*	*($)*	*(%)*
Financial						
Oil and natural gas revenues	**9,440**	1,618	483	**20,874**	5,590	273
Funds from operations [1]	**3,795**	462	721	**7,739**	1,681	360
Per share [1] – basic and diluted	**0.06**	0.02	200	**0.14**	0.08	75
Cash flow from operating activities	**8,910**	687	1,197	**6,346**	1,752	262
Net loss	**(353)**	(6,664)	(95)	**(3,243)**	(9,332)	(65)
Per share – basic and diluted	**(0.01)**	(0.29)	(97)	**(0.06)**	(0.46)	(87)
Capital expenditures [2]	**25,009**	3,574	600	**167,028**	14,744	1,033
Total assets	**206,885**	52,336	295	**206,885**	52,336	295
Working capital (deficit) [3]	**(3,356)**	20,668	(116)	**(3,356)**	20,668	(116)
Shareholders' equity	**176,346**	47,479	271	**176,346**	47,479	271
(000s)	*(#)*	*(#)*	*(%)*	*(#)*	*(#)*	*(%)*
Share Data						
At period-end	**63,152**	29,311	115	**63,152**	29,311	115
Weighted average – basic and diluted	**63,064**	23,117	173	**54,134**	20,452	165
			(%)			*(%)*
Operating [4]						
Production						
Natural gas *(mcf/d)*	**8,167**	3,958	106	**6,724**	4,449	51
Crude oil and NGLs *(bbls/d)*	**774**	18	4,200	**556**	16	3,375
Total *(boe/d)*	**2,135**	678	215	**1,677**	758	121
Average wellhead prices						
Natural gas *($/mcf)*	**3.82**	4.12	(7)	**3.82**	4.33	(12)
Crude oil and NGLs *($/bbl)*	**91.49**	71.24	28	**90.90**	72.74	25
Total *($/boe)*	**48.05**	25.95	85	**45.59**	27.01	69
Netbacks						
Operating netback *($/boe)*	**22.36**	12.93	73	**23.76**	13.33	78
Funds flow netback [1] *($/boe)*	**19.21**	7.42	159	**16.84**	8.12	107
Gross (net) wells drilled						
Gas *(#)*	**–**	1 (1.0)	–	**–**	5 (5.0)	–
Oil *(#)*	**3 (2.8)**	– (–)	–	**7 (6.8)**	– (–)	–
Standing *(#)*	**5 (3.8)**	1 (1.0)	400 (280)	**5 (3.8)**	1 (1.0)	500 (80)
Dry and abandoned *(#)*	**1 (1.0)**	3 (3.0)	-67 (-67)	**1 (1.0)**	6 (6.0)	-83 (-83)
Total *(#)*	**9 (7.6)**	5 (5.0)	80 (52)	**13 (11.6)**	12 (12.0)	8 (-3)
Average working interest *(%)*	**84**	100	(16)	**89**	100	(11)

(1) Funds from operations, funds from operations per share and funds flow netback 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) Current assets less current liabilities, excluding current derivative financial instruments.

(4) For a description of the boe conversion ratio, refer to the commentary in the Management's Discussion and Analysis under the heading "Other Measurements".

(5) Amounts presented for the three and nine months ended September 30, 2010 have been restated for the effect of the adoption of IFRS.

2 Letter to Shareholders

The three-month period ending September 30, 2011 was the most active quarter operationally in DeeThree Exploration Ltd.'s four-year history. Highlights for the period include:

- Drilling 9 gross (7.6 net) wells for an 89% success rate.
- Averaging 2,135 boe/d production (64% natural gas, 36% crude oil and NGLs) and exiting the quarter at 2,800 boe/d (58% natural gas, 42% crude oil and NGLs).
- Generating funds from operations of $3.8 million or $0.06 per share.
- Investing $25.0 million in capital expenditures.
- Maintaining a strong financial position with net debt of $3.5 million at September 30, 2011 on a bank line of $20.0 million.

Operational Review

Third quarter production was essentially flat, averaging 2,135 boe/d versus 2,167 boe/d in the second quarter. July production was adversely affected by a ten-day shut-in of 90 boe/d due to a pipeline curtailment on the TransCanada Pipeline system and a two-day shut-in of 350 boe/d due to a third party plant turnaround. During the three-month period, DeeThree embarked on an aggressive drilling program that focused entirely on oil projects and included 9 gross (7.6 net) wells with initial production from these wells not realized until the latter part of the quarter. As a result, the exit rate at September 30 rose to approximately 2,800 boe/d.

Quarter-over-quarter operating costs increased to $15.26/boe from $10.73/boe due primarily to adjustments relating to the Brazeau/West Pembina and Peace River Arch area assets that were acquired late in the first quarter. Operating costs for the nine months ended September 30, 2011 averaged $12.61/boe, which was in line with corporate expectations. We are actively looking for ways to reduce operating costs on our newly acquired properties.

During the three-month period, DeeThree invested $25.0 million in capital activities primarily in the Brazeau and Lethbridge areas. This represented 44% of our planned 2011 capital expenditure budget, which was increased by $15.0 million to $57.0 million (released September 28, 2011).

In the Lethbridge area of southern Alberta, the Company drilled two follow up horizontal oil wells to its previously announced Sunburst discovery. We expect to have these two wells on-stream in the coming weeks. We are extremely pleased with the results of this play to date, which have exceeded expectations. DeeThree has an extensive land base of approximately 100 sections on the Sunburst play with 3-D seismic coverage. Numerous follow up locations have been identified and the Company is actively licencing a number of wells in the area. Horizontal technology is showing significant promise in reviving this decades-old oil play with large oil in place numbers. The Company will continue to explore the Alberta Bakken throughout the final quarter of 2011 with its joint venture partners. Drilling operations are currently underway on the first well on the northern joint venture and one additional joint venture well is planned prior to year-end with results expected in the first quarter of 2012.

In the Brazeau area of west central Alberta, the Company is actively drilling its third well in the Belly River light oil resource play and anticipates keeping one rig active in the area for the remainder of the year. We have successfully increased area production by 30% to a current rate of 1,200 boe/d since acquiring this property in March 2011.

We are also pleased to announce a successful Montney horizontal oil well in the Peace River Arch area of northern Alberta. The well is currently producing at 300 boe/d (50% crude oil and NGLs). We are satisfied with the results of this well, and consequently, have plans for a vertical offset well to be tested by year-end.

Outlook

The recent drilling successes in the Brazeau and Lethbridge areas have opened up significantly more opportunities for the Company, and as a result, DeeThree now expects to drill a total of 20 gross (17.8 net) wells in 2011 that includes 13 gross (11.2 net) wells in the Lethbridge area, 4 gross (3.6 net) wells in the Brazeau area and 3 gross (3.0 net) wells in the Peace River Arch area. The Company's balance sheet remains strong with projected net debt at December 31, 2011 of approximately $13.0 million. DeeThree's lender approved an increase to the Company's credit facility to $40.0 million during the first quarter of 2011 (of which DeeThree elected an increase to only $20.0 million in order to reduce standby fees associated with the unutilized balance) with the next review of the facility expected to commence within the coming weeks. It is anticipated that the facility will be further increased by year-end.

We are pleased with the achievements we have made to date in 2011 and look forward to reporting our fourth quarter activities and year-end results as well as the opportunities that 2012 will present.

On behalf of the Board of Directors,

Martin Cheyne
President & Chief Executive Officer

November 8, 2011

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 November 8, 2011 and should be read in conjunction with the Company's unaudited interim financial statements and related notes for the three and nine-month periods ended September 30, 2011 as well as the audited financial statements and MD&A for the year ended December 31, 2010. Effective January 1, 2011, the Company adopted International Financial Reporting Standards ("IFRS") with a transition date of January 1, 2010. In 2010, the Canadian Institute of Chartered Accountants' Handbook was revised to incorporate IFRS and require publicly accountable enterprises to apply IFRS standards effective for years beginning on or after January 1, 2011. Accordingly, the Company has commenced reporting on this basis, and in this MD&A, the term "previous GAAP" refers to Canadian generally accepted accounting principles ("GAAP") before the adoption of IFRS.

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 IFRS or 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, if applicable. 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. 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 September 30,		Nine Months Ended September 30,	
	2011	2010	**2011**	2010
(000s)	*($)*	*($)*	*($)*	*($)*
Cash flow from operating activities	**8,910**	687	**6,346**	1,752
Changes in non-cash working capital	**(5,115)**	(225)	**1,393**	(71)
Funds from operations	**3,795**	462	**7,739**	1,681

During the three and nine months ended September 30, 2011, the Company's funds from operations totaled $3,795,000 ($0.06 per basic and diluted share) and $7,739,000 ($0.14 per basic and diluted share), respectively, versus $462,000 ($0.02 per basic and diluted share) and $1,681,000 ($0.08 per basic and diluted share) in the respective periods of 2010.

The Company considers corporate netbacks to be a key measure as they demonstrate DeeThree's 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, operating costs and transportation expenses. Funds flow netback starts with the operating netback and further deducts general and administrative costs, finance expense and adds finance income as well as realized gains on financial instruments. 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, unrealized gains on financial instruments, any impairment or exploration and evaluation 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 netback calculations.

Net debt and working capital (deficit), which represent current assets less current liabilities and bank debt, excluding current derivative financial instruments, are 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 (deficit).

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, and expectations regarding the Company's ability to raise capital and to continually add to reserves through acquisitions and development.

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

The unaudited interim financial statements and comparative information for the three and nine months ended September 30, 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.

Description of the Company

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 was 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 "First Quarter 2011 Acquisition" section for further information.

First Quarter 2011 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" or "acquired properties") for total cash consideration of $122,586,000 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 $1,125,000 were charged to general and administrative ("G&A") expense on the statement of income and comprehensive income.

Second Quarter 2011 Transactions

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.

In June 2011, the Company entered into a farm-out and joint venture agreement with a junior oil and gas company (the "farmee"). The farmee agreed to pay DeeThree $5,000,000 and has committed to drill and complete, at its sole risk and expense, two horizontal wells (the "test wells") evaluating the Mississippian and/or upper Devonian formations on 58 sections of land located in the northern portion of DeeThree's Lethbridge property approximately 40 miles north of recent drilling activity. The farmee is responsible for 100% of the costs of the test wells through completion to earn a 60% working interest in seven sections of farm-out lands (with no payout terms) for each well drilled. The test wells are to be drilled and completed prior to December 31, 2011. After fulfilling the two test well obligation, the farmee has the right to elect to drill additional wells on similar terms and conditions until it has either elected to not drill an option well or has earned an interest in the balance of the 58 sections of land.

