



## **Financial Statements**

**For the Six Months Ended  
August 31, 2012**

(Expressed in Canadian dollars)

**HEMISPHERE ENERGY CORPORATION**  
**Condensed Interim Statements of Financial Position**  
(Unaudited - Prepared by Management)  
(Expressed in Canadian dollars)

	Note	August 31, 2012	February 29, 2012
<b>Assets</b>			
<b>Current assets</b>			
Cash and cash equivalent	5(b)	\$ 525,751	\$ 2,183,898
Accounts receivable		912,845	1,252,385
Prepaid expenses		75,458	26,035
		<b>1,514,054</b>	<b>3,462,318</b>
<b>Non-current assets</b>			
Reclamation deposits	9	151,977	151,977
Exploration and evaluation assets	7	2,324,162	2,161,743
Deferred tax asset	17	1,394,544	1,394,544
Property and equipment	8, 9	16,094,861	11,743,489
<b>Total assets</b>		<b>\$ 21,479,597</b>	<b>\$ 18,914,071</b>
<b>Liabilities</b>			
<b>Current liabilities</b>			
Accounts payable and accrued liabilities		\$ 2,258,694	\$ 1,098,373
Bank debt	11	900,000	-
		<b>3,158,694</b>	<b>1,098,373</b>
<b>Non-current liabilities</b>			
Decommissioning obligations	9	387,449	358,428
		<b>3,546,142</b>	<b>1,456,801</b>
<b>Shareholders' Equity</b>			
<b>Capital stock</b>	12	<b>36,743,445</b>	<b>36,719,484</b>
<b>Share-based payment reserve</b>		<b>2,214,328</b>	<b>1,931,456</b>
<b>Warrant reserve</b>		<b>110,400</b>	<b>110,400</b>
<b>Deficit</b>		<b>(21,134,719)</b>	<b>(21,304,069)</b>
		<b>17,933,454</b>	<b>17,457,270</b>
<b>Total shareholders' equity and liabilities</b>		<b>\$ 21,479,597</b>	<b>\$ 18,914,071</b>

*The accompanying notes are an integral part of these financial statements.*

**On Behalf of the Board**

Signed:

"C.N. O'Sullivan" Director  
Charles N. O'Sullivan

"Don Simmons" Director  
Don Simmons

**HEMISPHERE ENERGY CORPORATION**  
**Condensed Interim Statements of Comprehensive Income (Loss)**

*(Unaudited - Prepared by Management)*

*(Expressed in Canadian dollars)*

	Note	Three Months Ended August 31,		Six Months Ended August 31,	
		2012	2011	2012	2011
<b>Oil and natural gas revenue</b>		\$ 2,029,140	\$ 297,526	\$ 4,450,803	\$ 553,389
Less: royalties		(436,636)	(31,144)	(876,981)	(75,431)
<b>Total oil and natural gas revenue</b>		<b>1,592,504</b>	<b>266,382</b>	<b>3,573,822</b>	<b>477,958</b>
<b>Expenses</b>					
Production and operating expenses		452,677	99,537	1,066,522	222,142
Depletion and depreciation	8	717,400	54,648	1,431,303	109,358
Share-based payments	12(c)	238,469	15,515	282,872	181,788
General and administrative expenses		315,545	168,998	611,942	341,128
		<b>1,724,091</b>	<b>338,698</b>	<b>3,392,639</b>	<b>854,416</b>
<b>Results from operating activities</b>		<b>(131,587)</b>	<b>(72,316)</b>	<b>181,183</b>	<b>(376,458)</b>
Finance income		90	-	90	843
Finance expense		(5,058)	(3,267)	(11,923)	(8,732)
<b>Net finance expense</b>	10	<b>(4,968)</b>	<b>(3,267)</b>	<b>(11,833)</b>	<b>(7,889)</b>
<b>Income (loss) and comprehensive income (loss) for the period</b>		<b>\$ (136,556)</b>	<b>\$ (75,583)</b>	<b>\$ 169,349</b>	<b>\$ (384,347)</b>
Income (loss) per share:					
Basic and diluted	12(e)	\$ (0.00)	\$ (0.00)	\$ 0.00	\$ (0.01)

