Hemisphere energy corporation

Q1 2013

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ACHIEVEMENTS AND HIGHLIGHTS

- Generated $2.1 million in revenue.
- Achieved funds flow from operating activities of $791,568 or $0.01 per share.
- Reported net income of $134,425 or $0.00 per share.
- Produced 414 boe/d (91% oil and NGL).
- Expanded land base in Jenner, Alberta by acquiring 8 sections (4,963 acres).
- Upgraded the infrastructure at Jenner adding a sweetening tower for associated gas production.
- Drilled the first horizontal well of 2013 in Jenner, subsequently tested an average 145 bbl/d oil and 1.5 mmcf/d natural gas for a total of 400 boe/d.
- Closed the final tranche of a non-brokered private placement announced in December raising the company total gross proceeds of $1.2 million to fund future drilling and other capital expenditures in Jenner.

SUBSEQUENT ACHIEVEMENTS

- Increased credit facility by 73% to $9.5 million to allow for greater financial flexibility.
- Graduated to Tier 1 of the TSX Venture Exchange – the premier tier reserved for the most advanced issuers with the most significant financial resources on the TSX Venture Exchange.

ANNUAL GENERAL MEETING OF SHAREHOLDERS

June 10, 2013 at 9:00 am Pacific Daylight Time
Walker Room at the Terminal City Club
837 Hastings Street West, Vancouver, British Columbia

Q1 2013 FINANCIAL AND OPERATING HIGHLIGHTS

	Three Months Ended	
	March 31, 2013	February 29, 2012[1]
FINANCIAL		
Petroleum and natural gas revenue	**$ 2,073,617**	$ 2,763,564
Petroleum and natural gas netback	**1,115,557**	1,796,187
Funds flow from operating activities[2]	**791,568**	1,355,098
Per share, basic and diluted	**0.01**	0.03
Income (loss) before tax	**134,425**	(664,040)
Per share, basic and diluted	**0.00**	(0.02)
Net income (loss) after tax	**134,425**	730,504
Per share, basic and diluted	**0.00**	0.02
Capital expenditures	**1,644,844**	8,461,567
Property development	**1,580,319**	2,354,795
Acquisitions	**64,525**	6,106,771
Working capital (deficiency) at end of period	**(4,718,134)**	2,363,944
Net debt at end of period	**$ 3,405,000**	$ -
OPERATING		
Average daily production		
Oil (bbl/d)	**371**	363
Natural gas (mcf/d)	**232**	258
NGL (bbl/d)	**4**	4
Combined (boe/d)	**414**	410
Oil and NGL weighting	**91%**	90%
Average sales prices		
Oil ($/bbl)	**$ 59.12**	$ 81.28
Natural gas ($/mcf)	**3.42**	2.49
NGL ($/bbl)	**74.43**	62.42
Combined ($/boe)[3]	**$ 55.66**	$ 74.05
Operating netback ($/boe)		
Petroleum and natural gas revenue[3]	**$ 55.66**	$ 74.05
Royalties	**7.92**	11.99
Operating costs	**14.96**	10.46
Transportation costs	**2.84**	3.47
Operating netback	**$ 29.95**	$ 48.13

Notes:

(1) Hemisphere's year-end changed from February 28 to December 31. As a result, year-end adjustments may not provide accurate comparisons to the current quarter.

(2) Funds flow from operating activities represents net income or loss before depletion, depreciation and accretion, share-based payments and future income tax.

(3) The Company's combined average realized price for the three months ended March 31, 2013 decreased by $18.39/boe from the comparable period. The decrease was mainly attributed to the price differentials between the West Texas Intermediate pricing and the Western Canada Select heavy crude oil pricing during the period. Oil differentials had increased due to pipeline constraints and supply and demand factors resulting in a lower realized crude oil price. The oil differentials began narrowing in March 2013 and are progressing favorably in the second quarter.

	As at	
	March 31, 2013	February 29, 2012[1]
COMMON SHARES		
Common shares outstanding	**53,961,048**	50,374,701
Warrants outstanding	**8,183,445**	9,351,976
Stock options outstanding	**4,995,000**	4,250,000
Weighted-average shares outstanding - basic	**54,023,809**	42,378,560
Weighted-average shares outstanding - diluted	**55,133,146**	43,863,784

MANAGEMENT'S DISCUSSION AND ANALYSIS

Dated as at May 23, 2013

The following discussion and analysis is a review of the current financial position and operating results of Hemisphere Energy Corporation ("Hemisphere" or the "Company") for the three months ended March 31, 2013, with comparatives for the three months ended February 29, 2012, and should be read in conjunction with the unaudited condensed interim financial statements and related notes for the three months ended March 31, 2013. These documents are available on SEDAR at www.sedar.com or the Company's website at www.hemisphereenergy.ca.

Please note that Hemisphere has changed its fiscal year-end from February 28 to December 31. As a result, the first quarter ended March 31, 2013 is compared to the fourth quarter ended February 29, 2012 and may not provide accurate comparisons due to year-end adjustments.

The information in this report is based on the unaudited condensed interim financial statements which were prepared in accordance with International Financial Reporting Standards ("IFRS") applicable to the preparation of condensed interim financial statements including IAS 34 "*Interim Financial Reporting*", as issued by the International Accounting Standards Board ("IASB").

Forward-Looking Statements

This document contains "forward-looking statements" that are based on Hemisphere's current expectations, estimates, forecasts and projections. These forward-looking statements include statements regarding Hemisphere's outlook for its future operations, plans and timing for the commencement or advancement of exploration and development activities on its properties, and other expectations, intention and plans that are not historical fact. The words "estimates", "projects", "expects", "intends", "believes", "plans", or their negatives or other comparable words and phrases are intended to identify forward-looking statements. Such forward-looking statements are subject to risks, uncertainties and other factors that could cause actual results to differ materially from future results expressed or implied by such forward-looking statements. Many of these factors are beyond the control of Hemisphere. Consequently, all forward-looking statements made in this document are qualified by this cautionary statement and there can be no assurance that actual results or developments anticipated by Hemisphere will be realized. For the reasons set forth above, investors should not place undue reliance on such forward-looking statements. Hemisphere disclaims any intention or obligation to update or revise forward-looking information, whether as a result of new information, future events or otherwise.

