August 10, 2011

Fellow Shareholders,

Birchcliff is pleased to report its second quarter financial and operating results for the three months ended June 30, 2011. In summary, Birchcliff had a very active quarter, drilling through break-up, constructing new facilities, completing new wells and adding new production.

In addition, Birchcliff Energy Ltd. announced the results of its Montney Doig Natural Gas Resource Assessment (see Press Release dated April 26th, 2011), increased aggregate credit facilities to $520 million (see Press Release dated May 18th, 2011) and expanded its capital budget to $227 million (see Press Release dated May 18th, 2011).

Birchcliff is now focused on the construction of the Phase III expansion of its 100% owned Pouce Coupe South Gas Plant ("**PCS Gas Plant**"), that is scheduled to start-up by November 1, 2012, together with the planning and execution of an estimated 32 Montney/Doig Horizontal natural gas wells that will be drilled between now and the start up of Phase III. The PCS Gas Plant Phase III expansion will increase processing capacity from 60 mmcf per day to 120 mmcf per day, which will allow Birchcliff to achieve a 2012 exit production rate between 27,000 and 28,000 boe/day.

## 2011 SECOND QUARTER RESULTS

### Production

Based on estimates from field reports, current production is approximately 17,700 boe/day.

Notwithstanding severely abnormal weather conditions, including a significant amount of rain and flooding, Birchcliff met its previous guidance for average production of 17,500 boe/day in the first half of 2011. Birchcliff expects to average approximately 18,500 boe/day for 2011, consistent with previous guidance.

Second quarter production averaged 17,324 boe/day, (76% natural gas and 24% light oil and natural gas liquids) up 40% from 12,357 boe/day in the second quarter of 2010. This significant increase in production volumes over the past year was primarily a result of Birchcliff's Montney/Doig horizontal natural gas drilling program and the completion of Phases I and II of the PCS Gas Plant in the Pouce Coupe area. We also achieved drilling successes in both the Worsley area and our east area.

### Cash Flow and Earnings

Cash flow was $34.3 million or $0.27 per share for the second quarter of 2011, as compared to $23.0 million or $0.18 per share in the second quarter of 2010. Net income during the second quarter was $10.1 million ($0.08 per share) as compared to $ 5.1 million ($0.04 per share) during the second quarter of 2010. Cash flow and earnings were also ahead of the first quarter of 2011, notwithstanding slightly less production in the second quarter.

We are very pleased that we have significant earnings during a quarter of low natural gas prices. This is reflective of both the low finding cost nature of our asset base as a result of our growth having been through the drill bit and the low operating costs per boe we achieve from our owned and operated facilities.

## Capital Expenditures and Drilling Results

During the second quarter of 2011, net capital spending aggregated $32.3 million. The specific breakdown of our capital expenditure program is contained in the Capital Expenditure section of our MD&A analysis.

During the second quarter of 2011, Birchcliff drilled 6 (4.8 net) wells, all of which were cased, for a success rate of 100%. These wells included 5 (3.8 net) Montney/Doig horizontal natural gas wells and 1 (1.0 net) Worsley horizontal light oil well.

## Operating Costs

Birchcliff achieved lower operating costs per boe at the PCS Gas Plant which resulted in a reduction in corporate operating costs per boe to $6.74.

In addition, we expect operating costs per boe to decline further as we move away from poor weather in the winter and spring of 2011 and maximize and maintain our volume through-put at the PCS Gas Plant.

For further details regarding our operating costs, please refer to the disclosures under the heading “PCS Gas Plant Operating Netback” in Management’s Discussion and Analysis set forth below.

## Indebtedness

At June 30, 2011, the amount outstanding under Birchcliff’s bank credit facilities was approximately $339.1 million. Birchcliff’s working capital deficiency as at June 30, 2011 was $10.1 million, for total debt of $349.2 million. The working capital deficiency does not reduce the amount Birchcliff can draw under its credit facilities.

In May 2011, Birchcliff’s bank syndicate increased Birchcliff’s total credit facilities to an aggregate limit of $520 million from $375 million.

The facilities include a $450 million revolving credit facility. The two year term out feature of Birchcliff’s credit facilities remains intact so that if the credit facilities are not renewed at their annual renewal date, they convert to a two year term loan repayable at maturity.

The second facility is a $70 million non-revolving 5 year term credit facility. This credit facility will be used primarily to fund the construction of the Phase lll expansion of the PCS Gas Plant.

## Land

Birchcliff continues to have a substantial undeveloped land base in the Peace River Arch, which at June 30, 2011 was comprised of 542,143 gross (501,188 net) acres.

Birchcliff has a high average working interest in its undeveloped land base (92%), which reflects our long standing strategy of acquiring high working interest undeveloped land proximate to our operated high working interest production base.

# OPERATIONS UPDATE

Currently, Birchcliff has 3 rigs working of which 2 rigs are in the Pouce Coupe area drilling horizontal Montney/Doig natural gas wells and the other rig is active on our Worsley Light Oil Resource Play drilling horizontal Charlie Lake light oil wells.

## Montney/Doig Natural Gas Resource Play Update

In the second quarter of 2011, Birchcliff’s activities on the Montney/Doig Natural Gas Resource Play included the drilling of 5 (3.8 net) horizontal natural gas wells utilizing multi-stage fracture stimulation techniques. Of these wells 1 (1.0 net) well was an exploration well that was successful in finding a new pool, the other 4 (2.8 net) were development wells.

Rapid advancements in horizontal drilling and multi-stage fracture stimulation technology have resulted in significant improvements in production and reserve capture for many different plays throughout North America. Birchcliff believes that the Montney/Doig Natural Gas Resource Play continues to experience some of the best results of the application of this technology due to its unique reservoir characteristics. Birchcliff classifies the Montney/Doig Natural Gas Resource Play as a hybrid resource play that significantly benefits from having approximately 300 meters (1,000 feet) of gas saturated rock that has both tight silt and sand reservoir rock inter layered with shale gas source rock. The horizontal wells are designed to maximize the contributions from this complex reservoir. As our knowledge grows with respect to both the reservoir characteristics and the operational technology of these resources, we expect our results to continue to improve.

Birchcliff's strategy for the Montney/Doig Natural Gas Resource Play has evolved into a full cycle, exploration, exploitation, development and production program. We continue to aggressively add to our undeveloped land inventory, we continue to build out our infrastructure, we are now drilling infill wells on 300 meter inter-well spacing. Further evaluation is being conducted to support down spacing to less than 300 meters, as has been done by other competitors on the play.

To date in 2011 we have added 20.5 (18.5 net) sections of land on the Montney/Doig Natural Gas Resource Play. In total Birchcliff now has 319.2 (286.6 net) sections of land that it believes have potential for the Montney/Doig Resource play. Based on the assumption that only one play of the two plays, Basal Doig/Upper Montney or the Middle/Lower Montney play, are considered and only 4 wells per section, Birchcliff controls land to develop over 1,200 locations.

Of these locations 60 (49.6 net) wells have been drilled to date. In its reserve evaluation dated February 9, 2011, prepared by AJM Petroleum Consultants ("**AJM**") as at December 31, 2010, AJM attributed Montney/Doig reserves to 219 net locations.

AJM conducted a Montney/Doig Natural Gas Play Resource Assessment (see April 26, 2011 Press Release). The resource assessment covered lands held by Birchcliff at December 31, 2010 which was comprised of 281 gross (256 net) sections of land which included Montney rights and 221 gross (194 net) sections of land, which included Doig rights. In total the assessment assigned resources on 298.7 (268.2 net) sections of land.

Birchcliff continues to explore to geographically and stratigraphically expand the Montney/Doig Natural Gas Resource Play. Of the wells drilled to date in 2011 on the play, 2 (2.0 net) horizontal wells are exploratory in nature and successfully found new pools and proved new lands. Birchcliff continues to expand its infrastructure to control the play and reduce operating costs per boe. This provides economic efficiencies as well as strategic control and reserve capture in the area.

Drilling plans for 2011 for the Montney/Doig Natural Gas Resource Play includes 12 (9.5 net) Basal Doig/Upper Montney horizontal wells, 11 (9.8 net) Middle/Lower Montney horizontal wells and 1 (1.0 net) vertical exploration well.

**Pouce Coupe South Gas Plant Update -** *Phase III and Phase IV Expansions*

Birchcliff is well underway in planning for construction of the Phase III expansion of the PCS Gas Plant. The engineering and design work is currently being completed and procurement of all major components has begun. Shop fabrication of all major skid packages will commence soon and field construction will start in the spring of 2012. Phase III is scheduled to start-up by November 1, 2012.

In order to continue to develop its large resource base, Birchcliff has recently commenced the process to obtain regulatory approval for a Phase IV expansion of the Pouce Coupe South Gas Plant which would increase the processing capacity from 120 mmcf per day to 240 mmcf per day.

### Worsley Light Oil Resource Play Update

The Worsley Light Oil Resource Play has demonstrated consistent and prolific production performance. Successful expansion of the pool, water flood performance and the application of horizontal drilling and multi-stage fracture stimulation technology have all contributed to its continued reserve growth, production growth and high netbacks.

To date in 2011, Birchcliff has drilled 10 (10.0 net) successful horizontal development oil wells in the Worsley Light Oil Resource Play. Our 2011 drilling program to date has successfully delineated and extended the pool to the west and south, which increased our estimate of original oil in place. With this success, a sizeable number of follow up locations have been identified. The water flood response is meeting our expectations and we are committed to further expansion of the water flood area, particularly in the south east area of the pool. On the Worsley Light Oil Resource Play, both the original oil in place and the estimated recoverable reserves for the pool continue to grow from July 1, 2007, the date we originally acquired these lands.

### New Resource Play Update

Birchcliff has invested considerable time and capital analyzing and evaluating various new resource plays in the Peace River Arch. Several industry competitors have recently announced important developments on new resource plays in this area of Alberta. Birchcliff has acquired several large contiguous blocks at 100% working interest that are prospective for one or more of these new resource plays. While still in the early development phase, based on the high level of industry activity and our own internal technical evaluation, we are optimistic about the potential value of these new resource plays on our lands.

Birchcliff is also conducting detailed core work on various plays to better understand rock properties and play potential in our area. We continue to plan for the drilling of a vertical exploration well in one of these new resource plays. The timing for the drilling of this well is dependent on the results of the preparatory technical work which is currently underway. Once this well has been drilled it will be evaluated to determine whether we should re-enter the well and/or drill horizontally to determine its commerciality**.**

## PROPOSED CHANGE OF AUDITOR

Effective June 1, 2011 Birchcliff's auditor, Deloitte & Touche LLP ("**Deloitte**") acquired the business of AJM Petroleum Consultants ("**AJM**") which is Birchcliff's independent reserves evaluator. As a result, Deloitte has advised Birchcliff that, to the extent that AJM provides a future independent reserves evaluation of Birchcliff's properties, Deloitte, under the applicable rules relating to its independence, cannot audit financial numbers that are based on such reserves evaluation by AJM since it would be auditing evaluation amounts prepared by Deloitte.

Birchcliff therefore expects that during the third quarter of 2011, Birchcliff's Directors will appoint a new auditor to replace Deloitte. The Audit Committee is currently reviewing proposals from other auditing firms and once the replacement auditor is determined a further announcement will be made.

It is with regret that we must proceed down this path as our relationship with Deloitte has been long standing. On behalf of Birchcliff and its shareholders, I thank Deloitte for the many years of excellent professional service that it has provided to Birchcliff and in particular I would like to single out Ms. Debbie Gerlach for her tireless efforts in this regard.

## SHAREHOLDER SUPPORT

During 2011, Mr Seymour Schulich has increased his share holdings in Birchcliff to just under 26%. We confirm Mr Schulich's unwavering commitment to our management team which allows us to focus on our strategy and on achieving our long term goals that we believe will create significant value for all Birchcliff shareholders.

## OUTLOOK

Birchcliff remains very confident that its two highly focused, high working interest, low cost, repeatable, sustainable long term growth resource plays in the Peace River Arch area of Alberta offer tremendous upside value to our shareholders. The Montney/Doig Natural Gas Resource Play continues to be one of the most active geological plays in North Western Alberta and Birchcliff is in the heart of the play.

We continue to exploit our Worsley Light Oil Resource Play. We expect that production and reserves will continue to grow each year providing significant cash flow to exploit our resource plays at a time when oil prices are strong and gas prices are low.

Our strategy has not changed, notwithstanding the weakness in natural gas prices. We believe that we can economically find, develop and produce natural gas from the Montney/Doig geological zone at low costs. Our significant earnings in 2011 are a testament to our strategy.

The key to our strategy of being a low cost producer is to own and operate our processing capacity and related infrastructure. We also believe that technology advances will continue to reduce our finding and development costs and increase our recovery factors.

We believe that the capital investments we are making are necessary to expand and improve our competitive position, to continue to reduce our operating costs and to make full use of our strategic advantages over our competitors. We have set a goal to exit 2012 producing between 27,000 and 28,000 boe/day, a target which we believe is achievable in light of our excellent results to date. Now, it is primarily about execution rather than geological risk.

On behalf of our management team and directors I thank all of our shareholders for their continued support and our staff for their hard work and dedication.

(signed) “A. Jeffery Tonken”

**A. Jeffery Tonken**
**President and Chief Executive Officer**

## FINANCIAL AND OPERATIONAL HIGHLIGHTS

| | **Three months ended June 30, 2011** | Three months ended June 30, 2010 | **Six months ended June 30, 2011** | Six months ended June 30, 2010 |
|---|---|---|---|---|
| **OPERATING** | | | | |
| Average daily production | | | | |
| Light oil – barrels | 3,589 | 3,096 | 3,666 | 3,039 |
| Natural gas – thousands of cubic feet | 78,714 | 53,074 | 79,635 | 47,840 |
| NGLs – barrels | 615 | 415 | 593 | 375 |
| **Total – barrels of oil equivalent (6:1)** | **17,324** | **12,357** | **17,532** | **11,388** |
| Average sales price ($ Canadian) | | | | |
| Light oil – per barrel | 99.31 | 76.24 | 93.08 | 78.09 |
| Natural gas – per thousand cubic feet | 4.15 | 4.16 | 4.08 | 4.69 |
| NGLs – per barrel | 94.15 | 73.33 | 88.63 | 73.25 |
| **Total – barrels of oil equivalent (6:1)** | **42.76** | **39.45** | **41.01** | **42.94** |
| Undeveloped land | | | | |
| Gross (acres) | 542,143 | 434,614 | 542,143 | 434,614 |
| Net (acres) | 501,188 | 390,827 | 501,188 | 390,827 |
| **NETBACK AND COST** | | | | |
| ($ per barrel of oil equivalent at 6:1) | | | | |
| Petroleum and natural gas revenue | 42.79 | 39.61 | 41.05 | 43.07 |
| Royalty expense | (5.58) | (3.22) | (4.73) | (4.36) |
| Operating expense(1) | (6.74) | (7.70) | (6.85) | (8.30) |
| Transportation and marketing expense | (2.67) | (2.61) | (2.60) | (2.60) |
| **Netback(1)** | **27.80** | **26.08** | **26.87** | **27.81** |
| General & administrative expense, net(1) | (3.07) | (2.83) | (2.88) | (3.19) |
| Interest expense | (2.99) | (2.78) | (3.01) | (2.97) |
| **Cash Flow Netback(1)** | **21.74** | **20.47** | **20.98** | **21.65** |
| Stock-based compensation expense, net(1) | (1.45) | (1.66) | (1.36) | (2.60) |
| Depletion and depreciation expense(1) | (10.17) | (11.19) | (10.12) | (10.90) |
| Accretion expense(1) | (0.28) | (0.31) | (0.28) | (0.33) |
| Amortization of deferred financing fees | (0.15) | (0.57) | (0.15) | (0.55) |
| Gain (loss) on sale of assets(1) | (0.58) | - | (0.29) | 7.53 |
| Deferred income tax expense(1) | (2.69) | (2.22) | (2.57) | (4.51) |
| **Net Income(1)** | **6.42** | **4.52** | **6.21** | **10.29** |
| **FINANCIAL** | | | | |
| Petroleum and natural gas revenue ($000) | 67,464 | 44,546 | 130,257 | 88,781 |
| Cash flow ($000)(1)(3) | 34,269 | 23,013 | 66,582 | 44,625 |
| Per share – basic ($)(1)(3) | 0.27 | 0.18 | 0.53 | 0.36 |
| Per share – diluted ($)(1)(3) | 0.26 | 0.18 | 0.51 | 0.35 |
| Net income ($000)(1) | 10,117 | 5,087 | 19,710 | 21,199 |
| Per share – basic ($)(1) | 0.08 | 0.04 | 0.16 | 0.17 |
| Per share – diluted ($)(1) | 0.08 | 0.04 | 0.15 | 0.17 |
| Common shares outstanding | | | | |
| End of period – basic | 126,496,677 | 124,792,136 | 126,496,677 | 124,792,136 |
| End of period – diluted | 140,137,084 | 137,255,386 | 140,137,084 | 137,255,386 |
| Weighted average shares for period – basic | 126,322,814 | 124,540,955 | 125,877,298 | 124,320,253 |
| Weighted average shares for period – diluted(1) | 131,380,901 | 127,966,923 | 131,030,694 | 128,235,511 |
| Capital expenditures, net ($000)(1)(2) | 32,300 | 42,270 | 84,479 | 76,674 |
| Working capital deficiency ($000) | 10,139 | 14,377 | 10,139 | 14,377 |
| Non-revolving term credit facilities ($000) | 68,773 | - | 68,773 | - |
| Revolving credit facilities ($000) | 270,278 | 235,993 | 270,278 | 235,993 |
| Total debt ($000) | 349,190 | 250,370 | 349,190 | 250,370 |

(1) Prior period amounts restated to comply with the requirements of International Financial Reporting Standards.

(2) Included as a reduction of net capital expenditures in the six months ended June 30, 2010 are proceeds of $17.5 million from the sale of minor non-core assets.

(3) Cash flow and cash flow per share amounts represent cash provided by operating activities as per the Condensed Statements of Cash flows before the effects of changes in non-cash working capital and decommissioning expenditures related to operating activities.

## MANAGEMENT'S DISCUSSION AND ANALYSIS

Birchcliff Energy Ltd. ("**Birchcliff"** or the "**Corporation**") is an intermediate oil and gas exploration, development and production company based in Calgary, Alberta. Additional information relating to the Corporation, including its Annual Information Form, is available on the SEDAR website at www.sedar.com. Birchcliff's common shares are listed for trading on the Toronto Stock Exchange ("**TSX**") under the symbol "**BIR**" and are included in the Standard and Poor's S&P/TSX Composite Index.

The following Management's Discussion and Analysis ("**MD&A**") is dated August 10, 2011. The unaudited condensed financial statements with respect to the three and six months ended June 30, 2011 (the "**Reporting Periods**") as compared to the three and six months ended June 30, 2010 (the "**Comparable Prior Periods**") and this MD&A have been prepared by management and approved by the Corporation's Audit Committee and Board of Directors. This MD&A should be read in conjunction with the unaudited condensed financial statements of the Corporation and related notes for the Reporting Periods. All financial information is expressed in thousands of Canadian dollars, unless otherwise stated.

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

Birchcliff's financial statements and the financial data included in this MD&A have been prepared in accordance with IFRS as issued by the International Accounting Standards Board ("**IASB**") and interpretations of the International Financial Reporting Interpretations Committee that are expected to be effective as at December 31, 2011, the date of the Corporation's first annual reporting under IFRS. The adoption of IFRS does not impact the underlying economics of Birchcliff's operations. Previously, the Corporation prepared its interim and annual financial statements in accordance with Canadian Generally Accepted Accounting Principles ("**Canadian GAAP**").