DeeThree has obtained commitments from third parties to drill a minimum of six horizontal wells on its Lethbridge property by December 31, 2011, thereby expediting the exploration of DeeThree's Alberta Bakken land base.

Third Quarter 2011 Transactions

In July 2011, the Company executed a purchase and sale agreement with a private oil and gas company pursuant to which DeeThree acquired producing assets and undeveloped land for cash consideration of $1,441,000 subject to certain adjustments. The Company purchased approximately 60 boe/d of crude oil and natural gas production primarily in the Brazeau/West Pembina area along with approximately 4,754 net acres of undeveloped land.

Also in July 2011, the Company executed a purchase and sale agreement with a small private oil and gas company whereby DeeThree issued 400,000 common shares out of treasury in exchange for approximately 12,800 net acres of undeveloped land located primarily in the Peace River Arch area of Alberta.

During the third quarter, DeeThree received the final statement of adjustments related to the March 2011 acquisition, and as a result, there were several adjustments related to that transaction recorded in the current quarter.

Financial and Operating Results

Sales Volumes

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	**2011**	2010
Sales				
Natural gas *(mcf/d)*	**8,167**	3,958	**6,724**	4,449
Crude oil *(bbls/d)*	**597**	17	**427**	15
NGLs *(bbls/d)*	**177**	1	**129**	1
Total sales *(boe/d)*	**2,135**	678	**1,677**	758
	(%)	*(%)*	*(%)*	*(%)*
Production Split				
Natural gas	**64**	97	**67**	98
Crude oil	**28**	3	**25**	2
NGLs	**8**	–	**8**	–
Total	**100**	100	**100**	100

For the third quarter of 2011, the Company's production averaged 2,135 boe/d compared to 678 boe/d in the same period of 2010 and was relatively consistent with the 2,167 boe/d recorded in the second quarter of 2011. The 215% year-over-year increase was primarily related to the property acquisition of approximately 1,830 boe/d that closed on March 22, 2011. Production throughout the month of July was adversely affected by a pipeline curtailment on the TransCanada Pipeline system and a third party plant turnaround. However, during the three-month period, the Company's focus on oil projects resulted in 6 gross (5.8 net) wells with initial production being realized in the latter part of the quarter.

For the nine months ended September 30, 2011, DeeThree's production averaged 1,677 boe/d compared to 758 boe/d a year ago, representing a 121% increase. During the 2011 nine-month period, production was comprised of 6,724 mcf/d of natural gas, 427 bbls/d of crude oil and 129 bbls/d of NGLs, thereby increasing the Company's crude oil and NGLs production to 33% of total corporate production versus 2% in the comparable period of 2010.

Revenue

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	**2011**	2010
(000s)	*($)*	*($)*	*($)*	*($)*
Natural gas	**2,869**	1,499	**7,015**	5,260
Crude oil	**5,094**	113	**10,934**	310
NGLs	**1,424**	6	**2,872**	20
Royalty income	**53**	–	**53**	–
Total oil and natural gas revenue	**9,440**	1,618	**20,874**	5,590

During the three months ended September 30, 2011, revenue increased 483% to $9,440,000 from $1,618,000 in the comparative period of 2010 and remained relatively consistent with the $9,465,000 recorded in the second quarter of 2011. The year-over-year increase was a result of the property acquisition (resulting in an increase in crude oil and NGLs production to 36% compared to 3% in the third quarter of 2010) along with additional production being brought on-stream from 2011 drills and higher realized prices for crude oil and NGLs, resulting in an increase in corporate average price per boe. During the third quarter of 2010, the Company had fixed price physical contracts for future natural gas sales, which were included as part of natural gas revenue. There were no similar contracts in place during the third quarter of 2011.

For the first nine months of 2011, revenue totaled $20,874,000 versus $5,590,000 for the same period of 2010. Total revenue increased 273% primarily as a result of the 121% year-over-year increase in sales volumes.

Commodity Prices and Foreign Exchange

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	**2011**	2010
	($)	*($)*	*($)*	*($)*
Benchmark Prices				
Natural gas				
NYMEX *(US$/mmbtu)* (1)	**4.19**	4.41	**4.23**	4.62
AECO *(CDN$/GJ)* (2)	**3.47**	3.36	**3.57**	3.91
Crude oil				
WTI *(US$/bbl)*	**89.76**	76.20	**95.48**	77.65
Edmonton light *(CDN$/boe)*	**91.93**	74.56	**94.43**	76.88
Average Realized Prices				
Natural gas *($/mcf)* (3)	**3.82**	4.12	**3.82**	4.33
Crude oil *($/bbl)*	**92.76**	73.12	**94.52**	73.91
NGLs *($/bbl)*	**87.23**	46.61	**78.87**	58.71
Total sales price *($/boe)*	**48.05**	25.95	**45.59**	27.01
Foreign Exchange				
CDN$/US$	**0.9802**	1.0391	**0.9780**	1.0359
US$/CDN$	**1.0202**	0.9624	**1.0225**	0.9654

(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.

(3) Natural gas prices for the three and nine-month periods ended September 30, 2010 include realized gains/losses from physical fixed price contracts.

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 "Risk Management" section below). 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 September 30, 2011, benchmark natural gas prices in Canada rose 3% 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 $3.47/GJ throughout the third quarter of 2011 compared to $3.36/GJ a year ago. DeeThree's average realized gas price during the three-month period was $3.82/mcf versus $4.12/mcf last year. During the third quarter of 2010, the Company's average realized gas price included approximately $0.64/mcf related to hedge contracts that were included as part of natural gas revenue. No similar contracts were in place during the 2011 three-month period.

Oil prices remained relatively strong in the third quarter of 2011 with West Texas Intermediate ("WTI") averaging $89.76/bbl compared to $76.20/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 $92.76/bbl for the third quarter of 2011 compared to $73.12/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 September 30,		Nine Months Ended September 30,	
	2011	2010	**2011**	2010
(000s)	*($)*	*($)*	*($)*	*($)*
Oil and natural gas revenues	**9,440**	1,618	**20,874**	5,590
Royalties				
Crown	**1,076**	35	**2,257**	284
Freehold	**483**	136	**819**	535
GORR	**288**	15	**528**	52
Total royalties	**1,847**	186	**3,604**	871
Total royalties *($/boe)*	**9.40**	2.98	**7.87**	4.21
Percent of revenue (1) *(%)*	**20**	13	**17**	17

(1) Royalties as a percent of revenue for the three and nine-month periods ended September 30, 2010 has been adjusted to exclude any hedging gains originally included in revenue.

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 payable 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 and overriding royalties on oil, natural gas and NGLs production. Crown royalties are also sensitive to both production levels and commodity prices; therefore, the Company's royalties will continue to fluctuate with commodity prices, well production rates, production declines of existing wells as well as performance and location of new wells drilled. Previously, the Company was weighted approximately 98% natural gas and its Lethbridge properties were primarily subject to freehold royalties. Subsequent to the acquisition, the Company's product mix is now weighted approximately 67% natural gas and 33% crude oil and NGLs, which are subject to Crown and overriding royalties.

For the third quarter of 2011, royalties totaled $1,847,000 or 20% of revenue compared to $186,000 or 13% of revenue (excluding hedging gains) for the same quarter in 2010 and $1,489,000 or 16% of revenue in the second quarter of 2011. The royalty rate increases were primarily due to the change in product mix resulting from the property acquisition that closed in March 2011. In addition, the increase in royalty rate was a result of new production from the Company's 6 gross (5.8 net) wells brought on-stream during the quarter, some which are subject to a freehold royalty based on the Alberta New Royalty Framework while others qualify for the 5% royalty holiday under the Government of Alberta royalty framework.

During the first nine months of 2011, royalties totaled $3,604,000 or 17% of revenue versus $871,000 or 17% of revenue a year ago.

Operating and Transportation Expenses

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	**2011**	2010
(000s)	*($)*	*($)*	*($)*	*($)*
Operating expenses	**2,998**	543	**5,774**	1,678
Transportation expenses	**202**	83	**616**	282
Total operating and transportation expenses	**3,200**	626	**6,390**	1,960
Operating expenses *($/boe)*	**15.26**	8.71	**12.61**	8.11
Transportation expenses *($/boe)*	**1.03**	1.33	**1.35**	1.36
Total operating and transportation expenses *($/boe)*	**16.29**	10.04	**13.96**	9.47

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 three months ended September 30, 2011 totaled $2,998,000 or $15.26/boe compared to $543,000 or $8.71/boe in the same period last year and $2,117,000 or $10.73/boe in the second quarter of 2011. Quarter-over-quarter operating costs increased due primarily to adjustments relating to the Brazeau/West Pembina and Peace River Arch area assets that were acquired late in the first quarter. Operating costs for the nine months ended September 30, 2011 averaged $12.61/boe, which was in line with corporate expectations.

Transportation expenses for the three months ended September 30, 2011 were $202,000 or $1.03/boe compared to $83,000 or $1.33/boe recorded in the third quarter of 2010 and $330,000 or $1.67/boe in the second quarter of 2011. Prior to the property acquisition that closed in March 2011, transportation expenses reflected primarily NOVA and ATCO transportation costs and fluctuated depending on the proportion of the Company's gas that was 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). Subsequent to the acquisition, the Company has increased production of both crude oil and NGLs, and the transportation costs associated with those products consist primarily of pipeline tariff charges (crude oil and NGLs attract a higher cost per boe for transportation compared to natural gas). In the third quarter of 2011, transportation costs decreased due to adjustments relating to the Brazeau/West Pembina and Peace River Arch assets acquired in March 2011.

For the nine months ended September 30, 2011, the Company incurred operating expenses of $5,774,000 or $12.61/boe compared to $1,678,000 or $8.11/boe in the corresponding 2010 period. The increase on a per barrel basis was primarily due to the acquired production attracting a higher cost per boe for operating than the Company's historical production. Transportation expenses for the first nine months of 2011 totaled $616,000 or $1.35/boe versus $282,000 or $1.36/boe in the same period last year.

