



To Our Shareholders

I am pleased to report the financial and operating results of Painted Pony Petroleum Ltd. ("Painted Pony" or the "Company") for the three months ended September 30, 2011. Highlights include:

- Production averaged 4,064 boe per day (weighted 65% gas and 35% oil and liquids), an increase of 32% from the third quarter of 2010;
- Painted Pony drilled a total of 18 (13.2 net) wells during the quarter, including 13 (10.3 net) in Saskatchewan and 5 (2.9 net) wells in British Columbia. To date in 2011, the Company has drilled a total of 39 (27.3 net) wells;
- In northeast British Columbia, operating and transportation costs declined by 32% to \$7.66 per boe in the third quarter of 2011 as compared to the same period in 2010;
- The Company completed and tested a 50% working interest lower Montney horizontal well at d-44-C/94-B-16 which tested in excess of 24 mmcf per day at 2,700 psi;
- Two (0.4 net) non-operated Montney wells at Cameron/Kobes were completed in the third quarter and tested at rates of 10.9 mmcf per day and 10.8 mmcf per day;
- Subsequent to quarter-end, the Company commenced production testing on the 100% working interest Blair a-41-F/94-B-16 pad. The upper Montney well on this pad produced at an average of 10.5 mmcf per day at over 700 psi for the first seven days on production;
- The Company has negotiated an expansion to the Blair Creek gas plant, which will increase gross processing capacity from 24 mmcf per day to 70 mmcf per day. Painted Pony's firm share of this capacity will increase to 32 mmcf per day. This expansion, which will be fully funded by the midstream operator, is expected to be completed by the end of the second quarter of 2012. Additionally, the Company is constructing a new production facility at its d-44-C/94-B-16 pad, which will deliver production from the northern Cameron area directly into the Spectra Energy Transmission sales system; and
- Painted Pony exited the quarter with a positive working capital position of \$6.7 million and an \$80 million undrawn credit facility. Subsequent to quarter-end, the Company closed a bought deal financing for total proceeds of \$103.8 million before costs.

PRODUCTION

Painted Pony's sales volumes averaged 4,064 boe per day during the three months ended September 30, 2011, an increase of 32% compared to the third quarter of 2010 and a 13% increase over the second quarter of 2011. Volumes were weighted 65% towards gas, compared to 43% in the comparable 2010 period.

In Saskatchewan, oilfield operations have gradually resumed as the wet surface conditions which have impeded industry activity since spring 2011 have begun to subside. Third quarter sales volumes averaged 1,365 boe per day compared to 1,422 boe per day in the second quarter of 2011. Solution gas and associated liquids sales from the Midale/Huntoon area resumed in late September after repairs were completed at a midstream gas processing facility.

Sales volumes in northeast British Columbia averaged 2,699 boe per day during the third quarter of 2011, compared to 2,171 boe per day in the second quarter of 2011. This represents an increase of 24% from the second to the third quarter of 2011 and a 99% increase from the third quarter of 2010.

BRITISH COLUMBIA ACTIVITY

Painted Pony continues to delineate and develop its Montney gas assets in northeast British Columbia. During the third quarter of 2011, the Company participated in the drilling of 4 (1.9 net) horizontal Montney wells and increased its total land position to 135,115 net acres (211 net sections). The Company currently has 85,200 net acres (133 net sections) of Montney rights.

On the Cameron/Kobes block, 3 (0.9 net) Lower Montney wells were drilled and completed. The 50% working interest well at d-44-C/94-B-16 tested at a stabilized rate of 24.5 mmcf per day, and at the c-A58-J/94-B-9 and a-C10-J/94-B-9 wells (both 20% working interest), initial production rates were 10.9 mmcf per day and 10.8 mmcf per day respectively. Two new production facilities (one operated and one non-operated) are presently under construction on the Cameron/Kobes block. Both are expected to be on stream by year end 2011, adding approximately 50 mmcf per day gross additional gas processing capacity to the area.

At Blair/Town, Painted Pony drilled one (1.0 net) well in the third quarter of 2011 at a-41-F/94-B-16. A second (1.0 net) well on this pad has been subsequently rig-released since the end of the third quarter. Initial combined production rates from this pad were approximately 13.5 mmcf per day. This includes 10.5 mmcf per day from the upper Montney well plus 3.0 mmcf per day from the lower Montney well. Production rates from the lower Montney well on this pad have been constrained by wellbore operational problems which arose during completion operations. The Company is investigating alternatives for remedial operations. The existing Blair Creek midstream gas processing facility is being expanded from 24 mmcf per day to a total capacity of 70 mmcf per day, of which Painted Pony's firm share will increase to 32 mmcf per day. The expansion is scheduled to be completed by the end of the second quarter of 2012.

SASKATCHEWAN ACTIVITY

In Saskatchewan, the Company drilled a total of 13 (10.3 net) wells, 11 (8.3 net) Bakken wells and 2 (2.0 net) Mississippian wells, during the third quarter of 2011. Sales of solution gas and associated liquids from the Midale-Huntoon area resumed late in the third quarter after repairs at a non-operated midstream facility were completed. In the Midale area, the gathering system was expanded and seven single well batteries were tied-in to the Company's existing facility. This expansion eliminates the need for the Company to truck produced volumes from individual well sites. In addition to the gathering system expansion, the Midale battery was connected to a third party oil sales line. These facility upgrades are expected to help lower area operating costs during the fourth quarter of 2011.

FINANCIAL RESOURCES

Subsequent to quarter-end, the Company closed a bought deal financing for total proceeds of \$103.8 million before costs. The Company has also announced the conversion of its Class B shares to Class A shares, subject to necessary regulatory approvals, effective on December 1, 2011. On the effective date, the holders of the 1,173,600 outstanding Class B shares will receive 0.8250 of a Class A share in exchange for each one (1) Class B share held, resulting in an aggregate of up to 968,220 Class A shares being issued, subject to rounding adjustments.

OUTLOOK

Painted Pony's development of the Montney asset continues. At Blair/Town, the corporate focus has shifted to developing the 100% working interest lands, and initial results have been encouraging. The Company intends to drill 4 (3.5 net) Montney wells in British Columbia and 9 (4.4 net) wells in Saskatchewan during the fourth quarter of 2011. For 2012, Painted Pony currently plans to spend approximately \$200 million on capital projects, to drill 25 (19.8 net) wells in British Columbia and 27 (18.0 net) wells in Saskatchewan. We look forward to a successful fourth quarter and a year of continued growth in 2012.

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

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

Financial and Operational Highlights

(unaudited)

	Three months ended September 30,		Nine months ended September 30,	
	2011	2010	2011	2010
Financial (000s, except per share)				
Petroleum and natural gas revenue (before royalties)	\$ 16,647	\$ 14,764	\$ 53,408	\$ 41,662
Funds flow from operations ⁽¹⁾	\$ 9,159	\$ 9,123	\$ 31,633	\$ 25,983
Per share – basic ⁽²⁾	\$ 0.15	\$ 0.19	\$ 0.55	\$ 0.58
Per share – diluted ⁽³⁾	\$ 0.15	\$ 0.19	\$ 0.53	\$ 0.57
Cash flow from operating activities	\$ 8,586	\$ 7,699	\$ 31,995	\$ 25,275
Net income	\$ 4,765	\$ 2,258	\$ 5,085	\$ 4,709
Per share – basic ⁽²⁾	\$ 0.08	\$ 0.05	\$ 0.09	\$ 0.10
Per share – diluted ⁽³⁾	\$ 0.08	\$ 0.05	\$ 0.09	\$ 0.10
Capital expenditures ⁽⁴⁾	\$ 45,924	\$ 20,670	\$ 108,416	\$ 88,175
Working capital	\$ 6,709	\$ 22,454	\$ 6,709	\$ 22,454
Total assets	\$ 360,227	\$ 223,347	\$ 360,227	\$ 223,347
Shares outstanding				
Class A	59,633,673	50,975,700	59,633,673	50,975,700
Class B	1,173,600	1,173,600	1,173,600	1,173,600
Diluted weighted-average shares	61,334,305	47,384,870	59,299,501	45,746,842
Operational				
Daily sales volumes				
Oil (bbls per day)	1,312	1,687	1,464	1,643
Condensate (bbls per day)	41	28	51	26
NGL's (bbls per day)	50	38	94	26
Gas (mcf per day)	15,965	7,961	13,715	5,720
Total (boe per day)	4,064	3,080	3,895	2,648
Realized prices				
Oil (per bbl)	\$ 89.48	\$ 75.94	\$ 92.16	\$ 76.92
Gas (per mcf)	\$ 3.60	\$ 3.65	\$ 3.76	\$ 4.09
Field operating netbacks				
British Columbia (per boe)	\$ 14.18	\$ 10.74	\$ 14.67	\$ 11.63
Saskatchewan (per boe)	\$ 51.56	\$ 54.01	\$ 57.90	\$ 54.85
Company combined (per boe)	\$ 26.73	\$ 34.97	\$ 32.66	\$ 38.90

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 cash expenditures and non-cash 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 nine months ended September 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 November 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 September 30,		Nine months ended September 30,	
	2011	2010	2011	2010
Cash flow from operating activities	\$ 8,586	\$ 7,699	\$ 31,995	\$ 25,275
Changes in non-cash working capital	492	1,331	(549)	615
Decommissioning expenditures	81	93	187	93
Funds flow from operations	\$ 9,159	\$ 9,123	\$ 31,633	\$ 25,983

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.