The IFRS accounting polices set forth in Note 3 of the unaudited condensed financial statements for the period ended March 31, 2011 have been applied in preparing the financial statements for the Reporting Periods and Comparable Prior Periods. Note 18 to the condensed financial statements for the Reporting Periods contains a detailed description of the Corporation's adoption of IFRS, including a reconciliation of the financial statements previously prepared under Canadian GAAP to those under IFRS. The most significant impacts of the adoption of IFRS, together with details of IFRS 1 *First-time Adoption of IFRS* exemptions taken, are described in the "Transition to International Financial Reporting Standards" section of this MD&A.

Comparative information in this MD&A has been restated to comply with IFRS requirements, unless otherwise indicated.

## SECOND QUARTER OVERALL PERFORMANCE

### Production

Birchcliff's production averaged 17,532 boe per day in the first half of 2011, slightly ahead of its previously announced guidance of 17,500 boe per day.

Production in the second quarter of 2011 averaged 17,324 boe per day. This is a 40% increase from the 12,357 boe per day in the second quarter of 2010. This increase was largely achieved through the success of Birchcliff's Montney/Doig horizontal natural gas drilling program and the ability to process new or incremental natural gas through Phases I and II of Birchcliff's 100% owned and operated Pouce Coupe South Gas Plant ("**PCS Gas Plant**"), which commenced operation in March and November of 2010, respectively.

Production consisted of approximately 76% natural gas and 24% crude oil and natural gas liquids in the second quarter of 2011 (72% natural gas and 28% crude oil and natural gas liquids in the second quarter of 2010).

## Commodity Prices

Oil sales prices at the wellhead averaged $99.31 per barrel in the current quarter, a 30% increase from the $76.24 per barrel in the second quarter of 2010. Natural gas sales prices at the wellhead averaged $4.15 per mcf in the second quarter of 2011, which is slightly below the $4.16 per mcf the Corporation averaged in the second quarter of 2010. The prices received for Birchcliff's petroleum and natural gas sales are impacted by world events that dictate the level of supply and demand for petroleum and natural gas. Birchcliff currently does not have any commodity hedges in place and is therefore subject to fluctuations in commodity prices.

Canadian Edmonton Par oil prices averaged $103.07 per barrel in the second quarter of 2011 as compared to $75.18 per barrel in the second quarter of 2010. The AECO daily natural gas spot price averaged $3.87 per mcf in the second quarter of 2011 as compared to $3.89 per mcf in the second quarter of 2010.

## PCS Gas Plant Operating Netback

The estimated operated netback for Birchcliff's Montney/Doig gas wells producing to Phases I and II of the PCS Gas Plant was approximately $3.43 per mcf ($20.58 per boe) during the six months ended June 30, 2011 while AECO daily natural gas spot price averaged $3.83 per mcf during that same period. The following table details Birchcliff's net production and operating netback for Phases I and II of the PCS Gas Plant for the first half of 2011.

| | | **Six months ended June 30, 2011**(2) |
|---|---|---|
| **PRODUCTION** | | |
| Average daily production: | | |
| Natural gas – thousands of cubic feet | | 37,348 |
| NGLs – barrels | | 85 |
| **Total – barrels of oil equivalent (6:1)** | | **6,310** |
| | | |
| **NETBACK AND COST** | **$/mcfe** | **$/boe**(3) |
| Petroleum and natural gas revenue | 4.21 | 25.27 |
| Royalty expense | (0.33) | (1.99) |
| Operating expense, net of recoveries | (0.17) | (1.01) |
| Transportation and marketing expense | (0.28) | (1.69) |
| **Estimated Netback**(1) | **3.43** | **20.58** |

(1) The estimated netback is based upon certain cost allocations and accruals directly related to Phases I and II of the PCS Gas Plant and related wells and infrastructure, and are disclosed on a production month basis.

(2) Phases I and II of the PCS Gas Plant commenced operations in March and November 2010, respectively, and therefore the 2010 comparative period is not applicable.

(3) Based on a boe and mcfe conversion ratio of six thousand cubic feet (6 mcf) of natural gas to one barrel of oil (1 bbl).

## Phase III Expansion PCS Gas Plant

On May 18, 2011, the Directors of Birchcliff authorized the Phase III expansion of the PCS Gas Plant, which will increase natural gas processing capacity from 60 mmcf per day to 120 mmcf per day. The Phase III expansion is expected to start-up by November 1, 2012. The Corporation's operating cash flow and increased aggregate credit facilities, as described below, will be used to fund the Phase III expansion and related infrastructure and the drilling of Montney/Doig horizontal natural gas wells that will produce to the PCS Gas Plant.

## Cash Flow and Earnings

The following schedule sets out the reconciliation of cash provided by operating activities to cash flow:

| | Three months ended June 30, | | Six months ended June 30, | |
|---|---|---|---|---|
| | **2011** | 2010 | **2011** | 2010 |
| Cash provided by operating activities | 40,905 | 18,181 | 62,946 | 36,836 |
| Adjustments: | | | | |
| Decommissioning expenditures | 212 | 160 | 678 | 195 |
| Changes in non-cash working capital | (6,848) | 4,672 | 2,958 | 7,594 |
| **Cash flow**(1) | **34,269** | 23,013 | **66,582** | 44,625 |
| Per share – basic ($) | 0.27 | 0.18 | 0.53 | 0.36 |
| Per share – diluted ($) | 0.26 | 0.18 | 0.51 | 0.35 |

(1) Management uses cash flow to analyze operating performance. Cash flow as presented does not have any standardized meaning prescribed by IFRS and therefore it may not be comparable with the calculations of similar measures for other issuers. Cash flow as presented is not intended to represent cash flow from operating activities, net income or other measures of financial performance calculated in accordance with IFRS. All references to cash flow throughout this report are based on cash flow from operating activities as per the Condensed Statements of Cash Flows and removing the adjustments for non-cash working capital and decommissioning expenditures. Cash flow per share is calculated based on the weighted average number of shares outstanding consistent with the calculation of net income per share.

The 49% increase in aggregate cash flow from each of the three and six months ended June 30, 2010 was largely due to increased average daily production and higher average oil prices realized at the wellhead, offset by increased cash general and administrative expenses, higher interest expenses and a proportionate increase in aggregate royalty, operating and transportation and marketing costs due to higher average production in the three and six months ended June 30, 2011 as compared to the same periods in 2010.

Birchcliff recorded net income of $10.1 million ($0.08 per share) in the current quarter as compared to net income of $5.1 million ($0.04 per share) in the second quarter of 2010. The increase in net income from the second quarter of 2010 was mainly attributable to higher cash flow, offset by an increase in depletion expense due to higher production in the current quarter.

## Bank Debt

On May 18, 2011, the Corporation's bank syndicate approved an increase of the revolving credit facilities to an aggregate limit of $450 million from $375 million and extended the conversion date of those facilities from May 20, 2011 to May 18, 2012. The bank syndicate also approved a new $70 million non-revolving five-year term credit facility with a maturity date on May 25, 2016. The aggregate maximum amount available under these credit facilities is $520 million. Further details of the Corporation's credit facilities are discussed under the section "Major Transactions Affecting Financial Results" in this MD&A.

The increased aggregate credit facilities will largely be used to fund the construction of the Phase III expansion of the PCS Gas Plant and related infrastructure and the drilling of Montney/Doig horizontal natural gas wells used to fill the PCS Gas Plant to 120 mmcf per day.

## Capital Expenditures

Total capital expenditures (excluding minor acquisitions and dispositions) in the second quarter of 2011 were $33.7 million as compared to $42.3 million in the second quarter of 2010. Of the $33.7 million in total capital spent during the current quarter, approximately $13.7 million (41%) was allocated to the drilling and completion of Montney/Doig horizontal natural gas wells that were tied into Phases I and II of the PCS Gas Plant and approximately $1.2 million (4%) on the initial engineering and design of the Phase III expansion of the PCS Gas Plant. The remaining $18.8 million in capital was spent acquiring land; expanding the Montney/Doig Natural Gas Resource Play and the Worsley Light Oil Resource Play and related infrastructure; and on other oil and gas exploration and development projects in the Peace River Arch. Further details of the Corporation's capital expenditures in the second quarter of 2011 are set forth in the table entitled "Capital Expenditures" in this MD&A.

## OUTLOOK

### Capital Expenditures

In the current quarter, the Corporation expanded the 2011 capital spending program to $227 million up from its previously announced capital budget of $159 million. The expanded capital spending program is focused on the initial construction of Phase III of the PCS Gas Plant and the drilling of Montney/Doig horizontal natural gas wells to fill Phase III, increase drilling of Montney/Doig horizontal natural gas wells to keep Phases I and II of the PCS Gas Plant operating at full capacity, continued development of the Montney/Doig Natural Gas Resource Play and the Worsley Light Oil Resource Play and related infrastructure, land acquisitions, sustaining capital and seed capital for new growth opportunities and other projects. The Corporation's operating cash flow and increased aggregate credit facilities will be used to fund the expanded capital spending program in 2011.

### Production

Birchcliff expects production to average approximately 18,500 boe per day for 2011. This forecast production rate is dependent on the success of Birchcliff's capital program in the second half of 2011.

Once the Phase III expansion of the PCS Gas Plant has been completed, Birchcliff's exit production rate in 2012 is expected to range between 27,000 and 28,000 boe per day. This range is a function of how much third party gas will be processed in the PCS Plant, the extent of production growth from Worsley in 2012, the performance of our base production and the total capital program for 2012, which is yet to be determined.

### Cash Flow and Bank Debt

The increased maximum credit limit of $520 million will provide Birchcliff with greater liquidity and financial flexibility to further increase the natural gas processing capacity of the PCS Gas Plant to 120 mmcf per day and to continue to develop and expand the Montney/Doig Natural Gas Resource Play and the Worsley Light Oil Resource Play. Despite the current low natural gas price environment, the Corporation does not foresee any liquidity issues with respect to the operation of its petroleum and natural gas business during the second half of 2011. Birchcliff expects to meet all its future obligations as they become due.

The Corporation intends to finance its petroleum and natural gas business primarily through cash flow, working capital, minor asset dispositions and increased borrowing base limit from its credit facilities. Should commodity prices deteriorate materially, Birchcliff may adjust its capital spending accordingly. Birchcliff is now at a size that it anticipates it will not require additional equity except to fund a significant acquisition or to significantly increase its capital spending beyond its cash flow. Management expects to be able to obtain debt financing, and should the need arise, raise additional equity sufficient to meet both its short term and long term growth requirements.

### Resource Plays and Infrastructure

The 100% owned and operated PCS Gas Plant will continue to increase the value of the Montney/Doig Natural Gas Resource Play by allowing for increased production growth, reduced operating costs per boe and increasing Birchcliff's strategic control over the Pouce Coupe area.

Birchcliff has a very strong asset base with its two main resource plays, the Montney/Doig Natural Gas Resource Play and the Worsley Light Oil Resource Play. The extensive portfolio of development opportunities on these resource plays will provide low risk, long life future production and reserves additions that are readily available with the investment of additional capital. Birchcliff continues to investigate and work towards development of new resource plays in its core area, the Peace River Arch.

Birchcliff's resource plays provide the Corporation with a long term and operationally reliable cash flow base, the level of which is primarily dependent on commodity prices. Commodity prices affect cash flow, thus dictating the pace at which Birchcliff invests in its resource plays and the rate at which its production will grow. Birchcliff has a long term view of the development of its resource plays and therefore short term commodity prices do not affect the quality or long term value of the Corporation's asset base.

## MAJOR TRANSACTIONS AFFECTING FINANCIAL RESULTS

On May 18, 2011, the Corporation's bank syndicate approved an increase of the revolving credit facilities to an aggregate limit of $450 million from $375 million and extended the conversion date of those facilities from May 20, 2011 to May 18, 2012 (the "**Revolving Credit Facilities**"). The amended Revolving Credit Facilities include an increased credit limit for the extendible revolving term credit facility (the "**Syndicated Credit Facility**") of $420 million from $345 million and an extendible revolving working capital facility (the "**Working Capital Facility**") of $30 million.

On May 18, 2011, the Corporation's bank syndicate approved a new $70 million non-revolving five-year term credit facility (the "**Non-Revolving Five-Year Term Facility**") with a maturity date on May 25, 2016. This facility requires principle payments of $350,000 per quarter commencing July 1, 2013. In May 2011, Birchcliff had drawn the full $70 million in the form of bankers' acceptances applicable to the Non-Revolving Five-Year Term Facility, the proceeds of which were used to reduce the amounts outstanding on the Corporation's Revolving Credit Facilities.

On November 30, 2010, the Corporation's bank syndicate approved an increase of the Revolving Credit Facilities to an aggregate limit of $375 million from $350 million.

On May 21, 2010, the Corporation's bank syndicate approved an increase of the Revolving Credit Facilities to an aggregate limit of $350 million from $255 million and extended the conversion date of those facilities from May 21, 2010 to May 20, 2011. In conjunction with these changes, the $50 million one-year non-revolving term credit facility (the "**Non-Revolving One-Year Term Facility**") was repaid and cancelled. The amended Revolving Credit Facilities included an increased credit limit for the Syndicated Credit Facility of $320 million from $235 million and an increased credit limit for the Working Capital Facility of $30 million from $20 million.

## LIQUIDITY

### Working Capital

The Corporation's working capital deficit (current assets minus current liabilities) increased to $10.1 million at June 30, 2011 from $4.0 million at December 31, 2010. The deficit at the end of the current period is mainly comprised of costs incurred on the drilling, completing, equipping and tie-in of new wells during the second quarter of 2011.

At June 30, 2011, the major components of Birchcliff's current assets were: joint interest billings (31%) to be received from its partners; and revenue (60%) to be received from its marketers in respect of June 2011 production, which was subsequently received in July 2011. In contrast, current liabilities largely consisted of trade payables (41%) and accrued capital and operating costs (44%).

Birchcliff manages its working capital deficit using its cash flow and advances under its credit facilities. The Corporation's working capital deficit does not reduce the amount available under the Corporation's credit facilities. The Corporation did not have any liquidity issues with respect to the operation of its petroleum and natural gas business during the first half of 2011.

## Total Debt and Bank Debt

Total debt (including working capital deficit) increased to $349.2 million at June 30, 2011 from $337.4 million at December 31, 2010. The increase in total debt from the end of 2010 was primarily a result of $17.9 million in total capital expended during the first half of 2011 in excess of cash flow during that same period. The amount outstanding on Birchcliff's total available credit facilities at June 30, 2011 was $339.1 million (December 31, 2010 – $333.5 million), which is net of $4.8 million (December 31, 2010 – $5.7 million) in unamortized interest and fees.

The following table shows the Corporation's total available credit at June 30, 2011 and December 31, 2010:

| | **June 30, 2011** | December 31, 2010 |
|---|---|---|
| *Maximum borrowing base limit* (1)(2)*:* | | |
| Non-Revolving Five-Year Term Facility | 70,000 | - |
| Revolving Credit Facilities | 450,000 | 375,000 |
| | 520,000 | 375,000 |
| *Principal amount utilized:* | | |
| Drawn Non-Revolving Five-Year Term Facility(3) | (70,000) | - |
| Drawn Revolving Credit Facilities(3) | (273,866) | (339,176) |
| Outstanding letters of credit(4) | (4,984) | (3,014) |
| | (348,850) | (342,190) |
| **Total unused credit** | **171,150** | 32,810 |

(1) The Corporation's credit facilities are subject to a semi-annual review of the borrowing base limit, which is directly impacted by the value of Birchcliff's petroleum and natural gas reserves.

(2) The Corporation was compliant with all financial covenants applicable under its credit facilities as at and during the periods ended June 30, 2011 and December 31, 2010 and continues to be compliant with such covenants at the date hereof.

(3) The drawn amounts are not reduced for unamortized costs and fees. The drawn Revolving Credit Facilities at the end of the current period consist of approximately $17.9 million (December 31, 2010 - $5.2 million) drawn on the Working Capital Facility and $256 million (December 31, 2010 - $334 million) drawn on the Syndicated Credit Facility.

(4) Letters of credit are issued to various service providers. No amounts were drawn on the letters of credit as at and during the periods ended June 30, 2011 and December 31, 2010.

## Contractual Obligations

The Corporation enters into contractual obligations in the course of conducting its day-to-day business. The following table lists Birchcliff's estimated material contractual obligations at June 30, 2011:

| | **2011** | **2012** | **2013 - 2015** | **Thereafter** |
|---|---|---|---|---|
| Accounts payable and accrued liabilities | 44,488 | - | - | - |
| Drawn Non-Revolving Five-Year Term Facility | - | - | 3,500 | 66,500 |
| Drawn Revolving Credit Facilities | - | - | 273,866 | - |
| Office lease(1) | 1,554 | 3,118 | 9,675 | 6,182 |
| Transportation and processing | 7,745 | 16,470 | 33,079 | - |
| **Total estimated contractual obligations(2)** | **53,787** | **19,588** | **320,120** | **72,682** |

(1) The Corporation is committed under an operating lease relating to its office premises, beginning December 1, 2007 and expiring on November 30, 2017. Birchcliff does not presently use all of the leased premises and has sublet approximately 24% of the excess space to an arms' length party on a basis that recovers all of the rental costs for the first five years.

(2) Contractual commitments that are routine in nature and form part of the normal course of operations for Birchcliff are not included in the above table.

## OUTSTANDING SHARE DATA

The common shares of Birchcliff are the only class of shares outstanding. Birchcliff's common shares began trading on the TSX on July 21, 2005 under the symbol "**BIR**" and were at the same time de-listed from the TSX Venture Exchange where they were trading under the same symbol prior to such time. Birchcliff's common shares are included in the Standard and Poor's S&P/TSX Composite Index. The following table summarizes the common shares issued in the Reporting Periods:

| | **Common Shares** |
|---|---:|
| Balance at December 31, 2010 | 125,129,234 |
| Issue of common shares upon exercise of options | 998,010 |
| Balance at March 31, 2011 | 126,127,244 |
| Issue of common shares upon exercise of options | 369,433 |
| **Balance at June 30, 2011** | **126,496,677** |

At August 4, 2011, there were outstanding 126,668,244 common shares, 10,494,941 stock options to purchase an equivalent number of common shares and 2,939,732 performance warrants to purchase an equivalent number of common shares.