Risk Management

The Company has elected not to use hedge accounting, and accordingly, the fair value of the financial contracts (as discussed in note 12 of the unaudited interim financial statements) is recorded at each period-end. The fair value may change substantially from period to period depending on commodity forward strip prices for the financial contracts outstanding at the balance sheet date. The change in fair value from period-end to period-end is reflected in the earnings for that period. As a result, earnings may fluctuate considerably based on the period ending commodity forward strip prices.

The Company had the following contracts applicable to future crude oil sales in place as at September 30, 2011:

Period	Commodity	Type of Contract	Quantity	Pricing Point	Contract Price
Jun.1/11 – Dec.31/11	Crude oil	Collar	250 bbls/d	WTI – NYMEX	US$95.00/bbl (floor) – US$106.00/bbl (cap)
Jan.1/12 – Dec.31/12	Crude oil	Collar	250 bbls/d	WTI – NYMEX	US$95.00/bbl (floor) – US$115.00/bbl (cap) (1)

(1) 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.

These contracts are considered to be financial instruments and the resulting derivative financial asset has been recorded on the Company's statement of financial position, with the unrealized gain being recorded on the statement of operations and comprehensive loss. In the comparative period of 2010, the Company also had financial contracts; however, these were considered "own use" physical contracts and the resulting income was included as part of revenue in the period.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	**2011**	2010
(000s)	*($)*	*($)*	*($)*	*($)*
Unrealized gain on financial instruments	**1,921**	–	**2,013**	–
Unrealized gain on financial instruments *($/boe)*	**9.78**	–	**4.40**	–

During the three months ended September 30, 2011, the Company also realized a gain on these financial instruments as a result of the third quarter WTI pricing in relation to the terms of the contracts.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	**2011**	2010
(000s)	*($)*	*($)*	*($)*	*($)*
Realized gain on financial instruments	**144**	–	**144**	–
Realized gain on financial instruments *($/boe)*	**0.73**	–	**0.31**	–

G&A Expense

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	**2011**	2010
(000s)	*($)*	*($)*	*($)*	*($)*
Gross G&A expense (1)	**1,006**	541	**4,010**	1,546
Capitalized G&A (direct) (1)	**(189)**	(170)	**(494)**	(404)
Overhead recoveries	**(28)**	(34)	**(112)**	(101)
G&A expenses (net)	**789**	337	**3,404**	1,041
Transaction costs	**(33)**	–	**(1,158)**	–
G&A expense (net)	**756**	337	**2,246**	1,041
G&A expense (net) *($/boe)*	**3.85**	5.40	**4.91**	5.03

(1) Gross G&A expense and capitalized G&A for the three and nine months ended September 30, 2010 have been restated for the effect of adopting IFRS.

Gross G&A expenses totaled $1,006,000 for the three-month period ended September 30, 2011 versus $541,000 recorded in the comparable period of 2010. Net G&A costs were $756,000 or $3.85/boe in the third quarter of 2011 compared to $337,000 or $5.40/boe a year ago and $770,000 or $3.90/boe recorded in the second quarter of 2011.

The Company capitalized direct G&A expenses amounting to $189,000 and had overhead recoveries of $28,000 in the third quarter of 2011 versus $170,000 and $34,000, respectively, in the comparative period of 2010, which have been restated for the effect of adopting IFRS, and $187,000 and $19,000, respectively, in the second quarter of 2011.

G&A net expenses for the first nine months of 2011 totaled $2,246,000 or $4.91/boe compared to $1,041,000 or $5.03/boe in the same period of 2010. Year-over-year G&A costs net of transaction costs increased on an absolute 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. Throughout the first nine months of 2011, the Company had an average of 13 full-time employees and two consultants versus eight full-time employees and three consultants in the same period of 2010. However, due to the 121% year-over-year increase in total production, the G&A cost per boe decreased as these are mainly fixed costs spread over a larger production base.

During the nine months ended September 30, 2011, the Company capitalized $494,000 in direct costs relating to its exploration and development efforts and $112,000 of capital overhead recoveries compared to $404,000 and $101,000, respectively, in the same period of 2010.

Share-Based Compensation

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	**2011**	2010
(000s)	*($)*	*($)*	*($)*	*($)*
Gross share-based compensation (1)	**473**	200	**1,102**	390
Share-based compensation reclassified to operating costs	**(19)**	–	**(29)**	–
Capitalized share-based compensation (1)	**(164)**	(87)	**(360)**	(172)
Share-based compensation expense	**290**	113	**713**	218
Share-based compensation expense *($/boe)*	**1.48**	1.81	**1.56**	1.05

(1) Gross share-based compensation and capitalized share-based compensation for the three and nine months ended September 30, 2010 have been restated for the effect of adopting IFRS.

The Company has a stock option plan, which is fully described in note 9 of the unaudited interim financial statements. The options have a four-year vesting term, expire in five years and the fair value of all options granted is estimated at the grant date using the Black-Scholes option pricing model. 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 the employees, consultants and directors of the Company. For those stock options granted to field employees, their portion of the share-based compensation is reclassified to operating expenses to be consistent with the recognition of their salaries on the statement of operations and comprehensive loss.

For the quarter ended September 30, 2011, the Company incurred a net expense of $290,000 or $1.48/boe versus $113,000 or $1.81/boe in the same period of 2010. The increase was directly attributable to increased staffing.

During the first nine months of 2011, DeeThree incurred a net expense of $713,000 or $1.56/boe compared to $218,000 or $1.05/boe recorded a year ago.

Depletion and Depreciation ("D&D")

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	**2011**	2010
(000s)	*($)*	*($)*	*($)*	*($)*
D&D provision (1)	**4,472**	800	**9,587**	2,598
D&D provision *($/boe)*	**22.77**	12.82	**20.94**	12.55

(1) D&D for the three and nine months ended September 30, 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 using the declining balance method at rates between 20% and 30%.

The Company's D&D expense for the three months ended September 30, 2011 was $4,472,000 or $22.77/boe compared to $800,000 or $12.82/boe in the comparable period of 2010 and $4,244,000 or $21.52/boe in the second quarter of 2011. The year-over-year increase was attributable to the increased value of the proved plus probable reserves that were acquired in March 2011 as well as the increased production related to those assets. The acquired assets have significant future development costs, which lead to a higher D&D rate when compared to the Company's historical assets.

For the nine months ended September 30, 2011, D&D expense totaled $9,587,000 or $20.94/boe compared to $2,598,000 or $12.55/boe recorded in the same period of 2010.

Impairment

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	**2011**	2010
(000s)	*($)*	*($)*	*($)*	*($)*
Impairment [(1)]	**–**	8,514	**–**	10,496
Impairment *($/boe)*	**–**	136.53	**–**	50.72

(1) Impairment for the three and nine months ended September 30, 2010 has been restated for the effect of adopting IFRS.

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 September 30, 2011, no impairment indicators were present, and therefore, no impairment testing was required.

On transition to IFRS, there was no impairment for the Company; however, as natural gas prices declined during 2010, DeeThree recorded an impairment of $10,496,000 or $50.72/boe at September 30, 2010. This impairment can be reversed in the future if the recoverable amount increases.

Exploration and Evaluation ("E&E") Expense

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	**2011**	2010
(000s)	*($)*	*($)*	*($)*	*($)*
E&E expense	**665**	–	**665**	–
E&E expense *($/boe)*	**3.38**	–	**1.45**	–

Under IFRS, DeeThree accumulates those costs related to E&E assets in cost centres by well, field or area, pending determination of technical feasibility and commercial viability. This primarily includes costs for undeveloped land and drilling costs until the drilling of the well is complete and results have been evaluated. Costs related to wells that have been determined to be uneconomical as well as cost of undeveloped land lease expiries are expensed as they occur.

During the third quarter of 2011, the Company recorded E&E expense of $665,000 or $3.38/boe related to one dry and abandoned well in the Lethbridge area as well as lease expiries in the Brazeau area. For the nine months ended September 30, 2011, this amounted to $1.45/boe.

Finance Income

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	**2011**	2010
(000s)	*($)*	*($)*	*($)*	*($)*
Finance income	**50**	–	**204**	2
Finance income *($/boe)*	**0.25**	–	**0.45**	0.01

During the third quarter of 2011, the Company recorded interest income totaling $50,000 or $0.25/boe as a result of the Company's cash balance, which is currently invested in a flexible guaranteed investment certificate versus $nil during the same period of 2010.

For the nine-month period ended September 30, 2011, the Company's interest income was $204,000 or $0.45/boe compared to $2,000 or $0.01/boe in the first nine months of 2010, again as a function of the cash balance during those periods.

Accretion and Finance Expenses

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	**2011**	2010
(000s)	*($)*	*($)*	*($)*	*($)*
Accretion expense on decommissioning liabilities	**69**	21	**159**	60
Finance expense	**22**	7	**114**	39
Total accretion and finance expenses	**91**	28	**273**	99
Accretion expense on decommissioning liabilities *($/boe)*	**0.35**	0.34	**0.35**	0.29
Finance expense *($/boe)*	**0.11**	0.11	**0.25**	0.19
Total accretion and finance expenses *($/boe)*	**0.46**	0.45	**0.60**	0.48

Accretion expense represents the increase for the reporting period in the present value of the Company's decommissioning liabilities. In the third quarter of 2011, the Company recorded accretion expense of $69,000 or $0.35/boe compared to $21,000 or $0.34/boe in the same period of 2010. The absolute increase was primarily due to new obligations related to the property acquisition that closed on March 22, 2011. The underlying liability may increase over time based on new obligations incurred from drilling wells, constructing facilities, acquiring operations, 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 three months ended September 30, 2011, the Company recorded finance expense of $22,000 or $0.11/boe compared to $7,000 or $0.11/boe in the same period of 2010 primarily related to standby charges on the unutilized credit facility of $20,000,000 (2010 – $12,000,000).

For the 2011 nine-month period, the Company recorded accretion expense of $159,000 versus $60,000 and finance expense of $114,000 compared to $39,000 a year ago. The increase in accretion over the period was a reflection of the increased balance of the related decommissioning liability and the increase in finance expense as related to Part XII.6 tax associated with flow-through shares, which was recorded in the first and second quarters of 2011.