Forward-looking statements are based upon the opinions and expectations of management of the Company as at the effective date of such statements and, in some cases, information supplied by third parties. Although the Company believes that the expectations reflected in such forward-looking statements are based upon reasonable assumptions and that information received from third parties is reliable, it can give no assurance that those expectations will prove to have been correct. Forward-looking statements are subject to certain risks and uncertainties that could cause actual events or outcomes to differ materially from those anticipated 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:

- sales volumes in the balance of 2011 are anticipated to be increasingly gas-weighted, as continued success from operations targeting the Montney formation in British Columbia add 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;
- fourth quarter royalties in 2011 will approximate 12% of total revenues, assuming similar commodity prices to those in the first nine months of 2011;
- per unit operating and transportation costs in the fourth quarter of 2011 are expected to be lower in Saskatchewan than the third quarter of 2011 and are expected to continue to benefit from increased sales volumes in British Columbia;
- the third party midstream gas plant expansion in the Blair/Town area is currently scheduled to be completed by the end of the second quarter of 2012;
- any shortfall under the ten-year firm-service contract of the minimum volume of 16 mmcf per day of natural gas during the first five years and 13 mmcf per day during the next five years would be expected to result in incremental charges for excess capacity (take-or-pay) under the terms of the contract, estimated to total \$23.8 million;
- net general and administrative costs in the fourth quarter of 2011 will be reflective of operated capital expenditure levels in the period;
- as gross Saskatchewan sales revenues fluctuate in the fourth quarter of 2011, the Saskatchewan resource surcharge for the period is expected to vary accordingly;

- the share-based payment expense for the fourth quarter of 2011 is expected to be approximately \$1.6 million, based on options currently granted;
- certain leases that are approaching expiry will be continued through execution of work programs;
- available credit facilities may be utilized on a periodic basis;
- the conversion of the Class B shares of the Company into Class A shares of the Company, with an effective date of December 1, 2011 will result in an aggregate of up to 968,220 Class A shares being issued, subject to rounding adjustments;
- the risk of accounts receivables becoming uncollectible is mitigated by the financial position of the applicable entities;
- the Company will be able to satisfy the funding for commitments through a combination of cash flows, the availability of credit facilities and investment capital; 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 \$9.2 million and \$31.6 million for the three and nine months ended September 30, 2011, compared to \$9.1 million and \$26.0 million for the three and nine months ended September 30, 2010. On a basic and diluted per share basis, funds flow from operations for the three months ended September 30, 2011 and September 30, 2010 were \$0.15 and \$0.19, respectively. For the nine months ended September 30, 2011, basic and diluted funds flow from operations per share were \$0.55 and \$0.53, compared to \$0.58 and \$0.57, respectively, for the nine months ended September 30, 2010.

Cash flow from operating activities was \$8.6 million and \$32.0 million for the three and nine months ended September 30, 2011, compared to \$7.7 million and \$25.3 million for the three and nine months ended September 30, 2010.

Painted Pony produced net income of \$4.8 million and \$5.1 million, respectively for the three and nine months ended September 30, 2011, compared to net income of \$2.3 million and \$4.7 million for the three and nine months ended September 30, 2010. On a basic and diluted basis, the income per share for the quarter and nine month period ended September 30, 2011 was \$0.08 and \$0.09, respectively, compared to basic and diluted income per share of \$0.05 and \$0.10, respectively, for the three and nine months ended September 30, 2010. During the third quarter of 2011, the Company recognized a \$7.3 million gain on assets (2010: \$3.3 million), triggered with the earning of lands from the farmout on the Company's Montney assets in the Cameron area of British Columbia. The gain is the estimated fair value received determined by reference to the proved and probable reserves established as a result of the farmout.

Sales Volumes

During the three and nine months ended September 30, 2011, Painted Pony's sales volumes averaged 4,064 and 3,895 boe per day respectively, compared to 3,080 and 2,648 boe per day for the three and nine months ended September 30, 2010. The increase is primarily from incremental gas sales in British Columbia.

In the first nine months of 2011, 58% of total volumes were from British Columbia, compared to 37% in the first nine months of 2010. Sales volumes in northeast British Columbia averaged 2,699 boe per day during the third quarter of 2011, as compared to 2,172 boe per day in the second quarter. This represents an increase of 24% increase quarter-over-quarter and a 99% increase from the third quarter of 2010.

Sales volumes in the third quarter of 2011 were weighted 65% towards gas compared to 43% 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 in the first nine months of 2011.

Average Daily Sales Volumes

	Three months ended September 30,		Nine months ended September 30,	
	2011	2010	2011	2010
Oil (bbls/d)	1,312	1,687	1,464	1,643
Condensate (bbls/d)	41	28	51	26
NGL's (bbls/d)	50	38	94	26
Gas (mcf/d)	15,965	7,961	13,715	5,720
Total (boe/d)	4,064	3,080	3,895	2,648

Gas sales in the third quarter of 2011 increased by 101% over the same period in 2010, as the results from the Montney drilling program are reflected in production gains. Gas sales during the three months ended September 30, 2011 increased by 2,953 mcf per day compared to the prior quarter primarily due to production from two (0.4 net) new wells.

During the third quarter, operating conditions in southeast Saskatchewan improved following an abnormally wet and prolonged spring break-up season. While daily oil sales volumes in the third quarter of 2011 declined by 22% compared to the same period in 2010, after production disruptions and declines, the Company managed to grow by 38 boe per day compared to the second quarter of 2011 with the added contribution from an additional 12 (8.5 net) wells towards the end of the quarter. In September 2011, sales of solution gas and associated liquids from the Midale-Huntoon area resumed following the completion of repairs at a non-operated midstream facility.

The Company anticipates sales volumes in the balance of 2011 to be increasingly 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.*

Revenues

Petroleum and natural gas sales increased 13% and 28%, respectively, to \$16.6 million and \$53.4 million in the three and nine months ending September 30, 2011, compared to \$14.8 million and \$41.7 million for the three and nine months ended September 30, 2010. In all 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 nine months of 2011, oil sales revenues were 69% of total sales dollars compared to 83% in the first nine months of 2010, while oil volumes were 38% and 62% for the nine months ended September 30, 2011 and 2010, respectively.

Sales by Product

(000s)	Three months ended September 30,		Nine months ended September 30,	
	2011	2010	2011	2010
Oil	\$ 10,802	\$ 11,789	\$ 36,840	\$ 34,493
Gas	5,283	2,674	14,074	6,390
Condensate	331	178	1,241	521
NGL's	231	123	1,253	258
Total	\$ 16,647	\$ 14,764	\$ 53,408	\$ 41,662

Revenue from gas sales totaled \$5.3 million during the three months ended September 30, 2011, compared to \$2.7 million received during the three months ended September 30, 2010. Painted Pony's gas revenues increased 98% third quarter 2011 over third quarter 2010, the net result of a 101% increase in sales volumes partially offset by lower gas prices of 1%. The Company received an average gas price of \$3.60 per mcf in the quarter ended September 30, 2011, a price comparable to the AECO daily spot average gas reference price of \$3.67 per mcf. In the third quarter of 2010, the Company received an average gas price of \$3.65 per mcf.

