

2011 *first quarter interim report*

HIGHLIGHTS

THREE MONTHS ENDED MARCH 31,	2011	2010	CHANGE
Financial (\$THOUSANDS, EXCEPT PER SHARE AMOUNTS)			
Petroleum and natural gas revenue	48,531	63,382	(23%)
Funds generated from operations ⁽¹⁾	29,833	42,756	(30%)
Per share – basic	\$0.29	\$0.42	(31%)
Per share – diluted	\$0.29	\$0.41	(29%)
Cash flow from operations (including changes in working capital)	25,096	44,544	(44%)
Per share – basic	\$0.24	\$0.43	(44%)
Per share – diluted	\$0.24	\$0.43	(44%)
Profit	32,650	11,085	195%
Per share – basic	\$0.32	\$0.11	191%
Per share – diluted	\$0.31	\$0.11	182%
Exploration and development expenditures	57,353	67,216	(15%)
Marlboro gas plant expenditures	14,303	–	–
Total capital expenditures	71,656	67,216	7%
Property dispositions	(123,460)	–	–
Working capital deficit (excluding convertible debentures)	47,175	34,741	36%
Bank indebtedness	101,774	102,536	(1%)
Convertible debentures	98,135	95,958	2%
Operations			
Average production			
Natural gas (<i>Mcf per day</i>)	63,550	60,878	4%
Crude oil (<i>bbls per day</i>)	2,710	3,000	(10%)
Natural gas liquids (<i>bbls per day</i>)	1,020	686	49%
Sulphur (<i>tonnes per day</i>) ^{(2), (4)}	67	54	24%
Total (<i>BOE per day</i>)	14,388	13,886	4%
Average sales price ⁽³⁾			
Natural gas (<i>\$ per Mcf</i>)	4.35	5.75	(24%)
Crude oil (<i>\$ per bbl</i>)	81.78	79.24	3%
Natural gas liquids (<i>\$ per bbl</i>)	54.68	48.71	12%
Sulphur (<i>\$ per tonne</i>) ⁽⁴⁾	98.26	–	–
Netback per BOE (<i>\$ per BOE</i>)			
Petroleum and natural gas sales ⁽³⁾	39.14	44.97	(13%)
Sulphur block revenue	–	5.57	–
Royalties	(2.99)	(4.43)	(33%)
Operating expenses	(9.39)	(8.64)	9%
Transportation	(1.04)	(1.03)	1%
Operating netback	25.72	36.44	(29%)
Wells drilled (<i>gross</i>)	22	16	38%
Undeveloped land (<i>net acres</i>)	227,513	229,270	(1%)

(1) Funds generated from operations is calculated using cash flow from operations as presented in the consolidated statement of cash flows before non-cash working capital and asset retirement expenditures. The calculation of funds generated from operations and cash flow from operations for the three months ended March 31, 2011 excludes \$4.2 million (March 31, 2010 – \$3.0 million) of interest expense which is classified as finance expense under IFRS.

(2) A BOE conversion ratio has been calculated using a conversion rate of one tonne of sulphur to one barrel.

(3) Excludes the change in fair value of derivatives.

(4) Excludes the sale of inventory at the West Pembina sulphur block.

Interim Management's Discussion & Analysis

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following Management Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") was prepared at, and is dated, May 24, 2011. This document is provided by the management of Fairborne Energy Ltd. ("Fairborne" or the "Company") to review first quarter 2011 activities and results as compared to the same period in the previous year, and should be read in conjunction with the unaudited interim consolidated financial statements including selected notes for the three months ended March 31, 2011 and the audited consolidated financial statements including notes for the years ended December 31, 2010 and 2009. The MD&A should be read in conjunction with the Company's MD&A for the year ended December 31, 2010, as disclosure which is unchanged from the December 31, 2010 MD&A has not been duplicated herein. Additional information relating to Fairborne, including Fairborne's annual information form, is available on SEDAR at www.sedar.com

Nature of Business: Fairborne is a growth-oriented exploration and production company. The Company maintains its head office in Calgary and is engaged in the business of exploring for, developing, acquiring and producing crude oil and natural gas in Western Canada. Fairborne follows a strategy of balancing risk and reward by focusing on opportunities by geographic area and prospect type. Within the selected areas, the Company develops a portfolio of exploration and development prospects in conjunction with an active acquisition strategy.

Forward Looking Statements: This document contains forward-looking statements. Management's assessment of future plans and operations and ability to satisfy Convertible Debentures when they are due may constitute forward-looking statements under applicable securities laws and necessarily involve risks including, without limitation, risks associated with oil and gas exploration, development, exploitation, production, marketing and transportation, loss of markets, volatility of commodity prices, currency fluctuations, imprecision of reserve estimates, environmental risks, competition from other producers, inability to retain drilling rigs and other services, incorrect assessment of the value of acquisitions, failure to realize the anticipated benefits of acquisitions, the inability to fully realize the benefits of the acquisitions, delays resulting from or inability to obtain required regulatory approvals and ability to access sufficient capital from internal and external sources. As a consequence, the Company's actual results may differ materially from those expressed in, or implied by, the forward looking statements. Forward looking statements or information are based on a number of factors and assumptions which have been used to develop such statements and information but which may prove to be incorrect. Although Fairborne believes that the expectations reflected in such forward-looking statements or information are reasonable, undue reliance should not be placed on forward looking statements because the Company can give no assurance that such expectations will prove to be correct. In addition to other factors and assumptions which may be identified in this document and other documents filed by the Company, assumptions have been made regarding, among other things: the impact of increasing competition; the general stability of the economic and political environment in which Fairborne operates; the ability of the Company to obtain qualified staff, equipment and services in a timely and cost efficient manner; drilling results; the ability of the operator of the projects which the Company has an interest in to operate the field in a safe, efficient and effective manner; Fairborne's ability to obtain financing on acceptable terms; field production rates and decline

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rates; the ability to replace and expand oil and natural gas reserves through acquisition, development or exploration; the timing and costs of pipeline, storage and facility construction and expansion; the ability of the Company to secure adequate product transportation; future oil and natural gas prices; currency, exchange and interest rates; the regulatory framework regarding royalties, taxes and environmental matters in the jurisdictions in which the Company operates; and Fairborne's ability to successfully market its oil and natural gas products. Readers are cautioned that the foregoing list of factors is not exhaustive. Additional information on these and other factors that could affect the Company's operations and financial results are included in reports on file with Canadian securities regulatory authorities and may be accessed through the SEDAR website (www.sedar.com) or at the Company's website (www.fairborne-energy.com).

Furthermore, the forward looking statements contained in this document are made as at the date of this document 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.

Non-IFRS Terms: This document contains the terms “funds generated from operations”, “funds generated from operations per share”, “cash flow from operations per share”, “net debt” and “netbacks” which are non-IFRS terms. The Company uses these measures to help evaluate its performance. The Company uses net debt (bank indebtedness plus negative working capital or less positive working capital, excluding convertible debentures) as an alternative measure of outstanding debt. The Company considers corporate netbacks a key measure as it demonstrates its profitability relative to current commodity prices. Netbacks which have no IFRS equivalent are calculated on a BOE basis by deducting royalties, operating costs, and transportation from petroleum and natural gas sales and sulphur block sales. The Company considers funds generated from operations a key measure as it demonstrates Fairborne's ability to generate funds necessary to repay debt and to fund future growth through capital investment. Funds generated from operations should not be considered as an alternative to, or more meaningful than, cash flow from operating activities as determined in accordance with IFRS as an indicator of Fairborne's performance. Fairborne's determination of funds generated from operations may not be comparable to that reported by other companies. The reconciliation between cash flow from operations and funds generated from operations can be found in the statement of cash flows in the consolidated financial statements with funds generated from operations calculated before non-cash working capital and asset retirement expenditures. Fairborne also presents funds generated from operations per share and cash flow from operations per share whereby per share amounts are calculated using weighted average shares outstanding consistent with the calculation of profit per share.

BOE Conversions: Barrel of oil equivalent (“BOE”) amounts may be misleading, particularly if used in isolation. A BOE conversion ratio has been calculated using a conversion rate of one tonne of sulphur to one barrel and six thousand cubic feet of natural gas to one barrel. This conversion ratio of six thousand cubic feet of natural gas to one barrel is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead.

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CHANGE IN ACCOUNTING POLICIES AND RECENT ACCOUNTING PRONOUNCEMENTS

Changeover to International Financial Reporting Standards ("IFRS")

Prior to 2011, Fairborne prepared its financial statements under Canadian Generally Accepted Accounting Principles ("GAAP"). Effective January 1, 2011, Canadian public companies were required to adopt International Financial Reporting Standards ("IFRS"). The Company's financial statements for the quarter ended March 31, 2011, including comparative amounts, have been prepared on an IFRS basis. The date of the transition for Fairborne is January 1, 2010, being the start date of the earliest period of comparative information.

In order to explain how Fairborne's reported performance, financial position and accounting policies are affected by the changeover to IFRS, information previously reported under Canadian GAAP has been restated under IFRS with reconciliations provided in the notes to the consolidated financial statements at March 31, 2011. The restated information and new accounting policies information are set out in the consolidated financial statements as at and for the period ending March 31, 2011.

PROPERTY DISPOSITION

On March 22, 2011 Fairborne completed a property disposition which included undeveloped land, facilities and producing properties in the Peace River Arch and Brazeau area of north and west central Alberta with net proceeds of \$123.5 million, subject to closing adjustments. Production associated with the properties disposed was approximately 1,830 BOE per day (60% natural gas and 40% oil and natural gas liquids ("NGLs")). Proceeds from the disposition were initially used to reduce bank indebtedness. Under IFRS, gains and losses are recognized in profit on the disposal of petroleum and natural gas assets ("P&NG assets"). The amount of the gain or loss is determined by comparing the proceeds from disposal with the carrying amount of the asset. As a result of this disposition, Fairborne recorded a gain of \$47.2 million in the statement of operations for the three months ended March 31, 2011.

FIRST QUARTER 2011 FINANCIAL RESULTS

Production

THREE MONTHS ENDED MARCH 31,	2011	2010
Natural gas (<i>Mcf per day</i>)	63,550	60,878
Crude oil (<i>bbls per day</i>)	2,710	3,000
Natural gas liquids (<i>bbls per day</i>)	1,020	686
Sulphur (<i>tonnes per day</i>) ^{(1), (2)}	67	54
Total (<i>BOE per day</i>)	14,388	13,886
Natural gas % of production	74%	73%

(1) A BOE conversion ratio has been calculated using a conversion rate of one tonne of sulphur to one barrel.

(2) Excludes the sale of inventory at the West Pembina sulphur block.

Fairborne's first quarter 2011 production was negatively impacted by a mechanical failure at a third party plant which required the shut in of the Company's entire Marlboro and Tower Creek production for 21 days of the first quarter. First quarter production was also impacted by the property disposition completed late in the first quarter. Fairborne reported average production of 14,388 BOE per day for the

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first quarter of 2011, a 10% decrease from the preceding fourth quarter of 2010 (16,010 BOE per day), and 4% higher than the comparative first quarter of 2010 (13,886 BOE per day). Compared to the prior year, 2011 production is higher due to a successful drilling program as well as the acquisition of producing properties at McLeod River during the third quarter of 2010.

Natural gas production of 63.6 MMcf per day during the first quarter of 2011 was 12% lower than the preceding fourth quarter of 2010 (71.8 MMcf per day) reflecting the shut in of production due to the mechanical failure at the third party plant as well as the property disposition. Compared to 2010, first quarter natural gas production increased 4% as a result of the 2010 drilling program and McLeod River property acquisition.

Crude oil and NGL production of 3,730 bbls per day for the first quarter of 2011 was consistent with the first quarter of 2010 and 6% lower than preceding fourth quarter of 2010 (3,974 BOE per day) reflecting the impact of the property disposition and the third party gas plant failure.

Commodity Prices & Risk Management Activities

THREE MONTHS ENDED MARCH 31,	2011	2010
Average Prices ⁽¹⁾		
Natural gas (\$ per Mcf)	4.35	5.75
Crude oil (\$ per bbl)	81.78	79.24
Natural gas liquids (\$ per bbl)	54.68	48.71
Sulphur (\$ per tonne) ⁽²⁾	98.26	–
BOE (\$ per BOE)	38.96	44.64
Benchmark Prices		
AECO Daily Index (Cdn\$ per Mcf)	3.77	4.95
AECO Monthly Index (Cdn\$ per Mcf)	3.77	5.36
Edmonton par (Cdn\$ per bbl)	88.44	80.31
Nymex Calendar Average (US\$ per bbl)	94.10	78.71

(1) Excludes the change in fair value of derivatives.

(2) Excludes revenue from the sale of inventory at the West Pembina sulphur block.

Risk Management – Physical Sales Contracts

Fairborne's risk management strategy is based on the following objectives:

- ❖ protect shareholder return on investment;
- ❖ reduce risk exposure in budgeted annual funds flow projections; and
- ❖ help ensure transaction economics on acquisitions.

Natural Gas

Fairborne's average realized natural gas price in the first quarter of 2011 was 15% higher than the AECO Daily benchmark reference price due to corporate hedging activities and the higher heat content of Fairborne's production. Compared to the prior year, Fairborne's realized natural gas prices were 24% lower due to different physical sales and derivative contracts in 2011 as well as lower average market prices.

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An average of 13,251 Mcf per day was sold under fixed price physical sales contracts representing 21% of the Company's natural gas production. Risk management activities increased the Company's natural gas revenue by an estimated \$2.0 million in the first quarter of 2011 which had the effect of increasing Fairborne's realized natural gas price by \$0.35 per Mcf to \$4.35 per Mcf.

At March 31, 2011, Fairborne had one natural gas swap that was accounted for as a derivative contract and the mark-to-market value of this contract was recorded as an asset of \$2.2 million at March 31, 2011.