Boe Conversion

Within this document, petroleum and natural gas volumes and reserves are converted to a common unit of measure, referred to as a barrel of oil equivalent ("boe"), using a ratio of 6,000 cubic feet of natural gas to one barrel of oil. Use of the term boe may be misleading, particularly if used in isolation. The conversion ratio is based on an energy equivalent method and does not necessarily represent a value equivalency at the wellhead.

Non-IFRS Measurements

This document contains the terms "funds flow from operating activities" and "operating netback" that are not recognized measures under IFRS. The Company's management considers these to be key measures that demonstrate the Company's ability to generate the funds flow necessary to support future growth through capital investment and to repay debt, if any. Funds flow from operating activities represents net income or loss before depletion, depreciation, accretion, share-based payments and any deferred tax adjustments. Operating netback is a benchmark used in the oil and natural gas industry and represents the profit margin associated with the production and sale of oil and natural gas sales, following the deduction of royalties, operating expenses and transportation costs. These terms should not be considered an alternative to, or more meaningful than, cash flow from operating activities or net income as determined in accordance with IFRS as an indicator of the Company's performance.

Business Overview

Hemisphere produces oil from its Jenner property in southeast Alberta and liquids-rich natural gas primarily from its Trutch property in northeastern British Columbia. The Company is headquartered in Vancouver, British Columbia and is traded on the TSX Venture Exchange under the symbol "HME".

Jenner, Alberta

The Jenner property, operated by Hemisphere, is accessible year-round and is located east of Brooks in southeastern Alberta. Hemisphere has a working interest in approximately 16,300 net acres (6,596 ha) and has continued to build a land position in the Jenner area through Crown land sales and strategic acquisitions and farm-ins.

During the quarter, Hemisphere successfully drilled one horizontal well in Jenner. The Company also expanded its landholdings through Crown land sales acquiring 7.75 sections (4,803 acres).

The Company continues to evaluate the oil development opportunities on the property on an ongoing basis.

Trutch, British Columbia

Hemisphere has varying working interests from 30% to 100% in approximately 34,788 net acres (14,078 ha) of the Trutch property which is located approximately 200 kilometres northwest of Fort St. John in British Columbia. Hemisphere currently has production from the unconventional liquids rich Halfway formation in Trutch and recognizes potential in the Montney and Slave Point formations. Competitors to the southeast of the Trutch area have been actively exploring and developing the prolific Tommy Lakes Halfway unconventional gas field for a number of years and have recently began using horizontal wells and multi-stage frac completions for development.

Operating Results

The Company generated funds flow from operating activities of $791,568 ($0.01/share) for the three months ended March 31, 2013, as compared to $1,355,098 ($0.03/share) for the three months ended February 29, 2012.

The Company reported net income of $134,425 ($0.00/share) for the three months ended March 31, 2013. This is compared to a net income of $730,504 ($0.02/share) for the three months ended February 29, 2012, which included a deferred tax recovery of $1,394,544. With the exclusion of the deferred tax adjustment, the Company incurred a loss of $664,040 (-$0.02/share) for the three months ended February 29, 2012.

Production

	Three Months Ended	
	March 31, 2013	February 29, 2012
Oil (bbl/d)	**371**	363
Natural gas (Mcf/d)	**232**	258
NGL (bbl/d)	**4**	4
Total (boe/d)	**414**	410
Oil and NGL weighting	**91%**	90%

The Company's production for the three months ended March 31, 2013 remained consistent with the comparable period, increasing 4 boe per day ("boe/d") to 414 boe/d with an oil and NGL weighting of 91%.

Revenue

	Three Months Ended	
	March 31, 2013	February 29, 2012
Oil	**$ 1,975,611**	$ 2,682,465
Natural gas	**71,355**	59,190
NGL	**26,652**	21,909
Total	**$ 2,073,617**	$ 2,763,564

Total revenue decreased by $689,947 or 25% to $2,073,617 for the three months ended March 31, 2013. This decrease in revenue is consistent with a 25% decrease in the Company's average realized sales price.

Average Benchmark and Realized Prices

	Three Months Ended	
	March 31, 2013	February 29, 2012
Benchmark Prices		
WTI (US$/bbl)(1)	**$ 94.35**	$ 100.33
Exchange rate (1 US$/Cdn$)	**1.0106**	1.0133
WTI (C$/bbl)	**95.35**	101.66
AECO natural gas ($/Mcf)(2)	**3.14**	2.59
Average realized prices		
Crude oil ($/bbl)	**59.12**	81.28
Natural gas ($/Mcf)	**3.42**	2.49
NGL ($/bbl)	**74.43**	62.42
Combined ($/boe)	**$ 55.66**	$ 74.05

Notes:

(1) WTI represents posting prices of West Texas Intermediate Oil.

(2) Represents the AECO daily posting.

The Company's combined average realized price for the three months ended March 31, 2013 decreased by $18.39/boe from the comparable period. The decrease was mainly attributed to the price differentials between the West Texas Intermediate pricing and the Western Canada Select heavy crude oil pricing during the period. Oil differentials had increased due to pipeline constraints and supply and demand factors resulting in a lower realized crude oil price. The oil differentials began narrowing in March 2013 and are progressing favorably in the second quarter.

Operating Netback

	Three Months Ended	
	March 31, 2013	February 29, 2012
Netback		
Revenue	**$ 2,073,617**	$ 2,763,564
Royalties	**294,990**	447,419
Operating costs	**557,173**	390,417
Transportation costs	**105,897**	129,542
Operating netback	**$ 1,115,557**	$ 1,796,187
Netback ($/boe)		
Revenue	**$ 55.66**	$ 74.05
Royalties	**7.92**	11.99
Operating costs	**14.96**	10.46
Transportation costs	**2.84**	3.47
Operating netback	**$ 29.95**	$ 48.13

Royalties consist of Alberta and British Columbia Crown royalties, as well as gross overriding royalties which are dependent on production volumes and commodity prices. For the three months ended March 31, 2013, royalties decreased by 34% to $294,990 ($7.92/boe) from the comparative quarter. This decrease can be attributed to the lower combined average realized price charged on royalty volumes which are calculated as a percentage of production.

