Yangarra Resources Ltd.

Interim Consolidated Financial Statements

September 30, 2010 and 2009

(Unaudited – Prepared by Management)

Notice of No Auditor Review of Interim Consolidated Financial Statements

In accordance with National Instrument 51-102 released by the Canadian Securities Administrators, the Company discloses that its auditors have not reviewed these unaudited interim consolidated financial statements as at and for the three and nine months ended September 30, 2010 and 2009.

		September 30 2010		December 31 2009
Assets				
Current				
Accounts receivable	$	**1,915,107**	$	658,080
Prepaid expenses and deposits		**262,123**		152,853
Commodity price risk contract *(note 9)*		**6,270**		–
		2,183,500		810,933
Property and equipment *(note 3)*		**46,733,504**		38,830,516
Asset acquisition deposit *(note 17(a))*		**400,000**		–
	$	**49,317,004**	$	39,641,449
Liabilities				
Current				
Bank debt *(note 4)*	$	**5,011,467**	$	8,195,069
Accounts payable and accrued liabilities		**4,863,435**		465,554
Commodity price risk contracts *(note 9)*		**–**		113,361
		9,874,902		8,773,984
Asset retirement obligation *(note 5)*		**2,306,684**		2,181,727
Preferred shares *(note 6(b))*		**1,000,000**		1,000,000
Future income tax liability		**818,728**		837,357
		14,000,314		12,793,068
Shareholders' Equity				
Share capital *(note 6)*		**50,659,642**		43,019,290
Warrants *(note 7)*		**2,283,216**		340,600
Contributed surplus *(note 8)*		**4,232,197**		2,972,097
Deficit		**(21,858,365)**		(19,483,606)
		35,316,690		26,848,381
	$	**49,317,004**	$	39,641,449

Nature of operations and basis of presentation *(note 1)*
Subsequent events *(note 17)*

The accompanying notes are an integral part of these unaudited interim consolidated financial statements

Yangarra Resources Ltd.

Interim Consolidated Statements of Operations, Comprehensive Loss and Deficit

For the three and nine months ended September 30
(unaudited)

	Three months ended September 30		Nine months ended September 30	
	2010	2009	**2010**	2009
Revenue				
Petroleum and natural gas sales	$ **1,821,333**	$ 889,449	$ **3,669,575**	$ 2,825,010
Royalties	**32,375**	(28,114)	**(36,325)**	(107,540)
Royalty recoveries *(note 11)*	**–**	–	**–**	175,636
	1,853,708	861,335	**3,633,250**	2,893,106
Interest	**–**	–	**–**	10,855
Commodity price risk contracts *(note 9)*	**6,270**	(255,687)	**193,131**	(120,344)
	1,859,978	605,648	**3,826,381**	2,783,617
Expenses				
Production	**482,944**	410,311	**1,081,852**	1,040,206
Transportation	**70,829**	20,062	**164,903**	82,882
General and administrative	**268,792**	178,991	**780,744**	564,828
Interest and financing fees	**68,511**	300,279	**170,471**	802,460
Dividends *(note 6(b))*	**12,397**	–	**37,397**	–
Stock-based compensation *(note 6(c))*	**121,645**	–	**784,955**	–
Depletion and depreciation	**959,199**	5,217,275	**3,028,464**	7,248,123
Accretion	**42,455**	37,134	**127,225**	109,544
Other (income) expenses	**–**	–	**25,129**	(23,201)
	2,026,772	6,164,052	**6,201,140**	9,824,842
Loss before income taxes	**(166,794)**	(5,558,404)	**(2,374,759)**	(7,041,225)
Future income tax reduction	**–**	(1,250,366)	**–**	(1,570,346)
Net loss and comprehensive loss for the period	**(166,794)**	(4,308,038)	**(2,374,759)**	(5,470,879)
Deficit, beginning of period	**(21,691,571)**	(13,378,427)	**(19,483,606)**	(12,215,586)
Deficit, end of period	$ **(21,858,365)**	$ (17,686,465)	$ **(21,858,365)**	$ (17,686,465)
Net loss per share				
Basic and diluted	$ **(0.00)**	$ (0.05)	$ **(0.05)**	$ (0.07)
Weighted average number of shares				
Basic and diluted	**60,713,640**	78,445,038	**52,092,914**	76,533,515

The accompanying notes are an integral part of these unaudited interim consolidated financial statements