*The accompanying notes are an integral part of these financial statements.*

**HEMISPHERE ENERGY CORPORATION**  
**Condensed Interim Statements of Cash Flows**  
*(Unaudited - Prepared by Management)*  
*(Expressed in Canadian dollars)*

	Note	Three Months Ended August 31,		Six Months Ended August 31,	
		2012	2011	2012	2011
<b>Operating activities</b>					
Net income (loss)		\$ (136,557)	\$ (75,583)	\$ 169,349	\$ (384,347)
Items not involving cash					
Depletion, depreciation and accretion		721,697	56,103	1,439,897	111,429
Share-based payments		238,469	15,515	282,872	181,788
		823,609	(3,965)	1,892,118	(91,130)
Changes in non-cash working capital					
Accounts receivable		146,620	(71,896)	339,540	(135,331)
Prepaid expenses		(58,551)	(46,602)	(49,423)	(60,834)
Accounts payable and accrued liabilities		(46,907)	(53,855)	(133,533)	(27,761)
		41,162	(172,353)	156,584	(223,926)
<b>Cash provided by (used in) operating activities</b>		<b>864,771</b>	<b>(176,318)</b>	<b>2,048,702</b>	<b>(315,056)</b>
<b>Investing activities</b>					
Acquisition of property and equipment		(2,591,278)	-	(4,575,043)	-
Reclamation deposits		-	-	-	47,549
Exploration and evaluation expenditures		(148,378)	(1,423,534)	(55,769)	(2,579,224)
<b>Cash provided by (used in) investing activities</b>	<b>15</b>	<b>(2,739,656)</b>	<b>(1,423,534)</b>	<b>(4,630,812)</b>	<b>(2,531,675)</b>
<b>Financing activities</b>					
Shares issued for cash, net of issue costs		-	1,610,796	23,961	3,144,446
Bank debt		900,000	-	900,000	-
Inflow (outflow) of cash		(974,883)	10,943	(1,658,147)	297,715
Cash and cash equivalent, beginning of period		1,500,634	2,228,940	2,183,898	1,942,169
<b>Cash and cash equivalent, end of period</b>		<b>\$ 525,751</b>	<b>\$ 2,239,883</b>	<b>\$ 525,751</b>	<b>\$ 2,239,883</b>

*The accompanying notes are an integral part of these financial statements.*

## HEMISPHERE ENERGY CORPORATION

### Condensed Interim Statements of Changes in Shareholders' Equity

(Unaudited - Prepared by Management)

(Expressed in Canadian dollars)

	Note	Number of Common Shares	Capital Stock	Share-based payment reserve	Warrant reserve	Deficit	Total Equity
<b>Balance March 1, 2011</b>		<b>26,071,682</b>	<b>\$ 24,678,806</b>	<b>\$ 507,276</b>	<b>\$ -</b>	<b>\$ (22,254,159)</b>	<b>\$ 2,931,923</b>
Non-flow-through share issuance		2,575,350	1,030,140	-	-	-	1,030,140
Flow-through share issuance		1,380,000	621,000	-	-	-	621,000
Warrant exercises		5,337,950	1,601,385	-	-	-	1,601,385
Stock option exercises		75,000	19,250	-	-	-	19,250
Share issuance costs		-	(127,330)	-	-	-	(127,330)
Finder's warrants issued		-	(36,638)	36,638	-	-	-
Share-based payments		-	-	181,788	-	-	181,788
Net income (loss) for the period		-	-	-	-	(384,347)	(384,347)
<b>Balance August 31, 2011</b>		<b>35,439,982</b>	<b>27,786,613</b>	<b>725,702</b>	<b>-</b>	<b>(22,638,506)</b>	<b>5,873,809</b>
<b>Balance March 1, 2012</b>		<b>50,374,701</b>	<b>36,719,485</b>	<b>1,931,456</b>	<b>110,400</b>	<b>(21,304,069)</b>	<b>17,457,269</b>
Warrant exercises	<b>12(b)</b>	37,853	22,711	-	-	-	22,711
Stock option exercises	<b>12(b)</b>	5,000	1,250	-	-	-	1,250
Share-based payments	<b>12(c)</b>	-	-	282,872	-	-	282,873
Net income (loss) for the period		-	-	-	-	169,349	169,350
<b>Balance August 31, 2012</b>		<b>50,417,554</b>	<b>\$ 36,743,445</b>	<b>\$ 2,214,328</b>	<b>\$ 110,400</b>	<b>\$ (21,134,719)</b>	<b>\$ 17,933,454</b>