Operating costs include all costs for gathering, processing, dehydration, compression, water processing and marketing of the oil, natural gas and NGLs, as well as additional costs incurred periodically for maintenance and repairs. Operating costs during the three months ended March 31, 2013 increased by $166,756 ($4.50/boe) from its comparable period. The increase in operating expenses per boe for the first quarter are mainly due to poor weather conditions, annual emergency response program training and a onetime process change with a gas/oil interface probe at the Company's main battery facility.

Transportation costs include all costs incurred to transport oil and gas to processing and distribution facilities. Transportation costs for the three months ended March 31, 2013 decreased by $23,645 ($0.63/boe) to $105,897 ($2.84/boe). The decrease can be attributed to lower production volumes required for transportation from wells being tied in to the Company's facilities.

Operating netback for the three months ended March 31, 2013 decreased by $18.18/boe from its comparable period. This decrease is largely due to the decrease in the Company's combined average realized price per boe.

Depletion and Depreciation

	Three Months Ended	
	March 31, 2013	February 29, 2012
Depletion expense	**$ 589,182**	$ 857,651
Depreciation expense	**1,262**	1,141
Total	**$ 590,444**	$ 858,792
$ per boe	**$ 15.85**	$ 23.01

The depletion rate is calculated using the unit-of-production method on proved and probable oil and natural gas reserves, taking into account the future development costs to produce the reserves. Depletion and depreciation expense for the three months ended March 31, 2013 decreased by $268,379 ($7.16/boe) to $590,444 ($15.85/boe). This decrease is due to the higher depletion recorded in the comparable quarter which was in relation to the annual reserve report analysis for the fiscal year ended February 29, 2012.

Capital Expenditures

	Three Months Ended	
	March 31, 2013	February 29, 2012
Land and lease	**$ (2,648)**	$ 12,105
Geological and geophysical	**88,988**	4,707
Drilling and completions	**899,908**	864,116
Investment in facilities	**594,070**	1,473,867
Development capital	**1,580,319**	2,354,795
Property acquisitions	**64,525**	6,106,771
Total capital expenditures	**$ 1,644,844**	$ 8,461,567

The development capital spent during the three months ended March 31, 2013 consists primarily of $899,908 on drilling and completing one new well and $594,070 on building infrastructure in the Company's core Jenner area. This infrastructure included an injection pump at the Company's main production facility, as well as a sweetening tower for associated gas production. The considerable decrease in capital expenditures is due to a major acquisition in the Company's core Jenner area that was completed in the three months ended February 29, 2012.

Share-based Payments

Share-based payments for the three months ended March 31, 2013 were $65,070 as compared to $907,950 for the three months ended February 29, 2012. This decrease in share-based payments is attributed to lesser stock options granted during the three months ended March 31, 2013 than the comparable three month period ended February 29, 2012.

General and Administrative

	Three Months Ended	
	March 31, 2013	February 29, 2012
Gross G&A	**$ 281,701**	$ 450,476
Overhead Recovery	**(1,198)**	(5,172)
Total	**$ 280,503**	$ 445,304
$ per boe	**$ 7.53**	$ 11.93

General and administrative expenses for the three months ended March 31, 2013 decreased by $164,801 ($4.40/boe) to $280,503 ($7.53/boe) from the three months ended February 29, 2012. The change in general and administrative costs in the first quarter is the result of decreased professional fees, transfer agent costs and salaries and wages associated with year-end expenses.

Finance Income and Expense

	Three Months Ended	
	March 31, 2013	February 29, 2012
Finance expense		
Interest expense	**$ 31,079**	$ -
Part XII.6 tax	**-**	(4,219)
Accretion of provision	**1,629**	1,005
Total finance expense	**$ 32,708**	$ (3,214)

The increase in finance expense for the three months ended March 31, 2013 can be attributed to monthly interest charged on the Company's bank debt, as well as the increase in accretion expense. Accretion expense represents the time value change of the Company's decommissioning liability which has increased as a result of the addition of new oil wells in the current and previous fiscal years.

Selected Annual Information

The following are highlights of the Company's financial data for the three most recently completed fiscal years:

	10 Months Ended December 31, 2012	12 Months Ended February 29, 2012	12 Months Ended February 28, 2011
Average daily production (boe/d)	**408**	188	35
Petroleum and natural gas revenue	**$ 7,875,723**	$ 4,590,608	$ 289,426
Petroleum and natural gas netback	**4,657,308**	2,942,544	60,877
Funds flow from operating activities	**3,265,658**	1,963,505	(516,574)
Per share, basic and diluted	**0.06**	0.06	(0.03)
Income (loss) before tax	**543,818**	(451,879)	(1,486,455)
Per share, basic and diluted	**0.01**	(0.01)	(0.07)
Net income (loss) after tax	**61,362**	942,665	(1,486,455)
Per share, basic and diluted	**0.00**	0.03	(0.07)
Average realized price ($/boe)	**63.15**	66.71	22.66
Operating netback ($/boe)	**37.33**	42.76	4.77
Working capital	**(3,927,595)**	2,363,944	1,729,423
Capital expenditures	**11,888,398**	13,807,836	530,349
Net bank debt	**$ 1,035,000**	$ -	$ -

Summary of Quarterly Results

	2013	2012					2011	
	Mar. 31	Dec. 31	Nov. 30	Aug. 31	May 31	Feb. 29	Nov. 30	Aug. 31
	Q1	Q4[(1)]	Q3	Q2	Q1	Q4	Q3	Q2
Average daily production (boe/d)	**414**	430	430	367	418	410	208	71
Petroleum and natural gas revenue	**2,073,617**	694,677	2,730,244	2,029,140	2,421,663	2,763,564	1,273,677	297,526
Petroleum and natural gas netback	**1,115,557**	356,307	1,784,702	1,139,827	1,367,473	1,796,187	890,541	166,845
Funds flow from operating activities	**791,568**	(75,268)	1,448,807	823,609	1,068,509	1,355,098	699,535	(3,965)
Per share, basic and diluted	**0.01**	0.00	0.03	0.02	0.02	0.03	0.02	0.00
Income (loss) before tax	**134,425**	(321,364)	695,833	(136,566)	305,905	(664,040)	596,509	(75,583)
Basic and diluted income (loss) per share	**0.00**	(0.01)	0.01	(0.00)	0.01	(0.02)	0.02	(0.00)
Net income (loss)	**134,425**	(803,821)	695,833	(136,556)	305,905	730,504	596,509	(75,583)
Basic and diluted income (loss) per share	**0.00**	(0.02)	0.01	(0.00)	0.01	0.02	0.02	(0.00)
Average realized price ($/boe)	**55.66**	52.10	69.78	60.10	62.90	74.05	67.39	46.14
Operating netback ($/boe)	**29.95**	27.40	45.62	33.76	35.52	48.13	47.12	25.87

Note:

(1) Due to the Company's fiscal year-end change, this quarter only represents results from one month of operations as compared to all other quarters which represent results from three months of operations.