Income Taxes

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	**2011**	2010
(000s)	*($)*	*($)*	*($)*	*($)*
Deferred income tax expense (recovery)	**554**	(2,322)	**1,842**	(2,359)
Deferred income tax expense (recovery) *($/boe)*	**2.82**	(37.23)	**4.02**	(11.40)

During the three and nine months ended September 30, 2011, the Company recorded a deferred income tax expense of $554,000 and $1,842,000, respectively. A component of this expense was due to approximately $5,252,000 in eligible capital expenditures being spent in relation to the March 2011 flow-through share issuance. As these eligible costs are incurred, the Company reverses the flow-through share premium liability and recognizes the deferred income tax expense at that time. The deferred income tax expense is also influenced by temporary differences related to the unrealized gain on financial instruments that has been recorded in the statement of operations and comprehensive loss.

DeeThree does not have current income taxes payable and does not expect to pay current income taxes in 2011 as the Company had estimated tax pools of $179,000,000 available at September 30, 2011.

Funds from Operations

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	**2011**	2010
(000s)	*($)*	*($)*	*($)*	*($)*
Net loss	**(353)**	(6,664)	**(3,243)**	(9,332)
Non-cash items:				
D&D	**4,472**	800	**9,587**	2,598
Impairment	**–**	8,514	**–**	10,496
Accretion	**69**	21	**159**	60
Share-based compensation (1)	**309**	113	**742**	218
Unrealized gain on financial instruments	**(1,921)**	–	**(2,013)**	–
E&E expense	**665**	–	**665**	–
Deferred income tax expense (recovery)	**554**	(2,322)	**1,842**	(2,359)
Funds from operations	**3,795**	462	**7,739**	1,681

(1) The share-based compensation amount included in the calculation of funds from operations has been adjusted for the non-cash portion related to certain field employees that was reclassified to operating expenses for presentation in the statement of operations and comprehensive loss.

During the three months ended September 30, 2011, the Company had funds from operations totaling $3,795,000 or $0.06 per basic and diluted share compared to $462,000 or $0.02 per basic and diluted share in the comparative period of 2010. This 721% absolute increase was primarily due to increased revenue from production offset by increased royalties and operating and transportation costs.

Funds from operations totaled $7,739,000 or $0.14 per basic and diluted share compared to $1,681,000 or $0.08 per basic and diluted share recorded in the same period of 2010.

Net Loss

For the three months ended September 30, 2011, the Company recorded a net loss of $353,000 or $0.01 per basic and diluted share compared to $6,664,000 or $0.29 per basic and diluted share in the same period of 2010. The year-over-year decrease in net loss was again primarily due to increased revenue related to the property acquisition, increased operating netbacks and no impairment charge during the period.

The net loss for the nine months ended September 30, 2011 was $3,243,000 or $0.06 per basic and diluted share versus $9,332,000 or $0.46 per basic and diluted share in the comparative period of 2010.

Netbacks (per unit)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	**2011**	2010
	($/boe)	*($/boe)*	*($/boe)*	*($/boe)*
Sales prices	**48.05**	25.95	**45.59**	27.01
Royalties	**(9.40)**	(2.98)	**(7.87)**	(4.21)
Operating	**(15.26)**	(8.71)	**(12.61)**	(8.11)
Transportation	**(1.03)**	(1.33)	**(1.35)**	(1.36)
Operating netback (1)	**22.36**	12.93	**23.76**	13.33
G&A and other (excludes non-cash items) (3)(4)	**(4.02)**	(5.40)	**(7.43)**	(5.03)
Realized gain on financial instruments	**0.73**	–	**0.31**	–
Finance income	**0.25**	–	**0.45**	0.01
Finance expenses	**(0.11)**	(0.11)	**(0.25)**	(0.19)
Funds flow netback (1)	**19.21**	7.42	**16.84**	8.12
D&D (3)	**(22.77)**	(12.82)	**(20.94)**	(12.55)
Impairment (3)	**–**	(136.53)	**–**	(50.72)
Accretion (3)	**(0.35)**	(0.34)	**(0.35)**	(0.29)
Share-based compensation (3)	**(1.48)**	(1.81)	**(1.56)**	(1.05)
Unrealized gain on financial instruments	**9.78**	–	**4.40**	–
E&E expense	**(3.38)**	–	**(1.45)**	–
Deferred income tax recovery (expense) (3)	**(2.82)**	37.23	**(4.02)**	11.40
Net loss netback (2)	**(1.81)**	(106.85)	**(7.08)**	(45.09)

(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 and nine months ended September 30, 2010 have been restated for the effect of the adoption of IFRS.

(4) G&A and other includes transaction costs of $33,000 and $1,158,000 relating to the acquisitions that closed during the three and nine-month periods ended September 30, 2011.

The operating netback was $22.36/boe for the three months ended September 30, 2011 compared to $12.93/boe in the same period last year. The Company experienced stronger pricing throughout the 2011 period offset by higher operating costs and royalties. The higher netback was largely the result of a shift to a proportionately higher oil production base, which attracts higher pricing.

For the first nine months of 2011, DeeThree achieved an operating netback of $23.76/boe versus $13.33/boe in the same period of 2010, again related to higher pricing offset by higher operating costs.

Investment and Investment Efficiencies

Capital Expenditures and Acquisitions

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	**2011**	2010
(000s)(excluding decommissioning liabilities, capitalized share-based compensation and non-cash transactions)	*($)*	*($)*	*($)*	*($)*
Property acquisitions and adjustments	**1,966**	–	**126,411**	–
Drilling and completions	**19,753**	2,459	**35,319**	7,021
Equipment and facilities	**1,803**	567	**2,038**	3,448
Land and lease retention	**1,177**	393	**2,639**	418
Geological and geophysical	**70**	(25)	**33**	3,438
Capitalized G&A and other (1)	**240**	180	**588**	419
Total capital expenditures	**25,009**	3,574	**167,028**	14,744
Proceeds from farm-out	**–**	–	**(5,000)**	–
Total capital expenditures, net proceeds from farm-out	**25,009**	3,574	**162,028**	14,744

(1) Capitalized G&A for the three and nine months ended September 30, 2010 has been restated for the effect of adopting IFRS.

During the third quarter of 2011, the Company incurred a total of $25,009,000 (2010 – $3,574,000) in capital expenditures, excluding the non-cash decommissioning liabilities, non-cash transactions and capitalized share-based compensation. DeeThree acquired additional assets in the Brazeau area as well as recorded adjustments to previous acquisitions during the three-month period ended September 30, 2011 for a total of $1,966,000 (2010 – $nil). Drilling and completion expenditures totaled $19,753,000 during the three months ended September 30, 2011 (2010 – $2,459,000), including the drilling of 9 gross (7.6 net) wells in the Lethbridge, Belly River and Rycroft areas. In the comparative quarter of 2010, the Company drilled 5 gross (5.0 net) shallow wells in the Lethbridge area. During the third quarter of 2011, DeeThree spent $1,803,000 (2010 – $567,000) on equipping and tie-ins, which consisted of various tie-ins in the Lethbridge area for wells drilled earlier in the year. The Company spent $1,177,000 (2010 – $393,000) at land sales and $70,000 related to the shooting of seismic programs (2010 – a reduction of $25,000 due to a credit adjustment from the 2010 3-D seismic program). The remaining $240,000 (2010 – $180,000) was invested in capitalized G&A and other corporate assets.

For the first nine months of 2011, capital expenditures totaled $167,028,000 versus $14,744,000 in the comparative period of 2010. A significant portion of capital spending during the first nine months of 2011 was directed towards the property acquisition for a consideration of $122,586,000 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. The Company also completed three smaller acquisitions that amounted to $3,825,000 for total property acquisition expenditures during the period of $126,411,000 (2010 – $nil). Drilling and completion expenditures totaled $35,319,000 (2010 – $7,021,000), equipping and tie-in costs were $2,038,000 (2010 – $3,448,000), $2,639,000 (2010 – $418,000) was spent on land purchases, $33,000 was spent on the Company's seismic programs (2010 – $3,438,000) and the remaining $588,000 (2010 – $419,000) was invested in capitalized G&A and other corporate assets. The Company received $5,000,000 as proceeds from a farm-out agreement entered into during the second quarter of 2011, which partially offset the total capital expenditures for the period.

Drilling Activity

	Exploration		Development		Total	
	Gross	Net	Gross	Net	Gross	Net
	(#)	(#)	(#)	(#)	(#)	(#)
Three Months Ended September 30, 2011						
Natural gas	**–**	**–**	**–**	**–**	**–**	**–**
Crude oil and NGLs	**–**	**–**	**3**	**2.8**	**3**	**2.8**
Standing	**3**	**1.8**	**2**	**2.0**	**5**	**3.8**
Dry and abandoned	**1**	**1.0**	**–**	**–**	**1**	**1.0**
Total wells	**4**	**2.8**	**5**	**4.8**	**9**	**7.6**
Success rate *(%)*		**75**		**100**		**89**
Average working interest *(%)*		**70**		**96**		**84**
Three Months Ended September 30, 2010						
Natural gas	–	–	1	1.0	1	1.0
Crude oil and NGLs	–	–	–	–	–	–
Standing	1	1.0	–	–	1	1.0
Dry and abandoned	2	2.0	1	1.0	3	3.0
Total wells	3	3.0	2	2.0	5	5.0
Success rate *(%)*		33		50		40
Average working interest *(%)*		100		100		100

	Exploration		Development		Total	
	Gross	Net	Gross	Net	Gross	Net
	(#)	(#)	(#)	(#)	(#)	(#)
Nine Months Ended September 30, 2011						
Natural gas	**–**	**–**	**–**	**–**	**–**	**–**
Crude oil and NGLs	**4**	**4.0**	**3**	**2.8**	**7**	**6.8**
Standing	**3**	**1.8**	**2**	**2.0**	**5**	**3.8**
Dry and abandoned	**1**	**1.0**	**–**	**–**	**1**	**1.0**
Total wells	**8**	**6.8**	**5**	**4.8**	**13**	**11.6**
Success rate *(%)*		**88**		**100**		**92**
Average working interest *(%)*		**85**		**96**		**89**
Nine Months Ended September 30, 2010						
Natural gas	1	1.0	4	4.0	5	5.0
Crude oil and NGLs	–	–	–	–	–	–
Standing	1	1.0	–	–	1	1.0
Dry and abandoned	5	5.0	1	1.0	6	6.0
Total wells	7	7.0	5	5.0	12	12.0
Success rate *(%)*		29		80		50
Average working interest *(%)*		100		100		100

During the third quarter of 2011, DeeThree drilled 9 gross (7.6 net) wells for an 89% success rate. Of the wells drilled, 2 gross (1.8 net) were horizontal Belly River oil wells in the Brazeau area of west central Alberta, 2 gross (2.0 net) were horizontal Montney wells in the Rycroft area of northern Alberta and 2 gross (2.0 net) were Sunburst wells in the Lethbridge area. The remaining wells included 2 gross (0.8 net) non-operated Bakken wells and 1 gross (1.0 net) dry and abandoned Sunburst gas well in the northern part of the Lethbridge land base. During the three months ended September 30, 2010, the Company drilled 5 gross (5.0 net) shallow wells at Lethbridge for a 40% success rate.