The following table summarizes the outstanding fixed price physical sales and derivative contracts for natural gas, including contracts outstanding at March 31, 2011 as well as contracts entered into after March 31, 2011:

	2011
Swaps	
Volume (Mcf per day)	13,274
Average price (\$ per Mcf)	5.71

Conversion factor: 1 Mcf = 1.13 GJ

Crude Oil

During the first quarter of 2011, Fairborne had an average of 1,000 bbls per day of crude oil under fixed price physical sales contracts representing 37% of crude oil production. Risk management activities, including option costs for puts purchased during the quarter reduced the Company's crude oil revenue by \$0.8 million (\$3.28 per bbl) in the first quarter. Fairborne's realized crude oil price of \$81.78 per bbl in the first quarter of 2011 increased marginally from the same period in 2010 which reflected the overall increase in market prices.

The following table summarizes the outstanding fixed price physical sales and derivative contracts on crude oil, including contracts outstanding at March 31, 2011 as well as contracts entered into after March 31, 2011:

	2011
Collars	
Volume (bbls per day)	500
Average floor (CDN\$ per bbl)	\$70.00
Average ceiling (CDN\$ per bbl)	\$101.25
Swaps	
Volume (bbls per day)	500
Average price (CDN\$ per bbl)	\$75.00
Total volume (bbls per day)	1,000
Average floor price (CDN\$ per bbl)	\$72.50

At March 31, 2011, Fairborne had one crude oil collar and one swap that were accounted for as derivative contracts and the combined mark-to-market value of these contracts was recorded as a liability of \$5.7 million at March 31, 2011. The liability was partially offset by the asset recorded on the derivative natural gas contract.

*Interim Management's Discussion & Analysis***Sulphur**

The Company's average realized sulphur price in the first quarter of 2011 was \$98.26 per tonne, compared to \$44.19 in the fourth quarter of 2010 reflecting the recovery of sulphur prices during 2011.

Petroleum and Natural Gas Revenue

THREE MONTHS ENDED MARCH 31, <i>(\$thousands except as noted)</i>	2011	2010	
		IFRS	GAAP ⁽¹⁾
Petroleum and natural gas sales:			
Natural gas	24,896	31,495	31,495
Crude oil	19,948	21,397	21,397
Natural gas liquids	5,018	3,005	3,005
Sulphur	591	(114)	(114)
Total	50,453	55,783	55,783
Per BOE	\$38.96	\$44.64	\$44.64
Other petroleum and natural gas revenue items:			
Sulphur block	–	6,959	6,959
Change in fair value of derivatives	(2,156)	222	222
Royalty income	234	418	418
Total	(1,922)	7,599	7,599
Total petroleum and natural gas revenue	48,531	63,382	63,382
Per BOE	\$37.48	\$50.72	\$50.72

(1) As previously reported under Canadian GAAP.

The calculation of Fairborne's reported petroleum and natural gas revenue for the three months ended March 31, 2010 was unchanged upon restatement to IFRS.

Fairborne reported petroleum and natural gas sales of \$50.5 million for the first quarter of 2011, representing a 13% decrease from the preceding fourth quarter of 2010 (\$58.0 million) and a 10% decrease from the \$55.8 million reported in the first quarter of 2010. Compared to the preceding fourth quarter of 2010 and the prior year, first quarter 2011 petroleum and natural gas sales reflected weaker natural gas prices.

Other revenue items in 2010 included \$7.0 million of revenue from Fairborne's contract for the sale of inventory at the West Pembina sulphur block. This contract was satisfied in June 2010 and no further revenue will be recognized in 2011. The change in fair value of derivatives represents the change in the mark-to-market value of derivative contracts. The \$2.2 million decrease recorded in the first quarter of 2011 (2010 – \$0.2 million increase) reflects both the changes in the unrealized value of existing contracts as well as a reduction for amounts realized on contracts that settled during the period. Fairborne's risk management program, including derivative contracts and physical sales contracts, increased the Company's realized revenue by an estimated \$1.2 million in the first quarter of 2011, compared to an increase in revenue of \$3.2 million in the first quarter of 2010.

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Royalties

THREE MONTHS ENDED MARCH 31,	2011	2010	
<i>(\$thousands except as noted)</i>		IFRS	GAAP ⁽¹⁾
Crown	1,727	3,636	3,636
Freehold and overriding	2,139	1,898	1,898
Total	3,866	5,534	5,534
Crown (% of P&NG sales)	3.4%	6.5%	6.5%
Freehold and overriding (% of P&NG sales)	4.2%	3.4%	3.4%
Total (% of P&NG sales)	7.6%	9.9%	9.9%
Per BOE	\$2.99	\$4.43	\$4.43

(1) As previously reported under Canadian GAAP.

The calculation of Fairborne's reported royalties for the three months ended March 31, 2010 was unchanged upon restatement to IFRS.

Fairborne recorded \$3.9 million of royalties for the first quarter of 2011, representing a royalty rate of 7.6%, 24% lower than the preceding fourth quarter and 23% lower than the 9.9% recorded in the first quarter of 2010. In the first quarter of 2011 crown royalties were reduced by a \$1.8 million adjustment resulting from the crown's deep gas royalty program. Excluding the deep gas crown royalty adjustment, Fairborne's normalized royalty rate for the first quarter of 2011 was 11%.

Production and Operating Costs

THREE MONTHS ENDED MARCH 31,	2011	2010	
<i>(\$thousands except as noted)</i>		IFRS	GAAP ⁽¹⁾
Operating costs			
Natural gas	8,708	7,946	8,173
Oil and NGLs	3,448	2,852	2,852
Transportation costs	1,352	1,291	1,291
Total	13,508	12,089	12,316
Operating costs, per BOE	\$9.39	\$8.64	\$8.82
Transportation costs, per BOE	\$1.04	\$1.03	\$1.03
Production and operating costs, per BOE	\$10.43	\$9.67	\$9.85

(1) As previously reported under Canadian GAAP.

The calculation of Fairborne's reported production and operating costs for the three months ended March 31, 2010 was reduced by \$0.2 million upon restatement to IFRS as a result of turnarounds and overhauls being capitalized under IFRS. In addition, transportation costs have been reclassified and are included in production and operating costs under IFRS.

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Fairborne's recorded operating costs of \$12.2 million (\$9.39 per BOE) during the first quarter of 2011 were marginally lower than the preceding fourth quarter of 2010 and 9% higher than the first quarter of 2010 (\$8.64 per BOE) as a result of increased third party processing costs as well as additional water trucking costs on the Company's Wild River property due to a pipeline repair.

Transportation costs of \$1.4 million (\$1.04 per BOE) for the first quarter of 2011 include clean oil trucking, trucking of natural gas liquids, certain third party fuel charges and transportation and fuel costs associated with the usage of natural gas pipelines. Transportation costs in the first quarter of 2011 are consistent when compared to the prior year.

Operating Netbacks

THREE MONTHS ENDED MARCH 31,	2011	2010	
(\$ per BOE)		IFRS	GAAP ⁽¹⁾
Petroleum and natural gas sales ⁽²⁾	38.96	44.64	44.64
Sulphur block revenue	—	5.57	5.57
Royalty income	0.18	0.33	0.33
Royalties	(2.99)	(4.43)	(4.43)
Operating costs	(9.39)	(8.64)	(8.82)
Transportation	(1.04)	(1.03)	(1.03)
Operating netback	25.72	36.44	36.26

(1) As previously reported under Canadian GAAP.

(2) Excludes the change in fair value of derivatives

Fairborne's operating netback of \$25.72 per BOE was marginally higher than the fourth quarter of 2010 (\$24.77 per BOE) and 29% lower when compared to the first quarter of 2010 (\$36.44 per BOE). The decrease in the operating netback in 2011 reflects weaker natural gas prices, lower sulphur block revenue and increased operating costs, partially offset by lower royalties.

General and Administrative ("G&A") Expenses

THREE MONTHS ENDED MARCH 31,	2011	2010	
(\$thousands except as noted)		IFRS	GAAP ⁽¹⁾
G&A expenses, net of recoveries	3,480	2,357	2,338
Compensation costs	714	352	2,275
Total G&A expenses	4,194	2,709	4,613
G&A expenses, net of recoveries, per BOE	\$2.69	\$1.89	\$1.87
Compensation costs, per BOE	\$0.55	\$0.28	\$1.82

(1) As previously reported under Canadian GAAP.

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Fairborne's G&A expenses for the three months ended March 31, 2010 were insignificantly impacted upon restatement to IFRS. Compensation costs were reduced by \$0.7 million upon restatement to IFRS as directly attributable general and administrative costs and associated compensation costs are capitalized to exploration and evaluation assets and petroleum and natural gas properties and equipment under IFRS. The amount that has been capitalized under IFRS is in excess of the capitalized portion permitted under joint operating agreements. In addition, compensation costs for the three months ended March 31, 2010 were further reduced by \$1.2 million upon restatement to IFRS as retention awards that were previously recorded on a liability basis under Canadian GAAP were measured at fair value under IFRS.

Fairborne recorded \$3.5 million (\$2.69 per BOE) of G&A expenses, net of recoveries, in the first quarter of 2011, a 15% decrease when compared to the preceding fourth quarter of 2010 and a 48% increase when compared to \$2.4 million (\$1.89 per BOE) in the first quarter of 2010. The increase in 2011 G&A expenses is related to costs associated with the 2010 employee bonus program payable in 2011.

Compensation expense of \$0.7 million in the first quarter of 2011 is consistent with the \$0.8 million recorded in the preceding fourth quarter of 2010 and the first quarter of 2010 (\$0.4 million).

Depreciation and Amortization ("D&A")

THREE MONTHS ENDED MARCH 31,	2011	2010	
		IFRS	GAAP ⁽¹⁾
Depreciation and amortization (<i>\$thousands</i>)	23,597	22,727	31,149
Per BOE	\$18.22	\$18.19	\$24.92

(1) As previously reported under Canadian GAAP.

Fairborne's depreciation and amortization for the three months ended March 31, 2010 was reduced by \$8.4 million upon restatement to IFRS. Although IFRS requires a unit of production calculation which is consistent with Canadian GAAP, under IFRS, depreciation is based on proved plus probable reserves while Canadian GAAP was proved reserves only. D&A also increased \$0.1 million as a result of the depreciation of turnarounds that are now capitalized under IFRS. In addition, ARO accretion of \$0.2 million has been reclassified to finance expense under IFRS.

Fairborne recorded \$23.6 million in depreciation and amortization in the first quarter of 2011. On a BOE basis, the 2011 first quarter D&A rate of \$18.22 per BOE was consistent with the prior year's rate of \$18.19.

Gain on Disposition of Capital Assets

THREE MONTHS ENDED MARCH 31,	2011	2010	
		IFRS	GAAP ⁽¹⁾
<i>(\$thousands except as noted)</i>			
Gain on disposition of P&NG assets	47,167	–	–
Gain on recognition of non-monetary transactions	928	141	–
Total gain on disposition of capital assets	48,095	141	–
Per BOE	\$37.14	\$0.12	–

(1) As previously reported under Canadian GAAP.

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Under the Canadian GAAP full cost accounting guideline, gains or losses were not recognized upon the disposition of P&NG assets unless the disposition resulted in a significant change in the depletion rate. Under IFRS, gains and losses are recognized in net income on the disposal of an item of P&NG assets. The amount of the gain or loss is determined by comparing the proceeds from disposal with the carrying amount of the item. This will include transactions such as sales of assets, farm-outs, asset swaps and other non-monetary transactions which typically were not recorded under Canadian GAAP.

Finance Expense

THREE MONTHS ENDED MARCH 31, (\$thousands except as noted)	2011	2010	
		IFRS	GAAP ⁽¹⁾
Interest expense	4,171	2,993	2,993
Accretion of convertible debentures	571	550	483
Accretion of asset retirement obligation	225	242	–
Impairment loss on trade receivable	117	–	–
Total finance expense	5,084	3,785	3,476
Per BOE	\$3.93	\$3.03	\$2.78

(1) As previously reported under Canadian GAAP.

Under IFRS, finance income and finance expenses are reported separately from operating activities. The accretion of convertible debentures for the three months ended March 31, 2010 was increased by \$0.1 million upon restatement to IFRS. Under IFRS, the allocation used to determine the equity and liability components of the convertible debentures was determined using the relative fair values on December 19, 2007 when Fairborne converted from a trust to a corporation as opposed to the date of issue under Canadian GAAP. In addition, under IFRS, accretion of asset retirement obligation of \$0.2 million was reclassified from D&A to finance expense.

Fairborne recorded \$5.1 million in finance expense in the first quarter of 2011, consistent with the preceding quarter (Q4 2010 – \$5.0 million) and an increase of 34% from \$3.8 million recorded in the first quarter of 2010. The increase in interest expense compared to the first quarter of 2010 is consistent with higher debt levels maintained during the last quarter of 2010 and the first three months of 2011. Also included in total interest is the amortization of financing charges associated with the issuance of the convertible debentures. The financing charges amortized in 2011 were consistent with the prior year. These costs will continue to be expensed over the term of the debentures.

Taxes

THREE MONTHS ENDED MARCH 31, (\$thousands)	2011	2010	
		IFRS	GAAP ⁽¹⁾
Deferred taxes	13,727	5,594	2,485
Per BOE	\$10.60	4.48	\$1.99

(1) As previously reported under Canadian GAAP.

Fairborne's deferred taxes for the three months ended March 31, 2010 increased \$3.1 million upon restatement to IFRS. Conceptually, the calculation of deferred taxes remains the same under IFRS. The change in deferred taxes reflects the tax effect of other changes recorded upon restatement to IFRS.

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Fairborne recorded deferred taxes of \$13.7 million in the first quarter of 2011 compared to deferred taxes of \$5.6 million during the first quarter of 2010, both of which reflect a provision for future tax at tax rates expected to apply when the related temporary differences reverse. The increase in tax expense is consistent with the increase in net earnings before taxes.