Crude oil revenue in the three months ended September 30, 2011 was \$10.8 million compared to \$11.8 million during the three months ended September 30, 2010. Oil revenues decreased 8% in the third quarter of 2011 compared to the comparable 2010 period, the net result of a reduction of sales volumes by 22% partially offset by oil prices averaging 18% higher. In the respective third quarter periods, the Company realized average oil prices of \$89.48 per barrel compared to \$75.94 per barrel. Painted Pony received an average crude oil price approximately 3% less than the Edmonton light reference price in the third quarter of 2011. 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 the Company's quality of 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 September 30,		Nine months ended September 30,	
	2011	2010	2011	2010
Exchange rate (US\$/Cdn\$)	1.0209	0.9624	1.0229	0.9658
Gas - AECO, daily spot (\$/mcf)	3.67	3.55	3.78	4.13
Oil - WTI (US\$/bbl)	89.54	76.21	95.49	77.71
- Edmonton par - light oil (\$/bbl)	92.45	74.82	94.88	76.90

Painted Pony's Realized Prices

	Three months ended September 30,		Nine months ended September 30,	
	2011	2010	2011	2010
Gas (\$/mcf)	3.60	3.65	3.76	4.09
Condensate (\$/bbl)	87.60	68.91	88.52	73.39
Oil (\$/bbl)	89.48	75.94	92.16	76.92
NGL's (\$/bbl)	50.32	35.74	49.10	37.03
Combined (\$/boe)	44.52	52.11	50.23	57.65

Royalties

Royalties for the nine months ended September 30, 2011 are slightly lower as a percentage of revenues and on a per boe basis in comparison to the nine months ended September 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 September 30, 2011, total royalties were \$2.0 million, or approximately 11.7% of total revenue. For the quarter ended September 30, 2010, total royalties were \$1.7 million, or approximately 11.9% of revenue. In the third quarter of 2011 and 2010, gas and associated product royalties averaged 4% of sales. Oil royalties increased in the third quarter of 2011 to average 15.7% of sales, compared to 13.6% in the third quarter of 2010, the combined effect of higher commodity prices and the maximum royalty incentive volume being reached.

In the fourth quarter of 2011, assuming similar commodity prices, the Company anticipates overall royalty rates to average approximately 12% 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.*

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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 38% of the crown royalty costs during the nine months ended September 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 September 30,		Nine months ended September 30,	
	2011	2010	2011	2010
Crown	1.9	1.4	2.0	1.5
Freehold	7.0	8.0	7.8	8.3
GOR	2.8	2.5	2.8	3.2
	11.7	11.9	12.6	13.0

Royalties by Type

(000s)	Three months ended September 30,		Nine months ended September 30,	
	2011	2010	2011	2010
Crown	\$ 322	\$ 208	\$ 1,061	\$ 606
Freehold	1,167	1,162	4,194	3,457
GOR	463	363	1,492	1,326
	\$ 1,952	\$ 1,733	\$ 6,747	\$ 5,389
Per boe (6 mcf:1 bbl)	\$ 5.22	\$ 6.12	\$ 6.34	\$ 7.46

Operating and Transportation

Operating and transportation costs for the three and nine months ended September 30, 2011 were \$4.7 million and \$11.9 million, respectively. This compares to \$3.1 million and \$8.2 million for the three and nine months ended September 30, 2010, respectively. On a per unit basis for the three and nine months ended September 30, 2011, operating and transportation costs were \$12.57 per boe and \$11.23 per boe, respectively. This compares to \$11.02 per boe and \$11.29 per boe for the three months and nine months ended September 30, 2010.

(000s, except per unit)	Three months ended September 30,		Nine months ended September 30,	
	2011	2010	2011	2010
British Columbia	\$ 1,903	\$ 1,406	\$ 4,837	\$ 3,470
Saskatchewan	2,796	1,715	7,105	4,688
Total	\$ 4,699	\$ 3,121	\$ 11,942	\$ 8,158
British Columbia (\$/boe)	7.66	11.28	7.79	13.01
Saskatchewan (\$/boe)	22.26	10.81	16.06	10.28
Operating & transportation cost (\$/boe)	12.57	11.02	11.23	11.29

Overall per unit operating costs increased 14% in the third quarter of 2011 compared to the same period of 2010, primarily reflecting repairs, maintenance and work-over costs, property taxes and lower crude oil sales volumes.

Operating costs for gas producing properties in British Columbia are mainly processing and treating, compression fees, contract operating fees, fuel and power, gas transportation and maintenance expenditures on the more mature properties. In the third quarter of 2011, per unit operating costs declined by 32% to \$7.66 per boe as compared to the same period in 2010, primarily due to increased 2011 volumes.

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, minor work-overs, equipment rentals and contract operator fees. During the third quarter of 2011, the abnormally wet and prolonged spring break-up in Saskatchewan was reflected in incremental costs as the Company incurred additional charges to maintain and/or restore production, incurring repair, maintenance and work-over costs of \$4.99 per boe along with property tax charges of \$1.03 per boe. In the Midale area, the gathering system was expanded and seven single well batteries were tied-in to the Company's existing facility. This expansion eliminates the need for the Company to truck produced volumes from individual well sites. In addition to the gathering system expansion, the Midale battery was connected to a third party oil sales line.

In the fourth quarter of 2011, the Company anticipates that per unit operating costs in British Columbia will continue to benefit from expected incremental sales volumes. In Saskatchewan, the quantum of repairs and maintenance in the fourth quarter of 2011 are anticipated to be less than in the third quarter of the year, tempered by the potential impact of winter conditions. These, combined with the facility upgrades, should help lower area operating costs during the fourth quarter of 2011*

**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.*

The Company has committed additional Montney gas volumes towards a third party midstream gas plant expansion in the Blair/Town area. With this expansion, total gas processing capacity will increase from 24 mmcf per day up to 70 mmcf per day. Painted Pony's firm share of this capacity will increase to 32 mmcf per day. The expansion is currently scheduled to be completed by the end of the second quarter of 2012. In conjunction with this, the Company is committed to a ten-year firm-service contract for the processing costs associated with the physical delivery of a minimum volume of 16 mmcf per day of natural gas during the first five years and 13 mmcf per day during the next five years, 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.*

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Other Income

Third party processing, salt water disposal fees and compression fees constitute other income. Other income increased dramatically to \$0.2 million and \$0.5 million for the three and nine month periods ended September 30, 2011 with completion of construction in two facilities and acquisition of the third facility 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 September 30,		Nine months ended September 30,	
	2011	2010	2011	2010
Other income	\$ 175	\$ 27	\$ 525	\$ 67

Operating Netbacks

For the three months ended September 30, 2011, field operating netbacks averaged \$26.73 per boe, compared to field operating netbacks of \$34.97 per boe during the quarter ended September 30, 2010, reflecting the higher weighting of gas sales in the third quarter of 2011, compared to the same period of 2010.

Combined Field Operating Netback

(\$/boe)	Three months ended September 30,		Nine months ended September 30,	
	2011	2010	2011	2010
Sales	\$44.52	\$ 52.11	\$50.23	\$ 57.65
Royalties	(5.22)	(6.12)	(6.34)	(7.46)
Operating and transportation costs	(12.57)	(11.02)	(11.23)	(11.29)
Field operating netback	\$26.73	\$ 34.97	\$32.66	\$ 38.90

The Company primarily produces gas from assets in British Columbia and oil on the Saskatchewan lands. The Saskatchewan assets contributed 65% of associated liquids (plus a comparatively small quantity of gas) volumes in the first nine months of 2011 compared to only 29% in the same period in 2010.

Netbacks by Province

	Three months ended September 30,		Nine months ended September 30,	
	2011	2010	2011	2010
British Columbia (\$/boe)	\$ 14.18	\$ 10.74	\$ 14.67	\$ 11.63
Saskatchewan (\$/boe)	\$ 51.56	\$ 54.01	\$ 57.90	\$ 54.85

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

In the third quarter and nine months ended September 30, 2011, per unit netbacks from British Columbia properties averaged \$14.18 per boe and \$14.67 per boe, respectively. Netbacks increased in British Columbia in 2011 compared to 2010 despite lower gas prices, due to significantly lower operating costs from incremental volumes and slightly lower royalty costs.

During the three and nine months ended September 30, 2011, Painted Pony's per unit netback for Saskatchewan production was \$51.56 per boe and \$57.90 per boe, respectively. The increased per boe netback for Saskatchewan during the first nine months of 2011 compared to 2010 reflects the higher oil prices partially offset by higher operating costs from minor work-overs, oil hauling costs and road and lease maintenance costs. The significant per unit operating costs incurred in the third quarter of 2011 account primarily for the reduced comparative netback from the comparable 2010 period, largely attributable to property taxes, combined with operational curtailments and project delays associated with the severe flooding conditions.

Exploration and evaluation

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

General and Administrative

Net general and administrative expenses were \$0.8 million and \$3.0 million for the three and nine months ended September 30, 2011 compared to \$0.6 million and \$1.6 million for the three and nine months ended September 30, 2010, respectively. On a per boe basis, net general and administrative costs were \$2.18 and \$2.78 for the three and nine month periods ended September 30, 2011, respectively. This compares to \$2.17 per boe and \$2.23 per boe in the three and nine months ended September 30, 2010.

