



## **FINANCIAL STATEMENTS**

**March 31, 2011**

# SURE ENERGY INC.

## Condensed Statement of Financial Position

(in thousands of Canadian dollars)  
(unaudited)

	Note	March 31, 2011	December 31, 2010	January 1, 2010
<b>Assets</b>				
Trade and other receivables		\$ 2,643	\$ 3,110	\$ 1,829
Deposits and prepaid expenses		1,559	853	457
Total current assets		4,202	3,963	2,286
Property, plant and equipment	6	52,999	46,062	33,723
Exploration and evaluation assets	6	2,298	1,481	1,899
Deferred financing costs		2,000	2,179	-
Total assets		\$ 61,499	\$ 53,685	\$ 37,908
<b>Liabilities</b>				
Bank debt		\$ 8,046	\$ 440	\$ 3,046
Trade and other payables		7,370	8,223	3,777
Total current liabilities		15,416	8,663	6,823
Note facility		10,000	10,000	-
Decommissioning obligations	7	2,008	1,792	1,450
Total liabilities		27,424	20,455	8,273
<b>Equity</b>				
Share capital	8	37,443	37,282	35,399
Warrants		2,065	2,065	-
Contributed surplus	8	3,470	3,331	3,152
Deficit		(8,903)	(9,448)	(8,916)
Total equity		34,075	33,230	29,635
Total equity and liabilities		\$ 61,499	\$ 53,685	\$ 37,908

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

# SURE ENERGY INC.

## Condensed Statements of Income and Comprehensive Income

For the three months ended March 31, 2011, and March 31, 2010  
(in thousands of Canadian dollars, except per share amounts)  
(unaudited)

	Note	2011	2010
Petroleum and natural gas revenues	\$	6,268	\$ 3,073
Royalties		(522)	(497)
		5,746	2,576
Production and operating		1,123	850
Transportation		274	139
Exploration and evaluation		40	46
General and administrative		980	367
Interest and financing charges		400	50
Depletion, depreciation and amortization		2,199	955
Stock based compensation		185	55
		5,201	2,462
Net income and comprehensive income for the period	\$	545	\$ 114
Earnings per share:			
Basic and diluted	9	\$ 0.01	\$ 0.00

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

# SURE ENERGY INC.

## Condensed Statements of Changes in Equity

(in thousands of Canadian dollars)  
(unaudited)

	Note	March 31, 2011		December 31, 2010		March 31, 2010	
		Number	\$	Number	\$	Number	\$
<b>Share capital</b>							
Balance, beginning of period		48,431,130	37,282	46,873,962	35,399	46,873,962	35,399
Exercise of stock options		97,500	161	1,588,666	1,912	7,000	3
Cancelled		-	-	(31,498)	(29)	(31,498)	(29)
Share capital, end of period		48,528,630	37,443	48,431,130	37,282	46,849,464	35,373
<b>Warrants</b>							
Balance, beginning of period		2,800,000	2,065	-	-	-	-
Issued for Note Facility		-	-	2,800,000	2,065	-	-
Warrants, end of period		2,800,000	2,065	2,800,000	2,065	-	-
<b>Contributed surplus</b>							
Balance, beginning of period		-	3,331	-	3,152	-	3,152
Cancellation of common shares		-	-	-	29	-	29
Exercise of stock options	8	-	(46)	-	(560)	-	-
Stock-based compensation expense		-	185	-	710	-	56
Contributed surplus, end of period		-	3,470	-	3,331	-	3,237
<b>Deficit</b>							
Balance, beginning of period		-	(9,448)	-	(8,916)	-	(8,916)
Net income (loss) for the period		-	545	-	(532)	-	114
Deficit, end of period		-	(8,903)	-	(9,448)	-	(8,802)

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

# SURE ENERGY INC.

## Condensed Statements of Cash Flows

For the three months ended March 31, 2011 and 2010  
(in thousands of Canadian dollars)  
(unaudited)