During the first nine months of 2011, DeeThree drilled 13 gross (11.6 net) wells at Lethbridge for a 92% success rate compared to 12 gross (12.0 net) wells at Lethbridge for a 50% success rate a year ago.

Liquidity and Capital Resources

Working Capital

The following table summarizes the change in working capital during the nine months ended September 30, 2011 and the year ended December 31, 2010:

	Nine Months Ended September 30, 2011	Year Ended December 31, 2010
(000s)	*($)*	*($)*
Working capital – beginning of period	**28,505**	375
Abandonment and reclamation costs	**(6)**	(39)
Funds from operations [(1)]	**7,739**	1,689
Issue of capital stock for cash (net of share issue expenses)	**122,434**	48,755
Capital expenditures [(1)]	**(40,617)**	(22,275)
Acquisitions	**(126,411)**	–
Proceeds from farm-out	**5,000**	–
Working capital (deficit) – end of period	**(3,356)**	28,505

(1) Funds from 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. In March, the Company issued 26,795,000 common shares at a price of $4.30 per share for total gross proceeds of $115,219,000 ($107,934,000 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 ($14,460,000 net of estimated share issue expenses). The proceeds of the flow-through share offering are being used by the Company to conduct exploration activity on its properties. The Company also issued additional capital stock for cash proceeds of $47,000 through the exercise of employee options and incurred share issue expenses of $7,000 related to the July transaction, which exchanged shares for land. During the period, the Company recorded funds from operations of $7,739,000 and invested a total of $167,028,000 in capital, including expenditures of $40,617,000 and property acquisitions of $126,411,000. The Company also received $5,000,000 as proceeds from a farm-out agreement entered into during the second quarter, which offset the total capital expenditures for the period. DeeThree exited the period with working capital deficit of $3,356,000.

As at September 30, 2011, the Company had a revolving demand credit facility to $20,000,000 with interest charged at the bank's prime rate plus a range of 1.0% to 1.25% per annum based on the Company's consolidated debt to cash flow ratio. Standby fees associated with this facility range from 0.4% to 0.7% per annum on the undrawn portion of the facility, again based on the Company's consolidated debt to cash flow ratio. As at September 30, 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 subject to semi-annual reviews by the Company's lender. The next semi-annual review of the credit facility is scheduled for the fall of 2011 and had not yet commenced as at the date of this report.

DeeThree expects to fund future capital expenditures with its current working capital, funds flow from operations and the unused demand credit facility.

Related Party Transactions and Off-Balance Sheet Transactions

As at September 30, 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 nine months ended September 30, 2011, the Company incurred $448,000 in costs with the firm (2010 – $229,000), which have been included in G&A expenses and share issue costs, and $nil (2010 – $49,000) remained in accounts payable at September 30, 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+	Total
(000s)		*($)*	*($)*	*($)*	*($)*	*($)*
Operating lease – office	26	441	441	491	800	2,199
Operating lease – equipment	55	193	68	41	–	357
Exploration expenditures (flow-through)	–	9,093	–	–	–	9,093
Drilling contracts	1,848	7,391	5,037	–	–	14,276
Total	1,929	17,118	5,546	532	800	25,925

As at September 30, 2011, the Company had contractual obligations for its office lease totaling approximately $2,199,000 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 $357,000 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 $15,450,000 of eligible exploration expenditures by December 31, 2012. As at September 30, 2011, approximately $6,357,000 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 September 30, 2011, all 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 is required to spend $3,500,000 of eligible exploration expenditures by December 31, 2011. As at September 30, 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 nine months of 2011, DeeThree entered into contracts for drilling rig services, and as at September 30, 2011, the Company had committed to using services totaling $14,276,000 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 September 30, 2011, the Company had fulfilled the drilling commitment, having drilled 30 wells, including those drilled as part of the farm-out agreements, and had approximately one-third of the final year's 3-D seismic data (approximately 11 sections) left to shoot in 2011. Subsequent to quarter-end, the Company negotiated a change to the existing seismic commitment and now has until December 31, 2011 to shoot the remaining seismic data (approximately 11 sections) in a different area.

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 November 8, 2011, the Company had 63,152,091 common shares outstanding and 4,352,000 stock options outstanding.

Selected Quarterly Information (1)(2)

Three Months Ended	**Sep.30, 2011**	Jun.30, 2011	Mar.31, 2011	Dec.31, 2010	Sep.30, 2010	Jun.30, 2010	Mar.31, 2010	Dec.31, 2009 (2)
(000s, except per share amounts)	*($)*	*($)*	*($)*	*($)*	*($)*	*($)*	*($)*	*($)*
Oil and natural gas revenues	**9,440**	9,465	1,969	1,483	1,618	1,679	2,293	1,563
Funds from (used in) operations	**3,795**	4,777	(833)	(19)	462	359	847	435
Per share – basic and diluted	**0.06**	0.08	(0.02)	–	0.02	0.02	0.05	0.03
Cash flow from (used in) operating activities	**8,910**	2,299	(4,863)	(23)	685	407	658	(39)
Net loss	**(353)**	(899)	(1,991)	(5,738)	(6,664)	(2,079)	(589)	(438)
Per share – basic and diluted	**(0.01)**	(0.01)	(0.05)	(0.19)	(0.29)	(0.10)	(0.03)	(0.03)
Total assets	**206,885**	195,267	192,682	65,334	52,336	38,691	44,730	31,329
Capital expenditures (3)	**25,009**	12,490	129,529	7,532	3,572	4,012	7,158	4,601
Working capital (deficit) (4)	**(3,356)**	17,871	20,659	28,505	20,668	3,133	6,601	375
Shareholders' equity	**176,346**	174,850	175,423	55,126	47,479	32,880	34,653	24,674
Production								
Natural gas *(mcf/d)*	**8,167**	8,214	3,744	3,691	3,958	4,191	5,211	3,636
Crude oil and NGLs *(bbls/d)*	**774**	798	89	19	18	15	16	17
Total *(boe/d)*	**2,135**	2,167	713	635	678	714	885	623

(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 period ended September 30, 2011, 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.

(4) Current assets less current liabilities, excluding current derivative financial instruments.

Factors That Have Caused Variations over the Quarters

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 recorded production decreases due to 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.

During the first quarter of 2011, DeeThree completed a transformational acquisition that significantly increased the Company's revenues, funds from operations and cash flow in subsequent periods. DeeThree's production also increased significantly and shifted from an approximate 98% natural gas focus to approximately 67% natural gas and 33% crude oil and NGLs for the first nine months of 2011. The third quarter of 2011 was the second full reporting period that included the additional production and value related to the acquired assets.

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.

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 designed, or caused to be designed under their supervision, internal controls over financial reporting to provide reasonable assurance regarding the reliability of the Company's financial reporting and the preparation of financial statements for external purposes. Based on their evaluation, DeeThree's CEO and CFO have concluded that, as of December 31, 2010, the Company's internal controls and procedures over financial reporting were effective. DeeThree is required to disclose herein any change in the design of the Company's internal control over financial reporting that occurred during the period ended September 30, 2011 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 its internal controls over financial reporting during the first nine months of 2011.

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 September 30, 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 nine 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 are effective, they do not expect that these controls will prevent all errors or 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 unaudited interim financial statements and comparative information has 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 15 of its September 30, 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	638	275	152	149
Accretion and finance expenses	61	16	16	16	13
Deferred income taxes	1,453	(417)	2,112	232	(474)
Impairments	(11,351)	(855)	(8,514)	(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 policies have been retrospectively applied, except where specific IFRS 1 optional and mandatory exemptions permitted an alternative treatment upon transition to IFRS.

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.

Property, 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 because any differences between the fair value of the property acquired and the carrying value of the property given up is recognized as a gain or loss.

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, and in 2010, the Company recorded an impairment of $5,299,000. As a result of the accounting policy change to IFRS, total impairment of $16,650,000 was recorded during 2010 (an adjustment of $11,351,000 for the year ended December 31, 2010) due primarily to declining natural gas prices, with $8,514,000 being recorded during the three-month period ended September 30, 2010. 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 the lower risk-free discount rate to value the decommissioning liabilities. During the period ended September 30, 2010, DeeThree's decommissioning liabilities increased an additional $608,000 as well as another $68,000 during the final three months of 2010 for a total increase of $676,000 as at December 31, 2010. 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 as such 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. 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.

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 critical estimates and judgements used by DeeThree can be found in note 2(d) to the September 30, 2011 unaudited interim 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" were 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; 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" was 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 balancing higher risk exploratory drilling with 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 by 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 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 "Commodity Prices and Foreign Exchange" 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 risks arise 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 on capital projects 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 credit. 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, and, if necessary, a tightening of liquidity sources. 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

The recent drilling successes in the Brazeau and Lethbridge areas have opened up significantly more opportunities for the Company, and as a result, DeeThree now expects to drill a total of 20 gross (17.8 net) wells in 2011 that includes 13 gross (11.2 net) wells in the Lethbridge area, 4 gross (3.6 net) wells in the Brazeau area and 3 gross (3.0 net) wells in the Peace River Arch area. The Company's balance sheet remains strong with projected net debt at December 31, 2011 of approximately $13.0 million. DeeThree's lender approved an increase to the Company's credit facility to $40.0 million during the first quarter of 2011 (of which DeeThree elected an increase to only $20.0 million in order to reduce standby fees associated with the unutilized balance) with the next review of the facility expected to commence within the coming weeks. It is anticipated that the facility will be further increased by year-end.

