

## NOVEMBER 5, 2010 — FAIRBORNE ENERGY LTD. – THIRD QUARTER INTERIM REPORT AND NEWS RELEASE

**HIGHLIGHTS**

	Three months ended September 30,		Nine months ended September 30,	
	2010	2009	2010	2009
<b>Financial</b> ( <i>\$thousands, except per share amounts</i> )				
Petroleum and natural gas revenue	<b>54,718</b>	55,244	<b>177,733</b>	182,219
Funds generated from operations <sup>(1)</sup>	<b>28,204</b>	37,236	<b>95,207</b>	105,948
Per share – basic	<b>\$0.28</b>	\$0.43	<b>\$0.93</b>	\$1.22
Per share – diluted	<b>\$0.28</b>	\$0.43	<b>\$0.93</b>	\$1.22
Cash flow from operations (including changes in working capital)	<b>24,803</b>	40,048	<b>88,017</b>	102,483
Per share – basic	<b>\$0.24</b>	\$0.46	<b>\$0.86</b>	\$1.18
Per share – diluted	<b>\$0.24</b>	\$0.46	<b>\$0.86</b>	\$1.18
Net loss	<b>(7,600)</b>	(497)	<b>(10,912)</b>	(22,521)
Per share – basic	<b>\$(0.07)</b>	\$(0.01)	<b>\$(0.10)</b>	\$(0.26)
Per share – diluted	<b>\$(0.07)</b>	\$(0.01)	<b>\$(0.10)</b>	\$(0.26)
Exploration and development expenditures	<b>40,123</b>	19,232	<b>124,082</b>	87,802
Acquisitions, net of dispositions	<b>74,321</b>	(8,400)	<b>77,254</b>	(9,005)
Working capital deficit (surplus)	<b>22,621</b>	(1,539)	<b>22,621</b>	(1,539)
Bank indebtedness	<b>194,042</b>	204,046	<b>194,042</b>	204,046
Convertible debentures	<b>97,959</b>	96,027	<b>97,959</b>	96,027
<b>Operations</b> ( <i>Units as noted</i> )				
Average production				
Natural gas ( <i>Mcf per day</i> )	<b>68,910</b>	56,797	<b>65,563</b>	63,648
Crude oil ( <i>bbls per day</i> )	<b>2,916</b>	3,292	<b>3,008</b>	3,480
Natural gas liquids ( <i>bbls per day</i> )	<b>1,036</b>	563	<b>958</b>	589
Sulphur ( <i>tonnes per day</i> ) <sup>(2) (4)</sup>	<b>66</b>	100	<b>70</b>	86
Total ( <i>BOE per day</i> )	<b>15,503</b>	13,421	<b>14,963</b>	14,763
Average sales price <sup>(3)</sup>				
Natural gas ( <i>\$ per Mcf</i> )	<b>4.79</b>	5.28	<b>5.12</b>	5.68
Crude oil ( <i>\$ per bbl</i> )	<b>74.09</b>	68.35	<b>76.37</b>	63.21
Natural gas liquids ( <i>\$ per bbl</i> )	<b>42.29</b>	32.19	<b>41.39</b>	28.70
Sulphur ( <i>\$ per tonne</i> ) <sup>(4)</sup>	<b>48.25</b>	–	<b>35.51</b>	96.07
Netback per BOE ( <i>\$ per BOE</i> )				
Petroleum and natural gas sales <sup>(3)</sup>	<b>38.41</b>	40.53	<b>40.84</b>	41.24
Sulphur block revenue	–	7.32	<b>2.58</b>	5.05
Royalties	<b>(3.32)</b>	(1.40)	<b>(4.64)</b>	(3.19)
Operating expenses	<b>(9.35)</b>	(9.05)	<b>(9.34)</b>	(10.72)
Transportation	<b>(1.11)</b>	(1.25)	<b>(1.08)</b>	(1.11)
Operating netback	<b>24.63</b>	36.15	<b>28.36</b>	31.27
Wells drilled (gross)	<b>16</b>	24	<b>33</b>	43
Undeveloped land (net acres)	<b>261,945</b>	218,293	<b>261,945</b>	218,293

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.

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.



*Message to Shareholders***FAIRBORNE REPORTS ANOTHER STRONG OPERATIONAL QUARTER AND RECORD CURRENT PRODUCTION**

Fairborne's successful drilling program and property acquisition completed during the third quarter have resulted in record current production of 16,500 BOE per day. With two Wilrich wells, one Harlech well and one Westerose well drilled and awaiting completion or tie in, the Company is positioned to record exit production of 17,000 to 17,500 BOE per day in 2010, which represents an increase of more than 30% from 2009 exit production of 13,000 BOE per day. Financial and operating highlights include:

- Current production of approximately 16,500 BOE per day (75% natural gas, 25% light oil and natural gas liquids) with four additional wells drilled and awaiting completion or tie in;
- Average production for the third quarter of 15,503 BOE per day (68.9 MMcf per day of natural gas and 3,952 bbls per day of light oil and NGLs), consistent with the second quarter of 2010 and 16% higher than the same period in 2009;
- Current light oil and natural gas liquids production is approximately 4,100 bbls per day;
- Funds generated from operations of \$28.2 million (\$0.28 per share) in the third quarter, 3% higher than the preceding second quarter despite lower natural gas prices;
- Third quarter operating netback of \$24.63 per BOE continues to benefit from a low cost structure with third quarter operating costs of \$9.35 per BOE, 8.7% average royalties and transportation costs of \$1.11 per BOE;
- Drilling activities included 16 (12.8 net) wells resulting in 12 (9.3 net) natural gas wells and four (3.5 net) oil wells;
- Property acquisition was completed which significantly expanded Fairborne's land position on the core asset at Marlboro/Pine Creek, including 71.8 net sections of Wilrich rights as well as a new producing property at McLeod River;
- Bank credit facilities were increased to \$325 million from \$285 million as a result of successful drilling results and the acquisition of the McLeod River property;
- Fairborne's hedging strategy continued to add significant value with third quarter realized natural gas prices 35% above the AECO Daily Index prices;
- 34% of natural gas production is hedged for the balance of 2010 at an average price of \$6.63 per Mcf and 17% of natural gas production is hedged for 2011 at an average price of \$5.66 per Mcf.

**PRODUCTION AND OPERATING RESULTS**

Third quarter production of 15,503 BOE per day was consistent with the second quarter of 2010 (15,486 BOE per day) with additional production from the newly acquired McLeod River properties added late in the third quarter. Fairborne's third quarter drilling program included 12 (9.3 net) natural gas wells concentrated on the Company's Marlboro, Clive and West Pembina properties with an additional four (3.5 net) crude oil wells drilled on the Sinclair and West Pembina properties. Capital expenditures of \$114.4 million included \$74.3 million in property acquisitions, \$29.5 million on drilling and completion activities, \$7.1 million on land and seismic and \$3.5 million on well equipment and facilities.

Natural gas prices remained low during the third quarter, with AECO Daily Index prices dropping an additional 9% from the second quarter of 2010. Fairborne's third quarter financial results reflected the decline in natural gas prices with an operating netback of \$24.63 per BOE and funds generated from operations of \$28.2 million (\$0.28 per share). Funds generated from operations were used to fund a portion of the third quarter capital program with the balance of expenditures, including the property acquisition, financed by bank debt.

*Message to Shareholders***OPERATIONS FOCUS**

- **Marlboro:** Fairborne has established a significant land position in the Marlboro area, which includes a total of 144 sections comprised of 17 net sections of Wilrich land in its core Marlboro development area and 127 additional net sections along the Wilrich shoreline trend. Fairborne drilled three (2.3 net) natural gas wells in the Marlboro operating area during the third quarter of 2010 and one (0.9 net) well at the beginning of the fourth quarter. Two of the wells drilled have been tied in with initial production rates of 4.8 MMcf per day and 6.4 MMcf per day respectively (the Wilrich zone yields approximately 15 bbls of natural gas liquids per MMcf of gas). The remaining two (1.7 net) wells are awaiting completion and are anticipated to commence production during the fourth quarter.
- **McLeod River/Edson:** This new development area was included in the third quarter property acquisition and is located adjacent to the Company's Marlboro/Pine Creek property. The property includes 980 bbls per day of production as well as an interest in 150 kms of pipelines and 14 MMcf per day capacity in the McLeod River gas plant.
- **Harlech:** Fairborne continues the development of liquid rich natural gas at Harlech targeting stacked multizone pay in vertical wells. Fairborne's current land position in Harlech includes 306 (202.2 net) sections. The most recent well was completed in six intervals including the Belly River, Viking, Glauconite and Gething formations and flowback operations are currently underway.
- **Clive/Westerose:** Fairborne expanded its land position in Westerose during the third quarter with two net sections acquired. Fairborne now controls 27.5 net sections of land on the prolific Hoadley gas trend. The Company drilled one (1.0 net) additional well early in the fourth quarter, which is currently awaiting completion and is expected to be on production by the end of the year.
- **Sinclair:** Fairborne continued its development of this high netback oil property with three (2.6 net) wells drilled in the third quarter. Utilizing a new technique for fracturing the wells, Fairborne achieved a 23% increase in initial production rates on the first of these wells.

