DEJOUR ENERGY INC.
RESOURCEFUL. ENTERPRISING.

INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

September 30, 2012

DEJOUR ENERGY INC.
INTERIM CONDENSED CONSOLIDATED BALANCE SHEETS
(Expressed in Canadian Dollars)
(Unaudited)

	Note	**September 30, 2012**	December 31, 2011
		$	$
ASSETS			
Current			
Cash and cash equivalents		**3,025,944**	2,487,850
Accounts receivable		**641,534**	887,181
Share subscription receivable	11	**-**	516,246
Prepaids and deposits		**220,666**	100,848
Current Assets		**3,888,144**	3,992,125
Non-current			
Deposits		**398,190**	403,764
Exploration and evaluation assets	5	**5,365,628**	5,282,652
Property and equipment	6	**20,953,674**	19,759,897
Total Assets		**30,605,636**	29,438,438
LIABILITIES			
Current			
Bank line of credit	8	**5,656,630**	5,545,457
Accounts payable and accrued liabilities		**2,867,937**	3,957,893
Warrant liability	9	**1,459,805**	2,245,210
Current Liabilities		**9,984,372**	11,748,560
Non-current			
Decommissioning liability	10	**1,478,414**	1,338,853
Other liabilities		**34,456**	43,989
Total Liabilities		**11,497,242**	13,131,402
SHAREHOLDERS' EQUITY			
Share capital	11	**90,273,576**	85,075,961
Contributed surplus	13	**8,328,706**	8,133,877
Deficit		**(78,808,915)**	(76,509,825)
Accumulated other comprehensive loss	18	**(684,973)**	(392,977)
Total Shareholders' Equity		**19,108,394**	16,307,036
Total Liabilites and Shareholders' Equity		**30,605,636**	29,438,438

Approved on behalf of the Board:

"Robert Hodgkinson" *"Craig Sturrock"*

Robert Hodgkinson - Director Craig Sturrock - Director

DEJOUR ENERGY INC.
INTERIM CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS
(Expressed in Canadian Dollars)
(Unaudited)

	Note	Three months ended September 30		Nine months ended September 30	
		2012	2011	**2012**	2011
		$	$	**$**	$
REVENUES AND OTHER INCOME					
Gross revenues		**1,552,366**	2,946,979	**5,251,495**	6,346,954
Royalties		**(234,263)**	(613,813)	**(855,398)**	(1,198,802)
Revenues, net of royalties		**1,318,103**	2,333,166	**4,396,097**	5,148,152
Financial instrument gain (loss)		-	-	**(54,819)**	(59,154)
Other income		**7,973**	8,959	**24,419**	25,663
Total Revenues and Other Income	17	**1,326,076**	2,342,125	**4,365,697**	5,114,661
EXPENSES					
Operating and transportation		**1,208,868**	663,975	**3,001,144**	1,642,051
General and administrative		**714,045**	718,358	**2,496,022**	2,668,120
Finance costs		**66,978**	270,373	**399,984**	795,419
Stock based compensation	12	**26,272**	150,425	**392,932**	549,437
Foreign exchange loss (gain)		**94,611**	10,816	**198,572**	91,184
Amortization, depletion and impairment losses	7	**596,631**	1,416,860	**1,983,502**	2,632,835
Change in fair value of warrant liability	9	**(15,908)**	(542,593)	**(1,807,369)**	(463,575)
Total Expenses		**2,691,497**	2,688,214	**6,664,787**	7,915,471
Loss before income taxes		**(1,365,421)**	(346,089)	**(2,299,090)**	(2,800,810)
Deferred tax recovery		-	-	-	187,145
Loss for the period		**(1,365,421)**	(346,089)	**(2,299,090)**	(2,613,665)
Foreign currency translation adjustment		**(309,123)**	991,485	**(291,996)**	638,497
Comprehensive gain (loss)		**(1,674,544)**	645,396	**(2,591,086)**	(1,975,168)
Loss per common share - basic and diluted	14	**(0.009)**	(0.003)	**(0.017)**	(0.022)

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

DEJOUR ENERGY INC.
INTERIM CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
(Expressed in Canadian Dollars)
(Unaudited)