Profit and Funds Generated from Operations

THREE MONTHS ENDED MARCH 31, <i>(\$thousands except as noted)</i>	2011	2010	
		IFRS	GAAP ⁽¹⁾
Funds generated from operations	29,833	42,756	39,555
Per share – basic	\$0.29	\$0.42	\$0.39
Per share – diluted	\$0.29	\$0.41	\$0.38
Cash flow from operations (including changes in working capital)	25,096	44,544	43,522
Per share – basic	\$0.24	\$0.43	\$0.42
Per share – diluted	\$0.24	\$0.43	\$0.42
Profit	32,650	11,085	3,809
Per share – basic	\$0.32	\$0.11	\$0.04
Per share – diluted	\$0.31	\$0.11	\$0.04

(1) As previously reported under Canadian GAAP.

The following table provides a reconciliation between cash flow from operations and funds generated from operations.

THREE MONTHS ENDED MARCH 31, <i>(\$thousands except as noted)</i>	2011	2010	
		IFRS	GAAP ⁽¹⁾
Cash flow from operations	25,096	44,544	43,522
Change in non-cash working capital	4,669	(2,099)	(4,278)
Asset retirement expenditures	68	311	311
Funds generated from operations	29,833	42,756	39,555

(1) As previously reported under Canadian GAAP.

The calculation of funds generated from operations and cash flow from operations for the three months ended March 31, 2011 excludes \$4.2 million (March 31, 2010 – \$3.0 million) of interest expense which is classified as finance expense under IFRS.

*Interim Management's Discussion & Analysis***BOE Analysis**

THREE MONTHS ENDED MARCH 31,	2011		2010 ⁽¹⁾	
	\$THOUSANDS	\$ PER BOE	\$THOUSANDS	\$ PER BOE
Petroleum and natural gas revenue ⁽²⁾	48,531	37.48	63,382	50.72
Royalties	(3,866)	(2.99)	(5,534)	(4.43)
Production and operating costs	(13,508)	(10.43)	(12,089)	(9.67)
Change in fair value of derivatives	2,156	1.67	(222)	(0.18)
General & administrative ⁽³⁾	(3,480)	(2.69)	(2,357)	(1.89)
Compensation expense ⁽⁴⁾	–	–	(424)	(0.34)
Funds generated from operations	29,833	23.04	42,756	34.21
Finance expense	(5,084)	(3.93)	(3,785)	(3.03)
Change in fair value of derivatives	(2,156)	(1.67)	222	0.18
Compensation expense – non-cash	(714)	(0.55)	72	0.06
Gain on disposition of capital assets	48,095	37.14	141	0.12
Depreciation and amortization	(23,597)	(18.22)	(22,727)	(18.19)
Deferred taxes	(13,727)	(10.60)	(5,594)	(4.48)
Profit	32,650	25.21	11,085	8.87

(1) Restated using IFRS.

(2) Including the change in fair value of derivatives (non-cash) and revenue from the sale of inventory at the West Pembina sulphur block.

(3) Net of compensation expense (non-cash).

(4) Cash component of compensation expense which resulted from the cash settlement of Restricted Units and Performance Units.

Fairborne reported funds generated from operations of \$29.8 million (\$23.04 per BOE) for the first quarter of 2011, a decrease of 30% when compared to the first quarter of 2010 (\$42.8 million). The decrease in funds generated from operations reflected lower natural gas prices, lower sulphur block revenues and increased operating costs in 2011. The profit of \$32.7 million (\$25.21 per BOE) for the first quarter of 2011 reflected the impact of the gain recorded on the property disposition completed late in the first quarter of 2011.

Interim Management's Discussion & Analysis

LIQUIDITY AND CAPITAL RESOURCES

Capital Expenditures

Under Canadian GAAP, all petroleum and natural gas assets were accounted for under the full cost accounting guideline. Under IFRS, P&NG assets have been divided into exploration and evaluation properties ("E&E assets") and petroleum and natural gas properties and equipment ("development assets").

Capital Expenditures – Petroleum and Natural Gas Properties and Equipment

THREE MONTHS ENDED MARCH 31, (\$thousands)	2011	2010	
		IFRS	GAAP ⁽¹⁾
Development expenditures			
Land and lease acquisitions	988	5,332	7,829
Geological and geophysical	2,820	3,258	3,321
Drilling and completions	49,690	43,482	43,882
Well equipment and facilities	18,091	10,506	10,509
Turnarounds and overhauls	–	227	–
Corporate assets	67	5	5
	71,656	62,810	65,546
Property acquisitions	–	1,464	1,464
Total	71,656	64,274	67,010

(1) As previously reported under Canadian GAAP.

Fairborne's development expenditures for the three months ended March 31, 2010 were reduced by \$2.9 million upon restatement to IFRS as E&E expenditures are evaluated separately under IFRS. In addition, development expenditures increased by \$0.2 million due to the capitalization of turnarounds and overhauls under IFRS.

During the first quarter of 2011, Fairborne's development expenditures totaled \$71.7 million with capital expenditures financed through funds generated from operations and bank debt. Land and lease acquisitions of \$1.0 million during the quarter were primarily focused in the Harlech, Marlboro and Westerosé areas where \$0.7 million was utilized to acquire additional acreage at provincial land sales. In first quarter of 2011, \$0.6 million of general and administrative costs were capitalized to development assets which included \$0.3 million of directly attributable G&A costs and \$0.3 million of stock based compensation costs.

Fairborne spent \$49.7 million on drilling and completion activities in the first quarter of 2011 with a total of 22 (16.2 net) wells drilled resulting in 11 (7.5 net) natural gas wells and 11 (8.7 net) oil wells. First quarter drilling activities were focused on Fairborne's Sinclair, Harlech, Marlboro and Westerosé properties, with seven (5.3 net) wells drilled in Sinclair, three (2.7 net) wells drilled on the Company's Harlech property, seven (4.4 net) horizontal wells drilled in Marlboro and two (1.6 net) horizontal wells at Westerosé.

Interim Management's Discussion & Analysis

Tangible development expenditures of \$18.1 million during the three months ended March 31, 2011 included the tie-in of various wells at Sinclair and Marlboro areas as well as the construction of the Marlboro gas plant.

Fairborne also completed a property disposition which included wells, land and facilities with a carrying value, including goodwill, of \$76.3 million. Proceeds of \$123.5 million were received resulting in a reported gain of \$47.2 million in the three months ended March 31, 2011.

Capital Expenditures – Intangible Exploration and Evaluation

THREE MONTHS ENDED MARCH 31, (\$thousands)	2011	2010	
		IFRS	GAAP ⁽¹⁾
Exploration expenditures			
Land and lease acquisitions	—	384	—
Geological and geophysical	—	62	—
Drilling and completions	—	2,496	—
Total	—	2,942	—

(1) As previously reported under Canadian GAAP.

There were no additions to E&E assets for the three months ended March 31, 2011 (March 31, 2010 – \$2.9 million). E&E assets include projects that are pending determination of technical feasibility and economic viability.

Working Capital and Bank Indebtedness

At March 31, 2011, Fairborne had drawn \$101.8 million (December 31, 2010 – \$206.3 million) against its credit facilities and had a working capital deficit of \$47.2 million (December 31, 2010 – \$17.7 million), excluding convertible debentures. Fairborne financed its 2011 first quarter capital expenditure program of \$71.7 million from funds generated from operations, with the excess financed through bank debt. Proceeds from the property disposition of \$123.5 million completed in the first quarter of 2011 were initially applied against bank debt resulting in a substantial reduction in bank debt at March 31, 2011.

Fairborne's credit facilities at March 31, 2011 included a \$310 million extendible revolving term credit facility and a \$15 million demand operating credit facility for a total available facility of \$325 million. The extendible revolving term facility is available on a revolving basis until May 27, 2011 and, if not renewed at this date, repayment of the amounts drawn will be required on May 27, 2012. The facilities continue to be subject to semi-annual reviews.

Subsequent to March 31, 2011, the lending syndicate borrowing base was extended to May 26, 2012 at \$325 million on substantially the same terms.

Interim Management's Discussion & Analysis

Convertible Debentures

At December 31, 2010, Fairborne had 100,000 Convertible Unsecured Subordinated Debentures (the "Debentures") with a face value of \$100 million. The Debentures bear interest at a rate of 6.5% per annum, which is payable semi-annually in arrears on December 31 and June 30 of each year. The Debentures mature on December 31, 2011 and can be converted into common shares of Fairborne at any time at the option of the holders at a conversion price of \$13.50 per share. Prior to the maturity date, the Debentures can be redeemed in whole or in part at the option of the Company at a redemption price of \$1,025 plus accrued and unpaid interest. If the Company does not choose to redeem the Debentures prior to the maturity date, the Debentures will be paid at their face of \$100 million on December 31, 2011.

Fairborne has adequate liquidity to satisfy the convertible debenture obligation when it comes due in December 2011 or earlier if the Company chooses to do so. At current debt levels, the Company has sufficient credit available on its bank facilities to satisfy the payment of convertible debentures. In determining the appropriate method for satisfying the debenture obligation, Fairborne will consider a variety of options including: the availability of other sources of debt with different characteristics than the existing bank debt; the sale of assets; limiting the size of the investment program; and new common equity if available on favorable terms.

Shareholders' Equity

The Company is authorized to issue an unlimited number of common shares and an unlimited number of preferred shares, issuable in series.

During the first quarter of 2011, 25,151 common shares were issued on the exercise of stock options.

The following table provides a summary of outstanding common shares, convertible debentures, shares and stock options at the dates indicated:

	MAY 25, 2011	MARCH 31, 2011	DECEMBER 31, 2010
<i>(thousands)</i>			
Common shares	102,531	102,531	102,506
Convertible debentures ⁽¹⁾	\$100,000	\$100,000	\$100,000
Stock options	6,885	6,944	7,024
Weighted average common shares ⁽²⁾			
Basic	n/a	102,508	102,486
Diluted	n/a	103,675	103,255

(1) The convertible debentures are convertible into common shares at a conversion price of \$13.50 per share.

(2) Weighted average common shares outstanding are for the twelve months ended December 31, 2010 and for the three months ended March 31, 2011.

Interim Management's Discussion & Analysis

BUSINESS ENVIRONMENT AND RISK

The business risks the Company is exposed to are those inherent in the oil and gas industry as well as those governed by the individual nature of Fairborne's operations. Geological and engineering risks, the uncertainty of discovering commercial quantities of new reserves, commodity prices, interest rate and foreign exchange risks, competition and government regulations – all of these govern the businesses and influence the controls and management at the Company. Fairborne manages these risks by:

- ❖ attracting and retaining a team of highly qualified and motivated professionals who have a vested interest in the success of the Company;
- ❖ operating properties in order to maximize opportunities;
- ❖ employing risk management instruments to minimize exposure to volatility of commodity prices, interest rate and foreign exchange rates;
- ❖ maintaining a strong financial position; and
- ❖ maintaining strict environmental, safety and health practices.

CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

Fairborne's Chief Executive Officer and Chief Financial Officer have designed or caused to be designed under their supervision, disclosure controls and procedures to provide reasonable assurance that (i) material information relating to the Company is made known to Fairborne's Chief Executive Officer and Chief Financial Officer by others, particularly during the period in which the annual and interim filings are being prepared; and (ii) information required to be disclosed by the Company in its annual filings, interim filings or other reports filed or submitted by it under securities legislation is recorded, processed, summarized and reported within the time period specified in securities legislation.

Internal Controls over Financial Reporting

Fairborne's Chief Executive Officer and Chief Financial Officer have designed or caused to be designed under their supervision, internal controls over financial reporting to provide reasonable assurance regarding the reliability of the Company's financial reporting and the preparation of financial reports for external purposes in accordance with IFRS.

No material changes in Fairborne's internal controls over financial reporting were identified during the three months ended March 31, 2011, that have materially affected, or are reasonably likely to materially affect, the Company's internal controls over financial reporting.

It should be noted that a control system, including Fairborne's disclosure and internal controls and procedures, no matter how well conceived, can provide only reasonable, but not absolute, assurance that the objectives of the control system will be met and it should not be expected that the disclosure and internal controls and procedures will prevent all errors or fraud.

Interim Management's Discussion & Analysis

QUARTERLY FINANCIAL INFORMATION

The following is a summary of select financial information for the quarterly periods indicated:

	2011 Q1	Q4	2010 ⁽¹⁾	
			Q3	Q2
Financial (<i>\$thousands, except per share amounts</i>)				
Petroleum and natural gas revenue	48,531	56,904	54,718	59,633
Funds generated from operations	29,833	32,642	32,533	32,260
Per share – basic	\$0.29	\$0.32	\$0.32	\$0.31
Per share – diluted	\$0.29	\$0.32	\$0.31	\$0.31
Cash flow from operations (including changes in working capital)	25,096	39,286	27,311	26,249
Per share – basic	\$0.24	\$0.38	\$0.27	\$0.26
Per share – diluted	\$0.24	\$0.38	\$0.26	\$0.25
Profit (loss)	32,650	(8,247)	3,201	2,361
Per share – basic	\$0.32	\$(0.08)	\$0.03	\$0.02
Per share – diluted	\$0.31	\$(0.08)	\$0.03	\$0.02
Total assets	1,039,135	1,072,064	1,071,759	973,304
Working capital deficit	47,175	17,743	22,622	6,487
Convertible debentures	98,135	97,564	97,058	96,508
Bank indebtedness	101,774	206,331	194,042	123,081
Operations				
Average production				
Natural gas (<i>Mcf per day</i>)	63,550	71,845	68,910	66,812
Crude oil (<i>bbls per day</i>)	2,710	2,946	2,916	3,110
Natural gas liquids (<i>bbls per day</i>)	1,020	1,028	1,036	1,149
Sulphur (<i>tonnes per day</i>) ⁽²⁾	67	62	66	92
Total (<i>BOE per day</i>)	14,388	16,010	15,503	15,486

(1) Restated using IFRS.

