



SECOND QUARTER 2014 INTERIM REPORT

For the Three and Six Months Ended June 30, 2014

Highlights: By The Numbers

	Three Months Ended June 30,			Six Months Ended June 30,		
	2014	2013	Change	2014	2013	Change
<i>(000s, except per share amounts)</i>	<i>(\$)</i>	<i>(\$)</i>	<i>(%)</i>	<i>(\$)</i>	<i>(\$)</i>	<i>(%)</i>
Financial						
Oil and natural gas revenues	80,560	39,882	102	146,203	70,372	108
Funds from operations ⁽¹⁾	43,167	22,437	92	78,703	39,225	101
Per share – basic	0.51	0.29	76	0.94	0.52	81
Per share – diluted	0.49	0.28	75	0.91	0.51	78
Cash flow from						
operating activities	44,103	21,876	102	67,710	39,876	70
Net income	18,133	6,800	167	26,815	6,173	334
Per share – basic	0.21	0.09	133	0.32	0.08	300
Per share – diluted	0.21	0.09	133	0.31	0.08	288
Capital expenditures ⁽²⁾	74,288	39,286	89	146,600	80,844	81
Working capital deficit ⁽³⁾	116,064	86,338	34	116,064	86,338	34
Shareholders' equity	410,944	253,336	62	410,944	253,336	62
<i>(000s)</i>	<i>(#)</i>	<i>(#)</i>	<i>(%)</i>	<i>(#)</i>	<i>(#)</i>	<i>(%)</i>
Share Data						
At period-end	88,832	76,474	16	88,832	76,474	16
Weighted average – basic	84,654	76,363	11	83,300	74,784	11
Weighted average – diluted	87,772	79,049	11	86,198	77,355	11
						<i>(%)</i>
Operating ⁽⁴⁾						
Production						
Natural gas (<i>mcf/d</i>)	12,967	10,093	28	12,675	10,186	24
Crude oil (<i>bbls/d</i>)	8,033	4,550	77	7,392	4,239	74
NGLs (<i>bbls/d</i>)	550	346	59	558	317	76
Total (<i>boe/d</i>)	10,744	6,578	63	10,063	6,254	61
Average wellhead prices						
Natural gas (<i>\$/mcf</i>)	5.02	3.79	32	5.49	3.61	52
Crude oil and NGLs (<i>\$/bbl</i>)	95.51	81.34	17	92.81	76.96	21
Combined average (<i>\$/boe</i>)	82.39	66.62	24	80.27	62.17	29
Netbacks						
Operating netback (<i>\$/boe</i>)	50.64	40.57	25	49.05	38.01	29
Funds flow netback (<i>\$/boe</i>)	44.14	37.40	18	43.18	34.59	25
Gross (net) wells drilled						
Gas (#)	–	–	–	1 (1.00)	–	–
Oil (#)	10 (10.00)	5 (5.00)	100 (100)	24 (23.97)	12 (11.22)	100 (114)
Standing (#)	–	2 (2.00)	–	–	2 (2.00)	–
Dry and abandoned (#)	–	1 (1.00)	–	2 (2.00)	2 (1.97)	– (2)
Total (#)	10 (10.00)	8 (8.00)	25 (25)	27 (26.97)	16 (15.19)	69 (78)
Average working interest (%)	100	100	–	100	95	5

⁽¹⁾ Funds from operations and funds from operations per share are not recognized measures under International Financial Reporting Standards (IFRS). Refer to the commentary in the Management's Discussion and Analysis under "Non-GAAP Measurements" for further discussion.

⁽²⁾ Total capital expenditures, including acquisitions and excluding non-cash transactions. Refer to commentary in the Management's Discussion and Analysis under "Capital Expenditures and Acquisitions" for further information.

⁽³⁾ Working capital deficit, which is calculated as current liabilities (excluding derivative financial instruments) and bank debt less current assets, is not a recognized measure under IFRS. Please refer to the commentary under "Non-GAAP Measurements" for further discussion.

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

Letter to Shareholders

We are very pleased to report our financial and operating results for the three and six months ended June 30, 2014.

SECOND QUARTER HIGHLIGHTS

DeeThree delivered another quarter of record results, including funds from operations of \$43.2 million, operating netbacks of \$50.64 per boe and production of 10,744 boe per day (80% oil and NGLs). This is DeeThree's eleventh consecutive quarter of production growth.

Highlights of the quarter include the following.

- Increased average production of 10,744 boe/d (80% oil and NGLs and 20% natural gas), an increase of 63% over the same quarter of 2013 and a 15% increase over the first quarter of 2014.
- Increased average oil and NGL production of 8,583 bbls/day, an increase of 75% or 3,687 bbls/day over the same quarter of 2013 and a 17% or 1,275 bbls/day increase over the first quarter of 2014.
- Increased operating netback of \$50.64 per boe from \$40.57/boe in the same quarter of 2013 and \$47.21 per boe in the first quarter of 2014, an increase of 25% and 7%, respectively.
- Increased funds flow from operations of \$43.2 million, an increase of 92% increase over the same quarter of 2013 and a 21% increase over the first quarter of 2014.
- Increased funds from operations on a fully diluted per share basis of \$0.49, a 75% increase over the same quarter of 2013 and 19% over the first quarter of 2014.
- Exited the quarter with total net debt of \$116.1 million, representing a debt to annualized cash flow ratio of 0.67:1.

OPERATIONAL UPDATE

Record second quarter production was driven by strong drilling results in the Belly River play, which is becoming the Company's key growth asset. Capital spending totaled \$74.3 million with \$51.7 million on drilling & completions (68% of drilling capital was directed to wells drilled and completed in the current period), \$10.5 million on facilities, \$4.1 million on tie-ins and \$7.4 million on land acquisitions.

BELLY RIVER

The Company's second quarter production growth was largely driven by growth in the Belly River play, which averaged 5,987 boe/d, up 25% quarter over quarter. This is the first quarter in which volumes from the Belly River play exceeded Alberta Bakken volumes. Accelerated growth is projected in the Belly River play as the play takes on a lower risk, exploitation profile. DeeThree remains very active in the area with three rigs currently in operation.

DeeThree drilled the first successful well into the Basal Belly River 'A' sand on its Belly River play during the second quarter. This is the 7th sand to demonstrate commerciality on the play and expands the scope and scale of the Belly River resource. In addition, DeeThree further extended the known scope of "C" sand with successful horizontal wells on farm-in lands both to the north and to the south of the core area. As a result, this highly prolific portion of the Belly River oil pool has increased in size to 12 sections of land.

DeeThree continues to expand infrastructure in pace with production growth. A total of \$5 million was spent in the second quarter of 2014 to secure equipment to increase oil processing capacity to 12,000 bbls/d from 8,000 bbls/d. The Company anticipates completing the facility work by the end of the third quarter of 2014.

The Company continues to expand its land position on the Belly River play, adding 12 sections of land during the quarter.

Well results continue to perform at or above expectations. Field activity commenced approximately three weeks earlier than in 2013 due to an earlier spring break-up.

ALBERTA BAKKEN

Production averaged 4,193 boe/d in the second quarter of 2014, up 5% quarter over quarter. The bulk of the horizontal drilling activity on the Alberta Bakken play occurred later in the quarter. The resulting production increases will occur in the third quarter of 2014.

DeeThree is committed to enhancing oil recoveries and profitability on this long life oil resource. The natural gas injection Enhanced Oil Recovery (EOR) scheme continues to show promising results. Second quarter capital expenditures included approximately \$5 million for a larger gas compressor and high pressure pipeline infrastructure for the EOR which is scheduled to come on-stream prior to the end of September 2014.

The Company is planning to build a 60 kilometer pipeline to existing oil loading rail facility. This infrastructure project will allow DeeThree to market the medium gravity crude via rail, which is expected to mitigate oil differential volatility go forward. This project is estimated to cost \$10 million and is scheduled to be completed near to year-end 2014.

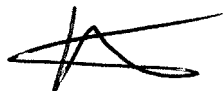
DeeThree will test its 34.5 section land block to the west of the main Alberta Bakken development area during the third quarter of 2014 with one vertical well and one horizontal well.

OUTLOOK

DeeThree projects strong quarter over quarter growth with targeted production for the third quarter of 2014 of 12,000 – 12,500 boe/d. Our balance sheet remains strong with the closing of a bought deal financing in the second quarter for total net proceeds of \$69.5 million and an increase to our syndicated credit facility from \$165 million to \$235 million.

We continue to build two high quality oil assets while maintaining a responsible level of debt that provides us with financial flexibility. We will continue to focus on per share growth in production, reserves, funds flow and net asset value and remain confident that we will achieve our 2014 target exit production rate of 13,000 – 13,500 boe/d (82% crude oil & NGLs).

On behalf of the Board of Directors,



Martin Cheyne
President & Chief Executive Officer

August 13, 2014

Management's Discussion and Analysis

The following Management's Discussion and Analysis (MD&A) of the financial condition and results of operations for DeeThree Exploration Ltd. ("DeeThree" or "the Company") is dated August 12, 2014 and should be read in conjunction with the Company's unaudited interim financial statements and related notes for the three and six months ended June 30, 2014, as well as the Company's audited financial statements and related notes for the years ended December 31, 2013 and 2012. All financial information is reported in Canadian dollars, unless otherwise noted.

This MD&A contains additional generally accepted accounting principles (GAAP) measures, non-GAAP measures and forward-looking statements. Readers are cautioned that the MD&A should be read in conjunction with the Company's disclosure under "Non-GAAP Measures" and "Forward-looking Information and Statements" included at the end of this MD&A.

ABOUT DEETHREE EXPLORATION LTD.

DeeThree is a Canadian company actively engaged in crude oil and natural gas exploration, development and production in key areas of the Western Canada Sedimentary Basin and headquartered in Calgary, Alberta. DeeThree is focused on creating long-term shareholder value through a successful drilling program, growth-oriented field operations and prudent financial management.

DeeThree has created a platform for growth through a sound business strategy that includes low-risk development and higher-risk exploration as well as strategic acquisitions. The Company has two core operating areas: the Brazeau area of west central Alberta, which is prospective for crude oil, natural gas and natural gas liquids (NGLs), and the Ferguson area of southern Alberta, which features Bakken oil and shallow natural gas. These two core areas have provided the Company with a balanced and diverse production base. The Company's experienced technical teams have a solid understanding of the assets and DeeThree has a proven track record of quarter-over-quarter organic growth.

DeeThree commenced operations in 2007 as a private company focused on development and production of natural gas in southern Alberta. In late 2008, DeeThree completed its first significant acquisition from a major oil and natural gas producer comprised of properties in the Lethbridge area of southern Alberta, which became known as the Ferguson area. Ferguson was the Company's primary focus until late in the first quarter of 2011, when DeeThree closed a transformational acquisition of properties in the Brazeau and Peace River Arch areas. Since 2012, the Company has been successful in exploration and development activities in the Brazeau and Ferguson areas and continues to achieve growth in production and reserves, as well as superior returns for its shareholders.

Common shares of DeeThree are listed for trading on the Toronto Stock Exchange under the symbol **DTX** and on the United States OTCQX under the symbol **DTHRF**.

FINANCIAL AND OPERATING HIGHLIGHTS

2014 Second Quarter Highlights

DeeThree's average production of 10,744 boe/d for the second quarter of 2014 reflects good operating performance from existing wells in the Ferguson and Brazeau areas as well as production from new wells drilled during 2014 to date.

For the quarter ended June 30, 2014, DeeThree realized a combined average sales price of \$82.39/boe, a 24 percent increase over the prior year and a 6 percent increase over the first quarter of this year. This was partially due to increased market prices for crude oil and natural gas and also partially related to the increase in crude oil as a percentage of total production. With average operating costs of \$11.00/boe, transportation costs of \$1.92/boe and average royalties of 23 percent, DeeThree achieved an operating netback of \$50.64/boe, a 25 percent increase over the prior year.

DeeThree incurred \$74.3 million of capital expenditures in Q2 2014, with a capital program that focused on the drilling of 10 gross (10.0 net) wells, with 7 gross (7.0 net) in the Ferguson area, 2 gross (2.0 net) in the Brazeau area and 1 gross (1.0 net) in the Peace River Arch area. The capital program also included approximately \$5.1 million of minor acquisitions, \$2.3 million on land and \$10.5 million related to existing facility upgrades as well as facility and pipeline construction to handle the Company's growing production. See "Capital Expenditures and Acquisitions" section for further details.

During the second quarter of the year, the Company entered into a new \$235 million committed credit facility with a syndicate of five financial institutions, led by National Bank of Canada (the "Syndicated Facility"), which replaced the existing \$165 million demand credit facility. The Company's debt under the Syndicated Facility is now classified as a long-term liability instead of a current liability. See "Liquidity and Financial Resources" section below for further details.

In May 2014, the Company issued 5,714,200 common shares (including 304,200 common shares issued in connection with the partial exercise of the underwriters' over-allotment option) at a price of \$11.10 per Common Share and 752,000 common shares issued on a flow-through basis at a price of \$13.30 per Flow-Through Common Share for aggregate gross proceeds of approximately \$73.4 million (\$69.5 million net of estimated share issuance costs).

2014 First Quarter Highlights

DeeThree's average production of 9,372 boe/d for the first quarter of 2014 reflects good operating performance from existing wells in the Ferguson and Brazeau areas as well as results from new wells drilled during the quarter.