General and Administrative Costs

(000s, except per boe)	Three months ended September 30,		Nine months ended September 30,	
	2011	2010	2011	2010
Gross costs	\$ 1,959	\$ 1,257	\$ 6,211	\$ 3,542
Capitalized	(600)	(316)	(1,813)	(1,007)
Recoveries	(543)	(325)	(1,437)	(923)
Net costs	\$ 816	\$ 616	\$ 2,961	\$ 1,612
Net G&A, per boe	\$ 2.18	\$ 2.17	\$ 2.78	\$ 2.23

Gross general and administrative costs in the nine months ended September 30, 2011 were 75% greater than in the first nine months of 2010, primarily due to salaries, consulting costs and associated administrative costs for thirty-one people compared to eighteen people in the first nine months of 2010. In the nine months ended September 30, 2011 and 2010, general and administrative costs included primarily 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 nine months ended September 30, 2011 compared to the same period of 2010. During the three and nine months ended September 30, 2011, the Company allocated \$0.6 million and \$1.8 million of administrative costs to capital projects, compared to \$0.3 million and \$1.0 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 nine months of 2011 reflect the increased operated capital expenditure levels compared to the first nine months of 2010. General and administrative cost recoveries in the three and nine months ended September 30, 2011, were \$0.5 million and \$1.4 million, compared to \$0.3 million and \$0.9 million during the three and nine months ended September 30, 2010, directly reflecting increased exploration staff and activity.

In 2011, net general and administrative costs per boe have increased compared to the first nine months of 2010 reflecting the incremental staffing and associated costs, partially offset by the increased production base. During the balance of 2011, variations in operated 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 \$0.7 million for the three and nine months ended September 30, 2011, compared to \$0.2 million and \$0.6 million for the three and nine months ended September 30, 2010. As gross Saskatchewan sales revenues fluctuate, capital taxes are expected to vary correspondingly in the fourth quarter of 2011.*

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Capital Taxes

(000s)	Three months ended September 30,		Nine months ended September 30,	
	2011	2010	2011	2010
Capital taxes	\$ 196	\$ 198	\$ 650	\$ 587

Share-Based Payments

Share-based payment costs were \$3.1 million and \$10.1 million in the three and nine months ended September 30, 2011, respectively, compared to \$2.5 million and \$4.6 million for the same periods in 2010. The aggregate grants of 2,117,400 options in the second and third quarters of 2011, with one-third vesting immediately, triggered most of the incremental expense for the nine months ended September 30, 2011. 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 fourth quarter of 2011 to be approximately \$1.6 million, based on options currently granted.*

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Capitalized share-based payments for the three and nine months ended September 30, 2011 were \$1.0 million and \$2.4 million respectively. During the same periods in 2010, the Company capitalized \$0.5 million and \$1.0 million, respectively. The remainder of \$2.1 million and \$7.7 million for the three and nine months ended September 30, 2011 (\$2.0 million and \$3.7 million for the three and nine months ended September 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 September 30,		Nine months ended September 30,	
	2011	2010	2011	2010
Gross cost	\$ 3,094	\$ 2,476	\$ 10,128	\$ 4,644
Capitalized	(952)	(489)	(2,394)	(969)
Net expense	\$ 2,142	\$ 1,987	\$ 7,734	\$ 3,675

Depletion and Depreciation

Depletion and depreciation expense in the three and nine months ended September 30, 2011 totaled \$6.9 million and \$21.0 million, compared to \$6.4 million and \$17.2 million in the three and nine months ended September 30, 2010. On a per boe basis, the charge decreased in the first nine months of 2011 compared to the same period of 2010, reflecting the addition of reserves at lower costs than historical levels. For the three months ended September 30, 2011, Painted Pony excluded exploration and evaluation assets of \$61.7 million from the depletion calculation, compared to \$38.9 million for the three months ended September 30, 2010.

Depletion and Depreciation Costs

(000s, except per boe)	Three months ended September 30,		Nine months ended September 30,	
	2011	2010	2011	2010
Depletion and depreciation	\$ 6,908	\$ 6,375	\$ 21,011	\$ 17,202
Per boe	\$ 18.48	\$ 22.50	\$ 19.76	\$ 23.80

The changes in the per unit depletion rates for the three and nine months ended September 30, 2011 and 2010 primarily reflect the impact of additional 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 Assets - Farmouts

After adjusting the financial statements in 2010 to reflect IFRS standards, five earnings events occurred in the first nine months resulting in a "gain on assets" of \$3.4 million. These earnings events were triggered by the earning of lands under a farm-out in northeast British Columbia, plus one undeveloped land property swap in northeast British Columbia. In the third quarter of 2011, two similar farm-out earning events occurred with a "gain on assets" of \$7.3 million. 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".

Gain on Assets - Farmouts

(000s)	Three months ended September 30,		Nine months ended September 30,	
	2011	2010	2011	2010
Gain on assets	\$ 7,280	\$ 3,289	\$ 7,280	\$ 3,393

Net Finance Expense

Painted Pony invests cash in interest-bearing deposit accounts and short-term deposits, generating interest income. The increased interest income earned in the nine months of 2011 reflects incremental funds on hand compared to the first nine months of 2010.

Finance charges are the result of fees, including standby charges, on the Company's available credit facility. Finance charges in the three and nine months ended September 30, 2011 totaled \$0.1 million and \$0.3 million, compared to \$0.1 million and \$0.2 million for the three and nine months ended September 30, 2010. Finance charges have increased as the Company had an available credit facility of \$80 million as at September 30, 2011 compared to two facilities totaling \$56 million as at September 30, 2010.

Accretion costs on decommissioning obligations were \$0.1 million and \$0.2 million for the three and nine months ended September 30, 2011 and 2010. Accretion cost has increased somewhat in 2011 as a result of additional wells drilled and acquired, along with ownership in additional facilities. At the end of the third quarter of 2011, the Company reduced the risk-free rate related to the decommissioning obligations to 3% from 4%, resulting in an increased estimated obligation of \$1.2 million.

Accretion costs from the convertible Class B shares were \$0.2 million and \$0.5 million for the three and nine months ended September 30, 2011 and 2010. The accretion cost has increased marginally in 2011 as a result of a higher present value.

Net Finance Expense

(000s)	Three months ended September 30,		Nine months ended September 30,	
	2011	2010	2011	2010
Interest income	\$ (112)	\$ (34)	\$ (383)	\$ (86)
Finance charges	55	86	263	209
Accretion of decommissioning obligations	85	57	234	156
Accretion of Class B share liability	186	173	549	512
Total	\$ 214	\$ 282	\$ 663	\$ 791

Capital Expenditures

In the nine months ended September 30, 2011, Painted Pony conducted an active drilling program with the drilling of 32 (22.5 net) wells, of which 22 (16.9 net) wells were targeting oil in Saskatchewan and 10 (5.6 net) wells were targeting Montney gas in British Columbia. Exploration and development capital expenditures, including facilities and land costs totaled \$42.9 million and \$95.8 million in the three and nine months ended September 30, 2011, compared to \$19.5 million and \$85.7 million incurred in the third quarter and first nine months of 2010.

Capital Expenditures

(000s)	Three months ended September 30,		Nine months ended September 30,	
	2011	2010	2011	2010
Lease acquisitions and retention	\$ 170	\$ 132	\$ 546	\$ 525
Drilling and completions	27,064	12,819	63,212	33,340
Facilities and equipment	6,563	4,122	13,184	11,634
Exploration and evaluation	9,074	2,456	18,894	40,248
Exploration and development	42,871	19,529	95,836	85,747
Head office expenditures	19	126	206	185
	42,890	19,655	96,042	85,932
Property acquisitions	161	-	7,545	-
Abandonment expenditures	81	93	187	93
Share-based payments	952	489	2,394	969
Decommissioning costs	1,840	433	2,248	1,181
Total expenditures	\$ 45,924	\$ 20,670	\$ 108,416	\$ 88,175

Capital Additions

(000s)	Three months ended September 30,		Nine months ended September 30,	
	2011	2010	2011	2010
Total capital expenditures:	\$ 45,924	\$ 20,670	\$ 108,416	\$ 88,175
Gain on assets - farmout	7,280	3,289	7,280	3,393
Exploration and evaluation expense	-	-	(91)	-
Total capital additions	\$ 53,204	\$ 23,959	\$ 115,605	\$ 91,568
Change in gross assets:				
Property, plant, and equipment	\$ 44,669	\$ 23,186	\$ 97,441	\$ 66,072
Exploration and evaluation	8,535	773	18,164	25,496
Total change in gross assets	\$ 53,204	\$ 23,959	\$ 115,605	\$ 91,568

In the first nine months of 2011, Painted Pony drilled 9 (4.6 net) horizontal Montney gas wells in British Columbia and one vertical well (1.0 net) in the Beg area. In the fourth quarter of 2011, the vertical well was disposed of as part of a land swap. In Saskatchewan, the Company drilled a total of 22 (16.9 net) wells, primarily in the Huntoon and Midale areas.