## RESULTS OF OPERATIONS

### Petroleum and Natural Gas Revenues

Petroleum and Natural Gas ("**P&NG**") revenues totalled $67.5 million ($42.79 per boe) for the three month Reporting Period and $130.3 million ($41.05 per boe) for the six month Reporting Period as compared to $44.5 million ($39.61 per boe) and $88.8 million ($43.07 per boe) for the Comparable Prior Periods. The increase in aggregate P&NG revenues was largely a result of increased average daily production and higher average oil prices realized at the wellhead, notwithstanding lower average natural gas prices realized at the wellhead during the Reporting Periods. The following table details Birchcliff's P&NG revenues, production, percentage of production and sales prices by category for the Reporting Periods and Comparable Prior Periods:

| | **Three months ended June 30, 2011** | | | | Three months ended June 30, 2010 | | | |
|---|---:|---:|---:|---:|---:|---:|---:|---:|
| | Total Revenue ($000's) | Average Daily Production | % | Average ($/unit) | Total Revenue ($000's) | Average Daily Production | % | Average ($/unit) |
| Light oil (bbls) | 32,440 | 3,589 | 21 | 99.31 | 21,482 | 3,096 | 25 | 76.24 |
| Natural gas (mcf) | 29,699 | 78,714 | 76 | 4.15 | 20,109 | 53,074 | 72 | 4.16 |
| Natural gas liquids (bbls) | 5,271 | 615 | 3 | 94.15 | 2,772 | 415 | 3 | 73.33 |
| Total P&NG sales | 67,410 | 17,324 | 100 | 42.76 | 44,363 | 12,357 | 100 | 39.45 |
| Royalty revenue | 54 | | | 0.03 | 183 | | | 0.16 |
| **Total P&NG revenues** | **67,464** | | | **42.79** | 44,546 | | | 39.61 |

| | **Six months ended June 30, 2011** | | | | Six months ended June 30, 2010 | | | |
|---|---:|---:|---:|---:|---:|---:|---:|---:|
| | Total Revenue ($000's) | Average Daily Production | % | Average ($/unit) | Total Revenue ($000's) | Average Daily Production | % | Average ($/unit) |
| Light oil (bbls) | 61,767 | 3,666 | 21 | 93.08 | 42,958 | 3,039 | 27 | 78.09 |
| Natural gas (mcf) | 58,849 | 79,635 | 76 | 4.08 | 40,571 | 47,840 | 70 | 4.69 |
| Natural gas liquids (bbls) | 9,513 | 593 | 3 | 88.63 | 4,970 | 375 | 3 | 73.25 |
| Total P&NG sales | 130,129 | 17,532 | 100 | 41.01 | 88,499 | 11,388 | 100 | 42.94 |
| Royalty revenue | 128 | | | 0.04 | 282 | | | 0.13 |
| **Total P&NG revenues** | **130,257** | | | **41.05** | 88,781 | | | 43.07 |

*Commodity Prices*

Birchcliff sells all of its crude oil on a spot basis and virtually all of its natural gas production for prices based on the AECO daily spot price. Birchcliff receives premium pricing for its natural gas due to its high heat content. The following table details the average sales price and differential received by Birchcliff for natural gas during the Reporting Periods and Comparable Prior Periods:

| | **Three months ended June 30, 2011** | Three months ended June 30, 2010 | **Six months ended June 30, 2011** | Six months ended June 30, 2010 |
|---|---|---|---|---|
| Average natural gas sales price ($/mcf) | 4.15 | 4.16 | 4.08 | 4.69 |
| Average AECO daily spot price ($/mmbtu) (1) | 3.87 | 3.89 | 3.83 | 4.43 |
| **Positive differential** | **0.28** | 0.27 | **0.25** | 0.26 |

(1) $1.00/mmbtu = $1.00/mcf based on a standard heat value mcf.

The price the Corporation receives for its petroleum and natural gas production depends on a number of factors, including AECO Canadian dollar spot market prices for natural gas, Canadian dollar Edmonton Par oil prices, US dollar oil prices, the US-Canadian dollar exchange rate and transportation and product quality differentials. Birchcliff had no financial derivatives such as commodity price risk management contracts, forward exchange rate contracts and interest rate swaps in place during the Reporting Period and Comparable Prior Period, but it actively monitors the market to determine if any are required. The Corporation has no current intention to enter into any such contracts at the date hereof.

## Royalties

Birchcliff recorded a royalty expense of $8.8 million ($5.58 per boe) for the three month Reporting Period and $15.0 million ($4.73 per boe) for the six month Reporting Period as compared to $3.6 million ($3.22 per boe) and $9.0 million ($4.36 per boe) for the Comparable Prior Periods. Royalties are paid to the Alberta Government and other land and mineral rights owners. The following table illustrates the Corporation's royalty expense for the Reporting Periods and Comparable Prior Periods:

| | **Three months ended June 30, 2011** | Three months ended June 30, 2010 | **Six months ended June 30, 2011** | Six months ended June 30, 2010 |
|---|---|---|---|---|
| Oil & natural gas royalties ($000's) | 8,801 | 3,621 | 15,000 | 8,984 |
| Oil & natural gas royalties ($/boe) | 5.58 | 3.22 | 4.73 | 4.36 |
| Effective royalty rate (%)(1) | 13% | 8% | 12% | 10% |

(1) The effective royalty rate is calculated by dividing the total aggregate royalties into petroleum and natural gas revenues for the period.

The increases in the effective royalty rates from the Comparable Prior Periods were largely due to lower royalty credits against natural gas royalties payable. This reduction in the royalty credits, totaling approximately $2.2 million, was due to a combination of the lower natural gas prices at the wellhead and the annual reconciliation of the 2010 Gas Costs Allowance estimates to actuals. Lower natural gas prices in 2010 reduced the Crown facility effective royalty rates that are used to determine the Gas Costs Allowance credits. Excluding the $2.2 million royalty credit adjustment, the adjusted effective royalty rates for each of the three and six month Reporting Periods was approximately 10%.

*Royalty and Drilling Incentives*

There have been no significant changes to Alberta's royalty framework since December 31, 2010. Refer to the 2010 annual MD&A for discussion on royalty and drilling incentives proposed by the Alberta Government in 2009 and 2010.

Birchcliff has realized under the Drilling Royalty Credit ("**DRC**") incentive program a total of $19.7 million in drilling credits between April 1, 2009 and March 31, 2011. Birchcliff was entitled to a DRC of $200 per meter drilled, up to a maximum of 50% of the aggregate Crown royalties paid by the Corporation, for new conventional oil and gas wells spud after April 1, 2009 and rig released before April 1, 2011.

**Operating Costs**

Operating costs were $10.6 million ($6.74 per boe) for the three month Reporting Period and $21.8 million ($6.85 per boe) for the six month Reporting Period as compared to $8.7 million ($7.70 per boe) and $17.1 million ($8.30 per boe) for the Comparable Prior Periods. The following table compares operating costs for the Reporting Periods and Comparable Prior Periods:

| | **Three months ended June 30, 2011** | | Three months ended June 30, 2010 | |
|---|---|---|---|---|
| | ($000's) | $/boe | ($000's) | $/boe |
| Field operating costs | 12,306 | 7.81 | 9,893 | 8.80 |
| Recoveries | (1,694) | (1.07) | (1,361) | (1.21) |
| Field operating costs, net | 10,612 | 6.74 | 8,532 | 7.59 |
| Expensed workovers and other | 6 | - | 125 | 0.11 |
| **Total operating costs** | **10,618** | **6.74** | 8,657 | 7.70 |

| | **Six months ended June 30, 2011** | | Six months ended June 30, 2010 | |
|---|---|---|---|---|
| | ($000's) | $/boe | ($000's) | $/boe |
| Field operating costs | 25,131 | 7.92 | 19,221 | 9.33 |
| Recoveries | (3,813) | (1.20) | (2,434) | (1.19) |
| Field operating costs, net | 21,318 | 6.72 | 16,787 | 8.14 |
| Expensed workovers and other | 434 | 0.13 | 323 | 0.16 |
| **Total operating costs** | **21,752** | **6.85** | 17,110 | 8.30 |

Operating costs per boe decreased by 12% and 17% from the three and six month Comparable Prior Periods largely due to the operating benefits achieved from Phases I and II of the PCS Gas Plant, which commenced processing natural gas in March and November 2010 respectively, and to increased associated recoveries.

Birchcliff continues to focus on controlling and reducing operating costs on a per boe basis.

**Transportation and Marketing Expenses**

Transportation and marketing expenses were $4.2 million ($2.67 per boe) for the three month Reporting Period and $8.2 million ($2.60 per boe) for the six month Reporting Period as compared to $2.9 million ($2.61 per boe) and $5.4 million ($2.60 per boe) for the Comparable Prior Periods. These aggregate costs consist primarily of transportation expenses that were higher in the Reporting Periods mainly due to an increase in oil production, which has higher associated trucking charges, and an increase in natural gas production.

## Administrative Expenses

Net administrative expenses were $7.1 million ($4.52 per boe) for the three month Reporting Period and $13.5 million ($4.24 per boe) for the six month Reporting Period as compared to $5.1 million ($4.49 per boe) and $11.9 million ($5.79 per boe) for the Comparable Prior Periods. The components of administrative expenses for the Reporting Periods and Comparable Prior Periods are as follows:

| | **Three months ended June 30, 2011** | | Three months ended June 30, 2010 | |
|---|---|---|---|---|
| | ($000's) | % | ($000's) | % |
| *Cash:* | | | | |
| Salaries and benefits[(1)] | 3,259 | 52 | 2,711 | 63 |
| Other | 2,966 | 48 | 1,606 | 37 |
| | 6,225 | 100 | 4,317 | 100 |
| Operating overhead recoveries | (245) | (4) | (312) | (7) |
| Capitalized overhead[(2)] | (1,148) | (18) | (819) | (19) |
| General & administrative, net | 4,832 | 78 | 3,186 | 74 |
| General & administrative, net per boe | $3.07 | | $2.83 | |
| *Non-cash:* | | | | |
| Stock-based compensation | 3,470 | 100 | 2,715 | 100 |
| Capitalized stock-based compensation[(2)] | (1,188) | (34) | (849) | (31) |
| Stock-based compensation, net | 2,282 | 66 | 1,866 | 69 |
| Stock-based compensation, net per boe | $1.45 | | $1.66 | |
| **Total administrative expenses, net** | **7,114** | **73** | 5,052 | 72 |
| **Total administrative expenses, net per boe** | **$4.52** | | $4.49 | |

| | **Six months ended June 30, 2011** | | Six months ended June 30, 2010 | |
|---|---|---|---|---|
| | ($000's) | % | ($000's) | % |
| *Cash:* | | | | |
| Salaries and benefits[(1)] | 6,478 | 55 | 5,322 | 57 |
| Other | 5,336 | 45 | 3,977 | 43 |
| | 11,814 | 100 | 9,299 | 100 |
| Operating overhead recoveries | (562) | (5) | (632) | (7) |
| Capitalized overhead[(2)] | (2,109) | (18) | (2,079) | (22) |
| General & administrative, net | 9,143 | 77 | 6,588 | 71 |
| General & administrative, net per boe | $2.88 | | $3.19 | |
| *Non-cash:* | | | | |
| Stock-based compensation | 6,440 | 100 | 7,513 | 100 |
| Capitalized stock-based compensation[(2)] | (2,110) | (33) | (2,158) | (29) |
| Stock-based compensation, net | 4,330 | 67 | 5,355 | 71 |
| Stock-based compensation, net per boe | $1.36 | | $2.60 | |
| **Total administrative expenses, net** | **13,473** | **74** | 11,943 | 71 |
| **Total administrative expenses, net per boe** | **$4.24** | | $5.79 | |

(1) Includes salaries and benefits paid to all directors, officers, employees and consultants of the Corporation.

(2) Includes a portion of salaries and benefits and stock-based compensation that are directly attributable to the exploration and development of the Corporation's assets that have been capitalized.

Net administrative expenses increased on an aggregate basis from the Comparable Prior Periods largely as a result of the increased company growth quarter over quarter. On a per boe basis, net administrative expenses decreased from the six month Comparable Prior Period mainly due to additional production volumes added from Phases I and II of the PCS Gas Plant.

A summary of the Corporation's outstanding stock options at June 30, 2011 is presented below:

| | Number | Weighted Average Exercise Price ($) |
|---|---|---|
| Outstanding, December 31, 2009 | 7,710,253 | 5.81 |
| Granted | 3,350,300 | 9.61 |
| Exercised | (1,314,232) | (4.63) |
| Forfeited | (498,801) | (7.41) |
| Outstanding, December 31, 2010 | 9,247,520 | 7.26 |
| Granted | 2,767,900 | 11.35 |
| Exercised | (998,010) | (5.22) |
| Forfeited | (121,302) | (7.90) |
| Outstanding, March 31, 2011 | 10,896,108 | 8.48 |
| Granted | 301,000 | 12.67 |
| Exercised | (369,433) | (5.66) |
| Forfeited | (127,000) | (11.69) |
| **Outstanding, June 30, 2011** | **10,700,675** | **8.66** |

On January 14, 2005, the Corporation issued 4,049,665 performance warrants with an exercise price of $3.00 and an expiration date of January 31, 2010 to members of its executive team. On May 28, 2009, the outstanding performance warrants were amended following receipt of shareholder approval to extend the expiration date from January 31, 2010 to January 31, 2015. There remained 2,939,732 outstanding and exercisable performance warrants at June 30, 2011.

Each stock option and performance warrant entitles the holder to purchase one common share at the exercise price.

### Depletion and Depreciation Expenses

Depletion and Depreciation ("**D&D**") expenses were $16.0 million ($10.17 per boe) for the three month Reporting Period and $32.1 million ($10.12 per boe) for the six month Reporting Period as compared to $12.6 million ($11.19 per boe) and $22.5 million ($10.90 per boe) for the Comparable Prior Periods. D&D expenses increased on an aggregate basis mainly due to a 40% and 54% increase in average daily production from the three and six month Comparable Prior Periods. D&D expenses decreased on a per boe basis from the Comparable Prior Periods mainly due to the reduced cost of adding significant proved plus probable reserves recorded in the fourth quarter of 2010.

D&D is a function of the estimated proved plus probable reserve additions, the finding and development costs attributable to those reserves, the associated future development capital required to recover those reserves and production in the period. The Corporation determines its D&D expenses on a field area basis.

*Impairment Test*

The Corporation performed an impairment review of its petroleum and natural gas assets to assess for recoverability. The Corporation's assets were not impaired at June 30, 2011 and December 31, 2010.

## Finance Expenses

Finance expenses were $5.4 million ($3.42 per boe) for the three month Reporting Period and $10.9 million ($3.44 per boe) for the six month Reporting Period as compared to $4.1 million ($3.66 per boe) and $7.9 million ($3.85 per boe) for the Comparable Prior Periods. The components of the Corporation's finance expenses for the Reporting Periods and Comparable Prior Periods are as follows:

| | **Three months ended June 30, 2011** | | Three months ended June 30, 2010 | |
|---|---|---|---|---|
| | ($000's) | $/boe | ($000's) | $/boe |
| *Cash:* | | | | |
| Interest on credit facilities(1) | 4,724 | 2.99 | 3,126 | 2.78 |
| *Non-cash:* | | | | |
| Accretion on decommissioning obligations | 446 | 0.28 | 350 | 0.31 |
| Amortization of deferred financing fees | 236 | 0.15 | 643 | 0.57 |
| **Total finance expenses** | **5,406** | **3.42** | 4,119 | 3.66 |

| | **Six months ended June 30, 2011** | | Six months ended June 30, 2010 | |
|---|---|---|---|---|
| | ($000's) | $/boe | ($000's) | $/boe |
| *Cash:* | | | | |
| Interest on credit facilities(1) | 9,533 | 3.01 | 6,105 | 2.97 |
| *Non-cash:* | | | | |
| Accretion on decommissioning obligations | 884 | 0.28 | 677 | 0.33 |
| Amortization of deferred financing fees | 490 | 0.15 | 1,137 | 0.55 |
| **Total finance expenses** | **10,907** | **3.44** | 7,919 | 3.85 |

(1) Interest costs for the three months ended June 30, 2011 consists of $4.4 million (June 30, 2010 - $3.1 million) related to the Corporation's Revolving Credit Facilities and $0.3 million (June 30, 2010 - $NIL million) related to non-revolving term credit facilities. For the six months ended June 30, 2011, the Corporation's interest costs include $9.2 million (June 30, 2010 - $5.4 million) related to the Revolving Credit Facilities and $0.3 million (June 30, 2010 - $0.7 million) related to non-revolving term credit facilities.

The aggregate interest expense from the Comparable Prior Periods increased mainly due to a higher average balance on the outstanding total credit facilities, offset by new lower pricing margins (that are used to determine Birchcliff's average effective interest rate) that became applicable when the bank syndicate increased the credit limit of the Corporation's Revolving Credit Facilities limit in each of the previous three years. The Corporation's average outstanding total credit facilities balance was approximately $338 million and $336 million in the three and six month Reporting Periods as compared to $223 million and $215 million in the Comparable Prior Periods, calculated as the simple average of the month end amounts. This increase was largely due to the significant capital expended on the PCS Gas Plant project in 2010.

In May 2011, the Corporation had drawn the full $70 million applicable to the Non-Revolving Five-Year Term Facility, the proceeds of which were used to reduce the amounts outstanding on the Corporation's Revolving Credit Facilities. During the same period in 2010, the corporation repaid and cancelled the $50 million Non-Revolving One-Year Term Facility, which was outstanding since January 2010.

The effective interest rate applicable to the Working Capital Facility was 5.8% at the end of the Reporting Period as compared to 5.8% at the end of the Comparable Prior Period. The effective interest rates applicable to the bankers' acceptances issued under the revolving Syndicated Credit Facility were 5.9% and 6.1% for the three and six month Reporting Periods as compared to 4.9% and 5.1% for the Comparable Prior Periods. The effective interest rates applicable to the bankers' acceptances issued under the non-revolving term credit facilities was 5.1% for both the three and six month Reporting Periods as compared to 5.7% and 5.9% for the Comparable Prior Periods.

### Gain (Loss) on Sale of Assets

During the current quarter, Birchcliff disposed of minor non-core assets for $5.5 million and recorded a net loss of approximately $0.9 million ($0.7 million, net of tax) or $0.58 per boe in that period.

In March 2010, Birchcliff disposed of its interest in a minor non-producing asset in the Kakut area of Alberta for $17.5 million and recognized a gain of approximately $15.5 million ($11.6 million, net of tax) or $7.53 per boe during the six months ended June 30, 2010.

### Income Taxes

Birchcliff recorded a deferred income tax expense of approximately $4.2 million ($2.69 per boe) and $8.2 million ($2.57 per boe) for the three and six month Reporting Periods, respectively, as compared to $2.5 million ($2.22 per boe) and $9.3 million ($4.51 per boe) for the Comparable Prior Periods. The increase in deferred income tax expense from the three month Comparable Prior Period was largely due to higher recorded net income in the current quarter as a result of higher average oil prices and increased production, offset by higher D&D expenses.

The decrease in deferred income tax expense from the six month Comparable Prior Period was largely due to the gain on sale of the Kakut assets in March 2010, which resulted in higher recorded net income in that period.

## CAPITAL EXPENDITURES AND CAPITAL RESOURCES

### Capital Expenditures

The following table sets forth a summary of the Corporation's capital expenditures incurred for the Reporting Periods and Comparable Prior Periods:

| **Three months ended June 30,** | **2011** | 2010 |
|---|---|---|
| Land | 6,398 | 8,786 |
| Seismic | 262 | 122 |
| Workovers | 3,334 | 2,732 |
| Drilling and completions(1) | 16,399 | 17,052 |
| Well equipment and facilities | 7,042 | 13,282 |
| Total finding and development costs (F&D) | 33,435 | 41,974 |
| Acquisitions and dispositions(2) | (1,403) | - |
| Total finding, development and acquisition costs (FD&A) | 32,032 | 41,974 |
| Administrative assets | 268 | 296 |
| **Total capital expenditures** | **32,300** | 42,270 |

| **Six months ended June 30,** | **2011** | 2010 |
|---|---|---|
| Land | 11,461 | 11,727 |
| Seismic | 2,876 | 559 |
| Workovers | 7,324 | 4,075 |
| Drilling and completions(1) | 45,907 | 39,215 |
| Well equipment and facilities | 17,360 | 38,233 |
| Total finding and development costs (F&D) | 84,928 | 93,809 |
| Acquisitions and dispositions(2) | (1,185) | (17,511) |
| Total finding, development and acquisition costs (FD&A) | 83,743 | 76,298 |
| Administrative assets | 736 | 376 |
| **Total capital expenditures** | **84,479** | 76,674 |

(1) Included in drilling and completions for the three and six months ended June 30, 2011 is a recovery of $1.2 million and $3.5 million (June 30, 2010 - $5.5 million and $11.9 million) related to the Alberta Drilling Royalty Credit Program.