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

# HEMISPHERE ENERGY CORPORATION

## Notes to the Financial Statements

For the Six Months Ended August 31, 2012

(Expressed in Canadian dollars)

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### 1. REPORTING ENTITY

Hemisphere Energy Corporation (the "Company") is a publicly listed company and was incorporated under the laws of British Columbia on March 6, 1978. The Company's principal business is the acquisition, exploration, development and production of petroleum and natural gas interests and its shares are listed on the TSX Venture Exchange under the symbol "HME". The Company's head office is located at 570-789 West Pender Street, Vancouver, British Columbia, Canada, V6C 1H2.

The Company incurred net income for the six months ended August 31, 2012 of \$169,349 (August 31, 2011 - net loss of \$384,347). As at August 31, 2012, the Company has a negative working capital of \$1,644,640 (February 29, 2012 - \$2,363,945) and an accumulated deficit of \$21,134,719 (February 29, 2012 - \$21,304,069).

These unaudited condensed interim financial statements have been prepared on the basis of accounting principles applicable to a going concern, which assumes that the Company will be able to continue in operation for the foreseeable future and will be able to realize its assets and discharge its liabilities and commitments in the normal course of business. Depending on the results of current drilling operations, the Company may require additional equity financing to meet its administrative overhead costs, and to continue exploration and development work on its petroleum and natural gas interests in the ensuing year.

### 2. BASIS OF PREPARATION

#### (a) Statement of compliance

These unaudited condensed interim financial statements are prepared in accordance with International Financial Reporting Standards ("IFRS") applicable to the preparation of interim financial statements including IAS 34 "*Interim Financial Reporting*", as issued by the International Accounting Standards Board ("IASB"). These condensed unaudited interim financial statements do not include all of the information required for full annual financial statements and should be read in conjunction with the Company's February 29, 2012 audited annual financial statements.

The unaudited condensed interim financial statements were authorized for issuance by the Board of Directors on October 29, 2012.

#### (b) Basis of presentation

These unaudited condensed interim financial statements have been prepared on a historical cost basis, except for financial instruments, which are stated at their fair values. In addition, these financial statements have been prepared using the accrual basis of accounting, except for cash flow information.

On August 20, 2012, the Company announced that it was changing its fiscal year-end date from February 28 to December 31. In accordance with relevant legislation, the Company will prepare condensed interim financial statements for the remaining periods ending August 31, 2012 and November 30, 2012 during the transition of the fiscal year-end change. The Company's next annual audited financial statements will be for the ten months ended December 31, 2012.

#### (c) Functional currency

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

# HEMISPHERE ENERGY CORPORATION

## Notes to the Financial Statements

For the Six Months Ended August 31, 2012

*(Expressed in Canadian dollars)*

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### 2. BASIS OF PREPARATION (Continued)

#### (d) Use of estimates and judgments

The preparation of these unaudited condensed interim financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that may affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

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

Significant areas requiring the use of estimates include the collectability of accounts receivable, the recoverability of property and equipment and exploration and evaluation assets, the fair value of financial instruments, valuation of accrued liabilities, determination of decommissioning obligations, the rates of depletion and amortization of property and equipment, assumptions used in the calculation of fair value of share-based payments and finder's warrants, and the recoverability of deferred income tax assets. While management believes these estimates are reasonable, actual results could differ from those estimates and could impact future results of operations and cash flows.

Management has applied judgment in the determination of reserve estimates. Reserve estimates affect a number of the areas referred to above, in particular the valuation of property and equipment, determination of decommissioning obligations, and the calculation of depletion of property and equipment.

