



To Our Shareholders

During the second quarter of 2011, Painted Pony Petroleum Ltd.'s (the "Company") operating and financial results include the following significant changes:

- The Company commissioned a contingent resource assessment for its Montney assets in northeast British Columbia, with an effective date of June 30, 2011. This assessment, resulted in a best-estimate contingent resource of 2.1 trillion cubic feet of gas equivalent net to Painted Pony, which equates to 358.2 million boe ("mmboe"), including 40.2 mmboe of liquids, having a net present value, using a 10% discount rate ("NPV10") of \$2.1 billion;
- Company total proved plus probable reserves grew to 85.6 mmboe (up 163% in 6 months) with a NPV10 of \$797.9 million (up 126% in 6 months);
- Production averaged 3,593 boe per day (weighted 60% gas and 40% oil and liquids), an increase of 42% from the second quarter of 2010;
- Exited the second quarter of 2011 with no debt and a positive working capital position of \$40.3 million and its credit facility was subsequently increased to \$80 million;
- Generated funds flow from operations of \$10.4 million (\$0.17 per diluted share); and
- Realized second quarter 2011 field netbacks of \$66.48 per boe for oil-weighted assets in Saskatchewan and \$15.66 per boe for gas-weighted assets in British Columbia.

RESERVES

Painted Pony completed a mid-year reserves update and a Montney contingent resource assessment. GLJ Petroleum Consultants Ltd. and Sproule Associates Limited were engaged to prepare independent evaluation reports of the reserves and contingent resources on the Company's British Columbia properties and the reserves on the Company's Saskatchewan assets, respectively. Both reports were dated effective June 30, 2011 and were prepared in accordance with National Instrument 51-101 (Standards of Disclosure for Oil and Gas Activities). As previously announced on July 27, 2011, the best estimate contingent resources for the Company's Montney assets increased to 2.1 trillion cubic feet of gas equivalent, equating to 358.2 million boe ("mmboe"), including 40.2 mmboe of liquids, with a net present value using a 10% discount rate ("NPV10") of \$2.1 billion. Total proved plus probable reserves totaled 85.6 mmboe, an increase of 163% since December 31, 2010. The NPV10 of the Company's proved plus probable reserves was \$797.9 million, an increase of 126% in the first six months of 2011.

LAND

At June 30, 2011, the Company had 81,896 net acres (128 net sections) of land in Saskatchewan and 132,175 net acres (207 net sections) of land in British Columbia, including over 127 net sections with Montney rights. As previously announced on July 27, 2011, the Company's British Columbia landholdings have been ascribed a value of \$123.7 million by Seaton-Jordan & Associates Ltd. in an updated independent valuation, effective June 30, 2011. Undeveloped Saskatchewan acreage was not included in the Seaton-Jordan Report and was valued at \$52.7 million, as at December 31, 2010. The fair value of the undeveloped acreage was determined in accordance with NI 51-101. At the August British Columbia Crown land sale the Company acquired an additional 4,200 net acres of land with Montney rights.

PRODUCTION

Painted Pony's sales volumes averaged 3,593 boe per day during the three months ended June 30, 2011, an increase of 42% compared to the second quarter of 2010 and 11% less than the first quarter of 2011. These volumes were weighted 60% towards gas compared to 38% in the comparable 2010 period. All of Painted Pony's light oil sales originate from Saskatchewan operations while 94% of the sales of gas, condensate and NGL's are from British Columbia.

Second quarter production in Saskatchewan was adversely affected by extensive flooding, which caused production curtailments and significant delays to operational activity. In addition, a mid-stream gas processing facility experienced an unscheduled plant inlet disruption midway through the second quarter. Repairs to the facility are underway. Sales volumes of solution gas and associated liquids from the Company's Midale Huntoon area are expected to resume in late September. As a result of these disruptions, Saskatchewan sales in the second quarter of 2011 averaged 1,422 boe per day. The Company currently has an estimated 320 boe per day shut-in in Saskatchewan. During recent weeks the excessive wet surface conditions have improved in many areas of Saskatchewan, allowing Painted Pony to progress toward resuming normal production operations.

Sales from British Columbia assets averaged 2,171 boe per day in the second quarter of 2011 compared to 1,945 boe per day in the first quarter. Late in the second quarter of 2011, gas sales from the Cameron/Kobes area were temporarily shut-in for 26 days for the scheduled McMahon gas processing plant turn-around. Gas sales from the Cypress area of approximately 50 boe per day ceased in late June 2011 after a third party pipeline was shut-in for repairs.

Painted Pony is engaged in discussions with a midstream provider in the Blair/Town area to increase gas plant capacity from 24 mmcf per day to 70 mmcf per day, of which at least 32 mmcf per day is expected to be firm service to the Company, by the second quarter of 2012.

SASKATCHEWAN ACTIVITY

The Company's second quarter 2011 drilling program was also significantly impacted by the extended wet conditions in Saskatchewan. Consequently the forecast drilling schedule has been delayed by more than 10 weeks in comparison to prior years. Recent drying weather has permitted the Company to resume its drilling program in some areas. Painted Pony closed the previously announced asset acquisition in the Flat Lake area of Saskatchewan in April. As at June 30, 2011, the Company has aggregated 21 net sections of land prospective for Bakken oil in the area. In the third quarter of 2011, Painted Pony has drilled 1 (0.3 net) well in the area, with production testing over 200 boe per day. The Company expects to drill 4 (1.8 net) additional wells in the Flat Lake area this year.

Painted Pony continues to pursue an active drilling program in Saskatchewan. To-date in the third quarter the Company has drilled 8 (6.6 net) wells. In the second half of 2011, the Company expects to drill a total of 28 (20.3 net) wells in Saskatchewan.

BRITISH COLUMBIA ACTIVITY

Painted Pony continued to delineate and develop its world-class Montney gas project at Blair/Town and Cameron/Kobes in northeast British Columbia during the second quarter of 2011. In the period, the Company completed and placed 5 (2.3 net) wells on production. Of these wells, 3 (1.5 net) were drilled on a single pad, with each well targeting a different geological layer (upper, middle and lower) of the Montney formation. Each of these three wells were successfully completed, tested and tied into production during the second quarter. The middle Montney well within this group represents the first horizontal completion in this zone, on the Blair/Town block. It is located more than 15 miles north of the nearest producing horizontal middle Montney well.

The two (1.2 net) Montney horizontal wells Painted Pony drilled in the second quarter are currently being completed or tested. In the third quarter to date, 2 (0.7 net) wells have been drilled, of which 1 (0.2 net) is currently being completed. There are 2 (1.2 net) wells are currently drilling, targeting the Montney. The Company plans to drill a total of 9 (5.6 net) Montney wells in the second half of 2011.

FINANCIAL RESOURCES

Painted Pony continues to emphasize conservative financial management, especially in periods of market and credit uncertainty. At June 30, 2011, Painted Pony continued to have an undrawn credit facility and a positive working capital position of \$40.3 million. In August 2011, the demand revolving credit facility was increased to \$80.0 million, replacing the previous \$75.0 million facility, subject to review on or before March 31, 2012.

OUTLOOK

The Company continues to delineate and develop its two world class resource plays; the Montney in northeast British Columbia and the Bakken in southeast Saskatchewan. In addition Painted Pony plans to commence its first fracture stimulations on the Buckinghorse formation in northeast British Columbia within the next six months. If successful, these exploratory completions could begin to unlock a vast new gas play, which would be vertically stacked over the underlying Montney project. We look forward to a successful second half.

On Behalf of the Board of Directors, we thank you for your support.

Patrick R. Ward
President and Chief Executive Officer
August 23, 2011

Financial and Operational Highlights

(unaudited)

	Three months ended June 30,		Six months ended June 30,	
	2011	2010	2011	2010
Financial (000s, except per share)				
Petroleum and natural gas revenue (before royalties)	\$ 17,446	\$ 12,752	\$ 36,761	\$ 26,898
Funds flow from operations ⁽¹⁾	\$ 10,376	\$ 7,704	\$ 22,474	\$ 16,860
Per share – basic ⁽²⁾	\$ 0.17	\$ 0.17	\$ 0.39	\$ 0.38
Per share – diluted ⁽³⁾	\$ 0.17	\$ 0.17	\$ 0.39	\$ 0.37
Cash flow from operating activities	\$ 11,854	\$ 8,355	\$ 23,409	\$ 17,576
Net income (loss)	\$ (1,824)	\$ 905	\$ 320	\$ 2,451
Per share – basic ⁽²⁾	\$ (0.03)	\$ 0.02	\$ 0.01	\$ 0.06
Per share – diluted ⁽³⁾	\$ (0.03)	\$ 0.02	\$ 0.01	\$ 0.05
Capital expenditures ⁽⁴⁾	\$ 37,407	\$ 32,127	\$ 62,492	\$ 67,505
Working capital (deficiency)	\$ 40,327	\$ (8,592)	\$ 40,327	\$ (8,592)
Total assets	\$ 326,471	\$ 175,983	\$ 326,471	\$ 175,983
Shares outstanding				
Class A	59,532,673	44,136,700	59,532,673	44,136,700
Class B	1,173,600	1,173,600	1,173,600	1,173,600
Diluted weighted-average shares	59,359,276	45,077,914	58,350,719	45,164,631
Operational				
Daily sales volumes				
Oil (bbls per day)	1,274	1,518	1,541	1,620
Condensate (bbls per day)	59	23	57	25
NGL's (bbls per day)	91	20	116	19
Gas (mcf per day)	13,012	5,826	12,572	4,581
Total (boe per day)	3,593	2,532	3,809	2,428
Realized prices				
Oil (per bbl)	\$ 102.10	\$ 75.04	\$ 93.32	\$ 77.44
Gas (per mcf)	\$ 3.95	\$ 4.07	\$ 3.86	\$ 4.48
Field operating netbacks				
British Columbia (per boe)	\$ 15.66	\$ 12.34	\$ 14.99	\$ 12.42
Saskatchewan (per boe)	\$ 66.48	\$ 51.92	\$ 60.41	\$ 55.30
Company combined (per boe)	\$ 35.76	\$ 36.36	\$ 35.85	\$ 41.43

1. This table contains the term "funds flow from operations", which should not be considered an alternative to, or more meaningful than "cash flow from operating activities" as determined in accordance with International Financial Reporting Standards ("IFRS") as an indicator of the Company's performance. Funds flow from operations and funds flow from operations per share (basic and diluted) does not have any standardized meaning prescribed by IFRS and may not be comparable with the calculation of similar measures for other entities. Management uses funds flow from operations to analyze operating performance and leverage and considers funds flow from operations to be a key measure as it demonstrates the Company's ability to generate the cash necessary to fund future capital investment. The reconciliation between funds flow from operations and cash flow from operating activities can be found in "Management's Discussion and Analysis". Funds flow from operations per share is calculated using the basic and diluted weighted average number of shares for the period, and after the deemed conversion of the Class B shares to Class A shares, consistent with the calculations of earnings per share.
2. Basic per share information is calculated on the basis of the weighted average number of Class A shares outstanding in the period.
3. Diluted per share information reflects the potential dilution effect of options and the convertible Class B shares, each of which may be anti-dilutive. Net income is adjusted for the amount of finance expense applicable to the Class B shares for the period. The conversion of Class B shares into Class A shares, if dilutive, is computed by dividing \$10 by the greater of \$1.00 and the Current Trading Price, defined as the weighted average trading price of the Class A shares for the last 30 consecutive trading days.
4. Including decommissioning obligations and share-based payments.

Management's Discussion and Analysis

The following Management's Discussion and Analysis ("MD&A") of the consolidated financial results as provided by the management of Painted Pony Petroleum Ltd. ("Painted Pony" or the "Company") should be read in conjunction with the unaudited condensed interim consolidated financial statements and related notes for the three and six months ended June 30, 2011 and for the three months ended March 31, 2011 and the consolidated financial statements and related notes for the year ended December 31, 2010. This commentary is dated August 23, 2011.

The condensed interim consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS"). The Company adopted IFRS on January 1, 2011. Previously Painted Pony prepared its interim consolidated financial statements in accordance with Canadian Generally Accepted Accounting Principles ("Canadian GAAP"). The financial data presented is in accordance with IFRS in Canadian dollars, except where indicated otherwise. These documents and additional information about Painted Pony, including the Annual Information Form, are available on SEDAR at www.sedar.com.

Description of Company

Painted Pony is a Calgary-based exploration and development company focused on oil in southeast Saskatchewan and liquids-rich natural gas in northeast British Columbia. The Class A and Class B shares of Painted Pony trade on the TSX Venture Exchange under the symbols "PPY.A" and "PPY.B", respectively.

Painted Pony commenced commercial operations on April 3, 2007 upon completion of a financial reorganization as part of an overall restructuring of the Company. On May 23, 2007, subsequent to completion of an initial public offering on May 17, 2007, the Class A shares and Class B shares of Painted Pony Petroleum Ltd. began trading on the TSX Venture Exchange. Painted Pony then commenced an active exploration program.

Non-IFRS Measures

This Management's Discussion and Analysis contains the term "funds flow from operations", which should not be considered an alternative to, or more meaningful than cash flow from operating activities as determined in accordance with IFRS as an indicator of the Company's performance. Funds flow from operations and funds flow from operations per share (basic and diluted) do not have any standardized meaning prescribed by IFRS and may not be comparable with the calculation of similar measures for other entities. Management uses funds flow from operations to analyze operating performance and considers funds flow from operations to be a key measure as it demonstrates the Company's ability to generate the cash necessary to fund future capital investment and to repay debt. Funds flow from operations per share is calculated using the basic and diluted weighted average number of shares for the period, and after deemed conversion of Class B shares into Class A shares, consistent with the calculations of earnings per share. The Company reconciles funds flow from operations to cash flow from operating activities, which is the most directly comparable measure calculated in accordance with IFRS, as follows:

(000s)	Three months ended June 30,		Six months ended June 30,	
	2011	2010	2011	2010
Cash flow from operating activities	\$ 11,854	\$ 8,355	\$ 23,409	\$ 17,576
Changes in non-cash working capital	(1,480)	(651)	(1,041)	(716)
Decommissioning expenditures	2	-	106	-
Funds flow from operations	\$ 10,376	\$ 7,704	\$ 22,474	\$ 16,860

This Management's Discussion and Analysis also contains other industry benchmarks and terms, such as net working capital position (calculated as current assets less current liabilities) and operating netbacks (calculated on a per unit basis as oil, gas and natural gas liquids revenues less royalties and transportation and operating costs), which are not recognized measures under IFRS. Management believes these measures are useful supplemental measures of, firstly, the total net position of current assets and current liabilities the Company has and, secondly, the Company's profitability relative to commodity prices. Readers are cautioned, however, that these measures should not be construed as alternatives to other terms such as current and long-term debt or net income determined in accordance with IFRS as measures of performance. Painted Pony's method of calculating these measures may differ from other companies, and accordingly, may not be comparable to similar measures used by other companies.

Forward-looking Information

This MD&A contains forward-looking statements relating to future events. Forward-looking information is information that does not relate strictly to historical or current facts, and can be identified by words such as "anticipate", "continue", "estimate", "expect", "forecast", "may", "will", "project", "should", "believe", "intend", or similar expressions. These statements represent management's reasonable projections, expectations, and estimates as of the date of this document, but undue reliance should not be placed upon them as they are derived from numerous assumptions. These assumptions are subject to known and unknown risks and uncertainties, including the business risks discussed in this MD&A, which may cause actual performance and financial results to differ materially from any projections of future performance or results expressed or implied by such forward-looking statements.