The quarterly figures above for the current and previous fiscal years are all presented with the application of IFRS.

Share Capital and Financing Activities

During the three months ended March 31, 2013, the Company issued 86,900 common shares, increasing the Company's total common shares outstanding to 54,047,948. On January 25, 2013, the Company closed the second and final tranche of a private placement consisting of 86,900 units at a price of $0.65 per unit for gross proceeds of $56,485. Each unit consisted of one common share and one-half of one non-transferrable share purchase warrant. Each whole warrant entitles the holder to purchase one additional common share at the price of $0.90 until January 25, 2014.

In conjunction with the closing of the private placement, $456 in finders' fees and legal fees were paid and 700 finders' warrants were issued. Each warrant entitles the holder to purchase one common share at a price of $0.90 until January 25, 2014.

Stock Options

Exercise Price	Expiry Date	Balance Outstanding December 31, 2012	Granted	Exercised	Expired/ Cancelled	Balance Outstanding & Exercisable March 31, 2013
$0.27	28-Sep-14	445,000	-	-	-	445,000
$0.25	8-Mar-15	485,000	-	-	-	485,000
$0.26	30-Sep-15	520,000	-	-	-	520,000
$0.30	23-Dec-15	425,000	-	-	-	425,000
$0.30	27-Jan-16	200,000	-	-	-	200,000
$0.38	9-Feb-16	50,000	-	-	-	50,000
$0.40	26-May-16	520,000	-	-	-	520,000
$0.48	5-Jul-16	50,000	-	-	-	50,000
$0.70	8-Feb-17	1,550,000	-	-	-	1,550,000
$0.65	24-Apr-17	75,000	-	-	-	75,000
$0.61	5-Jul-17	425,000	-	-	-	425,000
$0.50	8-Mar-18	-	250,000	-	-	250,000
		4,745,000	250,000		-	4,995,000
Weighted-average exercise price		$0.47	$0.50	-	-	$0.47

For the three months ended March 31, 2013, the Company recognized $65,070 in share-based payments as compared to $907,950 for the three months ended February 29, 2012. This expense can be attributed to the issuance of 250,000 options to a consultant of the Company. The fair value was determined using the Black-Scholes option pricing model with the following weighted-average assumptions:

	March 31, 2013	February 29, 2012
Expected life (years)	**3.75**	5.00
Interest rate	**1.25%**	1.54%
Volatility	**79.24%**	139.72%
Dividend yield	**0.00%**	0.00%

The weighted-average grant price for stock options granted during the three months ended March 31, 2013 was $0.50 (February 29, 2012 - $0.62). The forfeiture rate has been estimated at 0% (February 29, 2012 – 0%).

Included in share-based payments were 250,000 stock options granted to a company performing investor relations services (February 29, 2012 – 250,000). 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 25% at each three-month interval from the grant date. The total number of options that remain unvested at March 31, 2013 is nil (February 29, 2012 – 250,000).

Share Purchase Warrants

Exercise Price	Expiry Date	Balance Outstanding & Exercisable December 31,2012	Issued	Exercised	Expired/ Cancelled	Balance Outstanding & Exercisable March 31, 2013
$0.90	20-Dec-13	914,650	-	-	-	914,650
$0.90	20-Dec-13	114,191	-	-	-	114,191
$0.90	25-Jan-14	-	43,450	-	-	43,450
$0.90	25-Jan-14	-	700	-	-	700
$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
		8,139,295	44,150	-	-	8,183,445
Weighted-average exercise price		$0.92	$0.90	-	-	$0.92

	May 23 , 2013	**March 31, 2013**	December 31, 2012
Fully diluted share capital			
Common shares issued and outstanding	54,047,948	**54,047,948**	53,961,048
Share purchase warrants	8,183,445	**8,183,445**	8,139,295
Stock options	4,995,000	**4,995,000**	4,745,000
Total fully diluted	67,226,393	**67,226,393**	66,845,343

Liquidity and Capital Management

	March 31, 2013	December 31, 2012
Shareholders' equity	**$ 20,215,908**	$ 19,960,382
Undrawn component of bank credit facilities	**2,095,000**	4,465,000
Total capital	**$ 22,310,908**	$ 24,425,382

As at March 31, 2013, the Company has total credit facilities of $5,500,000 (December 31, 2012 – $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. As at March 31, 2013, the Company has drawn $2,050,000 from the revolving operating demand loan and $1,355,000 from the non-revolving acquisition and development demand loan for a total bank indebtedness of $3,405,000 (December 31, 2012 - $1,035,000).

In April 2013, the Company's credit facility increased from $5,500,000 to $9,500,000 as a result of the reserve additions and production increases from its 2012 drilling activity. The new credit facilities are comprised of a revolving operating demand loan of $6,500,000 and a non-revolving acquisition and development demand loan of $3,000,000. The Company's next annual review is scheduled to occur on or before September 1, 2013.

The Company manages its capital with the following objectives:

- To ensure sufficient 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 Company's 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 shareholders' equity and the undrawn component of the Company's credit facilities. The Company may manage its capital structure by issuing new shares, repurchasing outstanding shares, obtaining additional financing from the Company's credit facilities, 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.

Related Party Transactions

During the three months ended March 31, 2013, Hemisphere paid $10,000 in management fees charged by a director of the Company. During the three months ended February 29, 2012, the Company paid $40,000 in management fees of which a portion was charged by a director of the Company and the remainder charged by a managing consultant who transitioned to full-time employment in January 2012.

Compensation paid to Hemisphere's officers is as follows:

	Three Months Ended	
	March 31, 2013	February 29, 2012
Short-term benefits	**$ 135,000**	$ 204,583
Share-based payments	-	336,820

Short-term benefits, primarily salaries and wages, decreased during the three months ended March 31, 2012 as compensation associated with year-end were paid during the three months ended February 29, 2012.