	Three months ended September 30		Nine months ended September 30	
	2010	2009	**2010**	2009
Operating				
Net loss for the period	$ **(166,794)**	$ (4,308,038)	$ **(2,374,759)**	$ (5,470,879)
Add back non-cash items:				
Unrealized (gain) loss on commodity price risk contracts	**(6,270)**	255,687	**(119,631)**	120,344
Interest and financing fees	–	150,473	–	304,795
Shares issued for services	–	37,800	–	63,000
Stock-based compensation	**121,645**	–	**784,955**	–
Depletion and depreciation	**959,199**	5,217,275	**3,028,464**	7,248,123
Accretion	**42,455**	37,134	**127,225**	109,544
Gain on sale of investment	–	–	–	(23,201)
Future income tax reduction	–	(1,250,366)	–	(1,570,346)
Abandonment expenditures *(note 5)*	**(28,263)**	(6,064)	**(54,724)**	(33,943)
	921,972	133,901	**1,391,530**	747,437
Change in non-cash working capital *(note 11)*	**(346,430)**	360,560	**(602,311)**	460,157
	575,542	494,461	**789,219**	1,207,594
Financing				
Issue of equity instruments, net of costs	–	(19,664)	**9,405,957**	(19,664)
Bank debt proceeds (repayment), net	**1,601,557**	(466,870)	**(3,183,602)**	(528,443)
Financing fees	–	–	–	(270,000)
	1,601,557	(486,534)	**6,222,355**	(818,107)
Investing				
Expenditures on property and equipment	**(2,689,049)**	(524,935)	**(10,245,469)**	(955,846)
Asset acquisition deposit	**(400,000)**	–	**(400,000)**	–
Proceeds on sale of investment	–	–	–	33,669
Change in non-cash working capital *(note 11)*	**911,950**	517,008	**3,633,895**	532,690
	(2,177,099)	(7,927)	**(7,011,574)**	(389,487)
Change in cash	–	–	–	–
Cash, beginning of period	–	–	–	–
Cash, end of period	$ –	$ –	$ –	$ –
Supplemental cash flow information				
Interest paid	$ **68,511**	$ 146,071	$ **146,071**	$ 498,214
Dividends paid	$ –	$ –	$ **25,000**	$ –

The accompanying notes are an integral part of these unaudited interim consolidated financial statements

1. Nature of operations and basis of presentation

Yangarra Resources Ltd. (the "Company") is a publicly traded company involved in the production, exploration and development of resource properties in Western Canada.

On May 1, 2010, the Company and its wholly owned subsidiary Athabaska Energy Ltd. were amalgamated and continue to carry on business under the name Yangarra Resources Ltd.

These unaudited interim consolidated financial statements include the accounts of the Company and its wholly owned subsidiary, Yangarra Resources Corp. ("YRC") after the elimination of intercompany transactions and balances.

These unaudited interim consolidated financial statements have been prepared on a going concern basis which contemplates the realization of assets and the payment of liabilities in the ordinary course of business. As at September 30, 2010, the Company had a working capital deficiency of $7,691,402 (December 31, 2009 – $7,963,051) and an accumulated deficit of $21,913,365 (December 31, 2009 – $19,483,606). Should the Company be unable to continue as a going concern, it may be unable to realize the carrying value of its assets and to meet its liabilities as they become due. The Company's ability to continue as a going concern is dependent upon its ability to attain profitable operations and generate funds therefrom and to continue to obtain capital financing from investors sufficient to meet current and future obligations.

2. Significant accounting policies

These unaudited interim consolidated financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles and on a basis consistent with the audited December 31, 2009 consolidated financial statements except certain disclosures have been condensed or omitted. Accordingly, these unaudited interim consolidated financial statements should be read in conjunction with the notes contained in the Company's audited December 31, 2009 consolidated financial statements. Because a precise determination of many assets and liabilities is dependent upon future events, the preparation of periodic financial statements necessarily involves the use of estimates and approximations. Accordingly, actual results could differ from those estimates.