The forward looking information in this document is subject to significant risks and uncertainties and is based on a number of material factors and assumptions which may prove to be incorrect; including but not limited to the following:

- volumes in the balance of 2011 will be gas-weighted as continued success from operations targeting the Montney formation in British Columbia adds incremental volumes;
- the average oil price in the balance of 2011 will be approximately 3% less than the Edmonton par reference price and the natural gas price received will be equivalent to the AECO daily spot price;
- overall royalties in 2011 will approximate 13% of total revenues, assuming similar commodity prices to those in the first six months of 2011;
- a firm-service contract may be executed for the processing costs and firm delivery of natural gas whereby any shortfall of gas volumes delivered would result in incremental charges for excess capacity;
- per unit operating and transportation costs in Saskatchewan are expected to be similar to the second quarter of this year;
- net general and administrative costs will be reflective of capital expenditure levels in the balance of 2011;
- as gross Saskatchewan sales revenues fluctuate in 2011, the Saskatchewan resource surcharge is expected to vary accordingly;
- the share-based payment expense for the third quarter of 2011 is expected to be approximately \$2.2 million;
- continued improvement in surface conditions in Saskatchewan during the third quarter are expected to allow for normal drilling and completion activities to resume;
- certain leases that are approaching expiry in British Columbia will be continued through execution of work programs;
- available credit facilities may be utilized on a periodic basis in 2011;
- a commitment for minimum tolls to transport oil through a major carrier system is estimated to begin October 1, 2011 and end in 2016;

- the risk of accounts receivables becoming uncollectible is mitigated by the financial position of the applicable entities; and
- the Company has sufficient financial resources with which to conduct its capital program; further, this is subject to the additional assumption that the drilling rigs, field service providers, completion and tie-in equipment will be available as required and that the costs of securing such services and equipment will not materially exceed expectations.

While we anticipate that subsequent events and developments may cause our views to change, we do not have an intention to update this forward-looking information, except as required by applicable securities laws. This forward-looking information represents our views as of the date of this document and such information should not be relied upon as representing our views as of any date subsequent to the date of this document. We have attempted to identify important factors that could cause actual results, performance or achievements to vary from those current expectations or estimates expressed or implied by the forward-looking information contained here-in. However, there may be other factors that cause results, performance or achievements not to be as expected or estimated and that could cause actual results, performance or achievements to differ materially from current expectations. Other risks and uncertainties include, but are not limited to, the following:

- normal risks common to the oil and natural gas industry, including various operational risks in the carrying out of exploration, development and production operations;
- risks and uncertainty of oil and gas geological deposits;
- revisions, amendments or changes to capital expenditure plans including exploration, development and exploitation projects;
- risks as to the availability and pricing of appropriate financing alternatives on acceptable terms;
- potential changes in income tax regulations, governmental policies, rules, practices or approval process changes, or delays, or enhancements; and
- the Company's ability to attract and retain qualified professional employees.

Statements relating to "reserves" or "resources" are by their nature deemed to be forward-looking statements, as they involve the implied assessment based on certain estimates and assumptions that the resources and reserves described can be profitably produced in the future.

The reader is further cautioned that the preparation of consolidated financial statements in accordance with IFRS requires management to make certain judgments and estimates that affect the reported amounts of assets, liabilities, revenues and expenses. Estimating reserves is also critical to several accounting estimates and requires judgments and decisions based upon available geological, geophysical, engineering and economic data. These estimates may change, having either a negative or positive effect on net earnings as further information becomes available, and as the economic environment changes.

There can be no assurance that forward-looking information will prove to be accurate, as results and future events could differ materially from those expected or estimated in such statements. Accordingly, readers should not place undue reliance on forward-looking information. From time to time, Painted Pony's management makes estimates and forms opinions on which the forward-looking statements are based. The Company assumes no obligation to update forward-looking statements if circumstances, management's estimates, or opinions change, unless prescribed by securities laws.

BOE Presentation

Barrels of oil equivalent ("boe") may be misleading, particularly if used in isolation. A boe conversion ratio of six thousand cubic feet of gas ("mcf") to one barrel of oil ("bbl") (6 mcf:1 bbl) is used as an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead. All boe conversions in this report are derived by converting natural gas to oil in the ratio of six mcf of gas to one barrel of oil. Readers should be aware that historical results are not necessarily indicative of future performance.

Net Income and Funds Flow from Operations

Painted Pony generated funds flow from operations of \$10.4 million and \$22.5 million for the three and six months ended June 30, 2011, compared to \$7.7 million and \$16.9 million for the three and six months ended June 30, 2010. On a basic and diluted per share basis, funds flow from operations for the three months ended June 30, 2011 and June 30, 2010 were \$0.17. For the first half of 2011, basic and diluted funds flow from operations per share were \$0.39, compared to \$0.38 and \$0.37, respectively, for the first half of 2010.

Cash flow from operating activities was \$11.9 million and \$23.4 million for the three and six months ended June 30, 2011, compared to \$8.4 million and \$17.6 million for the three and six months ended June 30, 2010.

Painted Pony produced a net loss of \$1.8 million for the three months ended June 30, 2011 and net income of \$0.3 million for the six months ended June 30, 2011, compared to net income of \$0.9 million and \$2.5 million for the three and six months ended June 30, 2010. During the second quarter of 2011, the Company recognized a \$4.9 million expense for share-based payments primarily for stock options granted in the period. On a basic and diluted basis, the loss per share for the quarter ended June 30, 2011 was \$0.03 and the income per share for the six months ended June 30, 2011 was \$0.01, compared to basic income per share of \$0.02 and \$0.06 and diluted income per share of \$0.02 and \$0.05, respectively, for the three and six months ended June 30, 2010.

Sales Volumes

During the three and six months ended June 30, 2010, Painted Pony's sales volumes averaged 3,593 and 3,809 boe per day respectively. This compared to 2,532 and 2,428 boe per day for the three and six months ended June 30, 2010. The increase is primarily from incremental gas sales in British Columbia. In the first six months of 2011, 54% of total volumes were from British Columbia, compared to 32% in the first six months of 2010.

Sales volumes in the second quarter of 2011 were weighted 60% towards gas compared to 38% in the comparable 2010 period, reflecting the focus of the capital program towards British Columbia gas producing assets, as well as weather-related production disruptions in Saskatchewan. All of Painted Pony's light oil sales originate from Saskatchewan operations while 94% of the sales of gas, condensate and NGL's are from British Columbia.

Average Daily Sales Volumes

	Three months ended June 30,		Six months ended June 30,	
	2011	2010	2011	2010
Oil (bbls/d)	1,274	1,518	1,541	1,620
Condensate (bbls/d)	59	23	57	25
NGL's (bbls/d)	91	20	116	19
Gas (mcf/d)	13,012	5,826	12,572	4,581
Total (boe/d)	3,593	2,532	3,809	2,428

Daily oil sales volumes in the second quarter of 2011 declined by 16% compared to the same period in 2010 and gas sales increased by 123% over the same period in 2010, as the results from the Montney drilling program are reflected in production gains. During the second quarter, the Company completed and put five (2.3 net) gas wells onto production. Of these wells, three (1.5 net) were drilled on a single pad, each targeting a different layer (upper, middle and lower) of the Montney formation. Gas sales from the Cameron/Kobes area was temporarily shut-in for 26 days for the scheduled McMahon gas processing plant turn-around. Approximately 50 boe per day of gas and associated product sales from the Cypress area were shut in late in June 2011 due to a non-operated pipeline crossing washout. The Company anticipates sales volumes in the balance of 2011 to be gas-weighted, as continued success from operations targeting the Montney formation in British Columbia add incremental volumes.*

**This paragraph contains forward-looking information. Please refer to "Forward-looking Information" and "Business Risks, Uncertainties and Forward-looking Information" for a discussion of the risks and uncertainties related to such information.*

Saskatchewan operations and production volumes were negatively impacted during the second quarter of 2011 as an unusually wet and extended spring break-up caused oil production to be temporarily shut-in due to road bans and flooding. Many field operations were delayed. The non-operated mid-stream facility that Painted Pony's Midale and Huntoon batteries are tied into experienced mechanical failures midway through the second quarter. While the operator has been working to repair the problem, this equates to forgone sales of approximately 200 boe per day of solution gas and associated liquids. The facility is still not fully operational and this production is currently offline, with repairs expected shortly.

Revenues

Petroleum and natural gas sales increased 37% to \$17.4 million and \$36.8 million in the three and six months ending June 30, 2011, compared to \$12.8 million and \$26.9 million for the three and six months ended June 30, 2010. In both periods, oil sales contributed disproportionately more to total sales dollars compared to volumes, reflecting the relative strength of crude oil prices compared to gas prices. In the first half of 2011, oil sales revenues were 71% of total sales dollars compared to 84% in the first half of 2010, while oil volumes were 40% and 67% for the six months ended June 30, 2011 and 2010, respectively.

Sales by Product

(000s)	Three months ended June 30,		Six months ended June 30,	
	2011	2010	2011	2010
Oil	\$ 11,841	\$ 10,368	\$ 26,038	\$ 22,704
Gas	4,682	2,160	8,791	3,716
Condensate	513	156	910	343
NGL's	410	68	1,022	135
Total	\$ 17,446	\$ 12,752	\$ 36,761	\$ 26,898

Revenue from gas sales totaled \$4.7 million during the three months ended June 30, 2011, compared to \$2.2 million received during the three months ended June 30, 2010. Painted Pony's gas revenues increased 117% quarter over quarter, the net result of a 123% increase in sales volumes partially offset by lower gas prices of 3%. The Company received an average gas price of \$3.95 per mcf in the quarter ended June 30, 2011, a price comparable to the AECO daily spot average gas reference price of \$3.89 per mcf. In the second quarter of 2010, the Company received an average gas price of \$4.07 per mcf.

Crude oil revenue in the three months ended June 30, 2011 was \$11.8 million compared to \$10.4 million during the three months ended June 30, 2010. Oil revenues increased 14% in the second quarter of 2011 compared to the comparable 2010 period, the net result of oil prices averaging 36% higher partially offset by decreased sales volumes of 16%. In the respective second quarter periods, the Company realized average oil prices of \$102.10 per barrel compared to \$75.04 per barrel, respectively. Painted Pony received an average crude oil price approximating the Edmonton light reference price in the second quarters of both 2011 and 2010. Painted Pony's light oil is a premium light crude with low sulphur content.

To date, Painted Pony has not undertaken any risk management contracts or commodity price contracts.

The Company generally expects in the balance of 2011 to receive an average oil price approximately 3% less than the Edmonton par reference price, reflecting the prices currently paid for crude oil in Saskatchewan, where the Company tends to deliver the bulk of its oil production. The Company expects to receive a natural gas price equivalent to the AECO daily spot price. The average prices reported for Painted Pony's sales are the weighted net prices, which are reflective of month to month price and sales volume changes.*

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Average Benchmark Prices

	Three months ended June 30,		Six months ended June 30,	
	2011	2010	2011	2010
Exchange rate (US\$/Cdn\$)	1.0331	0.9731	1.0239	0.9675
Gas - AECO, daily spot (\$/mcf)	3.89	3.90	3.84	4.42
Oil - WTI (US\$/bbl)	102.34	78.05	98.33	78.47
- Edmonton par – light oil (\$/bbl)	103.48	75.29	95.98	77.94

Painted Pony's Realized Prices

	Three months ended June 30,		Six months ended June 30,	
	2011	2010	2011	2010
Gas (\$/mcf)	3.95	4.07	3.86	4.48
Condensate (\$/bbl)	94.76	73.87	88.86	75.95
Oil (\$/bbl)	102.10	75.04	93.32	77.44
NGL's (\$/bbl)	49.73	38.46	48.83	38.30
Combined (\$/boe)	53.35	55.34	53.32	61.21

Royalties

Royalties for the six months ended June 30, 2011 are slightly lower as a percentage of revenues and on a per boe basis in comparison to the six months ended June 30, 2010, primarily reflecting royalty incentives and incremental gas volumes from new horizontal wells in British Columbia plus lower gas prices. In the quarter ended June 30, 2011, total royalties were \$2.3 million, or approximately 13.1% of total revenue. For the quarter ended June 30, 2010, total royalties were \$1.6 million, or approximately 12.7% of revenue. In the three months ended June 30, 2011, oil royalties averaged 15.6% of sales, while gas and associated product royalties averaged 8.0%, compared to oil royalties of 15.1% and gas and associated product royalties of 2.0% for the second quarter of 2010.

Through the balance of 2011, assuming similar commodity prices, the Company anticipates overall royalty rates to continue at approximately 13% of total revenues, reflecting the combined impact of incremental sales volumes from newly drilled wells and royalty holidays, partially offset by incremental royalties on wells which have maximized provincial royalty incentives.*

**This paragraph contains forward-looking information. Please refer to "Forward-looking Information" and "Business Risks, Uncertainties and Forward-looking Information" for a discussion of the risks and uncertainties related to such information.*

Painted Pony's producing properties in British Columbia are all on crown lands and in Saskatchewan are on a combination of freehold and crown lands. Approximately 34% of the crown royalty costs during the six months ended June 30, 2011 were from sales on Saskatchewan oil properties, while sales of gas from recently drilled wells in British Columbia enjoyed provincial royalty incentives. Freehold royalties are from the sale of oil, gas and liquids within Saskatchewan. Gross overriding royalties are mainly from oil sales on lands earned through farm-ins and are mostly attributable to wells in Saskatchewan.

Royalties as a % of Revenue

	Three months ended June 30,		Six months ended June 30,	
	2011	2010	2011	2010
Crown	2.6	0.9	2.0	1.5
Freehold	8.0	8.5	8.2	8.5
GOR	2.5	3.3	2.8	3.6
	13.1	12.7	13.0	13.6

Royalties by Type

(000s)	Three months ended June 30,		Six months ended June 30,	
	2011	2010	2011	2010
Crown	\$ 459	\$ 114	\$ 739	\$ 398
Freehold	1,394	1,078	3,027	2,295
GOR	442	422	1,029	963
	\$ 2,295	\$ 1,614	\$ 4,795	\$ 3,656
Per boe (6 mcf:1 bbl)	\$ 7.02	\$ 7.01	\$ 6.96	\$ 8.32

Operating and Transportation

Operating and transportation costs for the three and six months ended June 30, 2011 were \$3.5 million and \$7.2 million, respectively. This compares to \$2.8 million and \$5.0 million for the three and six months ended June 30, 2010, respectively. On a per unit basis for the three and six months ended June 30, 2011, operating and transportation costs were flat at \$10.57 per boe and \$10.51 per boe, respectively. This compares to \$11.97 per boe and \$11.46 per boe for the three months and six months ended June 30, 2010.

(000s, except per unit)	Three months ended June 30,		Six months ended June 30,	
	2011	2010	2011	2010
British Columbia	\$ 1,537	\$ 1,176	\$ 2,935	\$ 2,064
Saskatchewan	1,920	1,584	4,308	2,973
Total	\$ 3,457	\$ 2,760	\$ 7,243	\$ 5,037
British Columbia (\$/boe)	7.78	12.98	7.88	14.52
Saskatchewan (\$/boe)	14.84	11.33	13.60	10.00
Operating & transportation cost (\$/boe)	10.57	11.97	10.51	11.46

Overall per unit operating costs decreased 12% in the second quarter of 2011 compared to the same period of 2010, primarily reflecting incremental sales volumes and cost-saving measures implemented by the Company, partially offset by incremental costs incurred in Saskatchewan from an extended and severe spring-break up.

Operating costs for gas producing properties in British Columbia are mainly compression fees, contract operating fees, fuel and power, gas transportation, processing and treating fees, and maintenance expenditures on the more mature properties. Per unit British Columbia operating costs were lower in the second quarter of 2011 compared to the same period of 2010 primarily due to increased 2011 volumes combined with incremental charges incurred in the first half of 2010 for excess capacity under a firm-service contract which has since expired.