	Note	Number of Shares	Share Capital	Contributed Surplus	Deficit	AOCI(L)*	Total
			$	$	$	$	$
Balance as at January 1, 2012		126,892,386	85,075,961	8,133,877	(76,509,825)	(392,977)	16,307,036
Shares issued via private placements, net of issuance costs	11	18,130,305	3,248,011				3,248,011
Issue of shares on exercise of warrants and options	11	3,893,683	1,465,812				1,465,812
Warrant liability reallocated on exercise of warrants	11		285,689				285,689
Contributed surplus reallocated on exercise of options	11		198,103	(198,103)			-
Stock-based compensation	12			392,932			392,932
Net loss					(2,299,090)		(2,299,090)
Foreign currency translation adjustment						(291,996)	(291,996)
Balance as at September 30, 2012		148,916,374	90,273,576	8,328,706	(78,808,915)	(684,973)	19,108,394
Balance as at January 1, 2011		110,180,545	79,298,053	7,638,609	(65,466,543)	(685,002)	20,785,117
Shares issued via private placements, net of issuance costs		11,010,000	2,781,643				2,781,643
Issue of shares on exercise of warrants and options		200,000	77,712				77,712
Warrant liability reallocated on exercise of warrants			34,851				34,851
Stock-based compensation	12			549,437			549,437
Net loss					(2,613,665)		(2,613,665)
Foreign currency translation adjustment						638,497	638,497
Balance as at September 30, 2011		121,390,545	82,192,259	8,188,046	(68,080,208)	(46,505)	22,253,592

* Accumulated other comprehensive income (loss)

DEJOUR ENERGY INC.
INTERIM CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Expressed in Canadian Dollars)
(Unaudited)

	Note	Three months ended September 30		Nine months ended September 30	
		2012	2011	**2012**	2011
		$	$	**$**	$
CASH FLOWS FROM (USED IN) OPERATING ACTIVITIES					
Net loss for the period		**(1,365,421)**	(346,089)	**(2,299,090)**	(2,613,665)
Adjustment for items not affecting cash:					
Amortization, depletion and impairment losses		**596,631**	1,416,860	**1,983,502**	2,632,835
Stock based compensation		**26,272**	150,425	**392,932**	549,437
Non-cash general and administrative expenses		**10,200**	5,582	**22,019**	16,485
Deferred tax recovery		**-**	-	**-**	(187,145)
Change in fair value of warrant liability		**(15,908)**	(542,593)	**(1,807,369)**	(463,575)
Amortization of deferred leasehold inducement		**(2,052)**	(2,052)	**(6,155)**	(6,156)
Changes in non-cash operating working capital	14	**328,520**	(80,120)	**(554,107)**	(618,692)
Total Cash Flows from (used in) Operating Activities		**(421,758)**	602,013	**(2,268,268)**	(690,476)
CASH FLOWS FROM (USED IN) INVESTING ACTIVITIES					
Deposits		**6,085**	52,774	**5,574**	53,058
Exploration and evaluation expenditures		**(99,899)**	(146,687)	**(258,483)**	(690,556)
Additions to property and equipment		**(1,159,644)**	(950,172)	**(3,187,561)**	(5,320,203)
Proceeds from sale of E&E assets		**-**	-	**9,064**	-
Proceeds from sale of property and equipment		**2,266**	-	**2,266**	1,238
Changes in non-cash investing working capital	14	**967,572**	(868,815)	**106,227**	66,264
Total Cash Flows from (used in) Investing Activities		**(283,620)**	(1,912,900)	**(3,322,913)**	(5,890,199)
CASH FLOWS FROM (USED IN) FINANCING ACTIVITIES					
Advance (repayment) of line of credit		**175,330**	4,307,828	**111,173**	4,307,828
Advance (repayment) of bridge loan		**-**	(4,300,000)	**-**	(4,800,000)
Advance (repayment) of loans from related parties & other liabilities		**(1,553)**	21,736	**(3,376)**	(228,264)
Shares issued on exercise of warrants and options		**-**	-	**1,465,812**	77,712
Shares issued for cash, net of share issue costs		**-**	10,830	**4,555,666**	3,004,429
Changes in non-cash financing working capital	14	**(120,649)**	(51,745)	**-**	(27,030)
Total Cash Flows from (used in) Financing Activities		**53,128**	(11,351)	**6,129,275**	2,334,675
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS		**(652,250)**	(1,322,238)	**538,094**	(4,246,000)
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD		**3,678,194**	1,833,763	**2,487,850**	4,757,525
CASH AND CASH EQUIVALENTS, END OF PERIOD		**3,025,944**	511,525	**3,025,944**	511,525

Supplemental cash flow information - Note 14

NOTE 1 – CORPORATE INFORMATION

Dejour Energy Inc. (the "Company") is a public company trading on the New York Stock Exchange AMEX ("NYSE-AMEX") and the Toronto Stock Exchange ("TSX"), under the symbol "DEJ." The Company is in the business of exploring and developing energy projects with a focus on oil and gas in North America. On March 9, 2011, the Company changed its name from Dejour Enterprises Ltd. to Dejour Energy Inc. The address of its registered office is 598 – 999 Canada Place, Vancouver, British Columbia.

The interim condensed consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries, Dejour Energy (USA) Corp. ("Dejour USA"), incorporated in Nevada, Dejour Energy (Alberta) Ltd. ("DEAL"), incorporated in Alberta, Wild Horse Energy Ltd. ("Wild Horse"), incorporated in Alberta and 0855524 B.C. Ltd., incorporated in B.C. All intercompany transactions are eliminated upon consolidation.