### 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

These unaudited condensed interim financial statements have been prepared in accordance with IFRS and follow the same accounting policies as described in Note 3 of the Company's audited annual financial statements for the year ended February 29, 2012. There have been no changes to the Company's accounting policies since these financial statements were issued.

### 4. FINANCIAL INSTRUMENTS

Fair value estimates of financial instruments are made at a specific point in time, based on relevant information about financial markets and specific financial instruments. As these estimates are subjective in nature, involving uncertainties and matters of significant judgment, they may be subject to future adjustment. Changes in assumptions can significantly affect estimated fair values. At August 31, 2012, the Company's financial instruments include cash and cash equivalent, accounts receivable, reclamation deposits, and accounts payable and accrued liabilities.

The fair values of accounts receivable, and accounts payable and accrued liabilities approximate their carrying values due to the short-term maturity of these financial instruments. The fair value of the reclamation deposits also approximates its carrying value.

# HEMISPHERE ENERGY CORPORATION

## Notes to the Financial Statements

For the Six Months Ended August 31, 2012

(Expressed in Canadian dollars)

### 5. 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 these risks. Management sets controls to manage such risks and monitors them on an ongoing basis pertaining 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 payment obligations. This risk arises principally from the Company's receivables from joint venture partners and oil and natural gas marketers, and from its cash and cash equivalent balance and reclamation deposits. The credit risk associated with cash, cash equivalent, and reclamation deposits is minimized substantially by ensuring that these financial assets are placed with major financial institutions with strong investment-grade ratings by a primary ratings agency. The Company does not anticipate any default. The maximum exposure to credit risk is as follows:

	<b>August 31, 2012</b>	<i>February 29, 2012</i>
Cash and cash equivalent	<b>\$ 525,751</b>	\$ 2,183,898
Accounts receivable	<b>912,845</b>	1,252,385
Reclamation deposits	<b>151,977</b>	151,977
	<b>\$ 1,590,573</b>	\$ 3,588,260

(c) Liquidity risk

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

The Company has a cash and cash equivalent balance at August 31, 2012 of \$525,751 (February 29, 2012 - \$2,183,898) and accounts receivable of \$912,845 (February 29, 2012 - \$1,252,385). At August 31, 2012, the Company has accounts payable and accrued liabilities of \$2,258,694 (February 29, 2012 - \$1,098,373) and a negative working capital of \$1,644,640 (February 29, 2012 - \$2,363,945). All of the Company's financial liabilities have contractual maturities of less than 90 days.

(d) Market risk

Market risk is the risk that changes in market prices, such as, foreign exchange rates, commodity prices, and interest rates will affect the value of the financial instruments. Market risk is comprised three types of risk: interest rate risk, foreign currency risk, and other price risk.

(i) Interest rate risk

The Company's cash and cash equivalent is held in bank accounts and due to the short-term nature of these financial instruments, fluctuations in market interest rates do not have an impact on their fair values as at August 31, 2012.



## HEMISPHERE ENERGY CORPORATION

### Notes to the Financial Statements

For the Six Months Ended August 31, 2012

(Expressed in Canadian dollars)

#### 5. FINANCIAL RISK MANAGEMENT (Continued)

(i) Interest rate risk (Continued)

The Company manages interest rate risk by maintaining an investment policy that focuses on the preservation of capital and liquidity.

(ii) Foreign currency risk

The Company is not exposed to significant foreign currency risk.

(iii) Other price risk

Other price risk is the risk that the fair or future cash flows of a financial instrument will fluctuate due to changes in market prices, other than those arising from interest rate risk or foreign currency risk. The Company is not exposed to significant other price risk.

#### 6. CAPITAL MANAGEMENT

The Company manages its capital with the following objectives:

- To ensure sufficient financial flexibility to achieve the Company's ongoing business objectives including the replacement of production, funding of future growth opportunities, and pursuit of accretive acquisitions; and
- To maximize shareholder return through enhancing the share value.