Painted Pony is currently engaged in discussions with a mid-stream provider in the Blair/Town area to incrementally increase gas handling capacity from 24 mmcf per day to 70 mmcf per day, of which at least 32 mmcf per day is expected to be firm service to the Company, by the second quarter of 2012. In conjunction with this, the Company anticipates it may commit to a firm-service contract for the processing costs associated with the physical delivery of a minimum volume of natural gas, thus ensuring deliverability of product. Any shortfall of the minimum volume would be expected to result in incremental charges for excess capacity under the terms of the contract.*

**This paragraph contains forward-looking information. Please refer to "Forward-looking Information" and "Business Risks, Uncertainties and Forward-looking Information" for a discussion of the risks and uncertainties related to such information.*

For the Company's oil producing properties in Saskatchewan, operating costs are primarily oil transportation, emulsion and hauling, road and lease maintenance, fuel and power expenditures, equipment rentals and contract operator fees. During the second quarter of 2011, these properties experienced higher per unit operating costs primarily due to unusually wet conditions throughout the quarter, as the Company incurred additional charges in efforts to keep production on-stream. Weather related issues have extended into the third quarter of 2011 resulting in similar incremental costs being incurred. Accordingly, in the third quarter of 2011, per unit operating and transportation costs in Saskatchewan are expected to be similar to the second quarter of this year.*

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Operating Netbacks

For the three months ended June 30, 2011, field operating netbacks averaged \$35.76 per boe, compared to field operating netbacks of \$36.36 per boe during the quarter ended June 30, 2010.

Combined Field Operating Netback

(\$/boe)	Three months ended June 30,		Six months ended June 30,	
	2011	2010	2011	2010
Sales	\$ 53.35	\$ 55.34	\$ 53.32	\$ 61.21
Royalties	(7.02)	(7.01)	(6.96)	(8.32)
Operating and transportation costs	(10.57)	(11.97)	(10.51)	(11.46)
Field operating netback	\$ 35.76	\$ 36.36	\$ 35.85	\$ 41.43

The Company historically monitored netbacks by including condensate and NGL's with gas, as initially all associated products were directly associated with the production of gas from British Columbia. As the Company continues enhancing its liquids recovery capabilities associated with its light oil production in Saskatchewan, sales of condensate and NGL's plus gas now originate from both provinces. Approximately 74% of associated liquids volumes in the first half of 2010 were from British Columbia wells. In contrast, in the first half of 2011, 74% of associated liquids volumes were from Saskatchewan wells plus a comparatively small quantity of gas. Accordingly, netbacks by province, as related to the primary commodity target are presented.

Netbacks by Province

(\$/boe)	Three months ended June 30,		Six months ended June 30,	
	2011	2010	2011	2010
British Columbia (\$/boe)	\$ 15.66	\$ 12.34	\$ 14.99	\$ 12.42
Saskatchewan (\$/boe)	\$ 66.48	\$ 51.92	\$ 60.41	\$ 55.30

The decrease in the Company's overall netbacks for the first half of 2011 is primarily due to the increased gas weighting and its associated lower per unit netback as compared to oil in the first half of 2011 compared to 2010.

In the second quarter and first half of 2011, per unit netbacks from British Columbia properties averaged \$15.66 and \$14.99 per boe, respectively. Netbacks increased in British Columbia despite lower gas prices and slightly higher royalty costs due to significantly lower operating costs from incremental volumes plus the absence of excess capacity charges.

During the three and six months ended June 30, 2011, Painted Pony's per unit netback for Saskatchewan production was \$66.48 and \$60.41 per boe, respectively. The increased per boe netback for Saskatchewan during the first half of 2011 reflects higher oil prices partially offset by higher operating costs from minor work-overs, oil hauling costs and road and lease maintenance costs in comparison to the first half of 2010.

Exploration and evaluation

During the three and six months ended June 30, 2011, the Company incurred \$0.1 million of exploration and evaluation expense due to lease expiries, compared to \$nil for the comparative 2010 periods.

Other Income

Processing, salt water disposal fees and compression fees constitute other income. Other income increased dramatically to \$0.2 million and \$0.4 million for the three and six month periods ended June 30, 2011 with completion of construction in two facilities and acquisition of the third generating processing income. In the comparable 2010 periods these facilities had yet to be constructed or acquired, hence other income was negligible.

Other Income

(000s)	Three months ended June 30,		Six months ended June 30,	
	2011	2010	2011	2010
Other income	\$ 154	\$ 36	\$ 350	\$ 40

General and Administrative

Net general and administrative expenses were \$1.3 million and \$2.1 million for the three and six months ended June 30, 2011 compared to \$0.5 million and \$1.0 million for the three and six months ended June 30, 2010, respectively. On a per boe basis, net general and administrative costs were \$3.93 and \$3.11 for the three and six month periods ended June 30, 2011, respectively. This compares to \$2.31 per boe and \$2.27 per boe in the three months and six months ended June 30, 2010.

General and Administrative Costs

(000s, except per boe)	Three months ended June 30,		Six months ended June 30,	
	2011	2010	2011	2010
Gross costs	\$ 2,528	\$ 1,034	\$ 4,252	\$ 2,285
Capitalized	(849)	(269)	(1,213)	(691)
Recoveries	(394)	(233)	(894)	(598)
Net costs	\$ 1,285	\$ 532	\$ 2,145	\$ 996
Net G&A, per boe	\$ 3.93	\$ 2.31	\$ 3.11	\$ 2.27

Gross general and administrative costs in the first half of 2011 were 86% greater than in the first half of 2010, primarily due to salaries, consulting costs and associated administrative costs for twenty-nine people compared to eighteen people in the first half of 2010. In the first half of both years, major general and administrative costs included office rent and parking, fees to professional service providers, costs associated with annual reporting and computer related charges. In 2011, costs include bonuses of \$0.7 million paid in the second quarter, IFRS conversion related costs of \$0.2 million and recruiting costs of \$0.1 million. In 2010, bonuses of \$0.2 million were paid in the first quarter.

The Company's policy of allocating and capitalizing costs associated with new capital projects was unchanged in the first half of 2011 compared to the same period of 2010. During the three and six months ended June 30, 2011, the Company allocated \$0.8 million and \$1.2 million of administrative costs to capital projects, compared to \$0.3 million and \$0.7 million during the same periods of 2010. The portion allocated to capital projects was in accordance with common industry practice whereby an operator calculates and allocates overhead to each working interest partner in proportion to their ownership interest, based on 100% of the capital expenditures. Increased cost allocations in the first half of 2011 reflect the increased operated capital expenditure levels compared to the first half of 2010. General and administrative cost recoveries in the three and six months ended June 30, 2011, were \$0.4 million and \$0.9 million, compared to \$0.2 million and \$0.6 million during the three and six months ended June 30, 2010, directly reflecting increased exploration staff and activity.

In 2011, net general and administrative costs per boe have increased compared to the first half of 2010 reflecting the incremental staffing and associated costs, partially offset by the increased production base. During the balance of 2011, variations in the capital expenditure levels will be reflected in the capitalization and recovery of general and administrative costs during the periods.*

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Capital Taxes

Capital taxes, specifically the Saskatchewan resource surcharge, were \$0.2 million and \$0.5 million for the three and six months ended June 30, 2011, compared to \$0.2 million and \$0.4 million for the three and six months ended June 30, 2010. As gross Saskatchewan sales revenues fluctuate, capital taxes are expected to vary correspondingly in 2011.*

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Capital Taxes

(000s)	Three months ended June 30,		Six months ended June 30,	
	2011	2010	2011	2010
Capital taxes	\$ 187	\$ 178	\$ 454	\$ 389

Share-Based Payments

Share-based payment costs were \$6.3 million and \$7.0 million in the three and six months ended June 30, 2011, respectively, compared to \$0.7 million and \$2.2 million for the same periods in the first half of 2010. The aggregate grants of 1,859,900 options in the second quarter of 2011, with one-third vesting immediately, triggered most of the incremental expense during the period. Share-based payment expense is a non-cash estimate of the cost of granting options to purchase shares, calculated using a Black-Scholes model. The Company expects the expense for the third quarter of 2011 to be approximately \$2.2 million.*

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Capitalized share-based payments for the three and six months ended June 30, 2011 were \$1.4 million. During the same periods in the first half of 2010, the Company capitalized \$0.1 million and \$0.5 million respectively. The remainder of \$4.9 million and \$5.6 million for the three and six months ended June 30, 2011 (\$0.5 million and \$1.7 million for the three and six months ended June 30, 2010) was expensed. This expense does not represent actual cash compensation realized by the recipients of the options upon the eventual exercise and disposition of these options.

Share-Based Payments

(000s)	Three months ended June 30,		Six months ended June 30,	
	2011	2010	2011	2010
Gross cost	\$ 6,309	\$ 674	\$ 7,034	\$ 2,168
Capitalized	(1,400)	(148)	(1,442)	(480)
Net expense	\$ 4,909	\$ 526	\$ 5,592	\$ 1,688

Depletion and Depreciation

Depletion and depreciation expense in the three and six months ended June 30, 2011 totaled \$6.1 million and \$14.1 million, compared to \$5.5 million and \$10.8 million in the three and six months ended June 30, 2010. On a per boe basis, the charge decreased in the first half of 2011 compared to the first half of 2010, reflecting the addition of reserves at lower costs than historical levels. For the three months ended June 30, 2011, Painted Pony excluded exploration and evaluation assets of \$53.2 million from the depletion calculation, compared to \$38.1 million for the three months ended June 30, 2010.

Depletion and Depreciation Costs

(000s, except per boe)	Three months ended June 30,		Six months ended June 30,	
	2011	2010	2011	2010
Depletion and depreciation	\$ 6,109	\$ 5,473	\$ 14,103	\$ 10,827
Per boe	\$ 18.68	\$ 23.75	\$ 20.46	\$ 24.64

Depletion rates reflect the all-in combined effect of the three and six months ended June 30, 2011 transition to IFRS, combined with reduced depletion rates with the addition of gas reserves. The depletion rate utilizes proved plus probable reserves in the calculation.

Depreciation expense was recognized for office furniture, office equipment, computer hardware and software being depreciated on a 20% per annum declining balance basis.

Gain on Sale of Assets

After adjusting the financial statements in 2010 to reflect IFRS standards, three earnings events occurred in the first quarter resulting in a "gain on sale of assets" of \$0.1 million. These earnings events were triggered by the earning of lands under a farm-out in north east British Columbia. This accounting treatment reflects the IFRS standard as outlined in the "Significant Accounting Policies" in note 3 of the condensed interim consolidated financial statements for the three months ended March 31, 2011 and in this MD&A under the heading "Property, Plant and Equipment and Impairment of Assets". No comparable gains or losses were recognized in the first half of 2011 or the second quarter of 2010.

Gain on Sale of Assets

(000s)	Three months ended June 30,		Six months ended June 30,	
	2011	2010	2011	2010
Gain on sale of assets	\$ -	\$ -	\$ -	\$ 104

Net Finance Expense

Painted Pony invests cash in interest-bearing deposit accounts and short-term deposits, generating interest income. Interest income in the first half of 2011 was significant due to the excess cash on hand while in the first half of 2010, minimal interest was earned reflecting lower investment levels and low interest rates.

Finance charges are the result of fees, including standby charges, on the Company's available credit. Finance charges in the three and six months ended June 30, 2011 totaled \$49,000 and \$0.2 million, compared to \$0.1 million for the three and six months ended June 30, 2010. Finance charges have increased as the Company had an available credit facility of \$75 million as at June 30, 2011 (subsequently increased to \$80 million) compared to \$43 million as at June 30, 2010.

Accretion costs from the convertible Class B shares were \$0.2 million and \$0.4 million for the three and six months ended June 30, 2011, compared to \$0.2 million and \$0.3 million for the three and six months ended June 30, 2010. The accretion cost has increased marginally in 2011 as a result of a higher present value.

Accretion costs on decommissioning obligations were \$0.1 million for the three and six months ended June 30, 2011, compared to \$0.1 million for the three and six months ended June 30, 2010. Accretion cost has increased in 2011 as a result of additional wells drilled and acquired, along with ownership in additional facilities.

Net Finance Expense

(000s)	Three months ended June 30,		Six months ended June 30,	
	2011	2010	2011	2010
Interest income	\$ (156)	\$ (17)	\$ (271)	\$ (52)
Finance charges	49	98	208	123
Accretion of decommissioning obligations	75	51	149	99
Accretion of Class B share liability	183	171	363	339
Total	\$ 151	\$ 303	\$ 449	\$ 509

Capital Expenditures

In the first half of 2011, Painted Pony conducted an active drilling program with the drilling of 14 (9.3 net) wells, of which 9 (6.6 net) wells were targeting oil in Saskatchewan and 5 (2.7 net) wells were targeting Montney gas in British Columbia. Exploration and development capital expenditures, including facilities and land costs totaled \$28.5 million and \$53.0 million in the three and six months ended June 30, 2011, compared to \$31.8 million and \$66.2 million incurred in the second quarter and first half of 2010.

Capital Expenditures

(000s)	Three months ended June 30,		Six months ended June 30,	
	2011	2010	2011	2010
Lease acquisitions and retention	\$ 192	\$ 207	\$ 376	\$ 393
Drilling and completions	16,572	8,955	36,148	20,521
Facilities and equipment	2,267	2,164	6,621	7,512
Exploration and evaluation	9,427	20,497	9,820	37,792
Exploration and development	28,458	31,823	52,965	66,218
Head office expenditures	136	30	187	59
	28,594	31,853	53,152	66,277
Property acquisitions	7,357	-	7,384	-
Abandonment expenditures	2	-	106	-
Share-based payments	1,400	148	1,442	480
Decommissioning costs	54	126	408	748
Total expenditures	\$ 37,407	\$ 32,127	\$ 62,492	\$ 67,505

In the first half of 2011, Painted Pony drilled 5 (2.7 net) horizontal Montney gas wells in British Columbia. In the first quarter, 3 (1.5 net) operated horizontal wells were drilled on the Blair/Town lands, followed by second quarter drilling of 1 (1.0 net) operated horizontal well at Blair/Town and 1 (0.2 net) non-operated horizontal well at Cameron/Kobes.

In the second quarter, the Company completed and placed 5 (2.3 net) wells onto production. Of these wells, three (1.5 net) horizontal wells were drilled on a single pad, each targeting a different layer (upper, middle and lower) of the Montney formation. All three (1.5 net) were successfully completed and put on production in the second quarter of 2011. The middle Montney wellbore is the first horizontal completion in this zone, on the Blair/Town block, with the nearest producing horizontal middle Montney well located over 15 miles south. In addition, 1 (0.5 net) vertical Montney well and 1 (0.3 net) lower Montney horizontal well were brought on-stream in May. The two (1.2 net) Montney horizontal wells drilled in the second quarter are currently being completed or tested.

In Saskatchewan, the Company drilled a total of 9 (6.6 net) wells in Saskatchewan during the first quarter of 2011, but was unable to drill any wells during the second quarter. The extreme wet surface conditions also prevented the Company from completing two of the wells drilled during the first quarter. While surface conditions have not yet returned to the seasonal norm, conditions are gradually improving. The Company anticipates continued improvement during the third quarter, allowing normal drilling and completion activities to resume.*

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Painted Pony's land position continues to grow. Currently, the Company owns 81,896 net acres of land (94% undeveloped) in Saskatchewan and 132,175 net acres of land (83% undeveloped) in British Columbia. During the second quarter of 2011, the Company added lands in both British Columbia and Saskatchewan through participation at provincial lands sales. At June 30, 2010, Painted Pony had 180,853 net acres in both provinces.