3. Property and equipment

September 30, 2010	*Cost*	*Accumulated depletion and depreciation*	*Net book value*
Petroleum and natural gas properties	$ 81,052,698	$ 34,391,691	$ 46,661,007
Office equipment	292,798	220,301	72,497
	$ 81,345,496	$ 34,611,992	$ 46,733,504

December 31, 2009	*Cost*	*Accumulated depletion and depreciation*	*Net book value*
Petroleum and natural gas properties	$ 70,134,763	$ 31,380,391	$ 38,754,372
Office equipment	279,281	203,137	76,144
	$ 70,414,044	$ 31,583,528	$ 38,830,516

3. Property and equipment (continued)

At September 30, 2010, the Company excluded $781,536 (December 31, 2009 – $1,206,467) of resource properties relating to unproved properties from the depletion calculation. Unproved properties have been separately evaluated by management for impairment. In addition, $9,086,000 (December 31, 2009 – $11,055,300) of future development costs were included in the depletion calculation.

During the period ended September 30, 2010, the Company capitalized $52,456 (2009 – nil) related to the asset retirement obligation of property and equipment and $633,527 (2009 – nil) comprised of stock-based compensation of $475,145 and $158,382 of related future income taxes for options granted to field consultants. The Company also capitalized $193,920 (2009 – $15,170) of general and administrative costs as well as related costs of the Company's working interest in operated capital expenditure programs on which operator's fees have been charged in accordance with standard industry operating agreements.

4. Bank debt

As at September 30, 2010, the maximum availability of the revolving operating demand loan was $6,000,000 (December 31, 2009 – $8,300,000) at an interest rate of bank prime plus 1% per annum, payable monthly. As at September 30, 2010, the $5,011,467 (December 31, 2009 – $8,195,069) reported amount of bank debt was comprised of $4,700,000 (December 31, 2009 – $7,800,000) drawn on the revolving operating demand loan and $311,467 (December 31, 2009 – $395,069) of bank overdraft.

The Company is subject to a financial covenant with respect to working capital, which the Company was in not compliance with at September 30, 2010.

In November 2010, the Company signed a credit facility agreement with a new lender for a revolving operating loan with a maximum availability of $8,500,000 in November 2010 based on production in the month of October 2010 and $9,000,000 based on production in the month of November 2010. The credit facility bears interest at bank prime plus 1% per annum, increased to bank prime plus 1.5% if the Company’s net debt to trailing cash flow ratio is equal to or greater than 1 to 1. See note 17(c).

5. Asset retirement obligation

The following table presents the reconciliation of the carrying amount of the obligation associated with the retirement of the Company’s property and equipment:

Asset retirement obligation, December 31, 2009	$ 2,181,727
Additions	10,823
Accretion	127,225
Expenditures	(54,724)
Revisions for change in estimates	41,633
Asset retirement obligation, September 30, 2010	$ 2,306,684

The following significant assumptions were used to estimate the asset retirement obligation:

Undiscounted cash flows	$ 4,343,140
Discount rate	7% - 10%
Inflation rate	2%
Weighted average expected timing of cash flows	10 years

6. Share capital

On April 30, 2010, the Company consolidated its common shares on a five old for one new (5:1) basis. All common share, warrant and stock option figures disclosed herein are presented on a consolidated basis.

a) Common shares issued

	Number of shares	*Amount*
Balance, December 31, 2009	37,388,006	$ 43,019,290
Unit private placement *(i)*	16,000,000	4,009,700
Exercise of warrants *(ii)*	280,000	187,684
Flow-through share private placement *(iii)*	3,745,454	2,060,000
Private placement *(iv)*	3,300,000	1,914,000
Share issue costs, net of $177,011 of future income tax	–	(531,032)
Balance, September 30, 2010	60,713,460	$ 50,659,642

i) On March 17, 2010, the Company completed a private placement of 16,000,000 Units at $0.375 per Unit for gross proceeds of $6,000,000. Each Unit is comprised of one common share of the Company and one half of one common share purchase warrant, with each full warrant exercisable anytime up to March 15, 2012, at a price of $0.50 per share, subject to certain earlier termination provisions. Management and directors subscribed for 2,671,334 Units for gross proceeds of $1,001,750 or 16% of the financing. Finder's fees of $364,480 were paid in conjunction with the financing.