For the quarter ended March 31, 2014, DeeThree realized a combined average sales price of \$77.83/boe, a 36 percent increase over the prior year and a 19 percent increase over the last quarter of 2013. This was partially due to increased market prices for crude oil and natural gas prices and also partially related to the increase in crude oil as a percentage of total production. With average operating costs of \$10.18/boe, transportation costs of \$1.69/boe and average royalties of 24 percent, DeeThree achieved an operating netback of \$47.21/boe, a 34 percent increase over the prior year.

DeeThree incurred \$72.3 million of capital expenditures in Q1 2014, with a capital program that focused on the drilling of 17 gross (16.97 net) wells, with 11 gross (10.97 net) in the Brazeau area and 6 gross (6.0 net) in the Ferguson area.

Funds from Operations ⁽¹⁾

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
(000s)	(\$)	(\$)	(\$)	(\$)
Net income	18,133	6,800	26,815	6,173
Non-cash items:				
Depletion and depreciation (D&D) expense	18,752	11,260	35,238	21,575
Deferred income tax expense	6,254	2,877	9,811	3,722
Share-based compensation ⁽²⁾	794	581	1,331	1,001
Accretion	209	107	408	186
Unrealized loss (gain) on financial instruments	(1,047)	(58)	3,140	976
Exploration and evaluation (E&E) expense	72	870	1,960	5,592
Funds from operations ⁽¹⁾	43,167	22,437	78,703	39,225

⁽¹⁾ Funds from operations and funds from operations per share are not recognized measures under IFRS. Refer to the commentary in the Management's Discussion and Analysis under "Non-GAAP Measurements" for further discussion.

⁽²⁾ The share-based compensation amount included in the calculation of funds from operations was 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 income.

During the three months ended June 30, 2014, the Company generated funds from operations totalling \$43.2 million (\$0.51 per basic share and \$0.49 per diluted share) compared to \$22.4 million (\$0.29 per basic share and \$0.28 per diluted share) in the comparative period of 2013 and \$35.5 million (\$0.43 per basic share and \$0.42 per diluted share) in the first quarter of 2014. The year-over-year and quarter-over-quarter increases reflect increased revenue associated with higher crude oil and NGLs production as well as increased crude oil and NGL prices, offset by increased royalties associated with a combination of those increased prices and royalties on new wells on production, as well as higher operating and transportation costs.

Funds from operations totalled \$78.7 million (\$0.94 per basic share and \$0.91 per diluted share) for the six months ended June 30, 2014 compared to \$39.2 million (\$0.52 per basic share and \$0.51 per diluted share) recorded in the same period of 2013.

Net Income

For the three months ended June 30, 2014, the Company recorded net income of \$18.1 million (\$0.21 per basic and diluted share) compared to a net income of \$6.8 million (\$0.09 per basic and diluted share) in the same period of 2013 and net income of \$8.7 million (\$0.11 per basic share and \$0.10 per diluted share) in the first quarter of 2014. The Company's increased net income for the quarter was primarily due to increased production as well as the increased operating netback achieved in the period.

The net income for the six months ended June 30, 2014 was \$26.8 million (\$0.32 per basic share and \$0.31 per diluted share) compared to net income of \$6.2 million (\$0.08 per basic and diluted share) in the comparative period of 2013.

FINANCIAL AND OPERATING RESULTS

Sales Volumes

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Sales				
Natural gas (<i>mcf/d</i>)	12,967	10,093	12,675	10,186
Crude oil (<i>bbls/d</i>)	8,033	4,550	7,392	4,239
NGLs (<i>bbls/d</i>)	550	346	558	317
Total sales (<i>boe/d</i>)	10,744	6,578	10,063	6,254
	(%)	(%)	(%)	(%)
Production Split				
Natural gas	20	26	21	27
Crude oil	75	69	73	68
NGLs	5	5	6	5
Total	100	100	100	100

For the second quarter of 2014, the Company's production averaged 10,744 boe/d compared to 6,578 boe/d in the same period of 2013 and 9,372 boe/d in the first quarter of 2014. This represents a 63 percent year-over-year and a 15 percent quarter-over-quarter increase and reflects new production from the tie-in of wells drilled during 2014.

For the first half of 2014, DeeThree's production averaged 10,063 boe/d compared to 6,254 boe/d a year ago, representing a 61 percent increase. During the 2014 six month period, production was comprised of 12,675 mcf/d of gas, 7,392 bbls/d of crude oil and 558 bbls/d of NGLs, thereby increasing the Company's crude oil and NGL production to 79 percent of total corporate production versus 73 percent in the comparable period of 2013.

Revenue

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
(000s)	(\$)	(\$)	(\$)	(\$)
Natural gas	5,918	3,480	12,606	6,657
Crude oil	71,905	34,752	127,438	60,697
NGLs and other	2,737	1,650	6,159	3,018
Total oil and natural gas revenue	80,560	39,882	146,203	70,372

During the three months ended June 30, 2014, revenue increased by 102 percent to \$80.6 million from \$39.9 million in the comparative period of 2013. The year-over-year increase was a result of increased production, a shift to a higher percentage of oil and NGLs (80 percent versus 74 percent), improved commodity prices and the resulting increase in the corporate average price per boe. When compared to the first quarter of 2014, revenue increased 23 percent from \$65.6 million due to increased production and an increased corporate average price per boe.

For the first half of 2014, revenue totalled \$146.2 million compared to \$70.4 million for the same period of 2013. During the first six months of 2014, total revenue increased 108 percent compared to 2013 primarily as a result of the increase in sales volumes and increase in corporate average price per boe.

Pricing for both the three and six month periods ended June 30, 2014 is discussed in further detail in "Commodity Prices and Foreign Exchange" below.

Commodity Prices and Foreign Exchange

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
	(\$)	(\$)	(\$)	(\$)
Benchmark Prices				
Natural gas				
NYMEX (US\$/mmbtu) ⁽¹⁾	4.56	4.09	4.73	3.72
AECO (Cdn\$/GJ) ⁽²⁾	4.44	3.35	4.93	3.19
Crude oil				
WTI (US\$/bbl)	102.99	94.22	100.84	94.30
Edmonton Light (MSW) (Cdn\$/boe)	105.55	92.53	102.67	90.45
Differential – MSW/WTI (US\$/bbl)	(6.14)	(3.67)	(7.19)	(5.31)
Hardisty Bow River (Cdn\$/boe)	100.57	87.60	97.23	80.79
Differential – Bow River/WTI (US\$/bbl)	(19.84)	(17.94)	(21.23)	(24.32)
Average Realized Prices				
Natural gas (\$/mcf)	5.02	3.79	5.49	3.61
Crude oil (\$/bbl)	98.35	83.92	95.25	79.11
NGLs (\$/bbl)	53.92	47.29	60.45	48.21
Combined average (\$/boe)	82.39	66.62	80.27	62.17
Foreign Exchange				
Cdn\$/US\$	1.0905	1.0234	1.0970	1.0161
US\$/Cdn\$	0.9170	0.9772	0.9116	0.9841

⁽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 1.05 GJ.

Prices for Canadian crude oil increased in 2014 from 2013 although differentials on Canadian crude oil remained volatile as a result of higher North American crude oil production, refinery outages, and constrained takeaway and infrastructure capacity. Certain pipeline and infrastructure projects and additional crude oil rail capacity are scheduled to come on-stream in 2014, and are expected to alleviate certain bottlenecks which have exacerbated Canadian crude oil differentials. It is expected that crude oil differentials will remain volatile throughout 2014 until additional infrastructure capacity is available to meet growing North American production. Natural gas prices fell slightly in the second quarter of 2014 after the increase that was seen in the first quarter of the year, however NYMEX Henry Hub and AECO monthly (AECO) prices both remain higher than 2013 levels. Demand for natural gas in the United States is expected to increase due to the commencement of liquefied natural gas exports, increased natural gas power generation, increased usage from the transportation and industrial sectors, and higher gas exports to Mexico and eastern Canada. Ongoing commodity price volatility may affect DeeThree's funds from operations and rates of return on capital programs. As continued volatility is expected in 2014, DeeThree will take steps to mitigate these risks and protect its financial position.

The benchmark for crude oil prices in North America, and widely quoted globally, is WTI delivered to Cushing, Oklahoma, again as determined by the NYMEX. Canadian crude prices are based on refinery 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. During the second quarter of 2014, approximately 45 percent of DeeThree's oil production was priced relative to Hardisty Bow River oil prices, while 55 percent was priced relative to Edmonton Light (MSW) oil prices, compared to two-thirds and one-third, respectively, in the same period of the prior year but relatively consistent with the first quarter of 2014.

For the past year, the Company has been moving a portion of its crude oil out of the Ferguson area via rail cars. The Company has been able to attract better pricing on these volumes and will continue to explore options to move its crude oil by rail as long as the market conditions are favorable to do so.

In the second quarter of 2014, WTI increased by 9 percent year-over year while DeeThree's realized oil price increased by 17 percent when compared to the prior year and 7 percent when compared to the first quarter of 2014, partially due to the change in crude oil production composition (55 percent of the Company's crude oil is now being sold at the higher Edmonton Light price versus 33 percent in the second quarter of 2013 and 50 percent in the first quarter of 2014) and partially attributable to the increase in the WTI benchmark pricing. Differentials remained relatively consistent for both Bow River prices (US\$19.84/boe versus US\$17.94/boe in Q2 2013 and US\$22.62/boe in Q1 2014) and Edmonton Light prices (US\$6.14/boe versus US\$3.67/boe in Q2 2013 and US\$8.25/boe in Q1 2014). Additionally, the value of the Canadian dollar weakened in comparison to the US dollar from an average of Cdn\$/US\$1.01 in 2013 to Cdn\$/US\$1.09 in 2014, which increased the Canadian dollar price that the Company ultimately received for its oil. The average realized price of DeeThree's crude oil was \$98.35/bbl for the second quarter of 2014 compared to \$83.92/bbl a year earlier and \$91.51/bbl in the first quarter of 2014.

During the three-month period ended June 30, 2014, benchmark natural gas prices in Canada were higher than the same period in 2013 as natural gas inventories decreased throughout the year due to increased residential and industrial demand from a cold winter. AECO prices averaged \$4.44/GJ throughout the second quarter of 2014 compared to \$3.35/GJ in the second quarter of 2013 and \$5.42/GJ in the first quarter of 2014. DeeThree's average realized natural gas price during the three-month period was \$5.02/mcf in the second quarter of 2014 versus \$3.79/mcf a year earlier and \$6.00/mcf in the first quarter of 2014, reflecting increased demand drawing on previously high storage levels.

For the six months ended June 30, 2014, the Company's average realized crude oil price was \$95.25/bbl compared to \$79.11/bbl in the same period of 2013. In terms of natural gas, the Company's average realized price was \$5.49/mcf compared to \$3.61/mcf in the same period of 2013.

The Company's financial results are significantly influenced by fluctuations in commodity prices, including price differentials and foreign exchange rates. The Company seeks to protect itself from fluctuations in prices and exchange rates by maintaining an appropriate hedging strategy. As at the date of this MD&A, DeeThree had seven crude oil hedges and three natural gas hedges (refer to "Risk Management" below for details). Most commodity prices are based on US dollar benchmarks, which result in the Company's realized prices being influenced by the Canadian/US exchange rates. The Company does not sell or transact in foreign currency, but may be affected by foreign currency exchange rate changes related to commodity prices as outlined above. As at the date of this MD&A, DeeThree had one foreign currency exchange risk management contract in place to mitigate these risks (see "Risk Management" below for contract details).

Royalties

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
	(\$)	(\$)	(\$)	(\$)
Oil and natural gas revenues (000s)	80,560	39,882	146,203	70,372
Total royalties (000s)	18,416	7,615	34,226	14,056
Total royalties (\$/boe)	18.83	12.72	18.79	12.42
Percent of revenue (%)	23	19	23	20

The Ferguson property is primarily subject to freehold royalties, which work on a sliding-scale determined monthly on a well-by-well basis using a calculation based on the new royalty regulation implemented in 2009 ("New Alberta Crown Royalty 2009") with a cap of 30 percent. The sliding scale provides varying rates 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 and crude oil prices). This area is also subject to freehold mineral taxes (which are included as royalties for financial reporting purposes) and overriding royalties related to farm-in arrangements. As the Company drills more successful oil wells in this area and production increases, an increase in royalties is to be expected.

The Brazeau property is primarily subject to Crown royalties payable to the provincial government and overriding royalties on oil, natural gas and NGLs production. These types of royalties are also sensitive to 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 along with performance and location of new wells drilled.

For the second quarter of 2014, royalties totalled \$18.4 million or 23 percent of revenue compared to \$7.6 million or 19 percent of revenue for the same quarter in 2013 and \$15.8 million or 24 percent of revenue in the first quarter of 2014. The year-over-year royalty rate increase was due to new production from the Company's wells brought on-stream during the past year, most of which are subject to a freehold royalty based on the New Alberta Crown Royalty 2009 or overriding royalties, while only some qualify for the 5 percent royalty holiday under the Government of Alberta's royalty framework.

During the first six months of 2014, royalties totalled \$34.2 million or 23 percent of revenue compared to \$14.1 million or 20 percent of revenue a year ago.

Operating and Transportation Expenses

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
<i>(000s except per boe)</i>	<i>(\$)</i>	<i>(\$)</i>	<i>(\$)</i>	<i>(\$)</i>
Operating expenses	10,758	6,430	19,344	10,751
Transportation expenses	1,874	1,553	3,299	2,537
Total	12,632	7,983	22,643	13,288
Operating expenses <i>(\$/boe)</i>	11.00	10.74	10.62	9.50
Transportation expenses <i>(\$/boe)</i>	1.92	2.59	1.81	2.24
Total operating and transportation expenses <i>(\$/boe)</i>	12.92	13.33	12.43	11.74

Operating costs include all costs associated with the production of crude oil and natural gas. The major components of operating costs include charges for contract operating, processing fees, lease rentals, property and pipeline taxes, utilities and well maintenance charges.