**2011 CAPITAL PROGRAM**

The Board of Directors has approved Fairborne's initial 2011 capital budget at \$140 million, with \$80 million allocated to the first six months of the year and \$60 million allocated to the last half of 2011. The initial capital budget is expected to be financed from 2011 cash flows, based on the following key assumptions: average production of 17,500 to 18,000 BOE per day; average realized prices of CDN\$4.70 per Mcf for natural gas, including in-place hedging contracts; CDN\$78.50 per bbl for crude oil; 12% average royalties and operating costs of \$9.00 to \$9.50 per BOE.

Fairborne's \$80 million capital program for the first six months of 2011 includes \$61.5 million of drilling and completion expenditures with 24 gross wells planned. The Company will continue to focus drilling operations on four core projects with four wells targeting natural gas at Marlboro (Wilrich); four wells targeting liquids rich natural gas at Harlech (multizone); two wells targeting liquids rich natural gas at Westerose (Glauconite) and 10 wells targeting light oil at Sinclair and Brazeau. In addition to drilling expenditures, the capital program for the first half of 2011 also includes \$8.0 million for land and seismic expenditures and an additional \$10.5 million for equipping and facility costs. Based on financial and operational results obtained in 2011, the actual allocation of capital and wells drilled may be adjusted.



*Message to Shareholders***OUTLOOK**

The Company remains on target to record exit production in 2010 of 17,000 to 17,500 BOE per day, as a result of a successful exploration, development and acquisition program throughout the first three quarters. More importantly, with the continued and focused expansion of its core asset base, Fairborne holds an extensive inventory of opportunities that will allow the Company to grow production levels and generate solid economic returns in a continued low natural gas price environment. Financial flexibility will continue to be a key goal moving forward. A strong balance sheet gave the Company the financial flexibility to take advantage of a strategic property acquisition in the third quarter. Successful drilling results, combined with the newly acquired operating area at McLeod River supported an increase in bank credit facilities to \$325 million during the quarter, providing continued financial flexibility moving into 2011. Operations in 2011 will continue to benefit from increased production levels as well as a risk management program with 34% of natural gas production for the balance of 2010 hedged at an average price of \$6.63 per Mcf and 17% of natural gas production for 2011 hedged at an average price of \$5.66 per Mcf.



**Steven R. VanSickle**  
President & CEO  
November 3, 2010

*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, November 3, 2010. This document is provided by the management of Fairborne Energy Ltd. ("Fairborne" or the "Company") to review third quarter 2010 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 and nine months ended September 30, 2010 and the audited consolidated financial statements including notes for the years ended December 31, 2009 and 2008. The MD&A should also be read in conjunction with the Company's MD&A for the year ended December 31, 2009, as disclosure which is unchanged from the December 31, 2009 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](http://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 forecast forward-looking statements. Management's assessment of future plans and operations, drilling plans and the timing thereof, anticipated timing to bring on additional production, 2010 exit production rate, planned capital expenditures, nature of capital expenditures, timing of capital expenditures and methods of financing capital expenditures (and assumptions related thereto) and timing of adoption of IFRS, policy choices to be made under IFRS and the impact of adoption of IFRS 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 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](http://www.sedar.com)) or at the Company's website ([www.fairborne-energy.com](http://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 GAAP 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-GAAP 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) 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 GAAP 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 Canadian GAAP 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 income 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.



*Interim Management's Discussion & Analysis***THIRD QUARTER 2010 FINANCIAL RESULTS****Property Acquisition**

On September 9, 2010, Fairborne completed a property acquisition which included undeveloped land, facilities interests and producing properties in the McLeod River area. The undeveloped land acquired expanded the Company's existing land holdings in the Marlboro/Pine Creek area. The McLeod River property is also immediately adjacent to Fairborne's existing properties. The cost of the acquisition was \$71.5 million, subject to closing adjustments, which was funded entirely from bank credit facilities.

**Production**

	Three months ended September 30,			Nine months ended September 30,		
	2010	2009	change	2010	2009	change
Natural gas ( <i>Mcf per day</i> )	<b>68,910</b>	56,797	21%	<b>65,563</b>	63,648	3%
Crude oil ( <i>bbls per day</i> )	<b>2,916</b>	3,292	(11%)	<b>3,008</b>	3,480	(14%)
Natural gas liquids ( <i>bbls per day</i> )	<b>1,036</b>	563	84%	<b>958</b>	589	63%
Sulphur ( <i>tonnes per day</i> ) <sup>(1),(2)</sup>	<b>66</b>	100	(34%)	<b>70</b>	86	(19%)
Total ( <i>BOE per day</i> )	<b>15,503</b>	13,421	16%	<b>14,963</b>	14,763	1%
Natural gas % of production	<b>74%</b>	71%	4%	<b>73%</b>	72%	1%

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 production remained consistent in the third quarter of 2010 averaging 15,503 BOE per day compared to 15,486 BOE per day in the preceding second quarter. Third quarter 2009 production was reduced by the Company's decision to shut in sour gas production as a result of depressed natural gas prices. On a year to date basis, production for the nine months ended September 30, 2010 of 14,963 BOE per day was comparable to the prior year (14,763 BOE per day).

Natural gas production of 68.9 MMcf per day during the third quarter of 2010 was 3% higher than the second quarter of 2010 (66.8 MMcf per day) due to successful drilling results on the Company's Marlboro property and the acquisition of producing properties at McLeod River which closed late in the third quarter.

Crude oil and NGL production of 3,952 bbls per day for the third quarter of 2010 was 7% lower than the preceding second quarter of 2010 (4,259 BOE per day) with new production offset by natural declines. Compared to 2009, third quarter oil and NGL production increased 3% reflecting the Company's successful drilling program on its Sinclair, Marlboro and Westeros properties throughout 2010.

## Interim Management's Discussion &amp; Analysis

## Commodity Prices &amp; Risk Management Activities

	Three months ended September 30,			Nine months ended September 30,		
	2010	2009	change	2010	2009	change
<b>Average Prices <sup>(1)</sup></b>						
Natural gas (\$ per Mcf)	<b>4.79</b>	5.28	(9%)	<b>5.12</b>	5.68	(10%)
Crude oil (\$ per bbl)	<b>74.09</b>	68.35	8%	<b>76.37</b>	63.21	21%
Natural gas liquids (\$ per bbl)	<b>42.29</b>	32.19	31%	<b>41.39</b>	28.70	44%
Sulphur (\$ per tonne) <sup>(2)</sup>	<b>48.25</b>	–	–	<b>35.51</b>	96.07	(63%)
BOE (\$ per BOE)	<b>38.27</b>	40.42	(5%)	<b>40.63</b>	41.07	(1%)
<b>Benchmark Prices</b>						
AECO Daily Index (Cdn\$ per Mcf)	<b>3.54</b>	2.98	19%	<b>4.13</b>	3.78	9%
AECO Monthly Index (Cdn\$ per Mcf)	<b>3.72</b>	3.02	23%	<b>4.31</b>	4.11	5%
Edmonton par (Cdn\$ per bbl)	<b>74.76</b>	71.72	4%	<b>76.61</b>	62.03	24%
Nymex Calendar Average (US\$ per bbl)	<b>76.20</b>	68.30	12%	<b>77.65</b>	57.00	36%

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

During the third quarter of 2010, Fairborne's realized prices were 35% 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 third quarter realized natural gas prices were 9% lower due to different physical sales and derivative contracts in 2010. An average of 24,455 Mcf per day was sold under fixed price physical sales contracts during the third quarter of 2010 representing 35% of the Company's natural gas production. Risk management activities during the third quarter of 2010 increased the Company's natural gas revenue by \$6.5 million which had an effect of increasing Fairborne's realized natural gas price by \$1.03 per Mcf to \$4.79 per Mcf.

The following table summarizes the outstanding fixed price physical sales and derivative contracts for natural gas, including contracts outstanding at September 30, 2010 as well as contracts entered into after September 30, 2010:

	Q4 2010	2011
Swaps		
Volume (Mcf per day)	<b>24,554</b>	<b>13,393</b>
Average price (\$ per Mcf)	<b>\$6.63</b>	<b>\$5.66</b>

Conversion factor: 1 Mcf = 1.12 GJ

At September 30, 2010, 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 \$2.5 million at September 30, 2010.



*Interim Management's Discussion & Analysis*

## CRUDE OIL

During the third quarter of 2010, Fairborne had an average of 1,500 bbls per day of crude oil under fixed price physical sales contracts. Risk management activities, including option costs for puts purchased during the third quarter of 2010, had no significant impact on the Company's crude oil revenue. The Company's realized crude oil price of \$74.09 per bbl for the third quarter of 2010 represented an increase of 8% from the same period in 2009, reflecting the overall increase in average market prices.

The following table summarizes the outstanding fixed price physical sales and derivative contracts on crude oil, including contracts outstanding at September 30, 2010 as well as contracts entered into after September 30, 2010.

	Q4 2010	2011
Collars		
Volume ( <i>bbls per day</i> )	1,500	500
Average floor price ( <i>CDN\$ per bbl</i> )	\$60.00	\$70.00
Average ceiling price ( <i>CDN\$ per bbl</i> )	\$103.72	\$101.25
Swaps		
Volume ( <i>bbls per day</i> )	–	500
Average price ( <i>CDN\$ per bbl</i> )	–	\$75.00

At September 30, 2010, Fairborne had three crude oil collars and one swap that were accounted for as derivative contracts and the combined mark-to-market value of these contracts was a liability of \$2.5 million at September 30, 2010, which largely offset the asset recorded on the derivative natural gas contract.