The Company continues to expect certain leases that are approaching expiry to be continued through execution of work programs comprised of seismic and/or drilling operations.*

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Liquidity and Capital Resources

As at June 30, 2011, Painted Pony had current assets of \$60.9 million and current liabilities of \$20.5 million, resulting in a positive net working capital position of \$40.3 million. Available cash has been, and is currently, on deposit in a major Canadian financial institution. Management has received confirmation from the financial institution that these funds are available on demand.

Management anticipates that the Company will continue to have adequate liquidity to fund future working capital requirements and capital expenditures through a combination of cash flows, the availability of credit facilities and investment capital. As a result of the global economic slowdown, there exists uncertainty in the commodity, credit and capital markets, which the Company continues to monitor in conjunction with its financing alternatives. The capital program will be reviewed, and adjusted if believed necessary based on commodity prices, perceived credit and investment capital availability and share price levels to support the Company's objectives of maintaining a net debt to funds flow from operations ratio of one times or less.*

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The Company has an \$80 million demand revolving credit facility with a Canadian chartered bank. Interest for the demand revolving credit facility is payable at a floating rate determined as the lender's prime rate plus 0.5% to 2.5%, depending on the Company's debt to cash flow ratio, as defined by the lender. A standby fee is charged at 0.20% to 0.45% of the undrawn portion of the credit facility, depending on the Company's cash flow ratio, as defined by the lender. Security is provided by a first fixed and floating charge demand debenture of \$100 million on all of the Company's assets. Painted Pony has provided a negative pledge and undertaking to provide fixed charges over major petroleum and natural gas reserves in certain circumstances.

The availability under the demand revolving credit facility is subject to an interim review on or before March 31, 2012. To date in 2011, the Company has not drawn on its credit facility. There can be no assurance that the amount of the available demand credit facility will not be decreased at the next interim review.

Commitments

At June 30, 2011, the Company is committed to minimum tolls for transportation of oil through a major carrier system that began June 1, 2010 and ends in 2015. At June 30, 2011, the Company has a second commitment for minimum tolls to transport oil through a major carrier system that is estimated to begin October 1, 2011 and end in 2016. The total minimum cost of the two commitments is estimated to be \$2.7 million.*

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At June 30, 2011, the Company was committed to future payments totaling \$1.9 million for office space rental and a proportionate share of operating costs through 2015.

Subsequent to June 30, 2011, the Company entered into an agreement for the expansion of a non-operated gas plant in British Columbia, whereby the Company, should it not elect to commit minimum production volumes to the plant, would incur a break fee equal to 43% of the engineering, front-end construction and restocking charges, estimated to be \$1.3 million net to the Company at September 1, 2011 or \$4.35 million net at December 15, 2011.

Share Capital

On February 17, 2011, the Company completed a bought deal financing of 7,620,000 Class A shares at a price of \$10.50 per share for total gross proceeds of \$80.0 million. As at June 30, 2011, there were 59,532,673 Class A shares and 1,173,600 Class B shares issued and outstanding.

The Company has a Stock Option Plan (the "Plan") whereby options to purchase Class A Shares may be granted by the Board of Directors to directors, officers, employees and consultants. The Plan has reserved for issuance a number of Class A Shares equal to ten percent of the aggregate number of Class A Shares and Class B Shares issued and outstanding from time to time.

In the first half of 2011, a total of 895,973 options were exercised at an average price of \$4.33 per Class A share and 77,980 options were forfeited and cancelled. Painted Pony granted two tranches of options during the three months ended June 30, 2011. The first tranche granted was 1,505,900 options at an exercise price of \$10.60 and the second tranche granted was 354,000 options at an exercise price of \$12.10. The outstanding options are exercisable over a five year period at a weighted-average price of \$6.86 per option for each Class A share with generally one-third vesting immediately, one-third vesting one year from the date of grant, and one-third vesting two years from the date of grant. As at June 30, 2011, 5,434,867 options to purchase Class A shares were issued and outstanding.

The Company is authorized to issue an unlimited number of Preferred Shares, issuable in series. As at June 30, 2011, no Preferred Shares were issued or outstanding.

As at August 23, 2011, there were 59,619,673 Class A shares, 1,173,600 Class B shares and 5,605,367 options at an average price of \$7.20 per Class A share issued and outstanding.

Income Taxes

At the end of the second quarter of 2011, the Company had a \$2.1 million (December 31, 2010: \$1.2 million) estimated deferred tax liability. In the first half of 2011, the Company recognized a deferred income tax benefit of \$1.1 million for share issue costs which was partially offset by a deferred tax expense of \$1.9 million.

Dividends

The Company has not declared or paid any dividends. Any decision to pay dividends on any of its shares will be made by the Board of Directors on the basis of earnings, financial requirements and other conditions existing at such future time.

Off Balance Sheet Arrangements

No off balance sheet arrangements existed as at June 30, 2011.

Related Party Transactions

The Company utilizes the services of a law firm in which the Corporate Secretary is a Partner. During the six months ended June 30, 2011, the Company incurred \$90,000 (2010: \$25,000) on legal services. All related party transactions have been measured at the agreed to terms and exchange values, being the consideration established and agreed to by the parties.

Financial Instruments and Other Instruments

The fair values of the Company's cash and cash equivalents, trade and other receivables and trade and other payables approximate their carrying amounts due to the short-term nature of these financial instruments.

The Company's trade and other receivables are primarily with industry partners and are subject to normal industry credit risks. The Company extends unsecured credit to these entities, and therefore, the collection of any receivables may be affected by changes in the economic environment or other conditions. Management believes the risk is mitigated by the financial position of the entities.*

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The Class B shares have been accorded compound instrument treatment, whereby they have been separated into their liability and equity components using the effective interest method. The liability component accretes up to the principal balance at maturity. The equity component will be reclassified to share capital upon conversion.

To date, the Company has not participated in any risk management contracts or commodity price contracts.

Performance Compared to Guidance

Readers are reminded that forward looking information in this document is subject to significant risks and uncertainties and is based on a number of material factors and assumptions which may prove to be incorrect. A comparison of performance in the second quarter of 2011 to previously announced guidance by the Company is as follows:

- The Company indicated it expected sales volumes in 2011 to be weighted increasingly towards gas sales. During the first half of 2011, gas sales averaged 55% of sales volumes. Second quarter 2011 sales were weighted towards gas as opposed to oil, as the Company continues to grow gas production in British Columbia combined by production disruptions from an extended spring break-up in Saskatchewan.
- The Company indicated it expected the average oil price in 2011 to be approximately 3% less than the reference price. In each month during the second quarter of 2011, the Company's weighted average price was between 1% and 3% less than the reference price.
- The Company indicated it expected the average natural gas price in 2011 to be at a premium to the AECO daily spot price. During the first half of 2011, Painted Pony received a weighted average price approximately the same as the reference price, reflecting the impact of associated gas sales from the oil properties in Saskatchewan.
- The Company indicated it expected overall royalty rates to approximate 13% of total revenues. For the first six months of 2011, royalties averaged approximately 13.1%.
- The Company indicated it expected weather related issues to result in incremental costs in Saskatchewan during the second and third quarters of 2011. In the second quarter, incremental costs attributable to excess surface water were incurred.
- The Company indicated it expected, variations in the capital expenditure levels will be reflected in the capitalization and recovery of general and administrative costs during the balance of 2011, which is consistent with second quarter 2011 results.
- The Company indicated expected economic benefits from the multi-well oil battery facility and water disposal facility in the Huntoon-Midale area would include fewer production disruptions, cost-effective water handling and disposal, reduced trucking costs, and eliminating the capital investment of oil storage tanks at each well location, which is consistent with second quarter 2011 operations.
- The Company indicated it expected capital taxes to correspondingly vary in 2011 as gross Saskatchewan sales revenues fluctuate, which is consistent with second quarter 2011 costs.

Change in Accounting Policies

IFRS

The condensed interim consolidated financial statements have been prepared in accordance with IFRS. The Company mandatorily adopted IFRS on January 1, 2011. Previously, Painted Pony prepared its interim consolidated financial statements in accordance with Canadian GAAP. The Company has provided IFRS accounting policies and prepared reconciliations between Canadian GAAP and IFRS in Notes 2, 3 and 20 of its March 31, 2011 condensed interim consolidated financial statements and notes 2 and 18 of the June 30, 2011 condensed interim consolidated financial statements. The adoption of IFRS did not have an impact on the Company's operations. The following table provides summary reconciliations of Painted Pony's 2010 net income under Canadian GAAP and IFRS to illustrate the impact on adoption.

Summary of Net Income

(000s)	Total 2010	Q4 2010	Q3 2010	Q2 2010	Q1 2010
Net Income (loss) - GAAP	\$ 1,894	\$ 1,373	\$ (510)	\$ 350	\$ 681
Additions / (deductions):					
Other income	(134)	(48)	(34)	(17)	(35)
General and administrative	248	65	85	74	25
Share-based payments	108	29	21	25	33
Depletion and depreciation	3,194	345	643	908	1,298
Net finance charges	(1,053)	(262)	(282)	(303)	(206)
Deferred income taxes	(2,517)	(1,078)	(954)	(132)	(354)
Gain on sale of assets	7,482	4,089	3,289	-	104
Total increase to income	7,328	3,140	2,768	555	865
Net Income - IFRS	\$ 9,222	\$ 4,513	\$ 2,258	\$ 905	\$ 1,546

Accounting Policy Changes

The following discussion illustrates the significant differences between Canadian GAAP and the accounting policies applied by the Company under IFRS. IFRS 1 "First-time Adoption of International Financial Reporting Standards" allows first-time adopters certain exemptions from retrospective application of certain IFRS policies. IFRS policies have been retrospectively applied except where specific IFRS 1 optional and mandatory exemptions permitted an alternative treatment upon transition to IFRS.

IFRS 1 Exemptions

IFRS 1 contains exemptions whereby a company may choose to apply IFRS to property, plant and equipment prospectively to its full cost pool provided an impairment test under IFRS standards is conducted at the transition date. More specifically a company may choose to allocate the historical full cost pool to cash generating units ("CGUs") by utilizing either volumes or values from current reserves at the transition date. Painted Pony elected to apply this optional exemption under IFRS 1 and has allocated the historical cost pool (net book value) to CGUs based on proven plus probable reserve values.

As part of the aforementioned exemption, Painted Pony re-measured its decommissioning liabilities, previously referred to as asset retirement obligations, as at the date of transition in accordance with IFRS standards and recognized the difference from the amount recorded under Canadian GAAP directly into retained earnings. Refer to "Decommissioning Obligations" below for further details.

The Company applied the optional exemption in respect of business combinations and share-based payment transactions, both of which grant a first-time adopter relief from restatement in accordance with IFRS prior to the date of transition to IFRS.

Painted Pony determined that the total impact of the conversion to IFRS was a reduction in retained earnings on January 1, 2010 in the amount of \$4.8 million. The Company has performed impairment calculations at the transition date and did not have any transitional write-downs associated with its petroleum and natural gas properties.

Exploration and Evaluation

Exploration and evaluation ("E&E") costs are expenditures incurred for which technical feasibility and commercial viability have not yet been determined. Such expenditures include costs of acquiring licenses, seismic and exploratory drilling and completion costs and directly attributable general and administration costs. When technical feasibility and commercial viability are determined, the costs are transferred to property, plant and equipment. At the date of transition, Painted Pony determined its E&E balance was \$13.4 million, almost entirely related to undeveloped land.

E&E will be expensed if the costs do not relate to an established CGU and the technical feasibility and commercial viability cannot be established. For the year ended December 31, 2010, no E&E costs were expensed. For the three and six months ended June 30, 2011 \$0.1 million of E&E costs were expensed.

Exploration and evaluation assets are assessed for impairment if (i) sufficient data exists to determine technical feasibility and commercial viability, (ii) facts and circumstances suggest that the carrying amount exceeds the recoverable amount and (iii) amounts are transferred to CGU's. For purposes of impairment testing, exploration and evaluation assets are combined with cash-generating units. For the six months ended June 30, 2011 \$0.1 million was impaired. For the year ended December 31, 2010, no impairment of E&E costs was recognized.

Property, Plant and Equipment and Impairment of Assets

Property, plant and equipment ("PP&E") costs include expenditures where technical feasibility and viability have been determined. Under IFRS, Painted Pony capitalizes these costs in PP&E, within CGU's, and measures them at cost less accumulated depletion, depreciation and impairment losses. The cost of property, plant and equipment at the date of transition to IFRS, was determined by adopting the IFRS 1 exemption whereby the carrying value of property, plant and equipment assets assumes the carrying value under GAAP at the transition date. Under IFRS, Painted Pony is required to recognize and measure an impairment loss if the carrying value of PP&E exceeds the recoverable amount for any individual CGU. This recoverable amount is the higher of fair value less costs to sell and value in use. The Company's CGUs will be used for the impairment testing, while under Canadian GAAP, impairment tests were measured at the country level. There were no impairments recorded upon transition, comparative periods or at June 30, 2011.

With respect to dispositions, under Canadian GAAP there is no recognition of a gain or loss unless the sale would result in a change to the depletion rate of 20 percent or greater. Under IFRS, property, plant and equipment dispositions will generally result in recognition of a gain or loss to income regardless of the amount of the transaction, as there is no threshold for measurement.

Under Canadian GAAP full cost principles, farm-out arrangements with third parties did not result in a recognizable event for financial reporting purposes. Under IFRS standards, farm-out arrangements result in a recognizable event. On a concurrent basis, a working interest in lease rights is exchanged or "sold" (derecognized) after an earnings event within a farm-out arrangement occurs for the value of reserves "received" (purchased). This transaction will result in a "gain or loss on asset sales", being the difference between the purchase amount and the sale amount.

Depletion and Depreciation

Under IFRS, the net carrying value of property, plant and equipment assets are depleted using the unit of production method with reference to the related proven and probable reserves at a CGU level, taking into account estimated future development costs necessary to bring those reserves into production. Under Canadian GAAP, proven reserves and associated future development costs were applied at a country level and used for depletion purposes. The reserve information is determined by independent reserve engineers on an annual basis. On a quarterly basis, this information may be updated internally or by independent reserve engineers. This change has resulted in a lower depletion and depreciation charge to net income during 2010. The impact of this change is illustrated in the reconciliation of net income above.

Decommissioning Obligations

The Company's activities give rise to dismantling, decommissioning and site disturbance re-mediation activities. Provision is made for the estimated cost of site restoration and capitalized in the relevant asset category.

Under Canadian GAAP, decommissioning liabilities were measured as the estimated fair value of the retirement and decommissioning expenditures expected to be incurred. In measuring the fair value, Painted Pony used a credit-adjusted risk-free rate. Under IFRS, decommissioning obligations are measured as the best estimate of the expenditures to be incurred using a lower risk-free discount rate. As a result, Painted Pony's decommissioning obligations increased at the date of transition by \$1.9 million. During the year ended December 31, 2010, the Company's decommissioning liabilities increased by \$3.2 million, including accretion adjustments. Due to the higher fair values and the reduced discount rate, the accretion recognized in net income throughout 2010 decreased. Under IFRS, this accretion is now classified and disclosed as a finance cost in the statement of income and comprehensive income. The impact of this change is illustrated in the reconciliation of net income above.

Share-Based Payments

Under Canadian GAAP, the Company accounted for options granted to directors, officers, employees and certain consultants by measuring the fair value of the instruments issued, and amortized this value over the instruments' vesting periods. Fair value was measured using the Black-Scholes option pricing model and inputs that included share price on measurement date, exercise price of the instrument, expected volatility, weighted average expected life of the instruments, expected dividends and a risk-free interest rate. Under IFRS the Company must also estimate and apply a forfeiture rate on the grant date and subsequently adjust it to reflect the actual number of options that vest. Under Canadian GAAP, forfeitures were recorded at the time of expiry or cancellation. The impact of the forfeiture rate changes was nominal for the Company. A required change in treatment for options granted to consultants under IFRS compared to GAAP was the primary reason for differences recognized.