At the time of issuance, the fair value of the warrants was estimated to be $1,990,300 ($0.25 per warrant) based on the Black-Scholes fair value pricing model (note 6(d)) and $4,009,700 was ascribed to common shares.

ii) In March 2010, the Company issued 280,000 flow-through common shares on the exercise of 280,000 warrants at $0.50 per share for cash proceeds of $140,000 plus a pro-rata allocation of the options' fair value in the amount of $47,684.

iii) On May 21, 2010, the Company completed a private placement of 3,745,454 flow-through common shares at $0.55 per share for gross proceeds of $2,060,000. An 8% cash commission was paid on the proceeds raised.

iv) On June 26, 2010, the Company completed a private placement of 1,650,000 common shares at $0.56 per share and 1,650,000 flow-through common shares at $0.60 per share for total gross proceeds of $1,914,000. A 6% cash commission was paid on the proceeds raised.

b) Preferred shares issued

As at September 30, 2010 and December 31, 2009, the Company had 1,000,000 preferred shares issued and outstanding with an annual dividend rate of 5% payable semi-annually in cash or common shares of the Company. The preferred shares have an eighteen month term, at which time they are redeemable for $1,000,000 cash.

As the terms of the preferred shares provide for a mandatory redemption at a fixed amount, they are classified as a financial liability. The September 30, 2010 estimated fair value of preferred shares approximates their carrying value and redemption value.

6. Share capital (continued)

c) Stock options

On January 7, 2010, the Company granted 100,000 stock options to a director. The options are exercisable at $0.50 per share, vest immediately and expire five years from the date of grant. The fair value of the options was estimated at $21,700 ($0.20 per option) using the Black-Scholes pricing model (note 6(d)), all of which was recognized as stock-based compensation expense on the date of grant.

On April 26, 2010, the Company granted 200,000 stock options to field consultants. The options are exercisable at $0.50 per share, vest immediately and expire five years from the date of grant. The fair value of the options was estimated at $129,400 ($0.65 per option) using the Black-Scholes pricing model (note 6(d)), all of which was capitalized to property and equipment (note 3) on the date of grant.

On June 29, 2010, the Company granted 1,600,000 stock options to directors, officers and consultants. The options are exercisable at $0.60 per share, vest immediately and expire five years from the date of grant. The fair value of the options was estimated at $746,600 ($0.47 per option) using the Black-Scholes pricing model (note 6(d)). $641,610 was recognized as stock-based compensation expense and $104,990 was capitalized to property and equipment (note 3) on the date of grant.

On July 30, 2010, the Company granted 715,000 stock options to an employee and consultants. The options are exercisable at $0.55 per share, vest immediately and expire five years from the date of grant. The fair value of the options was estimated at $362,400 ($0.51 per option) using the Black-Scholes pricing model (note 6(d)). $121,645 was recognized as stock-based compensation expense and $240,755 was capitalized to property and equipment (note 3) on the date of grant.

The following tables summarize information about stock options outstanding as at September 30, 2010:

	Number of Options	*Weighted – average exercise price*
Opening	3,542,255	$ 0.77
Granted	2,615,000	0.57
Expired	(69,350)	(3.58)
Forfeited	(35,000)	(1.39)
Closing	6,052,905	$ 0.65

Range of exercise price	*Number outstanding*	*Weighted-average remaining contractual life (years)*	*Weighted-average exercise price*	*Number exercisable*
$ 0.50 – $ 1.00	5,773,800	4.24	$ 0.58	5,773,800
$ 1.50 – $ 1.70	110,000	1.27	1.59	110,000
$ 2.25 – $ 2.50	154,105	0.17	2.50	154,105
$ 3.55	15,000	0.59	3.55	15,000
	6,052,905	4.07	$ 0.65	6,052,905

6. Share capital (continued)

d) Black-Scholes pricing model

The Black-Scholes pricing model calculations during the period ended September 30, 2010 were based on the following significant assumptions:

Risk-free interest rate	1.59% to 3.09%
Expected volatility	146% to 165%
Expected life	2 to 5 years

7. Warrants

The following table summarizes information about warrants outstanding and exercisable as at September 30, 2010:

	Number of warrants	*Weighted average exercise price*	*Fair value ascribed*
Balance – December 31, 2009	2,000,000	$ 0.50	$ 340,600
Issued *(note 6(a)(i))*	8,000,000	0.50	1,990,300
Exercised *(note 6(a)(ii))*	(280,000)	(0.50)	(47,684)
Balance – September 30, 2010	9,720,000	$0.50	$ 2,283,216

As at September 30, 2010, warrants had a weighted average remaining life of 2.2 years.

8. Contributed surplus

Balance, December 31, 2009	$ 2,972,097
Stock-based compensation *(note 6(c))*	1,260,100
Balance, September 30, 2010	$ 4,232,197

9. Commodity price risk contracts

As at January 1, 2010, the Company was committed to the following commodity price risk contracts for the sale of natural gas:

- 1,000 GJ per day from January 1 to January 31, 2010 at a fixed price of $5.51 per GJ;
- 1,000 GJ per day from February 1 to February 28, 2010 at a fixed price of $5.53 per GJ; and
- 500 GJ per day from January 1 to December 31, 2010 at a fixed price of $5.68 per GJ.