(2) Excludes the sale of inventory at the West Pembina sulphur block.

Interim Management's Discussion & Analysis

	2010 ⁽¹⁾ Q1	Q4	2009 ⁽²⁾ Q3	Q2
Financial (\$thousands, except per share amounts)				
Petroleum and natural gas revenue	63,382	58,338	55,244	58,430
Funds generated from operations	42,756	37,863	37,236	35,742
Per share – basic	\$0.42	\$0.37	\$0.43	\$0.41
Per share – diluted	\$0.41	\$0.37	\$0.43	\$0.41
Cash flow from operations (including changes in working capital)	44,544	38,750	40,048	27,653
Per share – basic	\$0.43	\$0.38	\$0.46	\$0.32
Per share – diluted	\$0.43	\$0.38	\$0.46	\$0.32
Profit (loss)	11,085	(3,124)	(497)	(17,333)
Per share – basic	\$0.11	\$(0.02)	\$(0.01)	\$(0.20)
Per share – diluted	\$0.11	\$(0.02)	\$(0.01)	\$(0.20)
Total assets	985,353	940,443	961,920	1,001,840
Working capital deficit (surplus)	34,741	6,370	(1,539)	(7,227)
Convertible debentures	95,958	96,510	96,027	95,525
Bank indebtedness	102,536	103,738	204,046	232,184
Operations				
Average production				
Natural gas (Mcf per day)	60,878	59,132	56,797	66,744
Crude oil (bbls per day)	3,000	3,037	3,292	3,552
Natural gas liquids (bbls per day)	686	617	563	632
Sulphur (tonnes per day) ⁽³⁾	54	33	100	64
Total (BOE per day)	13,886	13,542	13,421	15,372

(1) Restated using IFRS.

(2) As previously reported under Canadian GAAP.

(3) Excludes the sale of inventory at the West Pembina sulphur block.

Interim Consolidated Financial Statements

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

(unaudited)

	MARCH 31, 2011	DECEMBER 31, 2010	JANUARY 1, 2010
<i>(thousands of Canadian dollars)</i>			
Assets			
Current assets			
Cash and cash equivalents	\$ 365	\$ 319	\$ 147
Accounts receivable (Note 16)	28,054	31,825	35,155
Prepaid expenses and deposits	5,717	5,813	8,079
Total current assets	34,136	37,957	43,381
Petroleum and natural gas properties and equipment (Note 4)	989,267	1,012,015	875,485
Intangible exploration assets (Note 5)	15,732	15,732	5,407
Goodwill (Note 6)	-	6,360	16,170
Total capital assets	1,004,999	1,034,107	897,062
	\$ 1,039,135	\$ 1,072,064	\$ 940,443
Liabilities			
Current liabilities			
Accounts payable and accrued liabilities	\$ 77,788	\$ 54,333	\$ 46,474
Derivative liability (Note 17)	3,523	1,367	359
Deferred revenue	-	-	4,285
Convertible debentures (Note 9)	98,135	97,564	-
Total current liabilities	179,446	153,264	51,118
Bank indebtedness (Note 8)	101,774	206,331	103,738
Convertible debentures (Note 9)	-	-	95,409
Asset retirement obligation (Note 10)	10,746	12,730	11,200
Flow-through share premium	-	-	3,414
Deferred taxes (Note 11)	114,959	101,232	91,278
Total non-current liabilities	227,479	320,293	305,039
Total liabilities	406,925	473,557	356,157
Equity			
Common shares	536,864	536,812	536,532
Warrants	-	-	1,620
Equity portion of convertible debentures (Note 9)	2,964	2,964	2,964
Contributed surplus	32,989	31,988	24,827
Retained earnings	59,393	26,743	18,343
Total equity	632,210	598,507	584,286
	\$ 1,039,135	\$ 1,072,064	\$ 940,443

See accompanying notes which are an integral part of these consolidated financial statements.

*Interim Consolidated Financial Statements***CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME***(unaudited)*

FOR THE THREE MONTHS ENDED MARCH 31,	2011	2010
<i>(thousands of Canadian dollars except per share amounts)</i>		
Revenue		
Petroleum and natural gas	\$ 48,531	\$ 63,382
Royalties	(3,866)	(5,534)
	44,665	57,848
Expenses		
Production and operating	13,508	12,089
General and administrative	4,194	2,709
Depreciation and amortization <i>(Note 4)</i>	23,597	22,727
Results from operating activities	3,366	20,323
Gain on disposition of capital assets	48,095	141
Finance expense <i>(Note 15)</i>	(5,084)	(3,785)
Profit before taxes	46,377	16,679
Deferred taxes <i>(Note 11)</i>	13,727	5,594
Profit and comprehensive income	\$ 32,650	\$ 11,085
Profit per share <i>(Note 12)</i>		
Basic	\$ 0.32	\$ 0.11
Diluted	\$ 0.31	\$ 0.11

See accompanying notes which are an integral part of these consolidated financial statements.

Interim Consolidated Financial Statements

CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

(unaudited)

FOR THE THREE MONTHS ENDED MARCH 31 (thousands of Canadian dollars)	2011		2010	
	Number (thousands)	Amount	Number	Amount
Common shares				
Balance, beginning of period	102,506	\$ 536,812	102,462	\$ 536,532
Issued on vesting of Restricted Units and Performance Units	-	-	15	140
Issued on exercise of stock options	25	52	2	5
Balance, end of period	102,531	\$ 536,864	102,479	\$ 536,677
Warrants				
Balance, beginning and end of period	-	\$ -	4,406	\$ 1,620
Equity portion of convertible debentures (Note 9)				
Balance, beginning and end of period		\$ 2,964		\$ 2,964
Contributed surplus				
Balance, beginning of period		\$ 31,988		\$ 24,827
Equity based compensation (Note 13)		1,053		2,216
Stock options exercised		(52)		(5)
Balance, end of period		\$ 32,989		\$ 27,038
Retained earnings				
Balance, beginning of period		\$ 26,743		\$ 18,343
Profit		32,650		11,085
Balance, end of period		\$ 59,393		\$ 29,428
Total equity				
Balance, end of period		\$ 632,210		\$ 597,727

See accompanying notes which are an integral part of these consolidated financial statements.

*Interim Consolidated Financial Statements***CONSOLIDATED STATEMENTS OF CASH FLOWS***(unaudited)*

FOR THE THREE MONTHS ENDED MARCH 31,	2011	2010
<i>(thousands of Canadian dollars)</i>		
Operating activities		
Profit	\$ 32,650	\$ 11,085
Adjustments for:		
Depreciation and amortization <i>(Note 4)</i>	23,597	22,727
Deferred taxes <i>(Note 11)</i>	13,727	5,594
Change in fair values of derivatives <i>(Note 17)</i>	2,156	(222)
Finance expense (including accretion) <i>(Note 15)</i>	5,084	3,785
Gain on disposition of capital assets	(48,095)	(141)
Stock based compensation (recovery) <i>(Note 13)</i>	714	(72)
Change in non-cash working capital <i>(Note 14)</i>	(4,669)	2,099
Asset retirement expenditures <i>(Note 10)</i>	(68)	(311)
Net cash from (used in) operating activities	25,096	44,544
Financing activities		
Repayment of bank indebtedness	(104,557)	(1,202)
Interest paid	(2,492)	(816)
Net cash from (used in) financing activities	(107,049)	(2,018)
Investing activities		
Expenditures on petroleum and natural gas properties <i>(Note 4)</i>	(71,656)	(64,274)
Expenditures on exploration assets <i>(Note 5)</i>	–	(2,942)
Proceeds from sale of petroleum and natural gas properties	123,460	–
Change in non-cash working capital <i>(Note 14)</i>	30,195	24,737
Net cash from (used in) investing activities	81,999	(42,479)
Change in cash and cash equivalents	46	47
Cash and cash equivalents, beginning of period	319	147
Cash and cash equivalents, end of period	\$ 365	\$ 194

See accompanying notes which are an integral part of these consolidated financial statements.

*Interim Consolidated Financial Statements***SELECTED NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

FOR THE THREE MONTHS ENDED MARCH 31, 2011 (UNAUDITED)

(tabular amounts are stated in thousands and thousands of Canadian dollars except per share amounts)

NATURE OF OPERATIONS

Fairborne Energy Ltd. (the “Company” or “Fairborne”) is a resource-based company engaged in the exploration for and the development and production of natural gas, natural gas liquids and crude oil in western Canada. The Company is incorporated under the laws of the province of Alberta and is domiciled in Canada, with its principal place of business located at 3400, 450 – 1st Street SW Calgary, Alberta.

These consolidated financial statements as at and for the period ended March 31, 2011 and 2010 comprise the Company and its wholly owned subsidiaries. The Company has the following significant wholly owned subsidiaries, incorporated in Canada: Case Sub Ltd. and Fairborne Pivotal Production Partnership.

1. SIGNIFICANT ACCOUNTING POLICIES

The accounting policies set out below have been applied consistently to all periods presented in these consolidated financial statements, and have been applied consistently by the Company and its subsidiaries.

a) Basis of Presentation

These consolidated financial statements have been prepared by management in accordance with International Financial Reporting Standards (“IFRS”) which were adopted in Canada on January 1, 2011. In these financial statements, the term “Canadian GAAP” refers to Canadian GAAP before the adoption of IFRS.

These interim consolidated financial statements have been prepared in accordance with IFRS applicable to the preparation of interim financial statements, including IAS 34 and IFRS 1. Subject to certain transition elections disclosed in Note 2, the Company has consistently applied the same accounting policies in its opening IFRS statement of financial position at January 1, 2010 and throughout all periods presented, as if these policies had always been in effect. Note 2 discloses the impact of the transition to IFRS on the Company’s reported financial position, financial performance and cash flows, including the nature and effect of significant changes in accounting policies from those used in the Company’s consolidated financial statements for the three months ended March 31, 2010 and the year ended December 31, 2010. Comparative figures for 2010 in these financial statements have been restated to give effect to these changes.

The policies applied in these interim consolidated financial statements are based on IFRS issued and outstanding when the Board of Directors approved the statements. Any subsequent changes to IFRS that are given effect in the Company’s annual consolidated financial statements for the year ending December 31, 2011 could result in restatement of these interim consolidated financial statements, including the transition adjustments recognized on change-over to IFRS. The consolidated financial statements were authorized by the Board of Directors on May 25, 2011.

Interim Consolidated Financial Statements

b) Basis of Measurement

The consolidated financial statements have been prepared on the historical cost basis except that derivative financial instruments and liabilities for cash-settled share-based payment arrangements are measured at fair value.

c) Functional and Presentation Currency

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

d) Basis of Consolidation

Subsidiaries are entities controlled by the Company. Control exists when the Company has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, potential voting rights that currently are exercisable are taken into account. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases.

e) Petroleum and Natural Gas Properties and Equipment and Intangible Exploration and Evaluation Assets-recognition and Measurement.

INTANGIBLE EXPLORATION AND EVALUATION ("E&E") ASSETS: E&E expenditures, including the costs of acquiring licenses and directly attributable general and administrative costs, but excluding interest, are initially capitalized pending determination of technical feasibility and commercial viability. Pre-license costs (with the exception of purchased seismic which is capitalized with E&E assets) are recorded in profit and loss when incurred.

Intangible E&E assets are not depreciated and are carried forward until technical feasibility and commercial viability of extracting a mineral resource is considered to be determined, which is generally when proven reserves are determined to exist. A review of each exploration project is carried out, at least annually, to ascertain whether proven reserves have been discovered. Upon determination of technical feasibility and commercial viability, E&E assets attributable to the project are tested for impairment and reclassified from exploration assets to petroleum and natural gas properties and equipment.

E&E assets are assessed for impairment if sufficient data exists to determine technical feasibility and commercial viability, and facts and circumstances suggest that the carrying amount exceeds the recoverable amount.

PETROLEUM AND NATURAL GAS PROPERTIES AND EQUIPMENT: Items of petroleum and natural gas properties and equipment are measured at cost less accumulated depreciation and accumulated impairment losses, net of reversals. Each significant part of an item of petroleum and natural gas properties and equipment which have different useful lives have been accounted for and depreciated as separate items (major components). Petroleum and natural gas assets are grouped into cash-generating units (Northern Alberta, Southern Alberta, Deep Basin, West Pembina and Manitoba/Saskatchewan) for impairment testing.

Interim Consolidated Financial Statements

Gains and losses on the disposal of an item of petroleum and natural gas properties and equipment, including oil and natural gas interests, are determined by comparing the proceeds from disposal with the carrying amount of petroleum and natural gas properties and equipment and are recognized net in profit or loss.

Costs incurred subsequent to the determination of technical feasibility and commercial viability and the costs of replacing parts of petroleum and natural gas properties and equipment are recognized as petroleum and natural gas properties and equipment only when they increase the future economic benefits embodied in the specific asset to which they relate. All other expenditures are recognized in profit or loss as incurred. Such capitalized petroleum and natural gas properties and equipment generally represent costs incurred in developing proven and/or probable reserves and bringing on or enhancing production from such reserves. The carrying amount of any replaced or sold component is derecognized. The costs of the day-to-day servicing of petroleum and natural gas properties and equipment are recognized in profit or loss as incurred.

The net carrying value of developed petroleum and natural gas properties and equipment is depreciated using the unit of production method by reference to the ratio of production in the year to the related proven and probable reserves, including estimated future development costs. Future development costs are estimated taking into account the level of development required to bring reserves into production. These estimates are reviewed by independent reserve engineers at least annually.