Flow-through Shares

Flow-through shares are resource expenditure deductions for income tax purposes related to development and exploratory activities funded by flow-through share arrangements which are renounced to investors in accordance with income tax legislation. Under Canadian GAAP, the accounting treatment for flow-through shares was to record the full amount of the proceeds in share capital. When expenditures are renounced, the related tax effect is recorded to share capital and the deferred income tax liability. Under IFRS, the amount initially recorded in share capital was limited to the amount of proceeds that would have been received on that date if they were not issued as flow-through shares. The difference between the actual proceeds and the amount recorded in share capital is set up as a deferred premium on the statement of financial position. When the expenditures are incurred, the deferred premium on the flow-through shares is reversed and the related tax effect is recorded to the deferred income tax liability. The impact of this change in accounting policy is incorporated in the table in note 18(c) of the "notes to the condensed interim consolidated financial statements" for the period ending June 30, 2011 and note 20(c) of the "notes to the condensed interim consolidated financial statements" for the period ending March 31, 2011.

Income Tax

Income tax expense is comprised of deferred income tax expense and has been adjusted to reflect the tax effect arising from the differences between Canadian GAAP and IFRS. The impact of this change is illustrated in the reconciliation of net income above and in note 18(h) of the "notes to the condensed interim consolidated financial statements" for the period ending June 30, 2011 and note 20(h) of the "notes to the condensed interim consolidated financial statements" for the period ending March 31, 2011.

Critical Accounting Estimates

The significant accounting policies used by the Company are disclosed in note 3 of the condensed interim consolidated financial statements for the three months ended March 31, 2011 and 2010. The significant accounting policies followed by the Company under Canadian GAAP prior to conversion to IFRS are disclosed in the Company's annual audited consolidated financial statements. For a discussion on critical accounting policies and estimates under GAAP prior to conversion to IFRS, the reader is directed to the 2010 annual Management's Discussion and Analysis on SEDAR. Certain accounting policies require that management make appropriate decisions with respect to the formulation of estimates and assumptions that affect the reported amounts of assets, liabilities and expenses. The Company's management reviews its estimates regularly.

New Standards and Interpretations Not Yet Adopted

In November 2009, the IASB published IFRS 9 – “*Financial Instruments*”, which covers the classification and measurement of financial assets as part of its project to replace IAS 39 – “*Financial Instruments: Recognition and Measurement*”. In October 2010, the requirements for classifying and measuring financial liabilities were added to IFRS 9. Under this guidance, entities have the option to recognize financial liabilities at fair value through earnings. If this option is elected, entities would be required to reverse the portion of the fair value change due to credit risk out of earnings and recognize the change in other comprehensive income. IFRS 9 is effective for the Company on January 1, 2013. Early adoption is permitted and the standard is required to be applied retrospectively. There will be no significant impact to the Company upon implementation of the issued standard.

In May 2011, IFRS 10 “*Consolidated Financial Statements*” was issued which sets out the principles for the presentation and preparation of consolidated financial statements when an entity controls one or more other entities. IFRS 10 replaces SIC-12 “*Consolidation—Special Purpose Entities*” and parts of IAS 27 “*Consolidated and Separate Financial Statement*” and is effective for annual periods beginning on or after January 1, 2013. Earlier application is permitted. The Company is currently evaluating the impact of this standard on its consolidated financial statements.

In May 2011, IFRS 11 “*Joint Arrangements*” was issued to address reporting inconsistencies. This standard requires a single method to account for interests in jointly controlled entities, focusing on the rights and obligations of a joint arrangement, rather than its legal form (as is currently the case). IFRS 11 supersedes IAS 31 “*Interests in Joint Ventures*” and SIC-13 “*Jointly Controlled Entities—Non-Monetary Contributions by Venturers*”, and is effective for annual periods beginning on or after January 1, 2013. Earlier application is permitted. The Company is currently evaluating the impact of this standard on its consolidated financial statements.

In May 2011, IFRS 12 “*Disclosure of Interests in Other Entities*” was issued. This comprehensive standard applies to entities that have an interest in a subsidiary, a joint arrangement, an associate or an unconsolidated structured entity. IFRS 12 is effective for annual periods beginning on or after January 1, 2013. Earlier application is permitted. The Company is currently evaluating the impact of this standard on its consolidated financial statements.

In May 2011, IFRS 13 “*Fair Value Measurements*” was issued. This standard defines fair value, setting out a single IFRS framework for measuring fair value and required disclosures about fair value measurements. IFRS 13 is to be applied for annual periods beginning on or after January 1, 2013. Earlier application is permitted. The Company is currently evaluating the impact of this standard on its consolidated financial statements.

Business Risks, Uncertainties and Forward-looking Information*

Statements in this document may contain forward-looking information including expectations of future production, components of cash flow and earnings, expected future events and/or financial results that are forward-looking in nature and subject to substantial risks and uncertainties. The reader is cautioned that assumptions used in the preparation of such information may prove to be incorrect. The Company cautions the readers that actual performance will be affected by a number of factors, many of which may respond to changes in economic and political circumstances throughout the world. Events or circumstances may cause actual results to differ materially from those predicted, a result of numerous known and unknown risks, uncertainties, and other factors, many of which are beyond the control of the Company. These risks include, but are not limited to, the risks associated with the oil and gas industry, and changes to commodity prices and interest and foreign exchange rates. Industry related risks could include, but are not limited to, operational risks in exploration, development and production, delays or changes in plans, risks associated with the uncertainty of reserve estimates, health and safety risks and the uncertainty of estimates and projections of production, costs and expenses. The following external factors beyond the Company’s control may affect the marketability of oil and natural gas produced: industry conditions including changes in laws and regulations, changes in income tax regulations, increased competition, fluctuation in commodity prices, interest rates, and variations in the Canadian/United States dollar exchange rate. The reader is cautioned not to place undue reliance on this forward-looking information.

Painted Pony's production and exploration activities are concentrated in the Western Canadian Sedimentary Basin, where activity is highly competitive and includes a variety of different sized companies ranging from smaller junior producers to the much larger integrated petroleum companies. Painted Pony is subject to the various types of business risks and uncertainties including:

- Finding and developing oil and natural gas reserves at economic costs;
- Production of oil and natural gas in commercial quantities; and
- Marketability of oil and natural gas produced.

In order to reduce exploration risk, the Company strives to employ highly qualified and motivated professional employees with a demonstrated ability to generate quality proprietary geological and geophysical prospects. To help maximize drilling success, Painted Pony combines exploration in areas that afford multi-zone prospect potential, targeting a range of low to moderate risk prospects with some exposure to select high-risk plays with high-reward opportunities. Painted Pony also explores in areas where the Company's officers and employees have significant drilling experience.

The Company mitigates its risk related to producing hydrocarbons through the utilization of the most appropriate technology and information systems. In addition, Painted Pony seeks operational control of its projects, where feasible.

Oil and gas exploration and production can involve environmental risks such as pollution of the environment and destruction of natural habitat, as well as safety risks such as personal injury. In order to mitigate such risks, Painted Pony conducts its operations at high standards and follows safety procedures intended to reduce the potential for personal injury to employees, contractors and the public at large. The Company maintains current insurance coverage for general and comprehensive liability as well as limited pollution liability. The amount and terms of this insurance are reviewed on an ongoing basis and adjusted as necessary to reflect changing corporate requirements, as well as industry standards and government regulations. Painted Pony may periodically use financial or physical delivery hedges to reduce its exposure against the potential adverse impact of commodity price volatility, as governed by formal policies approved by senior management, subject to controls established by the Board of Directors.

**This section contains forward-looking information. Please refer to "Forward-looking Information" and "Business Risks, Uncertainties and Forward-looking Information" for a discussion of the risks and uncertainties related to such information.*

Legal, Environmental, Remediation and Other Contingent Matters

The Company reviews legal, environmental, remediation and other contingent matters to both determine whether a loss is probable based on judgment and interpretation of laws and regulations, and determine that the loss can reasonably be estimated. When the loss is determined, it is charged to earnings. The Company's management monitors known and potential contingent matters and makes appropriate provisions by charges to earnings when warranted by circumstances.

Selected Consolidated Quarterly Information

The following tables set forth selected consolidated financial information of the Company for the most recently completed quarters ending at the second quarter of 2011.

Quarter ended (unaudited) <i>(\$000s, except volumes and per share)</i>	March 31, 2011	June 30, 2011
Gross revenues ⁽¹⁾	19,315	17,446
Funds flow from operations	12,098	10,376
Basic per share	0.22	0.17
Diluted per share	0.21	0.17
Cash flow from operating activities	11,555	11,854
Net income (loss)	2,144	(1,824)
Basic per share	0.04	(0.03)
Diluted per share	0.04	(0.03)
Capital expenditures, net	24,558	28,594
Capital acquisitions, net	27	7,357
Net working capital	64,100	40,327
Total assets	330,156	326,471
Decommissioning obligations ⁽²⁾	7,574	7,702
Convertible Class B shares liability	10,716	10,899
Average daily sales volumes (boe/d)	4,027	3,593

(1) Petroleum and natural gas sales, before royalties and operating and transportation, excluding interest and other income.

(2) Formerly asset retirement obligations under Canadian GAAP.

Quarter ended (unaudited) <i>(\$000s, except volumes and per share)</i>	March 31, 2010	June 30, 2010	Sept. 30, 2010	Dec. 31, 2010
Gross revenues ⁽¹⁾	14,146	12,752	14,764	16,621
Funds flow from operations	9,156	7,704	9,122	10,411
Basic, per share	0.21	0.17	0.20	0.20
Diluted, per share	0.20	0.17	0.19	0.20
Cash flow from operating activities	9,221	8,355	7,698	10,200
Net income	1,546	905	2,258	4,513
Basic, per share	0.04	0.02	0.05	0.09
Diluted, per share	0.03	0.02	0.05	0.09
Capital expenditures, net	34,424	31,853	19,655	21,357
Capital acquisitions, net	-	-	-	12,846
Net working capital (deficiency)	15,639	(8,592)	22,454	(1,205)
Total assets	186,881	175,983	223,347	244,579
Decommissioning obligations ⁽²⁾	4,961	5,137	5,626	7,145
Convertible Class B shares liability	10,015	10,186	10,360	10,536
Average daily sales volumes (boe/d)	2,322	2,532	3,080	3,443

(1) Petroleum and natural gas sales, before royalties and operating and transportation, excluding interest and other income.

(2) Formerly asset retirement obligations under Canadian GAAP.

Quarter ended (unaudited) ⁽³⁾ (\$000s, except volumes and per share)	Sept. 30, 2009	Dec. 31, 2009
Gross revenues ⁽¹⁾	7,834	11,612
Funds flow from operations	4,513	6,981
Basic, per share	0.12	0.17
Diluted, per share	0.12	0.16
Cash flow from operating activities	4,273	6,157
Net income (loss)	(2,046)	1,953
Basic and diluted, per share	(0.05)	0.05
Capital expenditures, net	12,141	16,483
Capital acquisitions, net	13,587	1
Net working capital	1,096	40,679
Total assets	112,861	164,907
Decommissioning obligations ⁽²⁾	2,278	2,439
Average daily sales volumes (boe/d)	1,655	2,006

(1) Petroleum and natural gas sales, before royalties and operating and transportation, excluding interest and other income.

(2) Asset retirement obligations under Canadian GAAP.

(3) Painted Pony's IFRS transition date was January 1, 2010; therefore 2009 comparative information has not been restated from Canadian GAAP.

Significant factors and trends that have affected the Company's results during the above quarterly periods are as follows:

- Gross revenues are impacted by both fluctuating commodity prices and production volumes. The Company's successful capital program has generally generated incremental production volumes in all but the most recent of the last eight quarters, which has, in turn, directionally lead to higher cash flows over time. Sales volumes during the second quarter of 2011 were restricted due to an unusually extended and extreme spring break-up in Saskatchewan. The sales prices realized by the Company have approximated the Edmonton par light oil prices and AECO daily spot gas prices throughout the above periods. The reference price fluctuations reflect changes in supply and demand by commodity, both internationally and domestically.
- Funds flow from operations have both increased and decreased over time, reflecting primarily the impact of fluctuating commodity prices on a growing production base. Per production unit operating and transportation cost variations track seasonal weather-related issues combined with fixed commitments. Throughout 2010, commodity prices were substantially stronger than during 2009, increasing funds flow from operations. Oil prices continue to improve in 2011, while natural gas prices have modestly declined. The net effect of strong oil prices will contribute to increased funds flow from operations. Royalty changes vary due to commodity prices, production levels and the status of the different provincial royalty holiday incentive programs. As the production base in Saskatchewan matures, incremental royalties occur on wells as the maximum volumes provided for under the provincial incentive programs are attained. Royalty incentive programs have continued in British Columbia and the Company should continue to enjoy lower royalty rates.
- Cash flow from operating activities has increased or decreased in concert with funds flow from operations and is further impacted by the timing of related trade and other payable and receivable settlements.

- The net loss in the second quarter of 2011 results primarily from non-cash share-based payment and deferred income tax expenses. Net income in the first quarter of 2011 had improved due to growth in production, improved oil prices and stable operating costs. Net income in three of the four quarters of 2010 was significantly impacted by growth in production and increased strength in oil prices. In the third quarter of 2010, the Company recorded \$2.0 million of non-cash share-based payments for share options surrendered for cancellation. Throughout the third quarter of 2009, net income reflected relatively weaker commodity prices, lower production volumes and higher operating costs due to trucking oil. During the final quarter of 2009 Painted Pony realized net income as a result of increased production volumes from successful drilling operations and increases in oil prices.
- Net capital expenditures fluctuations have reflected both available capital resources and intentional capital spending restraint during weaker economic periods.
- Net capital acquisitions occurred in the second quarter of 2011, the fourth quarter of 2010, and the third quarter of 2009 when strategic opportunities were identified and completed.
- Total assets and non-current liabilities (provisions) have generally increased quarter over quarter, reflecting the execution of the Company's capital program, somewhat offset by depletion.

Additional Information

Additional information regarding the Company and its business and operations is available on the Company's profile at www.sedar.com. Copies of the information can also be obtained by contacting the Company at Painted Pony Petroleum Ltd., 300, 602 – 12 Avenue SW., Calgary, Alberta T2R 1J3 (Phone 403 475-0440), by email at info@paintedpony.ca or on the Company's website at www.paintedpony.ca.