	Note	2011	2010
Cash flows from operating activities:			
Net income and comprehensive income for the period		\$ 545	\$ 114
Adjustments for:			
Exploration and evaluation		40	46
Depletion, depreciation and amortization		2,199	955
Interest and financing charges		400	50
Stock based compensation		185	55
Change in non-cash working capital	10	(1,206)	500
Net cash from (used in) operating activities		2,163	1,720
Cash flows from investing activities:			
Exploration and evaluation		(40)	(46)
Property, plant and equipment expenditures		(6,020)	(2,028)
Acquisition of property, plant and equipment		(3,735)	(171)
Change in non-cash working capital	10	114	(1,325)
Net cash from (used in) investing activities		(9,681)	(3,570)
Cash flows from financing activities:			
Proceeds from issue of share capital		-	3
Proceeds from loans and borrowings		7,606	1,883
Proceeds from exercise of share options		115	-
Interest paid		(203)	(36)
Net cash from financing activities		7,518	1,850
Change in cash and cash equivalents		-	-
Cash and cash equivalents beginning of period		-	-
Cash and cash equivalents end of period		\$ -	\$ -

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

# SURE ENERGY INC.

## Notes to Condensed Financial Statements

For the three months ended March 31, 2011 and 2010  
(tabular amounts are in thousands of Canadian dollars except share and per share information)  
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### 1. Reporting entity:

Sure Energy Inc. ("Sure Energy" or the "Company") is an Alberta incorporated oil and natural gas exploration and production company whose business activities are focused primarily in Alberta. Sure Energy is a public company and trades on the Toronto Stock Exchange. The Company has no subsidiaries.

### 2. Basis of preparation:

#### (a) Statement of compliance:

The condensed financial statements have been prepared in accordance with International Accounting Standard ("IAS") 34 Interim Financial Reporting. These condensed financial statements do not include all of the information required for annual financial statements. Amounts relating to the three months ended March 31, 2010 and as at January 1, 2010 and December 31, 2010 were previously presented in accordance with Canadian Generally Accepted Accounting Principles ("Canadian GAAP"). These amounts have been restated as necessary to be compliant with our accounting policies under International Financial Reporting Standards ("IFRS"). Reconciliations and descriptions relating to the transition from Canadian GAAP to IFRS are included in Note 12.

The condensed financial statements were authorized for issue by the Board of Directors on May 24, 2011.

#### (b) Basis of measurement:

The condensed financial statements have been prepared on the historical cost basis. Historical cost is generally based on the fair value of the consideration given in exchange for assets.

The methods used to measure fair values are disclosed in note 4.

#### (c) Functional and presentation currency:

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

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

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

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

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Notes to Condensed Financial Statements, page 2

For the three months ended March 31, 2011 and 2010  
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Information about significant areas of estimation uncertainty and critical judgments in applying accounting policies that have the most significant effect on the amounts recognized in the condensed financial statements including the following:

- Valuation of property, plant and equipment
- Valuation of intangible exploration and evaluation assets
- Measurement of share-based payments
- Provisions and contingencies

Reserve estimates impact a number of the areas referred to above in particular, the valuation of property, plant and equipment and the calculation of depletion and depreciation.

### 3. Significant accounting policies:

The accounting policies set out below have been applied consistently to all periods presented in these condensed financial statements.

(a) Jointly controlled operations and jointly controlled assets:

Many of the Company's oil and natural gas activities involve jointly controlled assets. The condensed financial statements include the Company's share of these jointly controlled assets and a proportionate share of the relevant revenue and related costs.

(b) Financial instruments:

(i) Non-derivative financial instruments:

Non-derivative financial instruments comprise trade and other receivables, cash and cash equivalents, bank debt, note facility, and trade and other payables. Non-derivative financial instruments are recognized initially at fair value plus, for instruments not at fair value through profit or loss, any directly attributable transaction costs. Subsequent to initial recognition non-derivative financial instruments are measured as described below.

Financial assets at fair value through profit or loss:

An instrument is classified at fair value through profit or loss if it is held for trading or is designated as such upon initial recognition. Financial instruments are designated at fair value through profit or loss if the Company manages such investments and makes purchase and sale decisions based on their fair value in accordance with the Company's risk management or investment strategy. Upon initial recognition attributable transaction costs are recognized in profit or loss when incurred. Financial instruments at fair value through profit or loss are measured at fair value, and changes therein are recognized in profit or loss. The Company has designated cash and cash equivalents at fair value.