Proven and probable reserves are estimated using independent reserve engineer reports and represent the estimated quantities of crude oil, natural gas and natural gas liquids which geological, geophysical and engineering data demonstrate with a specified degree of certainty to be recoverable in future years from known reservoirs and which are considered commercially producible. There should be a 50% statistical probability that the actual quantity of recoverable reserves will be more than the amount estimated as proven and probable and a 50% statistical probability that it will be less. The equivalent statistical probabilities for the proven component of proven and probable reserves are 90% and 10%, respectively.

Such reserves may be considered commercially producible if management has the intention of developing and producing them and such intention is based upon:

- ❖ a reasonable assessment of the future economics of such production;
- ❖ a reasonable expectation that there is a market for all or substantially all of the expected oil and natural gas production; and
- ❖ evidence that the necessary production, transmission and transportation facilities are available or can be made available.

Reserves may only be considered proven and probable if producibility is supported by either actual production or conclusive formation tests. The area of reservoir considered proven includes a) that portion delineated by drilling and defined by gas-oil and/or oil-water contacts, if any, or both, and b) the

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immediately adjoining portions not yet drilled, but which can be reasonably judged as economically productive on the basis of available geophysical, geological and engineering data. In the absence of information on fluid contacts, the lowest known structural occurrence of oil and natural gas controls the lower proved limit of the reservoir.

Reserves which can be produced economically through application of improved recovery techniques (such as fluid injection) are only included in the proven and probable classification when successful testing by a pilot project, the operation of an installed program in the reservoir, or other reasonable evidence (such as, experience of the same techniques on similar reservoirs or reservoir simulation studies) provides support for the engineering analysis on which the project or program was based.

Components of petroleum and natural gas properties and equipment which have a useful life that is not based on the underlying reserves are depreciated on a straight line basis over their useful lives, which range from one to five years.

For corporate assets, depreciation is recognized in profit or loss on a 20% declining balance basis.

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

f) Provisions

A provision is recognized if, as a result of a past event, the Company has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the liability. Provisions are not recognized for future operating losses.

ASSET RETIREMENT OBLIGATION (“ARO”)

The Company’s activities give rise to dismantling, decommissioning and site disturbance re-mediation activities. The estimated ARO is recorded as a liability in the period in which it is incurred, with a corresponding increase in the carrying amount of the related asset. ARO is measured at the present value of management’s best estimate of the expenditure required to settle the present obligation at the statement of financial position date. Subsequent to the initial measurement, the obligation is adjusted at the end of each period to reflect the passage of time and changes in the estimated future cash flows underlying the obligation. The increase in the provision due to the passage of time is recognized as a finance expense and increases/decreases in the provision due to changes in estimated future cash flow are recorded as adjustments to the carrying amount of the related asset. The capitalized amount is depreciated along with the related asset using the unit-of-production method based on proven and probable reserves. Actual costs incurred upon the settlement of the ARO are charged against the ARO to the extent the provision was established.

Interim Consolidated Financial Statements**ONEROUS CONTRACTS**

A provision for onerous contracts is recognized when the expected benefits to be derived by the Company from a contract are lower than the unavoidable cost of meeting its obligations under the contract. The provision is measured at the present value of the lower of the expected cost of terminating the contract and the expected net cost of continuing with the contract. Before a provision is established, the Company recognizes any impairment loss on associated assets.

g) Joint Arrangements

Substantially all of the Company's oil and gas exploration and development activities involve jointly controlled assets and, accordingly, the financial statements reflect only the Company's share of these jointly controlled assets and a proportionate share of the relevant revenue and related costs.

h) Goodwill

As part of its transition to IFRS, the Company elected to restate only those business combinations that occurred on or after January 1, 2010. In respect of acquisitions prior to January 1, 2010, goodwill represents the amount recognized under the Company's previous accounting framework, Canadian GAAP.

For acquisitions on or after January 1, 2010, goodwill represents the excess of the cost of the acquisition over the net fair value of the identifiable assets, liabilities and contingent liabilities of the acquiree. When the excess is negative (negative goodwill), it is recognized immediately in profit or loss.

Goodwill is subsequently measured at cost less accumulated impairment losses. Impairment losses recorded on goodwill are not reversed.

i) Financial Instruments

Financial instruments may be utilized by the Company to manage its exposure to commodity price fluctuations and foreign currency exposures. The Company's practice is not to utilize financial instruments for trading or speculative purposes.

Fairborne recognizes all financial instruments, including embedded derivatives, on the statement of financial position initially at fair value. Measurement in subsequent periods depends on whether the financial instrument has been classified as "fair value through profit and loss", "available-for-sale", "other accounts receivables or payable" or "held-to-maturity".

Cash and cash equivalents, which consist of cash and short term deposits with original maturities of less than three months, and certain derivative contracts as discussed below, are classified as fair value through profit and loss and are recorded on the statement of financial position at fair value. Transaction costs related to financial instruments which are classified as fair value through profit and loss are recognized in profit or loss when incurred.

All of Fairborne's other financial instruments have been designated as other accounts receivable or payable and are measured at amortized cost net of transaction costs using the effective interest method, less any impairment losses.

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Fairborne manages its exposure to commodity price fluctuations by using physical delivery contracts with fixed prices, collars, puts or participating swaps. The majority of these contracts are “normal sale” contracts; therefore, these commodity contracts are not recorded on the statement of financial position at fair value. Amounts received on the settlement of the commodity contracts are included in petroleum and natural gas revenue as the contracts settle. Certain of these contracts do not qualify as “normal sale” contracts and, as such, are accounted for as derivative contracts and recorded on the statement of financial position at fair value. Changes in the fair value of derivative contracts are included in petroleum and natural gas revenue for the corresponding period.

The Company applies trade-date accounting for the recognition of the purchase or sale of cash equivalents and derivative contracts.

COMPOUND FINANCIAL INSTRUMENTS

As the convertible debentures issued by the Company can be converted into common shares, they are considered to represent both debt and equity to the Company. The debt component of the debentures was recorded at the fair value of the obligation without the conversion feature on the date that Fairborne converted from a trust to a corporation. This fair value was calculated based on the present value of all future payments of principal and interest using a discount rate applicable to similar debt instruments absent the conversion feature. The balance of the fair value of the convertible debentures, \$3.0 million, represents the fair value of the conversion feature and is recorded as the equity component of the debentures. The debt component will accrete up to the principal balance at maturity and the accretion is included in finance expense.

j) Equity Based Compensation

Prior to the reorganization of Fairborne Energy Ltd. on December 19, 2007, Fairborne Energy Trust (the “Trust”) had a Trust Incentive Plan which included granting of restricted trust units (“Restricted Units”) and performance trust units (“Performance Units”) to directors, officers, employees and consultants and other service providers to the Trust and its subsidiaries. In 2007, the Company instituted a Retention Award Plan which is also described in the Company’s annual financial statements. A portion of the Trust Incentive Plan and all of the Retention Award Plan were settled in cash. Compensation expense associated with these liability based compensation plans is recognized in profit or loss over the vesting period of the plans based on the fair value of the plans at each reporting period. The fair value of vested Retention Awards is calculated at each reporting period, using the Black Scholes model. The fair value of vested awards under the Trust Incentive Plan is calculated at each reporting period based on the trading price of the Company’s common shares on each reporting date. Cash payments on exercise of liability based compensation plans are recorded as a reduction in the liability at the exercise date. Changes in the fair value of the liability are recognized as compensation expense within general and administrative expenses. All grants under the Trust Incentive Plan and the Retention Award Plan were either exercised or expired as at March 31, 2011. No further grants will be made under either plan.

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In July 2008, Fairborne instituted a stock option plan which provides for the granting of stock options to directors, officers, employees, consultants and other service providers to the Company and its subsidiaries.

Compensation expense associated with equity based compensation plans is recognized in profit or loss, within general and administrative expenses, over the vesting period of the plan with a corresponding increase in contributed surplus. Compensation expense is based on the fair value of the equity based compensation at the date of the grant determined using the Black Scholes option pricing model. The amount recognized as an expense is adjusted to reflect the actual number of share options for which the related service conditions are met. Stock options are settled by physical delivery of shares. The amount of non-cash compensation expense for equity based plans is recognized in contributed surplus and is recorded as an increase in shareholders' equity when equity based compensation plans are exercised.

k) Income Taxes

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

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

Deferred tax is recognized using the statement of financial position method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is not recognized on the initial recognition of assets or liabilities in a transaction that is not a business combination. In addition, deferred tax is not recognized for taxable temporary differences arising on the initial recognition of goodwill. Deferred tax is measured at the tax rates expected to be applied to temporary differences when they reverse, based on laws enacted or substantively enacted by the reporting date. Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset, and they relate to income taxes levied by the same tax authority on the same taxable entity, or on different taxable entities when the Company intends to settle current tax liabilities and assets on a net basis, or when the tax assets and liabilities will be realized simultaneously.

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

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l) Measurement Uncertainty

The preparation of financial statements in conformity with IFRS requires management to make certain estimates and assumptions that affect the application of accounting policies and the reported amounts of assets and liabilities at the date of the financial statements and revenue and expenses for the period then ended. Actual results could differ from those estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the year in which the estimates are revised and in any future years affected.

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

- ❖ Note 4– valuation of petroleum and natural gas assets and equipment
- ❖ Notes 3, 6 and 7 – valuation of intangible exploration assets and goodwill
- ❖ Note 13 – measurement of share based payments

Note 3 refers to reserve estimates which impact a number of the areas referred to above, in particular the valuation of petroleum and natural gas assets and equipment and the calculation of depletion and depreciation.

m) Per Share Information

Basic per share amounts are calculated by dividing the profit or loss attributable to shareholders of the Company by the weighted average number of shares outstanding during the year. Diluted per share amounts are determined by adjusting the profit or loss attributable to common shareholders and the weighted average number of common shares outstanding for the effects of all dilutive potential common shares, which consist of convertible debentures, warrants, performance units, restricted units and stock options granted to employees.

n) Revenue Recognition

Revenue from the sale of petroleum and natural gas is recognized when the significant risks and rewards of ownership of the product is transferred to the buyer, which is usually when legal title passes to the external party and collectibility is reasonably assured. Revenue from processing and other miscellaneous sources is recognized in accordance with service agreements upon completion of the relevant service. Payments received prior to delivery of products, including sulphur sales, are recorded as deferred revenue.

o) Share Capital

Common shares are classified as equity. Incremental costs directly attributable to the issue of common shares are recognized as a deduction from equity, net of any tax effects.

*Interim Consolidated Financial Statements***p) Impairment****FINANCIAL ASSETS**

A financial asset is assessed at each reporting date to determine whether there is any objective evidence that it is impaired. A financial asset is considered to be impaired if objective evidence indicates that one or more events have had a negative effect on the estimated future cash flows of that asset. Impairment losses are recognized in profit or loss. An impairment loss is reversed if the reversal can be related objectively to an event occurring after the impairment loss was recognized.

NON-FINANCIAL ASSETS

The carrying amounts of the Company's non-financial assets, other than E&E assets and deferred tax assets, are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, then the asset's recoverable amount is estimated. For goodwill the recoverable amount is estimated each year at the same time. E&E assets are assessed for impairment when they are reclassified to petroleum and natural gas properties and equipment, as oil and natural gas interests, and also if facts and circumstances suggest that the carrying amount exceeds the recoverable amount.

For the purpose of impairment testing, assets are grouped together into the smallest group of assets that generates cash inflows from continuing use that are largely independent of the cash inflows of other assets or groups of assets (the cash-generating unit or "CGU"). The recoverable amount of an asset or a CGU is the greater of its value in use and its fair value less costs to sell. At March 31, 2011 the Company had four CGUs: Southern Alberta, West Pembina, Deep Basin, and Manitoba/Saskatchewan. At December 31, 2010, the Company had five CGUs: Northern Alberta, Southern Alberta, West Pembina, Deep Basin, and Manitoba/Saskatchewan. Substantially all assets in the Northern Alberta CGU were disposed of during the three months ended March 31, 2011.

In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. Value in use is generally computed by reference to the present value of the future cash flows expected to be derived from production of proven and probable reserves.

Goodwill acquired in a business combination, for the purpose of impairment testing, is allocated to CGU's that are expected to benefit from the synergies of the combination. E&E assets are allocated to related CGU's when they are assessed for impairment, both at the time of any triggering event and circumstances as well as on reclassification to producing assets (oil and natural gas interests in petroleum and natural gas properties and equipment).

An impairment loss is recognized in profit or loss if the carrying amount of an asset or its CGU exceeds its estimated recoverable amount. Impairment losses recognized in respect of CGU's are allocated first to reduce the carrying amount of any goodwill allocated to the CGU and then to reduce the carrying amounts of other assets in the CGU.

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An impairment loss in respect of goodwill is not reversed. In respect of other assets, impairment losses recognized in prior years are assessed at each reporting date for any indications that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation and amortization, if no impairment loss had been recognized.

NON-CURRENT ASSETS HELD FOR SALE

Non-current assets (or disposal groups comprising assets and liabilities) that are expected to be recovered primarily through sale rather than through continuing use are classified as held for sale. Immediately before classification as held for sale, the assets (or components of a disposal group) are re-measured in accordance with the Company's accounting policies. Thereafter the assets held for sale (or disposal group) are generally measured at the lower of their carrying amount and fair value less costs to sell. Any impairment loss on assets held for sale (or disposal group) is allocated first to goodwill, and then to remaining assets and liabilities on a pro rata basis, except that no loss is allocated to financial assets or deferred tax assets which continue to be measured in accordance with the Company's accounting policies. Impairment losses on initial classification as held for sale and subsequent gains or losses on re-measurement are recognized in profit or loss. Gains are not recognized in excess of any cumulative impairment loss. An impairment loss in respect of goodwill is not reversed.

q) Finance Income and Expenses

Finance income consists of interest income on funds invested.

Finance expense consists of interest expense on borrowings, accretion of the discount on provisions, interest expense and accretion expense on convertible debentures and impairment losses recognized on financial assets.