PAINTED PONY PETROLEUM LTD.
CONDENSED INTERIM CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

(unaudited)
(000s)

As at	June 30, 2011	December 31, 2010
ASSETS		
Current assets		
Cash and cash equivalents (note 3)	\$ 41,903	\$ 9,748
Trade and other receivables	18,585	17,200
Prepaid expenses and deposits	374	320
	60,862	27,268
Non-current assets		
Exploration and evaluation (note 4)	53,164	43,535
Property, plant and equipment (note 5)	212,445	173,776
	\$ 326,471	\$ 244,579
LIABILITIES		
Current liabilities		
Trade and other payables	\$ 20,535	\$ 28,473
Non-current liabilities		
Decommissioning obligations (note 7)	7,702	7,145
Convertible Class B shares liability (note 8)	10,899	10,536
Deferred tax liability	2,054	1,232
	41,190	47,386
EQUITY		
Share capital (note 9)	262,028	178,772
Equity component of convertible Class B shares (note 8)	(2,923)	(2,923)
Contributed surplus (note 9)	20,440	15,928
Retained earnings	5,736	5,416
	285,281	197,193
	\$ 326,471	\$ 244,579

Basis of presentation (note 2)
Commitments (note 13)
Subsequent events (notes 6 & 13)

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

PAINTED PONY PETROLEUM LTD.
CONDENSED INTERIM CONSOLIDATED STATEMENTS OF INCOME (LOSS) AND
COMPREHENSIVE INCOME (LOSS)

(unaudited)

(000s, except per share amounts)

	Three months ended June 30,		Six months ended June 30,	
	2011	2010	2011	2010
		<i>(note 18)</i>		<i>(note 18)</i>
Revenue				
Petroleum and natural gas	\$ 17,446	\$ 12,752	\$ 36,761	\$ 26,898
Royalties	(2,295)	(1,614)	(4,795)	(3,656)
Other	154	36	350	40
	15,305	11,174	32,316	23,282
Expenses				
Operating and transportation	3,457	2,760	7,243	5,037
Exploration and evaluation	91	-	91	-
General and administrative	1,285	532	2,145	996
Capital taxes	187	178	454	389
Share-based payments <i>(note 9)</i>	4,909	526	5,592	1,688
Depletion and depreciation <i>(note 5)</i>	6,109	5,473	14,103	10,827
Gain on sale of assets	-	-	-	(104)
	16,038	9,469	29,628	18,833
Results from operating activities	(733)	1,705	2,688	4,449
Finance income	(156)	(17)	(271)	(52)
Finance expense	307	320	720	561
Net finance expense <i>(note 11)</i>	151	303	449	509
Income (loss) before income tax	(884)	1,402	2,239	3,940
Deferred income tax expense	940	497	1,919	1,489
Net income (loss) and comprehensive income (loss) for the period	\$ (1,824)	\$ 905	\$ 320	\$ 2,451
Earnings (loss) per share:				
Basic <i>(note 10)</i>	\$ (0.03)	\$ 0.02	\$ 0.01	\$ 0.06
Diluted <i>(note 10)</i>	\$ (0.03)	\$ 0.02	\$ 0.01	\$ 0.05

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

PAINTED PONY PETROLEUM LTD.
CONDENSED INTERIM CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY
(unaudited)
(000s, except shares)

Periods Ended June 30, 2011 and 2010 and December 31, 2010

	Number of shares		Share capital	Equity component	Contributed	Retained	Total equity
	Class A	Class A	Class A	Class B	surplus	earnings (deficit)	
Balance, Jan. 1, 2010	44,081,700		\$ 135,731	\$ (2,923)	\$ 10,317	\$ (3,806)	\$ 139,319
Share-based payments	-		-	-	2,169	-	2,169
Options exercised	55,000		326	-	(108)	-	218
Income for the period	-		-	-	-	2,451	2,451
Balance, June 30, 2010	44,136,700		\$ 136,057	\$ (2,923)	\$ 12,378	\$ (1,355)	\$ 144,157
Issue of shares	6,800,000		44,064	-	-	-	44,064
Share issue costs, net of tax of \$653	-		(1,800)	-	-	-	(1,800)
Share-based payments	-		-	-	3,733	-	3,733
Options exercised	80,000		451	-	(183)	-	268
Income for the period	-		-	-	-	6,771	6,771
Balance at Dec. 31, 2010	51,016,700		\$ 178,772	\$ (2,923)	\$ 15,928	\$ 5,416	\$ 197,193
Issue of shares	7,620,000		80,010	-	-	-	80,010
Share issue costs, net of tax of \$1,097	-		(3,159)	-	-	-	(3,159)
Share-based payments	-		-	-	7,034	-	7,034
Options exercised	895,973		6,405	-	(2,522)	-	3,883
Income for the period	-		-	-	-	320	320
Balance at June 30, 2011	59,532,673		\$ 262,028	\$ (2,923)	\$ 20,440	\$ 5,736	\$ 285,281

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

PAINTED PONY PETROLEUM LTD.
CONDENSED INTERIM CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited)
(000s)

	Three months ended June 30,		Six months ended June 30,	
	2011	2010	2011	2010
		(note 18)		(note 18)
Operating activities:				
Net income (loss) for the period	\$ (1,824)	\$ 905	\$ 320	\$ 2,451
Items not affecting cash:				
Exploration and evaluation	91	-	91	-
Share-based payments	4,909	526	5,592	1,688
Depletion and depreciation	6,109	5,473	14,103	10,827
Net finance expense	151	303	449	509
Deferred income tax expense	940	497	1,919	1,489
Gain on sale of assets	-	-	-	(104)
Decommissioning expenditures	(2)	-	(106)	-
Changes in non-cash working capital (note 12)	1,480	651	1,041	716
	11,854	8,355	23,409	17,576
Investing activities:				
Exploration and evaluation additions	(9,427)	(20,497)	(9,820)	(37,792)
Property, plant and equipment additions	(19,167)	(11,356)	(43,332)	(28,485)
Acquisition of property, plant and equipment	(7,357)	-	(7,384)	-
Changes in non-cash working capital (note 12)	(8,645)	(13,097)	(10,418)	2,107
	(44,596)	(44,950)	(70,954)	(64,170)
Financing activities:				
Issue of share capital	-	-	80,010	-
Exercise of share options	1,697	-	3,883	218
Share issuance costs	(1)	-	(4,256)	-
Finance and interest received (paid) (note 11)	108	(82)	63	(72)
Changes in non-cash working capital (note 12)	(144)	-	-	(64)
	1,660	(82)	79,700	82
Change in cash and cash equivalents	(31,082)	(36,677)	32,155	(46,512)
Cash and cash equivalents, beginning of period	72,985	36,740	9,748	46,575
Cash and cash equivalents, end of period (note 3)	\$ 41,903	\$ 63	\$ 41,903	\$ 63

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

PAINTED PONY PETROLEUM LTD.
NOTES TO CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)
As at and for the three and six months ended June 30, 2011 and 2010

1. Reporting Entity

Painted Pony Petroleum Ltd. (the "Company") is a publically traded company incorporated under the laws of Alberta, whose principal business activity is the exploration, development and production of petroleum and natural gas resources in western Canada, many of which are conducted jointly with others. The condensed interim consolidated financial statements of the Company as at and for the three and six month periods ended June 30, 2011 and 2010 include the accounts of the Company and its wholly owned subsidiaries, Painted Pony Petroleum Corp. and Painted Rock Resources Ltd. The Company's head office is located at Suite 300, 602 – 12 Ave. S.W., Calgary, AB. These financial statements reflect only the Company's share of joint assets and a proportionate share of related revenues and costs.

2. Summary of Accounting Policies

(a) Conversion to International Financial Reporting Standards ("IFRS") and Statement of Compliance

These condensed interim consolidated financial statements as at June 30, 2011, including 2010 comparative periods, comprise a period of the Company's first annual consolidated financial statements to be issued under IFRS at December 31, 2011. As a result, these condensed interim consolidated financial statements have been prepared in accordance with IFRS 1 "First-time Adoption of International Financial Reporting Standards" and IAS 34 "Interim Financial Reporting". The condensed interim consolidated financial statements do not include all of the information required for full annual financial statements. The condensed interim consolidated financial statements were authorized for issue by the Board of Directors on August 23, 2011.

An explanation of how the transition to IFRS has affected the reported consolidated financial position, financial performance and cash flows of the Company is provided in Note 18. That note includes reconciliations as at June 30, 2010 and for the three and six month periods ended June 30, 2010. For reconciliations to IFRS at the date of transition, January 1, 2010, and December 31, 2010, refer to Note 20 of the condensed interim consolidated financial statements for the three months ended March 31, 2011.

These condensed interim financial statements should be read in conjunction with the condensed interim consolidated financial statements and accompanying notes for the period ended March 31, 2011. These condensed interim financial statements have been prepared following the same accounting policies and methods of computation as the consolidated financial statements for the Company for the period ended March 31, 2011.

(b) Accounting Policies

For a summary of the Company's detailed accounting policies, refer to Notes 2 and 3 of the condensed interim consolidated financial statements for the three months ended March 31, 2011. Certain amounts for the prior year comparative periods have been reclassified to conform to the current quarter and year to date presentation.

3. Cash and Cash Equivalents

(\$000s)	Six months ended June 30, 2011	Year ended December 31,
Bank balances	\$ 41,903	\$ 9,748
Term deposits	-	-
Cash and cash equivalents	\$ 41,903	\$ 9,748

4. Exploration and Evaluation Assets (“E&E”)

(\$000s)	
Cost:	
Balance, January 1, 2010	\$ 13,424
Additions	45,890
Acquisitions	1,800
Transfers to property, plant and equipment	(17,579)
Balance, December 31, 2010	\$ 43,535
Additions	9,820
Transfers to property, plant and equipment	(100)
Lease expiries	(91)
Balance, June 30, 2011	\$ 53,164

Exploration and evaluation assets are not depleted or depreciated.

Exploration and evaluation assets consist of the Company's exploration projects and undeveloped land which are pending the determination of proven or probable reserves. Acquisitions represent exploration and evaluation assets purchased during the period. Additions represent the Company's share of costs incurred on exploration and evaluation assets during the period.

5. Property, Plant and Equipment

(\$000s)	Oil and Natural Gas Properties	Office Furniture and Equipment	Total
Cost or deemed cost:			
Balance, January 1, 2010	\$ 96,103	\$ 272	\$ 96,375
Acquisitions	11,046	-	11,046
Cash additions	61,199	200	61,399
Non-cash additions	11,451	-	11,451
Transfers from exploration and evaluation	17,579	-	17,579
Balance, December 31, 2010	\$ 197,378	\$ 472	\$ 197,850
Acquisitions	7,384	-	7,384
Cash additions	43,145	187	43,332
Non-cash additions	1,956	-	1,956
Transfers from exploration and evaluation	100	-	100
Balance, June 30, 2011	\$ 249,963	\$ 659	\$ 250,622
Depletion and depreciation:			
Balance, January 1, 2010	\$ -	\$ 74	\$ 74
Depletion and depreciation	23,939	61	24,000
Balance, December 31, 2010	23,939	135	24,074
Depletion and depreciation	14,058	45	14,103
Balance, June 30, 2011	\$ 37,997	\$ 180	\$ 38,177
Carrying amounts:			
At January 1, 2010	\$ 96,103	\$ 198	\$ 96,301
At December 31, 2010	\$ 173,439	\$ 337	\$ 173,776
At June 30, 2011	\$ 211,966	\$ 479	\$ 212,445

(a) Depreciation and Impairment Charge

The depletion, depreciation and impairment of property, plant and equipment, and any eventual reversal thereof, are recognized in depletion and depreciation in the statement of income (loss) (see also note 15).

(b) Capitalized General and Administrative Expense and Share-based Payments

For the three and six months ended June 30, 2011 and 2010, the Company capitalized general and administrative expenses and share-based payments as follows:

(\$000s)	Three months ended June 30,		Six months ended June 30,	
	2011	2010	2011	2010
General and administrative	\$ 849	\$ 269	\$ 1,213	\$ 691
Share-based payments	1,400	148	1,442	480
Total	\$ 2,249	\$ 417	\$ 2,655	\$ 1,171

(c) Property acquisition

During the quarter ended June 30, 2011, the Company acquired certain southeast Saskatchewan light oil properties for cash consideration of \$7.4 million, including interim adjustments.

6. Bank Debt

Subsequent to June 30, 2011, the Company's demand revolving credit facility was increased from \$75 million to \$80 million with the next review date scheduled for March 31, 2012. There can be no assurance that the amount of the available demand credit facility will not be decreased at the next scheduled review. No amounts were drawn as of June 30, 2011.

Interest for the demand revolving credit facility is payable at a floating rate determined as the lender's prime rate plus 0.5% to 2.5%, depending on the Company's debt to cash flow ratio, as defined by the lender. A standby fee of 0.20% to 0.45% is charged on the undrawn portion of the credit facility, depending on the Company's cash flow ratio, as defined by the lender. Security is provided by a first fixed and floating charge debenture of \$100 million on all of the Company's assets. The Company has provided a negative pledge and undertaking to provide fixed charges over major petroleum and natural gas reserves in certain circumstances.

7. Decommissioning Obligations

(\$000s)	Six months ended	Year ended
	June 30, 2011	December 31, 2010
Balance, beginning of period	\$ 7,145	\$ 4,290
Provisions	459	2,731
Acquired	55	-
Decommissioning expenditures	(106)	(100)
Accretion	149	224
Balance, end of period	\$ 7,702	\$ 7,145

Decommissioning Obligations

The Company's decommissioning obligations result from its ownership interest in oil and natural gas assets including well sites and facilities. The total decommissioning 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 has estimated the net present value of the decommissioning obligations to be \$7.7 million as at June 30, 2011 (December 31, 2010: \$7.1 million) based on an undiscounted total future liability of \$15.2 million (December 31, 2010: \$14.2 million). These payments are expected to be made over the next 25 to 30 years with the majority of costs to be incurred between 2026 and 2028. The discount factor, being the risk-free rate related to the liability, is 4% (2010: 4%) and the inflation rate is 2% (2010: 2%).

8. Convertible Class B Shares

On reorganization, the Company had 6,615 convertible Class B shares (the "Class B shares") outstanding. On May 17, 2007, the Company issued 1,080,000 Class B shares on a flow-through basis and 86,985 Class B shares in satisfaction of debt, which were not on a flow-through basis, bringing the total number of Class B shares to 1,173,600. An unlimited number of Class B shares are authorized for issuance. The Class B shares are convertible at the option of the Company until the close of business on June 30, 2012, into Class A shares. The number of Class A shares obtained upon conversion of each Class B share will be equal to \$10.00 divided by the greater of \$1.00 and the then current market price (as defined) of the Class A shares (the "conversion formula"). If the Company fails to exercise the conversion option by the close of business on June 30, 2012, then the Class B shares shall be convertible at the option of the shareholder, at any time after June 30, 2012, and before August 1, 2012 into Class A shares pursuant to the conversion formula described above. Any Class B shares not converted prior to close of business on August 1, 2012 will be automatically converted into Class A shares pursuant to the conversion formula. The Class B shares are listed and posted for trading on the TSX Venture Exchange under the symbol "PPY.B".

The Class B shares were determined to be compound instruments. As the Class B shares are convertible into Class A shares, based on the conversion formula above, and the number of Class A shares is unknown, the Class B shares are presented as a liability. The Class B share liability is accreted using the effective interest rate method (7%) over the term of the Class B shares, such that the carrying amount of the financial liability will be equal to the principal balance of \$11.7 million at maturity.

The following table indicates the convertible Class B shares activities :

<i>(\$000s)</i>	Six months ended June 30, 2011	Year ended December 31, 2010
Balance, beginning of period	\$ 10,536	\$ 9,847
Accretion on convertible Class B share liability	363	689
Balance, end of period	\$ 10,899	\$ 10,536

At the date of transition to IFRS, the Company recognized the equity component for the convertible Class B shares as a conversion option of \$2.0 million and \$0.9 million related to the deferred income tax effect of the Class B shares.

9. Share Capital

(a) Authorized

Unlimited: Class A and B shares

Unlimited: Preferred shares, none outstanding as at June 30, 2011 and December 31, 2010

The Class A shares are voting on the basis of one vote per share. There are no dividends payable on the Class A shares. In the event of the liquidation or dissolution of the Company, the Class B shares will be converted at the conversion rate (note 8) into Class A shares and the Class A shares are entitled to receive, on a pro rata basis, all assets of the Company as are distributable to the holders of shares.

(b) Stock options

The Company has an option program that entitles officers, directors and employees to purchase shares in the Company. Options are granted at the market price of the shares at the date of grant, have a five year term, and generally vest one-third immediately with the balance over two years.