(2) During the current quarter, Birchcliff disposed of minor non-core assets for $5.5 million which resulted in a net loss on sale of approximately $0.9 million during the three and six months ended June 30, 2011. During the current quarter, the Corporation acquired approximately $4.1 million of properties. In March 2010, the Corporation disposed of a minor non-producing asset for $17.5 million which resulted in a gain of approximately $15.5 million on the sale during the six months ended June 30, 2010.

## Capital Resources

The following table sets forth a summary of the Corporation's capital resources for the Reporting Periods and Comparable Prior Periods:

| **Three months ended June 30,** | **2011** | 2010 |
|---|---|---|
| Cash flow | 34,269 | 23,013 |
| Changes in non-cash working capital from operations | 6,848 | (4,672) |
| Decommissioning expenditures | (212) | (160) |
| Exercise of stock options | 2,092 | 1,978 |
| Deferred financing fees paid | (1,356) | (1,018) |
| Increase (decrease) in amounts drawn under non-revolving term credit facilities | 69,456 | (50,000) |
| Increase (decrease) in amounts drawn under Revolving Credit Facilities | (64,506) | 78,092 |
| Changes in non-cash working capital from investing | (14,291) | (4,969) |
| **Total capital resources** | **32,300** | 42,264 |

| **Six months ended June 30,** | **2011** | 2010 |
|---|---|---|
| Cash flow | 66,582 | 44,625 |
| Changes in non-cash working capital from operations | (2,958) | (7,594) |
| Decommissioning expenditures | (678) | (195) |
| Exercise of stock options | 7,298 | 4,287 |
| Deferred financing fees paid | (1,356) | (1,268) |
| Increase in amounts drawn under non-revolving term credit facilities | 69,456 | - |
| Increase (decrease) in amounts drawn under Revolving Credit Facilities | (63,008) | 35,139 |
| Changes in non-cash working capital from investing | 4,345 | 1,680 |
| **Total capital resources** | **79,681** | 76,674 |

## SUMMARY OF QUARTERLY RESULTS

The following are the quarterly results of the Corporation for the eight most recently completed quarters:

| **Quarters Ended**<br>($000's, except for production, share and per share amounts) | **June 30, 2011** | March 31, 2011 | December 31, 2010 | September 30, 2010 |
|---|---|---|---|---|
| Petroleum and natural gas production (boe per day) | 17,324 | 17,742 | 16,375 | 13,109 |
| Petroleum and natural gas commodity price at wellhead ($ per boe) | 42.76 | 39.28 | 37.83 | 36.60 |
| Natural gas commodity price at wellhead ($ per mcf) | 4.15 | 4.02 | 3.94 | 3.79 |
| Petroleum commodity price at wellhead ($ per bbl) | 99.31 | 87.03 | 81.89 | 76.44 |
| Total petroleum and natural gas revenue | 67,464 | 62,793 | 57,072 | 44,125 |
| Total royalties | (8,801) | (6,199) | (4,388) | (3,561) |
| Total revenues, net | 58,663 | 56,594 | 52,684 | 40,564 |
| Total capital expenditures, net(1) | 32,300 | 52,179 | 45,730 | 92,520 |
| Net income(1) | 10,117 | 9,593 | 7,431 | 5,533 |
| Per share basic(1) | $0.08 | $0.08 | $0.06 | $0.04 |
| Per share diluted(1) | $0.08 | $0.07 | $0.06 | $0.04 |
| Cash flow(1) | 34,269 | 32,313 | 27,866 | 22,750 |
| Per share basic(1) | $0.27 | $0.26 | $0.22 | $0.18 |
| Per share diluted(1) | $0.26 | $0.25 | $0.22 | $0.18 |
| Book value of total assets(1) | 1,080,314 | 1,069,322 | 1,038,555 | 996,327 |
| Non-Revolving Five-Year Term Facility | 68,773 | - | - | - |
| Revolving Credit Facilities | 270,278 | 335,220 | 333,468 | 281,172 |
| Total debt | 349,190 | 352,804 | 337,424 | 319,921 |
| Shareholders' equity(1) | 632,588 | 616,909 | 599,140 | 587,796 |
| Common shares outstanding – end of period | | | | |
| basic | 126,496,677 | 126,127,244 | 125,129,234 | 124,912,134 |
| diluted | 140,137,084 | 139,963,084 | 137,316,486 | 137,364,386 |
| Weighted average common shares outstanding | | | | |
| basic | 126,322,814 | 125,424,658 | 124,994,761 | 124,872,806 |
| diluted(1) | 131,380,901 | 129,715,133 | 129,264,791 | 128,338,449 |

| **Quarters Ended**<br>($000's, except for production, share and per share amounts) | June 30, 2010 | March 31, 2010 | December 31, 2009(2) | September 30, 2009(2) |
|---|---|---|---|---|
| Petroleum and natural gas production (boe per day) | 12,357 | 10,407 | 10,515 | 10,552 |
| Petroleum and natural gas commodity price at wellhead ($ per boe) | 39.45 | 47.12 | 43.23 | 33.32 |
| Natural gas commodity price at wellhead ($ per mcf) | 4.16 | 5.34 | 4.81 | 3.20 |
| Petroleum commodity price at wellhead ($ per bbl) | 76.24 | 80.03 | 75.01 | 70.00 |
| Total petroleum and natural gas revenue | 44,546 | 44,235 | 41,908 | 32,446 |
| Total royalties | (3,621) | (5,363) | (5,172) | (3,644) |
| Total revenues, net | 40,925 | 38,872 | 36,736 | 28,802 |
| Total capital expenditures, net(1) | 42,270 | 34,404 | 44,368 | 33,442 |
| Net income (loss)(1) | 5,087 | 16,112 | 1,616 | (9,039) |
| Per share basic(1) | $0.04 | $0.13 | $0.01 | ($0.07) |
| Per share diluted(1) | $0.04 | $0.13 | $0.01 | ($0.07) |
| Cash flow(1) | 23,013 | 21,613 | 20,900 | 12,196 |
| Per share basic(1) | $0.18 | $0.17 | $0.17 | $0.10 |
| Per share diluted(1) | $0.18 | $0.17 | $0.17 | $0.10 |
| Book value of total assets(1) | 910,823 | 881,344 | 837,108 | 796,338 |
| Non-Revolving One-Year Term Facility | - | 49,661 | - | - |
| Revolving Credit Facilities | 235,993 | 158,614 | 201,230 | 182,589 |
| Total debt | 250,370 | 232,287 | 221,521 | 199,346 |
| Shareholders' equity(1) | 578,602 | 568,821 | 554,561 | 549,239 |
| Common shares outstanding – end of period | | | | |
| basic | 124,792,136 | 124,358,735 | 123,815,002 | 123,267,436 |
| diluted | 137,255,386 | 137,190,886 | 134,464,987 | 134,049,987 |
| Weighted average common shares outstanding | | | | |
| basic | 124,540,955 | 124,095,074 | 123,538,213 | 122,914,069 |
| diluted(1) | 127,966,923 | 128,048,514 | 126,358,921 | 122,914,069 |

(1) 2010 comparatives are restated to comply with IFRS requirements.

(2) Birchcliff's IFRS transition date was January 1, 2010 and therefore 2009 comparative information was not restated.

**Discussion of Quarterly Results**

Birchcliff's average production in the second quarter of 2011 was 17,324 boe per day, a 2% decrease from 17,742 boe per day in the first quarter of 2011 and a 40% increase from 12,357 boe per day in the second quarter of 2010. The decrease in production from the first quarter of 2011 was largely due to a scheduled plant turnaround at Worsley in late May 2011 and normal production declines through spring break-up. The increase in production from the second quarter of 2010 was largely achieved through the success of Birchcliff's Montney/Doig horizontal natural gas drilling program and the ability to process new or incremental natural gas through Phases I and II of the PCS Gas Plant, which commenced operation in March and November 2010, respectively.

Total capital expenditures (excluding minor acquisitions and dispositions) in the second quarter of 2011 were $33.7 million as compared to $52.0 million in the first quarter of 2011 and $42.3 million in the second quarter of 2010. Capital spent in the second quarter of 2011 was directed towards the drilling and completion of Montney/Doig horizontal natural gas wells that were tied into Phases I and II of the PCS Gas Plant; initial engineering and design of Phase III expansion of the PCS Gas Plant to bring total natural gas processing capacity to 120 mmcf per day from 60 mmcf per day; acquiring land; expanding the Montney/Doig Natural Gas Resource Play and the Worsley Light Oil Resource Play and related infrastructure; and on other projects. Further details of the Corporation's capital expenditures are set forth in the table entitled "Capital Expenditures" in this MD&A.

Cash flow generated by the Corporation in the second quarter of 2011 was $34.3 million as compared to $32.3 million in the first quarter of 2011 and $23.0 million in the second quarter of 2010. The 6% increase in cash flow from the previous quarter was mainly due to higher average petroleum and natural gas prices realized at the wellhead, notwithstanding lower average daily production in the current quarter as compared to the first quarter of 2011. The 49% increase in cash flow as compared to the second quarter of 2010 was largely due to increased average daily production and higher average oil prices realized at the wellhead, notwithstanding increased G&A expenses, higher interest expenses and a proportionate increase in royalty, operating and transportation and marketing costs due to higher average production in the current quarter as compared to the second quarter of 2010.

Despite low natural gas prices, Birchcliff has reported net income in each of its seven recently completed quarters. Birchcliff recorded net income of $10.1 million in the second quarter of 2011 as compared to net income of $9.6 million in the first quarter of 2011 and $5.1 million in the second quarter of 2010. The increase in net income from the comparative quarters was mainly a result of higher cash flow, notwithstanding higher D&D expenses reported during the current quarter as compared to the second quarter of 2010 as a result of significant increases in production. D&D expenses have largely remained unchanged since the first quarter of 2011.

Canadian Edmonton Par oil prices averaged $103.07 per barrel in the second quarter of 2011 as compared to $87.97 per barrel in the first quarter of 2011 and $75.18 per barrel in the second quarter of 2010. The AECO daily natural gas spot price averaged $3.87 per mcf in the second quarter of 2011 as compared to $3.79 per mcf in the first quarter of 2011 and $3.89 per mcf in the second quarter of 2010.

Total debt (including working capital deficit) was $349.2 million at the end of the current quarter as compared to $352.8 million at March 31, 2011 and $250.4 million at June 30, 2010. During the current quarter, Birchcliff had drawn the full $70 million using bankers' acceptances applicable to the Non-Revolving Five-Year Term Facility, the proceeds of which were used to reduce the amounts outstanding on the Corporation's Revolving Credit Facilities. The increase in total debt from June 30, 2010 was largely due to increased capital spending in excess of cash flow on Phase II of the PCS Gas Plant project.

## MERGERS & ACQUISITIONS

Within its focus area, the Corporation is always reviewing potential property acquisitions and corporate mergers and acquisitions for the purposes of determining whether any such potential transaction is of interest to the Corporation and the terms on which such a potential transaction would be available. As a result, the Corporation may from time to time be involved in discussions or negotiations with other parties or their agents in respect of potential property acquisitions and corporate merger and acquisition opportunities, but the Corporation is not committed to any such potential transaction and cannot be reasonably confident that it can complete any such potential transaction until appropriate legal documentation has been signed by the relevant parties.

## CONTROLS AND PROCEDURES

### Disclosure Controls

The Corporation has established and maintains disclosure controls and procedures that have been designed by, or under the supervision of, the Corporation's Chief Executive Officer and the Chief Financial Officer ("**Certifying Officers**") to provide reasonable assurance that information required to be disclosed by the Corporation in its annual filings, interim filings or other reports filed or submitted by it under securities legislation is recorded, processed, summarized and reported within the time periods specified in the securities legislation and to ensure that information required to be disclosed by an issuer in its annual filings, interim filings or other reports filed or submitted under securities legislation is accumulated and communicated to the Corporation's management, including its Certifying Officers, as appropriate to allow timely decisions regarding required disclosure. Such disclosure controls and procedures are referred to as the "**Disclosure Controls and Procedures**".

The Certifying Officers have evaluated, or caused to be evaluated under their supervision, the effectiveness of the Corporation's Disclosure Controls and Procedures as at June 30, 2011 and have concluded that such Disclosure Controls and Procedures were effective as at that date to provide reasonable assurance that information required to be disclosed by the Corporation in its annual filings, interim filings or other reports filed or submitted by it under securities legislation is recorded, processed, summarized, and reported within the time periods specified in the securities legislation and that information required to be disclosed by the Corporation in its annual filings, interim filings or other reports filed or submitted under securities legislation is accumulated and communicated to the Corporation's management, including the Certifying Officers, as appropriate to allow timely decisions regarding required disclosure.

While the Certifying Officers believe that the Corporation's Disclosure Controls and Procedures are effective to provide a reasonable level of assurance, they do not expect that the Disclosure Controls and Procedures will provide an absolute level of assurance or prevent all errors and fraud. A control system, no matter how well conceived, maintained and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are achieved.

### Internal Controls over Financial Reporting

The Corporation has established and maintains internal controls over financial reporting that have been designed by, or under the supervision of, the Corporation's Certifying Officers to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with IFRS applicable to the Corporation and reasonable assurance that all assets are safeguarded and transactions are appropriately authorized and recorded to facilitate the preparation of relevant, reliable and timely information. Such internal controls over financial reporting are herein referred to as "**ICFR"**. The Certifying Officers have evaluated, or caused to be evaluated under their supervision, the effectiveness of the Corporation's ICFR as required by National Instrument 52-109, *Certification of Disclosure in Issuers' Annual and Interim Filings*. Based on that evaluation, the Certifying

Officers concluded that the Corporation's ICFR was effective at June 30, 2011 for the purposes described above. It should be noted that a control system, no matter how well conceived, maintained and operated, can provide only reasonable, but not absolute, assurance that the objectives of the control system will be met and it should not be expected that the ICFR will prevent all errors and fraud.

## TRANSITION TO INTERNATIONAL FINANCIAL REPORTING STANDARDS

### First-time Adoption of IFRS

Birchcliff's condensed financial statements as at and for the three and six month periods ended June 30, 2011 and comparative financial statements as at and for the three and six months ended June 30, 2010, as at and for the year ended December 31, 2010 and an opening Statement of Financial Position as at January 1, 2010 (the "**transition date**") have been prepared in accordance with IFRS as issued by the IASB. Previously, the Corporation prepared its annual and interim financial statements in accordance with Canadian GAAP applicable to publically accountable enterprises. Since the condensed financial statements for the three and six months ended June 30, 2011 represent the Corporation's presentation of its results and financial position under IFRS, they have been prepared in accordance with International Accounting Standard ("**IAS**") 34 *Interim Financial Reporting* and IFRS 1 *First-time Adoption of IFRS.*

IFRS 1 requires the consistent and retrospective application of IFRS accounting policies for comparative information as at January 1, 2010 and subsequent 2010 comparative periods. To assist with the transition, the provisions of IFRS 1 allow for certain mandatory and optional exemptions for first-time adopters to alleviate the full retrospective application of IFRS. Birchcliff has elected to apply the following relevant exemptions:

- IFRS 1 *First-time Adoption of IFRS,* whereby Property, Plant and Equipment ("**PP&E**") balance as determined under the Corporation's previous accounting framework (Canadian GAAP) is allocated to the IFRS categories of exploration and evaluation assets and development and production properties. Under the exemption, for assets in the development and production phases, the amount is allocated to the underlying IFRS transitional assets on a pro-rata basis using proved plus probable reserve volumes as of the IFRS transition date;
- IFRS 2 *Share-based Payments*, whereby stock options that vested prior to January 1, 2010 are not required to be retrospectively restated. Therefore, IFRS 2 requirements apply only to those options that were unvested at the transition date; and
- IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, whereby the Corporation has elected to measure decommissioning obligations as at the transition date in accordance with IAS 37 and recognize directly in deficit the difference between that amount and the carrying amount of those liabilities at the date of transition determined under Canadian GAAP.

Hindsight was not used to create or revise estimates and accordingly the estimates previously made by the Corporation under Canadian GAAP are consistent with their application under IFRS. A summary of the IFRS 1 mandatory and optional exemptions are also described in Note 18 to the condensed financial statements.

### Significant IFRS Accounting Policies

The IFRS accounting policies are set forth in Note 3 of the condensed financial statements for the period ended March 31, 2011. A detailed explanation of how the transition from Canadian GAAP to IFRS has affected the Corporation's financial position, financial performance, and cash flow, including the reconciliations required by IFRS 1, is presented in Note 18 to the condensed financial statements for the Reporting Periods.

The adoption of IFRS does not impact the underlying economics of Birchcliff's operations. The most significant impacts of adoption are from the application of new accounting policies that reset the Corporation's opening financial position at January 1, 2010, and changes in the accounting for PP&E, decommissioning obligations, stock-based compensation and income taxes. Birchcliff also adopted certain presentation policies that differ from Canadian GAAP. The following discusses the significant accounting policy and presentation differences under IFRS:

*Depletion and depreciation expense*

Under Canadian GAAP, the Corporation used total proved reserves in determining D&D expenses. Under IFRS, the carrying amount of PP&E is depleted or amortized over the useful life of the assets. Birchcliff has determined that depleting on a total proved plus probable reserve basis better approximates the useful life of the Corporation's assets. D&D was calculated at the country cost center level using the unit of production method on the full cost pool of assets under Canadian GAAP. Under IFRS, the net carrying value of developed and producing assets is depleted using the unit of production method at the area level. As a result of this accounting policy difference, D&D expenses decreased on average by approximately $5.8 million per quarter in 2010.

*Gain on sale of assets*

Under Canadian GAAP, proceeds from the sale of assets were deducted from the full cost pool without the recognition of a gain or loss unless the sale resulted in a change in the full cost depletion rate of 20 percent or more. Under IFRS, gains or losses on disposition of assets are measured as the difference between the proceeds and carrying value of the assets divested. As a result of this accounting policy difference, Birchcliff recorded a gain on sale of assets of $15.5 million ($11.6 million, net of tax) in 2010.

*Impairment testing*

Under Canadian GAAP, the recoverable amount of Birchcliff's petroleum and natural gas assets under the first step of the impairment test is determined using undiscounted future cash flow from proved reserves. Under IFRS, the recoverable amount is calculated using discounted after-tax future cash flow from proved plus probable reserves. In addition, impairment testing under Canadian GAAP is performed at the country cost centre level, while under IFRS the Corporation's assets are grouped into cash-generating units based on their ability to generate largely independent cash flows. As of January 1, 2010 and December 31, 2010, no impairment was determined under IFRS.

*Decommissioning obligations*

Under Canadian GAAP, Birchcliff used a credit-adjusted discount rate of 8% in estimating the decommissioning obligations (formerly known as asset retirement obligations under Canadian GAAP). Under IFRS, the Corporation's policy is to estimate the decommissioning obligations using a risk-free discount rate on transition to IFRS. The effect of using a risk-free discount rate of 4.0% resulted in an increase of $12.0 million to the decommissioning liability with a corresponding increase to the Corporation's deficit at January 1, 2010. Accretion of decommissioning obligations has decreased by approximately $0.1 million per quarter in 2010.

*Stock-based compensation expense*

Under Canadian GAAP, the fair value of stock options was calculated using a Black-Scholes option-pricing model for each option grant and the resulting expense was recognized on a straight-line basis over the three year vesting period at a rate of one-third on each anniversary date of the stock option grant. Forfeitures of stock options were recognized as they occurred.

Under IFRS, each vesting tranche of an option grant with different vesting dates was considered a separate grant for the calculation of fair value. This resulted in accelerated expense recognition that attributed higher stock-based compensation expense in early years of an option grant and less expense in later years. Birchcliff also applied an estimated forfeiture rate at the initial grant date. When determining the fair value of each vesting tranche under IFRS, Birchcliff applied an estimated weighted average option life which reflects historical experiences. Under Canadian GAAP, the option life was equal to the expiry period of five years.