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Notes to Condensed Financial Statements, page 3

For the three months ended March 31, 2011 and 2010  
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Other:

Non-derivative financial instruments, such as trade and other receivables, bank debt, note facility, and trade and other payables, are measured at amortized cost using the effective interest method, less any impairment losses.

(ii) Share capital:

Common shares are classified as equity. Incremental costs directly attributable to the issue of common shares and share options are recognized as a deduction from equity, net of any tax effects.

(c) Property, plant and equipment ("PP&E") and intangible exploration and evaluation ("E&E") assets:

(i) Recognition and measurement:

E&E expenditures:

Pre-license costs are expensed in the statement of income as incurred.

E&E costs, including the costs of acquiring licenses, technical services and studies, and exploration drilling and testing, initially are capitalized as either tangible or intangible exploration and evaluation assets according to the nature of the assets acquired. The costs are accumulated in cost centres by well, field or exploration area pending determination of technical feasibility and commercial viability.

Technical feasibility and commercial viability of extracting a mineral resource is considered to be determinable when proved or probable reserves are determined to exist. A review of each lease or field is carried out, at least annually, to ascertain whether proved or probable reserves have been discovered. Upon determination of proved or probable reserves, intangible exploration and evaluation assets attributable to those reserves are first tested for impairment and then reclassified from exploration and evaluation assets to PP&E.

PP&E:

Items of PP&E, which include oil and gas development and production assets, are measured at cost less accumulated depletion and depreciation and accumulated impairment losses. PP&E is grouped into CGU's for impairment testing. IFRS 1 provides an exemption whereby PP&E is valued at deemed cost upon transition to IFRS. Deemed cost is equivalent to the carrying value of PP&E under Canadian GAAP and was allocated to six CGU's under IFRS. The allocation of deemed cost to the CGU's is made based on proved plus probable reserve values. CGU's are aligned with the geographic regions in which Sure Energy operates. When significant parts of an item of property, plant and equipment, including oil and natural gas interests, have different useful lives, they are accounted for as separate items (major components).

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Notes to Condensed Financial Statements, page 4

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Gains and losses on disposal of an item of property, plant and equipment, including oil and natural gas interests, are determined by comparing the proceeds from disposal with the carrying amount of property, plant and equipment and are recognized within "other income" or "other expenses" in profit or loss.

(ii) Subsequent costs:

Costs incurred subsequent to the determination of technical feasibility and commercial viability and the costs of replacing parts of property, plant and equipment are recognized as oil and natural gas interests only when they increase the future economic benefits embodied in the specific asset to which they relate. All other expenditures are recognized in profit or loss as incurred. Such costs generally represent amounts incurred in developing proved and/or probable reserves and bringing in or enhancing production from such reserves, and are accumulated on a field or geotechnical area basis. The carrying amount of any replaced or sold component is derecognized. The costs of the day-to-day servicing of property, plant and equipment are recognized in profit or loss as incurred.

(iii) Depletion and depreciation:

E&E expenditures are not depleted.

The net carrying value of PP&E is depleted using the unit of production method by reference to the ratio of production in the year to the related proved and probable reserves, taking into account estimated future development costs necessary to bring those reserves into production. Future development costs are estimated taking into account the level of development required to produce the reserves. These estimates are reviewed by independent reserve engineers at least annually.

Proved and probable reserves are estimated using independent reserve engineer reports and 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 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:

- a reasonable assessment of the future economics of such production;
- a reasonable expectation that there is a market for all or substantially all the expected oil and natural gas production; and
- evidence that the necessary production, transmission and transportation facilities are available or can be made available.

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(d) Impairment:

(i) Financial assets:

A financial asset is assessed at each reporting date to determine whether there is any objective evidence that it is impaired. A financial asset is considered to be impaired if objective evidence indicates that one or more events have had a negative effect on the estimated future cash flows of that asset.