Corporate Internal Controls

Management has evaluated the effectiveness of the Company's disclosure controls and procedures as at March 31, 2013 and has concluded, based on its evaluation, that these controls and procedures provide reasonable assurance that material information relating to the Company is made known to management and reported, as required. Management is also responsible for the design of internal controls over financial reporting in order to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with IFRS. Management believes the design to be sufficient and appropriate to provide such reasonable assurance.

Off-Balance Sheet Arrangements

The Company has not entered into any off-balance sheet transactions.

Proposed Transactions

As of the effective date, there are no outstanding proposed transactions.

Critical Accounting Estimates

The Company's significant accounting estimates and policies are set out in Notes 2 and 3 of the condensed interim financial statements for the three months ended March 31, 2013 and the audited annual financial statements for the ten months ended December 31, 2012. These policies have been consistently followed in the preparation of these financial statements.

The preparation of 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 petroleum and natural gas interest costs, the fair value of financial instruments, balance of accrued liabilities, determination of decommissioning and environmental obligations, the rates of depletion and accretion of petroleum and natural gas interests, assumptions used in the calculation of fair value of share-based and finder's warrants, and the recoverability of deferred income tax assets. While management believes that these estimates are reasonable, actual results could differ from those estimates and could impact future results of operations and cash flows.

Reserve estimates impact a number of the areas referred to above, in particular the valuation of petroleum and natural gas interests, determination of decommissioning and environmental obligation, and the calculation of depletion.

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 March 31, 2013, the Company's financial instruments include accounts receivable, reclamation deposits, bank indebtedness, accounts payable and accrued liabilities.

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

Risks

The Company's activities expose it to a variety of risks that arise as a result of its exploration, development, production and financing activities. The following provides information about the Company's exposure to any risks associated with the oil and gas industry as well as the Company's objectives, policies and processes for measuring and managing risk.

Business Risk

Oil and gas exploration and development involves a high degree of risk whereby many properties are ultimately not developed to a producing stage. There can be no assurance that the Company's future exploration and development activities will result in discoveries of commercial bodies of oil and gas. Whether an oil and gas property will be commercially viable depends on a number of factors including the particular attributes of the reserve and its proximity to infrastructure, as well as commodity prices and government regulations, including regulations relating to prices, taxes, royalties, land tenure, land use, and environmental protection. The exact effect of these factors cannot be accurately predicted, and the combination of these factors may result in an oil and gas property not being profitable.

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, its cash balance and its reclamation deposits. Any risk associated with accounts receivable is minimized substantially by the financial strength of the Company's joint venture partners, operators and marketers. The credit risk associated with cash, and reclamation deposits is mitigated by ensuring 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.

Liquidity Risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they come due. The Company manages liquidity risk by anticipating operating, investing and financing activities and ensuring 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 prepares expenditure budgets on a quarterly and annual basis which are regularly monitored and updated when necessary in order to review of debt forecasts and working capital requirements.

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 of three types of risk: interest rate risk, foreign currency risk, and other price risk.

Interest rate risk
Interest rate risk is the risk that future cash flows will fluctuate as a result of changes in market interest rates. Borrowings under the Company's credit facilities are subject to variable interest rates. A one percent change in interest rates would not have a material effect on net income and comprehensive income.

Foreign currency risk
The Company is not exposed to significant foreign currency risk.

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.

CONDENSED STATEMENTS OF FINANCIAL POSITION

(Expressed in Canadian dollars)
(Unaudited)

	Note		March 31, 2013		December 31, 2012
Assets					
Current assets					
Accounts receivable		**$**	**750,598**	$	904,454
Prepaid expenses			**95,938**		115,769
			846,536		1,020,223
Non-current assets					
Reclamation deposits	9		**105,535**		100,535
Exploration and evaluation assets	7		**2,708,945**		3,189,762
Deferred tax asset	17		**912,087**		912,087
Property and equipment	8		**21,701,059**		20,152,828
Total assets		**$**	**26,274,163**	$	25,375,435
Liabilities					
Current liabilities					
Accounts payable and accrued liabilities		**$**	**2,159,670**	$	3,912,818
Bank indebtedness	11		**3,405,000**		1,035,000
			5,564,670		4,947,818
Non-current liabilities					
Decommissioning obligations	9		**493,585**		467,235
			6,058,255		5,415,053
Shareholders' Equity					
Capital stock	12		**38,861,222**		38,805,193
Share-based payment reserve	12(c)		**2,279,395**		2,214,325
Warrant reserve	12(d)		**183,572**		183,572
Deficit			**(21,108,283)**		(21,242,708)
			20,215,908		19,960,382
Total liabilities and shareholders' equity		**$**	**26,274,163**	$	25,375,435

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

On Behalf of the Board of Directors

(signed) *"Bruce McIntyre"*
Bruce McIntyre, Director

(signed) *"Don Simmons"*
Don Simmons, Director

CONDENSED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME

(Expressed in Canadian dollars)
(Unaudited)

	Note		Three Months Ended March 31, 2013		Three Months Ended February 29, 2012
Oil and natural gas revenue		**$**	**2,073,617**	$	2,763,564
Royalties			**(294,990)**		(447,419)
Total oil and natural gas revenue			**1,778,627**		2,316,145
Expenses					
Production and operating			**663,070**		519,958
Exploration and evaluation	7		**12,407**		-
Depletion and depreciation	8		**590,444**		858,792
Share-based payments	12(c)		**65,070**		907,950
General and administrative			**280,503**		445,304
Impairment of property and equipment	8		**-**		251,394
			1,611,494		2,983,398
Results from operating activities			**167,133**		(667,254)
Finance expense	10		**(32,708)**		3,213
Income (loss) before income taxes			**134,425**		(664,040)
Deferred tax (expense) recovery	17		**-**		1,394,544
Net income and comprehensive income for the period		**$**	**134,425**	$	730,504
Income per share					
Basic and diluted	12(e)	**$**	**0.00**	$	0.02

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

CONDENSED STATEMENTS OF CASH FLOWS

(Expressed in Canadian dollars)
(Unaudited)