Operating expenses for the second quarter of 2014 totalled \$10.8 million or \$11.00/boe compared to \$6.4 million or \$10.74/boe in the same period of 2013 and \$8.6 million or \$10.18/boe in the first quarter of 2014. The year-over year increase was driven by several of the Company's new wells in the initial production phase in Ferguson incurring higher operating costs until they were pipeline-connected, increasing operating costs per barrel in those periods.

Transportation expenses for the three months ended June 30, 2014 were \$1.9 million or \$1.92/boe compared to \$1.6 million or \$2.59/boe in the second quarter of 2013 and \$1.4 million or \$1.69/boe in the first quarter of 2014. Transportation expenses reflect NOVA and ATCO transportation costs and fluctuate depending on the proportion of the Company's natural gas that flows on firm service versus interruptible service (interruptible service being slightly more expensive) as well as the proportion of Company volumes on ATCO versus NOVA (ATCO being less expensive). Over the past year, the Company has increased production of crude oil and NGLs, and the transportation costs associated with those products consist primarily of pipeline tariffs, terminal charges and trucking (crude oil and NGLs incur a higher cost per boe for transportation than natural gas). When the Company experiences pipeline capacity constraints, it must use alternative means of transportation to move production volumes to market.

For the six months ended June 30, 2014, the Company incurred operating expenses of \$19.3 million or \$10.62/boe compared to \$10.8 million or \$9.50/boe in the corresponding 2013 period. Transportation expenses for the first half of 2014 totalled \$3.3 million or \$1.81/boe versus \$2.5 million or \$2.24/boe in the same period of last year.

Risk Management

DeeThree maintains a risk management program to reduce the volatility of revenues and to increase the certainty of funds from operations. DeeThree considers all of its risk management contracts to be effective economic hedges of the underlying business transactions. The Company had the following crude oil, natural gas, foreign exchange and interest rate risk management contracts with a short-term mark-to-market liability of \$5.1 million and a long-term mark-to-market liability of \$0.2 million for a total of \$5.3 million at June 30, 2014 (March 31, 2014 – \$6.4 million and December 31, 2013 – \$2.2 million):

Crude Oil Contracts

Period	Commodity	Type of Contract	Quantity	Pricing Point	Contract Price
Jan. 1/14 – Dec. 31/14	Crude Oil	Collar	1,000 bbls/d	WTI-NYMEX	US\$85.00/bbl (floor) - US\$97.00/bbl (cap)
Jan. 1/14 – Dec. 31/14	Crude Oil	Collar	500 bbls/d	WTI-NYMEX	Cdn\$92.50/bbl (floor) - Cdn\$102.01/bbl (cap)
Jan. 1/14 – Dec. 31/14	Crude Oil	Collar	500 bbls/d	WTI-NYMEX	Cdn\$90.00/bbl (floor) - Cdn\$101.25/bbl (cap)
Jan. 1/14 – Dec. 31/14	Crude Oil	Collar	1,000 bbls/d	WTI-NYMEX	Cdn\$90.00/bbl (floor) - Cdn\$107.85/bbl (cap)
Mar. 1/14 – Dec. 31/14	Crude Oil	Swap	500 bbls/d	WTI-NYMEX	Cdn\$105.20
Mar. 1/14 – Dec. 31/14	Crude Oil	Swap	500 bbls/d	WTI-NYMEX	Cdn\$106.00
Jan. 1/15 – Dec. 31/15	Crude Oil	Collar	500 bbls/d	WTI-NYMEX	US\$85.00/bbl (floor) - US\$100.80/bbl (cap)

Natural Gas Contracts

Period	Commodity	Type of Contract	Quantity	Pricing Point	Contract Price
Feb. 1/14 – Dec. 31/14	Natural Gas	Swap	2,000 GJ/day	AECO	Cdn\$3.975/GJ
Mar. 1/14 – Dec. 31/14	Natural Gas	Swap	1,000 GJ/day	AECO	Cdn\$4.310/GJ
Apr. 1/14 – Oct. 31/14	Natural Gas	Swap	2,500 GJ/day	AECO	Cdn\$4.110/GJ

Foreign Exchange Contract

Period	Currency	Type of Contract	Quantity	Pricing Point (Cdn\$/US\$)
Sept. 1/13 – Dec. 31/14	US\$	Average Rate Range Bonus Accumulator	US\$2,500,000	Target – \$1.0825 Cdn\$/US\$ + \$1,500 bonus/day ⁽¹⁾

⁽¹⁾ The Company can earn a bonus payout of up to \$1,500 per day depending on the period in which the exchange rate remains in the applicable range of less than 1.0825.

Interest Rate Contract

Term	Amount	Fixed Rate	Index
Feb. 18/14 – Feb. 18/16	Cdn\$40 million	1.44%	CDOR

Gains and losses on risk management contracts are composed both of unrealized gains or losses that represent the change in the mark-to-market position of those contracts throughout the period and of realized gains and losses representing the portion of the contracts that have settled in cash during the period. The Company has elected not to use hedge accounting for its current risk management contracts.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
	(\$)	(\$)	(\$)	(\$)
Unrealized loss (gain) on financial instruments (000s)	(1,047)	(58)	3,140	976
Unrealized loss (gain) on financial instruments (\$/boe)	(1.07)	(0.10)	1.72	0.86

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
	(\$)	(\$)	(\$)	(\$)
Realized loss (gain) on financial instruments (000s)	2,815	(154)	4,413	(270)
Realized loss (gain) on financial instruments (\$/boe)	2.88	(0.26)	2.42	(0.24)

During the second quarter of 2014, the Company recorded an unrealized gain on financial instruments of \$1.0 million and a realized loss of \$2.8 million. In the same period of the prior year, the Company recorded an unrealized gain of \$58,000 and a realized gain of \$0.2 million and in the previous quarter, an unrealized loss of \$4.2 million and a realized loss of \$1.6 million. The unrealized loss resulted from the mark-to-market of financial risk management contracts at the period end. These non-cash unrealized derivative losses are generated by the change over the reporting period in the mark-to-market valuation of DeeThree's risk management contracts. The realized loss represents actual cash settlements under the respective commodity, foreign exchange and interest rate contracts in the period.

For the six months ended June 30, 2014, the Company recorded an unrealized loss of \$3.1 million and a realized loss of \$4.4 million compared to an unrealized loss of \$1.0 million and a realized gain of \$0.3 million, respectively, in the same period of 2013.

G&A

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
(000s except per boe)	(\$)	(\$)	(\$)	(\$)
Gross G&A expense	2,558	1,695	5,211	3,809
Capitalized G&A (direct)	(417)	(328)	(1,000)	(789)
Overhead recoveries	(199)	(150)	(397)	(259)
G&A expense (net)	1,942	1,217	3,814	2,761
G&A expense (net) (\$/boe)	1.99	2.03	2.09	2.44

Gross G&A expense totalled \$2.6 million for the three-month period ended June 30, 2014 compared to \$1.7 million in the comparable period of 2013 and \$2.7 million in the first quarter of 2014. Net G&A costs were \$1.94 million or \$1.99/boe in the second quarter of 2014 compared to \$1.2 million or \$2.03/boe a year earlier and \$1.9 million or \$2.22/boe in the first quarter of 2014. When compared to the same quarter of the prior year, gross G&A costs increased on an absolute basis due to increased staffing costs (including salaries, consulting and office rent) required to manage DeeThree's growing business. In the second quarter of 2014, the Company had an average of 32 full-time employees and three consultants versus 21 full-time employees and six consultants in the same period of 2013.

The Company capitalized direct G&A expenses amounting to \$0.4 million and had overhead recoveries of \$0.2 million in the second quarter of 2014 versus \$0.3 million and \$0.2 million, respectively, in the comparative period of 2013, and \$0.6 million and \$0.2 million, respectively, in the first quarter of 2014.

Net G&A expenses for the first six months of 2014 totalled \$3.8 million or \$2.09/boe compared to \$2.8 million or \$2.44/boe in the same period of 2013. During the six months ended June 30, 2014, the Company capitalized \$1.0 million in direct costs related to its exploration and development efforts and \$0.4 million of overhead recoveries compared to \$0.8 million and \$0.3 million, respectively, in the same period of 2013.

Share-Based Compensation

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
<i>(000s except per boe)</i>	<i>(\$)</i>	<i>(\$)</i>	<i>(\$)</i>	<i>(\$)</i>
Gross share-based compensation	1,289	928	2,128	1,542
Share-based compensation reclassified to operating costs	(5)	(53)	(72)	(73)
Capitalized share-based compensation	(495)	(347)	(796)	(541)
Share-based compensation expense (net)	789	528	1,260	928
Share-based compensation expense (net) <i>(\$/boe)</i>	0.81	0.88	0.69	0.82

The Company has a stock option plan, described in note 10 to the interim financial statements for the three and six months ended June 30, 2014. Options granted under the plan have a four-year vesting term and expire five years from the grant date, with the fair value of options granted estimated at the grant date using the Black-Scholes option-pricing model. At June 30, 2014, the Company had 7,233,328 options outstanding under this plan.

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 Company's employees, consultants and directors. For those stock options granted to field employees, their portion of the share-based compensation is reclassified to operating expenses, in order to be consistent with the recognition of their salaries on the statement of operations and comprehensive income.

For the quarter ended June 30, 2014, the Company incurred net share-based compensation expense of \$0.8 million or \$0.81/boe versus \$0.5 million or \$0.88/boe in the same period of 2013 and \$0.5 million or \$0.56/boe in the first quarter of 2014. The year-over-year absolute increase was directly attributable to a large grant issued during the second quarter and the resulting share-based compensation from that issuance. Also, in most quarters, approximately \$70,000 of the gross share-based compensation expense is reclassified to operating costs for those employees who work in the field. However, in Q2 2014, one of the field employees' options were forfeited, and the expense related to his unvested options was reversed, which offset the quarterly amount to be reclassified and netted to only \$5,000 for the period.

During the first six months of 2014, DeeThree incurred net share-based compensation expense of \$1.3 million or \$0.69/boe compared to \$0.9 million or \$0.82/boe recorded in the first half of 2013.

Depletion and Depreciation (D&D)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
	<i>(\$)</i>	<i>(\$)</i>	<i>(\$)</i>	<i>(\$)</i>
Depletion and depreciation expense <i>(000s)</i>	18,752	11,260	35,238	21,575
Depletion and depreciation expense <i>(\$/boe)</i>	19.18	18.81	19.35	19.06

DeeThree records D&D expense on its property and equipment over the individual useful lives of the assets, employing the unit-of-production method using proved plus probable reserves and associated estimated future development capital required for its oil and natural gas assets, a straight-line method for field facilities (20-year useful life) and a declining-balance method on corporate assets (20 to 30 percent). Assets in the E&E phase are not amortized.

For the three months ended June 30, 2014, the Company recorded D&D expense of \$18.8 million or \$19.18/boe compared to \$11.2 million or \$18.81/boe in the same period of 2013 and \$16.5 million or \$19.55/boe in the first quarter of 2014. The absolute increase in D&D expense quarter over quarter is related to the 15 percent increase in production volumes slightly offset by lower costs related to finding and developing reserves. The Company expects the D&D expense per barrel to fall within the \$18/boe to \$20/boe range going forward.

For the six months ended June 30, 2014, D&D expense was \$35.2 million or \$19.35/boe compared to \$21.6 million or \$19.06/boe in the same period of 2013.

Exploration and Evaluation (E&E)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
	(\$)	(\$)	(\$)	(\$)
Exploration and evaluation expense (000s)	72	870	1,960	5,592
Exploration and evaluation expense (\$/boe)	0.07	1.45	1.08	4.94

Under IFRS, DeeThree accumulates costs related to E&E assets in one pool pending determination of technical feasibility and commercial viability of the asset. E&E costs are primarily for seismic data, undeveloped land and drilling until the well in question is complete and results have been evaluated. Costs related to wells determined to be uneconomical as well as costs of undeveloped land lease expiries are expensed as they occur.

During the second quarter of 2014, the Company recorded E&E expense of \$72,000 or \$0.07/boe, which related to lease expiries in one of the Company's areas. This compares to \$0.9 million or \$1.45/boe in the same period of 2013, which related to lease expiries and one exploratory step-out well in Ferguson, and \$1.9 million or \$2.24/boe in the first quarter of 2014 including \$58,000 million of lease expiries and \$1.8 million related to two vertical strat test wells.

During the six months ended June 30, 2014, the Company recorded E&E expense of \$1.96 million or \$1.08/boe compared to \$5.6 million or \$4.94/boe in the comparable period of 2013.

Accretion and Finance Expenses

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
(000s except per boe)	(\$)	(\$)	(\$)	(\$)
Accretion expense on decommissioning liabilities	209	107	408	186
Finance expense	1,593	837	2,475	1,385
Total accretion and finance expenses	1,802	944	2,883	1,571
Accretion expense on decommissioning liabilities (\$/boe)	0.21	0.18	0.22	0.16
Finance expense (\$/boe)	1.63	1.40	1.36	1.22
Total accretion and finance expenses (\$/boe)	1.84	1.58	1.58	1.38

Accretion expense represents the increase in the present value of the Company's decommissioning liabilities. In the second quarter of 2014, the Company recorded accretion expense of \$0.2 million or \$0.21/boe compared to \$0.1 million or \$0.18/boe in the same period of 2013 and \$0.2 million or \$0.24/boe in the first quarter of 2014.