An impairment loss in respect of a financial asset measured at amortized cost is calculated as the difference between its carrying amount and the present value of the estimated future cash flows discounted at the original effective interest rate.

Individually significant financial assets are tested for impairment on an individual basis. The remaining financial assets are assessed collectively in groups that share similar credit risk characteristics.

All impairment losses are recognized in profit or loss.

An impairment loss is reversed if the reversal can be related objectively to an event occurring after the impairment loss was recognized. For financial assets measured at amortized cost the reversal is recognized in profit or loss.

(ii) Non-financial assets:

The carrying amounts of the Company's non-financial assets, other than E&E assets, are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, then the asset's recoverable amount is estimated. E&E assets are assessed for impairment when they are reclassified to property, plant and equipment, as oil and natural gas interests, where facts and circumstances suggest that the carrying amount exceeds the recoverable amount and are assessed for impairment at a minimum, on an annual basis.

For the purpose of impairment testing, assets are grouped together into CGU's, the smallest group of assets that generates cash inflows from continuing use that are largely independent of the cash inflows of other assets or groups of assets. The recoverable amount of an asset or a CGU is the greater of its value in use and its fair value less costs to sell.

In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. Value in use is generally computed by reference to the present value of the future cash flows expected to be derived from production of proven and probable reserves.

An impairment loss is recognized if the carrying amount of an asset or its CGU exceeds its estimated recoverable amount. Impairment losses are recognized in profit or loss. Impairment losses recognized in prior years are assessed at each reporting date for any indications that

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the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depletion and depreciation or amortization, if no impairment loss had been recognized.

(e) Share based payments:

The grant date fair value of options granted to employees is recognized as compensation expense, with a corresponding increase in contributed surplus over the vesting period. The fair value of an option is measured for each tranche of an option and amortized over the tranche's vesting period.

(f) Decommissioning obligations:

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

Decommissioning obligations are measured at the present value, using a risk-free rate, of management's best estimate of expenditures required to settle the present obligation at the balance sheet date. Subsequent to the initial measurement, the obligation is adjusted at the end of each period to reflect the passage of time and changes in the estimated future cash flows underlying the obligation. The increase in the provision due to the passage of time is recognized as interest and financing charges whereas increases/decreases due to changes in the estimated future cash flows are capitalized. Actual costs incurred upon settlement of the decommissioning obligations are charged against the provision to the extent the provision was established.

(g) Revenue:

Revenue from the sale of petroleum and natural gas is recorded when the significant risks and rewards of ownership of the product is transferred to the buyer which is usually when legal title passes to the external party. This is generally at the time product enters the pipeline.

Royalty income is recognized as it accrues in accordance with the terms of the overriding royalty agreements.

(h) Interest and financing charges:

Interest and financing charges comprises interest expense on borrowings, accretion on decommissioning obligations and accretion of deferred financing charges.

Borrowing costs incurred for the construction of qualifying assets are capitalized during the period of time that is required to complete and prepare the assets for their intended use or sale. All other borrowing costs are recognized in profit or loss. The capitalization rate used to

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determine the amount of borrowing costs to be capitalized is the weighted average interest rate applicable to the Company's outstanding borrowings during the period.

Deferred financing charges include note facility transaction costs and are amortized over the life of the note facility.

(i) Income tax:

Income tax expense comprises current and deferred tax. Income tax expense is recognized in profit or loss except to the extent that it relates to items recognized directly in equity, in which case it is recognized in equity.

Current tax is the expected tax payable on the taxable income for the period, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous years.

Deferred tax is recognized using the balance sheet method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is not recognized on the initial recognition of assets or liabilities in a transaction that is not a business combination and at the time of transaction affects neither tax or accounting profit or loss. In addition, deferred tax is not recognized for taxable temporary differences arising on the initial recognition of goodwill. Deferred tax is measured at the tax rates that are expected to be applied when the asset is realized or liability settled, based on the laws that have been enacted or substantively enacted by the reporting date. Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset, and they relate to income taxes levied by the same tax authority on the same taxable entity, or on different tax entities, but they intend to settle current tax liabilities and assets on a net basis or their tax assets and liabilities will be realized simultaneously.