## SULPHUR

Sulphur prices began to recover at the beginning of the year and have remained consistent into the third quarter. As a result, Fairborne received revenue for its sulphur production during the third quarter of 2010 with an average realized price of \$48.25 per tonne.

## Petroleum and Natural Gas Revenue

	Three months ended September 30,			Nine months ended September 30,		
	2010	2009	change	2010	2009	change
<i>(\$thousands except as noted)</i>						
Petroleum and natural gas sales:						
Natural gas	30,389	27,590	10%	91,731	98,624	(7%)
Crude oil	19,876	20,698	(4%)	62,722	60,048	4%
Natural gas liquids	4,031	1,666	142%	10,825	4,614	135%
Sulphur	293	(45)	751%	683	2,247	(70%)
Total	54,589	49,909	9%	165,961	165,533	–
Per BOE	\$38.27	\$40.42	(5%)	\$40.63	\$ 41.07	(1%)
Other revenue items:						
Sulphur block	–	9,034	(100%)	10,511	20,351	(48%)
Change in fair value of derivatives	(68)	(3,833)	98%	387	(4,330)	109%
Other income	197	134	47%	874	665	31%
Total	129	5,335	(98%)	11,772	16,686	(29%)
Total petroleum and natural gas revenue	54,718	55,244	(1%)	177,733	182,219	(2%)
Per BOE	\$38.36	\$44.74	(14%)	\$43.51	\$45.21	(4%)

*Interim Management's Discussion & Analysis*

Fairborne reported petroleum and natural gas sales of \$54.6 million for the third quarter of 2010, consistent with the preceding second quarter of 2010 (\$55.6 million). Compared to the third quarter of 2009 (\$49.9 million), increased production in 2010 offset reduced prices, resulting in higher petroleum and natural gas sales in the third quarter of 2010. On a year to date basis, consistent production levels and comparable commodity prices resulted in a marginal increase in petroleum and natural gas sales in 2010 compared to the prior year.

Other revenue items were immaterial in the third quarter of 2010. Comparatively, throughout 2009 and through the first six months of 2010, Fairborne recorded significant revenue pursuant to a contract for the sale of inventory at the West Pembina sulphur block. This contract was satisfied in June 2010 with no further revenue to be recognized. Similarly, in 2009 Fairborne recorded significant amounts related to the change in fair value of derivatives. For both the three and nine months ended September 30, 2010, the change in fair value of derivatives was insignificant.

**Royalties**

<i>(\$thousands except as noted)</i>	Three months ended September 30,			Nine months ended September 30,		
	2010	2009	change	2010	2009	change
Crown	<b>2,587</b>	131	–	<b>12,985</b>	7,362	76%
Freehold and overriding	<b>2,155</b>	1,598	35%	<b>5,977</b>	5,498	9%
Total	<b>4,742</b>	1,729	174%	<b>18,962</b>	12,860	47%
Crown ( <i>% of P&amp;NG sales</i> )	<b>4.7%</b>	0.3%	–	<b>7.8%</b>	4.4%	77%
Freehold and overriding ( <i>% of P&amp;NG sales</i> )	<b>4.0%</b>	3.2%	25%	<b>3.6%</b>	3.3%	9%
Total ( <i>% of P&amp;NG sales</i> )	<b>8.7%</b>	3.5%	149%	<b>11.4%</b>	7.8%	46%
Per BOE	<b>\$3.32</b>	\$1.40	137%	<b>\$4.64</b>	\$3.19	45%

Crown royalties of \$2.6 million during the third quarter of 2010 represents a decrease of \$4.2 million when compared to the preceding second quarter of 2010, which included \$3.3 million of prior year crown royalty adjustments. Comparatively, crown royalties for the third quarter of 2009 were unusually low due to prior year adjustments received during the third quarter of 2009. Freehold and overriding royalty rates for 2010 remain consistent with the prior year.

**Operating Costs**

<i>(\$thousands except as noted)</i>	Three months ended September 30,			Nine months ended September 30,		
	2010	2009	change	2010	2009	change
Operating costs						
Natural gas	<b>9,793</b>	8,229	19%	<b>28,035</b>	31,195	(10%)
Oil and NGLs	<b>3,544</b>	2,945	20%	<b>10,111</b>	11,993	(16%)
Total	<b>13,337</b>	11,174	19%	<b>38,146</b>	43,188	(12%)
Per BOE	<b>\$9.35</b>	\$9.05	3%	<b>\$9.34</b>	\$10.72	(13%)

Fairborne recorded operating costs of \$13.3 million (\$9.35 per BOE) during the third quarter of 2010, a decrease of 4% compared to the preceding second quarter of 2010 (\$9.78 per BOE), which included additional costs for scheduled overhauls and workovers. Compared to 2009, year to date operating costs have decreased as a result of cost reduction initiatives implemented in 2009 on the Company's Wild River and Sinclair properties.



*Interim Management's Discussion & Analysis***Transportation Expenses**

	Three months ended September 30,			Nine months ended September 30,		
	2010	2009	change	2010	2009	change
Transportation ( <i>\$thousands</i> )	<b>1,581</b>	1,541	3%	<b>4,425</b>	4,480	(1%)
Per BOE	<b>\$1.11</b>	\$1.25	(11%)	<b>\$1.08</b>	\$1.11	(3%)

Transportation costs of \$1.6 million (\$1.11 per BOE) for the third quarter of 2010 remained consistent with the second quarter of 2010 (\$1.10 per BOE). Transportation costs in the comparative third quarter of 2009 were higher (\$1.25 per BOE) as a result of prior period NGL trucking costs and additional trucking costs at Sinclair due to spring road bans. On a year to date basis, transportation costs have remained consistent.

**Operating Netbacks**

( <i>\$ per BOE</i> )	Three months ended September 30,			Nine months ended September 30,		
	2010	2009	change	2010	2009	change
Petroleum and natural gas sales <sup>(1)</sup>	<b>38.27</b>	40.42	(5%)	<b>40.63</b>	41.07	(1%)
Sulphur block revenue	–	7.32	–	<b>2.58</b>	5.05	(49%)
Other income <sup>(1)</sup>	<b>0.14</b>	0.11	27%	<b>0.21</b>	0.17	24%
Royalties	<b>(3.32)</b>	(1.40)	137%	<b>(4.64)</b>	(3.19)	45%
Operating costs	<b>(9.35)</b>	(9.05)	3%	<b>(9.34)</b>	(10.72)	(13%)
Transportation	<b>(1.11)</b>	(1.25)	(11%)	<b>(1.08)</b>	(1.11)	(3%)
Operating netback	<b>24.63</b>	36.15	(32%)	<b>28.36</b>	31.27	(9%)

1) Excludes the change in fair value of derivatives

Fairborne's operating netback of \$24.63 per BOE in the third quarter of 2010 reflects lower sulphur block revenues partially offset by lower royalties and operating costs compared to the second quarter (\$25.11 per BOE). Compared to 2009, lower sulphur block revenues and higher royalty costs offset operating cost reductions resulting in lower netbacks in 2010.

**General and Administrative ("G&A") Expenses**

( <i>\$thousands except as noted</i> )	Three months ended September 30,			Nine months ended September 30,		
	2010	2009	change	2010	2009	change
G&A expenses, net of recoveries	<b>3,561</b>	3,315	7%	<b>10,602</b>	8,632	23%
Compensation costs	<b>1,138</b>	401	184%	<b>4,507</b>	16,090	(72%)
Total G&A expenses	<b>4,699</b>	3,716	26%	<b>15,109</b>	24,722	(39%)
G&A expenses, net of recoveries, per BOE	<b>\$2.50</b>	\$2.68	(7%)	<b>\$2.60</b>	\$2.14	21%
Compensation costs, per BOE	<b>\$0.80</b>	\$0.32	150%	<b>\$1.10</b>	\$3.99	(72%)

Fairborne recorded \$3.6 million of G&A expenses, net of recoveries, in the third quarter of 2010, representing \$2.50 per BOE. Compared to the preceding second quarter of 2010, G&A expenses, net of recoveries, decreased from \$3.34 per BOE as a result of higher recoveries associated with the increased capital expenditure program in the third quarter. G&A expenses for the nine months ended September 30, 2010 included higher employee compensation costs than 2009, which was also reduced by an accrual adjustment for the 2008 employee bonus program. Fairborne does not capitalize G&A expenses, other than recoveries permitted under joint operating agreements.

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Non-cash compensation expense of \$1.1 million recorded in the third quarter of 2010 was consistent with the preceding second quarter of 2010 (\$1.1 million). On a year to date basis, compensation costs of \$16.0 million in 2009 included \$12.6 million of accelerated compensation expense for the remaining life of 6.6 million stock options that were voluntarily surrendered by employees, officers and directors on June 1, 2009.