During the three months ended June 30, 2014, interest and finance expenses increased to \$1.6 million or \$1.63/boe from \$0.8 million or \$1.40/boe in the same period of 2013 and \$0.9 million or \$1.05/boe in the previous quarter. The Company incurred interest charges and standby fees related to the \$235 million credit facility, which was drawn to \$86.2 million at the end of the year (June 30, 2013 – \$63.8 million and March 31, 2014 - \$108.2 million) as well as the \$0.5 million in fees associated with the new syndicated facility which was completed in May 2014.

For the first six months of 2014, the Company recorded accretion expense of \$0.4 million or \$0.22/boe compared to \$0.2 million or \$0.16/boe in the comparable period of 2013. The Company also recorded finance expense of \$2.5 million or \$1.36/boe compared to \$1.4 million or \$1.22/boe compared to the same period of the prior year.

Income Taxes

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
	(\$)	(\$)	(\$)	(\$)
Deferred income tax expense (000s)	6,254	2,877	9,811	3,722
Deferred income tax expense (\$/boe)	6.40	4.81	5.39	3.29

During the second quarter of 2014, the Company recorded a deferred income tax expense of \$6.3 million or \$6.40/boe compared to \$2.9 million or \$4.81/boe in same period of 2013 and \$3.6 million or \$4.22/boe in the first quarter of 2014. The second quarter expense was primarily related to positive net income in the period as well as an increase in the taxable base of the oil and natural gas assets, driven by capital spending during the period as well as the impact of capital spending associated with flow-through shares. As costs are incurred, the Company reverses the flow-through share liability and recognizes the deferred income tax expense at that time. During the three months ended June 30, 2014, the Company spent approximately \$0.1 million in eligible capital expenditures related to the December 2013 issuance of flow-through shares.

During the six months ended June 30, 2014, the Company recorded a deferred income tax expense of \$9.8 million or \$5.39/boe compared to \$3.7 million or \$3.29/boe in the same period of 2013. During the first six months of 2014, the Company spent approximately \$3.3 million in eligible capital expenditures related to the December 2013 issuance of flow-through shares.

DeeThree does not have current income taxes payable and does not expect to pay current income taxes in 2014 as the Company had estimated tax pools available at June 30, 2014 of \$454.7 million (December 31, 2013 – \$386 million).

Netbacks (per unit)⁽²⁾

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
	(\$/boe)	(\$/boe)	(\$/boe)	(\$/boe)
Average sales price	82.39	66.62	80.27	62.17
Royalties	(18.83)	(12.72)	(18.79)	(12.42)
Operating	(11.00)	(10.74)	(10.62)	(9.50)
Transportation	(1.92)	(2.59)	(1.81)	(2.24)
Operating netback ⁽¹⁾	50.64	40.57	49.05	38.01
G&A and other expense (excludes non-cash items)	(1.99)	(2.03)	(2.09)	(2.44)
Realized gain (loss) on financial instruments	(2.88)	0.26	(2.42)	0.24
Finance expense	(1.63)	(1.40)	(1.36)	(1.22)
Funds flow netback ⁽¹⁾	44.14	37.40	43.18	34.59
D&D expense	(19.18)	(18.81)	(19.35)	(19.06)
Accretion	(0.21)	(0.18)	(0.22)	(0.16)
Share-based compensation	(0.81)	(0.88)	(0.69)	(0.82)
Unrealized gain (loss) on financial instruments	1.07	0.10	(1.72)	(0.86)
E&E expense	(0.07)	(1.45)	(1.08)	(4.94)
Deferred income tax expense	(6.40)	(4.81)	(5.39)	(3.29)
Net income netback ⁽¹⁾	18.54	11.37	14.73	5.46

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

⁽²⁾ For a description of the boe conversion ratio, refer to "Other Measurements" below.

The operating netback was \$50.64/boe for the three months ended June 30, 2014 compared to \$40.57/boe in the same period of 2013 and \$47.21/boe in the first quarter of 2014. As compared to the prior year's second quarter, the Company experienced a higher realized average price throughout the three months ended June 30, 2014 but also higher royalties and operating expenses than a year earlier. As compared to the first quarter of 2014, the Company also realized a higher average price due to an increase in WTI prices, contributing to the increase in operating netback quarter-over-quarter.

For the first six months of 2014, DeeThree achieved an operating netback of \$49.05/boe compared to \$38.01/boe in the same period of 2013, again related to higher pricing but offset by higher royalties and operating expenses.

INVESTMENT AND INVESTMENT EFFICIENCIES

Capital Expenditures and Acquisitions

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
<i>(000s) (excluding decommissioning liabilities and capitalized share-based compensation)</i>	<i>(\$)</i>	<i>(\$)</i>	<i>(\$)</i>	<i>(\$)</i>
Property acquisitions and adjustments	5,105	–	5,215	2,130
Drilling and completions				
Prior period wells	13,882	4,584	2,133	1,592
Current period wells	35,110	23,096	106,054	56,954
Future wells and work overs	2,724	1,692	2,859	1,350
	51,716	29,372	111,046	59,896
Equipment and facilities				
Tie-in of prior period wells	2,691	1,516	671	1,034
Tie-in of current period wells	1,437	507	8,564	1,950
Facilities, pipelines and work overs	10,450	6,265	15,895	9,798
	14,578	8,288	25,130	12,782
Land and lease retention	2,335	303	3,074	4,242
Geological and geophysical	116	999	1,112	999
Capitalized G&A and other	438	324	1,023	795
Total capital expenditures	74,288	39,286	146,600	80,844
Total wells drilled (#)	10 (10.00)	8 (8.00)	27 (26.97)	16 (15.19)

During the second quarter of 2014, the Company incurred a total of \$74.3 million (second quarter 2013 - \$39.3 million) in capital expenditures, excluding non-cash decommissioning liabilities and capitalized share-based compensation. During the period, \$5.1 million was spent to complete several minor acquisitions (2013 - \$nil). Drilling and completion expenditures totalled \$51.7 million in the second quarter of 2014 (second quarter 2013 - \$29.4 million), \$14.6 million was spent on tie-ins and facilities (second quarter 2013 - \$8.3 million), \$2.3 million on Crown land sales (second quarter 2013 - \$0.3 million) and \$0.1 million related to seismic programs (second quarter 2013 - \$1.0 million). The remaining \$0.4 million in the second quarter of 2014 (second quarter 2013 - \$0.3 million) was invested in capitalized G&A and other corporate assets.

During the first six months of 2014, the Company incurred a total of \$146.6 million (2013 - \$80.8 million) in capital expenditures, excluding the non-cash decommissioning liabilities and capitalized share-based compensation. During the period, the Company spent \$5.2 million to complete several minor acquisitions (2013 - \$2.1 million). Drilling and completion expenditures totalled \$111.0 million (2013 - \$59.9 million), \$25.1 million was spent on tie-ins and facilities (2013 - \$12.8 million), \$3.1 million on Crown land sales (2013 - \$4.2 million) and \$1.1 million related to seismic programs (2013 - \$1.0 million). The remaining \$1.0 million spent in the first half of 2014 (2013 - \$0.8 million) was invested in capitalized G&A and other corporate assets.

Drilling Activity

	Exploration		Development		Total	
	Gross	Net	Gross	Net	Gross	Net
	(#)	(#)	(#)	(#)	(#)	(#)
Three Months Ended June 30, 2014						
Crude oil	–	–	10	10.00	10	10.00
Total wells	–	–	10	10.00	10	10.00
Success rate (%)		–		100		100
Average working interest (%)		–		100		100
Three Months Ended June 30, 2013						
Crude oil	–	–	5	5.00	5	5.00
Standing	–	–	2	2.00	2	2.00
Dry and abandoned	1	1.00	–	–	1	1.00
Total wells	1	1.00	7	7.00	8	8.00
Success rate (%)		–		100		88
Average working interest (%)		100		100		100
Six Months Ended June 30, 2014						
Gas	–	–	1	1.00	1	1.00
Crude oil	–	–	24	23.97	24	23.97
Dry and abandoned	2	2.00	–	–	2	2.00
Total wells	2	2.00	25	24.97	27	26.97
Success rate (%)		–		100		93
Average working interest (%)		100		100		100
Six Months Ended June 30, 2013						
Crude oil	1	1.00	11	10.22	12	11.22
Standing	–	–	2	2.00	2	2.00
Dry and abandoned	2	1.97	–	–	2	1.97
Total wells	3	2.97	13	12.22	16	15.19
Success rate (%)		34		100		87
Average working interest (%)		99		94		95

During the second quarter of 2014, DeeThree drilled a total of 10 gross (10.00 net) crude oil development wells with a 100 percent success rate. During the three months ended June 30, 2013, the Company drilled 7 gross (7.00 net) development wells, 5 gross (5.00 net) which were targeting crude oil and 2 gross (2.00 net) which were standing at the period end. In that quarter, the Company also drilled 1 gross (1.00 net) exploratory step-out well, which was deemed to be dry and abandoned during the period.

During the first half of 2014, DeeThree drilled 27 gross (26.97 net) wells in total, including 24 gross (23.97 net) development wells targeting crude oil, 1 gross (1.00 net) gas development well and 2 gross (2.00 net) exploration wells, both vertical strat test wells outside the core Ferguson area which were deemed to be dry and abandoned in the period. During the six months ended June 30, 2013, the Company drilled a total of 16 gross (15.19 net) wells, including 11 gross (10.22 net) development wells targeting crude oil, 2 gross (2.0 net) development wells that were standing at the period end, 1 gross (1.00 net) exploration well targeting crude oil and 2 gross (1.97 net) exploration wells that were deemed to be dry and abandoned.

Drilling Activity by Area

	Brazeau	Ferguson	Peace River Arch	Total
	(#)	(#)	(#)	(#)
Three Months Ended June 30, 2014				
Crude oil	2 (2.00)	7 (7.00)	1 (1.00)	10 (10.00)
Total wells	2 (2.00)	7 (7.00)	1 (1.00)	10 (10.00)
Success rate (%)	100	100	100	100
Average working interest (%)	100	100	100	100
Three Months Ended June 30, 2013				
Crude oil	– (–)	5 (5.00)	– (–)	5 (5.00)
Standing	1 (1.00)	1 (1.00)	– (–)	2 (2.00)
Dry and abandoned	– (–)	1 (1.00)	– (–)	1 (1.00)
Total wells	1 (1.00)	7 (7.00)	– (–)	8 (8.00)
Success rate (%)	100	86	0	88
Average working interest (%)	100	100	0	100
Six Months Ended June 30, 2014				
Gas	1 (1.00)	– (–)	– (–)	1 (1.00)
Crude oil	12 (11.97)	11 (11.00)	1 (1.00)	24 (23.97)
Dry and abandoned	– (–)	2 (2.00)	– (–)	2 (2.00)
Total wells	13 (12.97)	13 (13.00)	1 (1.00)	27 (26.97)
Success rate (%)	100	85	100	93
Average working interest (%)	100	100	100	100
Six Months Ended June 30, 2013				
Crude oil	5 (4.93)	6 (6.00)	1 (0.29)	12 (11.22)
Standing	1 (1.00)	1 (1.00)	– (–)	2 (2.00)
Dry and abandoned	1 (0.97)	1 (1.00)	– (–)	2 (1.97)
Total wells	7 (6.90)	8 (8.00)	1 (0.29)	16 (15.19)
Success rate (%)	100	88	100	87
Average working interest (%)	100	100	29	95

During the second quarter of 2014, DeeThree drilled a total of 10 gross (10.0 net) wells, including 2 gross (2.0 net) wells on its Brazeau property, 7 gross (7.0 net) Bakken wells on its Ferguson property and 1 gross (1.0 net) well in the Peace River Arch with a 100 percent success rate. During the three months ended June 30, 2013, the Company drilled 8 gross (8.0 net) wells for an 88 percent success rate, including 1 gross (1.0 net) horizontal Belly River well in the Brazeau area and 7 gross (7.0 net) Bakken wells in the Ferguson area, one of which was an exploratory step-out well and deemed to be dry and abandoned during the period.

During the first half of 2014, DeeThree drilled 27 gross (26.97 net) wells in total, including 13 gross (12.97 net) wells on its Brazeau property, 13 gross (13.0 net) Bakken wells on its Ferguson property and 1 gross (1.0 net) well in the Peace River Arch area with a 93 percent success rate. During the six months ended June 30, 2013, the Company drilled 16 gross (15.19 net) wells for an 87 percent success rate, including 7 gross (6.9 net) horizontal Belly River wells in the Brazeau area, 8 gross (8.0 net) Bakken wells in the Ferguson area and 1 gross (0.29 net) non-operated well in the Peace River Arch area.

LIQUIDITY AND FINANCIAL RESOURCES

Working Capital ⁽¹⁾

The following table summarizes the change in working capital during the six months ended June 30, 2014 and the year ended December 31, 2013:

	Six Months Ended June 30, 2014	Year Ended December 31, 2013
<i>(000s)</i>	<i>(\$)</i>	<i>(\$)</i>
Working capital deficit ⁽¹⁾ – beginning of period	(119,787)	(77,586)
Funds from operations	78,703	93,295
Capital expenditures	(141,385)	(200,191)
Acquisitions	(5,215)	(11,694)
Issuance of capital stock for cash (net of share issuance costs)	71,620	76,822
Abandonment and reclamation costs	–	(433)
Working capital deficit ⁽¹⁾ – end of period	(116,064)	(119,787)

⁽¹⁾ Working capital deficit, which is calculated as current liabilities (excluding derivative financial instruments) and bank debt less current assets, is not a recognized measure under IFRS. Please refer to the commentary under “Non-GAAP Measurements” for further discussion.