A deferred tax asset is recognized to the extent that it is probable that future taxable profits will be available against which the temporary difference can be utilized. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realized.

(j) Earnings per share:

Basic earnings per share is calculated by dividing the profit or loss attributable to common shareholders of the Company by the weighted average number of common shares outstanding during the period. Diluted earnings per share is determined by adjusting the profit or loss attributable to common shareholders and the weighted average number of common shares outstanding for the effects of dilutive instruments such as options granted to employees.

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(k) New standards and interpretations not yet adopted:

The Company has not applied the following new and revised IFRS that have been issued but are not yet effective:

i) IFRS 9 (as amended in 2010) Financial Instruments

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 requires all recognized financial assets that are within the scope of IAS 39 Financial Instruments: Recognition and Measurement to be subsequently measured at amortized cost or fair value. The most significant effect of IFRS 9 regarding the classification and measurement of financial liabilities relates to the accounting for changes in fair value of a financial liability (designated as at fair value through profit or loss) attributable to changes in the credit risk of that liability. IFRS 9 is effective for annual periods beginning on or after 1 January 2013, with earlier application permitted.

The directors anticipate that IFRS 9 that will be adopted in the Company's financial statements for the annual period beginning January 1, 2013 and that the application of the new Standard could have a significant impact on amounts reported in respect of the Company's financial assets and financial liabilities. However, it is not practicable to provide a reasonable estimate of that effect until a detailed review has been completed.

#### 4. Determination of fair values:

A number of the Company's accounting policies and disclosures require the determination of fair value, for both financial and non-financial assets and liabilities. Fair values have been determined for measurement and/or disclosure purposes based on the following hierarchy:

- (i) Level 1 – inputs to the valuation methodology are quoted process (unadjusted) for identical assets and liabilities in active markets.
- (ii) Level 2 – inputs valuation methodology include quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.
- (iii) Level 3 – inputs to the valuation methodology are unobservable and significant to the fair value measurement.

(a) Property, plant and equipment and intangible exploration assets:

The fair value of property, plant and equipment recognized in a business combination, is based on market values. The market value of property, plant and equipment is the estimated amount for which property, plant and equipment could be exchanged on the acquisition date between a willing buyer and a willing seller in an arm's length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently and without compulsion. The market value of oil and natural gas interests (included in property, plant and

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equipment) and intangible exploration assets is estimated with reference to the discounted cash flows expected to be derived from oil and natural gas production based on externally prepared reserve reports. The risk-adjusted discount rate is specific to the asset with reference to general market conditions, being 12.5% for 2011 (2010: 12.5%).

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

(b) Trade and other receivables, bank debt and trade and other payables

The fair value of trade and other receivables, bank debt and trade and other payables is estimated as the present value of future cash flows, discounted at the market rate of interest at the reporting date. The fair value of these balances approximated their carrying value due to their short term to maturity.

(c) Note facility:

The carrying value of the note facility approximates its fair value as the fixed interest rate is comparable to interest rates available to the Company.

(d) Stock options:

The fair value of employee stock options is measured using a Black Scholes option pricing model. Measurement inputs include share price on measurement date, exercise price of the instrument, expected volatility (based on weighted average historic volatility adjusted for changes expected due to publicly available information), weighted average expected life of the instruments (based on historical experience and general option holder behaviour), expected dividends, and the risk-free interest rate (based on government bonds).

## 5. Financial risk management:

The Company manages its exposure to financial risks by operating in a manner that minimizes its exposure to the extent practical. The main financial risks affecting the Company are as follows:

(a) Credit Risk

Credit risk is primarily related to the Company's receivables from petroleum and natural gas marketers and joint venture partners and the risk of financial loss if a customer, partner or counterparty to a financial instrument fails to meet its contractual obligations. Receivables from petroleum and natural gas marketers are normally collected on the 25th day of the month following production and the Company could be at risk for up to 55 days of production from any marketer. The Company sells its production to several petroleum and natural gas marketers so that the exposure to any one entity is minimized. The Company historically has not experienced any collection issues with its petroleum and natural gas marketers. Joint venture receivables are typically collected within one to three months of the joint venture bill being issued to the partner. The Company attempts to mitigate the risk from joint venture receivables by obtaining partner approval of significant capital expenditures prior to