**Interest**

<i>(\$thousands except as noted)</i>	Three months ended September 30,			Nine months ended September 30,		
	2010	2009	change	2010	2009	change
Interest expense	3,361	4,082	(18%)	9,580	11,290	(15%)
Accretion of convertible debentures	483	502	(4%)	1,449	1,505	(4%)
Total interest	3,844	4,584	(16%)	11,029	12,795	(14%)
Per BOE	\$2.70	\$3.71	(27%)	\$2.70	\$3.17	(15%)

Fairborne recorded \$3.4 million in interest expense in the third quarter of 2010, consistent with the \$3.2 recorded during the preceding second quarter of 2010. Compared to the prior year, interest expense has decreased in 2010 consistent with lower debt levels. Also included in interest expense is the accretion of convertible debentures. The costs associated with the debenture offering along with the amount allocated to the conversion feature are included in interest expense over the term of the debentures.

**Depletion, Depreciation and Accretion (DD&A)**

	Three months ended September 30,			Nine months ended September 30,		
	2010	2009	change	2010	2009	change
Depletion, depreciation and accretion <i>(\$thousands)</i>	36,125	32,876	10%	102,322	108,153	(5%)
Per BOE	\$25.32	\$26.63	(5%)	\$25.05	\$26.83	(7%)

Fairborne recorded \$36.1 million in depletion and depreciation of capital assets and accretion of asset retirement obligations during the third quarter of 2010. On a BOE basis, the 2010 third quarter DD&A rate of \$25.32 per BOE was consistent with the preceding second quarter of 2010 (\$24.87 per BOE) and 5% lower than the average DD&A rate for the prior year (\$26.63 per BOE) as a result of reserve additions associated with the Company's 2010 capital expenditure program, including the McLeod River property acquisition.

**Taxes**

	Three months ended September 30,			Nine months ended September 30,		
	2010	2009	change	2010	2009	change
Future tax expense (reduction) <i>(\$thousands)</i>	(2,010)	121	–	(1,348)	(1,458)	(8%)
Per BOE	\$(1.41)	\$0.10	–	\$(0.33)	\$(0.36)	(8%)

Fairborne recorded a future tax recovery of \$2.0 million in the third quarter of 2010 compared to the future tax recovery of \$1.8 million recorded during the second 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 decline in tax expense is consistent with the decline in net earnings before taxes.



## Interim Management's Discussion &amp; Analysis

## Net Loss and Funds Generated from Operations

(\$thousands except as noted)	Three months ended September 30,			Nine months ended September 30,		
	2010	2009	change	2010	2009	change
Funds generated from operations	<b>28,204</b>	37,236	(24%)	<b>95,207</b>	105,948	(10%)
Per share – basic	<b>\$0.28</b>	\$0.43	(35%)	<b>\$0.93</b>	\$1.22	(24%)
Per share – diluted	<b>\$0.28</b>	\$0.43	(35%)	<b>\$0.93</b>	\$1.22	(24%)
Cash flow from operations						
(including changes in working capital)	<b>24,803</b>	40,048	(38%)	<b>88,017</b>	102,483	(14%)
Per share – basic	<b>\$0.24</b>	\$0.46	(48%)	<b>\$0.86</b>	\$1.18	(27%)
Per share – diluted	<b>\$0.24</b>	\$0.46	(48%)	<b>\$0.86</b>	\$1.18	(27%)
Net loss	<b>(7,600)</b>	(497)	–	<b>(10,912)</b>	(22,521)	52%
Per share – basic	<b>\$(0.07)</b>	\$(0.01)	(600%)	<b>\$(0.10)</b>	\$(0.26)	62%
Per share – diluted	<b>\$(0.07)</b>	\$(0.01)	(600%)	<b>\$(0.10)</b>	\$(0.26)	62%

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

(\$thousands)	Three months ended September 30,		Nine months ended September 30,	
	2010	2009	2010	2009
Cash flow from operations	<b>24,803</b>	40,048	<b>88,017</b>	102,483
Change in non-cash working capital	<b>2,478</b>	(2,819)	<b>5,861</b>	2,374
Asset retirement expenditures	<b>923</b>	7	<b>1,329</b>	1,091
Funds generated from operations	<b>28,204</b>	37,236	<b>95,207</b>	105,948

## BOE ANALYSIS

	Three months ended September 30,			
	2010		2009	
	(\$thousands)	(\$ per BOE)	(\$thousands)	(\$ per BOE)
Petroleum and natural gas revenue <sup>(1)</sup>	<b>54,718</b>	<b>38.36</b>	55,244	44.74
Royalties	<b>(4,742)</b>	<b>(3.32)</b>	(1,729)	(1.40)
Operating expenses	<b>(13,337)</b>	<b>(9.35)</b>	(11,174)	(9.05)
Transportation	<b>(1,581)</b>	<b>(1.11)</b>	(1,541)	(1.25)
Change in fair value of derivatives	<b>68</b>	<b>0.05</b>	3,833	3.11
General & administrative <sup>(2)</sup>	<b>(3,561)</b>	<b>(2.50)</b>	(3,315)	(2.68)
Interest expense <sup>(3)</sup>	<b>(3,361)</b>	<b>(2.36)</b>	(4,082)	(3.31)
Funds generated from operations	<b>28,204</b>	<b>19.77</b>	37,236	30.16
Change in fair value of derivatives	<b>(68)</b>	<b>(0.05)</b>	(3,833)	(3.11)
Compensation expense – non-cash	<b>(1,138)</b>	<b>(0.80)</b>	(401)	(0.32)
Accretion of convertible debentures	<b>(483)</b>	<b>(0.34)</b>	(502)	(0.40)
Depletion, depreciation and accretion	<b>(36,125)</b>	<b>(25.32)</b>	(32,876)	(26.63)
Future tax reduction (expense)	<b>2,010</b>	<b>1.41</b>	(121)	(0.10)
Net loss	<b>(7,600)</b>	<b>(5.33)</b>	(497)	(0.40)

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

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

3) Net of accretion on convertible debentures (non-cash).

## Interim Management's Discussion &amp; Analysis

	Nine months ended September 30,			
	2010		2009	
	(\$thousands)	(\$ per BOE)	(\$thousands)	(\$ per BOE)
Petroleum and natural gas revenue <sup>(1)</sup>	<b>177,733</b>	<b>43.51</b>	182,219	45.21
Royalties	<b>(18,962)</b>	<b>(4.64)</b>	(12,860)	(3.19)
Operating expenses	<b>(38,146)</b>	<b>(9.34)</b>	(43,188)	(10.72)
Transportation	<b>(4,425)</b>	<b>(1.08)</b>	(4,480)	(1.11)
Change in fair value of derivatives	<b>(387)</b>	<b>(0.09)</b>	4,330	1.08
General & administrative <sup>(2)</sup>	<b>(10,602)</b>	<b>(2.60)</b>	(8,632)	(2.14)
Compensation expense <sup>(3)</sup>	<b>(424)</b>	<b>(0.10)</b>	(151)	(0.03)
Interest expense <sup>(4)</sup>	<b>(9,580)</b>	<b>(2.35)</b>	(11,290)	(2.80)
Funds generated from operations	<b>95,207</b>	<b>23.31</b>	105,948	26.30
Change in fair value of derivatives	<b>387</b>	<b>0.09</b>	(4,330)	(1.08)
Compensation expense – non-cash	<b>(4,083)</b>	<b>(1.00)</b>	(15,939)	(3.96)
Accretion of convertible debentures	<b>(1,449)</b>	<b>(0.35)</b>	(1,505)	(0.37)
Depletion, depreciation and accretion	<b>(102,322)</b>	<b>(25.05)</b>	(108,153)	(26.83)
Future tax reduction	<b>1,348</b>	<b>0.33</b>	1,458	0.36
Net loss	<b>(10,912)</b>	<b>(2.67)</b>	(22,521)	(5.58)

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

2) Net of compensation expense.

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

4) Net of accretion on convertible debentures (non-cash).

Fairborne reported funds generated from operations of \$28.2 million for the third quarter of 2010 (Q3 2009 – \$37.2 million) and \$95.2 million for the nine months ended September 30, 2010 (YTD 2009 – \$105.9 million). On a year to date basis the decrease in funds generated from operations reflects the decrease in revenue due to lower natural gas prices, a decrease in sulphur block revenue as well as an increase in royalties and general and administrative expenses in 2010.

The net loss of \$7.6 million for the third quarter of 2010 (Q3 2009 – net loss of \$0.5 million) and the net loss of \$10.9 million for the nine months ended September 30, 2010 (YTD 2009 – net loss of \$22.5 million) reflects the decrease in cash flows. The net loss in 2009 also includes the \$12.6 million charge to compensation expense for stock options that were surrendered in June 2009.

## LIQUIDITY AND CAPITAL RESOURCES

### Capital Expenditures

(\$thousands)	Three months ended September 30,		Nine months ended September 30,	
	2010	2009	2010	2009
Exploration and development				
Land and lease acquisitions	<b>6,490</b>	909	<b>20,554</b>	5,991
Geological and geophysical	<b>572</b>	400	<b>5,076</b>	484
Drilling, completions and workovers	<b>29,536</b>	11,679	<b>81,227</b>	56,890
Well equipment and facilities	<b>3,517</b>	6,117	<b>17,080</b>	24,201
Corporate assets	<b>8</b>	127	<b>145</b>	236
	<b>40,123</b>	19,232	<b>124,082</b>	87,802
Property acquisitions, net of dispositions	<b>74,321</b>	(8,400)	<b>77,254</b>	(9,005)
Total	<b>114,444</b>	10,832	<b>201,336</b>	78,797



## *Interim Management's Discussion & Analysis*

During the third quarter of 2010, Fairborne's exploration and development expenditures were \$40.1 million with capital expenditures financed by funds generated from operations and bank debt. Property acquisitions included the \$71.5 acquisition of McLeod River properties adjacent to the Company's Marlboro/Pine Creek area as well as a smaller acquisition in the same area. Land and lease acquisitions of \$6.5 million during the third quarter of 2010 were primarily focused in the Company's Marlboro area where \$4.0 million was utilized to acquire additional acreage at Alberta provincial land sales and \$1.8 million was spent to acquire additional acreage on the Company's Westerose property. Fairborne also purchased \$0.6 million of seismic data during the third quarter of 2010, the majority of which covered the Marlboro area.