DeeThree entered 2014 with a working capital deficit of \$119.8 million. During the first six months, the Company generated funds from operations of \$78.7 million and invested \$141.4 million in capital expenditures and \$5.2 million in acquisitions for total capital spending of \$146.6 million. In the second quarter of 2014, the Company issued 5,714,200 common shares at a price of \$11.10 per share for total gross proceeds of \$63.4 million (\$60.0 million net of estimated share issuance costs), including 304,200 common shares issued pursuant to the partial exercise of the over-allotment and 752,000 flow-through shares at a price of \$13.30 per share for total gross proceeds of \$10 million (\$9.5 million net of estimated share issuance costs). The Company also issued common shares on the exercise of options for total cash proceeds of \$2.1 million. DeeThree exited the quarter with a working capital deficit of \$116.1 million.

The Company may utilize any one of the following strategies to address its working capital deficiency and to fund its capital program: (i) issue new shares; (ii) issue new debt securities; (iii) amend, revise, renew or extend the terms of the existing \$235 million credit facility (the “Syndicated Facility”); (iv) enter into new agreements establishing new credit facilities; and (v) adjust its capital spending.

At June 30 2014, the Company had a committed term syndicated credit facility (the “Syndicated Facility”) with an authorized borrowing base of \$235 million, including a \$215 million extendible revolving facility and a \$20 million operating facility. At the period end, the facility was drawn to approximately \$86.2 million with \$148.8 million of unused borrowing capacity.

The Syndicated Facility is available for a revolving period of 364 days plus a one year term-out, which is extendible annually, subject to syndicate approval. Repayments of principal are not required provided that the borrowings under the Syndicated Facility do not exceed the authorized borrowing amount and the Company is in compliance with covenants, representations and warranties. As at June 30, 2014, the Company is in compliance with all covenants. Covenants include reporting requirements, permitted indebtedness, permitted hedging and other standard business operating covenants. There are no financial covenants under the Syndicated Facility. The authorized borrowing amount is subject to interim reviews by the financial institutions and the next semi-annual review of the Syndicated Facility is scheduled for the fall of 2014. Security is provided for by a floating charge demand debenture over all assets in the amount of \$1.0 billion.

The Syndicated Facility bears interest on a grid system which ranges from bank prime plus 1.0 percent to bank prime plus 3.5 percent depending on the Company’s total net debt to cash flow ratio as defined by the lender, ranging from less than 1:1 to greater than 3:1. The Syndicated Facility provides that advances may be made by way of prime rate loans, U.S. Base Rate loans, London InterBank Offered Rate (“LIBOR”) loans, bankers’ acceptances or letters of credit. A standby fee of 0.500 percent to 0.875 percent is charged on the undrawn portion of the Syndicated Facility, also calculated depending on the Company’s total net debt to cash flow ratio, as defined by the lender.

During 2014, DeeThree plans to invest approximately \$270 million on its capital program, which is focused on further exploration and development of the Ferguson and Brazeau properties and consists of a planned 46 gross wells. DeeThree expects to fund future capital expenditures with its funds from operations and the unused demand credit facility. The Company remains committed to maintaining financial flexibility, the prudent use of debt and a strong balance sheet, giving it the ability to take advantage of opportunities as they arise.

RELATED-PARTY TRANSACTIONS AND OFF-BALANCE-SHEET TRANSACTIONS

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

CONTRACTUAL OBLIGATIONS AND COMMITMENTS

Years Ended December 31,	2014	2015	2016	Total
<i>(000s)</i>	<i>(\$)</i>	<i>(\$)</i>	<i>(\$)</i>	<i>(\$)</i>
Operating lease – office	320	640	160	1,120
Operating lease – equipment	52	28	–	80
Exploration expenditures (flow-through)	1,732	10,002	–	11,734
Total	2,104	10,670	160	12,934

As at June 30, 2014, the Company had contractual obligations for its office leases totalling approximately \$1.1 million to March 2016. The head office lease obligations are comprised of the lease payments as well as parking and an estimate of occupancy costs of the Company's head office space. The Company also had contractual obligations for several vehicles and equipment totalling approximately \$80,000 to October 2015.

In connection with the Company's issuance of flow-through shares during the fourth quarter of 2013, DeeThree was required to spend \$5 million of eligible exploration expenditures by December 31, 2014. As at June 30, 2014, \$3.3 million of these expenditures had been incurred. The remaining \$1.7 million of qualifying expenditures will be incurred during 2014 and were renounced to shareholders in January 2014 effective December 31, 2013.

In connection with the Company's issuance of flow-through shares during the second quarter of 2014, DeeThree is required to spend an additional \$10 million of eligible exploration expenditures by December 31, 2015. As at June 30, 2014, \$nil of these expenditures had been incurred. These expenditures will be renounced to shareholders in January 2015 effective December 31, 2014.

SHARE CAPITAL

As at August 12, 2014, the Company had the following equity securities outstanding:

Common shares outstanding	88,832,460
Stock options outstanding	7,728,328

SELECTED QUARTERLY INFORMATION ⁽¹⁾

Three Months Ended	June 30, 2014	March 31, 2014	Dec. 31, 2013	Sept. 30, 2013	June 30, 2013	March 31, 2013	Dec. 31, 2012	Sept. 30, 2012
<i>(000s, except per share amounts and production figures)</i>	<i>(\$)</i>	<i>(\$)</i>	<i>(\$)</i>	<i>(\$)</i>	<i>(\$)</i>	<i>(\$)</i>	<i>(\$)</i>	<i>(\$)</i>
Oil and natural gas revenues	80,560	65,643	51,865	55,754	39,882	30,490	28,378	24,020
Funds from operations	43,167	35,536	24,660	29,410	22,437	16,788	16,231	14,265
Per share – basic	0.51	0.43	0.32	0.38	0.29	0.23	0.23	0.21
Per share – diluted	0.49	0.42	0.31	0.37	0.28	0.23	0.22	0.20
Cash flow from operating activities	44,103	23,607	25,499	32,073	21,876	18,000	30,978	12,555
Net income (loss)	18,133	8,682	3,305	8,570	6,800	(627)	3,483	1,294
Per share – basic	0.21	0.11	0.04	0.11	0.09	(0.01)	0.05	0.02
Per share – diluted	0.21	0.10	0.04	0.11	0.09	(0.01)	0.05	0.02
Total assets	626,620	564,393	497,280	457,679	387,056	353,574	329,666	292,348
Capital expenditures ⁽²⁾	74,288	72,312	56,072	74,969	39,286	41,558	45,134	33,205
Working capital deficit ⁽³⁾	116,064	155,517	119,787	131,295	86,338	70,174	77,586	69,698
Shareholders' equity	410,944	321,640	311,070	263,800	253,336	244,909	212,090	187,308
Production								
Natural gas (mcf/d)	12,967	12,381	10,251	8,910	10,093	10,279	9,377	8,883
Crude oil (bbls/d)	8,033	6,743	6,547	5,765	4,550	3,924	3,511	2,953
NGLs (bbls/d)	550	565	369	323	346	289	259	259
Total (boe/d)	10,744	9,372	8,625	7,573	6,578	5,926	5,333	4,692

⁽¹⁾ The selected quarterly information was prepared in accordance with the accounting principles described in the notes to the financial statements, except for funds from operations, which is not prescribed under IFRS (see "Non-GAAP Measurements" below).

⁽²⁾ Total capital expenditures, including acquisitions.

⁽³⁾ Working capital deficit, which is calculated as current liabilities (excluding derivative financial instruments) and bank debt less current assets, is not a recognized measure under IFRS. Please refer to the commentary under "Non-GAAP Measurements" for further discussion.

OUTLOOK

DeeThree is well positioned to continue to deliver strong quarter over quarter growth with targeted production for the third quarter of 2014 of between 12,000 – 12,500 boe/d. The Company's balance sheet remains strong with the closing of a bought deal financing for total net proceeds of \$69.5 million as well as an increase to the syndicated credit facility from \$165 million to \$235 million with a syndicate of five Canadian chartered banks both completed in the second quarter of 2014.

The Company continues to build two high quality oil assets while maintaining a responsible level of debt that provides for financial flexibility. DeeThree will continue to focus on per share growth in production, reserves, funds flow and net asset value and remain confident that the Company will achieve the 2014 target exit production rate of 13,000 – 13,500 boe/d (82% crude oil & NGLs).

BUSINESS RISKS AND RISK MITIGATION

The DeeThree management team conducts focused strategic planning and has identified the key risks, uncertainties and opportunities associated with Company's business that can affect its financial results. They include, but are not limited to:

Reserves and Resource Estimates

DeeThree's exploration and production activities are concentrated in the Western Canada Sedimentary Basin, where the industry is very competitive. There are a number of risks facing participants in the oil and natural gas industry, some of which are common to all businesses, while others are specific to the sector. These include risks such as finding and developing oil and natural gas reserves economically, estimating 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's future oil and natural gas reserves and production and, therefore, its cash flows, will be highly dependent on the Company's success in exploiting its reserve base and acquiring additional reserves. The Company mitigates the risk of finding and developing economical oil and natural gas reserves 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 opportunities, including 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 oil and natural gas reserves may not be economically produced at prevailing prices. DeeThree minimizes this risk by generating exploration prospects internally, targeting high-quality projects, operating the project, and by attempting to access sales markets through Company-owned infrastructure or mid-stream operators.

DeeThree has retained an independent engineering consulting firm that assists the Company in evaluating oil and natural gas reserves. Reserve values are based on a number of variable factors and assumptions such as commodity prices, projected production, future production costs and governmental regulation. The reserves and recovery information contained in the independent reserves evaluation is an estimate. The actual production and ultimate reserves from the properties may be greater or less than the estimates prepared by the independent reserves evaluator.

Volatility of Oil and Natural Gas Prices

The Company's operational results and financial condition depend on the prices received for oil and natural gas production. Differentials on Canadian crude oil showed significant volatility throughout 2013 due to pipeline and infrastructure constraints. There are numerous projects proposed to alleviate pipeline bottlenecks into and in the United States, expand refinery capacity and expand or build new pipelines in Canada and the United States to source new markets, many of which are in the regulatory application phase. There can be no assurance that such regulatory approvals will be secured on a timely basis or at all. Any movement in oil and natural gas prices will have an effect on DeeThree's ability to conduct its capital expenditure program. Oil and natural gas prices are determined by economic and, in some circumstances, political factors. Supply and demand factors, including weather and general economic conditions as well as conditions in other oil and natural gas regions, influence prices.

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 oil and natural gas are affected 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 and may enter into oil and natural gas risk management contracts. If the Company engages in activities to manage its commodity price exposure, it may forego the benefits it would otherwise experience if commodity prices were to increase. In addition, commodity derivatives contracts activities could expose DeeThree to losses. To the extent that DeeThree engages in risk management activities related to commodity prices, it will be subject to credit risks associated with the counterparties with which it contracts. As at the date of this MD&A, DeeThree has seven crude oil hedges, three natural gas hedges and one foreign currency exchange hedge in place (refer to "Risk Management" above for details).

Operational Matters

The operation of oil and natural gas wells involves a number of operating and natural hazards that may result in blowouts, environmental damage and other unexpected or dangerous conditions resulting in damage to DeeThree and possible liability to third parties. 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. DeeThree maintains a comprehensive insurance plan, which includes liability insurance, where available, in amounts consistent with industry standards as well as business interruption insurance for selected facilities, to the extent that such insurance is available, to mitigate risks and protect against significant losses where possible. DeeThree may become liable for damages arising from such events against which it cannot insure or against which it may elect not to insure because of high premiums or other reasons. DeeThree operates in accordance with all applicable environmental legislation and strives to maintain compliance with such regulations. DeeThree's mandate includes ongoing development of procedures, standards and systems to allow DeeThree staff to make the best decisions possible and ensuring those decisions are in compliance with the Company's environmental, health and safety policies.

Access to Capital

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 that are beyond the Company's control, such as general economic and market conditions. Internally generated funds will also fluctuate with changing commodity prices. DeeThree currently has a \$235 million syndicated facility with two banks. The Company is required to comply with covenants under this facility and in the event it does not comply, access to capital could be restricted or repayment could be required. DeeThree routinely reviews the covenants based on actual and forecast results and has the ability to make changes to development plans to comply with the covenants under the credit facility. 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 expenditure program that can be adjusted to capitalize on acquisition opportunities and, if necessary, a tightening of liquidity sources. From its founding to the date of this MD&A, DeeThree has had no defaults or breaches on its bank debt or any of its financial liabilities.

Counterparty Risk

DeeThree assumes customer credit risk associated with oil and gas sales, financial hedging transactions and joint venture participants. In the event that DeeThree's counterparties default on payments to DeeThree, cash flows will be impacted. 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 has established credit policies and controls designed to mitigate the risk of default or non-payment with respect to oil and natural gas sales, financial hedging transactions and joint venture participants. The Company makes every effort to sell its commodities to major companies with excellent credit ratings.