During the third quarter of 2011, the Company invested \$3.0 million on well equipment and tie-in's in both British Columbia and Saskatchewan. The Company also spent \$0.7 million on facilities in Saskatchewan, primarily upgrading an operated oil battery and \$2.9 million on gathering systems. In the Midale area, the gathering system was expanded and seven single well batteries were tied-in to the Company's existing facility, eliminating the need to truck produced volumes from individual well sites. In addition to the gathering system expansion, the Midale battery was connected to a third party oil sales line.

Painted Pony's land position continues to grow. At September 30, 2011, the Company owns 81,508 net acres of land (93% undeveloped) in Saskatchewan and 135,115 net acres of land (83% undeveloped) in British Columbia. During the third quarter of 2011, the Company invested \$7.2 million in land acquired at provincial land sales. Other exploration and evaluation expenditures included exploratory drilling and completion investments of \$1.9 million.

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 September 30, 2011, Painted Pony had current assets of \$48.3 million and current liabilities of \$41.6 million, resulting in a positive net working capital position of \$6.7 million. On November 8, 2011, the Company issued 8,800,000 Class A shares at a price of \$11.80 per share for gross proceeds of \$103.8 million by way of a bought-deal financing. 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 September 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 September 30, 2011, the Company has a second commitment for minimum tolls to transport oil through a major carrier system that began September 1, 2011 and ends in 2016. The total minimum cost of the two commitments is \$2.5 million at September 30, 2011.

At September 30, 2011, the Company is also committed to a ten-year take-or-pay contract for minimum gas gathering and processing fees, estimated to begin in July 2012. This commitment is estimated to total \$23.8 million over the ten-year period.*

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At September 30, 2011, the Company was committed to future payments totaling \$1.7 million for office space rental and a proportionate share of operating costs through 2015.

The Company expects it will be able to satisfy the funding for commitments through a combination of cash flows, the availability of credit facilities and investment capital.*

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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. On November 8, 2011, the Company issued 8,800,000 Class A shares at a price of \$11.80 per share for gross proceeds of \$103.8 million by way of a bought deal financing. As at September 30, 2011, there were 59,633,673 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 nine months of 2011, a total of 996,973 options were exercised at an average price of \$4.20 per Class A share and 107,980 options were forfeited and cancelled. Painted Pony granted two tranches of options during the three months ended September 30, 2011. The first tranche granted was 105,000 options at an exercise price of \$11.19 and the second tranche granted was 152,500 options at an exercise price of \$14.15. The outstanding options are generally exercisable over a five year period at a weighted-average price of \$7.19 per option for each Class A share with 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 September 30, 2011, 5,561,367 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 September 30, 2011, no Preferred Shares were issued or outstanding.

As at November 23, 2011, there were 68,654,306 Class A shares, 1,173,600 Class B shares and 5,340,734 options at an average price of \$7.30 per Class A share issued and outstanding.

Painted Pony is triggering the conversion of all existing Class B shares of the Company into Class A shares of the Company, subject to applicable regulatory approvals. The effective date of the conversion will be on December 1, 2011. On the effective date, the holders of Class B shares will receive 0.8250 of a Class A share for each one (1) Class B share held, resulting in an aggregate of up to 968,220 Class A shares being issued, subject to rounding adjustments. No fractional Class A shares will be issued; however, any fractional interest in a Class A share will be rounded up to the next whole number of Class A shares.*

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Income Taxes

At the end of the third quarter of 2011, the Company had a \$4.5 million (December 31, 2010: \$1.2 million) estimated deferred tax liability. In the first nine months 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 \$4.3 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 September 30, 2011.

Related Party Transactions

The Company utilizes the services of a law firm in which the Corporate Secretary is a Partner. During the nine months ended September 30, 2011, the Company incurred \$158,000 (2010: \$154,000) 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 third quarter of 2011 to previously announced guidance by the Company is as follows:

- The Company indicated it expected sales volumes in the second half of 2011 to be gas-weighted. During the first half of 2011, gas sales averaged 55% of sales volumes of which gas sales in the second quarter were 60% of period sales. In the third quarter of 2011, gas sales contributed 65% of total sales, the net effect of the incremental volumes from the Montney drilling program in British Columbia combined with production disruptions and operational delays from an extended spring break-up in Saskatchewan.
- The Company indicated it expected the average oil price in the second half of 2011 to be approximately 3% less than the Edmonton par reference price. In the third quarter of 2011, Painted Pony received an average oil price of \$89.48 per bbl, 3% less than the reference price.
- The Company indicated it expected to receive a natural gas price equivalent to the AECO daily spot price. During the third quarter of 2011, Painted Pony received a weighted average price of \$3.60 per mcf, or 2% less than the reference price, reflecting the impact of reduced gas sales from the oil properties in Saskatchewan during the quarter.
- The Company indicated it expected overall royalty rates to approximate 13% of total revenues. For the three months ending September 30, 2011, royalties averaged 12%, primarily due to additional gas sales from new wells enjoying provincial royalty incentives.
- The Company indicated it expected weather related issues to result in incremental costs in Saskatchewan during the second and third quarters of 2011. Per unit operating and transportation costs in Saskatchewan in the third quarter were expected to be similar to the second quarter costs of \$14.84 per boe; however, during the third quarter of 2011, operating and transportation costs averaged \$22.26 per boe. Additional charges were incurred to maintain and/or restore production, incurring repair, maintenance and work-over costs of \$4.99 per boe along with property tax charges of \$1.03 per boe.
- The Company indicated it expected variations in the capital expenditure levels to be reflected in the capitalization and recovery of general and administrative costs during the balance of 2011, which is consistent with third quarter 2011 results.
- The Company indicated it expected capital taxes to vary in 2011 as gross Saskatchewan sales revenues fluctuate, which is consistent with third quarter 2011 charges.
- The Company indicated it expected the third quarter 2011 expense for share based payment expense to be approximately \$2.2 million. Actual costs for the period were \$2.1 million.
- The Company indicated it anticipated improvement in surface conditions in Saskatchewan in the third quarter which would allow for resumption of normal drilling and completion activities. Conditions did improve, although later in the quarter than the Company had originally expected. Minimal production is still shut in due to excess water.
- The Company indicated 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. This agreement was finalized in September 2011.

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 19 of the September 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	64	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)	(1,077)	(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 nine months ended September 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 nine months ended September 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 September 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.

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.

Decommissioning Obligations

The Company's activities give rise to dismantling, decommissioning and site disturbance re-remediation 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.

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 19(c) of the "notes to the condensed interim consolidated financial statements" for the period ending September 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 19(h) of the "notes to the condensed interim consolidated financial statements" for the period ending September 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. The effective date for IFRS 9 has been deferred indefinitely. 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, fluctuations 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 third quarter of 2011.

Quarter ended (unaudited) (\$000s, except volumes and per share)	March 31, 2011	June 30, 2011	Sept. 30, 2011
Gross revenues ⁽¹⁾	19,315	17,446	16,647
Funds flow from operations	12,098	10,376	9,159
Basic per share	0.22	0.17	0.15
Diluted per share	0.21	0.17	0.15
Cash flow from operating activities	11,555	11,854	8,586
Net income (loss)	2,144	(1,824)	4,765
Basic per share	0.04	(0.03)	0.08
Diluted per share	0.04	(0.03)	0.08
Capital expenditures, net	24,558	28,594	42,890
Capital acquisitions, net	27	7,357	161
Net working capital	64,100	40,327	6,709
Total assets	330,156	326,471	360,227
Decommissioning obligations ⁽²⁾	7,574	7,702	9,627
Convertible Class B shares liability	10,716	10,899	11,085
Average daily sales volumes (boe/d)	4,027	3,593	4,064