Fairborne spent \$29.5 million on drilling and completion activities in the third quarter of 2010 with a total of 16 (12.8 net) wells drilled. Third quarter activities were focused on Fairborne's core areas with 12 (9.3 net) natural gas wells drilled on the Company's Marlboro, Clive and West Pembina properties with an additional four (3.5 net) oil wells drilled on the Sinclair and West Pembina properties.

Tangible capital expenditures of \$3.5 million during the three months ended September 30, 2010 included various tie-ins in the Sinclair, Marlboro and West Pembina areas.

### **Working Capital and Bank Indebtedness**

At September 30, 2010, Fairborne had drawn \$194.1 million against its credit facilities and had a working capital deficit of \$22.6 million for a net debt position (excluding convertible debentures) of \$216.7 million (December 31, 2009 – \$110.1 million). The September 30, 2010 bank indebtedness included funds to finance the McLeod River property acquisition which was completed in the third quarter.

Fairborne's credit facilities at September 30, 2010 included a \$270 million extendible revolving term credit facility and a \$15 million demand operating credit facility for a total available facility of \$285 million. Subsequent to September 30, 2010, the lending syndicate approved an increase in the total borrowing base to \$325 million, including a \$310 million extendible revolving term credit facility and a \$15 million demand operating credit facility. 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.

### **Convertible Debentures**

Fairborne had 100,000 Convertible Unsecured Subordinated Debentures outstanding at September 30, 2010 with a principal amount 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.

### **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 third quarter of 2010, 10,130 common shares were issued on the exercise of stock options.

As a result of the 2009 flow-through financing, Fairborne had a commitment to spend \$20.0 million on qualifying Canadian exploration expenditures prior to December 31, 2010. As at September 30, 2010, the Company has satisfied this commitment.

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

<i>(thousands)</i>	<b>October 31, 2010</b>	<b>September 30, 2010</b>	December 31, 2009
Common shares	<b>102,499</b>	<b>102,499</b>	102,462
Warrants <sup>(1)</sup>	–	–	4,406
Convertible debentures <sup>(2)</sup>	<b>\$100,000</b>	<b>\$100,000</b>	\$100,000
Incentive plans			
Restricted units	–	–	30
Performance units	–	–	92
Stock options	<b>6,923</b>	<b>6,774</b>	5,235
Weighted average common shares <sup>(3)</sup>			
Basic	<b>n/a</b>	<b>102,481</b>	90,609
Diluted	<b>n/a</b>	<b>102,481</b>	90,609

1) Each warrant entitled the holder to acquire 0.39 of a common share at an exercise price of \$8.13 per common share. All remaining warrants expired on June 1, 2010.

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

3) Weighted average common shares are for the twelve months ended December 31, 2009 and for the nine months ended September 30, 2010.

## 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 rates and foreign exchange rates;
- maintaining a strong financial position; and
- maintaining strict environmental, safety and health practices.

## CHANGE IN ACCOUNTING POLICIES AND RECENT ACCOUNTING PRONOUNCEMENTS

### International Financial Reporting Standards ("IFRS")

Effective January 11, 2011, Canadian public companies are required to adopt International Financial Reporting Standards ("IFRS"). Some Canadian standards have already changed to converge with IFRS. Fairborne's financial statements up to and including the December 31, 2010 financial statements will continue to be reported in accordance with Canadian generally accepted accounting principles ("GAAP") as it exists on each reporting date. Financial statements for the quarter ended March 31, 2011, including comparative amounts, will be prepared on an IFRS basis.



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In order to transition to IFRS, management has formed an executive steering committee which oversees the project team. A transition plan is in place to convert the financial statements to IFRS. Training has been provided to key employees and the Company continues to assess the effect of the transition on information systems, internal controls over financial reporting and disclosure controls and procedures. Systems and controls are being updated as IFRS accounting processes are implemented. Significant system and control changes are not anticipated. Analysis and quantification of differences between IFRS and Fairborne's current accounting policies is continuing. Some accounting policies may change on adoption of IFRS even though Fairborne's current accounting policies are acceptable under IFRS. Changes in accounting policy may materially impact the financial statements.

The Company has prepared a preliminary balance sheet as at January 1, 2010 as well as preliminary financial statements for the three months ended March 31, 2010 on an IFRS basis. Calculations of the impact of changes in accounting policy have been prepared by management and have been provided to the Company's Audit Committee. Quantitative information is provided herein to allow readers to assess the impact of applying IFRS at January 1, 2010 and for the three months ended March 31, 2010. However readers are cautioned that the calculations have not been audited by the Company's auditors and may still be subject to change. Specifically, interpretation and analysis of IFRS standards applicable to the period when Fairborne was a trust is ongoing and may result in material adjustments to the Company's opening balance sheet under IFRS. The Company is also currently preparing the financial statements for the six months ended June 30, 2010 on an IFRS basis.

Numerous accounting policy changes will be made under IFRS, with the most significant changes expected to include accounting for petroleum and natural gas assets and equipment ("P&NG assets"), accounting for business combinations and accounting for future taxes. Changes in IFRS prior to adoption and ongoing analysis by the Company may result in other accounting policy changes which could significantly impact the financial statements as well as quantitative information provided herein.

#### PETROLEUM AND NATURAL GAS ASSETS

IFRS standards would generally require that a company report its petroleum and natural gas assets on the date of adoption of IFRS at the amount which would have been recorded had the company always followed IFRS standards. Alternatively, IFRS standards allow for a conversion exemption whereby companies can choose to record opening petroleum and natural gas assets at a deemed cost equal to historic cost as calculated under Canadian GAAP or at fair value on the date of adoption of IFRS. Fairborne intends to elect to record P&NG assets at historic cost as calculated under Canadian GAAP on January 1, 2010. As such, the reported value of petroleum and natural gas assets at January 1, 2010 will not change under IFRS.

Under Canadian GAAP, all petroleum and natural gas assets are accounted for under the full cost accounting guideline. Under IFRS, P&NG assets will be divided into exploration and evaluation properties ("E&E assets") and petroleum and natural gas properties and equipment ("development assets"). E&E assets will initially be capitalized and amounts accumulated pending determination of technical feasibility and economic viability. E&E assets will not be depreciated and will be carried at cost less any accumulated impairment losses. Development assets will be measured at cost less accumulated depletion and depreciation and any accumulated impairment losses. E&E assets will initially be recorded at January 1, 2010 based on the Canadian GAAP historic cost of those assets. IFRS permits the remaining deemed cost of P&NG assets at January 1, 2010 to be allocated to individual development assets on a pro rata basis using either reserve values or reserve volumes. Fairborne intends to allocate the deemed cost to development assets pro rata based on reserve values. Due to the nature of Fairborne's assets, which are primarily development in nature, management has estimated E&E assets to be \$5.4 million at January 1, 2010 with \$875.5 million in development assets. At March 31, 2010, management has estimated E&E assets to be \$8.3 million.

*Interim Management's Discussion & Analysis*

E&E assets and development assets have been assessed to determine whether impairment losses exist under IFRS as at January 1, 2010. These impairment tests differed from the current Canadian GAAP full cost ceiling test in several significant ways. Assets (including goodwill) were allocated to Cash Generating Units ("CGU"s) and a separate impairment test was completed for each CGU identified. Fairborne has identified five CGUs: Northern Alberta, Southern Alberta, Deep Basin, West Pembina and Manitoba/Saskatchewan. Fairborne has completed an IFRS impairment test for each CGU as at January 1, 2010 and does not anticipate that any impairment will be recorded at January 1, 2010. At March 31, 2010 the Company determined that no indicators of impairment were identified which would cause an impairment test to be completed and accordingly does not anticipate that any impairment will be recorded at March 31, 2010.

Under current Canadian GAAP the ceiling test is a two step test. The carrying value of assets is first compared to the undiscounted future cash flows. If the carrying value of the assets exceeds the undiscounted future cash flows, then the second step of the test is completed whereby the assets are written down to the value of the discounted future cash flows. Under IFRS, the impairment test compares the carrying value of the assets to the greater of the fair value of the assets and the value-in-use of the assets, which is a discounted cash flow measure. As a result, impairments may be recorded more frequently under IFRS. Future impairment tests may be required when management determines that indicators of impairment exist. Should impairment losses be recorded in accordance with IFRS, certain of those losses can reverse in the future if facts and circumstances change.