Variations in Interest Rates and Foreign Exchange Rates

Variations in interest rates could result in an increase in the amount DeeThree pays to service debt. World oil prices are quoted in US dollars and the price received by Canadian producers is therefore affected by the Canadian/US dollar exchange rate, which may fluctuate over time. A material increase in the value of the Canadian dollar would, other variables remaining constant, negatively impact DeeThree's net production revenue. Volatility in interest rates and the Canadian dollar may affect future cash flow from operations and reduce funds available for capital expenditures. DeeThree may initiate certain derivative contracts to attempt to mitigate these risks. To the extent DeeThree engages in risk management activities related to foreign exchange rates, it will be subject to credit risk associated with counterparties with which it contracts. At the date of this MD&A, DeeThree has one foreign currency exchange risk management contract and one interest rate swap risk management contract in place.

Changes in Income Tax Legislation

In the future, income tax laws or other laws may be changed or interpreted in a manner that adversely affects DeeThree or its shareholders. Tax authorities having jurisdiction over DeeThree or its shareholders may disagree with how DeeThree calculates its income for tax purposes to the detriment of DeeThree and its shareholders.

Environmental Concerns

The oil and natural gas industry is subject to environmental regulation pursuant to local, provincial and federal legislation. A breach of such legislation may result in the imposition of fines or issuance of clean-up orders in respect of DeeThree or its working interests. Such legislation may be changed to impose higher standards and potentially more costly obligations to DeeThree. DeeThree focuses on conducting transparent, safe and responsible operations in the communities in which its people live and work.

Project Risks

DeeThree's ability to execute projects and market oil and natural gas depends on numerous factors beyond its control, including: availability of processing capacity, availability and proximity of pipeline capacity, availability of storage capacity, supply of and demand for oil and natural gas, availability of alternative fuel sources, effects of inclement weather, availability of drilling and related equipment, unexpected cost increases, accidental events, changes in regulations, and availability and productivity of skilled labour. Because of these factors, DeeThree could be unable to execute projects on time, on budget or at all, and may not be able to effectively market the oil and natural gas that it produces.

In addition, DeeThree is also subject to other risks and uncertainties which are described in the Company's Annual Information Form (AIF) dated March 24, 2014.

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. They are developed based on the best available information and are believed by management to be reasonable under the circumstances. New events or additional information may result in the revision of these estimates over time. DeeThree's financial and operating results incorporate certain estimates, including:

- Estimated revenues, royalties and operating expenses on production as at a specific reporting date but for which actual revenues and costs have not yet been received;
- Estimated capital expenditures on projects that are in progress;
- Estimated D&D charges that are based on estimates of oil and gas reserves that DeeThree expects to recover in the future;
- Estimated fair values of financial instruments that are subject to fluctuation depending on underlying commodity prices, foreign exchange rates and interest rates, volatility curves and the risk of non-performance;
- Estimated value of decommissioning liabilities that depend on estimates of future costs and timing of expenditures;
- Estimated future recoverable value of PP&E and any associated impairment charges or recoveries; and
- Estimated compensation expense under DeeThree's share-based compensation plan.

DeeThree has hired individuals and consultants who have the skills required to make such estimates and ensures that individuals or departments with the most knowledge of the activity are responsible for the estimates. Further, past estimates are reviewed and compared to actual results, and actual results are compared to budget in order to make more informed decisions on future estimates. For further information on certain estimates inherent in the financial statements, refer to Note 2 in the audited financial statements for the years ended December 31, 2013 and 2012.

INTERNAL CONTROL OVER FINANCIAL REPORTING

Internal control over financial reporting is a process designed to provide reasonable assurance that all the assets are safeguarded and transactions are appropriately authorized, and to facilitate the preparation of relevant, reliable and timely information. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements.

DeeThree is required to comply with National Instrument 52-109 – "Certification of Disclosure in Issuers' Annual and Interim Filings" and management has assessed the effectiveness of the Company's internal control over financial reporting as defined by this instrument. The assessment was based on the framework in *Internal Control – Integrated Framework (1992)* issued by

the Committee of Sponsoring Organizations of the Treadway Commission. The certification of interim filings for interim period ended June 30, 2014 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 have materially affected, or are 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 three and six months ended June 30, 2014.

CHANGES IN ACCOUNTING POLICIES

As of January 1, 2014, the Company adopted several new IFRS standards and amendments in accordance with the transitional provisions of each standard. A brief description of each new or amended standard and its impact on the Company's financial statements follows below:

- Amendments to International Accounting Standard (IAS) 36 "Impairment of Assets" reduce the circumstances in which the recoverable amount of CGUs is required to be disclosed and clarify the disclosures required when an impairment loss has been recognized or reversed in the period. The amendments must be adopted retrospectively for fiscal years beginning January 1, 2014, with earlier adoption permitted. These amendments have been applied by the Company on January 1, 2014 and have not had any material impact on the financial statements. The adoption will only impact its disclosures in the notes to the financial statements in periods when an impairment loss or impairment reversal is recognized.
- Amendments to IAS 32 "Offsetting Financial Assets and Financial Liabilities" clarify that an entity currently has a legally enforceable right to off-set if that right is not contingent on a future event and is enforceable both in the normal course of business and in the event of default, insolvency or bankruptcy of the entity and all counterparties. The amendments to IAS 32 also clarify when a settlement mechanism provides for net settlement or gross settlement that is equivalent to net settlement. The effective date for the amendments to IAS 32 is annual periods beginning on or after January 1, 2014. These amendments are to be applied retrospectively. The Company has adopted the amendments to IAS 32 in its financial statements for the annual period beginning January 1, 2014 and have not had any material impact on the financial statements.
- IFRIC 21 "Levies," which was developed by the IFRS Interpretations Committee, clarifies that an entity recognizes a liability for a levy when the activity that triggers payment, as identified by the relevant legislation, occurs. The interpretation also clarifies that no liability should be recognized before the specified minimum threshold to trigger that levy is reached. IFRIC 21 must be adopted retrospectively for fiscal years beginning January 1, 2014, with earlier adoption permitted. The Company has adopted IFRIC 21 in its financial statements for the annual period beginning January 1, 2014 and there has been no impact on the financial statements.

FUTURE ACCOUNTING POLICY CHANGES

The IASB has undertaken a three-phase project to replace IAS 39 "Financial Instruments: Recognition and Measurement" with IFRS 9 "Financial Instruments." In November 2009, the IASB issued the first phase of IFRS 9, which details the classification and measurement requirements for financial assets. Requirements for financial liabilities were added to the standard in October 2010. The new standard replaces the current multiple classification and measurement models for financial assets and liabilities with a single model that has only two classification categories: amortized cost and fair value. In November 2013, the IASB issued the third phase of IFRS 9, which details the new general hedge accounting model. Hedge accounting remains optional and the new model is intended to allow reporting issuers to better reflect risk management activities in the financial statements and provide more opportunities to apply hedge accounting. The Company does not employ hedge accounting for its current risk management contracts. The new standard removes the January 1, 2015 effective date of IFRS 9. The new mandatory effective date will be determined once the classification and measurement and impairment phases of IFRS 9 are finalized; however, in its February 2014 meeting, the IASB tentatively decided that IFRS 9 would be mandatorily effective for annual periods beginning on or after January 1, 2018. The full impact of the standard on the Company's financial statements will not be known until the project is complete.

In December 2013, the IASB issued narrow-scope amendments to a total of nine standards as part of its annual improvements process. It uses this process to make amendments to IFRS that are non-urgent but deemed necessary. Most amendments will apply prospectively for annual periods beginning on or after July 1, 2014; earlier application is permitted, in which case the related consequential amendments to other IFRS would also apply. The Company intends to adopt these amendments in its financial statements for the annual period beginning on January 1, 2015. The impact of adopting the amendments has not yet been determined.

NON-GAAP MEASUREMENTS

Funds from Operations

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 (used in) operating activities as determined in accordance with IFRS. These terms do not have any standardized meaning under IFRS. 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 with cash flow from operating activities, which is the most directly comparable measure calculated in accordance with IFRS:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
(000s)	(\$)	(\$)	(\$)	(\$)
Cash flow from operating activities	44,103	21,894	67,710	39,961
Changes in non-cash working capital	(936)	543	10,993	(736)
Funds from operations	43,167	22,437	78,703	39,225

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 income (loss) netbacks. Operating netback is calculated as the average sales price of the Company’s commodities, less royalties, operating costs and transportation expenses. Funds flow netback starts with the operating netback and further deducts general and administrative costs and finance expense, and then adds finance income as well as realized gains on financial instruments. To calculate the net income (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 or losses on financial instruments, any impairment or exploration and evaluation expense and deferred income taxes. No IFRS measure is reasonably comparable to netbacks. See “Netbacks (per unit)” for the netback calculations.

Net Debt and Working Capital Deficit

Net debt and working capital deficit, which represent current liabilities (excluding derivative financial instruments) and bank debt less current assets, are used to assess efficiency, liquidity and the Company’s general financial strength. No IFRS measure is reasonably comparable to net debt or working capital deficit.

OTHER MEASUREMENTS

All financial figures are 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 6,000 cubic feet of gas to 1 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 boe may be misleading, particularly if used in isolation. Readers should be aware that historical results are not necessarily indicative of future performance.

FORWARD-LOOKING INFORMATION AND STATEMENTS

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

In particular, this MD&A contains forward-looking statements pertaining to the following: projections of market prices and costs, supply and demand for 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 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 discussed 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. In addition, test results are not necessarily indicative of long-term performance or of ultimate recovery.

This forward-looking information represents the Company's views as of the date of this MD&A and such information should not be relied upon as representing its views as of any subsequent date. 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. There may be other factors, however, 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.

Additional information regarding the Company and factors that could affect its operations and financial results are included in reports on file with Canadian securities regulatory authorities, including the Company's Annual Information Form, and may be accessed through the SEDAR website (www.sedar.com), or at the Company's website (www.deethree.ca). Furthermore, the forward-looking statements contained in this MD&A are made as of the date of this MD&A and the Company does not undertake any obligation to update publicly or to revise any of the included forward-looking statements, whether as a result of new information, future events or otherwise, except as may be required by applicable securities laws. The Company's forward-looking statements are expressly qualified in their entirety by this cautionary statement.

Statements of Financial Position

(Unaudited)

As at	June 30, 2014	December 31, 2013
(000s)	(\$)	(\$)
Assets		
Current assets		
Accounts receivable	38,786	22,308
Deposits and prepaid expenses	1,484	596
	40,270	22,904
Non-current assets		
Exploration and evaluation assets (note 5)	51,840	45,611
Property and equipment (note 6)	534,510	428,765
Total assets	626,620	497,280
Liabilities		
Current liabilities		
Bank debt (note 7)	–	88,404
Accounts payable and accrued liabilities	70,180	54,287
Derivative financial instruments (note 12)	5,135	2,224
	75,315	144,915
Non-current liabilities		
Bank debt (note 7)	86,154	–
Decommissioning liabilities (note 8)	28,477	26,291
Flow-through share premium liabilities (note 9)	1,896	699
Deferred tax liability	23,606	14,305
Derivative financial instruments (note 12)	228	–
Total liabilities	215,676	186,210
Shareholders' equity		
Share capital (note 9)	381,095	309,323
Contributed surplus	9,889	8,602
Retained earnings (deficit)	19,960	(6,855)
Total shareholders' equity	410,944	311,070
Total liabilities and shareholders' equity	626,620	497,280
Commitments (note 13)		

See accompanying notes to the interim financial statements.

Statements of Operations and Comprehensive Income

(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
(000s, except per share amounts)	(\$)	(\$)	(\$)	(\$)
Revenue				
Oil and natural gas revenues	80,560	39,882	146,203	70,372
Royalties	(18,416)	(7,615)	(34,226)	(14,056)
Oil and natural gas revenues, net of royalties	62,144	32,267	111,977	56,316
Expenses				
Operating and transportation	12,632	7,983	22,643	13,288
General and administrative	1,942	1,217	3,814	2,761
Depletion and depreciation (note 6)	18,752	11,260	35,238	21,575
Share-based compensation (note 10)	789	528	1,260	928
Exploration and evaluation expense (note 5)	72	870	1,960	5,592
	34,187	21,858	64,915	44,144
Unrealized loss (gain) on financial instruments	(1,047)	(58)	3,140	976
Realized loss (gain) on financial instruments	2,815	(154)	4,413	(270)
Accretion and finance expenses	1,802	944	2,883	1,571
	37,757	22,590	75,351	46,421
Income before income tax	24,387	9,677	36,626	9,895
Taxes				
Deferred income tax expense	6,254	2,877	9,811	3,722
Net income and comprehensive income for the period	18,133	6,800	26,815	6,173
Retained earnings (deficit), beginning of the period	1,827	(25,530)	(6,855)	(24,903)
Retained earnings (deficit), end of the period	19,960	(18,730)	19,960	(18,730)
Net income per share (note 9)				
Basic	0.21	0.09	0.32	0.08
Diluted	0.21	0.09	0.31	0.08

See accompanying notes to the interim financial statements.

Statements of Changes in Shareholders' Equity

(Unaudited)

	Share Capital	Contributed Surplus	Retained Earnings (Deficit)	Total Equity
<i>(000s)</i>	<i>(\$)</i>	<i>(\$)</i>	<i>(\$)</i>	<i>(\$)</i>
Balance – January 1, 2014	309,323	8,602	(6,855)	311,070
Common shares issued	63,428	–	–	63,428
Flow-through shares issued	10,002	–	–	10,002
Premium on flow-through shares	(1,654)	–	–	(1,654)
Share issuance costs	(3,862)	–	–	(3,862)
Tax benefit of share issuance costs	963	–	–	963
Share-based compensation	–	2,129	–	2,129
Exercise of options	2,895	(842)	–	2,053
Net income	–	–	26,815	26,815
Balance – June 30, 2014	381,095	9,889	19,960	410,944
Balance – January 1, 2013	231,415	5,578	(24,903)	212,090
Common shares issued	34,564	–	–	34,564
Share issuance costs	(2,320)	–	–	(2,320)
Tax benefit of share issuance costs	579	–	–	579
Share-based compensation	–	1,542	–	1,542
Exercise of options	1,076	(368)	–	708
Net income	–	–	6,173	6,173
Balance – June 30, 2013	265,314	6,752	(18,730)	253,336

See accompanying notes to the interim financial statements.