In addition the Company sold calls which provided a ceiling for the price it received for natural gas as follows:

- 500 GJ per day from January 1 to December 31, 2010 at the ceiling price of $6.25 per GJ;
- 500 GJ per day from March 1 to December 31, 2010 at the ceiling price of $6.50 per GJ; and
- 500 GJ per day from March 1 to December 31, 2010 at the ceiling price of $6.70 per GJ.

In March 2010, the Company settled all outstanding commodity price risk contracts for proceeds of $73,500 and reported an unrealized gain of $113,361 related to the reversal of the mark-to-market liability recognized at December 31, 2009.

9. Commodity price risk contracts (continued)

As at September 30, 2010, the Company was committed to a commodity price risk "basis" contract for the sale of 1,000 MMBTU of natural gas per day from November 1, 2010 to March 31, 2011, the terms of which were related to the difference in price between AECO and NYMEX fixed at $0.45 per MMBTU. The mark-to-market value of the unfulfilled portion of the above contracts at September 30, 2010 is an asset of $6,270. The Company terminated the contract in November 2010 at a cost of $14,616.

Included in petroleum and natural gas revenue for the three and nine months ended September 30, 2010 is nil and $31,131, respectively, of realized gains (three and nine months ended September 30, 2009 – $383,988 and $688,168) on the fulfilled portion of commodity contracts.

10. Royalty recoveries

During the nine months ended September 30, 2009, the Company recognized a recovery in the amount of $175,636 of freehold and gross overriding royalties calculated and paid in previous years.

11. Change in non-cash working capital

	Three months ended September30		*Nine months ended September 30*	
	2010	*2009*	*2010*	*2009*
Accounts receivable	$ (1,143,996)	$ (108,358)	$ (1,257,027)	$ 294,390
Prepaid expenses and deposits	(153,902)	66,810	(109,270)	41,499
Accounts payable and accrued liabilities	1,863,418	919,116	4,397,881	656,958
	$ 565,520	$ 877,568	$ 3,031,584	$ 992,847

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

	Three months ended September30		*Nine months ended September 30*	
	2010	*2009*	*2010*	*2009*
Operating	$ (346,430)	$ 360,560	$ (602,311)	$ 460,157
Investing	911,950	517,008	3,633,895	532,690
	$ 565,520	$ 877,568	$ 3,031,584	$ 992,847

12. Related party transactions

In addition to those disclosed elsewhere in these financial statements, the Company had the following related party transactions:

During the three and nine months ended September 30, 2010 and 2009, the Company was charged or invoiced the following amounts by certain of its officers and directors and by companies controlled by certain of the Company's officers and directors:

	Three months ended September 30		*Nine months ended September 30*	
	2010	*2009*	*2010*	*2009*
Administration and consulting fees	$ 73,200	$ 26,350	$ 136,860	$ 37,826
Production and capital expenditures	$ 118,116	$ 31,652	$ 526,357	$ 91,294

12. Related party transactions (continued)

Included in accounts payable and accrued liabilities at September 30, 2010 is $105,900 (December 31, 2009 – $12,000) relating to the above transactions. These transactions were in the normal course of operations and were measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

13. Financial instruments and financial risk management

The Company's financial instruments include accounts receivable, investment, accounts payable and accrued liabilities, bank debt, credit facility and preferred shares (note 6(b)). The carrying values of accounts receivable, accounts payable and accrued liabilities, bank debt and credit facility approximate their fair values due to their relatively short periods to maturity.

The Company is required to classify fair value measurements using a hierarchy that reflects the significance of the inputs used in making the measurements. The fair value hierarchy is as follows:

- Level 1 - quoted prices in active markets for identical assets or liabilities;
- Level 2 - inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly; and
- Level 3 - inputs for the asset or liability that are not based on observable market data.

The Company's risk management policies are established to identify and analyze the risks faced by the Company, to set appropriate risk limits and controls, and to monitor risks and adherence to market conditions and the Company's activities. The Company has exposure to credit risk, liquidity risk and market risk as a result of its use of financial instruments. This note presents information about the Company's exposure to each of the above risks and the Company's objectives, policies and processes for measuring and managing these risks. Further quantitative disclosures are included throughout these financial statements.