Depreciation under Canadian GAAP is calculated using a unit-of-production method based on total proved reserves for all accumulated costs (excluding unproved properties). Under IFRS, the net carrying value of development assets will still be depleted using a unit of production method; however, significant components with different useful lives will be accounted for as separate items and depreciated separately. Fairborne has determined the components which will be used for the purpose of depreciating development assets. In addition, IFRS allows depreciation to be calculated using either proved reserves or proved plus probable reserves. Fairborne intends to depreciate assets using proved plus probable reserves. As a result, depreciation calculated on an IFRS basis for the three months ended March 31, 2010 is approximately \$8.2 million lower than that recorded under Canadian GAAP.

Under the full cost accounting guideline, gains or losses are not recognized upon the disposition of P&NG assets unless the disposition results 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 did not result in gains or losses being recorded under Canadian GAAP. Fairborne has reviewed asset sales and non-monetary transactions which occurred in the three months ended March 31, 2010 and has estimated the impact on net income of recording gains or losses on these transactions to be less than \$0.5 million.

Under Canadian GAAP, Fairborne did not capitalize general and administrative expenses to P&NG assets other than recoveries permitted under joint operating agreements. IFRS offers more guidance on amounts which should be capitalized. There is no impact of this change on P&NG assets recorded at January 1, 2010 due to the conversion exemption which Fairborne intends to elect. Fairborne has estimated the amount which will be capitalized under IFRS for the three months ended March 31, 2010 and expects that the amount of general and administrative costs capitalized will be approximately \$0.7 million higher than that which was recorded under Canadian GAAP. This will result in an increase in profit, net of tax and an increase in P&NG assets for the three months ended March 31, 2010.



## *Interim Management's Discussion & Analysis*

### BUSINESS COMBINATIONS

Accounting for business combinations also differs under IFRS. Fairborne has elected not to restate business combinations recorded prior to January 1, 2010 in accordance with IFRS standards. As a result, in respect of acquisitions prior to January 1, 2010, goodwill continues to represent the amount recognized under Canadian GAAP. However, goodwill recognized in business combinations after January 1, 2010 recorded under IFRS will represent the excess of the cost of the acquisition over the net fair value of the identifiable assets, liabilities and recognized contingent liabilities of the acquired entity. When the excess is negative, it will be recognized immediately in profit and loss. In addition, transaction costs which are included in the cost of the acquisition under Canadian GAAP will be expensed under IFRS. Fairborne did not enter into any business combinations in the first six months of 2010. The business combination entered into during the three months ended September 30, 2010 has been accounted for under Canadian GAAP. The effect of applying IFRS standards to this business combination has not yet been analyzed; however, the \$230,000 of transaction costs that were capitalized under Canadian GAAP will be expensed under IFRS.

### DEFERRED INCOME TAXES

Deferred income taxes are calculated under IFRS using a liability approach which is conceptually similar to Canadian GAAP however there are differences in the manner in which deferred income taxes are calculated. In addition, each other adjustment recorded on adoption of IFRS was assessed to determine if there was a related income tax impact, resulting in a decrease in deferred tax liability of \$3.3 million with a corresponding increase in retained earnings as at January 1, 2010.

In addition to these changes, Fairborne calculated the tax effects of accounting for share issue costs and flow through shares using IFRS standards. Under Canadian GAAP, when shares are issued the related costs are recorded on an after tax basis as an offset to the proceeds of the share issue. As the tax effect of the share issue costs reverses, the change in deferred income tax is recorded through profit and loss. Under IFRS, subsequent changes in tax rates related to these tax amounts are recorded to share capital, where the original tax benefit was recognized. This adjustment did not affect the tax liability account at January 1, 2010 however, it resulted in a decrease in share capital of \$0.3 million with a corresponding adjustment to retained earnings at January 1, 2010. No adjustment was required for the three months ended March 31, 2010. 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", are recorded as a deferred charge. When expenditures are renounced, 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 in flow through share premium of \$4.0 million representing the tax effect of proceeds of a flow through share issuance completed in 2009 for which the related expenditures had not yet been renounced, with a corresponding decrease to retained earnings and an insignificant adjustment to share capital. For the three months ended March 31, 2010 when expenditures from this 2009 flow-through share issue were renounced it resulted in the reversal of the \$4.0 million deferred charge recorded on January 1, 2010, an increase in share capital of \$5.0 million and an increase in deferred tax expense of \$1.0 million.

### OTHER ITEMS

There are other accounting policy changes with potentially material impacts, including accounting for asset retirement obligations (ARO), convertible debentures, warrants, exchangeable shares and stock based compensation. The ARO calculation differs under IFRS in some respects. Fairborne has re-calculated the ARO

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liability using a risk free discount rate at January 1, 2010. The result was an increase of \$11.7 million in the ARO liability at January 1, 2010 with a corresponding adjustment in retained earnings. The impact of the ARO calculation for the three months ended March 31, 2010 was an increase in the ARO liability, an increase in P&NG assets and a decrease in accretion expense; each of which were insignificant (less than \$0.4 million).

Retention Awards are cash settled stock based payments which are recorded as a liability under both Canadian GAAP and IFRS. Under Canadian GAAP, the retention awards are measured at their intrinsic value while under IFRS they are measured at fair value. The impact of accounting for retention awards under IFRS was an increase of \$1.4 million in compensation liability at January 1, 2010 with a corresponding adjustment to retained earnings. For the three months ended March 31, 2010, the impact was a decrease in the current portion of the compensation liability and a decrease in general and administrative expenses of \$1.2 million.

Under IFRS, accounting for equity items such as trust units, warrants, convertible debentures and exchangeable shares held within a trust structure can be materially different than under Canadian GAAP. Given that Fairborne was a trust from June 2005 until December 2007, certain of these items may result in a material adjustment to the Company's statements under IFRS. Fairborne is in the process of assessing and quantifying the impact of these differences on the Company's IFRS statements.

## **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 statements for external purposes in accordance with Canadian GAAP.

No material changes in Fairborne's internal controls over financial reporting were identified during the three months ended September 30, 2010, 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:

	2010			2009
	Q3	Q2	Q1	Q4
<b>Financial</b> ( <i>\$thousands, except per share amounts</i> )				
Petroleum and natural gas revenue	<b>54,718</b>	59,633	63,382	58,338
Funds generated from operations	<b>28,204</b>	27,448	39,555	37,863
Per share – basic	<b>\$0.28</b>	\$0.27	\$0.39	\$0.37
Per share – diluted	<b>\$0.28</b>	\$0.27	\$0.38	\$0.37
Cash flow from operations (including changes in working capital)	<b>24,803</b>	19,692	43,522	38,750
Per share – basic	<b>\$0.24</b>	\$0.19	\$0.42	\$0.38
Per share – diluted	<b>\$0.24</b>	\$0.19	\$0.42	\$0.38
Net income (loss)	<b>(7,600)</b>	(7,121)	3,809	(3,124)
Per share – basic	<b>\$(0.07)</b>	\$(0.07)	\$0.04	\$(0.02)
Per share – diluted	<b>\$(0.07)</b>	\$(0.07)	\$0.04	\$(0.02)
Total assets	<b>1,035,104</b>	951,477	976,138	940,443
Working capital deficit	<b>22,621</b>	6,352	34,611	6,370
Bank indebtedness	<b>194,042</b>	123,081	102,536	103,738
Convertible debentures	<b>97,959</b>	97,476	96,993	96,510
<b>Operations</b>				
Average production				
Natural gas ( <i>Mcf per day</i> )	<b>68,910</b>	66,812	60,878	59,132
Crude oil ( <i>bbls per day</i> )	<b>2,916</b>	3,110	3,000	3,037
Natural gas liquids ( <i>bbls per day</i> )	<b>1,036</b>	1,149	686	617
Sulphur ( <i>tonnes per day</i> ) <sup>(1)</sup>	<b>66</b>	92	54	33
Total ( <i>BOE per day</i> )	<b>15,503</b>	15,486	13,886	13,542

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

## Interim Management's Discussion &amp; Analysis

	2009			2008
	Q3	Q2	Q1	Q4
<b>Financial</b> ( <i>\$thousands, except per share amounts</i> )				
Petroleum and natural gas revenue	55,244	58,430	68,545	85,165
Funds generated from operations	37,236	35,742	32,970	40,309
Per share – basic	\$0.43	\$0.41	\$0.38	\$0.46
Per share – diluted	\$0.43	\$0.41	\$0.38	\$0.46
Cash flow from operations				
(including changes in working capital)	40,048	27,653	34,782	37,693
Per share – basic	\$0.46	\$0.32	\$0.40	\$0.43
Per share – diluted	\$0.46	\$0.32	\$0.40	\$0.43
Net income (loss)	(497)	(17,333)	(4,691)	11,657
Per share – basic	\$(0.01)	\$(0.20)	\$(0.05)	\$0.14
Per share – diluted	\$(0.01)	\$(0.20)	\$(0.05)	\$0.14
Total assets	961,920	1,001,840	1,023,526	1,013,177
Working capital deficit (surplus)	(1,539)	(7,227)	31,641	27,917
Bank indebtedness	204,046	232,184	209,925	196,282
Convertible debentures	96,027	95,525	95,024	94,522
<b>Operations</b>				
Average production				
Natural gas ( <i>Mcf per day</i> )	56,797	66,744	67,520	69,460
Crude oil ( <i>bbls per day</i> )	3,292	3,552	3,599	4,086
Natural gas liquids ( <i>bbls per day</i> )	563	632	572	657
Sulphur ( <i>tonnes per day</i> ) <sup>(1)</sup>	100	64	93	138
Total ( <i>BOE per day</i> )	13,421	15,372	15,517	16,458