The interim condensed consolidated financial statements are presented in Canadian dollars, which is also the functional currency of the parent company. These interim condensed consolidated financial statements were authorized and approved for issuance by the Audit Committee on November 5, 2012.

NOTE 2 – BASIS OF PRESENTATION AND ADOPTION OF INTERNATIONAL FINANCIAL REPORTING STANDARDS

(a) Basis of presentation

These interim condensed consolidated financial statements have been prepared in accordance with IAS 34, Interim Financial Reporting ("IAS 34"), as issued by the International Accounting Standards Board ("IASB"), and its interpretations. Accordingly, these interim condensed consolidated financial statements do not include all of the information and footnotes required by International Financial Reporting Standards ("IFRS") for complete annual financial statements. Results for the three and nine months ended September 30, 2012, are not necessarily indicative of future results. The accounting policies applied by the Company in these interim condensed consolidated financial statements are the same as those applied by the Company in its most recent annual consolidated financial statements as at and for the year ended December 31, 2011 as filed on SEDAR at www.sedar.com.

(b) Going concern

The financial statements were prepared on a going concern basis. The going concern basis assumes that the Company will continue in operation for the foreseeable future and will be able to realize its assets and discharge its liabilities and commitments in the normal course of business. The Company has a working capital deficiency of $6,096,228 and accumulated deficit of $78,808,915.

As described in note 8, in September 2011, the Company obtained a $7 million revolving operating demand loan ("line of credit") from a Canadian Bank to refinance the bridge loan and to provide funds for general corporate purposes. The next review date for the line of credit is scheduled on or before February 15, 2013. As described in note 11, during the nine months ended September 30, 2012, the Company raised net proceeds of approximately $6.0 million on the issue of common shares (December 31, 2011 - $5.4 million). The Company's ability to continue as a going concern is dependent upon attaining profitable operations and obtaining sufficient financing to meet obligations and continue exploration and development activities. There is no assurance that these activities will be successful. These material uncertainties cast significant doubt upon the Company's ability to continue as going concern. These interim condensed consolidated financial statements do not reflect the adjustments to the carrying values of assets and liabilities, the reported expenses, and the balance sheet classifications used that would be necessary if the going concern assumption were not appropriate.

(c) Basis of measurement

The interim condensed consolidated financial statements have been prepared on the historical cost basis except for the revaluation of certain financial assets and liabilities to fair value, including derivative instruments, as explained in the accounting policies in note 3 to the Company's annual consolidated financial statements.

NOTE 2 – BASIS OF PRESENTATION AND ADOPTION OF INTERNATIONAL FINANCIAL REPORTING STANDARDS (continued)

(d) Use of estimates and judgments

The preparation of interim condensed consolidated financial statements in compliance with IFRS requires management to make certain critical accounting estimates. It also requires management to exercise judgment in applying the Company's accounting policies. The areas involving a higher degree of judgment or complexity, or areas where assumptions and estimates are significant to the financial statements are disclosed in note 4 to the Company's annual consolidated financial statements.

(e) Functional and presentation currency

These interim condensed consolidated financial statements are presented in Canadian dollars, which is the Company's presentation currency. Subsidiaries measure items using the currency of the primary economic environment in which the entity operates with entities having a functional currency different from the parent company, translated into Canadian dollars.

NOTE 3 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting policies, as described in the Company's annual consolidated financial statements, have been applied consistently to all periods presented in these interim condensed consolidated financial statements and have been applied consistently by the Company's entities.

NOTE 4 - CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS

The Company makes estimates and assumptions about the future that affect the reported amounts of assets and liabilities. Estimates and judgments are continually evaluated based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. In the future, actual experience may differ from these estimates and assumptions.

The effect of a change in an accounting estimate is recognized prospectively by including it in profit or loss in the period of the change, if the change affects that period only; or in the period of the change and future periods, if the change affects both.

Information about critical judgments in applying accounting policies that have the most significant risk of causing material adjustment to the carrying amounts of assets and liabilities recognized in the consolidated annual financial statements within the next financial year are described in the Company's annual consolidated financial statements.