Borrowing costs incurred for the construction of qualifying assets, other than E&E assets, are capitalized during the period of time that is required to complete and prepare the assets for their intended use or sale. All other borrowing costs are recognized in profit or loss using the effective interest method. The capitalization rate used to determine the amount of borrowing costs to be capitalized is the weighted average interest rate applicable to the Company's outstanding borrowings during the year.

r) Flow-through Shares

The resource expenditure deductions for income tax purposes related to exploratory development activities funded by flow-through share arrangements are renounced to investors in accordance with tax legislation. Flow-through shares issued are recorded in share capital at the fair value of common shares on the date of issue. The premium received on issuing flow-through shares is initially recorded as a deferred credit. As qualifying expenditures are incurred, the premium is reversed and a deferred tax liability is recorded. The net amount is then recognized as deferred tax expense.

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2. CHANGES IN ACCOUNTING POLICIES AND PRACTICES

a) Initial Adoption of IFRS

Effective January 1, 2010 the Company adopted IFRS. The following tables reconcile previously reported amounts to adjusted IFRS amounts.

AT THE DATE OF TRANSITION TO IFRS – JANUARY 1, 2010

	NOTES	CANADIAN GAAP	EFFECT OF TRANSITION TO IFRS	IFRS
<i>(thousands of Canadian dollars)</i>				
Assets				
Current assets				
Cash and cash equivalents		\$ 147	–	\$ 147
Accounts receivable		35,155	–	35,155
Prepaid expenses and deposits		8,079	–	8,079
Total current assets		43,381	–	43,381
Petroleum and natural gas				
properties and equipment	<i>a,b,n</i>	880,892	(5,407)	875,485
Intangible exploration assets	<i>a</i>	–	5,407	5,407
Goodwill		16,170	–	16,170
Total capital assets		897,062	–	897,062
		\$ 940,443	–	\$ 940,443
Liabilities				
Current liabilities				
Accounts payable and accrued liabilities	<i>e</i>	\$ 45,107	1,367	\$ 46,474
Derivative liability		359	–	359
Deferred revenue		4,285	–	4,285
Total current liabilities		49,751	1,367	51,118
Bank indebtedness		103,738	–	103,738
Convertible debentures	<i>f</i>	96,510	(1,101)	95,409
Asset retirement obligation		11,200	–	11,200
Flow-through share premium	<i>j</i>	–	3,414	3,414
Deferred taxes	<i>f,j</i>	89,919	1,359	91,278
Total non-current liabilities		301,367	3,672	305,039
Total liabilities		351,118	5,039	356,157
Equity				
Common shares	<i>j</i>	536,789	(257)	536,532
Warrants	<i>k</i>	2,721	(1,101)	1,620
Equity component of convertible debentures	<i>f</i>	5,581	(2,617)	2,964
Contributed surplus		24,827	–	24,827
Retained earnings	<i>e,f,j,k</i>	19,407	(1,064)	18,343
Total equity		589,325	(5,039)	584,286
		\$ 940,443	–	\$ 940,443

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AT THE END OF THE LAST REPORTING PERIOD UNDER PREVIOUS GAAP – DECEMBER 31, 2010

	NOTES	CANADIAN GAAP	EFFECT OF TRANSITION TO IFRS	IFRS
<i>(thousands of Canadian dollars)</i>				
Assets				
Current assets				
Cash and cash equivalents		\$ 319	–	\$ 319
Accounts receivable		31,825	–	31,825
Prepaid expenses and deposits		5,813	–	5,813
Total current assets		37,957	–	37,957
Petroleum and natural gas				
properties and equipment	<i>a, c, g, i, l, n</i>	982,250	29,765	1,012,015
Intangible exploration assets	<i>a</i>	–	15,732	15,732
Goodwill	<i>m</i>	16,170	(9,810)	6,360
Total capital assets		998,420	35,687	1,034,107
		\$ 1,036,377	35,687	\$1,072,064
Liabilities				
Current liabilities				
Accounts payable and accrued liabilities		\$ 54,333	–	\$ 54,333
Derivative liability		1,367	–	1,367
Convertible debentures	<i>f</i>	98,397	(833)	97,564
Total current liabilities		154,097	(833)	153,264
Bank indebtedness		206,331	–	206,331
Asset retirement obligation		12,730	–	12,730
Deferred taxes	<i>f, j</i>	89,405	11,827	101,232
Total non-current liabilities		308,466	11,827	320,293
Total liabilities		462,563	10,994	473,557
Equity				
Common shares	<i>j</i>	532,021	4,791	536,812
Equity component of convertible debentures	<i>f</i>	5,581	(2,617)	2,964
Contributed surplus	<i>k</i>	33,089	(1,101)	31,988
Retained earnings	<i>c, e, f, g, j, k, l</i>	3,123	23,620	26,743
Total equity		573,814	24,693	598,507
		\$ 1,036,377	35,687	\$1,072,064

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STATEMENT OF OPERATIONS FOR THE THREE MONTHS ENDED MARCH 31, 2010

	NOTES	CANADIAN GAAP (ADJUSTED FOR IFRS PRESENTATION)	EFFECT OF TRANSITION TO IFRS	IFRS
<i>(thousands of Canadian dollars except per share amounts)</i>				
Revenue				
Petroleum and natural gas		\$ 63,382	–	\$ 63,382
Royalties		(5,534)	–	(5,534)
		57,848	–	57,848
Expenses				
Production and operating	<i>l</i>	12,316	(227)	12,089
General and administrative	<i>e,g</i>	4,613	(1,904)	2,709
Depreciation and amortization	<i>c,l</i>	30,904	(8,177)	22,727
Results from operating activities		10,015	10,308	20,323
Gain on disposition of capital assets	<i>i</i>	–	141	141
Finance expense	<i>f,h</i>	(3,721)	(64)	(3,785)
Profit before taxes		6,294	10,385	16,679
Deferred taxes	<i>j</i>	2,485	3,109	5,594
Profit and comprehensive income		\$ 3,809	7,276	\$ 11,085
Profit per share				
Basic		\$ 0.04	\$ 0.07	\$ 0.11
Diluted		\$ 0.04	\$ 0.07	\$ 0.11

STATEMENT OF OPERATIONS FOR THE YEAR ENDED DECEMBER 31, 2010

	NOTES	CANADIAN GAAP (ADJUSTED FOR IFRS PRESENTATION)	EFFECT OF TRANSITION TO IFRS	IFRS
<i>(thousands of Canadian dollars except per share amounts)</i>				
Revenue				
Petroleum and natural gas		\$ 234,637	–	\$ 234,637
Royalties		(24,790)	–	(24,790)
		209,847	–	209,847
Expenses				
Production and operating	<i>l</i>	58,434	(1,771)	56,663
General and administrative	<i>e,g</i>	21,251	(5,056)	16,195
Depreciation and amortization	<i>c,l,m</i>	135,197	(25,336)	109,861
Results from operating activities		(5,035)	32,163	27,128
Gain on disposition of capital assets	<i>i</i>	–	4,891	4,891
Finance expense	<i>f,h</i>	(16,811)	(268)	(17,079)
Profit before taxes		(21,846)	36,786	14,940
Deferred taxes (reduction)	<i>j</i>	(5,562)	12,102	6,540
Profit and comprehensive income		\$ (16,284)	24,684	\$ 8,400
Profit per share				
Basic		\$ (0.16)	\$ 0.25	\$ 0.09
Diluted		\$ (0.16)	\$ 0.25	\$ 0.09

Interim Consolidated Financial Statements**TOTAL EQUITY AS AT MARCH 31, 2010**

	NOTES	CANADIAN GAAP	EFFECT OF TRANSITION TO IFRS	IFRS
<i>(thousands of Canadian dollars)</i>				
Common shares	<i>j</i>	531,886	4,791	536,677
Warrants	<i>k</i>	2,721	(1,101)	1,620
Equity component of convertible debentures	<i>f</i>	5,581	(2,617)	2,964
Contributed surplus		27,038	–	27,038
Retained earnings	<i>c, e, f, g, h, i, j, k, l</i>	23,216	6,212	29,428
Total equity		590,442	7,285	597,727

NOTES:

- a) **RECLASSIFICATION OF EXPLORATION AND EVALUATION COSTS** – Under Canadian GAAP petroleum and natural gas properties and equipment included evaluation and exploration expenditures. Under IFRS such costs are recognized separately as exploration and evaluation assets. At January 1, 2010 this resulted in the reclassification from petroleum and natural gas assets and equipment to intangible exploration and evaluation assets of \$5.4 million (December 31, 2010 – \$15.7 million).
- b) **IFRS 1 ELECTION FOR FULL COST OIL AND GAS ENTITIES** – The Company elected to measure intangible exploration assets and petroleum and natural gas assets and equipment at January 1, 2010 based on amounts calculated under previous Canadian GAAP. Exploration and evaluation assets were reclassified from the full cost pool to intangible exploration and evaluation assets at the amount that was recorded under Canadian GAAP. The remaining book value of the full cost pool was allocated to petroleum and natural gas assets and equipment pro rata based on reserve values as at January 1, 2010. On transition, an impairment test was completed for each CGU and no impairment was recorded (Note 7).
- c) **DEPRECIATION AND AMORTIZATION** – Under Canadian GAAP, the full cost pool was depleted as one unit on a unit of production basis over proven reserves. Under IFRS, the Company depletes petroleum and natural gas interests on a unit of production basis over proven plus probable reserves. In addition, depreciation is calculated at an individual component (i.e. area) level. There is no impact on the January 1, 2010 statement of financial position of this change due to the IFRS 1 election for full cost oil and gas entities. For the year ended December 31, 2010 the impact was an increase in petroleum and natural gas assets and equipment of \$35.9 million and a corresponding decrease in depreciation and amortization expense. For the three months ended March 31, 2010 this change in policy resulted in a decrease in depreciation and amortization expense of \$8.4 million.
- d) **PRE-LICENSE COSTS** – Under Canadian GAAP all costs incurred prior to having obtained license rights were included within petroleum and natural gas properties and equipment. Under IFRS such expenditures are expensed as incurred. There is no impact on the January 1, 2010 statement of financial position of this change due to the IFRS 1 election for full cost oil and gas entities. For the three months ended March 31, 2010 and the year ended December 31, 2010 this change in policy had no material impact on the financial results.

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- e) **SHARE BASED PAYMENTS** – Under Canadian GAAP, share based payments accounted for on a liability basis (Restricted and Performance Units and Retention Awards) are measured at their intrinsic values. Under IFRS they are measured at their fair values. At January 1, 2010 this resulted in an increase in the current portion of compensation plan of \$1.4 million with a corresponding decrease in retained earnings. For the year ended December 31, 2010, this change in policy resulted in no change in the current portion of compensation plans and a decrease in general and administrative expenses of \$1.4 million. For the three months ended March 31, 2010, this change in policy resulted in a decrease in general and administrative expenses of \$1.2 million.
- f) **CONVERTIBLE DEBENTURES** – Under Canadian GAAP, convertible debentures were initially allocated to equity and liability components based on the relative fair values of the components on the date of issue. Under IFRS, the convertible debentures are also allocated to equity and liability components however this allocation was determined using the relative fair values of the components on December 19, 2007 when Fairborne converted from a trust to a corporation. At January 1, 2010, this resulted in a decrease in convertible debentures of \$1.1 million, a decrease in equity component of convertible debentures of \$2.6 million, an increase in deferred tax liability of \$1.0 million and an increase in retained earnings of \$2.7 million. At December 31, 2010, this resulted in a decrease in convertible debentures of \$1.0 million, a decrease in equity component of convertible debentures of \$2.6 million, an increase in retained earnings of \$2.7 million, an increase in deferred tax liability of \$1.0 million and an increase in finance expenses of \$0.3 million. For the three months ended March 31, 2010, this also resulted in an increase in finance expenses of \$0.1 million.
- g) **CAPITALIZED GENERAL AND ADMINISTRATION EXPENSE** – Under Canadian GAAP, directly attributable general and administration costs were capitalized to petroleum and natural gas properties and equipment. Under IFRS, directly attributable general and administration costs are capitalized to evaluation and exploration assets and petroleum and natural gas properties and equipment, however the makeup of directly attributable general and administration costs varies. There is no impact on the January 1, 2010 statement of financial position of this change due to the IFRS 1 election for full cost oil and gas entities. For the year ended December 31, 2010 this change in policy resulted in an increase in petroleum and natural gas assets and equipment of \$3.7 million with a corresponding decrease in general and administrative expenses. For the three months ended March 31, 2010 this change in policy resulted in a decrease in general and administrative expenses of \$0.7 million.
- h) **ACCRETION** – Under IFRS accretion is included in finance expense where under Canadian GAAP it was included in depletion and depreciation.
- i) **NON-MONETARY TRANSACTIONS** – Under Canadian GAAP, non-monetary transactions including farm-outs, pooling of interests and asset swaps did not result in the recognition of gains or losses from disposition. Under IFRS, gains and losses on the disposal of an item of petroleum and natural gas properties and equipment, including oil and natural gas interests, are determined by comparing the proceeds from disposal with the carrying amount of petroleum and natural gas properties and equipment and are recognized net in profit or loss. For the year ended December 31, 2010, this change in policy resulted in an increase in petroleum and natural gas properties and equipment of \$4.9 million with a corresponding gain on disposition of capital assets. For the three months ended March 31, 2010, this change in policy resulted in a gain on disposition of capital assets of \$0.1 million.