The above accounting policy differences resulted in an increase of $2.5 million to contributed surplus with a corresponding increase to the Corporation's deficit at January 1, 2010. Stock-based compensation expense increased during the year ended December 31, 2010 by approximately $2.7 million (June 30, 2010 - $2.3 million) from the amounts previously recorded under Canadian GAAP.

*Administrative expense*

Under Canadian GAAP, "capitalized overhead" related to estimated time spent on capital projects by engineering, land, accounting and operations and was based on an industry standard overhead charge per Authorization for Expenditure. Stock-based compensation was not capitalized under Canadian GAAP. Under IFRS, capitalized overhead includes a portion of salaries and benefits that are "directly" attributable to the exploration and development of the Corporation's assets. This varies in some respects from the amounts recorded under Canadian GAAP. In addition, under IFRS, Birchcliff has capitalized a portion of stock-based compensation directly attributable to exploration and development projects.

These accounting policy differences resulted in an increase to net general and administrative expenses (cash) by $5.6 million during the year ended December 31, 2010 (June 30, 2010 – $2.2 million) from amounts previously reported under Canadian GAAP. In addition, the Corporation capitalized non-cash stock-based compensation totalling $5.5 million during the year ended December 31, 2010 (June 30, 2010 – $2.2 million).

*Share capital*

Under Canadian GAAP, the proceeds from the issuance of flow-through shares are recognized as shareholders' equity. The tax basis of assets related to expenditures incurred to satisfy flow-through share obligations is reduced when the renunciation of the related tax pools occurs which then increases the deferred income tax liability and reduces share capital.

Under IFRS, the amount recorded to share capital from the issuance of flow-through shares reflects the fair market value of "regular" common shares. The difference between the total value of a flow-through share issuance and the fair market value of regular common share issuance (premium) is initially accrued as a deferred obligation when the flow-through shares are issued. Pursuant to the terms of the flow-through share agreements, the tax deductions associated with the expenditures are renounced to the subscribers. Accordingly, on renunciation with the Canada Revenue Agency, a deferred tax liability is recorded equal to the estimated amount of deferred income taxes payable by the Corporation as a result of the renunciations, the obligation on issuance of flow-through shares is reduced, and the difference is recognized in profit or loss. There is no impact to share capital on renunciation of flow-through shares.

The above accounting policy differences resulted in an increase to share capital of $4.3 million with a corresponding increase to deficit at January 1, 2010. There was no impact due to this accounting policy difference as at and during the periods ended December 31, 2010.

*Deferred income tax expense*

Each of the adjustments discussed above result in a change in deferred income tax assets and liabilities based on Birchcliff's effective tax rate. The Corporation recorded a decrease in deferred tax liabilities of $3.0 million at January 1, 2010 and an increase in deferred tax liabilities of $5.5 million at December 31, 2010 from amounts previously reported under Canadian GAAP. Additional deferred income tax expenses of $6.5 million for the six months ended June 30, 2010 and $8.5 million for the year ended December 31, 2010 were recorded under IFRS.

*Reclassifications*

Under Canadian GAAP, interest expense, financing charges and accretion were disclosed as separate line items in profit or loss. Under IFRS, these amounts were reported as finance expenses. Interest paid is disclosed separately as an operating item in the Condensed Statements of Cash Flows.

Under Canadian GAAP, G&A expenses (cash) and non-cash stock-based compensation expenses were disclosed as separate line items in profit or loss. Under IFRS, these items were grouped and reported as administrative expenses.

## CRITICAL ACCOUNTING ESTIMATES

The preparation of the condensed financial statements requires management to make judgments, estimates and assumptions that affect the application of IFRS accounting policies and reported amounts of assets and liabilities and income and expenses. Accordingly, 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 period in which the estimates are revised and in any future periods affected. The following are the critical judgments and estimations that management has made in the process of applying the Corporation's IFRS accounting policies and that have the most significant effect on the amounts recognized in these financial statements:

*Reserves*

Estimation of reported recoverable quantities of proved and probable reserves include judgmental assumptions regarding production profile, commodity prices, exchange rates, remediation costs, timing and amount of future development costs, and production, transportation and marketing costs for future cash flows. It also requires interpretation of geological and geophysical models in order to make an assessment of the size, shape, depth and quality of reservoirs, and their anticipated recoveries. The economical, geological and technical factors used to estimate reserves may change from period to period. Changes in reported reserves can impact the carrying values of the Corporation's petroleum and natural gas properties and equipment, the calculation of depletion and depreciation, the provision for decommissioning obligations, and the recognition of deferred tax assets due to changes in expected future cash flows. The recoverable quantities of reserves and estimated cash flows from Birchcliff's petroleum and natural interests are independently evaluated by reserve engineers at least annually.

The Corporation's petroleum and natural gas reserves represent the estimated quantities of crude oil, natural gas and natural gas liquids which geological, geophysical and engineering data demonstrate with a specified degree of certainty to be economically recoverable in future years from known reservoirs and which are considered commercially producible. Such reserves may be considered commercially producible if management has the intention of developing and producing them and such intention is based upon (i) a reasonable assessment of the future economics of such production; (ii) a reasonable expectation that there is a market for all or substantially all the expected oil and natural gas production; and (iii) evidence that the necessary production, transmission and transportation facilities are available or can be made available. Reserves may only be considered proven and probable if producibility is supported by either production or conclusive formation tests. Birchcliff's oil and gas reserves are determined pursuant to National Instrument 51-101, *Standard of Disclosures for Oil and Gas Activities*.

*Decommissioning obligations*

The Corporation estimates future remediation costs of production facilities, wells and pipelines at different stages of development and construction of assets or facilities. In most instances, removal of assets occurs many years into the future. This requires judgment regarding abandonment date, future environmental and regulatory legislation, the extent of reclamation activities, the engineering methodology for estimating cost, future removal technologies in determining the removal cost and liability-specific discount rates to determine the present value of these cash flows.

*Stock-based compensation*

All share-based awards issued by the Corporation are fair valued using the Black-Scholes option-pricing model. In assessing the fair value of share-based compensation, estimates have to be made regarding the expected volatility in share price, option life, dividend yield, risk-free rate and estimated forfeitures at the initial grant date.

*Impairment of assets*

The impairment testing of PP&E is based on estimates of proved plus probable reserves, production rates, forecasted petroleum and natural gas prices, future costs and other relevant assumptions. Birchcliff's assets are aggregated into cash-generating units, for the purpose of calculating impairment, based on their ability to generate largely independent cash flows. By their nature, these estimates and assumptions are subject to measurement uncertainty and may impact the carrying value of the Corporation's assets in future periods.

*Income taxes*

Tax provisions are based on enacted or substantively enacted laws. Changes in those laws could affect amounts recognized in profit or loss both in the period of change, which would include any impact on cumulative provisions, and in future periods.

## ADVISORIES

### *BOE Conversions*

*Barrels of oil equivalent ("boe") amounts may be misleading, particularly if used in isolation. A boe conversion ratio of six thousand cubic feet (6 mcf) of natural gas to one barrel of oil (1 bbl) is based on an energy equivalent conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead.*

### *Non-IFRS Measures*

*This MD&A and the Corporation's Quarterly and Annual Reports may use terms such as "cash flow", "netback", "cash flow netback", "operating netback", "cash flow per share", "cash flow from operations and "EBITDA", which do not have standardized meanings prescribed by IFRS and therefore may not be comparable to measures by other companies where similar terminology is used. Cash flow from operations denotes cash flow from operating activities as it appears on the Corporation's Condensed Statements of Cash Flows before decommissioning expenditures and changes in non-cash working capital. Netback denotes petroleum and natural gas revenue less royalties, less operating expenses and less transportation and marketing expenses. Cash flow netback denotes net earnings plus non-cash items including deferred income tax expense (less any recovery), depletion and depreciation expense, accretion expense, stock-based compensation expense, amortization of deferred financing fees and gain (loss) on divestitures.*

### *Forward Looking Information*

*This MD&A contains certain forward-looking statements and forward-looking information (hereinafter collectively referred to as "forward-looking information") within the meaning of applicable Canadian securities laws. These statements relate to future events or future performance and are based upon the Corporation's current internal expectations, estimates, projections, assumptions and beliefs. All statements other than statements of historical fact are forward-looking statements. In some cases, words such as "plan", "expect", "project", "intend", "believe", "anticipate", "estimate", "may", "will", "potential", "proposed" and other similar words, or statements that certain events or conditions "may" or "will" occur, are intended to identify forward-looking statements.*

*In particular, this MD&A contains forward-looking information relating to Birchcliff's intention to expand its processing facilities, drill and complete future wells, increase its production, scale up the development of its assets and estimating the number of its potential Montney/Doig horizontal natural gas drilling locations. Other forward looking information includes but is not limited to planned 2011 and 2012 capital spending and sources of funding; expected results from the Corporation's portfolio of oil and gas assets; the quantity and development of oil and gas reserves; future net cash flows and discounted cash flows; expected operating, general administrative, services, environmental compliance costs and expenses; royalty rates and incentives; treatment under tax laws; expected ability to adopt new accounting pronouncements and other expectations, beliefs, plans, goals, objectives, assumptions, information and statements about possible future events, conditions, results of operations or performance. The Corporation cannot guarantee future results, levels of activity, performance or achievements. Consequently, there is no representation by the Corporation that actual results achieved will be the same in whole or in part as those set out in the forward-looking information.*

*With respect to such forward-looking information the key assumptions on which the Corporation relies are: that future prices for crude oil and natural gas, future currency exchange rates and interest rates, and future availability of debt and equity financing will be at levels and costs that allow the Corporation to manage, operate and finance its business and develop its properties and meet its future obligations; that the regulatory framework in respect of royalties, taxes and environmental matters applicable to the Corporation will not become so onerous as to preclude the Corporation from viably managing, operating and financing its business and the development of its properties; that the Corporation will continue to be* *able to identify, attract and employ qualified staff and obtain the outside expertise and specialized and other equipment it requires to manage, operate and finance its business and develop its properties; and various assumptions as to future prices for crude oil and natural gas, currency exchange rates, inflation rates, future well production rates, well drainage areas, success rates of future well drilling and future costs and availability of labour and services. With respect to estimates of reserves volumes and associated future net revenues and numbers of future wells to be drilled, a key assumption is the validity of the commodity prices, currency exchange rates, future capital and operating costs and well production rates forecast by the Corporation's independent reserves evaluator. With respect to the number of future wells to be drilled, a key assumption is the validity of the geological and other technical interpretations that have been performed by Birchcliff's technical staff and that indicate that commercially economic reserves can be recovered from Birchcliff's lands as a result of drilling such future wells.*

*Undue reliance should not be placed on forward-looking information, as there can be no assurance that the plans, intentions or expectations upon which they are based will occur. Forward-looking information involves numerous assumptions, uncertainties and both known and unknown risks. There is a risk that such predictions, forecasts and projections may not occur. Although the Corporation believes that the expectations reflected in the forward-looking statements are reasonable, there can be no assurance that such expectations will prove to be correct. Some of those risks include: risks inherent in the oil and gas industry, such as operational risks in exploring for, developing and producing crude oil and nature gas, market demand and unpredictable facilities outages; risks and uncertainties involving geology of oil and gas deposits; uncertainty of reserves and resources estimates, reserves life and underlying reservoir risk; general economic conditions in Canada, the United States and globally; changes in governmental regulation of the oil and gas industry, including environmental regulation; fluctuations in foreign exchange rates or interest rates; adverse conditions in the debt and equity markets; and competition from others for scarce resources.*

*The foregoing list of risk factors is not exhaustive. The forward-looking information contained in this MD&A is expressly qualified by this cautionary statement. Additional information on these and other risk factors that could affect operations or financial results are included in the Corporation's most recent Annual Information Form. In addition, information is available in the Corporation's other reports filed with Canadian securities regulatory authorities. Forward-looking information is based on estimates and opinions of management at the time the information is presented. The Corporation is not under any duty to update the forward-looking information after the date of this MD&A to conform such information to actual results or to changes in the Corporation's plans or expectations, except as otherwise required by applicable securities laws.*

**BIRCHCLIFF ENERGY LTD.**
**Condensed Statements of Financial Position**
**Unaudited** *(Expressed in thousands of Canadian Dollars)*

| | **June 30, 2011** | December 31, 2010 |
|---|---|---|
| **ASSETS** | | |
| Current assets: | | |
| Cash | **65** | 4,863 |
| Accounts receivable (Note 15) | **30,901** | 39,241 |
| Prepaid expenses and deposits | **3,383** | 2,661 |
| | **34,349** | 46,765 |
| Non-current assets: | | |
| Exploration and evaluation (Note 4) | **1,825** | 1,540 |
| Petroleum and natural gas properties and equipment (Note 5) | **1,044,140** | 990,250 |
| | **1,045,965** | 991,790 |
| | **1,080,314** | 1,038,555 |
| **LIABILITIES** | | |
| Current liabilities: | | |
| Accounts payable and accrued liabilities | **44,488** | 50,721 |
| Non-current liabilities: | | |
| Non-revolving term credit facilities (Note 6) | **68,773** | - |
| Revolving credit facilities (Note 7) | **270,278** | 333,468 |
| Decommissioning obligations (Note 8) | **42,916** | 42,106 |
| Deferred income taxes | **21,271** | 13,120 |
| | **403,238** | 388,694 |
| | **447,726** | 439,415 |
| **SHAREHOLDERS' EQUITY** | | |
| Share capital (Note 9) | **565,335** | 554,419 |
| Contributed surplus | **36,281** | 33,459 |
| Retained earnings (deficit) | **30,972** | 11,262 |
| | **632,588** | 599,140 |
| | **1,080,314** | 1,038,555 |

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

APPROVED BY THE BOARD

(signed) "Larry A. Shaw"
**Larry A. Shaw, Director**

(signed) "A. Jeffery Tonken"
**A. Jeffery Tonken, Director**

**BIRCHCLIFF ENERGY LTD.**

**Condensed Statements of Net Income and Comprehensive Income**

**Unaudited** *(Expressed in thousands of Canadian Dollars, except share information)*

| | Three months ended June 30, 2011 | Three months ended June 30, 2010 | Six months ended June 30, 2011 | Six months ended June 30, 2010 |
|---|---|---|---|---|
| **REVENUE** | | | | |
| Petroleum and natural gas | **67,464** | 44,546 | **130,257** | 88,781 |
| Royalties | **(8,801)** | (3,621) | **(15,000)** | (8,984) |
| | **58,663** | 40,925 | **115,257** | 79,797 |
| **EXPENSES** | | | | |
| Operating (Note 10) | **10,618** | 8,657 | **21,752** | 17,110 |
| Transportation and marketing | **4,220** | 2,943 | **8,247** | 5,369 |
| Administrative, net (Notes 11,13) | **7,114** | 5,052 | **13,473** | 11,943 |
| Depletion and depreciation (Note 5) | **16,039** | 12,587 | **32,103** | 22,471 |
| Finance (Note 12) | **5,406** | 4,119 | **10,907** | 7,919 |
| (Gain) loss on sale of assets (Note 5) | **915** | - | **915** | (15,528) |
| | **44,312** | 33,358 | **87,397** | 49,284 |
| **INCOME BEFORE TAXES** | **14,351** | 7,567 | **27,860** | 30,513 |
| Deferred income tax expense | **4,234** | 2,480 | **8,150** | 9,314 |
| **NET INCOME AND COMPREHENSIVE INCOME** | **10,117** | 5,087 | **19,710** | 21,199 |
| Net income per common share | | | | |
| basic | **$0.08** | $0.04 | **$0.16** | $0.17 |
| diluted | **$0.08** | $0.04 | **$0.15** | $0.17 |
| Weighted average common shares | | | | |
| basic | **126,322,814** | 124,540,955 | **125,877,298** | 124,320,253 |
| diluted | **131,380,901** | 127,966,923 | **131,030,694** | 128,235,511 |

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

**BIRCHCLIFF ENERGY LTD.**

**Condensed Statements of Changes in Shareholders' Equity**

**Unaudited** *(Expressed in thousands of Canadian Dollars, except share information)*

| | **Number of Common Shares** | **Share Capital** | **Contributed Surplus** | **Retained Earnings (Deficit)** | **Total** |
|---|---|---|---|---|---|
| Balance, January 1, 2010 | 123,815,002 | 545,675 | 22,828 | (22,901) | 545,602 |
| Exercise of stock options (Note 13) | 977,134 | 6,114 | (1,826) | - | 4,288 |
| Stock-based compensation (Note 11) | - | - | 7,513 | - | 7,513 |
| Net income and comprehensive income | - | - | - | 21,199 | 21,199 |
| Balance, June 30, 2010 | 124,792,136 | 551,789 | 28,515 | (1,702) | 578,602 |
| Balance, December 31, 2010 | 125,129,234 | 554,419 | 33,459 | 11,262 | 599,140 |
| Exercise of stock options (Note 13) | 1,367,443 | 10,916 | (3,618) | - | 7,298 |
| Stock-based compensation (Note 11) | - | - | 6,440 | - | 6,440 |
| Net income and comprehensive income | - | - | - | 19,710 | 19,710 |
| **Balance, June 30, 2011** | **126,496,677** | **565,335** | **36,281** | **30,972** | **632,588** |

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

**BIRCHCLIFF ENERGY LTD.**
**Condensed Statements of Cash Flows**
**Unaudited** *(Expressed in thousands of Canadian Dollars)*

| Cash provided by (used in): | Three months ended June 30, 2011 | Three months ended June 30, 2010 | Six months ended June 30, 2011 | Six months ended June 30, 2010 |
|---|---|---|---|---|
| **OPERATING** | | | | |
| Income before taxes | **14,351** | 7,567 | **27,860** | 30,513 |
| Adjustments for items not affecting operating cash: | | | | |
| Depletion and depreciation | **16,039** | 12,587 | **32,103** | 22,471 |
| Stock-based compensation | **2,282** | 1,866 | **4,330** | 5,355 |
| Finance | **5,406** | 4,119 | **10,907** | 7,919 |
| (Gain) loss on sale of assets | **915** | - | **915** | (15,528) |
| Interest paid | **(4,724)** | (3,126) | **(9,533)** | (6,105) |
| Decommissioning expenditures (Note 8) | **(212)** | (160) | **(678)** | (195) |
| Changes in non-cash working capital (Note 17) | **6,848** | (4,672) | **(2,958)** | (7,594) |
| | **40,905** | 18,181 | **62,946** | 36,836 |
| **FINANCING** | | | | |
| Exercise of stock options | **2,092** | 1,978 | **7,298** | 4,287 |
| Deferred financing fees paid | **(1,356)** | (1,018) | **(1,356)** | (1,268) |
| Increase (decrease) in non-revolving term credit facilities | **69,456** | (50,000) | **69,456** | - |
| Increase (decrease) in revolving credit facilities | **(64,506)** | 78,092 | **(63,008)** | 35,139 |
| | **5,686** | 29,052 | **12,390** | 38,158 |
| **INVESTING** | | | | |
| Acquisition of petroleum and natural gas properties and equipment | **(4,138)** | - | **(4,356)** | - |
| Sale of petroleum and natural gas properties and equipment | **5,541** | - | **5,541** | 17,511 |
| Additions of exploration and evaluation assets | **(20)** | (59) | **(280)** | (839) |
| Development of petroleum and natural gas properties and equipment | **(33,683)** | (42,211) | **(85,384)** | (93,346) |
| Changes in non-cash working capital (Note 17) | **(14,291)** | (4,969) | **4,345** | 1,680 |
| | **(46,591)** | (47,239) | **(80,134)** | (74,994) |
| **NET CHANGE IN CASH** | **-** | (6) | **(4,798)** | - |
| **CASH, BEGINNING OF PERIOD** | **65** | 146 | **4,863** | 140 |
| **CASH, END OF PERIOD** | **65** | 140 | **65** | 140 |

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

## 1. NATURE OF OPERATIONS

Birchcliff Energy Ltd. ("**Birchcliff**" or the "**Corporation**") is domiciled and incorporated in Canada. Birchcliff is engaged in the exploration for and the development, production and acquisition of petroleum and natural gas reserves in Western Canada. The Corporation's financial year end is December 31. The address of the Corporation's registered office is 500, 630 – 4$^{th}$ Avenue SW, Calgary, Alberta, Canada T2P 0J9. Birchcliff trades on the Toronto Stock Exchange under the symbol "**BIR**".