Statements of Financial Position

As at	**September 30, 2011**	December 31, 2010
(000s)(unaudited)	*($)*	*($)*
Assets		
Current assets		
Cash and cash equivalents	**7,457**	32,994
Accounts receivable	**9,038**	884
Deposits and prepaid expenses	**575**	271
Derivative financial instruments *(note 12)*	**2,013**	–
	19,083	34,149
Non-current assets		
Exploration and evaluation assets *(note 5)*	**27,834**	11,052
Property and equipment *(notes 4, 6)*	**159,968**	17,758
Deferred tax asset	**–**	2,375
Total assets	**206,885**	65,334
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities	**20,426**	5,644
	20,426	5,644
Non-current liabilities		
Decommissioning liabilities *(note 8)*	**8,124**	2,498
Flow-through share premium liabilities *(note 9)*	**1,498**	2,498
Deferred tax liability	**491**	–
Total liabilities	**30,539**	10,208
Shareholders' equity		
Share capital *(note 9)*	**196,901**	73,530
Contributed surplus	**2,199**	1,107
Deficit	**(22,754)**	(19,511)
Total equity	**176,346**	55,126
Total liabilities and shareholders' equity	**206,885**	65,334

Credit facility *(note 7)*

Commitments *(note 14)*

See accompanying notes to the financial statements.

Statements of Operations and Comprehensive Loss

	Three Months Ended September 30, 2011	2010	Nine Months Ended September 30, 2011	2010
(000s, except per share amounts)(unaudited)	*($)*	*($)*	*($)*	*($)*
Revenue				
Oil and natural gas revenues	**9,440**	1,618	**20,874**	5,590
Royalties	**(1,847)**	(186)	**(3,604)**	(871)
Oil and natural gas revenues, net of royalties	**7,593**	1,432	**17,270**	4,719
Unrealized gain on financial instruments *(note 12)*	**1,921**	–	**2,013**	–
Realized gain on financial instruments	**144**	–	**144**	–
	9,658	1,432	**19,427**	4,719
Expenses				
Operating and transportation	**3,200**	626	**6,390**	1,960
General and administrative	**789**	337	**3,404**	1,041
Depletion and depreciation *(note 6)*	**4,472**	800	**9,587**	2,598
Impairment *(note 6)*	**–**	8,514	**–**	10,496
Share-based compensation *(note 9)*	**290**	113	**713**	218
Exploration and evaluation expense *(note 5)*	**665**	–	**665**	–
	9,416	10,390	**20,759**	16,313
Finance income	**(50)**	–	**(204)**	(2)
Accretion and finance expenses *(note 8)*	**91**	28	**273**	99
	9,457	10,418	**20,828**	16,410
Income (loss) before income tax	**201**	(8,986)	**(1,401)**	(11,691)
Taxes				
Deferred income tax expense (recovery)	**554**	(2,322)	**1,842**	(2,359)
Net loss and comprehensive loss for the period	**(353)**	(6,664)	**(3,243)**	(9,332)
Deficit, beginning of period	**(22,401)**	(7,109)	**(19,511)**	(4,441)
Deficit, end of period	**(22,754)**	(13,773)	**(22,754)**	(13,773)
Net loss per share *(note 9)*				
Basic and diluted	**(0.01)**	(0.29)	**(0.06)**	(0.46)

See accompanying notes to the financial statements.

Statements of Changes in Shareholders' Equity

	Share Capital	Share Purchase Warrants	Contributed Surplus	Deficit	Total Equity
(000s)(unaudited)	*($)*	*($)*	*($)*	*($)*	*($)*
Balance – January 1, 2011	**73,530**	**–**	**1,107**	**(19,511)**	**55,126**
Common shares issued	**116,602**	**–**	**–**	**–**	**116,602**
Flow-through shares issued	**15,450**	**–**	**–**	**–**	**15,450**
Share issue costs	**(8,283)**	**–**	**–**	**–**	**(8,283)**
Tax benefit of share issue costs	**2,094**	**–**	**–**	**–**	**2,094**
Premium on flow-through shares	**(2,550)**	**–**	**–**	**–**	**(2,550)**
Share-based compensation	**–**	**–**	**1,102**	**–**	**1,102**
Exercise of options	**58**	**–**	**(10)**	**–**	**48**
Net loss	**–**	**–**	**–**	**(3,243)**	**(3,243)**
Balance – September 30, 2011	**196,901**	**–**	**2,199**	**(22,754)**	**176,346**
Balance – January 1, 2010	26,530	283	467	(4,441)	22,839
Common shares issued	32,074	–	–	–	32,074
Flow-through shares issued	3,462	–	–	–	3,462
Share issue costs	(2,628)	–	–	–	(2,628)
Tax benefit of share issue costs	699	–	–	–	699
Premium on flow-through shares	(496)	–	–	–	(496)
Share-based compensation	–	–	351	–	351
Exercise of options	299	–	(21)	–	278
Exercise of warrants	535	(283)	–	–	252
Forfeiture of options	–	–	(20)	–	(20)
Net loss	–	–	–	(9,332)	(9,332)
Balance – September 30, 2010	60,475	–	777	(13,773)	47,479

See accompanying notes to the financial statements.

Statements of Cash Flows

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	**2011**	2010
(000s)(unaudited)	*($)*	*($)*	*($)*	*($)*
Cash flow from (used in):				
Operating activities				
Net loss for the period	**(353)**	(6,664)	**(3,243)**	(9,332)
Adjustments for:				
Depletion and depreciation	**4,472**	800	**9,587**	2,598
Deferred income tax expense (recovery)	**554**	(2,322)	**1,842**	(2,359)
Share-based compensation	**309**	113	**742**	218
Accretion	**69**	21	**159**	60
Unrealized gain on financial instruments	**(1,921)**	–	**(2,013)**	–
Exploration and evaluation expense	**665**	–	**665**	–
Impairment	**–**	8,514	**–**	10,496
Change in non-cash working capital *(note 10)*	**5,115**	225	**(1,393)**	71
	8,910	687	**6,346**	1,752
Financing activities				
Decrease in bank debt	**–**	–	**–**	(2,436)
Issuance of share capital	**–**	22,206	**130,717**	36,006
Share issue expenses	**(7)**	(1,559)	**(8,283)**	(2,630)
Changes in non-cash working capital *(note 10)*	**–**	66	**–**	66
	(7)	20,713	**122,434**	31,006
Investing activities				
Property and equipment expenditures	**(27,059)**	(3,273)	**(25,811)**	(11,006)
Exploration and evaluation expenditures *(note 5)*	**4,016**	(301)	**(14,806)**	(3,738)
Proceeds from farm-out	**–**	–	**5,000**	–
Property acquisitions *(note 4)*	**(1,966)**	–	**(126,411)**	–
Decrease in restricted cash	**–**	–	**–**	4,000
Changes in non-cash working capital *(note 10)*	**1,587**	15	**7,711**	(274)
	(23,422)	(3,559)	**(154,317)**	(11,018)
Change in cash and cash equivalents	**(14,519)**	17,841	**(25,537)**	21,740
Cash and cash equivalents – beginning of period	**21,976**	3,899	**32,994**	–
Cash and cash equivalents – end of period	**7,457**	21,740	**7,457**	21,740

See accompanying notes to the financial statements.

Notes to the Financial Statements

As at and for the period ended September 30, 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 2200, 520 Third 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 15.

These interim financial statements for the period ended September 30, 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 15, 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 15 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 15 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 November 8, 2011.

(b) Basis of Measurement

The interim 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 – acquisitions
- Note 6 – valuation of property and equipment
- Note 8 – provisions for decommissioning costs
- Note 9 – measurement of share-based compensation

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:

(i) 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 incorporate 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 that 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.

(ii) 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.

(iii) 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 may 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.

(iv) 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.

(v) 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.

(vi) 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 Company's IFRS accounting policies are described in Note 3 to the March 31, 2011 unaudited interim financial statements. Those accounting policies 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.

Note 16 to the Company's March 31, 2011 unaudited interim financial statements contains reconciliations of IFRS amounts as of the transition date and as at and for the year ended December 31, 2010 to amounts previously published in accordance with Canadian GAAP prior to January 1, 2011. Reconciliations of IFRS amounts for the three and nine months ended September 30, 2010 to amounts previously published in accordance with Canadian GAAP are provided in note 15 of these unaudited interim financial statements.

4. Acquisitions

During the first quarter of 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 $122,586,000. The property acquisition closed on March 22, 2011 and was accounted for as a business combination under IFRS 3 – "Business Combinations". Acquisition costs of $1,125,000 were charged to general and administrative expense on the statement of income and comprehensive income. Had the acquisition closed January 1, 2011, an additional $6,526,000 in net operating revenue, $1,764,000 in operating and transportation expenses, and $2,348,000 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.

(000s)	*($)*
Net assets acquired	
Petroleum and natural gas assets	122,081
E&E assets	7,773
Adjustments related to January 1 to March 22, 2011 period	(2,414)
Decommissioning liabilities	(4,854)
	122,586
Consideration	
Total cash consideration	122,586

During the second quarter of 2011, the Company acquired additional interest in certain oil and gas assets located in the Brazeau/West Pembina area of central Alberta for total cash consideration of $1,324,000. The property acquisition closed on April 27, 2011 and was accounted for as a business combination under IFRS 3 – "Business Combinations". Net operating revenue and expenses and net income is not readily determinable had the acquisition closed January 1, 2011.

(000s)	*($)*
Net assets acquired	
Petroleum and natural gas assets	1,466
Adjustments related to April 1 to April 27, 2011 period	(111)
Decommissioning liabilities	(31)
	1,324
Consideration	
Total cash consideration	1,324

During the third quarter of 2011, the Company acquired producing assets and undeveloped land for total cash consideration of $1,441,000. The property acquisition was effective as of June 1, 2011, closed on July 12, 2011 and was accounted for as a business combination under IFRS 3 – "Business Combinations". Net operating revenue and expenses and net income is not readily determinable had the acquisition closed January 1, 2011.

(000s)	*($)*
Net assets acquired	
Petroleum and natural gas assets	1,292
E&E assets	476
Adjustments related to June 1 to July 12, 2011 period	(59)
Decommissioning liabilities	(268)
	1,441
Consideration	
Total cash consideration	1,441

5. Exploration and Evaluation Assets

	Nine Months Ended September 30, 2011	Year Ended December 31, 2010
(000s)	($)	($)
Balance – beginning of period	**11,052**	2,915
Additions	**21,892**	10,213
Proceeds from farm-out	**(5,000)**	–
Acquisitions through business combinations	**8,249**	–
Transfers to property and equipment	**(7,694)**	(2,076)
E&E expenses	**(602)**	–
Lease expiries	**(63)**	–
Balance – end of period	**27,834**	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 incurred on E&E assets during the period and acquisitions represent E&E assets included in business combinations during the period.