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- j) **DEFERRED TAXES** – The impact on deferred taxes related to other applicable accounting policy changes at January 1, 2010 was a decrease in deferred taxes of \$0.3 million with a corresponding increase in retained earnings. For the year ended December 31, 2010 the impact was an increase in deferred tax expense of \$10.8 million. For the three months ended March 31, 2010, the impact was an increase in deferred tax expense of \$3.1 million. As well, the treatment of the tax effect of flow-through shares differs under Canadian GAAP and IFRS. Under Canadian GAAP, share capital is recorded at net proceeds less the deferred tax liability related to the renounced expenditures. Under IFRS, the increase to share capital when flow-through shares are issued is measured based on the current market price of common shares. The incremental proceeds, or “premium” is recorded as a deferred charge. When expenditures are incurred a deferred tax liability is recognized and the deferred charge is reversed. The net amount is recognized as deferred tax expense. At January 1 2010, this resulted in an increase to flow-through share premium of \$3.4 million, a \$4.1 million decrease to retained earnings, a \$0.7 million increase to deferred taxes and an insignificant adjustment to share capital. For the year ended December 31, 2010 this resulted in an increase in share capital of \$4.8 million, an increase in deferred tax expense of \$1.0 million and a decrease to retained earnings of \$4.0 million. The treatment of tax rate changes also differs under Canadian GAAP and IFRS. Under Canadian GAAP, when income tax rates change the impact is recorded through tax expense. Under IFRS, if the initial taxes were recorded through equity the adjustment is also recorded through equity. At January 1, 2010 and December 31, 2010 the impact is a decrease to share capital of \$0.3 million and a corresponding increase to retained earnings.
- k) **WARRANTS** – Under Canadian GAAP, warrants were recorded at fair value on the date of issue. Under IFRS the warrants are recorded at fair value on the date when Fairborne converted to a corporation. The impact of this at January 1, 2010 was a decrease to warrants of \$1.1 million and a corresponding increase to retained earnings. There is no impact to the carrying value of the warrants at December 31, 2010 as they expired unexercised in the second quarter of 2010.
- l) **TURNAROUNDS AND OVERHAULS** – Under Canadian GAAP, turnarounds and overhauls were included in operating expenses; however under IFRS these expenditures are capitalized as a separate component of petroleum and natural gas properties and equipment and are depreciated over their estimated useful lives. For the year ended December 31, 2010, the impact of this change was an increase in petroleum and natural gas properties and equipment of \$1.1 million, a decrease in production and operating expenses of \$1.8 million and an increase in depreciation and amortization of \$0.7 million. For the three months ended March 31, 2010, the impact of this change is a decrease in production and operating expenses of \$0.2 million and an increase in depreciation and amortization of \$0.2 million.
- m) **GOODWILL IMPAIRMENT** – Under IFRS goodwill is allocated to the CGU or group of CGUs which benefited from the synergies of the related acquisition and tested for impairment at least annually. For the year ended December 31, 2010 this resulted in a goodwill impairment charge, which is included in depreciation and amortization expense, of \$9.8 million with a corresponding decrease to goodwill allocated to the Southern Alberta CGU.

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n) This table provides a summary of changes to petroleum and natural gas properties and equipment:

	NOTE	DECEMBER 31, 2010	JANUARY 1, 2010
Balance previously reported under Canadian GAAP		\$ 982,250	\$ 880,892
Reclassification of exploration and evaluation costs	a	(15,732)	(5,407)
Depreciation and amortization policy	c	35,865	–
Capitalized general and administrative costs	g	3,688	–
Non-monetary transactions	i	4,891	–
Turnarounds and overhauls, net of depreciation	l	1,053	–
Balance under IFRS		\$ 1,012,015	\$ 875,485

b) New Standards and Interpretations Not Yet Adopted

IFRS 9, Financial Instruments, was issued in November 2009. It addresses classification and measurement of financial assets and replaces the multiple category and measurement models in IAS 39 with a new measurement model having only two categories: amortized cost and fair value through profit or loss. IFRS 9 also replaces the models for measuring investments in equity instruments and such instruments are either recognized at fair value through profit or loss or at fair value through other comprehensive income. Where such equity instruments are measured at fair value through other comprehensive income, dividends, to the extent not clearly representing a return of investment, are recognized in profit or loss; however, other gains and losses (including impairments) associated with such instruments remain in accumulated comprehensive income. This standard is required to be applied for accounting periods beginning on or after January 1, 2013, with earlier adoption permitted. The impact of the standard is not expected to be significant based on the financial assets held at this time. The Company is currently not anticipating early adopting the new standard.

3. DETERMINATION OF FAIR VALUES

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

Petroleum and Natural Gas Assets and Equipment and Intangible Exploration Assets

The fair value of petroleum and natural gas assets and equipment recognized as a result of a business combination and used in impairment assessments is based on market values. The market value is the estimated amount for which petroleum and natural gas assets and equipment could be exchanged on the date of valuation 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 oil and natural gas interests (included in petroleum and natural gas properties and equipment) 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, being between approximately five and 11% at March 31, 2011, December 31, 2010, and January 1, 2010.

Interim Consolidated Financial Statements

Undeveloped land represents the majority of Fairborne's E&E assets. The fair value of E&E assets is determined with reference to recent sales of undeveloped land in the area, including crown land sales which are publicly posted.

Cash and Cash Equivalents, Accounts Receivable, and Accounts Payable and Accrued Liabilities

The fair value of trade and other receivables is estimated as the present value of future cash flows, discounted at the market rate of interest at the reporting date. The fair value of these balances approximated their carrying value due to their short term to maturity.

Derivatives

The fair value of commodity contracts recorded at fair value is determined by discounting the difference between the contracted prices and published forward price curves as at the statement of financial position date, using the remaining contracted oil and natural gas volumes and a discount rate that considers the credit risk of the counterparties to the contract. The fair value of options and costless collars is based on option models that use published information with respect to volatility, prices and interest rates.

Share-based Payment Transactions

The fair value of employee stock options and retention awards is measured using Black Scholes option pricing models. Measurement inputs include share price on the measurement date, exercise price of the instrument, expected volatility (based on weighted average historic volatility adjusted for changes expected due to publicly available information), weighted average expected life of the instrument (based on historical experience and general option holder behaviour), expected dividends and the risk-free interest rate. Service and non-market performance conditions attached to the transactions are not taken into account in determining fair value.

4. PETROLEUM AND NATURAL GAS PROPERTIES AND EQUIPMENT

Resource Properties and Equipment

	FOR THE THREE MONTHS ENDED MARCH 31, 2011	FOR THE YEAR ENDED DECEMBER 31, 2010
Cost		
Balance, beginning of period	\$ 1,109,728	\$ 873,586
Additions	76,215	170,092
Acquired in business combinations	-	72,677
Dispositions	(90,978)	(6,627)
Balance, end of period	\$ 1,094,965	\$ 1,109,728
Accumulated depreciation and impairment losses		
Balance, beginning of period	\$ (99,519)	\$ -
Depreciation	(23,532)	(99,665)
Disposals	15,545	146
Balance, end of period	\$ (107,506)	\$ (99,519)
Net book value, end of period	\$ 987,459	\$ 1,010,209

Interim Consolidated Financial Statements

Corporate Assets

	FOR THE THREE MONTHS ENDED MARCH 31, 2011	FOR THE YEAR ENDED DECEMBER 31, 2010
Cost		
Balance, beginning of period	\$ 4,600	\$ 4,307
Additions	67	293
Balance, end of period	\$ 4,667	\$ 4,600
Accumulated depreciation and impairment losses		
Balance, beginning of period	\$ (2,794)	\$ (2,408)
Depreciation	(65)	(386)
Balance, end of period	\$ (2,859)	\$ (2,794)
Net book value, end of period	\$ 1,808	\$ 1,806
	MARCH 31, 2011	DECEMBER 31, 2010
Petroleum and natural gas properties and equipment – cost	\$ 1,099,632	\$ 1,114,328
Petroleum and natural gas properties and equipment – accumulated depreciation	(110,365)	(102,313)
Petroleum and natural gas properties and equipment – net book value	\$ 989,267	\$ 1,012,015

On March 22, 2011, Fairborne sold properties in the Peace River Arch and Brazeau area of north and west central Alberta for net proceeds of \$123.5 million resulting in a gain of \$47.2 million.

The depreciation and impairment of property plant and equipment, and any reversal thereof, are recognized in depreciation and amortization in the statement of operations.

5. INTANGIBLE EXPLORATION ASSETS

Evaluation and Exploration Assets

	FOR THE THREE MONTHS ENDED MARCH 31, 2011	FOR THE YEAR ENDED DECEMBER 31, 2010
Cost		
Balance, beginning of period	\$ 15,732	\$ 5,407
Additions	–	10,325
Balance, end of period	\$ 15,732	\$ 15,732

Exploration and Evaluation (E&E) assets consist of the Company's exploration projects which are pending the determination of proven and probable reserves. Additions represent the Company's share of costs incurred on E&E assets during the period.

E&E assets are not amortized. The impairment of intangible exploration assets, and any eventual reversal thereof, is recognized as additional depreciation and amortization expense in the statement of operations.

Interim Consolidated Financial Statements**6. GOODWILL**

	FOR THE THREE MONTHS ENDED MARCH 31, 2011	FOR THE YEAR ENDED DECEMBER 31, 2010
Cost		
Balance, beginning of period	\$ 6,360	\$ 16,170
Disposal through property sale	(6,360)	—
Impairment loss (Note 7)	—	(9,810)
Balance, end of period	\$ —	\$ 6,360

The impairment of goodwill is recognized as amortization expense in the statement of operations and will not be reversed.

7. IMPAIRMENT OF ASSETS

The recoverable amount of CGUs tested for impairment was estimated based on the higher of the value in use and fair value less costs to sell. For the purpose of impairment testing, goodwill is allocated to the CGU or group of CGUs which benefited from the synergies of the related acquisition and at which the goodwill is monitored for internal management purposes. The estimate of fair value less costs to sell at December 31, 2010 was determined using recent market transactions as well as a discount rate of 5% for the Manitoba/Saskatchewan CGU and 10% for the Deep Basin, Northern Alberta, Southern Alberta, and West Pembina CGUs and forecasted cash flows, with escalating prices and future development costs as obtained from the reserve report. The prices used to estimate fair value less costs to sell are those used by independent industry reserve engineers.

December 31, 2010:

YEAR	WTI OIL (US\$/BBL)	FOREIGN EXCHANGE RATE	EDMONTON LIGHT	
			CRUDE OIL (CDN\$/BBL)	AECO GAS (\$CDN/MMBTU)
2011	88.00	0.98	86.22	4.16
2012	89.00	0.98	89.29	4.74
2013	90.00	0.98	90.92	5.31
2014	92.00	0.98	92.96	5.77
2015	95.17	0.98	96.19	6.22
2016	97.55	0.98	98.62	6.53
2017	100.26	0.98	101.39	6.76
2018	102.74	0.98	103.92	6.90
2019	105.45	0.98	106.68	7.06
2020	107.56	0.98	108.84	7.21
Escalate thereafter 2.0% per year				

Interim Consolidated Financial Statements

January 1, 2010:

YEAR	WTI OIL (US\$/BBL)	FOREIGN EXCHANGE RATE	EDMONTON LIGHT CRUDE OIL (CDN\$/BBL)	AECO GAS (\$CDN/MMBTU)
2010	80.00	1.05	83.26	5.96
2011	83.00	1.05	86.42	6.79
2012	86.00	1.05	89.58	5.89
2013	89.00	1.05	92.74	6.95
2014	92.00	1.05	95.90	7.05
2015	93.84	1.05	97.84	7.16
2016	95.72	1.05	99.81	7.42
2017	97.64	1.05	101.83	7.95
2018	99.59	1.05	103.88	8.52
2019	101.58	1.05	105.98	8.69
Escalate thereafter 2.0% per year				

Using the estimated fair values, and given the decrease in estimated future natural gas prices from January 1, 2010 to December 31, 2010, it was determined the Southern Alberta CGU had a book value that exceeded its fair value by the amount of goodwill associated with the CGU. Accordingly, a goodwill impairment loss of \$9.8 million was recorded at December 31, 2010.

8. BANK INDEBTEDNESS

At March 31, 2011 the Company had a \$310 million extendible revolving term credit facility and a \$15 million demand operating credit facility available from a syndicate of Canadian chartered banks, subject to the banks' semi-annual valuation of Fairborne's petroleum and natural gas properties. The extendible revolving term facility is available on a revolving basis until May 27, 2011 (364 day facility) at which time it may be extended, at the lenders option. If the revolving period is not extended, the undrawn portion of the facility will be cancelled and the amount outstanding will convert to a 365 day non-revolving term facility. The amounts outstanding under the non-revolving term facility are required to be repaid at the end of the term facility being May 27, 2012. Interest payable on amounts drawn under the facilities is at the prevailing bankers' acceptance rates plus stamping fees, lenders' prime rate or LIBOR rates plus applicable margins, depending on the form of borrowing by the Company. The margins and stamping fees vary from 0.56% to 4.00% depending on financial statement ratios and the form of borrowing. The credit facilities are secured by a general security agreement and a first ranking floating charge on the assets of the Company. At March 31, 2011 letters of credit totaling \$2.1 million were outstanding.

Subsequent to March 31, 2011, the lending syndicate borrowing base was extended to May 26, 2012 at \$325 million on substantially the same terms.

*Interim Consolidated Financial Statements***9. CONVERTIBLE DEBENTURES**

	NUMBER OF DEBENTURES	DEBT COMPONENT	EQUITY COMPONENT
Balance, January 1, 2010	100,000	\$ 95,409	\$ 2,964
Accretion	–	2,155	–
Balance, December 31, 2010	100,000	97,564	2,964
Accretion	–	571	–
Balance March 31, 2011	100,000	\$ 98,135	\$ 2,964

At March 31, 2011 the Company had 100,000 convertible unsecured subordinated debentures outstanding with a face value of \$100 million that mature on December 31, 2011. The debentures bear interest at a rate of 6.5% per annum, which is payable semi-annually in arrears on December 31 and June 30 of each year. The debentures can be converted into common shares of Fairborne at any time at the option of the holders at a conversion price of \$13.50 per share. After December 31, 2010 and prior to the maturity date, the debentures are redeemable in whole or in part at the option of the Company at a redemption price of \$1,025 plus accrued and unpaid interest.