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expenditure. The Company does not typically obtain collateral from joint venture partners; however in certain circumstances, it may cash call a partner in advance of the work being performed. The Company establishes an allowance for doubtful accounts as determined by management based on their assessment of collection therefore the carrying amount of accounts receivable generally represents the maximum credit exposure. The maximum exposure to credit risk at the balance sheet date was equal to the carrying value of accounts receivable. As of March 31, 2011, substantially all receivables were current and there were no receivables provided for or written off during the three months ended March 31, 2011.

## (b) Market Risk

Market risk consists of commodity price, foreign currency and interest rate risks.

### (i) Commodity Price Risk

Commodity price risk is the risk that future cash flows will fluctuate as a result of changes in commodity prices. Commodity prices for petroleum and natural gas are impacted by world economic events that dictate the levels of supply and demand. The Company has no financial derivative sales contracts in place as at or during the period ended March 31, 2011.

### (j) Foreign Currency Exchange Risk

Foreign currency exchange rate risk is the risk that future cash flows will fluctuate as a result of changes in foreign exchange rates. Although substantially all of the Company's petroleum and natural gas sales are denominated in Canadian dollars, the underlying market prices in Canada for petroleum and natural gas are impacted by changes in the exchange rate between the Canadian and United States dollar. The Company had no forward exchange rate contracts in place as at or during the period ended March 31, 2011.

### (k) Interest Rate Risk

Interest rate cash flow risk is the risk that future cash flows will fluctuate as a result of changes in market interest rates. The Company is exposed to interest rate fluctuations on its bank debt which bears a floating rate of interest. If interest rates on the bank debt increased by one percent, net income would have decreased by \$10,000 during the three months ended March 31, 2011.

## (c) Liquidity Risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they become due. The Company's approach to managing liquidity is to ensure, as far as possible, that it will have sufficient liquidity to meet its liabilities when due without incurring unacceptable losses or risking harm to the Company's reputation. The Company prepares capital expenditures budgets which are regularly monitored and updated as considered

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necessary. As well, the Company utilizes authorizations for expenditures on both operated and non-operated projects to further manage capital expenditures. To facilitate the capital expenditure program, the Company has bank debt that is reviewed periodically by the lender and a note facility.

## (d) Capital Management

The Company's policy is to maintain a strong capital base for the objectives of maintaining financial flexibility, creditor and market confidence, and to sustain future investing in oil and gas activities which may or may not be successful. The objective is to balance the proportion of debt and equity in its capital structure. The Company defines its capital structure to include shareholders' equity, bank debt, the note facility and working capital. The key measures that the Company utilizes in evaluating its capital structure are net debt to funds flow from operations, net debt as a percent of total capitalization and the current credit available from its creditors in relation to the Company's budgeted capital program. Funds flow from operations is a non-GAAP measure and it is used by the Company to analyze operating performance, leverage and liquidity. The Company's capitalization and calculation of funds flow from operations is as follows:

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For the three months ended March 31, 2011 and 2010  
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	March 31, 2011	December 31, 2010
Net debt		
Working capital		
Trade and other receivables	(2,643)	(3,110)
Deposits and prepaid expenses	(1,559)	(853)
Trade and other payables	7,370	8,223
	3,168	4,260
Note facility	10,000	10,000
Bank debt	8,046	440
Total net debt	21,214	14,700
Market capitalization		
Common shares outstanding	48,528,630	48,431,130
Closing price, TSX	1.80	1.75
Total market capitalization	87,352	84,754
Total net debt and market capitalization	108,566	99,454
Net debt as a percent of total capitalization	20%	15%
	Three Months Ended	Year Ended
	March 31, 2011	December 31, 2010
Funds flow from operations:		
Net income for the period	545	(532)
Adjustments:		
Exploration and evaluation expenditures	40	602
Depletion, depreciation and amortization	2,199	4,860
Impairment	-	423
Interest and financing charges	400	344
Stock based compensation	185	710
Total funds flow from operations	3,369	6,407
Trailing 12 months funds flow from operations	8,556	6,407
Net debt to trailing 12 months funds flow from operations ratio	2.48	2.29

The Company also assesses its capital structure by forecasting cash flows and estimated debt levels. There are several strategies to maintain or adjust capital structure including increasing bank credit as a result of reserve growth, decreasing capital spending and new equity issues.