(Expressed in Canadian dollars)

NOTE 5 – EXPLORATION AND EVALUATION ("E&E") ASSETS

	Canadian Uranium Properties	Canadian Oil and Gas Interests	United States Oil and Gas Interests	Total
	$	$	$	$
Cost:				
Balance at January 1, 2011	533,085	41,060	27,500,879	28,075,024
Additions	-	22,727	966,980	989,707
Transfers to property and equipment (Note 6)	-	-	(1,352,620)	(1,352,620)
Change in decommissioning provision	-	9,246	-	9,246
Disposals	-	(1,481)	-	(1,481)
Foreign currency translation and other	-	-	657,088	657,088
Balance at December 31, 2011	533,085	71,552	27,772,327	28,376,964
Additions	-	796	252,823	253,619
Change in decommissioning provision	-	17,876	-	17,876
Disposals	-	-	(1,654,967)	(1,654,967)
Foreign currency translation and other	-	-	(822,565)	(822,565)
Balance at September 30, 2012	533,085	90,224	25,547,618	26,170,927

	Canadian Uranium Properties	Canadian Oil and Gas Interests	United States Oil and Gas Interests	Total
	$	$	$	$
Accumulated impairment losses:				
Balance at January 1, 2011	(9,880)	-	(17,807,885)	(17,817,765)
Impairment losses (Note 7)	-	-	(4,886,261)	(4,886,261)
Foreign currency translation and other	-	-	(390,286)	(390,286)
Balance at December 31, 2011	(9,880)	-	(23,084,432)	(23,094,312)
Impairment losses (Note 7)	-	-	(18,230)	(18,230)
Disposals	-	-	1,644,426	1,644,426
Foreign currency translation and other	-	-	662,817	662,817
Balance at September 30, 2012	(9,880)	-	(20,795,419)	(20,805,299)

	Canadian Uranium Properties	Canadian Oil and Gas Interests	United States Oil and Gas Interests	Total
	$	$	$	$
Carrying amounts:				
At December 31, 2011	523,205	71,552	4,687,895	5,282,652
At September 30, 2012	523,205	90,224	4,752,199	5,365,628

Exploration and evaluation ("E&E") assets consist of the Company's exploration projects which are pending the determination of proven reserves. During the nine months ended September 30, 2012, the Company capitalized $Nil (2011 - $Nil) of general and administrative costs on its Canadian and $77,879 (2011- $38,257) on its United States oil and gas interests. The Company determined that there were no indicators of impairment or impairment reversal at September 30, 2012.

(Expressed in Canadian dollars)

NOTE 6 – PROPERTY AND EQUIPMENT

	Canadian Oil and Gas Interests	United States Oil and Gas Interests	Corporate and Other Assets	Total
	$	$	$	$
Cost:				
Balance at January 1, 2011	16,191,797	1,695,655	298,057	18,185,509
Additions	6,457,404	866,097	28,867	7,352,368
Transfers from exploration and evaluation assets	-	1,352,620	-	1,352,620
Change in decommissioning provision	500,284	121,030	-	621,314
Disposals	-	-	(2,407)	(2,407)
Foreign currency translation and other	-	40,372	1,395	41,767
Balance at December 31, 2011	23,149,485	4,075,774	325,912	27,551,171
Additions	1,375,321	1,807,224	1,915	3,184,460
Change in decommissioning provision	102,684	11,065	-	113,749
Disposals	-	-	(16,957)	(16,957)
Foreign currency translation and other	-	(145,723)	(2,322)	(148,045)
Balance at September 30, 2012	24,627,490	5,748,340	308,548	30,684,378

During the nine months ended September 30, 2012, the Company capitalized $1,625 (2011 - $87,424) of general and administrative costs on its Canadian and $476,252 (2011- $617,090) on its United States oil and gas interests.

The Company determined that there were no indicators of impairment or impairment reversal at September 30, 2012.

	Canadian Oil and Gas Interests	United States Oil and Gas Interests	Corporate and Other Assets	Total
	$	$	$	$
Accumulated amortization, depletion and impairment losses:				
Balance at January 1, 2011	(3,814,045)	-	(196,483)	(4,010,528)
Amortization and depletion (Note 7)	(2,366,156)	-	(37,198)	(2,403,354)
Impairment losses (Note 7)	(937,939)	(424,078)	-	(1,362,017)
Disposals	-	-	1,169	1,169
Foreign currency translation and other	-	(15,832)	(712)	(16,544)
Balance at December 31, 2011	(7,118,140)	(439,910)	(233,224)	(7,791,274)
Amortization and depletion (Note 7)	(1,944,016)	-	(21,256)	(1,965,272)
Disposals	-	-	10,055	10,055
Foreign currency translation and other	-	14,620	1,167	15,787
Balance at September 30, 2012	(9,062,156)	(425,290)	(243,258)	(9,730,704)

(Expressed in Canadian dollars)

NOTE 6 – PROPERTY AND EQUIPMENT (continued)

	Canadian Oil and Gas Interests	United States Oil and Gas Interests	Corporate and Other Assets	Total
	$	$	$	$
Carrying amounts:				
At December 31, 2011	16,031,345	3,635,864	92,688	19,759,897
At September 30, 2012	15,565,334	5,323,050	65,290	20,953,674