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



*Interim Consolidated Financial Statements***INTERIM CONSOLIDATED BALANCE SHEETS**

(Unaudited)

<i>(\$thousands)</i>	<b>September 30, 2010</b>	December 31, 2009
<b>Assets</b>		
Current assets		
Cash and cash equivalents	\$ 291	\$ 147
Accounts receivable	28,270	35,155
Derivative asset <i>(Note 8)</i>	28	–
Prepaid expenses and deposits	5,583	8,079
	<b>34,172</b>	43,381
Petroleum and natural gas properties and equipment <i>(Note 2)</i>	<b>984,762</b>	880,892
Goodwill	<b>16,170</b>	16,170
	<b>\$ 1,035,104</b>	\$ 940,443
<b>Liabilities</b>		
Current liabilities		
Accounts payable and accrued liabilities	\$ 56,793	\$ 44,602
Derivative liability <i>(Note 8)</i>	–	359
Current portion of compensation plans	–	505
Deferred revenue	–	4,285
	<b>56,793</b>	49,751
Bank indebtedness <i>(Note 3)</i>	<b>194,042</b>	103,738
Convertible debentures <i>(Note 4)</i>	<b>97,959</b>	96,510
Asset retirement obligation <i>(Note 5)</i>	<b>14,727</b>	11,200
Future income taxes	<b>93,619</b>	89,919
<b>Shareholders' equity</b>		
Common shares <i>(Note 6)</i>	<b>532,004</b>	536,789
Warrants <i>(Note 6)</i>	–	2,721
Equity component of convertible debentures <i>(Note 4)</i>	<b>5,581</b>	5,581
Contributed surplus <i>(Note 6)</i>	<b>31,884</b>	24,827
Retained earnings	<b>8,495</b>	19,407
	<b>577,964</b>	589,325
	<b>\$ 1,035,104</b>	\$ 940,443

*See accompanying notes to the interim consolidated financial statements.*

*Interim Consolidated Financial Statements***INTERIM CONSOLIDATED STATEMENTS OF OPERATIONS AND RETAINED EARNINGS**

(Unaudited)

<i>(\$thousands except per share amounts)</i>	For the three months ended September 30,		For the nine months ended September 30,	
	<b>2010</b>	2009	<b>2010</b>	2009
<b>Revenue</b>				
Petroleum and natural gas	<b>\$ 54,718</b>	\$ 55,244	<b>\$ 177,733</b>	\$ 182,219
Royalties	<b>(4,742)</b>	(1,729)	<b>(18,962)</b>	(12,860)
	<b>49,976</b>	53,515	<b>158,771</b>	169,359
<b>Expenses</b>				
Operating	<b>13,337</b>	11,174	<b>38,146</b>	43,188
Transportation	<b>1,581</b>	1,541	<b>4,425</b>	4,480
General and administrative	<b>4,699</b>	3,716	<b>15,109</b>	24,722
Interest	<b>3,844</b>	4,584	<b>11,029</b>	12,795
Depletion, depreciation and accretion	<b>36,125</b>	32,876	<b>102,322</b>	108,153
	<b>59,586</b>	53,891	<b>171,031</b>	193,338
<b>Loss before taxes</b>	<b>(9,610)</b>	(376)	<b>(12,260)</b>	(23,979)
Future taxes (reduction)	<b>(2,010)</b>	121	<b>(1,348)</b>	(1,458)
<b>Net loss and comprehensive loss</b>	<b>(7,600)</b>	(497)	<b>(10,912)</b>	(22,521)
Retained earnings, beginning of period	<b>16,095</b>	23,028	<b>19,407</b>	45,052
<b>Retained earnings, end of period</b>	<b>\$ 8,495</b>	22,531	<b>\$ 8,495</b>	22,531
<b>Net loss per share</b> <i>(Note 6)</i>				
Basic	<b>\$ (0.07)</b>	\$ (0.01)	<b>\$ (0.10)</b>	\$ (0.26)
Diluted	<b>\$ (0.07)</b>	\$ (0.01)	<b>\$ (0.10)</b>	\$ (0.26)

See accompanying notes to the interim consolidated financial statements.



*Interim Consolidated Financial Statements***INTERIM CONSOLIDATED STATEMENTS OF CASH FLOWS**

(Unaudited)

(\$thousands)	For the three months ended September 30,		For the nine months ended September 30,	
	<b>2010</b>	2009	<b>2010</b>	2009
<b>Cash provided by (used in):</b>				
<b>Operating activities</b>				
Net loss	\$ (7,600)	\$ (497)	\$ (10,912)	\$ (22,521)
Items not involving cash:				
Depletion, depreciation and accretion	36,125	32,876	102,322	108,153
Compensation expense	1,138	401	4,083	15,939
Future taxes (reduction)	(2,010)	121	(1,348)	(1,458)
Accretion of convertible debentures	483	502	1,449	1,505
Change in fair value of derivatives	68	3,833	(387)	4,330
Asset retirement expenditures	(923)	(7)	(1,329)	(1,091)
	27,281	37,229	93,878	104,857
Change in non-cash working capital	(2,478)	2,819	(5,861)	(2,374)
	24,803	40,048	88,017	102,483
<b>Financing activities</b>				
Bank indebtedness	70,961	(28,138)	90,304	7,764
Issuance of common shares	1	–	11	–
	70,962	(28,138)	90,315	7,764
<b>Investing activities</b>				
Expenditures on petroleum and natural gas properties	(40,123)	(19,232)	(124,082)	(87,802)
Acquisition of petroleum and natural gas properties	(74,321)	(1,951)	(77,254)	(1,951)
Disposition of petroleum and natural gas properties	–	10,351	–	10,956
Change in non-cash working capital	18,714	(1,125)	23,148	(31,470)
	(95,730)	(11,957)	(178,188)	(110,267)
Change in cash and cash equivalents	35	(47)	144	(20)
Cash and cash equivalents, beginning of period	256	153	147	126
<b>Cash and cash equivalents, end of period</b>	<b>\$ 291</b>	<b>\$ 106</b>	<b>\$ 291</b>	<b>\$ 106</b>
Interest paid	\$ 1,631	\$ 2,290	\$ 7,418	\$ 11,127

*See accompanying notes to the interim consolidated financial statements.*

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

For the nine months ended September 30, 2010 (unaudited)

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

The interim consolidated financial statements of Fairborne Energy Ltd. (the “Company” or “Fairborne”) have been prepared by management in accordance with accounting principles generally accepted in Canada. The interim consolidated financial statements have been prepared following the same accounting policies and methods of computation as the consolidated financial statements for the year ended December 31, 2009. The disclosure which follows is incremental to the disclosure included with the annual financial statements. These interim consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto for the year ended December 31, 2009.

**1. PROPERTY ACQUISITION**

On September 9, 2010, the Company acquired certain petroleum and natural gas assets which included undeveloped land, facilities interests and producing properties in the McLeod River area. The acquired properties expanded the Company’s existing interests in the Marlboro/Pine Creek area of North Central Alberta. The acquisition has been accounted for by the purchase method. The results of operations from the assets acquired have been included in Fairborne’s financial statements beginning September 9, 2010.

Details of the acquisition are as follows, subject to closing adjustments:

Net assets acquired:	
Petroleum and natural gas properties and equipment	\$ 75,208
Asset retirement obligations	(3,662)
	<b>\$ 71,546</b>
Consideration:	
Cash	\$ 71,316
Transaction costs	230
	<b>\$ 71,546</b>

**2. PETROLEUM AND NATURAL GAS PROPERTIES AND EQUIPMENT**

	<b>September 30, 2010</b>	December 31, 2009
Petroleum and natural gas properties and equipment	<b>\$ 1,640,520</b>	\$ 1,435,282
Accumulated depletion and depreciation	<b>(657,511)</b>	(556,289)
Corporate assets	<b>4,452</b>	4,307
Accumulated depreciation	<b>(2,699)</b>	(2,408)
	<b>\$ 984,762</b>	\$ 880,892

As at September 30, 2010, future development costs of \$208.3 million (December 31, 2009 – \$193.8 million) were included in the depletion calculation and costs of acquiring unproved properties in the amount of \$73.8 million (December 31, 2009 – \$48.2 million) were excluded from the depletion calculation.



*Interim Consolidated Financial Statements***3. BANK INDEBTEDNESS**

At September 30, 2010 the Company had a \$270 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 September 30, 2010 letters of credit totaling \$2.1 million were outstanding.

Subsequent to September 30, 2010, the lending syndicate approved an increase in the total borrowing base to \$325 million, including a \$310 million extendible revolving term credit facility and a \$15 million demand operating credit facility.