(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	9,123	10,411
Basic, per share	0.21	0.17	0.19	0.20
Diluted, per share	0.20	0.17	0.19	0.20
Cash flow from operating activities	9,221	8,355	7,699	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	10,359	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⁾ <i>(\$000s, except volumes and per share)</i>	Dec. 31, 2009
Gross revenues ⁽¹⁾	11,612
Funds flow from operations	6,981
Basic, per share	0.17
Diluted, per share	0.16
Cash flow from operating activities	6,157
Net income	1,953
Basic and diluted, per share	0.05
Capital expenditures, net	16,483
Capital acquisitions, net	1
Net working capital	40,679
Total assets	164,907
Decommissioning obligations ⁽²⁾	2,439
Average daily sales volumes (boe/d)	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.
- Net income in the third quarter results primarily from a \$7.3 million gain on assets. 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. 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	September 30, 2011	December 31, 2010
ASSETS		
Current assets		
Cash and cash equivalents (note 3)	\$ 31,415	\$ 9,748
Trade and other receivables	16,315	17,200
Prepaid expenses and deposits	592	320
	48,322	27,268
Non-current assets		
Exploration and evaluation (note 4)	61,699	43,535
Property, plant and equipment (note 5)	250,206	173,776
	\$ 360,227	\$ 244,579
LIABILITIES		
Current liabilities		
Trade and other payables	\$ 41,613	\$ 28,473
Non-current liabilities		
Decommissioning obligations (note 7)	9,627	7,145
Convertible Class B shares liability (note 8)	11,085	10,536
Deferred tax liability	4,461	1,232
	66,786	47,386
EQUITY		
Share capital (note 9)	262,524	178,772
Equity component of convertible Class B shares (note 8)	(2,923)	(2,923)
Contributed surplus	23,339	15,928
Retained earnings	10,501	5,416
	293,441	197,193
	\$ 360,227	\$ 244,579

Basis of presentation (note 2)
Commitments (note 13)
Subsequent events (note 18)

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

PAINTED PONY PETROLEUM LTD.
CONDENSED INTERIM CONSOLIDATED STATEMENTS OF COMPREHENSIVE
INCOME

(unaudited)
(000s, except per share amounts)

	Three months ended September 30,		Nine months ended September 30,	
	2011	2010	2011	2010
		<i>(note 19)</i>		<i>(note 19)</i>
Revenue				
Petroleum and natural gas	\$ 16,647	\$ 14,764	\$ 53,408	\$ 41,662
Royalties	(1,952)	(1,733)	(6,747)	(5,389)
Other	175	27	525	67
	14,870	13,058	47,186	36,340
Expenses				
Operating and transportation	4,699	3,121	11,942	8,158
Exploration and evaluation	-	-	91	-
General and administrative	816	616	2,961	1,612
Capital taxes	196	198	650	587
Share-based payments <i>(note 9)</i>	2,142	1,987	7,734	3,675
Depletion and depreciation <i>(note 5)</i>	6,908	6,375	21,011	17,202
Gain on assets <i>(note 5)</i>	(7,280)	(3,289)	(7,280)	(3,393)
	7,481	9,008	37,109	27,841
Results from operating activities	7,389	4,050	10,077	8,499
Finance income	(112)	(34)	(383)	(86)
Finance expense	326	316	1,046	877
Net finance expense <i>(note 11)</i>	214	282	663	791
Income before income tax	7,175	3,768	9,414	7,708
Deferred income tax expense	2,410	1,510	4,329	2,999
Comprehensive income for the period	\$ 4,765	\$ 2,258	\$ 5,085	\$ 4,709
Earnings per share:				
Basic <i>(note 10)</i>	\$ 0.08	\$ 0.05	\$ 0.09	\$ 0.10
Diluted <i>(note 10)</i>	\$ 0.08	\$ 0.05	\$ 0.09	\$ 0.10

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 September 30, 2011 and 2010 and December 31, 2010

	Number of shares Class A	Share capital Class A	Equity component Class B	Contributed surplus	Retained earnings (deficit)	Total equity
Balance, January 1, 2010	44,081,700	\$ 135,731	\$ (2,923)	\$ 10,317	\$ (3,806)	\$ 139,319
Issue of shares	6,800,000	44,064	-	-	-	44,064
Share issue costs, net of tax of \$653	-	(1,801)	-	-	-	(1,801)
Share-based payments	-	-	-	4,644	-	4,644
Options exercised	94,000	512	-	(180)	-	332
Income for the period	-	-	-	-	4,709	4,709
Balance, September 30, 2010	50,975,700	\$ 178,506	\$ (2,923)	\$ 14,781	\$ 903	\$ 191,267
Issue of shares	-	-	-	-	-	-
Share issue costs	-	1	-	-	-	1
Share-based payments	-	-	-	1,257	-	1,257
Options exercised	41,000	265	-	(110)	-	155
Income for the period	-	-	-	-	4,513	4,513
Balance at December 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 \$1,100	-	(3,162)	-	-	-	(3,162)
Share-based payments	-	-	-	10,128	-	10,128
Options exercised	996,973	6,904	-	(2,717)	-	4,187
Income for the period	-	-	-	-	5,085	5,085
Balance at September 30, 2011	59,633,673	\$ 262,524	\$ (2,923)	\$ 23,339	\$ 10,501	\$ 293,441

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 September 30,		Nine months ended September 30,	
	2011	2010 <i>(note 19)</i>	2011	2010 <i>(note 19)</i>
Operating activities:				
Income for the period	\$ 4,765	\$ 2,258	\$ 5,085	\$ 4,709
Items not affecting cash:				
Exploration and evaluation	-	-	91	-
Share-based payments	2,142	1,987	7,734	3,675
Depletion and depreciation	6,908	6,375	21,011	17,202
Net finance expense	214	282	663	791
Deferred income tax expense	2,410	1,510	4,329	2,999
Gain on sale of assets	(7,280)	(3,289)	(7,280)	(3,393)
Decommissioning expenditures	(81)	(93)	(187)	(93)
Changes in non-cash working capital <i>(note 12)</i>	(492)	(1,331)	549	(615)
	8,586	7,699	31,995	25,275
Investing activities:				
Exploration and evaluation additions	(9,074)	(2,456)	(18,894)	(40,248)
Property, plant and equipment additions	(33,816)	(17,199)	(77,148)	(45,684)
Acquisition of property, plant and equipment	(161)	-	(7,545)	-
Changes in non-cash working capital <i>(note 12)</i>	23,622	754	13,204	2,861
	(19,429)	(18,901)	(90,383)	(83,071)
Financing activities:				
Issue of share capital	-	44,064	80,010	44,064
Exercise of share options	304	113	4,187	331
Share issuance costs	(6)	(2,455)	(4,262)	(2,455)
Finance and interest received (paid) <i>(note 11)</i>	57	(51)	120	(123)
Changes in non-cash working capital <i>(note 12)</i>	-	30	-	(34)
	355	41,701	80,055	41,783
Change in cash and cash equivalents	(10,488)	30,499	21,667	(16,013)
Cash and cash equivalents, beginning of period	41,903	63	9,748	46,575
Cash and cash equivalents, end of period <i>(note 3)</i>	\$ 31,415	\$ 30,562	\$ 31,415	\$ 30,562

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 nine months ended September 30, 2011 and 2010

1. Reporting Entity

Painted Pony Petroleum Ltd. (the "Company") is a publicly 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 nine month periods ended September 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 September 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 November 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 19. That note includes reconciliations as at September 30, 2010 and for the three and nine month periods ended September 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

<i>(000s)</i>	As at September 30, 2011	As at December 31, 2010
Bank balances	\$ 31,415	\$ 9,748
Cash and cash equivalents	\$ 31,415	\$ 9,748

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

<i>(000s)</i>	
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	18,894
Transfers to property, plant and equipment	(639)
Lease expiries	(91)
Balance, September 30, 2011	\$ 61,699

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

<i>(000s)</i>	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	7,545	-	7,545
Cash additions	76,942	206	77,148
Non-cash additions	12,109	-	12,109
Transfers from exploration and evaluation	639	-	639
Balance, September 30, 2011	\$ 294,613	\$ 678	\$ 295,291
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	20,942	69	21,011
Balance, September 30, 2011	\$ 44,881	\$ 204	\$ 45,085
Carrying amounts:			
At January 1, 2010	\$ 96,103	\$ 198	\$ 96,301
At December 31, 2010	\$ 173,439	\$ 337	\$ 173,776
At September 30, 2011	\$ 249,732	\$ 474	\$ 250,206

(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 comprehensive income (see also note 15).

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

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

(000s)	Three months ended September 30,		Nine months ended September 30,	
	2011	2010	2011	2010
General and administrative	\$ 600	\$ 316	\$ 1,813	\$ 1,007
Share-based payments	952	489	2,394	969
Total	\$ 1,552	\$ 805	\$ 4,207	\$ 1,976

(c) Property acquisition

During the quarter ended June 30, 2011, the Company acquired certain southeast Saskatchewan light oil properties for cash consideration of \$7.5 million, including final adjustments.