During the nine months ended September 30, 2011, the Company incurred costs to drill a well that was unsuccessful, and as a result, the well was abandoned. Consequently, the related costs, which were originally included in the E&E balance, were written off and the expense of $602,000 was included in the calculation of net loss for the period. In addition, an expense of $63,000 was recorded to recognize lease expiries on undeveloped land that occurred during the period.

6. Property and Equipment

	Oil and Natural Gas Properties	Office Equipment	Total
(000s)	($)	($)	($)
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	**122,255**	**–**	**122,255**
Additions	**21,753**	**95**	**21,848**
Transfers from E&E assets	**7,694**	**–**	**7,694**
Balance – September 30, 2011	**189,394**	**154**	**189,548**
Accumulated depletion and depreciation			
Balance – January 1, 2010	–	13	13
Depletion and depreciation for the year	3,320	10	3,330
Impairment	16,650	–	16,650
Balance – December 31, 2010	19,970	23	19,993
Depletion and depreciation for the period	**9,575**	**12**	**9,587**
Balance – September 30, 2011	**29,545**	**35**	**29,580**
Net book value			
January 1, 2010	23,077	24	23,101
December 31, 2010	17,722	36	17,758
September 30, 2011	**159,849**	**119**	**159,968**

6. Property and Equipment *(continued)*

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

During the nine months ended September 30, 2011, approximately $494,000 of directly attributable general and administrative expense and $360,000 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).

(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 September 30, 2011.

(c) Future Development Costs and Salvage Value

During the nine months ended September 30, 2011, an estimated $17,883,000 of future development costs associated with proved plus probable undeveloped reserves was included in the calculation of depletion and depreciation expense and an estimated $4,041,000 of salvage value of production equipment was excluded (December 31, 2010 – $610,000 and $2,400,000, respectively).

7. Credit Facility

At September 30, 2011, the Company had a revolving demand credit facility with an authorized borrowing base of $20,000,000 with interest charged at the bank's prime rate plus a range of 1.0% to 1.25% per annum based on the Company's consolidated debt to cash flow ratio. Standby fees associated with this facility range from 0.4% to 0.7% per annum on the undrawn portion of the facility, again based on the Company's consolidated debt to cash flow ratio. At September 30, 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 and had not yet commenced as at the date of this report. 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 $8,124,000 as at September 30, 2011 (December 31, 2010 – $2,498,000) based on an undiscounted total future liability of $11,751,000 (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 September 30, 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.

	Nine Months Ended September 30, 2011	Year Ended December 31, 2010
(000s)	*($)*	*($)*
Balance – beginning of period	**2,498**	2,255
Liabilities incurred	**392**	200
Liabilities acquired	**5,153**	–
Revisions/settlements	**(78)**	(40)
Accretion of decommissioning liabilities	**159**	83
Balance – end of period	**8,124**	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

	Nine Months Ended September 30, 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)*	**27,195,000**	**116,602**	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	**–**	**(8,283)**	–	(3,751)
Tax benefit of share issue costs	**–**	**2,094**	–	1,000
Balance – end of period	**63,152,091**	**196,901**	32,937,091	73,530

(i) Private Placements

In July 2011, DeeThree issued 400,000 common shares at a price of $3.46 per common share in exchange for approximately 12,800 net acres of undeveloped land located primarily in the Peace River Arch area of Alberta. Share issue expenses of approximately $7,000 were recorded in relation to this transaction and the value of the acquired land has been included in the Company's E&E balance at September 30, 2011.

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 ($107,934,000 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 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.

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.

(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 ($14,460,000 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 September 30, 2011, the Company is committed to spending an additional $9,093,000 on qualified exploration and development expenditures by December 31, 2012.

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 September 30, 2011, the Company had met its obligation for qualified expenditures related to this issuance.

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 ($415,500) 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 September 30, 2011, the Company had met its obligation for qualified expenditures related to this issuance.

9. Share Capital *(continued)*

(b) Issued – Common Shares (continued)

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

(iv) 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.

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.

(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 September 30, 2011	Three Months Ended September 30, 2010	Nine Months Ended September 30, 2011	Nine Months Ended September 30, 2010
(000s)	*($)*	*($)*	*($)*	*($)*
Loss for the period	**(353)**	(6,664)	**(3,243)**	(9,332)
	(#)	*(#)*	*(#)*	*(#)*
Weighted average number of common shares – basic and diluted	**63,064**	23,117	**54,134**	20,452
	($)	*($)*	*($)*	*($)*
Net income per weighted average common share – basic and diluted	**(0.01)**	(0.29)	**(0.06)**	(0.46)

(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:

	Nine Months Ended September 30, 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	**1,363,000**	**4.07**	1,045,000	2.60
Exercised	**(20,000)**	**2.37**	(106,374)	2.05
Forfeited	**(76,000)**	**2.96**	(100,683)	2.13
Outstanding – end of period	**3,152,000**	**3.02**	1,885,000	2.26
Exercisable – end of period	**935,900**	**2.21**	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 September 30, 2011			
1.20 – 1.99	**200,000**	**1.67**	**150,000**
2.00 – 2.99	**1,605,000**	**3.40**	**752,000**
3.00 – 3.99	**102,500**	**4.75**	**–**
4.00 – 4.45	**1,244,500**	**4.58**	**33,900**
	3,152,000	**3.80**	**935,900**

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	**September 30, 2011**	December 31, 2010
Risk-free interest rate *(%)*	**1.83**	2.28
Expected life *(years)*	**2.1**	2.1
Expected volatility *(%)*	**76**	123
Expected dividend yield *(%)*	**0**	0
Fair value of options granted during the period *($/share)*	**1.71**	1.77

A forfeiture rate of 0% for those options granted during the nine months ended September 30, 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 $713,000 was expensed during the nine months ended September 30, 2011 (nine months ended September 30, 2010 – $218,000 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 September 30,		Nine Months Ended September 30,	
	2011	2010	**2011**	2010
(000s)	*($)*	*($)*	*($)*	*($)*
Accounts receivable	**(3,098)**	(93)	**(8,156)**	81
Prepaid expenses and other	**(79)**	99	**(304)**	32
Accounts payable and accrued liabilities	**9,885**	300	**14,784**	(230)
Abandonment and reclamation costs	**(6)**	–	**(6)**	(20)
	6,702	306	**6,318**	(137)
Related to operating activities	**5,115**	225	**(1,393)**	71
Related to financing activities	**–**	66	**–**	66
Related to investing activities	**1,587**	15	**7,711**	(274)
	6,702	306	**6,318**	(137)

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. The fair value measurement of the derivative financial instruments has a fair value hierarchy of Level 2.

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 that the Company would encounter should it have difficulty 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 September 30, 2011.

The following table details the Company's financial liabilities as at September 30, 2011:

As at September 30, 2011	Total	Within 1 Year	Over 1 Year
(000s)	*($)*	*($)*	*($)*
Accounts payable and accrued liabilities	**20,426**	**20,426**	**–**
Total financial liabilities	**20,426**	**20,426**	**–**

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 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 crude oil 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 financial contracts for its crude oil production.

As at September 30, 2011, the Company had the following crude oil contracts in place with a mark-to-market asset value of $2,013,000:

Period	Commodity	Type of Contract	Quantity	Pricing Point	Contract Price
Jun.1/11 – Dec.31/11	Crude oil	Collar	250 bbls/d	WTI – NYMEX	US$95.00/bbl (floor) – US$106.00/bbl (cap)
Jan.1/12 – Dec.31/12	Crude oil	Collar	250 bbls/d	WTI – NYMEX	US$95.00/bbl (floor) – US$115.00/bbl (cap) (1)

(1) 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.

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 as well as in relation to the crude oil contracts, which are priced in U.S. dollars.

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 September 30, 2011, the Company had no debt and no interest rate swaps or hedges. Due to the Company's positive cash position at September 30, 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	**September 30 2011**	December 31, 2010
(000s)	*($)*	*($)*
Cash and cash equivalents	**7,457**	32,994
Shareholders' equity	**176,346**	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 September 30, 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 September 30, 2011, the Company incurred $448,000 in costs with the firm (period ended September 30, 2010 – $229,000), which have been included in general and administrative expenses and share issue costs, and $nil remained in accounts payable at September 30, 2011 (September 30, 2010 – $49,000). 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+	Total
(000s)	*($)*	*($)*	*($)*	*($)*	*($)*	*($)*
Operating lease – office	26	441	441	491	800	2,199
Operating lease – equipment	55	193	68	41	–	357
Exploration expenditures (flow-through)	–	9,093	–	–	–	9,093
Drilling contracts	1,848	7,391	5,037	–	–	14,276
Total	1,929	17,118	5,546	532	800	25,925

As at September 30, 2011, the Company had contractual obligations for its office leases totaling approximately $2,199,000 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 $357,000 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 $15,450,000 of eligible exploration expenditures by December 31, 2012. As at September 30, 2011, approximately $6,357,000 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 September 30, 2011, all 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 is required to spend $3,500,000 of eligible exploration expenditures by December 31, 2011. As at September 30, 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 nine months of 2011, DeeThree entered into contracts for drilling rig services under which the Company is committed to using services totaling $14,276,000 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 September 30, 2011, the Company had fulfilled the drilling commitment, having drilled 30 wells, including those drilled as part of the farm-out agreements, and had approximately one-third of the final year's 3-D seismic data (approximately 11 sections) left to shoot in 2011. Subsequent to quarter-end, the Company negotiated a change to the existing seismic commitment and now has until December 31, 2011 to shoot the remaining seismic data (approximately 11 sections) in a different area.

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. Transition to IFRS

As stated in note 2(a), these financial statements have been prepared in accordance with IFRS. The Company's first interim financial statements prepared in accordance with IFRS were for the period ended March 31, 2011.

The policies referred to in note 3 of this report have been applied in preparing the financial statements for the period ended September 30, 2011, the comparative information presented in these financial statements for the period ended September 30, 2010 and for the year ended December 31, 2010.