The Company monitors its capital structure and makes adjustments according to market conditions in an effort to meet its objectives given the current outlook of the business and industry in general. The capital structure of the Company is composed of working capital, share capital, and the undrawn component of the bank credit facility. The Company may manage its capital structure by issuing new shares, repurchasing outstanding shares, obtaining additional financing from the Company's credit facility, issuing new debt instruments, other financial or equity-based instruments, adjusting capital spending, or disposing of assets. The capital structure is reviewed on an ongoing basis.

The Company's capital structure as at August 31, 2012 and August 31, 2011 are as follows:

	<i>August 31, 2012</i>	<i>August 31, 2011</i>
Current assets	\$ 1,514,054	\$ 2,472,605
Current liabilities	3,158,694	516,589
Working capital surplus/(deficit)	<b>(1,644,640)</b>	1,956,016
Share capital	36,743,445	27,572,168
Undrawn component of bank credit facility	4,600,000	-
<b>Total capital</b>	<b>\$ 39,698,805</b>	<b>\$ 29,528,184</b>

The Company has total available credit facilities of \$5,500,000 (August 31, 2011 - \$nil). As at August 31, 2012, the Company has drawn \$900,000 (August 31, 2011 - \$nil) on these credit facilities.

## HEMISPHERE ENERGY CORPORATION

### Notes to the Financial Statements

For the Six Months Ended August 31, 2012

(Expressed in Canadian dollars)

#### 7. EXPLORATION AND EVALUATION ASSETS

Exploration and evaluation assets consist of the Company's exploration projects which are pending the determination of proved reserves. For the six months ended August 31, 2012, \$612,229 (February 29, 2012 - \$nil) was transferred to property and equipment.

<b>Cost</b>	
Balance March 1, 2011	\$ 473,527
Additions	1,688,216
Balance February 29, 2012	2,161,743
Additions	774,648
Transfer to property and equipment	(612,229)
<b>Balance August 31, 2012</b>	<b>\$ 2,324,162</b>

#### 8. PROPERTY AND EQUIPMENT

	<i>Petroleum and Natural Gas</i>	<i>Other Equipment</i>	<i>Total</i>
<b>Cost</b>			
Balance March 1, 2011	\$ 3,188,325	\$ 57,323	\$ 3,245,648
Additions	12,406,326	10,199	12,416,525
Transfer from exploration and evaluation assets	-	-	-
Balance February 29, 2012	15,594,651	67,522	15,662,173
Additions	5,782,675	-	5,782,675
Transfer from exploration and evaluation assets	-	-	-
<b>Balance August 31, 2012</b>	<b>\$ 21,377,326</b>	<b>\$ 67,522</b>	<b>\$ 21,444,848</b>
<b>Accumulated Depletion, Depreciation, Amortization and Impairment Losses</b>			
Balance March 1, 2011	\$ 2,556,722	\$ 40,361	\$ 2,597,083
Charge for the year	1,065,656	4,551	1,070,207
Impairment loss	251,394	-	251,394
Balance February 29, 2012	3,873,772	44,912	3,918,684
Charge for the period	1,428,158	3,145	1,431,303
Impairment loss	-	-	-
<b>Balance August 31, 2012</b>	<b>\$ 5,301,930</b>	<b>\$ 48,057</b>	<b>\$ 5,349,987</b>
<b>Net Book Value</b>			
March 1, 2011	\$ 631,603	\$ 16,962	\$ 648,565
February 29, 2012	11,720,879	22,610	11,743,489
<b>August 31, 2012</b>	<b>\$ 16,075,396</b>	<b>\$ 19,465</b>	<b>\$ 16,094,861</b>

## HEMISPHERE ENERGY CORPORATION

### Notes to the Financial Statements

For the Six Months Ended August 31, 2012

(Expressed in Canadian dollars)

#### 8. PROPERTY AND EQUIPMENT (Continued)

During the year ended February 29, 2012, the Company performed an impairment test on its petroleum and natural gas interests which resulted in an impairment charge of \$251,394 (February 28, 2011 – \$434,094) being recorded at year-end. The impairment test was based on annual data prepared by the Company's independent engineering consultant.

Although the Company believes it has title to its petroleum and natural gas properties, it cannot control or completely protect itself against the risk of title disputes or challenges.