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

	Weighted Average Exercise Price	Number
Balance, January 1, 2010	\$ 3.53	2,755,000
Granted	6.25	1,938,920
Exercised	3.60	(135,000)
Forfeited and cancelled	5.88	(10,000)
Balance, December 31, 2010	\$ 4.68	4,548,920
Granted	10.89	1,859,900
Exercised	4.33	(895,973)
Forfeited and cancelled	5.16	(77,980)
Balance, June 30, 2011	\$ 6.86	5,434,867
Exercisable at June 30, 2011	\$ 5.78	2,851,866

Number of Options Outstanding	Exercise Price	Remaining Life (yrs)	Grant Date Fair Value	Exercisable Options	Exercise Price
832,000	\$ 3.97	1.6	\$ 2.62	832,000	\$ 3.97
75,000	\$ 1.40	2.4	0.90	75,000	\$ 1.40
587,500	\$ 2.85	3.1	1.84	371,334	\$ 2.85
340,500	\$ 3.15	3.1	2.04	188,000	\$ 3.15
134,500	\$ 5.88	3.4	3.80	88,166	\$ 5.88
562,667	\$ 5.88	3.5	3.71	369,000	\$ 5.88
30,000	\$ 5.60	3.9	3.62	6,000	\$ 5.60
1,012,800	\$ 6.51	4.2	4.21	302,400	\$ 6.51
1,505,900	\$10.60	4.8	6.86	501,966	\$10.60
354,000	\$12.10	4.9	7.83	118,000	\$12.10
5,434,867	\$ 6.86	3.7	\$ 4.43	2,851,866	\$ 5.78

The weighted average share price at the date of exercise for share options exercised during the six months ended June 30, 2011 was \$10.54 (six months ended June 30, 2010: \$6.57).

The Company accounts for its stock options granted to employees, consultants, officers and directors using the fair value method. In accordance with the Company's incentive stock plan, these options have an exercise price equal to the fair value of the Company's Class A shares at the date of grant using the Black-Scholes option-pricing model. The following weighted-average fair value of the options granted and the assumptions used are as follows:

Six months ended June 30,	2011	2010
Fair value per option (weighted average)	\$ 7.03	\$ 3.70
Volatility (%)	80	80
Option life (years)	5	5
Dividends	-	-
Risk-free interest rate (%)	1.98	1.90

1,859,900 stock options were granted at an average price of \$10.89 during the three and six months ended June 30, 2011 (three and six months ended June 30, 2010: 72,000 at \$5.60 and 761,000 at \$5.85).

A forfeiture rate of 2% (2010: 0%) is used when measuring share-based payments. Share-based payments of \$4.9 million and \$5.6 million for the three and six months ended June 30, 2011, respectively, (three and six months ended June 30, 2010: \$0.5 million and \$1.7 million) were expensed and \$1.4 million (three and six months ended June 30, 2010: \$0.1 million and \$0.5 million, respectively) was capitalized during both the three and six months ended June 30, 2011.

10. Earnings per Share

Basic earnings per share was calculated as follows:

<i>(000s, except shares)</i>	Three months ended June 30,		Six months ended June 30,	
	2011	2010	2011	2010
Net income (loss) for the period	\$ (1,824)	\$ 905	\$ 320	\$ 2,451
<i>Weighted average number of shares</i>				
Class A shares - basic	59,359,276	44,136,700	57,232,566	44,132,418
Class A shares - diluted	59,359,276	45,077,914	58,350,719	45,164,631
Net income per share – basic	\$ (0.03)	\$ 0.02	\$ 0.01	\$ 0.06
Net income per share - diluted	\$ (0.03)	\$ 0.02	\$ 0.01	\$ 0.05

The average market value of the Company's shares for purposes of determining the dilutive effect of converting the Class B shares to Class A shares and of outstanding share options was based on quoted market prices for the period. All of the Class B shares were excluded from the diluted earnings per share calculation as they were determined to be anti-dilutive for the three and six months ended June 30, 2011 and 2010. During the three and six months ended June 30, 2011, 5,434,867 and 1,859,900 (three and six months ended June 30, 2010: nil) options were excluded from the weighted-average diluted share calculation of Class A shares as they were anti-dilutive.

11. Finance Income and Expense

<i>(000s)</i>	Three months ended		Six months ended	
	2011	June 30, 2010	2011	June 30, 2010
Finance income:				
Interest income	\$ (156)	\$ (17)	\$ (271)	\$ (52)
	(156)	(17)	(271)	(52)
Finance expense:				
Financing costs	49	98	208	123
Accretion of decommissioning obligations	75	51	149	99
Accretion of convertible Class B share liability	183	171	363	339
	307	320	720	561
Net finance expense recognized in income or loss	\$ 151	\$ 303	\$ 449	\$ 509

12. Supplemental Cash Flow Information

Changes in non-cash working capital is comprised of:

(000s)	Three months ended June 30,		Six months ended June 30,	
	2011	2010	2011	2010
Source/(use) of cash:				
Trade and other receivables	\$ 3,850	\$ 372	\$ (1,385)	\$ (2,374)
Prepaid expenses and deposits	(41)	7	(54)	48
Trade and other payables	(11,118)	(12,825)	(7,938)	5,085
	\$ (7,309)	\$ (12,446)	\$ (9,377)	\$ 2,759
<hr/>				
Related to operating activities	\$ 1,480	\$ 651	\$ 1,041	\$ 716
Related to investing activities	(8,645)	(13,097)	(10,418)	2,107
Related to financing activities	(144)	-	-	(64)
	\$ (7,309)	\$ (12,446)	\$ (9,377)	\$ 2,759

13. Operating Commitments

- (a) At June 30, 2011, the Company is committed to two contracts, that expire in 2016, that require an estimated \$2.7 million of minimum tolls for transportation of oil through a major carrier system, and are payable as follows:

(000s)	Amount
2011	\$ 396
2012	842
2013	623
2014	469
2015	258
2016	101
	\$ 2,689

- (b) The Company is committed to future payments for office space rental through to 2015 as follows:

(000s)	Amount
2011	\$ 316
2012	624
2013	443
2014	263
2015	241
	\$ 1,887

- (c) Subsequent to June 30, 2011, the Company entered into an agreement for the expansion of a non-operated gas plant in British Columbia, whereby the Company, should it not elect to commit minimum production volumes to the plant, would incur a break fee equal to 43% of the engineering, front-end construction and restocking charges, estimated to be \$1.3 million net to the Company at September 1, 2011 or approximately \$4.35 million net at December 15, 2011.

14. Related Party Transactions

The Company utilizes the services of a law firm in which the Corporate Secretary is a Partner. During the three and six months ended June 30, 2011, the Company incurred \$24,000 and \$90,000 (2010: \$14,000 and \$25,000) on services obtained from the firm, excluding disbursements. As at June 30, 2011, the Company owed this related party \$21,696 (December 31, 2010: \$15,329).

15. 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.

(a) Property, Plant and Equipment and Exploration and Evaluation Assets

The fair value of property, plant and equipment recognized in a business combination, is based on market values. The fair value of property, plant and equipment is the estimated amount for which property, plant and equipment could be exchanged on the acquisition date between a willing buyer and a willing seller in an arm's length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently and without compulsion. The fair value of oil and natural gas interests (included in property, plant and equipment) and exploration and evaluation assets is estimated with reference to the discounted cash flows expected to be derived from oil and natural gas production based on externally prepared reserve reports. The risk-adjusted discount rate is specific to the asset with reference to general market conditions.

The market value of other items of property, plant and equipment is based on the quoted market prices for similar items.

(b) Cash and Cash Equivalents, Trade and Other Receivables and Trade and Other Payables

The fair value of cash and cash equivalents, trade and other receivables and trade and other payables are estimated as the present value of future cash flows, discounted at the market rate of interest at the reporting date. At June 30, 2011 and December 31, 2010, the fair value of these balances approximated their carrying value due to their short term to maturity.

(c) Stock Options

The fair value of employee stock options is measured using a Black-Scholes option pricing model. Measurement inputs include share price on measurement date, exercise price of the instrument, expected volatility, weighted average expected life of the instruments (based on historical experience and general option holder behavior), expected dividends and the risk-free interest rate.

(d) Class B Shares

The fair value of the convertible Class B liability at June 30, 2011 was \$10.8 million (December 31, 2010: \$10.9 million) based on the market price of \$9.20 per Class B share (December 31, 2010: \$9.25 per Class B share, based on the December 24, 2010 closing price being the last trade of 2010).

16. Financial Risk Management

(a) Overview

The Company's activities expose it to a variety of financial risks that arise as a result of its exploration, development, production and financing activities such as:

- credit risk;
- liquidity risk; and
- market risk.

This note presents information about the Company's exposure to each of the above risks, the Company's objectives, policies and processes for measuring and managing risk, and the Company's management of capital. Further quantitative disclosures are included throughout these consolidated financial statements.

The Board of Directors oversees management's establishment and execution of the Company's risk management framework. Management has implemented and monitors compliance with risk management policies. The Company's risk management policies are established to identify and analyze the risks faced by the Company, to set appropriate risk limits and controls and to monitor risks and adherence to market conditions and the Company's activities.

(b) Credit Risk

Credit risk is the risk of financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its contractual obligations and arises principally from the Company's receivables from joint venture partners and oil and natural gas purchasers. The Company's maximum exposure to credit risk at June 30, 2011 and December 31, 2010 is as follows:

(\$000s)	June 30, 2011	December 31, 2010
Cash and cash equivalents	\$ 41,903	\$ 9,748
Trade and other receivables	18,585	17,200
Total current assets	\$ 60,488	\$ 26,948

Trade and other receivables

All of the Company's operations are conducted in Canada. The Company's exposure to credit risk is influenced mainly by the individual characteristics of each customer.

Receivables from oil and natural gas purchasers are normally collected on the 25th day of the month following production. The Company's policy to mitigate credit risk associated with these balances is to establish marketing relationships with large purchasers. The Company historically has not experienced any collection issues with its oil and natural gas purchasers. Receivables from joint venture partners are typically collected within one to three months of the joint venture bill being issued. The Company attempts to mitigate the risk from joint venture receivables by obtaining partner pre-approval. However, the receivables are from participants in the oil and natural gas sector and collection of the outstanding balances is dependent on industry factors such as commodity price fluctuations, escalating costs and the risk of unsuccessful drilling. In addition, further risk exists with joint venture partners if a disagreement were to arise, which may increase the potential for non-collection. The Company does not typically obtain collateral from oil and natural gas purchasers or joint venture partners; however, the Company does have the ability to withhold production from joint venture partners in the event of non-payment.

The Company does not anticipate any default as it transacts with creditworthy customers and management does not expect any losses from non-performance by these customers. As such, a provision for doubtful accounts has not been recorded at either June 30, 2011 or December 31, 2010. The breakdown of trade and other receivables at the reporting date by type of customer was:

(\$000s)	June 30, 2011	December 31, 2010
Sales revenue	\$ 6,081	\$ 7,109
Joint interest	11,591	9,045
Other	913	1,046
Total trade and other receivables	\$ 18,585	\$ 17,200

The Company has two significant independent commodity purchasers. One entity purchases the majority of natural gas produced in British Columbia which accounted for \$1.6 million of trade and other receivables at June 30, 2011 (December 31, 2010: \$1.5 million). A second entity purchases the majority of oil produced in Saskatchewan which accounted for \$3.5 million of trade and other receivables at June 30, 2011 (December 31, 2010: \$5.0 million).

As at June 30, 2011 and December 31, 2010, the Company's trade and other receivables are aged as follows:

<i>(\$000s)</i>	June 30, 2011	December 31, 2010
Not past due (less than 30 days)	\$ 18,175	\$ 15,339
Past due (31 – 90 days)	185	1,691
Past due (more than 90 days)	225	170
Total receivables	\$ 18,585	\$ 17,200

Cash and cash equivalents

The Company limits its exposure to credit risk by only investing in liquid securities that are guaranteed by the Province of Alberta. Given these credit ratings, management does not expect any counterparty to fail to meet its obligations.

(c) Liquidity Risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they fall due. The Company's approach to managing liquidity is to ensure, to the extent possible, that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Company's reputation.

Typically the Company ensures that it has sufficient cash on demand to meet expected operational expenses currently and in the foreseeable future, including the servicing of financial obligations; this excludes the potential impact of extreme circumstances that cannot reasonably be predicted, such as natural disasters. To achieve this objective, the Company prepares annual capital expenditure budgets, which are regularly monitored and updated as considered necessary. Further, the Company utilizes authority for expenditures on both operated and non-operated projects to further manage capital expenditures. The Company also attempts to match its payment cycle with collection of oil and natural gas revenue on the 25th of each month. In addition, the Company maintains an \$80 million credit facility to provide capital when needed, of which \$75 million was available at the end of the period and \$80 million is available subsequent to June 30, 2011.

(d) Market Risk

Market risk is the risk that changes in market prices, such as commodity prices, foreign exchange rates and interest rates, will affect the Company's income or the value of the financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimizing the return.

The Company may use both financial derivatives and physical delivery sales contracts to manage market risks. All such transactions are conducted within risk management tolerances that are reviewed by the Board of Directors. As at June 30, 2011, the Company had not entered into any derivatives to manage market risk.

Prices for oil are determined in global markets and generally denominated in United States dollars. Natural gas prices obtained by the Company are influenced by both US and Canadian demand and the corresponding North American supply, and recently, by imports of liquefied natural gas. The exchange rate effect cannot be quantified but generally an increase in the value of the Canadian dollar as compared to the U.S. dollar will reduce the prices received by the Company for its petroleum and natural gas sales. Commodity price risk is the risk that the fair value or future cash flows will fluctuate as a result of changes in commodity prices. Commodity prices for oil and natural gas are impacted by not only the relationship between the Canadian and United States dollars, but also world economic events that dictate the levels of supply and demand.

The Company's production is usually sold using "spot" or near term contracts, with prices fixed at the time of transfer of custody or on the basis of a monthly average market price. The Company, however, may give consideration in certain circumstances to the appropriateness of entering into long term, fixed price marketing contracts. To date, the Company has not undertaken any risk management contracts or commodity price contracts. The Company has contracted the majority of its oil to one purchaser on a month-to-month rolling contract. The majority of the Company's natural gas is sold monthly on a best-efforts basis to one purchaser under a one-year term contract, which runs from November 1 to October 31 of each year.

Interest rate risk is the risk that future cash flows will fluctuate as a result of changes in market interest rates. For the three and six months ended June 30, 2011, if interest rates had been 0.5% lower than the weighted-average rate of 1.25%, with all other variables held constant, income and comprehensive income for the period would have been \$62,000 and \$108,000 lower due to lower interest income. An equal and opposite impact would have occurred to income and comprehensive income had interest rates been 0.5% higher.

(e) Capital Management

The Company's policy is to maintain a strong capital base so as to maintain investor, creditor and market confidence and to sustain future development of the business. The Company manages its capital structure and makes adjustments to it in the light of changes in economic conditions and the risk characteristics of the underlying oil and natural gas assets. The Company considers its capital structure to include shareholders' equity, loans and borrowings and working capital. In order to maintain or adjust the capital structure, the Company may issue shares and adjust its capital spending to manage current and projected debt levels.

The Company monitors capital based on the ratio of net debt to annualized cash flow. This ratio is calculated as net debt, defined as outstanding loans and borrowings plus or minus working capital, divided by cash flow from operations before changes in non-cash working capital for the most recent calendar quarter and then annualized. The Company's objective is to maintain a net debt to funds flow from operations ratio of 1:1 or less. This ratio may increase at certain times as a result of acquisitions. In order to facilitate the management of this ratio, the Company prepares annual capital expenditure budgets, which are updated as necessary depending on varying factors including current and forecast prices, successful capital deployment and general industry conditions. The annual and updated budgets are approved by the Board of Directors. As at June 30, 2011, the Company did not have a debt balance on its statement of financial position.