These condensed financial statements were approved and authorized for issuance by the Board of Directors on August 10, 2011.

## 2. BASIS OF PREPARATION

In conjunction with the Corporation's first annual audited financial statements to be issued under International Financial Reporting Standards ("**IFRS**") for the year ended December 31, 2011, these condensed financial statements present Birchcliff's financial results of operations and financial position under IFRS as at and for the three and six months ended June 30, 2011, including 2010 comparative periods. As a result, they have been prepared in accordance with International Accounting Standard ("**IAS**") 34 *Interim Financial Reporting*, as issued by the International Accounting Standards Board ("**IASB**").

These condensed financial statements have been prepared following the same IFRS accounting policies and methods of computation as set forth in Note 3 of the condensed financial statements for the period ended March 31, 2011. These condensed financial statements do not include all the necessary annual disclosures in accordance with IFRS. Previously, the Corporation prepared its interim and annual financial statements in accordance with Canadian Generally Accepted Accounting Principles ("**Canadian GAAP**").

The preparation of these condensed financial statements resulted in selected changes to the Corporation's accounting policies as compared to those disclosed in the Corporation's annual audited financial statements for the year ended December 31, 2010 issued under Canadian GAAP. Accordingly, the IFRS accounting policies have been retrospectively and consistently applied in preparing the financial statements for the 2010 comparative periods, except where specific exemptions permitted an alternative treatment upon transition to IFRS in accordance with IFRS 1 *First-time Adoption of IFRS.* Note 18 to these condensed financial statements contains a detailed description of the Corporation's adoption of IFRS, including a reconciliation of the financial statements previously prepared under Canadian GAAP to those under IFRS, for the comparative periods as at and for the three and six months ended June 30, 2010 and as at and for the year ended December 31, 2010.

These condensed financial statements have been prepared on a historical cost basis, except for certain financial and non-financial assets and liabilities, which have been measured at fair value. The Corporation's condensed financial statements include the accounts of Birchcliff only. There are no subsidiary companies.

## 3. CHANGES IN ACCOUNTING POLICIES

### Accounting standards and interpretations issued but not yet effective:

On May 12, 2011, the IASB issued the following new and revised IFRSs effective for annual periods beginning on or after January 1, 2013. Earlier application is permitted providing that IFRS 10, IFRS 11, IFRS 12, IFRS 27 and IFRS 28 are adopted together, except that IFRS 12 may be adopted earlier.

Birchcliff is currently assessing the impact of adopting these pronouncements, however, it anticipates that these standards will not have a material impact on the Corporation's financial statements.

IFRS 10 *Consolidated Financial Statements* builds on existing principles by identifying the concept of control as the determining factor in whether an entity should be included within the consolidated financial statements of the parent company. The standard provides additional guidance to assist in the determination of control where this is difficult to assess. IFRS 10 replaces those parts of IAS 27 *Consolidated and Separate Financial Statements (revised 2011)* that address when and how an entity should prepare consolidated financial statements and replaces SIC 12 *Consolidation – Special Purpose Entities* in its entirety. IAS 27 retains the current guidance for separate financial statements.

IFRS 11 *Joint Arrangements* provides for a more substance based reflection of joint arrangements by focusing on the rights and obligations of the arrangement, rather than its legal form (as is currently the case). The standard addresses inconsistencies in the reporting of joint arrangements by requiring a single method to account for interests in jointly controlled entities. IFRS 11 supersedes IAS 31 *Interests in Joint Ventures* and SIC 13 *Jointly Controlled Entities – Non-Monetary Contributions by Ventures*. IAS 28 *Investments in Associates and Joint Ventures* (revised 2011) has been amended to conform to changes based on the issuance of IFRS 10 and IFRS 11.

IFRS 12 *Disclosure of Interests in Other Entities* requires extensive disclosures relating to an entity's interests in subsidiaries, joint arrangements, associates and unconsolidated structured entities. An entity is required to disclose information that helps users of its financial statements evaluate the nature of and risks associated with its interests in other entities and the effects of those interests on its financial statements. The effective date of IFRS 12 is January 1, 2013 but entities are permitted to incorporate any of the new disclosures in their financial statements before that date.

IFRS 13 *Fair Value Measurement* establishes a single framework for measuring fair values. This standard applies to all transactions and balances (whether financial or non-financial) for which IFRSs require or permit fair value measurements, with the exception of share-based payment transactions accounted for under IFRS 2 *Share-based Payment* and leasing transactions within the scope of IAS 17 *Leases*. IFRS 13 defines fair value, provides guidance on its determination and introduces consistent requirements for disclosures on fair value measurements.

IFRS 7 *Financial Instruments* includes amendments issued by the IASB on *Disclosures – Transfers of Financial Assets* that increase the disclosure requirements for transactions involving transfers of financial assets. These amendments are intended to provide greater transparency around risk exposures of transactions where a financial asset is transferred but the transferor retains some level of continuing exposure in the asset. The amendments also require disclosure where transfers of financial assets are not evenly distributed throughout the period. These amendments are effective for annual periods beginning on or after July 1, 2011, with early application permitted.

IFRS 9 *Financial Instruments* issued in November 2009 and amended in October 2010 introduces new requirements for the classification and measurement of financial assets and financial liabilities and for derecognition. IFRS 9 is expected to be published in three parts. The first part, Phase 1 – classification and measurement of financial instruments sets out the requirements for recognizing and measuring financial assets, financial liabilities and some contracts to buy or sell non-financial items. Phase 1 simplifies the measurement of financial assets by classifying all financial assets as those being recorded at amortized cost or being recorded at fair value. Phase 1 is effective for periods beginning on or after January 1, 2013, although earlier adoption is allowed. Except for certain additional disclosures, the adoption of this standard is not expected to have an impact on the Corporation's financial statements.

## 4. EXPLORATION AND EVALUATION ASSETS

The components of the Corporation's Exploration and Evaluation ("**E&E**") assets are as follows:

| | **E&E**[(1)(2)] |
|---|---|
| As at January 1, 2010 | 640 |
| Additions | 900 |
| As at December 31, 2010 | 1,540 |
| Additions | 285 |
| **As at June 30, 2011** | **1,825** |

(1) Exploration and evaluation activities are pending the determination of economic quantities of commercially producible reserves. There were no costs reclassified from exploration and evaluation to petroleum and natural gas properties and equipment during the periods ended June 30, 2011 and December 31, 2010.

(2) At the end of each reporting period, the Corporation performs an impairment review of its exploration and evaluation assets to ensure that the carrying values of those assets are recoverable. The Corporation's exploration and evaluation assets were not impaired at June 30, 2011, December 31, 2010 and January 1, 2010.

## 5. PETROLEUM AND NATURAL GAS PROPERTIES AND EQUIPMENT

The components of the Corporation's Petroleum and Natural Gas ("**P&NG**") Properties and Equipment are as follows:

| | **P&NG** | **Corporate** | **Total** |
|---|---|---|---|
| *Cost*: | | | |
| As at January 1, 2010 | 800,220 | 3,415 | 803,635 |
| Additions | 237,954 | 1,960 | 239,914 |
| Acquisitions | 2,051 | - | 2,051 |
| Dispositions[(1)] | (2,572) | - | (2,572) |
| As at December 31, 2010 | 1,037,653 | 5,375 | 1,043,028 |
| Additions | 87,436 | 658 | 88,094 |
| Acquisitions | 4,356 | - | 4,356 |
| Dispositions[(1)] | (6,657) | - | (6,657) |
| As at June 30, 2011[(2)] | 1,122,788 | 6,033 | 1,128,821 |
| | | | |
| *Accumulated depletion and depreciation*: | | | |
| As at January 1, 2010 | - | (1,852) | (1,852) |
| Accumulated depletion and depreciation expense[(1)] | (50,260) | (666) | (50,926) |
| As at December 31, 2010 | (50,260) | (2,518) | (52,778) |
| Accumulated depletion and depreciation expense[(1)] | (31,434) | (469) | (31,903) |
| As at June 30, 2011 | (81,694) | (2,987) | (84,681) |
| | | | |
| *Net book value*[(3)]: | | | |
| As at December 31, 2010 | 987,393 | 2,857 | 990,250 |
| **As at June 30, 2011** | **1,041,094** | **3,046** | **1,044,140** |

(1) During the three months ended June 30, 2011, Birchcliff disposed of minor non-core assets for $5.5 million which resulted in a net loss on sale of approximately $0.9 million. In March 2010, the Corporation disposed of a minor non-producing asset for $17.5 million which resulted in a gain of approximately $15.5 million on the sale during that period.

(2) Included as a reduction of P&NG assets at June 30, 2011 is a recovery of $19.7 million related to a drilling royalty incentive for new conventional petroleum and natural gas wells drilled on or after April 1, 2009, but before April 1, 2011.

(3) At the end of each reporting period, the Corporation performed an impairment review of its petroleum and natural gas properties and equipment to assess for recoverability. The Corporation's petroleum and natural gas properties and equipment were not impaired at June 30, 2011, December 31, 2010 and January 1, 2010.

## 6. NON-REVOLVING TERM CREDIT FACILITIES

Non-Revolving Five-Year Term Credit Facility

On May 18, 2011, the Corporation entered into a $70 million non-revolving five-year term credit facility (the "**Non-Revolving Five-Year Term Facility**") with a maturity date on May 25, 2016. This facility is provided by a syndicate of banks (the "**Syndicate**"). The Non-Revolving Five-Year Term Facility requires principle payments of $350,000 per quarter commencing July 1, 2013. In May 2011, the Corporation had drawn the full $70 million on the Non-Revolving Five-Year Term Facility, the proceeds of which were used to reduce the amounts outstanding on the Corporation's revolving credit facilities (Note 7).

The Corporation paid a fee to the Syndicate to establish the Non-Revolving Five-Year Term Facility. This fee has been deferred and netted against the amounts drawn under this facility and is being amortized to income over the five year period. During the three months ended June 30, 2011, the Corporation amortized to income approximately $16,600 in deferred fees applicable to the Non-Revolving Five-Year Term Facility. The overall effective interest rate applicable to the bankers' acceptances issued under this facility was 5.1% during the three months ended June 30, 2011.

The Non-Revolving Five-Year Term Facility allows for prime rate loans and bankers' acceptances. The interest rates applicable to the drawn loans are based on a pricing grid and will increase as a result of the increased ratio of outstanding indebtedness to earnings before interest, taxes, depreciation and amortization. The Non-Revolving Five-Year Term Facility is secured by a fixed and floating charge debenture, an instrument of pledge and a general security agreement encompassing all of the Corporation's assets.

*Non-Revolving One-Year Term Credit Facility*

On May 21, 2009, the Corporation entered into a $50 million non-revolving one-year term credit facility (the "**Non-Revolving One-Year Term Facility**"). In May 2010, the Corporation repaid and cancelled the Non-Revolving One-Year Term Facility using the increased funds available from the revolving credit facilities.

During the three and six months ended June 30, 2010, the Corporation amortized to income approximately $0.3 million and $0.5 million in deferred fees applicable to the Non-Revolving One-Year Term Facility. The overall effective interest rates applicable to the bankers' acceptances issued under this facility was 5.7% and 5.9% during the three and six months ended June 30, 2010.

## 7. REVOLVING CREDIT FACILITIES

| As at, | **June 30, 2011** | Dec. 31, 2010 |
|---|---|---|
| Syndicated credit facility | 256,000 | 334,000 |
| Working capital facility | 17,866 | 5,176 |
| Drawn revolving credit facilities | 273,866 | 339,176 |
| Unamortized prepaid interest on bankers' acceptances | (3,009) | (5,311) |
| Unamortized deferred financing fees | (579) | (397) |
| **Total revolving credit facilities** | **270,278** | 333,468 |

Effective May 18, 2011, Birchcliff amended its agreement with its Syndicate, which increased the Corporation's revolving credit facilities limit from $375 million to an aggregate limit of $450 million. At June 30, 2011, the revolving credit facilities consisted of an extendible revolving term credit facility with an authorized limit of $420 million (the "**Syndicated Credit Facility**") and an extendible revolving working capital facility with an authorized limit of $30 million (the "**Working Capital Facility**"). The Corporation paid a fee to the Syndicate to extend the conversion date of the revolving credit facilities from May 20, 2011 to May 18, 2012. These fees have been deferred and netted against the amounts drawn under this facility and are being amortized to income over the one year extension period. During the three and six months ended June 30, 2011, the Corporation amortized to income approximately $0.2 million and $0.5 million (June 30, 2010 – $0.3 million and $0.6 million) in deferred fees applicable to this facility.

At June 30, 2011, the effective interest rate applicable to the Working Capital Facility was 5.8% (June 30, 2010 – 5.8%). The overall effective interest rates applicable to the bankers' acceptances issued under the Syndicated Credit Facility was 5.9% and 6.1% for the three and six months ended June 30, 2011 (June 30, 2010 – 4.9% and 5.1%).

The revolving credit facilities allow for prime rate loans, US base rate loans, bankers' acceptances, letters of credit and LIBOR loans. The interest rates applicable to the drawn loans are based on a pricing grid and will increase as a result of the increased ratio of outstanding indebtedness to earnings before interest, taxes, depreciation and amortization. The revolving credit facilities are subject to the Syndicate's redetermination of the borrowing base twice each year as of November 15 and the conversion date. Upon any change in or redetermination of the borrowing base limit which results in a borrowing base shortfall, Birchcliff must eliminate the borrowing base shortfall amount. The revolving credit facilities are secured by a fixed and floating charge debenture, an instrument of pledge and a general security agreement encompassing all of the Corporation's assets.

**Syndicated Credit Facility**

The Syndicated Credit Facility has a conversion date of May 18, 2012 and a maturity date which is two years after the conversion date. Birchcliff may request an extension of the conversion date with such an extension not exceeding 364 days, in order to maintain the revolving Syndicated Credit Facility. If the conversion date of the Syndicated Credit Facility is not extended, then on the conversion date, the revolving Syndicated Credit Facility will convert to a term loan whereby all principal and interest will be required to be repaid at the maturity date.

**Working Capital Facility**

The Working Capital Facility has a conversion date of May 18, 2012 and a maturity date which is two years after the conversion date. Birchcliff may request an extension of the conversion date with such an extension not exceeding 364 days, in order to maintain the revolving Working Capital Facility. If the Syndicate does not grant an extension of the conversion date, then upon four months after the expiry of the conversion date, the revolving Working Capital Facility will convert to a term loan whereby all principal and interest will be required to be repaid at the maturity date.

## 8. DECOMMISSIONING OBLIGATIONS

The Corporation's decommissioning obligations result from net ownership interests in petroleum and natural gas properties and equipment including well sites, gathering systems and processing facilities. The total estimated undiscounted cash flows required to settle the Corporation's decommissioning obligations at June 30, 2011 is $92.8 million (December 31, 2010 – $91.5 million) and is expected to be incurred between 2011 and 2062. A risk-free discount rate of 4% and an inflation rate of 2% were used to calculate the discounted fair value of the obligation.

A reconciliation of the decommissioning obligations is provided below:

| As at, | **June 30, 2011** | December 31, 2010 |
|---|---|---|
| Balance, beginning | 42,106 | 36,697 |
| Obligations incurred | 714 | 2,385 |
| Obligations disposed, net | (178) | 85 |
| Changes in estimate | 68 | 2,427 |
| Accretion expense | 884 | 1,414 |
| Actual expenditures | (678) | (902) |
| **Balance, ending** | **42,916** | 42,106 |

## 9. SHARE CAPITAL

### (a) Authorized:

Unlimited number of voting common shares, with no par value
Unlimited number of non-voting preferred shares, with no par value

The preferred shares may be issued in one or more series and the directors are authorized to fix the number of shares in each series and to determine the designation, rights, privileges, restrictions and conditions attached to the shares of each series.

**(b) Issued:** Refer to the Condensed Statements of Changes in Shareholders' Equity for movement in share capital.

## 10. OPERATING EXPENSES

The Corporation's operating expenses include all costs with respect to day-to-day well and facility operations. Processing recoveries related to joint interest and third party natural gas reduces operating expenses. The components of operating expenses are as follows:

| | **Three months ended June 30,** | | **Six months ended June 30,** | |
|---|---|---|---|---|
| | **2011** | 2010 | **2011** | 2010 |
| Field operating costs | 12,306 | 9,893 | 25,131 | 19,221 |
| Recoveries | (1,694) | (1,361) | (3,813) | (2,434) |
| Field operating costs, net | 10,612 | 8,532 | 21,318 | 16,787 |
| Expensed workovers and other | 6 | 125 | 434 | 323 |
| **Total operating expenses** | **10,618** | 8,657 | **21,752** | 17,110 |

## 11. ADMINISTRATIVE EXPENSES

The components of administrative expenses are as follows:

| | **Three months ended June 30,** | | **Six months ended June 30,** | |
|---|---|---|---|---|
| | **2011** | 2010 | **2011** | 2010 |
| *Cash:* | | | | |
| Salaries and benefits(1) | 3,259 | 2,711 | 6,478 | 5,322 |
| Other | 2,966 | 1,606 | 5,336 | 3,977 |
| | 6,225 | 4,317 | 11,814 | 9,299 |
| Operating overhead recoveries | (245) | (312) | (562) | (632) |
| Capitalized overhead(2) | (1,148) | (819) | (2,109) | (2,079) |
| General and administrative, net | 4,832 | 3,186 | 9,143 | 6,588 |
| *Non-cash:* | | | | |
| Stock-based compensation (Note 13) | 3,470 | 2,715 | 6,440 | 7,513 |
| Capitalized stock-based compensation(2) | (1,188) | (849) | (2,110) | (2,158) |
| Stock-based compensation, net | 2,282 | 1,866 | 4,330 | 5,355 |
| **Total administrative expenses, net** | **7,114** | 5,052 | **13,473** | 11,943 |

(1) Includes salaries and benefits paid to all directors, officers, employees and consultants of the Corporation.

(2) Represents a portion of salaries and benefits and stock-based compensation directly attributed to the exploration and development activities which have been capitalized.

## 12. FINANCE EXPENSES

The components of the Corporation's finance expenses are as follows:

| | Three months ended June 30, | | Six months ended June 30, | |
|---|---|---|---|---|
| | **2011** | 2010 | **2011** | 2010 |
| *Cash:* | | | | |
| Interest on Non-Revolving One-Year Term Facility (Note 6) | - | - | - | 700 |
| Interest on Non-Revolving Five-Year Term Facility (Note 6) | 349 | - | 349 | - |
| Interest on revolving credit facilities (Note 7) | 4,375 | 3,126 | 9,184 | 5,405 |
| | 4,724 | 3,126 | 9,533 | 6,105 |
| *Non-cash:* | | | | |
| Accretion on decommissioning obligations (Note 8) | 446 | 350 | 884 | 677 |
| Amortization of deferred financing fees (Notes 6,7) | 236 | 643 | 490 | 1,137 |
| **Total finance expenses** | **5,406** | 4,119 | **10,907** | 7,919 |

## 13. SHARE-BASED PAYMENTS

### Stock Options

The Corporation has established a stock-based compensation plan whereby directors, officers and employees may be granted options to purchase common shares at a fixed price not less than the fair market value of the stock at the time of grant, subject to certain conditions. All stock options granted are for a five year term. Each stock option entitles the holder to purchase one common share at the exercise price. The Corporation is authorized to issue stock options for a maximum of 10% of the issued and outstanding common shares pursuant to the Amended and Restated Stock Option Plan.