**4. CONVERTIBLE DEBENTURES**

The following table sets forth a reconciliation of the convertible debentures for the nine months ended September 30, 2010:

	Number of debentures	Debt component	Equity component
Balance, beginning of period	100,000	\$ 96,510	\$ 5,581
Accretion	–	1,449	–
Balance, end of period	<b>100,000</b>	<b>\$ 97,959</b>	<b>\$ 5,581</b>

**5. ASSET RETIREMENT OBLIGATION**

The following table sets forth a reconciliation of the asset retirement obligation for the nine months ended September 30, 2010:

Balance, beginning of period	\$ 11,200
Liabilities incurred	385
Liabilities acquired	3,662
Liabilities settled	(1,329)
Accretion expense	809
Balance, end of period	<b>\$ 14,727</b>

*Interim Consolidated Financial Statements***6. SHAREHOLDERS' EQUITY**

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

**a) Common Shares**

The following table sets forth a reconciliation of the common shares issued and outstanding for the nine months ended September 30, 2010:

	Number of shares	Amount
Balance, beginning of period	102,462	\$ 536,789
Issued on vesting of restricted units and performance units	15	140
Issued on exercise of stock options	22	123
Tax effect of flow through shares issued in 2009	–	(5,048)
<b>Balance, end of period</b>	<b>102,499</b>	<b>\$ 532,004</b>

As a result of the 2009 flow-through financing, Fairborne had a commitment to spend \$20.0 million on qualifying Canadian exploration expenditures. As at September 30, 2010, the Company has satisfied this commitment.

**b) Warrants**

On June 1, 2010 all remaining warrants expired unexercised.

**c) Per share amounts**

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

	Three months ended September 30,		Nine months ended September 30,	
	2010	2009	2010	2009
Numerator				
Net loss – basic & diluted	\$ (7,600)	\$ (497)	\$ (10,912)	\$ (22,521)
Denominator				
Weighted average shares – basic and diluted	102,494	87,033	102,481	87,010
Basic net loss per share	\$ (0.07)	\$ (0.01)	\$ (0.10)	\$ (0.26)
Diluted net loss per share	\$ (0.07)	\$ (0.01)	\$ (0.10)	\$ (0.26)

Excluded from the diluted number of shares for the three and nine months ended September 30, 2010 is the effect of convertible debentures (7.4 million shares) and 6.8 million stock options as they are anti-dilutive to the net loss per share for the period. Excluded from the diluted number of shares for the three and nine months ended September 30, 2009 is the effect of convertible debentures (7.4 million shares), warrants (1.7 million shares) and 2.0 million stock options.



*Interim Consolidated Financial Statements***d) Equity and liability based compensation plans****i) STOCK OPTION PLAN**

The following table sets forth a reconciliation of the stock option plan activity for the nine months ended September 30, 2010:

	Number of options	Weighted average exercise price
Balance, beginning of period	5,235	\$ 4.25
Granted	1,929	4.18
Exercised	(79)	3.71
Forfeited	(311)	4.32
Balance, end of period	<b>6,774</b>	<b>\$ 4.23</b>
Exercisable, end of period	<b>1,674</b>	<b>\$ 4.55</b>

The weighted average fair value of options granted during the nine months ended September 30, 2010 was \$1.66 per option using the Black-Scholes option pricing model with the following assumptions: risk free interest rate of two percent, expected volatility of 64 percent, average expected life of three years and dividend rate of nil. An estimated forfeiture rate of two percent has been applied to the compensation costs recognized.

The following table summarizes stock options outstanding at September 30, 2010:

Exercise Price	Options outstanding	Remaining term (years)
\$ 2.00 – \$ 4.99	6,586	4.1
\$ 5.00 – \$ 7.99	55	3.6
\$ 8.00 – \$ 10.99	58	3.0
\$ 11.00 – \$ 13.99	75	2.8
	<b>6,774</b>	<b>4.1</b>

**ii) RETENTION AWARD PLAN**

The following table sets forth a reconciliation of the retention award plan activity for the nine months ended September 30, 2010:

	Number of awards	Weighted average exercise price
Balance, beginning of period	1,390	\$ 5.74
Forfeited	(460)	5.75
Balance, end of period	<b>930</b>	<b>\$ 5.74</b>
Exercisable, end of period	<b>620</b>	<b>\$ 5.74</b>

**iii) INCENTIVE PLAN**

In March 2010, all remaining restricted and performance units vested and were settled with either cash or common shares.

*Interim Consolidated Financial Statements***e) Contributed Surplus**

The following table sets forth a reconciliation of the contributed surplus for the nine months ended September 30, 2010:

Balance , beginning of period	\$ 24,827
Equity based compensation	4,448
Warrants expired	2,721
Stock options exercised	(112)
Balance, end of period	<b>\$ 31,884</b>

**7. FINANCIAL INSTRUMENTS**

As at September 30, 2010, the Company's accounts receivable is aged as follows:

Current (less than 90 days)	\$ 23,819
Past due (more than 90 days)	4,451
Total	<b>\$ 28,270</b>

**Fair value of financial instruments:**

The carrying value of Fairborne's financial instruments, other than bank indebtedness and convertible debentures, approximate their fair value due to their short maturity. The fair value of the bank indebtedness approximates its carrying value as it bears interest at a floating rate. The fair value of the convertible debentures at September 30, 2010 was \$102.1 million (December 31, 2009 – \$100.3 million).

**8. COMMODITY CONTRACTS**

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

**a) Commodity Contracts Recorded at Fair Value:**

At September 30, 2010 certain contracts have been recorded on the balance sheet at their estimated fair value as a \$28,000 asset (December 31, 2009 – \$0.4 million liability). The change in the fair value has been recorded in petroleum and natural gas sales for the nine months ended September 30, 2010.

**Oil:**

	Volume (bbls per day)	Price (CDN\$ per bbl)	Settlement Index
Collars			
Oct 1, 2010 – Dec 31, 2010	500	55.00 – 108.00	WTI
Oct 1, 2010 – Dec 31, 2010	500	70.00 – 100.15	WTI
Jan 1, 2011 – Dec 31, 2011	500	70.00 – 101.25	WTI
Swaps			
Jan 1, 2011 – Dec 31, 2011	500	75.00	WTI

**Natural Gas:**

	Volume (GJs per day)	Price (CDN\$ per GJ)	Settlement Index
Swaps			
Jan 1, 2011 – Dec 31, 2011	5,000	5.16	AECO C Monthly



*Interim Consolidated Financial Statements***b) Commodity Contracts not Recorded at Fair Value:**

The following crude oil and natural gas fixed price physical sales contracts outstanding at September 30, 2010 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.

**Oil:**

	Volume (bbls per day)	Price (CDN\$ per bbl)	Settlement Index
Collars			
Oct 1, 2010 – Dec 31, 2010	500	55.00 – 103.00	WTI

**Natural Gas:**

	Volume (GJs per day)	Price (CDN\$ per GJ)	Settlement Index
Swaps			
Oct 1, 2010 – Dec 31, 2010	5,000	5.86	AECO C Monthly
Oct 1, 2010 – Dec 31, 2010	2,500	5.67	AECO C Monthly
Oct 1, 2010 – Dec 31, 2010	1,500	5.90	AECO C Monthly
Oct 1, 2010 – Dec 31, 2010	1,500	5.86	AECO C Monthly
Oct 1, 2010 – Dec 31, 2010	1,500	5.88	AECO C Monthly
Oct 1, 2010 – Dec 31, 2010	1,500	6.00	AECO C Monthly
Oct 1, 2010 – Dec 31, 2010	4,000	6.00	AECO C Monthly
Oct 1, 2010 – Dec 31, 2010	2,000	6.13	AECO C Monthly
Oct 1, 2010 – Dec 31, 2010	2,000	6.15	AECO C Monthly
Oct 1, 2010 – Dec 31, 2010	2,000	6.16	AECO C Monthly
Oct 1, 2010 – Dec 31, 2010	4,000	5.72	AECO C Monthly
Jan 1, 2011 – Dec 31, 2011	5,000	5.00	AECO C Monthly
Jan 1, 2011 – Dec 31, 2011	5,000	5.00	AECO C Monthly

*Corporate Directory***FAIRBORNE ENERGY LTD.**

3400, 450 – 1st Street SW  
 Calgary, Alberta T2P 5H1  
 Telephone [403] 290-7750  
 Fax [403] 290-7724

**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](http://www.sedar.com)

**OFFICERS**

**Steven R. VanSickle**  
 President  
 and Chief Executive Officer

**David L. Summers**  
 Chief Operating Officer

**Aaron G. Grandberg**  
 Chief Financial Officer

**Jackie M. Cugnet**  
 Vice President  
 Finance

**David S. Cymbalisky**  
 Vice President  
 Engineering

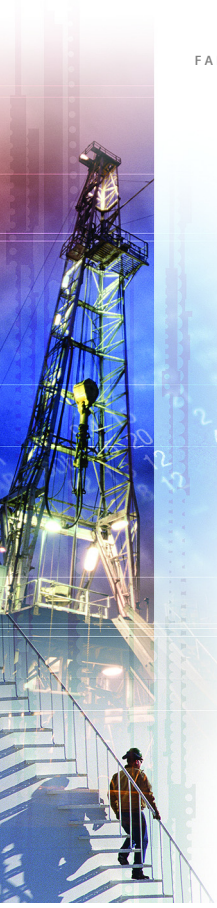
**Scott W. Hadley**  
 Vice President  
 Exploration

**F. Tom Park**  
 Vice President  
 Marketing

**Gary M. Poirier**  
 Vice President  
 Production

**David E.T. Pyke**  
 Vice President  
 Land and Contracts





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