NOTE 7 – AMORTIZATION, DEPLETION AND IMPAIRMENT LOSSES

	Nine months ended September 30, 2012	2011
	$	$
Exploration and Evaluation Assets (E & E assets)		
Impairment losses (Note 5)	**18,230**	352,113
Property and Equipment (D & P assets)		
Amortization and depletion (Note 6)	**1,965,272**	1,596,644
Impairment losses (Note 6)	**-**	684,078
	1,983,502	2,632,835

NOTE 8 – BANK LINE OF CREDIT

In September 2011, the Company obtained a $7 million revolving operating demand loan (“line of credit”), including a letter of credit facility to a maximum of $700,000 for a maximum one year term, from a Canadian Bank to refinance the bridge loan and to provide operating funds. The line of credit is at an interest rate of Prime + 1% (total 4% p.a. currently) and collateralized by a $10,000,000 debenture over all assets of DEAL and a $10,000,000 guarantee from Dejour Energy Inc. In October 2012, the Company renewed the line of credit with the Canadian Bank. Per the amended agreement, the maximum amount of the line of credit is reduced to $6.9 million, including a letter of credit facility to a maximum of $600,000 for a maximum one year term. The availability of the line of credit is reduced by $100,000 per month commencing November 1, 2012. The next review date is scheduled on or before February 15, 2013, but subject to change at the discretion of the bank. As at September 30, 2012, a total of $5,656,630 of this facility was utilized.

According to the terms of the facility, DEAL is required to maintain an adjusted working capital ratio of greater than 1:1 at all times. The adjusted working capital ratio is defined as the ratio of (i) current assets (including any undrawn and authorized availability under the facility) less unrealized hedging gains to (ii) current liabilities (excluding current portion of outstanding balances of the facility) less unrealized hedging losses. As at September 30, 2012, DEAL is in compliance with the working capital ratio requirement.

(Expressed in Canadian dollars)

NOTE 9 – WARRANT LIABILITY

Warrants that have their exercise prices denominated in currencies other than the Company's functional currency of Canadian dollars are accounted for as derivative financial liabilities, other than agents' warrants. These warrants are recorded at the fair value at each reporting date with the change in fair value for the period recorded in profit or loss for the period.

	#	$
Balance at January 1, 2011	8,075,000	**1,092,762**
Granted, investor warrants	5,505,002	310,616
Exercise of warrants – value reallocation	(3,460,418)	(738,548)
Change in fair value	-	1,580,380
Balance at December 31, 2011	10,119,584	**2,245,210**
Granted, investor warrants	13,597,729	1,307,653
Exercise of warrants – value reallocation	(2,419,584)	(285,689)
Change in fair value	-	(1,807,369)
Balance at September 30, 2012	21,297,729	**1,459,805**

As described in Note 11, in June 2012, the Company issued 13,597,729 investor warrants each of which entitles the holder to purchase one common share of the Company at an exercise price of US$0.40 beginning 6 months from the date of issuance until June 4, 2017. The fair value of these warrants was estimated using the Hull-White Trinomial option pricing model under the following weighted average inputs: expected dividend yield of 0%, expected volatility of 91%, risk-free interest rate of 0.68% and an expected life of five years.

During the nine months ended September 30, 2012, 2,419,584 US$ warrants were exercised (December 31, 2011 - 3,460,418).

NOTE 10 – DECOMMISSIONING LIABILITY

	Canadian Oil and Gas Properties [1]	United States Oil and Gas Properties [1]	Total
	$	$	$
Balance at January 1, 2011	**706,082**	**-**	**706,082**
Liabilities incurred during the year	231,767	118,567	350,334
Change in estimated future cash flows	277,764	2,463	280,227
Actual costs incurred	(18,332)	-	(18,332)
Unwinding of discount	19,642	900	20,542
Balance at December 31, 2011	**1,216,923**	**121,930**	**1,338,853**
Change in estimated future cash flows	120,560	11,065	131,625
Actual costs incurred and other	(5,203)	(4,213)	(9,416)
Unwinding of discount	15,756	1,596	17,352
Balance at September 30, 2012	**1,348,036**	**130,378**	**1,478,414**

(1) relates to property and equipment

NOTE 10 – DECOMMISSIONING LIABILITY (continued)

The present value of the decommissioning liability was calculated using the following weighted average inputs:

	Canadian Oil and Gas Properties	United States Oil and Gas Properties
As at September 30, 2012:		
Discount rate	1.57%	1.60%
Inflation rate	2.50%	2.50%
As at December 31, 2011:		
Discount rate	1.67%	1.72%
Inflation rate	2.00%	2.00%