The Board of Directors has overall responsibility for the establishment and oversight of the Company's risk management framework. The Board has implemented and monitors compliance with the risk management policies as set out herein:

a) Credit risk

Credit risk is the risk of financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its contractual obligations. A substantial portion of the Company's accounts receivable are with natural gas and liquids marketers and joint venture partners in the oil and gas industry and are subject to normal industry credit risks. Purchasers of the Company's natural gas and liquids are subject to credit review to minimize the risk of non-payment. As at September 30, 2010, the maximum credit exposure is the carrying amount of the accounts receivable and accruals of $1,915,107 (December 31, 2009 – $658,080). As at September 30, 2010, the Company's receivables consisted of $1,198,965 from joint venture partners and other trade receivables and $714,142 of revenue receivable from petroleum and natural gas marketers.

Receivables from petroleum and natural gas marketers are typically collected on the 25th day of the month following production. The Company's policy to mitigate credit risk associated with these balances is to establish marketing relationships with large purchasers. The Company historically has not experienced any significant collection issues with its petroleum and natural gas marketers. All of the revenue accruals and receivables from petroleum and natural gas marketers were received in October and November 2010.

13. Financial instruments and financial risk management (continued)

c) Credit risk (continued)

Joint venture receivables are typically collected within one to three months of the joint venture bill being issued to the partner. The Company mitigates the risk from joint venture receivables by obtaining partner approval of capital expenditures prior to starting a project. However, the receivables are from participants in the petroleum and natural gas sector, and collection is dependent on typical industry factors such as commodity price fluctuations, escalating costs and the risk of unsuccessful drilling. Further risk exists with joint venture partners as disagreements occasionally arise which increases the potential for non-collection. For properties that are operated by the Company, production can be withheld from joint venture partners who are in default of amounts owing. In addition, the Company often has offsetting amounts payable to joint venture partners from which it can net receivable balances.

The Company did not provide for any doubtful accounts nor was it required to write-off any receivables during the period ended September 30, 2010. The Company would only choose to write-off a receivable balance (as opposed to providing an allowance) after all reasonable avenues of collection had been exhausted.

As at September 30, 2010, the Company considers its receivables to be aged as follows:

Not past due	$	1,379,794
Past due by less than 90 days		13,120
Past due by more than 90 days		522,193
	$	1,915,107

b) Liquidity risk

Liquidity risk is the risk that the Company will incur difficulties meeting its financial obligations as they are due. The Company's approach to managing liquidity is to ensure, as far as possible, that it will have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions without incurring unacceptable losses or risking harm to the Company's reputation.

The Company prepares annual capital expenditure budgets, which are regularly monitored and updated as considered necessary. The Company uses authorizations for expenditures on both operated and non-operated projects to further manage capital expenditures.

To facilitate the capital expenditure program, the Company has a revolving reserve-based bank facility, as disclosed in note 4, which is regularly reviewed by the lender. The Company monitors its total debt position monthly. The Company also attempts to match its payment cycle with collection of petroleum and natural gas revenues on the 25th of each month. The Company anticipates it will have adequate liquidity to fund its financial liabilities through its future cash flows. The Company's financial liabilities are comprised of accounts payable and accrued liabilities, bank debt and the credit facility, which have expected maturities of less than one year resulting in their current classification on the balance sheet.

c) Market risk

Market risk consists of interest rate risk, currency risk and commodity price risk. The objective of market risk management is to manage and control market risk exposures within acceptable limits, while maximizing returns. The Company may use both financial derivatives and physical delivery sales contracts to manage market risks. All such transactions are conducted in accordance with a risk management policy as set out herein:

13. Financial instruments and financial risk management (continued)

c) Market risk (continued)

i) Interest rate risk
Interest rate risk is the risk that future cash flows will fluctuate as a result of changes in market interest rates. The Company is exposed to interest rate fluctuations on its bank debt which bears interest at a floating rate. For the three and nine months ended September 30, 2010, if interest rates had been 1% lower with all other variables held constant, earnings for the period would have been $9,452 and $46,747 (three and nine months ended September 30, 2009 – $21,267 and $61,145) higher, respectively, due to lower interest expense. An equal and opposite impact would have occurred had interest rates been higher by the same amounts. The Company had no interest rate swap or financial contracts in place at September 30, 2010.