Statements of Cash Flows

(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
<i>(000s)</i>	<i>(\$)</i>	<i>(\$)</i>	<i>(\$)</i>	<i>(\$)</i>
Cash flow from (used in):				
Operating activities				
Net income for the period	18,133	6,800	26,815	6,173
Adjustments for:				
Depletion and depreciation expense <i>(note 6)</i>	18,752	11,260	35,238	21,575
Deferred income tax expense	6,254	2,877	9,811	3,722
Share-based compensation <i>(note 10)</i>	794	581	1,331	1,001
Accretion <i>(note 8)</i>	209	107	408	186
Unrealized loss (gain) on financial instruments	(1,047)	(58)	3,140	976
Exploration and evaluation expense <i>(note 5)</i>	72	870	1,960	5,592
	43,167	22,437	78,703	39,225
Change in non-cash working capital <i>(note 11)</i>	936	(561)	(10,993)	651
	44,103	21,876	67,710	39,876
Financing activities				
Change in bank debt	(22,048)	18,006	(2,250)	665
Issuance of share capital	74,422	693	75,482	35,272
Share issuance costs	(3,848)	10	(3,862)	(2,320)
Change in non-cash working capital <i>(note 11)</i>	16	(16)	16	–
	48,542	18,693	69,386	33,617
Investing activities				
Property and equipment expenditures	(66,232)	(36,470)	(135,944)	(67,335)
Exploration and evaluation expenditures	(2,951)	(2,816)	(5,441)	(11,379)
Property acquisitions <i>(note 4)</i>	(5,105)	–	(5,215)	(2,130)
Changes in non-cash working capital <i>(note 11)</i>	(18,357)	(1,283)	9,504	7,351
	(92,645)	(40,569)	(137,096)	(73,493)
Change in cash and cash equivalents	–	–	–	–
Cash and cash equivalents – beginning of period	–	–	–	–
Cash and cash equivalents – end of period	–	–	–	–

See accompanying notes to the interim financial statements.

Notes to the Financial Statements

As at and for the period ended June 30, 2014

(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 financial statements reflect only the Company’s interests in such activities. DeeThree is registered and domiciled in Canada. Its main office is at Suite 2200, 520 Third Avenue S.W., Calgary, Alberta.

2. BASIS OF PRESENTATION

(a) Statement of Compliance

These interim financial statements for the three and six months ended June 30, 2014 were prepared in accordance with International Accounting Standard 34 “Interim Financial Reporting” as issued by the International Accounting Standards Board (IASB).

The interim financial statements should be read in conjunction with the Company’s audited financial statements for the year ended December 31, 2013.

The financial statements were authorized for issuance by the Board of Directors on August 12, 2014.

3. SIGNIFICANT ACCOUNTING POLICIES

(a) Current accounting policies

The Company’s accounting policies are described in Note 3 to the December 31, 2013 audited annual financial statements. Those accounting policies have been applied consistently to all periods presented in these interim financial statements with the exception of adoption of the following new standards and interpretations effective as of January 1, 2014:

In May 2013, the International Accounting Standards Board (IASB) issued amendments to International Accounting Standard (IAS) 36 “Impairment of Assets” which reduces the circumstances in which the recoverable amount of CGUs is required to be disclosed and clarify the disclosures required when an impairment loss has been recognized or reversed in the period. The amendments must be adopted retrospectively for fiscal years beginning January 1, 2014, with earlier adoption permitted. These amendments have been applied by the Company on January 1, 2014 and the adoption will only impact its disclosures in the notes to the financial statements in periods when an impairment loss or impairment reversal is recognized.

In December 2011 the IASB published amendments to IAS 32 “Offsetting Financial Assets and Financial Liabilities”. The effective date for the amendments to IAS 32 is annual periods beginning on or after January 1, 2014. These amendments are to be applied retrospectively. The amendments to IAS 32 clarify that an entity currently has a legally enforceable right to off-set if that right is not contingent on a future event and is enforceable both in the normal course of business and in the event of default, insolvency or bankruptcy of the entity and all counterparties. The amendments to IAS 32 also clarify when a settlement mechanism provides for net settlement or gross settlement that is equivalent to net settlement. The Company has adopted the amendments to IAS 32 in its financial statements for the annual period beginning January 1, 2014 and there has been no material impact.

In May 2013, the IASB issued IFRIC 21 “Levies,” which was developed by the IFRS Interpretations Committee. IFRIC 21 clarifies that an entity recognizes a liability for a levy when the activity that triggers payment, as identified by the relevant legislation, occurs. The interpretation also clarifies that no liability should be recognized before the specified minimum threshold to trigger that levy is reached. IFRIC 21 must be adopted retrospectively for fiscal years beginning January 1, 2014, with earlier adoption permitted. The Company has adopted IFRIC 21 in its financial statements for the annual period beginning January 1, 2014 and there has been no material impact.

(b) Future accounting policy changes

The IASB has undertaken a three-phase project to replace IAS 39 “Financial Instruments: Recognition and Measurement” with IFRS 9 “Financial Instruments.” In November 2009, the IASB issued the first phase of IFRS 9, which details the classification and measurement requirements for financial assets. Requirements for financial liabilities were added to the standard in October 2010. The new standard replaces the current multiple classification and measurement models for financial assets and liabilities with a single model that has only two classification categories: amortized cost and fair value. In November 2013, the IASB issued the third phase of IFRS 9, which details the new general hedge accounting model. Hedge accounting remains optional and the new model is intended to allow reporting issuers to better reflect risk management activities in the financial statements and provide more opportunities to apply hedge accounting. The Company does not employ hedge accounting for its current risk management contracts. The new standard removes the January 1, 2015 effective date of IFRS 9. The new mandatory effective date will be determined once the classification and measurement and impairment phases of IFRS 9 are finalized; however, in its February 2014 meeting, the IASB tentatively decided that IFRS 9 would be mandatorily effective for annual periods beginning on or after January 1, 2018. The full impact of the standard on the Company’s financial statements will not be known until the project is complete.

In December 2013, the IASB issued narrow-scope amendments to a total of nine standards as part of its annual improvements process. It uses this process to make amendments to IFRS that are non-urgent but deemed necessary. Most amendments will apply prospectively for annual periods beginning on or after July 1, 2014; earlier application is permitted, in which case the related consequential amendments to other IFRS would also apply. The Company intends to adopt these amendments in its financial statements for the annual period beginning on January 1, 2015. The impact of adopting the amendments has not yet been determined.

4. ACQUISITIONS

During the six-month period ended June 30, 2014, the Company completed several minor transactions to acquire interests in producing oil and natural gas assets principally located in the Brazeau Belly River area of Alberta for total consideration of \$5.2 million. Had the acquisitions closed on January 1, 2014, the Company estimates that its pro forma revenue and net income for the period would not have been significantly affected.

<i>(000s)</i>	<i>(\$)</i>
Net assets acquired	
Petroleum and natural gas assets	2,985
E&E assets	2,568
Decommissioning liabilities	(338)
	5,215
Consideration	
Total cash consideration	5,215

5. EXPLORATION AND EVALUATION ASSETS

<i>(000s)</i>	Six Months Ended June 30, 2014	Year Ended December 31, 2013
	<i>(\$)</i>	<i>(\$)</i>
Balance – beginning of period	45,611	29,893
Additions	7,423	33,164
Acquisitions through business combinations	2,568	901
Transfers to property and equipment	(1,802)	(9,471)
E&E expenses	(1,830)	(8,594)
Lease expiries	(130)	(282)
Balance – end of period	51,840	45,611

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 six month period ended June 30, 2014, the Company incurred \$1.8 million to drill two vertical strat test wells in Ferguson (year ended December 31, 2013 – \$8.6 million on three D&A wells and preliminary drill costs) and \$0.1 million related to lease expiries on undeveloped land (year ended December 31, 2013 - \$0.3 million).

During the six month period ended June 30, 2014, approximately \$0.3 million of directly attributable general and administrative expense and \$0.2 million of directly attributable share-based compensation expense were capitalized as expenditures on exploration and evaluation assets (year ended December 31, 2013 – \$1.2 million and \$0.7 million, respectively).

6. PROPERTY AND EQUIPMENT

	Oil and Natural Gas Properties	Office Equipment	Total
(000s)	(\$)	(\$)	(\$)
Cost or deemed cost			
Balance – January 1, 2013	345,000	309	345,309
Acquisitions	12,202	–	12,202
Additions	179,132	109	179,241
Transfers from E&E assets	9,471	–	9,471
Balance – December 31, 2013	545,805	418	546,223
Additions	136,174	22	136,196
Acquisitions	2,985	–	2,985
Transfers from E&E assets	1,802	–	1,802
Balance – June 30, 2014	686,766	440	687,206
Accumulated depletion and depreciation			
Balance – January 1, 2013	66,053	96	66,149
Depletion and depreciation for the year	51,252	57	51,309
Balance – December 31, 2013	117,305	153	117,458
Depletion and depreciation for the period	35,203	35	35,238
Balance – June 30, 2014	152,508	188	152,696
Net book value			
December 31, 2013	428,500	265	428,765
June 30, 2014	534,258	252	534,510

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

During the six month period ended June 30, 2014, approximately \$0.7 million of directly attributable general and administrative expense and \$0.6 million of directly attributable share-based compensation expense were capitalized as expenditures on property and equipment (year ended December 31, 2013 – \$0.8 million and \$0.7 million, respectively).

(b) Amortization and Impairment Charges

For the period ended June 30, 2014, management determined that no impairment indicators were present and as such, did not perform an impairment test.

(c) Future Development Costs and Salvage Value

During the six months ended June 30, 2014, an estimated \$342 million of future development costs associated with proved plus probable undeveloped reserves were included in the calculation of depletion and depreciation expense and an estimated \$20.1 million of salvage value of production equipment was excluded (year ended December 31, 2013 – \$328.5 million and \$16.4 million, respectively).

7. BANK DEBT

At June 30, 2014, the Company had a committed term syndicated credit facility (the “Syndicated Facility”) with an authorized borrowing base of \$235 million, including a \$215 million extendible revolving facility and a \$20 million operating facility. At June 30, 2014, \$86.2 million was drawn against this facility (December 31, 2013 – \$88.4 million drawn on a revolving demand credit facility with an authorized borrowing base of \$165 million).

The Syndicated Facility is available for a revolving period of 364 days plus a one year term-out, which is extendible annually, subject to syndicate approval. Repayments of principal are not required provided that the borrowings under the Syndicated Facility do not exceed the authorized borrowing amount and the Company is in compliance with covenants, representations and warranties. As at June 30, 2014, the Company is in compliance with all covenants. Covenants include reporting requirements, permitted indebtedness, permitted hedging and other standard business operating covenants. There are no financial covenants under the Syndicated Facility. The authorized borrowing amount is subject to interim reviews by the financial institutions and the next semi-annual review of the Syndicated Facility is scheduled for the fall of 2014. Security is provided for by a floating charge demand debenture over all assets in the amount of \$1.0 billion.

The borrowings under the Syndicated Facility are available on a fully revolving basis for a period of 364 days until April 29, 2015, at which time the Company can request approval by the lenders for an extension of an additional 364 days or convert the outstanding indebtedness to a one-year term loan with full repayment due at April 29, 2016. As a result of these terms, the bank debt is classified as a long-term liability on the statement of financial position at June 30, 2014.

The Syndicated Facility bears interest on a grid system which ranges from bank prime plus 1.0 percent to bank prime plus 3.5 percent depending on the Company’s total net debt to cash flow ratio as defined by the lender, ranging from less than 1:1 to greater than 3:1. The Syndicated Facility provides that advances may be made by way of prime rate loans, U.S. Base Rate loans, London InterBank Offered Rate (“LIBOR”) loans, bankers’ acceptances or letters of credit. A standby fee of 0.500 percent to 0.875 percent is charged on the undrawn portion of the Syndicated Facility, also calculated depending on the Company’s total net debt to cash flow ratio, as defined by the lender.

8. DECOMMISSIONING LIABILITIES

The Company has estimated the net present value of decommissioning obligations to be \$28.5 million as at June 30, 2014 (December 31, 2013 – \$26.3 million) based on an undiscounted total future liability of \$41.4 million (December 31, 2013 – \$34 million). These payments are expected to be incurred over a period of two to 20 years with the majority of costs to be incurred between 2016 and 2026. At June 30, 2014, a risk-free rate of 3.00 percent (December 31, 2013 – 3.00 percent) and an inflation rate of 2 percent (December 31, 2013 – 2 percent) were used to calculate the net present value of the decommissioning liabilities.