#### 9. DECOMMISSIONING OBLIGATIONS

The Company's decommissioning obligations result from its ownership interest in petroleum and natural gas assets including well sites and gathering systems. 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 total undiscounted amount of cash flows required to settle its decommissioning obligations of \$670,000 at August 31, 2012. These payments are expected to be made over the next 26 years with the majority of costs to be incurred between 2019 and 2028. The discount factor, being the risk-free rate related to the liability, is 2.54% (August 31, 2011 – 3.10%). Inflation of 2.20% (August 31, 2011 – 2.20%) has been factored into the calculation. The Company has \$151,977 (August 31, 2011 - \$100,535) in various reclamation bonds for its properties held by the British Columbia Ministry of Energy, Mines and Petroleum Resources.

	<i>August 31, 2012</i>	<i>February 29, 2012</i>
Asset retirement obligation, beginning of period	\$ 358,428	\$ 67,676
Increase in estimated future obligations	20,427	286,708
Accretion expense	8,594	4,044
<b>Asset retirement obligation, end of period</b>	<b>\$ 387,449</b>	<b>\$ 358,428</b>

#### 10. FINANCE INCOME AND EXPENSES

	<i>Three Months Ended August 31,</i>		<i>Six Months Ended August 31,</i>	
	<i>2012</i>	<i>2011</i>	<i>2012</i>	<i>2011</i>
<b>Finance income:</b>				
Interest income	\$ (90)	\$ -	\$ (90)	\$ (843)
<b>Finance expense:</b>				
Interest expense	762	1,811	3,330	6,661
Accretion of provision	4,297	1,456	8,594	2,071
	5,058	3,267	11,923	8,732
<b>Net finance expense</b>	<b>\$ 4,968</b>	<b>\$ 3,267</b>	<b>\$ 11,833</b>	<b>\$ 7,889</b>

## HEMISPHERE ENERGY CORPORATION

### Notes to the Financial Statements

For the Six Months Ended August 31, 2012

(Expressed in Canadian dollars)

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#### 11. BANK LOAN

At August 31, 2012, the Company has total authorized credit facilities to borrow up to \$5,500,000. The credit facilities are comprised of a revolving operating demand loan of \$4,000,000 and a non-revolving acquisition and development demand loan of \$1,500,000. Advances under the operating demand loan are payable on demand and are available by way of prime rate loans with an interest of 1.5% over the lender's prime lending rate. Advances under the acquisition and development demand loan are payable on demand and available by way of prime rate loans subject to prior engineering review by the bank with an interest rate of 2.0% over the lender's prime lending rate. The credit facilities are secured by a first floating charge debenture with negative pledge, a revolving credit agreement and general assignment of book debts. The Company's next review date with the bank is scheduled for November 1, 2012.

As at August 31, 2012, the Company has drawn \$900,000 from the non-revolving acquisition and development demand loan.

#### 12. CAPITAL STOCK

(a) Authorized

Unlimited number of common shares without par value.

(b) Issued and outstanding

During the six months ended August 31, 2012, \$22,711 was received through the exercise of 37,853 common share purchase warrants. Additionally, \$1,250 was received through the exercise of 5,000 stock options.

(c) Stock options

The Company has a stock option plan in place under which it is authorized to grant incentive stock options to officers, directors, employees and to persons in consideration for services. Stock options must be non-transferable and the aggregate number of shares that may be reserved for issuance may not exceed 10% of the issued shares at the time of grant and to each individual may not exceed 5% of the issued shares. The exercise price of stock options is determined by the Board of Directors of the Company at the time of grant and may not be less than the average closing price of the Company's shares on the ten trading days immediately preceding the day on which the option is granted and publicly announced, and may not be less than \$0.10 per share. Options have a maximum term of five years and terminate not later than 90 days (30 days if the optionee is engaged in providing investor relations services) following the termination of the optionee's employment, except in the case of retirement, death or disability, in which case they terminate one year after the event. Vesting of the options is determined at the time of granting of the options at the discretion of the Board of Directors. Once approved and vested, the options are exercisable at any time.