There were no changes in the Company's approach to capital management during the period. Neither the Company nor any of its subsidiaries are subject to externally imposed capital requirements. The credit facilities are subject to a periodic review of the borrowing base which is directly impacted by the value of the oil and natural gas reserves.

17. Contingencies

Although the Company believes it has title to its oil and natural gas properties, it cannot control or completely protect itself against the risk of title disputes or challenges. There can be no assurance that claims or challenges by third parties against the Company's properties will not be asserted at a future date.

18. Transition to IFRS

Painted Pony's accounting policies under IFRS are different from those followed under Canadian GAAP, as disclosed in Note 3 to the condensed interim financial statements for the three months ended March 31, 2011 and 2010. These accounting policies have been applied in preparing the condensed interim consolidated financial statements for the three and six month periods ended June 30, 2011, and the comparative statements for the three and six month periods ended June 30, 2010. The adjustments arising from the application of IFRS to amounts on the statement of financial position on the transition date, and on transactions prior to that date, were recognized as an adjustment to the Company's opening retained earnings on the statement of financial position when appropriate.

IFRS 1 "First-Time Adoption of International Financial Reporting" allowed first-time adopters certain exemptions from retrospective application of certain IFRS. On transition to IFRS as at January 1, 2010, Painted Pony utilized certain mandatory and optional exemptions for first-time adopters, as allowed and disclosed in Note 20 to the condensed consolidated interim financial statements for the three months ended March 31, 2011 and 2010.

Reconciliation of the Condensed Interim Consolidated Statement of Financial Position from Canadian GAAP to IFRS

As at June 30, 2010

(Unaudited)

(\$000s)

	Canadian GAAP	Effect of Transition to IFRS	IFRS
ASSETS			
Current assets			
Cash and cash equivalents	\$ 63	\$ -	\$ 63
Trade and other receivables	7,572	-	7,572
Prepaid expenses and deposits	276	-	276
	7,911	-	7,911
Non-current assets			
Exploration and evaluation <i>(note a)</i>	-	38,147	38,147
Property, plant and equipment <i>(note a, e)</i>	164,196	(35,833)	128,363
Deferred tax asset <i>(note h)</i>	1,888	(326)	1,562
	\$ 173,995	\$ 1,988	\$ 175,983
LIABILITIES			
Current liabilities			
Trade and other payables	\$ 16,503	\$ -	\$ 16,503
Non-current liabilities			
Decommissioning obligations <i>(note b)</i>	2,948	2,189	5,137
Convertible Class B shares liability <i>(note c)</i>	-	10,186	10,186
	19,451	12,375	31,826
EQUITY			
Share capital <i>(note f)</i>	140,065	(4,008)	136,057
Equity component of convertible Class B shares <i>(note c)</i>	-	(2,923)	(2,923)
Contributed surplus <i>(note d)</i>	12,497	(119)	12,378
Retained earnings (deficit) <i>(notes b, c, d, h)</i>	1,982	(3,337)	(1,355)
	154,544	(10,387)	144,157
	\$ 173,995	\$ 1,988	\$ 175,983

Reconciliation of the Condensed Interim Consolidated Statement of Income and Comprehensive Income

For the Three Months ended June 30, 2010 from Canadian GAAP to IFRS

(Unaudited)

(\$000s, except per share amounts)

	Canadian GAAP	Effect of Transition to IFRS	IFRS
Revenue			
Petroleum and natural gas	\$ 12,752	\$ -	\$ 12,752
Royalties	(1,614)	-	(1,614)
Other	53	(17)	36
	11,191	(17)	11,174
Expenses			
Operating and transportation	2,760	-	2,760
General and administrative	606	(74)	532
Capital taxes	178	-	178
Share-based payments <i>(note d)</i>	551	(25)	526
Depletion and depreciation <i>(note e)</i>	6,381	(908)	5,473
	10,476	(1,007)	9,469
Results from operating activities	715	990	1,705
Finance income	-	(17)	(17)
Finance expense <i>(note b)</i>	-	320	320
Net finance expense	-	303	303
Income before income tax	715	687	1,402
Deferred income tax expense <i>(note h)</i>	365	132	497
Net income and comprehensive income for the period	\$ 350	\$ 555	\$ 905
Earnings per share:			
Basic	\$ 0.01		\$ 0.02
Diluted	\$ 0.01		\$ 0.02

Reconciliation of the Condensed Interim Consolidated Statement of Income and Comprehensive Income

For the Six Months ended June 30, 2010 from Canadian GAAP to IFRS

(Unaudited)

(\$000s, except per share amounts)

	Canadian GAAP	Effect of Transition to IFRS	IFRS
Revenue			
Petroleum and natural gas	\$ 26,898	\$ -	\$ 26,898
Royalties	(3,656)	-	(3,656)
Other	92	(52)	40
	23,334	(52)	23,282
Expenses			
Operating and transportation	5,037	-	5,037
General and administrative	1,095	(99)	996
Capital taxes	389	-	389
Share-based payments <i>(note d)</i>	1,746	(58)	1,688
Depletion and depreciation <i>(note e)</i>	13,033	(2,206)	10,827
Gain on sale of assets <i>(note g)</i>	-	(104)	(104)
	21,300	(2,467)	18,833
Results from operating activities	2,034	2,415	4,449
Finance income	-	(52)	(52)
Finance expense <i>(note b)</i>	-	561	561
Net finance expense	-	509	509
Income before income tax	2,034	1,906	3,940
Deferred income tax expense <i>(note h)</i>	1,003	486	1,489
Net income and comprehensive income for the period	\$ 1,031	\$ 1,420	\$ 2,451
Earnings per share:			
Basic	\$ 0.02		\$ 0.06
Diluted	\$ 0.02		\$ 0.05

(a) IFRS 1 Election for Full Cost Oil and Gas Entities

The Company elected an IFRS 1 exemption whereby the Canadian GAAP full cost pool was measured upon transition to IFRS as follows:

- (i) exploration and evaluation assets were reclassified from the full cost pool to exploration and evaluation assets at the amount that was recorded under Canadian GAAP; and
- (ii) the remaining full cost pool was allocated to the producing/development assets pro-rata using proven plus probable pre-tax reserve values based on a discount rate of 10%.

The impact on the reclassification from the full cost pool to exploration and evaluation assets on the condensed consolidated statements of financial position for the period ended June 30, 2010 is as follows:

Condensed Consolidated Statement of Financial Position:

(\$000s)	June 30, 2010
Exploration and evaluation	\$ 38,147
Property, plant and equipment	(38,147)
Impact on total assets	\$ -

(b) Decommissioning Obligations

Under Canadian GAAP asset retirement obligations were discounted at a credit adjusted risk free rate of 8%. Under IFRS the estimated cash flow to abandon and remediate the wells and facilities has been risk adjusted; therefore, the provision is discounted at a risk free rate in effect at the end of each reporting period (4% for all periods presented in these notes). Upon transition to IFRS this resulted in a \$1.9 million increase in the decommissioning obligations with a corresponding increase in the deficit. As a result of the lower discount rate, the Company recorded additional decommissioning costs to PP&E and lower related accretion expense during the 2010 periods. In addition, under Canadian GAAP accretion of the discount was included in depletion and depreciation. Under IFRS it is included in finance expense.

As a result of the change in the decommissioning obligation, the impact on the condensed consolidated statement of financial position as at June 30, 2010 and consolidated statements of income and comprehensive income for the three and six months ended June 30, 2010 is as follows:

Condensed Consolidated Statements of Financial Position:

(\$000s)	June 30, 2010
Property, plant and equipment	\$ 351
Decommissioning obligations	(2,189)
Impact on retained earnings (deficit)	\$ (1,838)

Condensed Consolidated Statements of Income and Comprehensive Income:

(\$000s)	Three months ended June 30, 2010	Six months ended June 30, 2010
Finance expense	\$ (7)	\$ (13)
Impact on income and comprehensive income	\$ 7	\$ 13

(c) Convertible Class B Shares

Under Canadian GAAP, the Company's convertible Class B shares were presented as share capital. Under IFRS, the Class B shares do not qualify for equity presentation and must be presented as a liability due to the number of Class A shares issued on conversion, based on the conversion formula (note 8), being variable until the Company or shareholders exercise conversion rights. The value of the Class A shares on issuance was determined to be \$5.2 million (\$1.00 per Class A share). It was also determined that the face value of convertible Class B shares is \$11.7 million (\$9.97 per Class B share). Using a 7 percent discount rate and a term of 5.21 years, the Company calculated a present value of approximately \$8.2 million on issuance, which will accrete to the \$11.7 million face value on August 1, 2012, the expiration date of the shareholder's conversion option. A deferred tax liability of \$0.9 million was recognized on issuance relating to the difference between the face value and present value of the Class B shares. The deferred tax liability is reversed proportionately to the accretion expense on the convertible Class B share liability.

The flow-through share premium of \$1.6 million was recognized for the Class A and Class B shares issued on the initial public offering. The flow-through share premium reduced share capital, and as expenditures were incurred, the premium was recorded through income. The amount recorded for the Class B equity component relates to the conversion feature of \$2.0 million, recognizing the value of the Company's lower limit of \$1.00 per Class A share in the Class B to Class A conversion formula, along with the deferred income tax effect of the Class B shares of \$0.9 million.

The following table provides the effect of transition to IFRS for the Company's share capital transactions involving convertible Class B shares from previous GAAP to IFRS at the date of transition:

<i>(\$000s)</i>	Effect of Transition to IFRS
Class A share capital	\$ 3,916
Convertible Class B share capital	(11,704)
Convertible Class B share liability	8,247
Deferred income tax liability	899
Equity component of Class B shares	(2,923)
Retained earnings	1,565
	\$ -

In addition to the above adjustment, the Company recorded the effect of accretion expense from May 2007 through to June 30, 2011. As a result of adopting this policy, the effect of the change to accretion expense and the Class B liability was as follows:

Consolidated Statements of Financial Position:

<i>(\$000s)</i>	June 30, 2010
Impact on convertible class B liability	\$ 339

Consolidated Statements of Income and Comprehensive Income:

<i>(\$000s)</i>	Three months ended June 30, 2010	Six months ended June 30, 2010
Impact on finance expense	\$ 171	\$ 339
Impact on income and comprehensive income	\$ (171)	\$ (339)

(d) Share-Based Payments

Under Canadian GAAP, the Company recognized an expense related to share-based payments on a graded basis over individual vesting periods, but did not incorporate a forfeiture rate. Under IFRS, the Company is required to estimate a forfeiture rate and apply this to the Black-Scholes model. Furthermore, the Company has determined that option recipients classified as consultants under Canadian GAAP would not be classified as such under IFRS. The impact of the changes to share-based payments for the periods ended June 30, 2010 is as follows:

Consolidated Statements of Financial Position:

<i>(000s)</i>	June 30, 2010
Property, plant and equipment	\$ (18)
Contributed surplus	119
Impact on retained earnings (deficit)	\$ 101

Consolidated Statements of Income and Comprehensive Income:

<i>(000s)</i>	Three months ended June 30, 2010	Six months ended June 30, 2010
Share-based payments	\$ (25)	\$ (58)
Impact on income and comprehensive income	\$ 25	\$ 58

(e) Depletion Policy

Upon transition to IFRS, the Company adopted a policy of depleting oil and natural gas interests on a unit of production basis over proven plus probable reserves. The depletion policy under Canadian GAAP was based on units of production over proven reserves. In addition depletion was done on the Canadian cost centre under Canadian GAAP. IFRS requires depletion and depreciation to be calculated based on a component basis, as determined by the Company. In addition, accretion expense is reported as finance expense under IFRS.

There was no impact on property, plant and equipment of the depletion policy change on adoption of IFRS at January 1, 2010. As a result of the change in the policy of depleting oil and natural gas interests on a proven plus probable basis and the reclassification of accretion expense to finance expense, the impact on the condensed consolidated statement of financial position at June 30, 2010 and condensed consolidated statements of income and comprehensive income for the three and six months ended June 30, 2010 is as follows:

Consolidated Statements of Financial Position:

<i>(\$000s)</i>	June 30, 2010
Property, plant and equipment	\$ 2,094
Impact on total assets	\$ 2,094

Consolidated Statements of Income and Comprehensive Income:

<i>(\$000s)</i>	Three months ended June 30, 2010	Six months ended June 30, 2010
Depletion and depreciation expense	\$ (908)	\$ (2,206)
Impact on income and comprehensive income	\$ 908	\$ 2,206

(f) Flow-Through Shares

In 2007, the Company issued flow-through shares where the amount of the issue represented the “flow-through” of tax pool deductions to investors. Under Canadian GAAP, the accounting treatment for the flow-through shares is to record the full amount of the proceeds in share capital. When expenditures are renounced, the related tax effect is recorded to share capital and the future tax liability. Under IFRS, the amount initially recorded in share capital is limited to the value that would have been received for shares issued on a non-flow-through basis, and the difference between the actual proceeds and the amount recorded in share capital is set up as a deferred premium on flow-through shares. When the expenditures are incurred, the related deferred premium on flow-through shares is reversed and the related tax effect is recorded to the deferred income tax liability (see note 18 (c)).

(g) Gains and Losses on Disposition of Assets

Under Canadian GAAP, proceeds from asset sales were deducted from the full cost pool without recognition of a gain or loss unless the deduction resulted in a change in the depletion rate of 20 percent or greater, in which case a gain or loss was recorded. Under IFRS, gains and losses are recorded on asset sales and are calculated as the difference between the proceeds and the net book value of the asset disposed. For the three and six months ended June 30, 2010, the Company recognized gains of \$nil and \$0.1 million, respectively, on farm out's of certain lands held by the Company.

(h) Income Taxes

Deferred income taxes have been adjusted to reflect the tax effect arising from the differences between IFRS and Canadian GAAP. The application of the IFRS adjustments for note 18 (a) through to (g) resulted in the following impact for the periods ended June 30, 2010 as follows:

Consolidated Statements of Financial Position:

(\$000s)	June 30, 2010
Property, plant and equipment	\$ (194)
Deferred income tax asset (liability)	
Related to property, plant and equipment	(477)
Related to decommissioning obligations	566
Related to convertible Class B shares	(414)
Impact on retained earnings (deficit)	\$ (519)

Consolidated Statements of Income and Comprehensive Income:

(\$000s)	Three months ended June 30, 2010	Six months ended June 30, 2010
Deferred income tax expense	\$ 132	\$ 486
Impact on income and comprehensive income	\$ (132)	\$ (486)

(i) Cash Flow Statement

The transition from prior Canadian GAAP to IFRS has had no material effect upon the reported cash flows generated by the Company. Exploration costs of \$25,000 incurred during the three months ended June 30, 2010 were included in general and administrative expenses for IFRS rather than capitalized and, as such, are now included in cash provided from operating activities. Furthermore, net finance costs of \$82,000 and \$72,000 for the three and six months ended June 30, 2010 are included in cash flows from financing activities for IFRS.

Corporate Information

BOARD OF DIRECTORS

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Calgary, Alberta

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Surge Energy Inc.
Calgary, Alberta

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Glenn R. Carley
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Calgary, Alberta

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EXCHANGE LISTING

The TSX Venture Exchange
Trading symbols:
Class A Shares: PPY.A
Class B Shares: PPY.B

OFFICERS

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President and Chief Executive Officer

Joan E. Dunne
Vice President, Finance and Chief Financial Officer

Michael E. Belenkie
*Vice President, Reservoir Engineering & Corporate
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James H. French
Vice President, Production Operations

James D. Reimer
Vice President, Exploration

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Vice President, Land

Mary Kay Axford
Controller

Douglas T. McCartney
Partner, Burstall Winger LLP
Corporate Secretary

LEGAL COUNSEL

Burstall Winger LLP

AUDITORS

KPMG LLP

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National Bank of Canada

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