During the three and six months ended June 30, 2011, the Corporation recorded $2.3 million and $4.3 million (June 30, 2010 - $1.9 million and $5.4 million) of stock-based compensation expense, net of $1.2 million and $2.1 million (June 30, 2010 – $0.8 million and $2.2 million) in capitalized amounts directly attributable to the exploration and development of the Corporation's assets. In determining the stock-based compensation expense for options issued during the three months ended June 30, 2011, the Corporation applied a weighted average estimated forfeiture rate of 15.3% (June 30, 2010 – 16.8%).

At June 30, 2011, the Corporation's Amended and Restated Stock Option Plan permitted the grant of options in respect of a maximum 12,649,668 (June 30, 2010 – 12,479,214) common shares. At June 30, 2011, there remained available for issuance options in respect of 1,948,933 (June 30, 2010 – 2,955,696) common shares. For stock options exercised during the three months ended June 30, 2011, the weighted average share price was $12.79 (June 30, 2010 - $9.38) per share. A summary of the Corporation's outstanding stock options is presented below:

| | **Number** | **Weighted Average Exercise Price ($)** |
|---|---|---|
| Outstanding, December 31, 2009 | 7,710,253 | 5.81 |
| Granted | 3,350,300 | 9.61 |
| Exercised | (1,314,232) | (4.63) |
| Forfeited | (498,801) | (7.41) |
| Outstanding, December 31, 2010 | 9,247,520 | 7.26 |
| Granted | 2,767,900 | 11.35 |
| Exercised | (998,010) | (5.22) |
| Forfeited | (121,302) | (7.90) |
| Outstanding, March 31, 2011 | 10,896,108 | 8.48 |
| Granted | 301,000 | 12.67 |
| Exercised | (369,433) | (5.66) |
| Forfeited | (127,000) | (11.69) |
| **Outstanding, June 30, 2011** | **10,700,675** | **8.66** |

The weighted average fair value per option issued during the three months ended June 30, 2011 was $5.81 (June 30, 2010 - $4.67). The weighted average assumptions used in calculating the fair values are set forth below:

| Three months ended, | **June 30, 2011** | June 30, 2010 |
|---|---|---|
| Risk-free interest rate | 2.3% | 2.3% |
| Option life (years) | 3.7 | 3.7 |
| Expected volatility | 60.4% | 64.2% |
| Dividend yield | - | - |

A summary of the stock options outstanding and exercisable under the plan at June 30, 2011 is presented below:

| **Exercise Price** | | **Awards Outstanding** | | | **Awards Exercisable** | | |
|---|---|---|---|---|---|---|---|
| Low | High | Quantity | Weighted Average Remaining Contractual Life | Weighted Average Exercise Price | Quantity | Weighted Average Remaining Contractual Life | Weighted Average Exercise Price |
| $3.87 | $6.00 | 2,737,640 | 2.21 | $4.87 | 1,855,021 | 2.04 | $4.77 |
| $6.01 | $9.00 | 1,845,967 | 2.21 | $7.68 | 1,366,465 | 1.79 | $7.50 |
| $9.01 | $12.00 | 5,628,268 | 4.06 | $10.46 | 900,386 | 3.50 | $9.78 |
| $12.01 | $14.25 | 488,800 | 3.76 | $12.82 | 148,200 | 2.01 | $12.99 |
| | | **10,700,675** | **3.25** | **$8.66** | **4,270,072** | **2.27** | **$6.98** |

### Performance Warrants

On January 14, 2005, as part of the Corporation's initial restructuring to become a public entity, the Corporation issued 4,049,665 performance warrants with an exercise price of $3.00 and an expiration date of January 31, 2010 to members of its executive team. Each performance warrant entitles the holder to purchase one common share at the exercise price. Because the performance conditions were fulfilled in 2005, resulting in the performance warrants vesting, the full amount of the related compensation expense was recorded in net income in that year. The fair value of each performance warrant was determined on the date of the grant using the Black-Scholes option-pricing model. On May 28, 2009, the Corporation's outstanding performance warrants were amended to extend the expiration date from January 31, 2010 to January 31, 2015.

No performance warrants were issued or exercised during the six months ended June 30, 2011 and the year ended December 31, 2010. At June 30, 2011, there remained outstanding and exercisable 2,939,732 performance warrants.

## 14. CAPITAL MANAGEMENT

The Corporation's general policy is to maintain a sufficient capital base in order to manage its business in the most effective manner with the goal of increasing the value of its assets and thus its underlying share value. The Corporation's objectives when managing capital are to maintain financial flexibility in order to preserve its ability to meet financial obligations, including potential obligations arising from additional acquisitions; to maintain a capital structure that allows Birchcliff to favour the financing of its growth strategy using primarily internally-generated cash flow and its available debt capacity; and to optimize the use of its capital to provide an appropriate investment return to its shareholders.

There were no changes in the Corporation's approach to capital management during the reporting periods. The following table shows the Corporation's total available credit:

| As at, | **June 30, 2011** | December 31, 2010 |
|---|---|---|
| *Maximum borrowing base limit(1)(2):* | | |
| Drawn Non-Revolving Five-Year Term Facility (Note 6) | 70,000 | - |
| Revolving credit facilities (Note 7) | 450,000 | 375,000 |
| | 520,000 | 375,000 |
| *Principal amount utilized:* | | |
| Drawn Non-Revolving Five-Year Term Facility | (70,000) | - |
| Drawn revolving credit facilities | (273,866) | (339,176) |
| Outstanding letters of credit(3) | (4,984) | (3,014) |
| | (348,850) | (342,190) |
| **Total unused credit** | **171,150** | 32,810 |

(1) The Corporation's credit facilities are subject to a semi-annual review of the borrowing base limit, which is directly impacted by the value of Birchcliff's petroleum and natural gas reserves.

(2) The Corporation was compliant with all financial covenants applicable under its credit facilities as at and during the periods ended June 30, 2011 and December 31, 2010.

(3) Letters of credit are issued to various service providers. No amounts were drawn on the letters of credit as at and during the periods ended June 30, 2011 and December 31, 2010.

The capital structure of the Corporation is as follows:

| As at, | **June 30, 2011** | Dec. 31, 2010 | Change |
|---|---|---|---|
| Total shareholders' equity(1) | 632,588 | 599,140 | 6% |
| Total shareholders' equity as a % of total capital | 64% | 64% | |
| | | | |
| Working capital deficit(2) | 10,139 | 3,956 | |
| Drawn Non-Revolving Five-Year Term Facility | 70,000 | - | |
| Drawn revolving credit facilities | 273,866 | 339,176 | |
| Total drawn debt | 354,005 | 343,132 | 3% |
| Total drawn debt as a % of total capital | 36% | 36% | |
| | | | |
| **Total capital** | **986,593** | 942,272 | 5% |

(1) Shareholders' equity is defined as share capital plus contributed surplus plus retained earnings, less any deficit.

(2) Working capital deficit is defined as current assets less current liabilities.

During the six months ended June 30, 2011, total shareholders' equity increased due to the exercise of options (Note 13) and an increase in net income for the period. Total debt increased from December 31, 2010 largely due to net capital spent in excess of cash flow during the six months ended June 30, 2011.

## 15. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT CONTRACTS

Birchcliff is exposed to credit risk, liquidity risk and market risk as part of its normal course of business. The Board of Directors has overall responsibility for the establishment and oversight of the Corporation's financial risk management framework and periodically reviews the results of all risk management activities and all outstanding positions. Management has implemented and monitors compliance with risk management guidelines as outlined by the Board of Directors. The Corporation's risk management guidelines are established to identify and analyze the risks faced by the Corporation, to set appropriate risk limits and controls and to monitor risks and adherence to market conditions and the Corporation's activities.

### Credit Risk

Cash is comprised of bank balances. Historically, the Corporation has not carried short term investments. Should this change in the future, counterparties will be selected based on credit ratings, management will monitor all investments to ensure a stable return and complex investment vehicles with higher risk will be avoided. The Corporation's exposure to cash credit risk at the balance sheet date is very low.

A substantial portion of the Corporation's accounts receivable are with marketers and joint interest partners in the oil and natural gas industry and are subject to normal industry credit risks. The carrying amount of accounts receivable reflects management's assessment of the credit risk associated with these customers.

The following table illustrates the Corporation's maximum exposure for accounts receivable:

| As at, | **June 30, 2011** | Dec. 31, 2010 |
|---|---|---|
| Marketers[(1)] | 20,589 | 20,800 |
| Joint interest partners and other | 10,312 | 18,441 |
| **Total accounts receivable** | **30,901** | 39,241 |

(1) At June 30, 2011, approximately 48% of the Corporation's significant individual accounts receivable was due from one marketer (December 31, 2010 – 41%, one marketer). For the six months ended June 30, 2011, the Corporation received 47%, 15%, 15% and 15% of its revenue, respectively, from 4 core marketers. The Corporation received the majority of its revenue for the six months ended June 30, 2010 from five marketers, who individually accounted for 12%, 43%, 13%, 14% and 11%, respectively.

Typically, Birchcliff's maximum credit exposure from its marketers is revenue from two months of commodity sales. Receivables from marketers are normally collected on the 25th day of the month following production. Birchcliff mitigates the credit risk associated with these receivables by establishing marketing relationships with credit worthy purchasers, obtaining guarantees from their ultimate parent companies and obtaining letters of credit as appropriate. The Corporation historically has not experienced any material collection issues with its marketers.

At June 30, 2011, approximately $0.3 million or 1% of Birchcliff's total accounts receivable are aged over 120 days and considered past due. The majority of these accounts are due from various joint interest partners. Birchcliff attempts to mitigate the credit risk from joint interest receivables by obtaining pre-approval of significant capital expenditures. However, the receivables are from participants in the oil and natural gas sector, and collection of the outstanding balances is dependent on industry factors such as commodity price fluctuations, escalating costs and the risk of unsuccessful drilling. In addition, further risk exists with joint interest partners as disagreements occasionally arise that increase the potential for non-collection. The Corporation does not typically obtain collateral from petroleum and natural gas marketers or joint interest partners; however, the Corporation does have the ability to withhold production from joint interest partners in the event of non-payment.

Should Birchcliff determine that the ultimate collection of a receivable is in doubt, it will provide the necessary provision in its allowance for doubtful accounts with a corresponding charge to income. If the Corporation subsequently determines an account is uncollectible, the account is written off with a corresponding charge to the allowance for doubtful accounts. Birchcliff did not have an allowance for doubtful accounts balance as at June 30, 2011 and December 31, 2010.

**Liquidity Risk**

Liquidity risk is the risk that the Corporation will not be able to meet its obligations associated with financial liabilities that are settled by cash as they become due. Birchcliff's approach to managing liquidity is to ensure, as much as possible, that it will have sufficient liquidity to meet its short term and long term financial obligations when due, under both normal and unusual conditions without incurring unacceptable losses or risking harm to the Corporation's reputation.

All of the Corporation's contractual financial liabilities are to be settled in cash. Typically, the Corporation ensures that it has sufficient cash on demand to meet expected operational expenses, including the servicing of financial obligations. To achieve this objective, the Corporation prepares annual capital expenditure budgets, which are approved by the Board of Directors and are regularly reviewed and updated as considered necessary. Petroleum and natural gas production is monitored weekly and is used to provide monthly cash flow estimates. Further, the Corporation utilizes authorizations for expenditures on both operated and non-operated projects to manage capital expenditure. The

Corporation also attempts to match its payment cycle with collection of petroleum and natural gas revenue on the 25th of each month.

To facilitate the capital expenditure program, the Corporation has reserve-based bank credit facilities which are reviewed semi-annually by the lender. The principal amount utilized under the Corporation's total credit facilities at June 30, 2011 was $348.9 million (December 31, 2010 – $342.2 million) and $171.2 million (December 31, 2010 – $32.8 million) in unused credit was available at the end of the period to fund future obligations.

The following table lists the contractual obligations of the Corporation's financial liabilities at June 30, 2011:

| | 2011 | 2012 | 2013 - 2015 | Thereafter |
|---|---|---|---|---|
| Accounts payable and accrued liabilities | 44,488 | - | - | - |
| Drawn revolving credit facilities | - | - | 273,866 | - |
| Drawn Non-Revolving Five-Year Term Facility | - | - | 3,500 | 66,500 |
| **Total financial liabilities** | **44,488** | **-** | **277,366** | **66,500** |

**Market Risk**

Market risk is the risk that changes in market conditions, such as commodity prices, exchange rates and interest rates, will affect the Corporation's net income or the value of its financial instruments, if any. The objective of market risk management is to manage and control exposures within acceptable limits, while maximizing returns. These risks are consistent with prior years. All risk management transactions are conducted within risk management tolerances that are reviewed by the Board of Directors.

*Commodity Price Risk*

Commodity price risk is the risk that the fair value of future cash flows will fluctuate as a result of changes in commodity prices. Significant changes in commodity prices can materially impact the Corporation's borrowing base limit. Lower commodity prices can also reduce the Corporation's ability to raise capital. Commodity prices for petroleum and natural gas are not only influenced by Canadian ("**CDN**") and United States ("**US**") demand, but also by world events that dictate the levels of supply and demand.

The Corporation may attempt to mitigate commodity price risk through the use of financial derivatives such as commodity price risk management contracts. Birchcliff had no risk management contracts in place as at or during the periods ended June 30, 2011 and December 31, 2010. The Corporation actively monitors the market to determine whether any additional commodity price risk management contracts are warranted.

*Foreign Currency Risk*

Foreign currency risk is the risk that future cash flows will fluctuate as a result of changes in foreign currency exchange rates. The exchange rate effect cannot be quantified but generally an increase in the value of the CDN dollar as compared to the US dollar will reduce the prices received by Birchcliff for its petroleum and natural gas sales. The Corporation had no forward exchange rate contracts in place as at or during the periods ended June 30, 2011 and December 31, 2010.

*Interest Rate Risk*

Interest rate risk is the risk that future cash flows will fluctuate as a result of changes in market interest rates. The Corporation's credit facilities are exposed to interest rate cash flow risk on a floating interest rate due to fluctuations in market interest rates. The remainder of Birchcliff's financial assets and liabilities are not exposed directly to interest rate risk.

A 1% change in the CDN prime interest rate during the three and six months ended June 30, 2011 would have increased (decreased) net income and comprehensive income by approximately $0.8 million and $1.7 million (June 30, 2010 – $0.6 million and $1.1 million), assuming that all other variables remain constant. A sensitivity of 1% is considered reasonable given the current level of the bank prime rate and market expectations for future movements. The Corporation considers this risk to be limited and thus does not hedge its interest rate risk.

The Corporation had no interest rate swap contracts in place as at or during the periods ended June 30, 2011 and December 31, 2010.

**Fair Value of Financial Instruments**

Birchcliff's financial instruments include cash, accounts receivable, deposits, accounts payable and accrued liabilities and outstanding credit facilities. All of Birchcliff's financial instruments are transacted in active markets. Financial instruments carried at fair value are assessed using the following hierarchy based on the amount of observable inputs used to value the instrument:

- Level 1 – Quoted prices are available in active markets for identical assets or liabilities as of the reporting date. Active markets are those in which transactions occur in sufficient frequency and volume to provide pricing information on an ongoing basis.
- Level 2 – Pricing inputs are other than quoted prices in active markets included in Level 1. Prices in Level 2 are either directly or indirectly observable as of the reporting date. Level 2 valuations are based on inputs, including quoted forward prices for commodities, time value and volatility factors, which can be substantially observed or corroborated in the marketplace.
- Level 3 – Valuations in this level are those with inputs for the asset or liability that are not based on observable market data.

Assessment of the significance of a particular input to the fair value measurement requires judgment and may affect the placement within the fair value hierarchy level. The carrying value and fair value of financial instruments at June 30, 2011 is disclosed below by financial instrument category, as well as any related loss or interest expense for the period:

| | Carrying Value | Fair Value | Loss | Interest Expense |
|---|---|---|---|---|
| Assets Held for Trading: | | | | |
| Cash(1) | 65 | 65 | - | - |
| Loans and Receivables: | | | | |
| Accounts receivable(2) | 30,901 | 30,901 | - | - |
| Deposits(2) | 1,541 | 1,541 | - | - |
| Other Liabilities: | | | | |
| Accounts payable and accrued liabilities(2) | 44,488 | 44,488 | - | - |
| Drawn Non-Revolving Five-Year Term Facility(3) | 70,000 | 70,000 | - | 349 |
| Drawn revolving credit facilities(3) | 273,866 | 273,866 | - | 9,184 |

(1) Cash is reported at fair value, based on a Level 1 designation.

(2) Accounts receivable, deposits and accounts payable and accrued liabilities are reported at amortized cost. Due to the short term nature of accounts receivable, deposits and accounts payable and accrued liabilities, their carrying values approximate their fair values.

(3) The Corporation's credit facilities bear interest at a floating rate and accordingly the fair market value approximates the carrying value before the carrying value is reduced for any remaining unamortized costs as described in Notes 6 and 7.

## 16. COMMITMENTS

The Corporation is committed under an operating lease relating to its office premises beginning December 1, 2007 which expires on November 30, 2017. Birchcliff does not use all of the leased space and has sublet approximately 24% of the excess space to an arm's length party on a basis that recovers all of the rental costs for the first five years. The Corporation is committed to the following aggregate minimum lease payments (not reduced by rents receivable by the Corporation):

| Year | Amount |
|---|---|
| 2011 | 1,554 |
| 2012 | 3,118 |
| 2013 | 3,225 |
| 2014 | 3,225 |
| 2015 | 3,225 |
| Thereafter | 6,182 |

## 17. SUPPLEMENTARY CASH FLOW INFORMATION

| | Three months ended June 30, | | Six months ended June 30, | |
|---|---|---|---|---|
| | **2011** | 2010 | **2011** | 2010 |
| Provided by (used in): | | | | |
| Accounts receivable | 6,025 | (332) | 8,340 | (2,824) |
| Prepaid expenses and deposits | (576) | 1,745 | (721) | 1,701 |
| Accounts payable and accrued liabilities | (12,892) | (11,054) | (6,232) | (4,791) |
| | **(7,443)** | (9,641) | **1,387** | (5,914) |
| Provided by (used in): | | | | |
| Operating | 6,848 | (4,672) | (2,958) | (7,594) |
| Investing | (14,291) | (4,969) | 4,345 | 1,680 |
| | **(7,443)** | (9,641) | **1,387** | (5,914) |

## 18. TRANSITION TO INTERNATIONAL FINANCIAL REPORTING STANDARDS

The IFRS accounting policies as disclosed in Note 3 of the condensed financial statements for the period ended March 31, 2011 have been applied in preparing the financial statements as at and for the three and six months ended June 30, 2011, and comparative financial statements as at and for the three and six months ended June 30, 2010, as at and for the year ended December 31, 2010 and an opening Statement of Financial Position as at January 1, 2010 (the "**transition date**"). In preparing the 2010 comparative financial statements, the Corporation adjusted amounts reported previously in financial statements prepared in accordance with Canadian GAAP.

IFRS 1 *First-time Adoption of IFRS* requires the presentation of comparative information as at the transition date and subsequent 2010 comparative periods as well as the consistent and retrospective application of IFRS accounting policies. To assist with the transition, the provisions of IFRS 1 allow for mandatory and optional exemptions for first-time adopters to alleviate the retrospective application of certain IFRSs as discussed below.