## HEMISPHERE ENERGY CORPORATION

### Notes to the Financial Statements

For the Six Months Ended August 31, 2012

(Expressed in Canadian dollars)

#### 12. CAPITAL STOCK (Continued)

##### (c) Stock options (Continued)

Details of the Company's stock options for the six months ended August 31, 2012 are as follows:

Exercise Price	Expiry Date	Changes in the Period				Balance Outstanding August 31, 2012	Balance Exercisable August 31, 2012
		Balance Outstanding February 29, 2012	Granted	Expired/ Exercised	Cancelled		
\$ 0.27	28-Sep-14	445,000	-	-	-	445,000	445,000
\$ 0.25	8-Mar-15	490,000	-	(5,000)	-	485,000	485,000
\$ 0.26	30-Sep-15	520,000	-	-	-	520,000	520,000
\$ 0.30	23-Dec-15	425,000	-	-	-	425,000	425,000
\$ 0.30	27-Jan-16	200,000	-	-	-	200,000	200,000
\$ 0.38	9-Feb-16	50,000	-	-	-	50,000	50,000
\$ 0.40	26-May-16	520,000	-	-	-	520,000	520,000
\$ 0.48	5-Jul-16	50,000	-	-	-	50,000	50,000
\$ 0.70	8-Feb-17	1,550,000	-	-	-	1,550,000	1,425,000
\$ 0.65	24-Apr-17	-	75,000	-	-	75,000	75,000
\$ 0.61	5-Jul-17	-	425,000	-	-	425,000	425,000
		4,250,000	500,000	(5,000)	-	4,745,000	4,620,000
<b>Weighted-average exercise price</b>		<b>\$ 0.45</b>	<b>\$ 0.62</b>	<b>\$ 0.25</b>	<b>\$ -</b>	<b>\$ 0.47</b>	<b>\$ 0.47</b>

For the six months ended August 31, 2012, the Company recognized \$282,872 (August 31, 2011 - \$181,788) in share-based payment expense from the issuance of 500,000 options to consultants and employees of the Company. The fair value was determined using the Black-Scholes option pricing model with the following weighted-average assumptions:

	August 31, 2012	August 31, 2011
Expected life (years)	3.75	5.00
Interest rate	1.36%	1.72%
Volatility (weekly)	140.23%	143.47%
Dividend yield	0.00%	0.00%

The weighted-average grant date fair value for stock options granted during the six months ended August 31, 2012 was \$0.62 (August 31, 2011 - \$0.42). The forfeiture rate has been estimated at 0% (August 31, 2011 - 0%)

Included in share-based payments were 250,000 stock options granted to a company performing investor relations services (August 31, 2011 - 30,000). These options were granted on February 8, 2012, have an exercise price of \$0.70 per share and expire on February 8, 2017. The options vest at 25% at each three-month interval from the grant date. The total number of options that remain unvested at August 31, 2012 is 125,000 (August 31, 2011 - nil).

## HEMISPHERE ENERGY CORPORATION

### Notes to the Financial Statements

For the Six Months Ended August 31, 2012

(Expressed in Canadian dollars)

#### 12. CAPITAL STOCK (Continued)

##### (c) Stock options (Continued)

Option pricing models require the input of highly subjective assumptions including the expected price volatility. Changes in the subjective input assumptions can materially affect the fair value estimate.

##### (d) Share purchase warrants

Details of the Company's share purchase warrants for the six months ended August 31, 2012 are as follows:

Exercise Price	Expiry Date	Balance Outstanding & Exercisable			Expired/ Canceled	Balance Outstanding & Exercisable	
		February 29, 2012	Issued	Exercised		August 31, 2012	
\$0.60	29-Oct-12	2,108,872	-	(37,853)	-	2,071,019	
\$0.80	10-Nov-12	132,650	-	-	-	132,650	
\$0.95	27-Jan-14	6,161,578	-	-	-	6,161,578	
\$0.95	27-Jan-14	86,256	-	-	-	86,256	
\$0.70	27-Jan-14	862,620	-	-	-	862,620	
		9,351,976	-	(37,853)	-	9,314,123	
<b>Weighted-average exercise price</b>		<b>\$ 0.85</b>	<b>\$ -</b>	<b>\$ 0.60</b>	<b>\$ -</b>	<b>\$ 0.84</b>	