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 September 30, 2010 and December 31, 2010, Statements of Loss and Comprehensive Loss for the three and nine months ended September 30, 2010 and Statements of Cash Flow for the three and nine months ended September 30, 2010.

Reconciliation of the Statement of Financial Position as at September 30, 2010

	Previous GAAP	Effect of Transition to IFRS	IFRS
(000s)	*($)*	*($)*	*($)*
Assets			
Current			
Cash and cash equivalents	21,740	–	21,740
Accounts receivable	978	–	978
Deposits and prepaid expenses	222	–	222
	22,940	–	22,940
Exploration and evaluation assets *(note a)*	–	6,653	6,653
Property and equipment *(notes a,d)*	37,917	(16,587)	21,330
Deferred tax asset *(note f)*	–	1,413	1,413
Total assets	60,857	(8,521)	52,336
Liabilities			
Current			
Accounts payable and accrued liabilities	2,272	–	2,272
	2,272	–	2,272
Decommissioning liabilities *(note b)*	1,837	608	2,445
Flow-through share premium liabilities *(note g)*	–	140	140
Deferred tax liability *(note f)*	836	(836)	–
Total liabilities	4,945	(88)	4,857
Shareholders' Equity			
Share capital *(note g)*	59,831	644	60,475
Contributed surplus *(note c)*	911	(134)	777
Deficit	(4,830)	(8,943)	(13,773)
Total equity	55,912	(8,433)	47,479
Total liabilities and shareholders' equity	60,857	(8,521)	52,336

15. 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

15. Transition to IFRS *(continued)*

Reconciliation of the Statement of Loss and Comprehensive Loss for the Three Months Ended September 30, 2010

	Previous GAAP	Effect of Transition to IFRS	IFRS
(000s, except per share amounts)	*($)*	*($)*	*($)*
Revenue			
Oil and natural gas revenues	1,618	–	1,618
Royalties	(186)	–	(186)
Oil and natural gas revenues, net of royalties	1,432	–	1,432
Expenses			
Operating and transportation	626	–	626
General and administrative	386	(49)	337
Depletion and depreciation *(note d)*	1,075	(275)	800
Impairment	–	8,514	8,514
Share-based compensation *(note c)*	177	(64)	113
	2,264	8,126	10,390
Finance income	–	–	–
Accretion and finance expenses *(note b)*	44	(16)	28
	2,308	8,110	10,418
Loss before income taxes	(876)	(8,110)	(8,986)
Taxes			
Deferred income tax expense (recovery) *(note f)*	(210)	(2,112)	(2,322)
Net loss and comprehensive loss for the period	(666)	(5,998)	(6,664)
Net loss per share			
Basic and diluted	(0.03)	(0.26)	(0.29)

15. Transition to IFRS *(continued)*

Reconciliation of the Statement of Loss and Comprehensive Loss for the Nine Months Ended September 30, 2010

	Previous GAAP	Effect of Transition to IFRS	IFRS
(000s, except per share amounts)	($)	($)	($)
Revenue			
Oil and natural gas revenues	5,590	–	5,590
Royalties	(871)	–	(871)
Oil and natural gas revenues, net of royalties	4,719	–	4,719
Expenses			
Operating and transportation	1,960	–	1,960
General and administrative	1,096	(55)	1,041
Depletion and depreciation *(note d)*	3,174	(576)	2,598
Impairment *(note e)*	–	10,496	10,496
Share-based compensation *(note c)*	317	(99)	218
	6,547	9,766	16,313
Finance income	–	(2)	(2)
Accretion and finance expenses *(note b)*	142	(43)	99
	6,689	9,721	16,410
Loss before income taxes	(1,970)	(9,721)	(11,691)
Taxes			
Deferred income tax expense (recovery) *(note f)*	(489)	(1,870)	(2,359)
Net loss and comprehensive loss for the period	(1,481)	(7,851)	(9,332)
Net loss per share			
Basic and diluted	(0.07)	(0.39)	(0.46)

15. Transition to IFRS *(continued)*

Reconciliation of the Statement of Cash Flows for the Three Months Ended September 30, 2010

	Previous GAAP	Effect of Transition to IFRS	IFRS
(000s)	*($)*	*($)*	*($)*
Cash flow from (used in):			
Operating activities			
Net loss for the period	(666)	(5,998)	(6,664)
Add back non-cash items:			
Depletion and depreciation	1,075	(275)	800
Impairment	–	8,514	8,514
Accretion	37	(16)	21
Share-based compensation	177	(64)	113
Deferred income tax expense (recovery)	(210)	(2,112)	(2,322)
	413	49	462
Change in non-cash working capital	225	–	225
	638	49	687
Financing activities			
Issuance of share capital	22,206	–	22,206
Share issue expenses	(1,559)	–	(1,559)
Change in non-cash working capital	66	–	66
	20,713	–	20,713
Investing activities			
Property and equipment additions	(3,525)	252	(3,273)
Exploration and evaluation expenditures	–	(301)	(301)
Change in non-cash working capital	15	–	15
	(3,510)	(49)	(3,559)
Change in cash and cash equivalents	17,841	–	17,841
Cash and cash equivalents – beginning of period	3,899	–	3,899
Cash and cash equivalents – end of period	21,740	–	21,740

15. Transition to IFRS *(continued)*

Reconciliation of the Statement of Cash Flows for the Nine Months Ended September 30, 2010

(000s)	Previous GAAP ($)	Effect of Transition to IFRS ($)	IFRS ($)
Cash flow from (used in):			
Operating activities			
Net loss for the period	(1,481)	(7,851)	(9,332)
Add back non-cash items:			
Depletion and depreciation	3,174	(576)	2,598
Impairment	–	10,496	10,496
Accretion	105	(45)	60
Share-based compensation	317	(99)	218
Deferred income tax expense (recovery)	(489)	(1,870)	(2,359)
	1,626	55	1,681
Change in non-cash working capital	71	–	71
	1,697	55	1,752
Financing activities			
Decrease in bank debt	(2,436)	–	(2,436)
Issuance of share capital	36,006	–	36,006
Share issue expenses	(2,630)	–	(2,630)
Change in non-cash working capital	66	–	66
	31,006	–	31,006
Investing activities			
Property and equipment additions	(14,689)	3,683	(11,006)
Exploration and evaluation expenditures	–	(3,738)	(3,738)
Decrease in restricted cash	4,000	–	4,000
Change in non-cash working capital	(274)	–	(274)
	(10,963)	(55)	(11,018)
Change in cash and cash equivalents	21,740	–	21,740
Cash and cash equivalents – beginning of period	–	–	–
Cash and cash equivalents – end of period	21,740	–	21,740

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. Details of the transition exceptions and exemptions have been included in note 16 of the Company's March 31, 2011 unaudited interim financial statements. Details below have been included as they relate to the September 30, 2010 and December 31, 2010 periods.

(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.

This resulted in transfers of $6,653,000 for the period ended September 30, 2010 and $11,052,000 for the year ended December 31, 2010.

15. Transition to IFRS *(continued)*

Notes to Reconciliations (continued)

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

(ii) 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. Refer to “Decommissioning Liabilities” below for further details.

(iii) 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.

(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%. As a result of an adjustment to the deficit on adoption of IFRS, accretion expense decreased $16,000 for the three months ended September 30, 2010 and decreased $43,000 for the nine months ended September 30, 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.

For the period ended September 30, 2010 and year ended December 31, 2010, contributed surplus decreased $134,000 and $215,000, respectively, with an offsetting increase to opening deficit.

(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.

For the three and nine-month periods ended September 30, 2010, depletion and depreciation under IFRS was $275,000 and $576,000 less, respectively, than under Canadian GAAP primarily due to the depreciation of major facilities over 20 years and impairment recognized at September 30, 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 $1,982,000 at June 30, 2010, $8,514,000 at September 30, 2010 and $6,154,000 at December 31, 2010 ($5,299,000 of which had already been recorded under previous GAAP). These amounts were included in impairment expense. Impairments can be reversed in the future if the recoverable amount increases.

15. Transition to IFRS *(continued)*

Notes to Reconciliations (continued)

(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	September 30, 2010	December 31, 2010
(000s)	($)	($)
Canadian GAAP – balance	(836)	1,196
Adjustment related to:		
Temporary differences	2,936	3,113
Reversal of GAAP flow-through share provision *(note g)*	1,871	1,871
Flow-through shares *(note g)*	(2,558)	(3,805)
	2,249	1,179
IFRS – balance	1,413	2,375

These adjustments resulted in a deferred tax recovery adjustment of $2,112,000 for the three months ended September 30, 2010, a deferred tax recovery adjustment of $1,870,000 for the nine months ended September 30, 2010 and a deferred tax recovery adjustment of $1,453,000 for the year ended December 31, 2010.

Under IFRS, 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, the Company recorded an adjustment to record a flow-through premium liability of $705,000 with respect to flow-through shares that were issued during 2008 and 2009.

During the nine-month period ended September 30, 2010, all remaining expenditures relating to the 2008 and 2009 flow-through commitment that was set up on transition were incurred. As a result, the premium liability decreased $705,000, deferred income tax liabilities increased $1,090,000 and the net amount of $385,000 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.

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. During the nine-month period ended September 30, 2010, expenditures incurred accounted for approximately 71% of the flow-through commitment, and as a result, the premium liability decreased $353,000, deferred income tax liabilities increased $687,000 and the net amount of $335,000 was recognized as deferred income tax. Expenditures incurred during the period ended December 31, 2010 accounted for the remainder of the total flow-through commitment, and as a result, the premium liability decreased $142,000, deferred income tax liabilities increased $276,000 and the net amount of $134,000 was recognized as deferred income tax expense.

In November 2010, the Company issued flow-through shares, 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
Executive Vice President
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
Executive Vice President

Trevor Murray
Vice President, Land

Clayton Thatcher
Vice President, Geophysics

Daniel Kenney
Corporate Secretary

Head Office

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Auditors

KPMG LLP
Calgary, Alberta

Banker

Canadian Imperial Bank of Commerce
Calgary, Alberta

Evaluation Engineers

Sproule Associates Limited
Calgary, Alberta

Legal Counsel

Davis LLP
Calgary, Alberta

Registrar and Transfer Agent

Olympia Trust Company
Calgary, Alberta

Stock Trading

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.