10. ASSET RETIREMENT OBLIGATION

The Company's asset retirement obligation results from ownership interests in petroleum and natural gas assets including well site, gathering systems and processing facilities. The total obligation is estimated based on the Company's net ownership interest in all wells and facilities, estimated costs to reclaim and abandon these wells and facilities and the estimated timing of the costs to be incurred in future years. The Company estimated the total undiscounted amount required to settle its asset retirement obligation at March 31, 2011 to be approximately \$40.1 million (December 31, 2010 - \$46.0 million). The majority of the costs are scheduled to be incurred between 2019 and 2023. A discount rate, being the credit-adjusted risk-free rate related to the liability, of 8.5% percent (2010 – 8.5%) was used to calculate the provision for the asset retirement obligation.

A reconciliation of the asset retirement obligation is provided below:

	FOR THE THREE MONTHS ENDED MARCH 31, 2011	FOR THE YEAR ENDED DECEMBER 31, 2010
Balance, beginning of period	\$ 12,730	\$ 11,200
Acquired in business combination	–	1,262
Provisions made during the period	243	711
Provisions used during the period	(68)	(1,491)
Disposals	(2,384)	(81)
Accretion	225	1,129
Balance, end of period	\$ 10,746	\$ 12,730

Interim Consolidated Financial Statements

11. DEFERRED TAXES

The provision for income taxes in the financial statements differs from the result which would have been obtained in applying the combined federal and provincial tax rate to the Company's profit before income taxes. The difference results from the following items:

FOR THE THREE MONTHS ENDED MARCH 31,	2011	2010
Profit before taxes	\$ 46,377	\$ 16,679
Combined federal and provincial tax rate	26.7%	28.2%
Computed "expected" deferred tax expense	12,383	4,703
Increase (decrease) in deferred taxes resulting from:		
Non-deductible stock based compensation	281	174
Effect of flow through shares	-	385
Non-taxable gain on sale	1,698	-
Other	(635)	332
Deferred taxes	\$ 13,727	\$ 5,594

12. PROFIT PER SHARE

The following table summarizes the weighted average common shares used in calculating profit per share:

FOR THE THREE MONTHS ENDED MARCH 31,	2011	2010
Numerator		
Profit for the period – basic and diluted	\$ 32,650	\$ 11,085
Denominator		
Weighted average shares – basic	102,508	102,465
Stock options	1,167	790
Denominator for diluted profit per share	103,675	103,255
Basic profit per share	\$ 0.32	\$ 0.11
Diluted profit per share	\$ 0.31	\$ 0.11

Excluded from the diluted number of shares for the period ended March 31, 2011 is the effect of convertible debentures (7.4 million shares) and 0.2 million stock options as their effect is anti-dilutive. Excluded from the diluted number of shares for the period ended March 31, 2010 is the effect of convertible debentures (7.4 million shares), warrants (1.7 million shares) and 3.6 million stock options.

*Interim Consolidated Financial Statements***13. EQUITY BASED COMPENSATION**

Stock based compensation expense of \$1.1 (March 31, 2010 – \$1.0 million) was recognized in the period, all of which (March 31, 2010 – \$2.2 million) was related to awards accounted for as equity settled transactions. Of this amount, stock based compensation costs of \$0.3 million (March 31, 2010 – \$0.7 million) were capitalized during the period.

i. Stock option plan

In July 2008, Fairborne instituted a stock option plan which provides for the granting of stock options to directors, officers, employees, consultants and other service providers to the Company and its subsidiaries. Outstanding stock options vest over a three year period and expire five years from the date of grant. Under the terms of the plan, stock options must be issued with an exercise price of not less than the volume weighted average trading price of common shares for the five trading days prior to the date of the grant. The maximum number of shares reserved for issuance under the stock option plan is 10.3 million (10% of the outstanding common shares at March 31, 2011). The amount recognized as an expense is adjusted to reflect the actual number of share options for which the related service conditions are met.

The following table sets forth a reconciliation of the stock option plan activity:

	FOR THE THREE MONTHS ENDED MARCH 31, 2011		FOR THE YEAR ENDED DECEMBER 31, 2010	
	NUMBER OF OPTIONS	WEIGHTED AVERAGE EXERCISE PRICE	NUMBER OF OPTIONS	WEIGHTED AVERAGE EXERCISE PRICE
Balance, beginning of period	7,024	\$ 4.24	5,235	\$ 4.25
Granted	20	4.68	2,200	4.20
Exercised	(55)	2.72	(97)	3.49
Forfeited	(45)	4.39	(314)	4.31
Balance, end of period	6,944	\$ 4.25	7,024	\$ 4.24
Exercisable, end of period	3,695	\$ 4.32	1,713	\$ 4.59

The fair value of options granted in the period was estimated using the Black-Scholes option pricing model. The weighted average assumptions used in the valuation model are as follows:

	FOR THE THREE MONTHS ENDED MARCH 31, 2011	FOR THE YEAR ENDED DECEMBER 31, 2010
Fair value at grant date	\$ 1.85	\$ 1.68
Share price	\$ 4.68	\$ 4.20
Exercise price	\$ 4.68	\$ 4.20
Risk free interest rate	1.9%	1.6%
Expected volatility	59%	64%
Average expected life	3 years	3 years
Dividend rate	Nil	Nil

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An estimated forfeiture rate of two percent (2010 – two percent) has been applied to the compensation costs recognized. This estimate is adjusted to the actual forfeiture rate.

The weighted average share price for options exercised during the period at the date of exercise was \$4.92 (December 31, 2010 – \$4.41). The expected volatility was determined using historical volatility for a period commensurate with the option life.

The following table summarizes stock options outstanding at March 31, 2011:

EXERCISE PRICE	OPTIONS OUTSTANDING	REMAINING TERM (YEARS)
\$ 2.00 – \$ 4.99	6,756	3.61
\$ 5.00 – \$ 7.99	55	3.12
\$ 8.00 – \$ 10.99	58	2.50
\$ 11.00 – \$ 13.99	75	2.31
	6,944	3.58

ii. Retention Award Plan

Fairborne had a Retention Award Plan which included granting of Retention Awards to directors, officers, employees, consultants and other service providers to the Company and its subsidiaries.

Retention Awards vested annually over a three-year period and expired three years from the date of grant. Upon vesting, the holder was entitled to exercise the Retention Awards for cash equal to the amount by which the exercise price (the fair value of a Fairborne common share on the date of exercise) exceeded the grant price (the fair value of a Fairborne common share on the date of grant).

The following table sets forth a reconciliation of the retention award plan activity:

	FOR THE THREE MONTHS ENDED MARCH 31, 2011		FOR THE YEAR ENDED DECEMBER 31, 2010	
	NUMBER OF AWARDS	WEIGHTED AVERAGE EXERCISE PRICE	NUMBER OF AWARDS	WEIGHTED AVERAGE EXERCISE PRICE
Balance, beginning of period	60	\$ 5.52	1,390	\$ 5.74
Forfeited	-	-	(870)	5.75
Cancelled	(60)	5.52	(460)	5.75
Balance, end of period	-	\$ -	60	\$ 5.52
Exercisable, end of period	-	\$ -	40	\$ 5.52

Interim Consolidated Financial Statements**14. SUPPLEMENTAL CASH FLOW INFORMATION:**

The following table sets forth the changes in non-cash working capital:

FOR THE THREE MONTHS ENDED MARCH 31,	2011	2010
Change in receivables	\$ 3,771	\$ 232
Change prepaid expenses and deposits	96	412
Change in accounts payable and accrued liabilities	21,659	26,925
Change in deferred revenue	-	(733)
	\$ 25,526	\$ 26,836
Operating	\$ (4,669)	\$ 2,099
Investing	\$ 30,195	\$ 24,737

15. FINANCE EXPENSE

FOR THE THREE MONTHS ENDED MARCH 31,	2011	2010
Interest on bank indebtedness	\$ 2,546	\$ 1,368
Interest on convertible debentures	1,625	1,625
Accretion of convertible debentures	571	550
Accretion of asset retirement obligation	225	242
Impairment loss on trade receivables	117	-
Finance expenses recognized in profit and loss	\$ 5,084	\$ 3,785

16. FINANCIAL INSTRUMENTS**Credit Risk**

The Company's accounts receivable is aged as follows:

	MARCH 31, 2011	DECEMBER 31, 2010	JANUARY 1, 2010
Current (less than 90 days)	\$ 24,649	\$ 28,709	\$ 31,282
Past due (more than 90 days)	3,405	3,116	3,873
Total	\$ 28,054	\$ 31,825	\$ 35,155

Market Risk

Market risk is the risk that fluctuations in currency rates, interest rates and commodity prices will affect the Company's income or the value of its financial assets and liabilities.

Interim Consolidated Financial Statements

Commodity Price Risk

Commodity price risk is the risk that the fair value of future cash flows will fluctuate as a result of changes in commodity prices. Commodity prices for petroleum and natural gas are impacted by not only the relationship between the Canadian dollar and United States dollar, but also world economic events that dictate the levels of supply and demand. Fairborne has attempted to mitigate commodity price risk through the use of various commodity contracts as outlined in Note 17. The derivative contracts resulted in the recognition of a loss of \$2.2 million (March 31, 2010 – gain of \$0.2 million) for the period ended March 31, 2011 which has been included in petroleum and natural gas sales. In addition, fixed price physical delivery contracts for natural gas that settled during period ended March 31, 2011 increased realized revenue by an estimated \$2.0 million (March 31, 2010 – \$3.2 million). The fixed price physical delivery contracts for oil that settled during the period ended March 31, 2011, reduced realized revenue by an estimated \$0.8 million (March 31, 2010 – \$ nil). A one dollar change to the price per barrel of oil would have an impact on the value of the derivative liability at March 31, 2011 of \$0.4 million. A \$0.25 change to the price per thousand cubic feet of natural gas would have a \$0.5 million impact on the value of the derivative liability at March 31, 2011.

Interest rate risk

Interest rate risk is the risk that future cash flows will fluctuate as a result of changes in market interest rates. The Company is exposed to interest rate risk on its bank debt which has a floating interest rate. The convertible debentures do not bear interest rate risk as they are at a fixed rate. An increase in interest rates of 1% would reduce after tax net earnings for the three months ended March 31, 2011 by approximately \$1.5 million (March 31, 2010 – \$0.8 million) based on the average amount of bank debt outstanding during the period. An opposite impact would have occurred to after tax net earnings had interest rates decreased 1%. The Company had no interest rate derivatives outstanding at March 31, 2011 or 2010.

17. COMMODITY CONTRACTS

Fairborne has a risk management program whereby the Company sells forward a portion of its future production through fixed price physical sales contracts with customers.

a) Commodity Contracts Recorded at Fair Value:

At March 31, 2011, certain contracts have been recorded on the statement of financial position at their estimated fair value as an \$3.5 million liability (December 31, 2010 – \$1.4 million). The change in the fair value has been recorded in petroleum and natural gas.

OIL:

	VOLUME (bbls PER DAY)	PRICE (CDN\$ PER bbl)	SETTLEMENT INDEX
Collars			
Apr 1, 2011 – Dec 31, 2011	500	70.00 – 101.25	WTI
Swaps			
Apr 1, 2011 – Dec 31, 2011	500	75.00	WTI

Interim Consolidated Financial Statements**NATURAL GAS:**

	VOLUME (GJs PER DAY)	PRICE (CDN\$ PER GJ)	SETTLEMENT INDEX
AECO Swap			
Jan 1, 2011 – Dec 31, 2011	5,000	5.16	AECO C Monthly

b) Commodity Contracts Not Recorded at Fair Value:

The following natural gas fixed price physical sales contracts outstanding at March 31, 2011 have been entered into for the purpose of physical delivery of a non-financial item; therefore, the physical delivery contracts are not fair valued. Settlements on these contracts are included in petroleum and natural gas revenue as they occur.

NATURAL GAS:

	VOLUME (GJs PER DAY)	PRICE (CDN\$ PER GJ)	SETTLEMENT INDEX
Swaps			
Apr 1, 2011 – Dec 31, 2011	5,000	5.00	AECO C Monthly
Apr 1, 2011 – Dec 31, 2011	5,000	5.00	AECO C Monthly

Corporate Information

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AUDITORS

KPMG LLP

RESERVE EVALUATORS

GLJ Petroleum Consultants Ltd.

BANKERS

Royal Bank of Canada
National Bank of Canada
Canadian Imperial Bank
of Commerce
Alberta Treasury Branch
Union Bank

LEGAL COUNSEL

Burnet, Duckworth & Palmer LLP
McCarthy Tetrault LLP

STOCK EXCHANGE LISTING

The Toronto Stock Exchange

Trading Symbol: **FEL**
 Convertible Debentures: **FEL.DB**

CORPORATE GOVERNANCE

A system of corporate governance for Fairborne has been established to provide the Board of Directors, management and shareholders of the Company with effective governance. A more detailed discussion of corporate governance is available in the Information Circular for the Annual Meeting of Shareholders.

DIRECTORS

Greg Bay
 President and CEO
 Cypress Capital Management Ltd.

Robert B. Hodgins
 Investor and Corporate Director

Johannes J. Nieuwenburg
 General Partner
 KERN Partners Ltd.

Carl J. Tricoli
 Founder and Managing Partner
 Denham Capital Management LP

Steven R. VanSickle
 President and CEO
 Fairborne Energy Ltd.

Richard A. Walls
 President and
 Chief Executive Officer
 C & C Energia Ltd.

Rodney D. Wimer
 President
 Mazama Capital Partners

GENERAL INFORMATION

Shareholders and interested investors are encouraged to visit our web site:
<http://www.fairborne-energy.com>
 Historical public documents, corporate information, latest presentation material and press releases are all available. Filings also available at: www.sedar.com

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