(d) Gain on assets – Farmouts

During the three and nine months ended September 30, 2011, the Company recognized a gain of \$7.3 million (three and nine months ended September 30, 2010: \$3.3 million and \$3.4 million) based on the estimated fair value received, determined by reference to proved and probable reserves established, on assets farmed out.

6. Bank Debt

At September 30, 2011, the Company had an \$80 million demand revolving credit facility available for use. Undrawn as of September 30, 2011, this facility is subject to a review on or before 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.

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)	Nine months ended September 30, 2011	Year ended December 31, 2010
Balance, beginning of period	\$ 7,145	\$ 4,290
Provisions	1,224	2,731
Acquired	55	-
Revisions	1,156	-
Decommissioning expenditures	(187)	(100)
Accretion	234	224
Balance, end of period	\$ 9,627	\$ 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 \$9.6 million as at September 30, 2011 (December 31, 2010: \$7.1 million) based on an undiscounted total future liability of \$16.1 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 3% (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>	Nine months ended September 30, 2011	Year ended December 31, 2010
Balance, beginning of period	\$ 10,536	\$ 9,847
Accretion on convertible Class B share liability	549	689
Balance, end of period	\$ 11,085	\$ 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 September 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	11.14	2,117,400
Exercised	4.20	(996,973)
Forfeited and cancelled	6.67	(107,980)
Balance, September 30, 2011	\$ 7.19	5,561,367
Exercisable at September 30, 2011	\$ 5.82	3,560,565

Number of Options Outstanding	Exercise Price	Remaining Life (yrs)	Grant Date Fair Value	Exercisable Options	Exercise Price
832,000	\$ 3.97	1.3	\$ 2.62	832,000	\$ 3.97
587,500	\$ 2.85	2.8	1.84	587,500	\$ 2.85
331,500	\$ 3.15	2.8	2.04	331,500	\$ 3.15
134,500	\$ 5.88	3.2	3.80	88,166	\$ 5.88
562,667	\$ 5.88	3.3	3.71	369,000	\$ 5.88
28,000	\$ 5.60	3.6	3.62	4,000	\$ 5.60
1,012,800	\$ 6.51	3.9	4.21	657,600	\$ 6.51
1,460,900	\$10.60	4.5	6.86	486,966	\$10.60
354,000	\$12.10	4.7	7.83	118,000	\$12.10
105,000	\$11.19	4.8	7.24	35,000	\$11.19
152,500	\$14.15	4.8	9.16	50,833	\$14.15
5,561,367	\$ 7.19	3.5	\$ 4.65	3,560,565	\$ 5.82

The weighted average share trading price at the date of exercise for share options exercised during the nine months ended September 30, 2011 was \$10.84 (nine months ended September 30, 2010: \$6.58).

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:

Nine months ended September 30,	2011	2010
Fair value per option (weighted average)	\$ 7.21	\$ 3.70
Volatility (%)	80	80
Option life (years)	5	5
Dividends	-	-
Risk-free interest rate (%)	1.98	1.90

During the three and nine months ended September 30, 2011, 257,500 and 2,117,400 stock options were granted at an average price of \$12.94 and \$11.14, respectively (three and nine months ended September 30, 2010: 1,177,920 at \$6.51 and 1,983,920 at \$6.25).

A forfeiture rate of 2% (2010: 0%) is used when measuring share-based payments. Share-based payments of \$2.1 million and \$7.7 million for the three and nine months ended September 30, 2011, respectively, (three and nine months ended September 30, 2010: \$2.0 million and \$3.7 million) were expensed and \$1.0 million and \$2.4 million (three and nine months ended September 30, 2010: \$0.5 million and \$1.0 million, respectively) were capitalized during the three and nine months ended September 30, 2011.

10. Earnings per Share

Basic earnings per share was calculated as follows:

<i>(000s, except shares)</i>	Three months ended September 30,		Nine months ended September 30,	
	2011	2010	2011	2010
Income for the period	\$ 4,765	\$ 2,258	\$ 5,085	\$ 4,709
<i>Weighted average number of shares</i>				
Class A shares - basic	59,592,021	46,883,841	58,027,694	45,059,638
Class A shares - diluted	61,334,305	47,384,870	59,299,501	45,746,842
Net income per share – basic	\$ 0.08	\$ 0.05	\$ 0.09	\$ 0.10
Net income per share - diluted	\$ 0.08	\$ 0.05	\$ 0.09	\$ 0.10

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 nine months ended September 30, 2011 and 2010. During the three and nine months ended September 30, 2011, 152,500 and 611,500 (three and nine months ended September 30, 2010: 1,177,920 and 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 September 30,		Nine months ended September 30,	
	2011	2010	2011	2010
Finance income:				
Interest income	\$ (112)	\$ (34)	\$ (383)	\$ (86)
	(112)	(34)	(383)	(86)
Finance expense:				
Financing costs	55	86	263	209
Accretion of decommissioning obligations	85	57	234	156
Accretion of convertible Class B share liability	186	173	549	512
	326	316	1,046	877
Net finance expense recognized in income	\$ 214	\$ 282	\$ 663	\$ 791

12. Supplemental Cash Flow Information

Changes in non-cash working capital is comprised of:

(000s)	Three months ended September 30,		Nine months ended September 30,	
	2011	2010	2011	2010
Source/(use) of cash:				
Trade and other receivables	\$ 2,270	\$ 37	\$ 885	\$ (2,337)
Prepaid expenses and deposits	(218)	(176)	(272)	(128)
Trade and other payables	21,078	(408)	13,140	4,677
	\$ 23,130	\$ (547)	\$ 13,753	\$ 2,212
Related to operating activities	\$ (492)	\$ (1,331)	\$ 549	\$ (615)
Related to investing activities	23,622	754	13,204	2,861
Related to financing activities	-	30	-	(34)
	\$ 23,130	\$ (547)	\$ 13,753	\$ 2,212

13. Operating Commitments

- (a) At September 30, 2011 the Company is committed to two contracts, payable as follows, that expire in 2016 and require an estimated \$2.5 million of minimum tolls for transportation of oil through a major carrier system:

(000s)	Amount
2011	\$ 268
2012	837
2013	619
2014	466
2015	253
2016	90
	\$ 2,533

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

(000s)	Amount
2011	\$ 158
2012	624
2013	443
2014	263
2015	241
	\$ 1,729

- (c) At September 30, 2011, the Company is committed to a ten-year take-or-pay contract, estimated to begin in July 2012, that requires an estimated \$23.8 million of minimum gas gathering and processing fees, and are payable as follows:

(000s)	Amount
2012	\$ 1,325
2013	2,628
2014	2,628
2015	2,628
2016	2,628
Thereafter to 2022	11,979
	\$ 23,816

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 nine months ended September 30, 2011, the Company incurred \$68,000 and \$158,000 (2010: \$129,000 and \$154,000) on services obtained from the firm, excluding disbursements. As at September 30, 2011, the Company owed this related party \$14,497 (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 September 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 September 30, 2011 was \$10.8 million (December 31, 2010: \$10.9 million) based on the market price of \$9.17 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 condensed interim 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 September 30, 2011 and December 31, 2010 is as follows:

<i>(000s)</i>	September 30, 2011	December 31, 2010
Cash and cash equivalents	\$ 31,415	\$ 9,748
Trade and other receivables	16,315	17,200
Total current assets	\$ 47,730	\$ 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 September 30, 2011 or December 31, 2010.

The breakdown of trade and other receivables at the reporting date by type of customer was:

<i>(000s)</i>	September 30, 2011	December 31, 2010
Sales revenue	\$ 6,579	\$ 7,109
Joint interest	8,111	9,045
Other	1,625	1,046
Total trade and other receivables	\$ 16,315	\$ 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 \$2.1 million of trade and other receivables at September 30, 2011 (December 31, 2010: \$1.5 million). A second entity purchases the majority of oil produced in Saskatchewan which accounted for \$4.1 million of trade and other receivables at September 30, 2011 (December 31, 2010: \$5.0 million). These receivables have been collected subsequent to September 30, 2011.

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

<i>(000s)</i>	September 30, 2011	December 31, 2010
Not past due (less than 30 days)	\$ 15,800	\$ 15,339
Past due (31 – 90 days)	99	1,691
Past due (more than 90 days)	416	170
Total receivables	\$ 16,315	\$ 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 \$80 million was available at the end of the period.