NOTE 11 – SHARE CAPITAL

Issued and outstanding

	Common Shares	
	# of Shares	$ Value of shares
Balance at December 31, 2010	110,180,545	**79,385,883**
- Issue of shares on exercise of warrants and options	4,751,841	1,574,401
- Warrant liability reallocated on exercise of warrants	-	738,548
- Contributed surplus reallocated on exercise of options	-	167,070
- Shares issued via private placements, net of issuance costs	11,010,000	2,693,813
- Subscriptions receivable on exercise of options	950,000	516,246
Balance at December 31, 2011	126,892,386	**85,075,961**
- Issue of shares on exercise of warrants and options	3,893,683	1,465,812
- Warrant liability reallocated on exercise of warrants	-	285,689
- Contributed surplus reallocated on exercise of options	-	198,103
- Shares issued via private placements, net of issuance costs	18,130,305	3,248,011
Balance at September 30, 2012	148,916,374	**90,273,576**

In June 2012, the Company completed a private placement of 18,130,305 units at US$0.26 per unit. Each unit consists of one common share and 3/4 of one common share purchase warrant. Each whole warrant entitles the holder to acquire one additional common share of the Company at US$0.40 per common share beginning 6 months from the date of issuance until June 4, 2017. Gross proceeds raised were $4,909,133 (US$4,713,879). In connection with this private placement, the Company paid finders' fees of $294,655 (US$282,833) and other related costs of $187,442. The grant date fair value of the warrants, estimated to be $1,307,653, has been recognized as a derivative financial liability (Note 9). Issue costs of $128,629 related to the warrants were expensed.

During the nine months ended September 30, 2012, 2,968,683 warrants denominated in US dollars (including 549,099 agents' warrants) were exercised with an average common share market price of US$0.47 and 925,000 stock options were exercised with an average common share market price of $0.51.

(Expressed in Canadian dollars)

NOTE 12 – STOCK OPTIONS AND SHARE PURCHASE WARRANTS

(a) Stock Options

The Stock Option Plan (the "Plan") is a 10% "rolling" plan pursuant to which the number of common shares reserved for issuance is 10% of the Company's issued and outstanding common shares as constituted on the date of any grant of options.

The Plan provides for the grant of options to purchase common shares to eligible directors, senior officers, employees and consultants of the Company ("Participants"). The exercise periods and vesting periods of options granted under the Plan are to be determined by the Company with approval from the Board of Directors. The expiration of any option will be accelerated if the participant's employment or other relationship with the Company terminates. The exercise price of an option is to be set by the Company at the time of grant but shall not be lower than the market price (as defined in the Plan) at the time of grant.

The following table summarizes information about outstanding stock option transactions:

	Number of options	Weighted average exercise price
		$
Balance at January 1, 2011	**6,946,500**	**0.40**
Options granted	3,212,500	0.35
Options exercised	(1,150,000)	0.35
Options cancelled/forfeited	(200,000)	0.40
Options expired	(305,000)	0.45
Balance at December 31, 2011	**8,504,000**	**0.39**
Options granted	2,125,001	0.43
Options exercised	(925,000)	0.38
Options cancelled/forfeited	(212,459)	0.40
Balance at September 30, 2012	**9,491,542**	**0.40**

Details of the outstanding and exercisable stock options as at September 30, 2012 are as follows:

	Outstanding			Exercisable		
		Weighted average			Weighted average	
	Number of options	exercise price	contractual life (years)	Number of options	exercise price	contractual life (years)
		$			$	
$0.35	4,829,000	0.35	2.00	4,355,125	0.35	1.98
$0.45	4,662,542	0.45	1.73	3,736,964	0.45	1.73
	9,491,542	0.40	1.86	8,092,089	0.40	1.87

The fair value of the options issued during the period was estimated using the Black Scholes option pricing model with the following weighted average inputs:

(Expressed in Canadian dollars)

NOTE 12 – STOCK OPTIONS AND SHARE PURCHASE WARRANTS (continued)

(a) Stock Options (continued)

For the nine months ended September 30	**2012**	2011
Fair value at grant date	**$ 0.13**	$ 0.15
Exercise price	**$ 0.43**	$ 0.35
Share price	**$ 0.41**	$ 0.36
Expected volatility	**70%**	74%
Expected option life	**1.71 years**	2.10 years
Dividends	**0.0%**	0.0%
Risk-free interest rate	**0.99%**	1.65%

Expected volatility is based on historical volatility and average weekly stock prices were used to calculate volatility. Management believes that the annualized weekly average of volatility is the best measure of expected volatility. A weighted average forfeiture rate of 7.83% (2011 – 9.92%) is used when recording stock based compensation. This estimate is adjusted to the actual forfeiture rate. Stock based compensation of $392,932 (September 30, 2011 - $549,437) was expensed during the nine months ended September 30, 2012.