An explanation of how the transition from Canadian GAAP to IFRS has affected the Corporation's financial position and financial performance is illustrated in the following reconciliations. Certain amounts in these financial statement reconciliations have been reclassified, where applicable, to conform to IAS 1 *Presentation of Financial Statements*.

## RECONCILIATION OF THE STATEMENT OF FINANCIAL POSITION FROM CANADIAN GAAP TO IFRS:

| | As at June 30, 2010 | | | |
|---|---|---|---|---|
| | GAAP | Effect of Transition to IFRS | Notes | IFRS |
| **ASSETS** | | | | |
| Current assets: | | | | |
| Cash | 140 | - | | 140 |
| Accounts receivable | 32,489 | - | | 32,489 |
| Prepaid expenses and deposits | 2,934 | - | | 2,934 |
| | 35,563 | - | | 35,563 |
| Non-current assets: | | | | |
| Exploration and evaluation | - | 1,500 | (a) | 1,500 |
| Petroleum and natural gas properties and equipment | 847,716 | 26,044 | (a),(b),(d)-(f) | 873,760 |
| | 847,716 | 27,544 | | 875,260 |
| | 883,279 | 27,544 | | 910,823 |
| **LIABILITIES** | | | | |
| Current liabilities: | | | | |
| Accounts payables and accrued liabilities | 49,940 | - | | 49,940 |
| Non-current liabilities: | | | | |
| Revolving credit facilities | 235,993 | - | | 235,993 |
| Decommissioning obligations | 25,748 | 12,377 | (b) | 38,125 |
| Deferred income taxes | 4,655 | 3,508 | (h) | 8,163 |
| | 266,396 | 15,885 | | 282,281 |
| | 316,336 | 15,885 | | 332,221 |
| **SHAREHOLDERS' EQUITY** | | | | |
| Share capital | 547,782 | 4,007 | (g) | 551,789 |
| Contributed surplus | 23,640 | 4,875 | (c) | 28,515 |
| Deficit | (4,479) | 2,777 | | (1,702) |
| | 566,943 | 11,659 | | 578,602 |
| | 883,279 | 27,544 | | 910,823 |

## RECONCILIATION OF THE STATEMENT OF FINANCIAL POSITION FROM CANADIAN GAAP TO IFRS (CONTINUED):

| | As at December 31, 2010 | | | |
|---|---|---|---|---|
| | **GAAP** | **Effect of Transition to IFRS** | **Notes** | **IFRS** |
| **ASSETS** | | | | |
| Current assets: | | | | |
| Cash | 4,863 | - | | 4,863 |
| Accounts receivable | 39,241 | - | | 39,241 |
| Prepaid expenses and deposits | 2,661 | - | | 2,661 |
| | 46,765 | - | | 46,765 |
| Non-current assets: | | | | |
| Exploration and evaluation | - | 1,540 | (a) | 1,540 |
| Petroleum and natural gas properties and equipment | 948,626 | 41,624 | (a),(b),(d)-(f) | 990,250 |
| | 948,626 | 43,164 | | 991,790 |
| | 995,391 | 43,164 | | 1,038,555 |
| **LIABILITIES** | | | | |
| Current liabilities: | | | | |
| Accounts payables and accrued liabilities | 50,721 | - | | 50,721 |
| Non-current liabilities: | | | | |
| Revolving credit facilities | 333,468 | - | | 333,468 |
| Decommissioning obligations | 26,448 | 15,658 | (b) | 42,106 |
| Deferred income taxes | 7,631 | 5,489 | (h) | 13,120 |
| | 367,547 | 21,147 | | 388,694 |
| | 418,268 | 21,147 | | 439,415 |
| **SHAREHOLDERS' EQUITY** | | | | |
| Share capital | 550,472 | 3,947 | (g) | 554,419 |
| Contributed surplus | 28,096 | 5,363 | (c) | 33,459 |
| Retained earnings (deficit) | (1,445) | 12,707 | | 11,262 |
| | 577,123 | 22,017 | | 599,140 |
| | 995,391 | 43,164 | | 1,038,555 |

**RECONCILIATION OF THE STATEMENT OF NET INCOME AND COMPREHENSIVE INCOME FROM CANADIAN GAAP TO IFRS:**

| | For the three months ended June 30, 2010 | | | |
|---|---|---|---|---|
| | GAAP | Effect of Transition to IFRS | Notes | IFRS |
| **REVENUE** | | | | |
| Petroleum and natural gas revenue | 44,546 | - | | 44,546 |
| Royalties | (3,621) | - | | (3,621) |
| | 40,925 | - | | 40,925 |
| **EXPENSES** | | | | |
| Operating | 8,782 | (125) | (e) | 8,657 |
| Transportation and marketing | 2,943 | - | | 2,943 |
| Administrative, net | 4,980 | 72 | (c),(f) | 5,052 |
| Depletion and depreciation | 18,754 | (6,167) | (e) | 12,587 |
| Finance | 4,222 | (103) | (b) | 4,119 |
| | 39,681 | (6,323) | | 33,358 |
| **INCOME BEFORE TAXES** | 1,244 | 6,323 | | 7,567 |
| Deferred income tax expense | 1,029 | 1,451 | (h) | 2,480 |
| **NET INCOME AND COMPREHENSIVE INCOME** | 215 | 4,872 | | 5,087 |

| | For the six months ended June 30, 2010 | | | |
|---|---|---|---|---|
| | GAAP | Effect of Transition to IFRS | Notes | IFRS |
| **REVENUE** | | | | |
| Petroleum and natural gas revenue | 88,781 | - | | 88,781 |
| Royalties | (8,984) | - | | (8,984) |
| | 79,797 | - | | 79,797 |
| **EXPENSES** | | | | |
| Operating | 17,235 | (125) | (e) | 17,110 |
| Transportation and marketing | 5,369 | - | | 5,369 |
| Administrative, net | 9,577 | 2,366 | (c),(f) | 11,943 |
| Depletion and depreciation | 33,858 | (11,387) | (e) | 22,471 |
| Finance | 8,108 | (189) | (b) | 7,919 |
| (Gain) on sale of assets | - | (15,528) | (d) | (15,528) |
| | 74,147 | (24,863) | | 49,284 |
| **INCOME BEFORE TAXES** | 5,650 | 24,863 | | 30,513 |
| Deferred income tax expense | 2,782 | 6,532 | (h) | 9,314 |
| **NET INCOME AND COMPREHENSIVE INCOME** | 2,868 | 18,331 | | 21,199 |

## RECONCILIATION OF THE STATEMENT OF NET INCOME AND COMPREHENSIVE INCOME FROM CANADIAN GAAP TO IFRS (CONTINUED):

| | For the year ended December 31, 2010 | | | |
|---|---|---|---|---|
| | **GAAP** | **Effect of Transition to IFRS** | **Notes** | **IFRS** |
| **REVENUE** | | | | |
| Petroleum and natural gas revenue | 189,978 | - | | 189,978 |
| Royalties | (16,933) | - | | (16,933) |
| | 173,045 | - | | 173,045 |
| **EXPENSES** | | | | |
| Operating | 36,745 | (490) | (e) | 36,255 |
| Transportation and marketing | 12,359 | - | | 12,359 |
| Administrative, net | 20,714 | 2,780 | (c),(f) | 23,494 |
| Depletion and depreciation | 74,636 | (23,120) | (e) | 51,516 |
| Finance | 16,932 | (419) | (b) | 16,513 |
| (Gain) on sale of assets | - | (15,528) | (d) | (15,528) |
| | 161,386 | (36,777) | | 124,609 |
| **INCOME BEFORE TAXES** | 11,659 | 36,777 | | 48,436 |
| Deferred income tax expense | 5,757 | 8,516 | (h) | 14,273 |
| **NET INCOME AND COMPREHENSIVE INCOME** | 5,902 | 28,261 | | 34,163 |

**Notes to reconciliations:**

The following discussion explains the significant differences between Birchcliff's Canadian GAAP accounting policies and those applied by the Corporation under IFRS. IFRS policies have been retrospectively and consistently applied except where specific IFRS 1 optional and mandatory exemptions permitted an alternative treatment upon transition to IFRS for first-time adopters. The note captions below correspond to the adjustments presented in the preceding reconciliations.

In preparing the comparative financial statements in accordance with IFRS 1, the Corporation has applied the following optional exemptions from full retrospective application of IFRS.

- IFRS 1 – Deemed cost election for full cost oil and gas reporting entities;
- IFRS 2 – Share-based payments; and
- IAS 37 – Decommissioning obligations

Hindsight was not used to create or revise estimates and accordingly the estimates previously made by the Corporation under Canadian GAAP are consistent with their application under IFRS. The remaining IFRS 1 exemptions were not applicable or material to the preparation of the Corporation's Statement of Financial Position at the date of transition to IFRS on January 1, 2010.

**(a) IFRS 1 deemed cost election for full cost oil and gas reporting entities**

The Corporation has elected to use the IFRS 1 exemption, whereby the petroleum and natural gas properties and equipment balance, as determined under Canadian GAAP, is allocated to the IFRS categories of exploration and evaluation costs and development and production costs. Under the exemption, for assets in the development and production phases, the amounts were allocated (on an area basis) to the underlying IFRS transitional assets on a pro-rata basis using proved plus probable reserve volumes as of the transition date. Exploration and evaluation assets were recorded at amounts previously recorded under Canadian GAAP.

Under IFRS, exploration and evaluation costs are those expenditures for an area where technical feasibility and commercial viability has not yet been determined. Development and production costs include those expenditures for areas where technical feasibility and commercial viability has been determined and are included in the general balance of petroleum and natural gas properties and equipment.

Exploration and evaluation assets at January 1, 2010 were deemed to be $0.6 million, representing the unproved properties balance under Canadian GAAP. This resulted in a reclassification of $0.6 million from petroleum and natural gas properties and equipment to exploration and evaluation assets as at the transition date. As at December 31, 2010, the Corporation's exploration and evaluation assets totalled $1.5 million. These exploration activities were pending the determination of economic quantities of commercially producible reserves. As such, no costs have been reclassified from exploration and evaluation to petroleum and natural gas properties and equipment as at and during the year ended December 31, 2010.

The Corporation performed an impairment test on its exploration and evaluation assets and petroleum and natural gas properties and equipment to assess for recoverability. The recoverable amount of Birchcliff's assets were estimated based on the fair value less cost to sell approach using discounted after-tax cash flows from proved plus probable reserves, taking into consideration escalated prices and future development costs, as obtained from the Corporation's independent reserve report. Based on the above assessment, Birchcliff's exploration and evaluation assets and petroleum and natural gas properties and equipment were not impaired on transition to IFRS, as at June 30, 2010 and as at December 31, 2010.

**(b) Decommissioning obligations**

The Corporation has elected to measure decommissioning obligations (formerly known as asset retirement obligations under Canadian GAAP) on transition to IFRS in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* and recognize directly in deficit the difference between that amount and the carrying amount of those obligations determined under Canadian GAAP at the transition date. Because of the IFRS 1 deemed cost exemption described above, no adjustment to petroleum and natural gas properties and equipment was recorded on transition to IFRS. Under Canadian GAAP, accretion on decommissioning obligations was included in depletion and depreciation expense. Under IFRS, accretion expense is included in finance expenses.

Under Canadian GAAP, decommissioning obligations were discounted at a credit-adjusted risk-free rate of 8%. Under IFRS, the estimated cash flow to abandon and remediate both wells and facilities has been risk-adjusted and therefore the provision was discounted at a risk-free rate of 4% in 2010 based on Government of Canada long-term bonds.

The application of IAS 37 resulted in a $12.0 million increase to decommissioning obligations with a corresponding increase to the Corporation's deficit at the date of transition. This resulted in a $3.0 million decrease to deferred income tax liability with a corresponding decrease to the Corporation's deficit at the date of transition. Accretion expense decreased during the year ended December 31, 2010 by $0.4 million (June 30, 2010 – $0.2 million) from the amounts previously recorded under Canadian GAAP.

**(c) Share-based payments**

The Corporation has elected to apply IFRS 2 *Share-based Payments* to equity instruments granted after November 7, 2002 that have not vested by the transition date. Under Canadian GAAP, stock-based compensation expense was disclosed as a separate line item in profit or loss. Under IFRS, stock-based compensation expense is included in administrative expenses.

Under Canadian GAAP, the fair value of stock options was calculated using a Black-Scholes option-pricing model for each option grant and the resulting expense was recognized on a straight-line basis over the three year vesting period at a rate of one-third on each anniversary date of the stock option grant. Forfeitures of stock options were recognized as they occurred.

Under IFRS, each vesting tranche of an option grant with different vesting dates was considered a separate grant for the calculation of fair value. This resulted in accelerated expense recognition which attributed higher stock-based compensation expense in early years of an option grant and less expense in later years. Birchcliff also applied an estimated forfeiture rate at the initial grant date. The forfeiture rate is taken into account by adjusting the number of stock options expected to vest under each vesting tranche and subsequently revising this estimate throughout the vesting period, as necessary. When determining the fair value of each vesting tranche under IFRS, Birchcliff applied an estimated weighted average option life for each respective tranche which reflects historical experiences. Under Canadian GAAP, the option life was equal to the expiry period of five years.

The application of IFRS 2 resulted in a $2.5 million increase to contributed surplus with a corresponding increase to the Corporation's deficit at the date of transition. Stock-based compensation expense increased during the year ended December 31, 2010 by $2.7 million (June 30, 2010 – $2.3 million) from the amounts previously recorded under Canadian GAAP.

**(d) Gain on sale of assets**

Under Canadian GAAP, proceeds from the sale of assets were applied in full against petroleum and natural gas properties and equipment, with no gain or loss recognized, unless such a sale would change the rate of depletion and depreciation by 20 percent or more. Under IFRS, a gain or loss is recorded when petroleum and natural gas properties and equipment are sold. There was no impact of this policy on the transition date due to the IFRS 1 deemed cost exemption discussed above.

The above accounting policy difference resulted in a gain of $15.5 million, as a result of a sale of a minor non-producing asset in March 2010, with a corresponding increase to petroleum and natural gas properties and equipment during the year ended December 31, 2010. No gain or loss was recorded on the sale of these assets under Canadian GAAP.

**(e) Depletion and depreciation**

Under Canadian GAAP, the Corporation depleted the full cost pool based on the unit of production method using proved reserves for each country cost centre. Under IAS 16 *Property, Plant & Equipment*, the Corporation has elected to deplete its development and production costs (excluding plant turnaround costs) on an area basis using the unit of production method over proved plus probable reserves. Exploration and evaluation costs are not amortized under IFRS.

Under GAAP, plant turnaround costs were recognized as an expense in the period incurred and included in operating expenses in profit or loss. Under IFRS, plant turnaround costs are capitalized and depreciated on a straight-line basis over the estimated time until the next turnaround is completed.

The above accounting policy differences resulted in a decrease to depletion and depreciation of $23.1 million for the year ended December 31, 2010 (June 30, 2010 – $11.4 million) from amounts previously reported under Canadian GAAP.

**(f) Administrative expenses**

Administrative expenses includes the total cash remuneration from salaries and benefits paid to directors, officers, employees and consultants of the Corporation, other general business expenses and non-cash stock-based compensation, net of any capitalized portions thereof. Under Canadian GAAP, “capitalized overhead” related to estimated time spent on capital projects by engineering, land, accounting and operations and was based on an industry standard overhead charge per Authorization for Expenditure. Stock-based compensation was not capitalized under Canadian GAAP. Under IFRS, capitalized overhead includes a portion of salaries and benefits that are “directly” attributable to the exploration and development of the Corporation’s assets. This varies in some respects from the amounts recorded under Canadian GAAP. In addition, under IFRS, Birchcliff has capitalized a portion of stock-based compensation directly attributable to the exploration and development of its assets.

These accounting policy differences resulted in an increase to net general and administrative expenses (cash) by $5.6 million during the year ended December 31, 2010 from amounts previously reported under Canadian GAAP (June 30, 2010 – $2.2 million). In addition, the Corporation capitalized non-cash stock-based compensation totalling $5.5 million during the year ended December 31, 2010 (June 30, 2010 – $2.2 million).

**(g) Share capital**

Under Canadian GAAP, the proceeds from the issuance of flow-through shares are recognized as shareholders’ equity. The tax basis of assets related to expenditures incurred to satisfy flow-through share obligations is reduced when the renunciation of the related tax pools occurs which then increases the deferred income tax liability and reduces share capital.

Under IFRS, the amount recorded to share capital from the issuance of flow-through shares reflects the fair market value of "regular" common shares. The difference between the total value of a flow-through share issuance and the fair market value of regular common share issuance (premium) is initially accrued as a deferred obligation when the flow-through shares are issued. Pursuant to the terms of the flow-through share agreements, the tax deductions associated with the expenditures are renounced to the subscribers. Accordingly, on renunciation with the Canada Revenue Agency, a deferred tax liability is recorded equal to the estimated amount of deferred income taxes payable by the Corporation as a result of the renunciations, the obligation on issuance of flow-through shares is reduced, and the difference is recognized in profit or loss. There is no impact to share capital on renunciation of flow-through shares.

The above accounting policy difference resulted in an increase to share capital of $4.3 million with a corresponding increase to deficit at the transition date. The Corporation had no deferred obligation with respect to the issuance of flow-through shares at the transition date.

**(h) Income taxes**

Each of the adjustments discussed above result in a change in deferred income tax assets and liabilities based on Birchcliff's effective tax rate. The Corporation recorded a decrease in deferred tax liabilities of $3.0 million at January 1, 2010 and an increase in deferred tax liabilities of $5.5 million at December 31, 2010 from amounts previously reported under Canadian GAAP. Additional deferred income tax expenses of $6.5 million during the six months ended June 30, 2010 and $8.5 million for the year ended December 31, 2010 were recorded under IFRS.

## OFFICERS

**A. Jeffery Tonken**
President & Chief Executive Officer

**Myles R. Bosman**
Vice President, Exploration & Chief Operating Officer

**Bruno P. Geremia**
Vice President & Chief Financial Officer

**David M. Humphreys**
Vice President, Operations

**Karen A. Pagano**
Vice President, Engineering

**James W. Surbey**
Vice President, Corporate Development

## DIRECTORS

**Larry A. Shaw (Chairman)**
Calgary, Alberta

**Gordon W. Cameron**
Calgary, Alberta

**Kenneth N. Cullen**
Calgary, Alberta

**Werner A. Siemens**
Calgary, Alberta

**A. Jeffery Tonken**
President & Chief Executive Officer
Calgary, Alberta

## SOLICITORS

**Borden Ladner Gervais LLP**
Calgary, Alberta

## AUDITORS

**Deloitte & Touche LLP**
Chartered Accountants
Calgary, Alberta

## RESERVES EVALUATOR

**AJM Petroleum Consultants**
Calgary, Alberta

## BANKERS

**Scotia Bank**
**HSBC Bank Canada**
**Alberta Treasury Branch**
**Union Bank**
**The Toronto Dominion Bank**

## TRANSFER AGENT

**Olympia Trust Company**
Calgary, Alberta

## STOCK EXCHANGE LISTING

**TSX Exchange**
Symbol: BIR

## HEAD OFFICE

500, 630 – 4th Avenue S.W.
Calgary, Alberta T2P 0J9
Phone: 403-261-6401
Fax: 403-261-6424

## SPIRIT RIVER OFFICE

5604 – 49th Avenue
Spirit River, Alberta T0H 3G0
Phone: 780-864-4624
Fax: 780-864-4628

Email: info@birchcliffenergy.com
www.birchcliffenergy.com