	Three Months Ended March 31, 2013	Three Months Ended February 29, 2012
Operating activities		
Net income for the period	$ **134,425**	$ 730,504
Items not affecting cash		
Depletion, depreciation and accretion	**592,072**	859,794
Impairment of property and equipment	**-**	251,394
Deferred tax expense (recovery)	**-**	(1,394,544)
Share-based payments	**65,070**	907,950
	791,568	1,355,098
Changes in non-cash working capital		
Accounts receivable	**153,856**	(624,627)
Prepaid expenses	**19,831**	57,283
Accounts payable and accrued liabilities	**30,989**	172,160
Cash provided by operating activities	**996,243**	959,913
Investing activities		
Acquisition of property and equipment	**(3,313,105)**	(11,501,424)
Reclamation deposits	**(5,000)**	-
Exploration and evaluation expenditures	**(104,168)**	2,893,340
Cash used in investing activities	**(3,422,273)**	(8,608,085)
Financing activities		
Shares issued for cash, net of issue costs	**56,029**	7,906,741
Proceeds from bank indebtedness	**2,370,000**	-
Cash provided by financing activities	**2,426,029**	7,906,741
Inflow (outflow) of cash	**-**	258,570
Cash, beginning of period	**-**	1,925,328
Cash, end of period	$ **-**	$ 2,183,898

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

Supplemental cash flow information (Note 15)

CONDENSED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

(Expressed in Canadian dollars)
(Unaudited)

	Note	Number of common shares	Capital stock	Share-based payment reserve	Warrant reserve	Deficit	Total Equity
Balance November 30, 2011		**37,829,032**	**$ 28,969,002**	**$ 735,627**	**$ -**	**$ (21,827,553)**	**$ 7,877,076**
Non-flow-through share issuance		12,323,157	8,626,210	-	-	-	8,626,210
Flow-through share issuance		-	(110,400)	-	110,400	-	-
Warrant exercises		50,000	55,175	(25,175)	-	-	30,000
Stock option exercises		-	22,586	(22,586)	-	-	-
Share issuance costs		-	(500,025)	-	-	(214,445)	(714,470)
Finder's units issued		172,512	120,758	-	-	-	120,758
Corporate finance expense		-	(120,758)	-	-	-	(120,758)
Finder's warrants issued		-	(343,064)	343,064	-	-	-
Share-based payments		-	-	907,950	-	-	907,950
Expiry of stock options		-	-	(7,425)	-	7,425	-
Net income for the period		-	-	-	-	730,504	730,504
Balance, February 29, 2012		**50,374,701**	**36,719,485**	**1,931,453**	**110,400**	**(21,304,069)**	**17,457,269**
Balance December 31, 2012		**53,961,048**	**$ 38,805,193**	**$ 2,241,325**	**$ 183,572**	**$ (21,242,708)**	**$ 19,960,382**
Share-based payments	12(c)	-	-	65,070	-	-	65,070
Share issuance	12(b)	86,900	56,485	-	-	-	56,485
Share issuance costs	12(b)	-	(456)	-	-	-	(456)
Net income for the period		-	-	-	-	134,425	134,425
Balance, March 31, 2013		**54,047,948**	**$ 38,861,222**	**$ 2,279,395**	**$ 183,572**	**$ (21,108,283)**	**$ 20,215,908**

NOTES TO THE CONDENSED INTERIM FINANCIAL STATEMENTS

For the three months ended March 31, 2013 and February 29, 2012

(Expressed in Canadian dollars)

(Unaudited)

1. Nature and Continuance of Operations

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.

These unaudited condensed interim financial statements ("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 Presentation

(a) Statement of compliance

These financial statements are prepared in accordance with International Financial Reporting Standards ("IFRS"), as issued by the International Accounting Standards Board ("IASB"). The 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 annual financial statements for the ten months ended December 31, 2012.

The financial statements were authorized for issuance by the Board of Directors on May 23, 2013.

(b) Basis of presentation

On August 20, 2012, the Company announced that it would be changing its fiscal year-end date from February 28 to December 31. As a result, the first quarter ended March 31, 2013 will be compared to the fourth quarter ended February 29, 2012 which may not provide accurate comparisons due to year-end adjustments.

These 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.

(c) Functional and presentation currency

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

(d) Use of estimates and judgments

The preparation of these 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 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 ten months ended December 31, 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 March 31, 2013, the Company's financial instruments include cash, accounts receivable, reclamation deposits, bank indebtedness, and accounts payable and accrued liabilities.

The fair values of accounts receivable, accounts payable and accrued liabilities, and bank indebtedness 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.

5. Financial Risk Management

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.

(a) 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 balance and reclamation deposits. The credit risk associated with cash and reclamation deposits is minimized substantially by ensuring these financial assets are placed with major financial institutions with strong investment-grade ratings by a primary ratings agency. The credit risk associated with accounts receivable is mitigated as the Company monitors monthly balances to limit the risk associated with collections. The Company does not anticipate any default. The maximum exposure to credit risk is as follows:

		March 31, 2013		December 31, 2012
Accounts receivable	**$**	**750,598**	$	904,454
Reclamation deposits		**105,535**		100,535
Total	**$**	**856,133**	$	1,004,989

(b) 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 an accounts receivable balance at March 31, 2013 of $750,598 (December 31, 2012 - $904,454). At March 31, 2013, the Company had accounts payable and accrued liabilities of $2,159,670 (December 31, 2012 – $3,912,818) and a negative working capital of $4,718,134 (December 31, 2012 – $3,927,595). All of the Company's financial liabilities have contractual maturities of less than 90 days.

(c) 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 of three types of risk: interest rate risk, foreign currency risk and other price risk.

(i) Interest rate risk

Interest rate risk is the risk that future cash flows will fluctuate as a result of changes in market interest rates. Borrowings under the Company's credit facilities are subject to variable interest rates. A one percent change in interest rates would not have a material effect on net income and comprehensive income.