(b) Share Purchase Warrants

The following table summarizes information about warrant transactions:

	Number of Warrants	Weighted average Exercise price
		$
Balance at January 1, 2011	**21,010,455**	**0.44**
Warrants granted	5,505,002	0.37
Warrants exercised	(4,551,841)	0.37
Warrants expired	(3,540,026)	0.48
Balance at December 31, 2011	**18,423,590**	**0.43**
Warrants granted	13,597,729	0.39
Warrants exercised	(2,968,683)	0.36
Balance at September 30, 2012	**29,052,636**	**0.42**

Details of the outstanding and exercisable warrants as at September 30, 2012 are as follows:

	Outstanding			Exercisable		
		Weighted average			Weighted average	
	Number of warrants	exercise price	contractual life (years)	Number of warrants	exercise price	contractual life (years)
		$			$	
$0.40	3,642,856	0.40	3.13	3,642,856	0.40	3.13
$0.55	4,015,151	0.55	1.72	4,015,151	0.55	1.72
$0.40 US	7,700,000	0.39	2.23	7,700,000	0.39	2.23
$0.40 US	13,597,729	0.39	4.68	-	-	-
$0.46 US	96,900	0.45	2.09	96,900	0.45	2.09
	29,052,636	0.42	3.42	15,454,907	0.44	2.31

(Expressed in Canadian dollars)

NOTE 12 – STOCK OPTIONS AND SHARE PURCHASE WARRANTS (continued)

(b) Share Purchase Warrants (continued)

Warrants that have their exercise prices denominated in currencies other than the Company's functional currency of Canadian dollars are accounted for as derivative financial liabilities, other than agents' warrants (Note 9). 13,597,729 warrants with an exercise price of US$0.40 and expiry date of June 4, 2017 can be exercised after December 4, 2012.

NOTE 13 – CONTRIBUTED SURPLUS

Contributed surplus is used to recognize the value of stock option grants and share warrants prior to exercise. Details of changes in the Company's contributed surplus balance are as follows:

	$
Balance at January 1, 2011	**7,638,609**
Stock based compensation	662,339
Exercise of options – value reallocation	(167,070)
Balance at December 31, 2011	**8,133,877**
Stock based compensation	392,932
Exercise of options – value reallocation	(198,103)
Balance at September 30, 2012	**8,328,706**

NOTE 14 – SUPPLEMENTAL INFORMATION

(a) Changes in non-cash working capital consisted of the following:

	Three months ended September 30		**Nine months ended September 30**	
	2012	2011	**2012**	2011
	$	$	**$**	$
Changes in non-cash working capital:				
Accounts receivable	**133,549**	39,419	**245,647**	(446,693)
Share subscription receivable	**-**	-	**516,246**	-
Prepaids and deposits	**(2,142)**	(24,385)	**(119,818)**	10,550
Accounts payable and accrued liabilities	**1,044,036**	(1,015,714)	**(1,089,955)**	(143,315)
	1,175,443	(1,000,680)	**(447,880)**	(579,458)
Comprised of:				
Operating activities	**328,520**	(80,120)	**(554,107)**	(618,692)
Investing activities	**967,572**	(868,815)	**106,227**	66,264
Financing activities	**(120,649)**	(51,745)	**-**	(27,030)
	1,175,443	(1,000,680)	**(447,880)**	(579,458)
Other cash flow information:				
Cash paid for interest	**55,663**	113,524	**175,817**	388,538
Income taxes paid	**-**	-	**-**	-

(Expressed in Canadian dollars)

NOTE 14 – SUPPLEMENTAL INFORMATION (continued)

(b) Per share amounts:

Basic loss per share amounts has been calculated by dividing the loss for the period attributable to the shareholders of the Company by the weighted average number of common shares outstanding. The basic and diluted loss per share is the same as there are no dilutive effects on earnings (loss). The following table summarizes the common shares used in calculating basic and diluted loss per common share:

	Three months ended September 30,		**Nine months ended September 30,**	
	2012	2011	**2012**	2011
Weighted average common shares outstanding				
Basic	**148,916,374**	121,390,545	**138,417,046**	119,828,439
Diluted	**148,916,374**	121,390,545	**138,417,046**	119,828,439

NOTE 15 – RELATED PARTY TRANSACTIONS

During the nine months ended September 30, 2012 and 2011, the Company entered into the following transactions with related parties:

(a) Compensation awarded to key management included a total of salaries and consulting fees of $887,608 (2011 - $979,587) and non-cash stock-based compensation of $98,218 (2011 - $368,369). Key management includes the Company's officers and directors. The salaries and consulting fees are included in general and administrative expenses. Included in accounts payable and accrued liabilities at September 30, 2012 is $Nil (December 31, 2011 - $396,618) owing to the companies controlled by the officers of the Company.

(b) The Company incurred a total of $Nil (2011 - $2,301) in finance costs to a company controlled by an officer of the Company.

(c) Included in interest and other income is $22,500 (2011 - $22,500) received from the companies controlled by officers of the Company for rental income.