	Six Months Ended June 30, 2014	Year Ended December 31, 2013
(000s)	(\$)	(\$)
Balance – beginning of period	26,291	13,982
Liabilities incurred	1,440	2,164
Liabilities acquired	338	1,409
Revisions	–	8,672
Settlements	–	(433)
Accretion of decommissioning liabilities	408	497
Balance – end of period	28,477	26,291

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

	Six Months Ended June 30, 2014		Year Ended December 31, 2013	
	Shares	Amount	Shares	Amount
	(#)	(\$000s)	(#)	(\$000s)
Balance – beginning of period	81,560,316	309,323	71,080,173	231,415
Common shares issued (i)	5,714,200	63,428	9,453,000	74,986
Flow-through shares issued (ii)	752,000	10,002	465,900	5,008
Premium on flow-through shares (ii)	–	(1,654)	–	(699)
Exercise of options (iii)	805,944	2,895	561,243	2,203
Share issuance costs	–	(3,862)	–	(4,786)
Tax benefit of share issuance costs	–	963	–	1,196
Balance – end of period	88,832,460	381,095	81,560,316	309,323

(i) Common Share Issuances

In May 2014, DeeThree issued 5,714,200 common shares at a price of \$11.10 per share for total gross proceeds of \$63.4 million (\$60.0 million net of estimated share issuance costs), including 304,200 common shares issued pursuant to the partial exercise of the over-allotment.

In December 2013, DeeThree issued 3,800,000 common shares at a price of \$9.25 per share for total gross proceeds of \$35.2 million (\$33.2 million net of estimated share issuance costs). Subsequent to the original issuance, DeeThree also issued 570,000 common shares at a price of \$9.25 per share for total gross proceeds of \$5.3 million (\$5 million net of estimated share issue costs) on the exercise in full of the underwriters' over-allotment option.

In February 2013, the Company issued 4,420,000 common shares at a price of \$6.80 per share for total gross proceeds of \$30.1 million (\$28.1 million net of estimated share issuance costs). In March 2013, the Company issued 663,000 common shares at a price of \$6.80 per share for total gross proceeds of \$4.5 million (\$4.2 million net of estimated share issuance costs) on the exercise in full of the underwriters' over-allotment option from the February issuance.

(ii) Flow-Through Share Issuances

In May 2014, DeeThree issued 752,000 flow-through shares at a price of \$13.30 per share for total gross proceeds of \$10 million (\$9.5 million net of estimated share issuance costs). The implied premium on the flow-through shares of \$2.20 per share or \$1.7 million was recorded as a liability on the statement of financial position and remains at June 30, 2014. To date, the Company has incurred \$nil of the total \$10 million of qualifying exploration expenditures, with the entire amount to be spent by December 31, 2015.

In December 2013, DeeThree issued 465,900 flow-through shares at a price of \$10.75 per share for total gross proceeds of \$5 million (\$4.8 million net of estimated share issue costs). The implied premium on the flow-through shares of \$1.50 per share or \$0.7 million was initially recorded as a liability on the statement of financial position and \$0.2 remains at June 30, 2014. To date, the Company has incurred \$3.3 million of the total \$5 million of qualifying exploration expenditures, with the remaining amount to be spent by December 31, 2014.

(iii) Exercising of Options

During the six months ended June 30, 2014, 805,944 options were exercised at a weighted-average price of \$2.55 per share for total cash proceeds of \$2.1 million and previously recognized share-based compensation expense of \$0.8 million.

During 2013, 561,243 options were exercised at a weighted-average price of \$2.875 per share for total cash proceeds of \$1.6 million and previously recognized share-based compensation expense of \$0.6 million.

(c) Per Share Amounts

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
<i>(000s, except per share amounts)</i>	<i>(\$)</i>	<i>(\$)</i>	<i>(\$)</i>	<i>(\$)</i>
Net income for the period	18,133	6,800	26,815	6,173
	<i>(#)</i>	<i>(#)</i>	<i>(#)</i>	<i>(#)</i>
Weighted-average number of common shares				
– basic	84,654	76,363	83,300	74,784
– diluted	87,772	79,049	86,198	77,355
	<i>(\$)</i>	<i>(\$)</i>	<i>(\$)</i>	<i>(\$)</i>
Net income per weighted average common share				
– basic	0.21	0.09	0.32	0.08
– diluted	0.21	0.09	0.31	0.08

10. SHARE-BASED COMPENSATION

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

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

	Six Months Ended June 30, 2014		Year Ended December 31, 2013	
	Options	Weighted- Average Exercise Price	Options	Weighted- Average Exercise Price
	<i>(#)</i>	<i>(\$)</i>	<i>(#)</i>	<i>(\$)</i>
Outstanding – January 1	6,524,272	4.21	5,699,632	3.19
Issued	1,580,000	9.55	1,414,000	7.83
Exercised	(805,944)	2.55	(561,243)	2.87
Forfeited	(65,000)	9.25	(28,117)	6.67
Outstanding – end of period	7,233,328	5.52	6,524,272	4.21
Exercisable – end of period	3,371,972	3.98	3,528,136	3.37

Weighted-Average Exercise Price	Options Outstanding	Weighted- Average Contractual Life	Options Exercisable
(\$)	(#)	(years)	(#)
As at June 30, 2014			
2.00 – 2.99	1,957,250	1.78	1,325,250
3.00 – 3.99	971,820	2.59	567,087
4.00 – 4.99	1,376,158	2.10	981,335
5.00 – 5.99	9,000	3.20	–
6.00 – 6.99	100,000	3.44	28,000
7.00 – 7.99	1,154,100	3.84	450,300
8.00 – 8.99	90,000	4.38	10,000
9.00 – 9.56	1,335,000	4.74	10,000
10.00 – 10.99	140,000	4.93	–
11.00 – 11.74	100,000	4.83	–
	7,233,328	2.98	3,371,972

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

	Six Months Ended June 30, 2014	Year Ended December 31, 2013
Risk-free interest rate (%)	1.30	1.13
Expected life (years)	3.10	3.10
Expected volatility (%)	50	66
Expected dividend yield (%)	0	0
Fair value of options granted during the year (\$/option)	3.34	3.45

A forfeiture rate of 2 percent for options granted during the first half of 2014 (2013 – 2 percent) was used when recording share-based compensation expense. This estimate is adjusted to the actual forfeiture rate. Gross share-based compensation was \$2.1 million for the period ended June 30, 2014 (year ended December 31, 2013 - \$3.6 million). Of this amount, \$72,000 was reclassified to operating expense for the amount related to field employees (year ended December 31, 2013 – \$0.2 million) and \$0.8 million was capitalized (year ended December 31, 2013 – \$1.4 million), resulting in total net share-based compensation expense of \$1.3 million for the period (2013 – \$2.1 million).

11. SUPPLEMENTAL CASH FLOW INFORMATION

Changes in non-cash working capital are comprised of:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
(000s)	(\$)	(\$)	(\$)	(\$)
Accounts receivable	(5,058)	(1,822)	(16,478)	485
Prepaid expenses and other	(332)	(294)	(888)	(156)
Accounts payable and accrued liabilities	(12,015)	274	15,893	7,758
Abandonment and reclamation costs	–	–	–	–
	(17,405)	(1,842)	(1,473)	8,087
Related to operating activities	936	(543)	(10,993)	736
Related to financing activities	16	(16)	16	–
Related to investing activities	(18,357)	(1,283)	9,504	7,351
	(17,405)	(1,842)	(1,473)	8,087

12. DETERMINATION OF FAIR VALUES

A number of the Company's accounting policies and disclosures require the determination of fair value for 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 at June 30, 2014 due to their short term to maturity.

(c) Stock Options

The fair value of stock options is measured using the Black-Scholes option-pricing model. Measurement inputs include share price on measurement date, exercise price of the instrument, expected volatility (based on weighted-average historical 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 of Canada bonds).

DeeThree classifies the fair value of these transactions according to the following hierarchy based on the nature of the 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 continuous pricing information.
- 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 are derived from inputs 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.

(d) Derivative financial instruments

As at June 30, 2014, the Company had the following crude oil, natural gas, foreign exchange and interest rate risk management contracts, with a short term mark-to-market liability of \$5.1 million and a long term mark-to-market liability of \$0.2 million for a total mark-to-market liability of \$5.3 million (December 31, 2013 – liability of \$2.2 million):

Crude Oil Contracts

Period	Commodity	Type of Contract	Quantity	Pricing Point	Contract Price
Jan. 1/14 – Dec. 31/14	Crude Oil	Collar	1,000 bbls/d	WTI-NYMEX	US\$85.00/bbl (floor) - US\$97.00/bbl (cap)
Jan. 1/14 – Dec. 31/14	Crude Oil	Collar	500 bbls/d	WTI-NYMEX	Cdn\$92.50/bbl (floor) - Cdn\$102.01/bbl (cap)
Jan. 1/14 – Dec. 31/14	Crude Oil	Collar	500 bbls/d	WTI-NYMEX	Cdn\$90.00/bbl (floor) - Cdn\$101.25/bbl (cap)
Jan. 1/14 – Dec. 31/14	Crude Oil	Collar	1,000 bbls/d	WTI-NYMEX	Cdn\$90.00/bbl (floor) - Cdn\$107.85/bbl (cap)
Mar. 1/14 – Dec. 31/14	Crude Oil	Swap	500 bbls/d	WTI-NYMEX	Cdn\$105.20
Mar. 1/14 – Dec. 31/14	Crude Oil	Swap	500 bbls/d	WTI-NYMEX	Cdn\$106.00
Jan.1/15 – Dec.31/15	Crude Oil	Collar	500 bbls/d	WTI-NYMEX	US\$85.00/bbl (floor) - US\$100.80/bbl (cap)

Natural Gas Contracts

Period	Commodity	Type of Contract	Quantity	Pricing Point	Contract Price
Feb. 1/14 – Dec. 31/14	Natural Gas	Swap	2,000 GJ/day	AECO	Cdn\$3.975/GJ
Mar. 1/14 – Dec. 31/14	Natural Gas	Swap	1,000 GJ/day	AECO	Cdn\$4.310/GJ
Apr. 1/14 – Oct. 31/14	Natural Gas	Swap	2,500 GJ/day	AECO	Cdn\$4.110/GJ

Foreign Currency Contract

Period	Currency	Type of Contract	Quantity	Pricing Point (Cdn\$/US\$)
Sept. 1/13 – Dec. 31/14	US\$	Average Rate Range Bonus Accumulator	US\$2,500,000	Target – \$1.0825 Cdn\$/US\$ + \$1,500 bonus/day ⁽¹⁾

⁽¹⁾ The Company can earn a bonus payout of up to \$1,500 per day depending on the period in which the exchange rate remains in the applicable range of less than 1.0825.

Interest Rate Contract

Term	Amount	Fixed Rate	Index
Feb. 18/14 – Feb. 18/16	Cdn\$40 million	1.44%	CDOR

13. COMMITMENTS

Years Ended December 31,	2014	2015	2016	Total
(000s)	(\$)	(\$)	(\$)	(\$)
Operating lease – office	320	640	160	1,120
Operating lease – equipment	52	28	–	80
Exploration expenditures (flow-through)	1,732	10,002	–	11,734
Total	2,104	10,670	160	12,934

As at June 30, 2014, the Company had contractual obligations for its office leases totalling approximately \$1.1 million to March 2016. The head office lease obligations are comprised of the lease payments as well as parking and an estimate of occupancy costs of the Company's head office space. The Company also had contractual obligations for several vehicles and equipment totalling approximately \$80,000 to October 2015.

In connection with the Company's issuance of flow-through shares during the fourth quarter of 2013, DeeThree was required to spend \$5 million of eligible exploration expenditures by December 31, 2014. As at June 30, 2014, \$3.3 million of these expenditures have been incurred. The remaining \$1.7 million of qualifying expenditures will be incurred during 2014 and were renounced to shareholders in January 2014 effective December 31, 2013.

In connection with the Company's issuance of flow-through shares during the second quarter of 2014, DeeThree is required to spend an additional \$10 million of eligible exploration expenditures by December 31, 2015. As at June 30, 2014, \$nil of these expenditures have been incurred. The expenditures will be renounced to shareholders in January 2015 effective December 31, 2014.

Corporate Information

Board of Directors

Michael Kabanuk
Executive Chairman
DeeThree Exploration Ltd.

Brendan Carrigy
Independent Businessman

Martin Cheyne
President & Chief Executive Officer
DeeThree Exploration Ltd.

Henry Hamm ⁽¹⁾⁽²⁾⁽³⁾⁽⁴⁾
Independent Businessman

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

Brad Porter ⁽¹⁾⁽²⁾⁽³⁾⁽⁴⁾
Independent Businessman

Kevin Andrus ⁽⁴⁾
Portfolio Manager of
Energy Investments
GMT Capital Corp.

(1) Audit Committee Member

(2) Reserves Committee Member

(3) Corporate Governance & Compensation
Committee Member

(4) Nominating Committee Member

Officers

Martin Cheyne
President & Chief Executive Officer

Gail Hannon
Chief Financial Officer

Trevor Murray
Vice President, Land

Clayton Thatcher
Vice President, Exploration

Jonathan Fleming
Vice President, Capital Markets

Casey Paulhus
Controller

Daniel Kenney
Corporate Secretary

Head Office

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520 Third Avenue S.W.
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Facsimile: 403-263-9710
Website: www.deethree.ca

Auditors

KPMG LLP
Calgary, Alberta

Bankers

National Bank of Canada
Calgary, Alberta

ATB Financial
Calgary, Alberta

The Bank of Nova Scotia
Calgary, Alberta

The Toronto-Dominion Bank
Calgary, Alberta

Union Bank, Canada Branch
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**

OTCQX

Trading Symbol: **DTHRF**

Abbreviations

bbls	barrels
boe	barrels of oil equivalent
GJ	gigajoules
/d	per day
mbbls	thousand barrels
mboe	thousand barrels of oil equivalent
mcf	thousand cubic feet
mm	million
mmbtu	million British thermal units
mmcf	million cubic feet
NGLs	natural gas liquids

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



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