(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 September 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 of 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 nine months ended September 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 for the period would have been \$45,000 and \$153,000 lower due to lower interest income. An equal and opposite impact would have occurred to 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 September 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. Subsequent Events

a) *Property Swap*

Subsequent to September 30, 2011, the Company completed a property swap in northeast British Columbia, valued at \$2 million plus estimated interim adjustments of \$(1.6) million.

b) *Financing*

On November 8, 2011, the Company issued 8,800,000 Class A shares at a price of \$11.80 per share for gross proceeds of \$103.8 million by way of a bought-deal financing.

c) *Class B Conversion*

Effective on December 1, 2011, all existing Class B Shares will be exchanged for Class A Shares of the Company, subject to applicable regulatory approvals. The holders of Class B Shares will receive 0.8250 of a Class A Share for each one (1) Class B Share held, resulting in an aggregate of up to 968,220 Class A Shares being issued, subject to rounding adjustments. No fractional Class A Shares will be issued; however, any fractional interest in a Class A Share will be rounded up to the next whole number of Class A Shares.

19. 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 consolidated 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 nine month periods ended September 30, 2011, and the comparative statements for the three and nine month periods ended September 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 interim consolidated 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 September 30, 2010

(Unaudited)

(000s)

	Canadian GAAP	Effect of Transition to IFRS	IFRS
ASSETS			
Current assets			
Cash and cash equivalents	\$ 30,562	\$ -	\$ 30,562
Trade and other receivables	7,535	-	7,535
Prepaid expenses and deposits	452	-	452
	38,549	-	38,549
Non-current assets			
Exploration and evaluation <i>(note a)</i>	-	38,920	38,920
Property, plant and equipment <i>(note a, e)</i>	177,919	(32,747)	145,172
Deferred tax asset <i>(note h)</i>	1,814	(1,108)	706
	\$ 218,282	\$ 5,065	\$ 223,347
LIABILITIES			
Current liabilities			
Trade and other payables	\$ 16,095	\$ -	\$ 16,095
Non-current liabilities			
Decommissioning obligations <i>(note b)</i>	3,275	2,351	5,626
Convertible Class B shares liability <i>(note c)</i>	-	10,359	10,359
	19,370	12,710	32,080
EQUITY			
Share capital <i>(note f)</i>	182,514	(4,008)	178,506
Equity component of convertible Class B shares <i>(note c)</i>	-	(2,923)	(2,923)
Contributed surplus <i>(note d)</i>	14,926	(145)	14,781
Retained earnings (deficit) <i>(notes b, c, d, h)</i>	1,472	(569)	903
	198,912	(7,645)	191,267
	\$ 218,282	\$ 5,065	\$ 223,347

**Reconciliation of the Condensed Interim Consolidated Statement of Comprehensive Income (Loss)
For the Three Months ended September 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	\$ 14,764	\$ -	\$ 14,764
Royalties	(1,733)	-	(1,733)
Other	61	(34)	27
	13,092	(34)	13,058
Expenses			
Operating and transportation	3,121	-	3,121
General and administrative	701	(85)	616
Capital taxes	198	-	198
Share-based payments <i>(note d)</i>	2,008	(21)	1,987
Depletion and depreciation <i>(note e)</i>	7,018	(643)	6,375
Gain on assets <i>(note g)</i>	-	(3,289)	(3,289)
	13,046	(4,038)	9,008
Results from operating activities	46	4,004	4,050
Finance income	-	(34)	(34)
Finance expense <i>(note b)</i>	-	316	316
Net finance expense	-	282	282
Income before income tax	46	3,722	3,768
Deferred income tax expense <i>(note h)</i>	556	954	1,510
Comprehensive income (loss) for the period	\$ (510)	\$ 2,768	\$ 2,258
Earnings (loss) per share:			
Basic	\$ (0.01)		\$ 0.05
Diluted	\$ (0.01)		\$ 0.05

**Reconciliation of the Condensed Interim Consolidated Statement of Comprehensive Income
For the Nine Months ended September 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	\$ 41,662	\$ -	\$ 41,662
Royalties	(5,389)	-	(5,389)
Other	153	(86)	67
	36,426	(86)	36,340
Expenses			
Operating and transportation	8,158	-	8,158
General and administrative	1,796	(184)	1,612
Capital taxes	587	-	587
Share-based payments <i>(note d)</i>	3,754	(79)	3,675
Depletion and depreciation <i>(note e)</i>	20,051	(2,849)	17,202
Gain on assets <i>(note g)</i>	-	(3,393)	(3,393)
	34,346	(6,505)	27,841
Results from operating activities	2,080	6,419	8,499
Finance income	-	(86)	(86)
Finance expense <i>(note b)</i>	-	877	877
Net finance expense	-	791	791
Income before income tax	2,080	5,628	7,708
Deferred income tax expense <i>(note h)</i>	1,559	1,440	2,999
Comprehensive income for the period	\$ 521	\$ 4,188	\$ 4,709
Earnings per share:			
Basic	\$ 0.01		\$ 0.10
Diluted	\$ 0.01		\$ 0.10

(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 September 30, 2010 is as follows:

Condensed Consolidated Statement of Financial Position:

<i>(000s)</i>	September 30, 2010
Exploration and evaluation	\$ 38,920
Property, plant and equipment	(38,920)
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 September 30, 2010 and consolidated statements of income and comprehensive income for the three and nine months ended September 30, 2010 is as follows:

Condensed Consolidated Statements of Financial Position:

<i>(000s)</i>	September 30, 2010
Property, plant and equipment	\$ 521
Decommissioning obligations	(2,351)
Impact on retained earnings (deficit)	\$ (1,830)

Condensed Consolidated Statements of Income and Comprehensive Income:

<i>(000s)</i>	Three months ended September 30, 2010	Nine months ended September 30, 2010
Finance expense	\$ (8)	\$ (21)
Impact on income and comprehensive income	\$ 8	\$ 21

(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 September 30, 2010. 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>	September 30, 2010
Impact on convertible Class B liability	\$ 512

Consolidated Statements of Income and Comprehensive Income:

<i>(000s)</i>	Three months ended September 30, 2010	Nine months ended September 30, 2010
Impact on finance expense	\$ 173	\$ 512
Impact on income and comprehensive income	\$ (173)	\$ (512)

(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 September 30, 2010 is as follows:

Consolidated Statements of Financial Position:

<i>(000s)</i>	September 30, 2010
Property, plant and equipment	\$ (23)
Contributed surplus	145
Impact on retained earnings (deficit)	\$ 122

Consolidated Statements of Income and Comprehensive Income:

<i>(000s)</i>	Three months ended September 30, 2010	Nine months ended September 30, 2010
Share-based payments	\$ (21)	\$ (79)
Impact on income and comprehensive income	\$ 21	\$ 79

(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 September 30, 2010 and condensed consolidated statements of income and comprehensive income for the three and nine months ended September 30, 2010 is as follows:

Consolidated Statements of Financial Position:

<i>(000s)</i>	September 30, 2010
Property, plant and equipment	\$ 2,673
Impact on total assets	\$ 2,673

Consolidated Statements of Income and Comprehensive Income:

<i>(000s)</i>	Three months ended September 30, 2010	Nine months ended September 30, 2010
Depletion and depreciation expense	\$ (643)	\$ (2,849)
Impact on income and comprehensive income	\$ 643	\$ 2,849

(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 19 (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 nine months ended September 30, 2010, the Company recognized gains of \$3.3 million and \$3.4 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 19 (a) through to (g) resulted in the following impact for the periods ended September 30, 2010 as follows:

Consolidated Statements of Financial Position:

(000s)	September 30, 2010
Property, plant and equipment	\$ (366)
Deferred income tax asset (liability)	
Related to property, plant and equipment	(1,351)
Related to decommissioning obligations	608
Related to convertible Class B shares	(364)
Impact on retained earnings (deficit)	\$ (1,473)

Consolidated Statements of Income and Comprehensive Income:

(000s)	Three months ended September 30, 2010	Nine months ended September 30, 2010
Deferred income tax expense	\$ 954	\$ 1,440
Impact on income and comprehensive income	\$ (954)	\$ (1,440)

(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 \$51,000 and \$123,000 for the three and nine months ended September 30, 2010 are included in cash flows from financing activities for IFRS.

Corporate Information

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Calgary, Alberta

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Arthur J. G. Madden
Chief Financial Officer
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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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Joan E. Dunne
Vice President, Finance and Chief Financial Officer

Michael E. Belenkie
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Mary Kay Axford
Controller

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Partner, Burstall Winger LLP
Corporate Secretary

LEGAL COUNSEL

Burstall Winger LLP

AUDITORS

KPMG LLP

BANKERS

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