(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 value 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:

(a) 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

(b) To maximize shareholder return through enhancing the Company's 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 shareholders' equity and the undrawn component of the Company's credit facilities. The Company may manage its capital structure by issuing new shares, repurchasing outstanding shares, obtaining additional financing from the Company's credit facilities, issuing new debt instruments or 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 March 31, 2013 and December 31, 2012 are as follows:

		March 31, 2013		December 31, 2012
Shareholders' equity	**$**	**20,215,908**	$	19,960,382
Undrawn component of bank credit facilities		**2,095,000**		4,465,000
Total capital	**$**	**22,310,908**	$	24,425,382

As at March 31, 2013, the Company had total available credit facilities of $5,500,000 (December 31, 2012 - $5,500,000) of which the Company had drawn $3,405,000 (December 31, 2012 - $1,035,000).

7. Exploration and Evaluation Assets

Exploration and evaluation assets consist of the Company's exploration projects, which are pending the determination of proved reserves. At March 31, 2013, the Company transferred $1,457,288 (December 31, 2012 - $3,642,159) to property and equipment.

Cost		
Balance February 29, 2012	$	2,161,743
Additions		4,791,060
Exploration and evaluation expense		(120,882)
Transfer to property and equipment		(3,642,159)
Balance, December 31, 2012		3,189,762
Additions		988,179
Exploration and evaluation expense		(11,707)
Transfer to property and equipment		(1,457,288)
Balance, March 31, 2013	$	2,708,945

8. Property and Equipment

		Petroleum and Natural Gas		Other Equipment		Total
Cost						
Balance, December 31, 2012		26,428,633		67,522		26,496,155
Additions		681,387		-		681,387
Transfer from exploration property and evaluation Assets		1,457,288		-		1,457,288
Balance March 31, 2013	**$**	**28,567,309**	**$**	**67,522**	**$**	**28,634,831**
Accumulated Depletion, Depreciation, Amortization and Impairment Losses						
Balance, December 31, 2012		6,293,348		49,980		6,343,328
Charge for period		589,181		1,262		590,444
Balance March 31, 2013	**$**	**6,882,529**	**$**	**51,242**	**$**	**6,933,772**
Net Book Value						
December 31, 2012		20,135,286		17,542		20,152,828
March 31, 2013	**$**	**21,684,780**	**$**	**16,280**	**$**	**21,701,059**

During the three months ended March 31, 2013, the Company purchased land in Jenner for total capital expenditures of $64,525 through a land sale from the Alberta Department of Energy.

The Company performs an impairment test annually on its petroleum and natural gas interests. The impairment test is performed by comparing the estimated net present value of future cash flows from wells classified as proved and probable against their respective carrying amounts. Accordingly, the Company recognized an impairment charge for the three months ended March 31, 2013 and February 29, 2012 of $nil and $251,394, respectively.

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 estimates the total undiscounted amount of cash flows required to settle its decommissioning obligations as at March 31, 2013 is $748,000 (December 31, 2012 - $728,000). 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 2.52%. Inflation of 1.00% has also been factored into the calculation. The Company also has $105,535 (December 31, 2012 - $100,535) in various reclamation bonds for its properties held by the British Columbia Ministry of Energy, Mines and Petroleum Resources.

		March 31, 2013		December 31, 2012
Decommissioning obligations, beginning of period	**$**	**467,235**	$	358,428
Increase in estimated future obligations		**24,722**		94,484
Accretion expense		**1,628**		14,323
Decommissioning obligations, end of period	**$**	**493,585**	$	467,235

10. Finance Income and Expenses

		Three Months Ended		
		March 31, 2013		February 29, 2012
Finance expense:				
Interest expense	**$**	**31,079**	$	-
Part XII.6 tax		**-**		(4,219)
Accretion of provision		**1,629**		1,004
Net finance expenses	**$**	**32,708**	$	(3,213)

11. Bank Indebtedness

At March 31, 2013, the Company had 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 rate 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, a revolving credit agreement and general assignment of book debts.

As at March 31, 2013, the Company has drawn $2,050,000 from the revolving operating demand loan and $1,355,000 from the non-revolving acquisition and development demand loan for a total bank indebtedness of $3,405,000 (December 31, 2012 - $1,035,000).

12. Capital Stock

(a) Authorized

Unlimited number of common shares without par value.

(b) Issued and outstanding

On January 25, 2013, the Company closed the second and final tranche of a private placement consisting of 86,900 units at a price of $0.65 per unit for gross proceeds of $56,485. Each unit consisted of one common share and one-half of one non-transferrable share purchase warrant. Each whole warrant entitles the holder to purchase one additional common share at the price of $0.90 until January 25, 2014.

In conjunction with the closing of the private placement, $456 in finders' fees and legal fees were paid and 700 finders' warrants were issued. Each warrant entitles the holder to purchase one common share at a price of $0.90 until January 25, 2014.

(c) Stock options

The Company has a stock option plan in place and is authorized to grant stock options to officers, directors, employees and consultants whereby the aggregate number of shares reserved for issuance may not exceed 10% of the issued shares at the time of grant and 5% of the issued shares to each optionee. Stock options are non-transferable and have a maximum term of five years. Stock options terminate no later than 90 days (30 days for investor-related services) upon termination of employment/contract and one year in the case of retirement/death/disability. The grant price may not be less than the last closing price of the Company's shares and not less than $0.10 per share.

Details of the Company's stock options for the three months ended March 31, 2013 are as follows:

			Changes in the Period			
Exercise Price	Expiry Date	Balance Outstanding December 31, 2012	Granted	Exercised	Expired/ Cancelled	Balance Outstanding & Exercisable March 31, 2013
$0.27	28-Sep-14	445,000	-	-	-	445,000
$0.25	8-Mar-15	485,000	-	-	-	485,000
$0.26	30-Sep-15	520,000	-	-	-	520,000
$0.30	23-Dec-15	425,000	-	-	-	425,000
$0.30	27-Jan-16	200,000	-	-	-	200,000
$0.38	9-Feb-16	50,000	-	-	-	50,000
$0.40	26-May-16	520,000	-	-	-	520,000
$0.48	5-Jul-16	50,000	-	-	-	50,000
$0.70	8-Feb-17	1,550,000	-	-	-	1,550,000
$0.65	24-Apr-17	75,000	-	-	-	75,000
$0.61	5-Jul-17	425,000	-	-	-	425,000
$0.50	8-Mar-18	-	250,000	-	-	250,000
		4,745,000	250,000	-	-	4,955,000
Weighted-average exercise price		$0.47	$0.50	-	-	$0.47

For the three months ended March 31, 2013, the Company recognized $65,070 (February 29, 2012 - $907,950) in share-based payment expense from the granting of 250,000 (February 29, 2012 - 2,120,000) options to a consultant of the Company. The fair value was determined using the Black-Scholes option pricing model with the following weighted average assumptions:

	March 31, 2013	February 29, 2012
Expected life (years)	**3.75**	5.00
Interest rate	**1.25%**	1.54%
Volatility	**79.24%**	139.72%
Dividend yield	**0.00%**	0.00%

The weighted average grant date fair value for stock options granted during the three months ended March 31, 2013 was $0.50 (February 29, 2012 - $0.62). The forfeiture rate has been estimated at 0% (February 29, 2012 - 0%).