(d) In December 2009, a company controlled by the CEO of the Company ("HEC") became a 5% working interest partner in the Woodrush property. Included in accounts payable and accrued liabilities at September 30, 2012 is $13,731 (December 31, 2011 - $53,668) owing to HEC.

(e) With respect to the private placement of 11,010,000 units issued at US$0.30 per unit completed in February 2011, directors and officers of the Company purchased 2,000,000 units of this offering (see Note 13 to the annual consolidated financial statements for details).

(f) In December 2011, HEC exercised 250,000 warrants with an exercise price of US$0.35 each that were issued in February 2011.

(g) In January 2012, directors and officers of the Company exercised 750,000 warrants with an exercise price of US$0.35 each that were issued in February 2011.

(Expressed in Canadian dollars)

NOTE 16 – INCOME TAXES

The Company has the approximate amounts of tax pools available as follows:

As at December 31	2011 $	2010 $
Canada:		
Exploration and development expenditures	18,439,000	16,047,000
Unamortized share issue costs	913,000	1,003,000
Capital losses	8,242,000	8,242,000
Non-capital losses	18,416,000	15,997,000
	46,010,000	41,289,000
United States:		
Exploration and development expenditures	28,553,000	27,146,000
Non-capital losses	11,883,000	10,009,000
	40,436,000	37,155,000
Total	86,446,000	78,444,000

The described 2011 US tax pools are updated for a typographical correction from the amount disclosed in the Company's annual consolidated financial statements filed on SEDAR.

The exploration and development expenditures at December 31, 2011 can be carried forward to reduce future income taxes indefinitely. The non-capital losses for income tax purposes expire as follows:

	Canada $	United States $	Total $
2015	1,729,000	-	1,729,000
2026	-	480,000	480,000
2027	4,151,000	-	4,151,000
2028	4,674,000	2,020,000	6,694,000
2029	3,373,000	6,397,000	9,770,000
2030	2,081,000	1,112,000	3,193,000
2031	2,408,000	1,874,000	4,282,000
	18,416,000	11,883,000	30,299,000

The Company does not recognize deferred tax assets related to the foregoing tax pools because it is not probable that future taxable profit will be available against which the tax pools can be utilized.

(Expressed in Canadian dollars)

NOTE 17 – OPERATING SEGMENTS

Segment information is provided on the basis of geographic segments as the Company manages its business through two geographic regions – Canada and the United States. The two geographic segments presented reflect the way in which the Company's management reviews business performance. The Company's revenue and losses of each geographic segment are as follows:

	Canada		United States		Total	
	2012	2011	2012	2011	2012	2011
	$	$	$	$	$	$
Three months ended September 30						
Revenues and other income	1,326,076	2,342,125	-	-	1,326,076	2,342,125
Segmented income (loss)	(1,127,749)	439,469	(237,672)	(785,558)	(1,365,421)	(346,089)
Amortization, depletion and impairment losses	584,979	833,792	11,652	583,068	596,631	1,416,860
Interest expense	55,378	113,524	285	-	55,663	113,524
Deferred tax recovery	-	-	-	-	-	-
Nine months ended September 30						
Revenues and other income	4,365,697	5,114,661	-	-	4,365,697	5,114,661
Segmented loss	(1,663,447)	(1,221,404)	(635,643)	(1,392,261)	(2,299,090)	(2,613,665)
Amortization, depletion and impairment losses	1,956,591	1,851,153	26,911	781,682	1,983,502	2,632,835
Interest expense	174,912	388,538	905	-	175,817	388,538
Deferred tax recovery	-	187,145	-	-	-	187,145
As at September 30						
Total capital expenditures	1,376,117	4,870,818	2,060,047	1,092,921	3,436,164	5,963,739

NOTE 18 – ACCUMULATED OTHER COMPREHENSIVE LOSS

The components of accumulated other comprehensive loss were as follows:

As at	**September 30, 2012**	December 31, 2011
	$	$
Unrealized financial instrument loss	**-**	-
Foreign currency translation adjustment	**684,973**	392,977
	684,973	392,977

NOTE 19 – SEASONALITY OF OPERATIONS

There are factors causing quarterly variances that may not be reflective of the Company's future performance. These include, but are not limited to weather conditions, oil and gas production, drilling activities which are affected by oil and natural gas commodity prices, global economic environment, as well as unexpected production curtailment caused by activities such as plant shutdown work. As the Company has operations in the United States, the consolidated financial results may vary between periods due to the effect of foreign exchange fluctuations in translating the expenses of its operations in the United States to Canadian dollars. As a result, quarterly operating results should not be relied upon as any indication of results for any future period.

NOTE 20 – COMPARATIVE AMOUNTS

Certain comparative amounts have been reclassified to conform to the current period's presentation.