ii) Currency risk
Foreign currency exchange rate risk is the risk that the fair value or future cash flows will fluctuate as a result of changes in foreign exchange rates. All of the Company's petroleum and natural gas sales are denominated in Canadian dollars; however, the underlying market prices in Canada for petroleum and natural gas are impacted by changes in the exchange rate between the Canadian and United States dollar. The Company had no outstanding forward exchange rate contracts in place at September 30, 2010.

iii) Commodity price risk
Commodity price risk is the risk that the fair value or future cash flows will fluctuate as a result of changes in commodity prices. Commodity prices for petroleum and natural gas are impacted by world economic events that dictate the levels of supply and demand as well as the relationship between the Canadian and United States dollar, as outlined above. The Company's commodity price risk contracts are disclosed in note 9.

14. Capital management

The Company's objective when managing capital is to maintain a flexible capital structure which will allow it to execute its capital expenditure program, which includes expenditures in oil and gas activities which may or may not be successful. Therefore, the Company monitors the level of risk incurred in its capital expenditures to balance the proportion of debt and equity in its capital structure.

The Company considers its capital structure to include:

	September 30 2010	*December 31 2009*
Working capital deficiency	$ (7,691,402)	$ (7,963,051)
Shareholders' equity	$ 35,316,690	$ 26,848,381

The Company monitors capital based on annual funds from operations and capital expenditure budgets, which are updated as necessary and are reviewed and periodically approved by the Company's Board of Directors.

The Company manages its capital structure and makes adjustments by continually monitoring its business conditions including the current economic conditions, the risk characteristics of the Company's petroleum and natural gas assets, the depth of its investment opportunities, current and forecasted net debt levels, current and forecasted commodity prices and other facts that influence commodity prices and funds from operations such as quality and basis differentials, royalties, operating costs and transportation costs.

14. Capital management (continued)

In order to maintain or adjust the capital structure, the Company considers its forecasted funds from operations while attempting to finance an acceptable capital expenditure program including acquisition opportunities, the current level of bank credit available from the Company's lender, the level of bank credit that may be attainable from its lender as a result of petroleum and natural gas reserve growth, the availability of other sources of debt with different characteristics than existing debt, the sale of assets, limiting the size of the capital expenditure program and the issue of new equity if available on favorable terms. At September 30, 2010, the Company's capital structure was not subject to external restrictions.

15. Contingency

In December 2009, the Company terminated the Standstill Agreement that it had with an industry partner regarding a joint producing property and served that industry partner with a Statement of Claim issued from The Court of Queen's Bench of Alberta, by which the Company claims breach of the agreements between the parties, gross negligence and default of operator. The Company seeks judgment for specified and such further damages to be determined by the Court, as well as appointment as operator. The industry partner has indicated it plans to file a Statement of Defence and Counterclaim. The potential outcome of the lawsuit and claims are undetermined however they may be material. As the likely outcome of this litigation cannot be determined at this time, no provision has been made in these consolidated financial statements.

16. Commitments

During the first quarter of 2010, the Company incurred all of the $500,000 of qualifying flow-through expenditures required pursuant to flow-through shares issued in December 2009 that will be renounced effective December 31, 2010.

As at September 30, 2010, the Company has until December 31, 2011 to incur $3,190,000 of qualifying flow-through expenditures related to flow-through shares issued in March, May and June 2010 as disclosed in note 6(a), of which approximately $3,024,500 has been incurred.

17. Subsequent events

a) Asset acquisition

On October 25, 2010, the Company closed an asset acquisition in the Ferrier/Willesden Green area of Alberta for total consideration of $4.0 million cash, of which the Company paid $400,000 in September 2010 as a deposit and the final $3.6 million on closing.

b) Special warrant financing

On October 25 and 28, 2010, the Company completed a special warrant financing ("Special Warrants") for total gross proceeds of $13,000,000. The financing consisted of 8,666,667 flow-through special warrants priced at $0.75 each, issued on a flow-through basis and 10,000,000 common share special warrants priced at $0.65 each. Each Special Warrant is exercisable into common shares of the Company, and all unexercised warrants will be deemed to be exercised the 5th day after receiving receipts from the various securities regulatory authorities for a Final Prospectus, which receipts were obtained on November 22, 2010.

c) Credit facility

On November 15, 2010, the Company signed a credit facility agreement with a new lender as disclosed in note 4. The credit facility with the previous lender was paid out and cancelled.