Included in share-based payments expense at March 31, 2013 were 250,000 (February 29, 2012 - 250,000) stock options granted to an individual performing investor relations services. These options were granted on February 8, 2012, have an exercise price of $0.70 per share and expire 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 March 31, 2013 is nil (February 29, 2012 - 250,000).

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 three months ended March 31, 2013 are as follows:

Exercise Price	Expiry Date	Balance Outstanding & Exercisable December 31, 2012	Changes in the Period: Issued	Changes in the Period: Exercised	Changes in the Period: Expired/ Cancelled	Balance Outstanding & Exercisable March 31, 2013
$0.90	20-Dec-13	914,650	-	-	-	914,650
$0.90	20-Dec-13	114,191	-	-	-	114,191
$0.90	25-Jan-14	-	43,450	-	-	43,450
$0.90	25-Jan-14	-	700	-	-	700
$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
		8,139,295	44,150	-	-	8,183,445
Weighted-average exercise price		$0.92	$0.90	-	-	$0.92

(e) Income (loss) per share

	Three Months Ended March 31, 2013	Three Months Ended February 29, 2012
Net income for the period	**$ 134,425**	$ 730,504
Weighted average number of common shares outstanding, basic	**54,023,809**	42,378,560
Dilutive stock options and share purchase warrants	**1,109,337**	1,485,224
Weighted average number of common shares outstanding, fully diluted	**55,133,146**	43,863,784
Income per share, basic	**$ 0.00**	$ 0.02
Income per share, fully diluted	**$ 0.00**	$ 0.02

For the three months ended March 31, 2013, 2,050,000 stock options and 8,183,445 share purchase warrants were excluded from the fully diluted weighted-average common shares outstanding calculation because their exercise price was higher than the average market price for the quarter.

13. Commitment

The Company has a commitment to make monthly rental payments pursuant to an office rental agreement. The agreement expires July 31, 2014 and will require total payments in the remaining fiscal years of $66,988 for December 31, 2013 and $52,102 for December 31, 2014.

14. Related Party Transactions

For the three months ended March 31, 2013, the Company paid management fees of $10,000 (February 29, 2012 - $40,000) that were charged by a director of the Company. Salaries and wages of key executive personnel, consisting of the Company's officers and directors, were awarded in the following amounts during the three months ended March 31, 2013 and February 29, 2012:

	Three Months Ended	
	March 31, 2013	February 29, 2012
Short-term benefits	**$ 135,000**	$ 204,583
Share-based payments	**$ -**	$ 336,820

During the three months ended March 31, 2013 and February 29, 2012, no long-term benefits were paid to related parties.

15. Supplemental Cash Flow Information

	Three Months Ended	
	March 31, 2013	February 29, 2012
Non-cash transactions		
Increase in decommissioning obligations charged to property and equipment	**$ 24,722**	$ 286,707
Property and equipment expenses included in accounts payable	**760,045**	636,753
Exploration and evaluation expenses included in accounts payable	**872,304**	114,066

16. Subsequent Events

On April 19, 2013, the Company's credit facility increased from $5,500,000 to $9,500,000 as a result of the reserve additions and production increases from its 2012 drilling activity. The new credit facilities are comprised of a revolving operating demand loan of $6,500,000 and a non-revolving acquisition and development demand loan of $3,000,000.

17. Income Taxes

As at December 31, 2012, the Company had a deferred tax recovery in the amount of $912,087 (February 29, 2012 - $1,394,544). The tax effected items that give rise to significant portions of the deferred tax asset at December 31, 2012 and February 29, 2012 are presented below:

	December 31, 2012	February 29, 2012
Deferred tax assets		
Non-capital losses	**$ 1,133,375**	$ 855,172
Exploration and evaluation assets	**3,795,028**	2,611,169
Share issue costs	**183,126**	213,699
Other	**146,658**	114,015
	5,258,187	3,794,055
Deferred income tax liability		
Property and equipment	**(4,346,100)**	(2,399,511)
	$ 912,087	$ 1,394,544

The Company has begun recognizing its deferred tax assets since the twelve months ended February 29, 2012, as it is probable that future taxable profits will be available. The Company does not have any remaining unrecognized deductible temporary differences and unused tax losses for which no deferred tax assets are recognized.

As at December 31, 2012, the Company has non-capital losses of approximately $4,534,000 that may be applied to reduce future Canadian taxable income, expiring as follows:

Available to		
2014	$	502,000
2025		547,000
2026		341,000
2027		216,000
2028		312,000
2029		323,000
2030		557,000
2031		623,000
2032		1,113,000
	$	4,534,000

OFFICERS

Don Simmons, P.Geol.
President & Chief Executive Officer

Dorlyn Evancic, CGA
Chief Financial Officer

Andrew Arthur, P.Geol.
Vice President, Exploration

Ian Duncan, P.Eng.
Vice President, Engineering

BOARD OF DIRECTORS

Charles O'Sullivan, B.Sc., *Chairman*(2)(3)

Frank Borowicz, QC, CA (Hon)(1)(3)

Bruce McIntyre, P.Geol.(1)(2)(4)

Greg Sadler, P. Eng.(2)(3)(4)

Don Simmons, P.Geol.(4)

Gregg Vernon, P.Eng.(1)(4)

(1) Audit Committee
(2) Compensation/Nominating Committee
(3) Corporate Governance Committee
(4) Reserves Committee

BANKER

Canadian Western Bank
Calgary, Alberta

LEGAL COUNSEL

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Vancouver, British Columbia

AUDITOR

Smythe Ratcliffe LLP
Vancouver, British Columbia

INDEPENDENT ENGINEER

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