##### (e) Income (loss) per share

	<i>Three Months Ended August 31,</i>		<i>Six Months Ended August 31,</i>	
	<i>2012</i>	<i>2011</i>	<i>2012</i>	<i>2011</i>
Comprehensive income (loss)	\$ (136,556)	\$ (75,583)	\$ 169,349	\$ (384,347)
Weighted average number of common shares outstanding, basic	50,417,554	27,469,200	50,412,451	27,469,200
Dilutive options and warrants	-	-	1,387,963	-
Weighted average number of common shares outstanding, fully diluted	50,417,554	27,469,200	51,800,413	27,469,200
<b>Income (loss) per share, basic</b>	<b>\$ (0.00)</b>	<b>\$ (0.00)</b>	<b>\$ 0.00</b>	<b>\$ (0.01)</b>
<b>Income (loss) per share, fully diluted</b>	<b>\$ (0.00)</b>	<b>\$ (0.00)</b>	<b>\$ 0.00</b>	<b>\$ (0.01)</b>

For the six months ended August 31, 2012, 2,050,000 stock options and 7,243,104 share purchase warrants were excluded from the fully diluted weighted-average common shares outstanding calculation because their exercise price is higher than the average market price for the period.

## HEMISPHERE ENERGY CORPORATION

### Notes to the Financial Statements

For the Six Months Ended August 31, 2012

(Expressed in Canadian dollars)

#### 13. COMMITMENT

The Company has a commitment to make monthly rental payments pursuant to an agreement to rent office space. The agreement expires July 31, 2014, and will require total payments in the remaining fiscal periods, ending February 28, in the amounts of \$85,940 for 2013 and \$35,808 for 2014.

#### 14. RELATED PARTY TRANSACTIONS

The following represents related party transactions entered into for the six months ended August 31, 2012:

- (a) Management fees of \$20,000 (August 31, 2011 - \$50,000) were charged by a director of the Company, and
- (b) Compensation of key management personnel, consisting of the Company's officers, were awarded in the following denominations:

	<i>Six Months Ended August 31,</i>	
	<i>2012</i>	<i>2011</i>
Salaries and wages	\$ 218,750	\$ 81,250
Share-based payments	196,387	94,328

During the six months ended August 31, 2012, no long-term benefits were paid to related parties (August 31, 2011 - \$nil).

#### 15. SUPPLEMENTAL CASH FLOW INFORMATION

	<i>Six Months Ended August 31,</i>	
	<i>2012</i>	<i>2011</i>
Non-cash transactions		
Increase (decrease) in decommissioning obligation charged to property and equipment	\$ 20,428	\$ 58,695
Property and equipment expenses included in accounts payable	1,938,023	338,407
Exploration and evaluation expenses included in accounts payable	106,650	-

#### 16. SUBSEQUENT EVENTS

Subsequent to August 31, 2012 the Company's share capital increased by \$1,028,516 as a result of the exercise of 1,714,194 share purchase warrants at a price of \$0.60 per share.

#### 17. INCOME TAXES

As at February 29, 2012, the Company recorded a deferred tax recovery in the amount of \$1,394,554. The tax effected items that gave rise to significant portions of the deferred tax asset are disclosed in Note 17 of the Company's annual audited financial statements for the year ended February 29, 2012.

## HEMISPHERE ENERGY CORPORATION

### Notes to the Financial Statements

For the Six Months Ended August 31, 2012

(Expressed in Canadian dollars)

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#### 17. INCOME TAXES (Continued)

As at February 29, 2012, the Company had non-capital losses of \$3,421,000 that may be applied to reduce future Canadian taxable income purposes, expiring as follows:

Available to	
2015	\$ 502,000
2026	547,000
2027	341,000
2028	216,000
2029	312,000
2030	323,000
2031	557,000
2032	623,000
	<hr/>
	\$ 3,421,000

#### 18. COMPARATIVE FIGURES

Certain comparative figures have been re-classified to conform to the current year's presentation.