The Company is subject to a covenant on its credit facility to maintain its ratio of current assets (including the undrawn portion of the demand credit facility) to current liabilities (not including current bank debt) at a 1.0:1.0 level. As at March 31, 2011, the ratio was 1.51 (December 31, 2010 - 2.25).

# SURE ENERGY INC.

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For the three months ended March 31, 2011 and 2010  
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## 6. PP&E and E&E assets:

	PP&E	E&E Assets	Total
Cost or deemed cost:			
Balance at January 1, 2010	\$ 33,743	\$ 1,899	\$ 35,642
Expiries	-	(418)	(418)
Additions	17,622	-	17,622
Balance at December 31, 2010	51,365	1,481	52,846
Additions	9,136	817	9,953
Balance at March 31, 2011	\$ 60,501	\$ 2,298	\$ 62,799
Depletion, depreciation and impairment losses:			
Balance at January 1, 2010	20	-	20
Depletion and depreciation for the period	4,860	-	4,860
Impairment	423	-	423
Balance at December 31, 2010	5,303	-	5,303
Depletion and depreciation for the period	2,199	-	2,199
Balance at March 31, 2011	7,502	-	7,502
Carrying amounts:			
At January 1, 2010	\$ 33,723	\$ 1,899	\$ 35,622
At December 31, 2010	\$ 46,062	\$ 1,481	\$ 47,543
At March 31, 2011	\$ 52,999	\$ 2,298	\$ 55,297

## 7. Decommissioning obligations:

	March 31 2011	December 31 2010
Carrying amount, beginning of period	\$ 1,792	\$ 1,450
Additions	197	279
Accretion expense	19	63
Carrying amount, end of period	2,008	1,792

# SURE ENERGY INC.

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## 8. Share capital:

During the year ended December 31, 2010, 1.6 million stock options and Performance Incentive Rights were exercised for a total cash consideration of \$1.4 million. Due to the exercise of the stock options, \$560,000 should have been transferred out of contributed surplus to share capital. This amount reflects the stock based compensation that was previously recorded attributable to these options. This amount was not recorded in the year ended December 31, 2010 but has been correct in these financial statements. Contributed surplus was decreased by \$560,000 and share capital was increased as at December 31, 2010 for this restatement.

During the three months ended March 31, 2011, 97,500 stock options and Performance Incentive Rights were exercised for a total cash consideration of \$115,000. Due to the exercise of the stock options, \$46,000 was transferred out of contributed surplus to share capital. This amount reflects the stock based compensation that was previously recorded attributable to these options.

## 9. Earnings per share:

	Three months ended March 31	
	2011	2010
Profit (loss)	\$ 545	\$ 114
Earnings per share – basic	0.01	0.00
Weighted average shares outstanding - basic	48,509,769	46,852,127

Diluted earnings per share is not disclosed because all in-the-money options, PIRs and warrants are anti-dilutive.

## 10. Supplemented cash flow information:

Changes in non-cash working capital items increased (decreased) cash and cash equivalents as follows:

	Three months ended March 31	
	2011	2010
Trade and other receivables	\$ 467	\$ (257)
Deposits and prepaid expenses	(706)	(14)
Trade and other payables	(853)	(554)
	\$ (1,092)	\$ (825)
Operating activities	\$ (1,206)	\$ 500
Investing activities	\$ 114	\$ (1,325)

# SURE ENERGY INC.

Notes to Condensed Financial Statements, page 15

For the three months ended March 31, 2011 and 2010  
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## 11. Subsequent events:

On April 18, 2011, the Company closed an acquisition of assets for \$7.5 million. Concurrent with the closing, the Company received an increase to its existing bank credit facility from \$15 million to \$25 million.

## 12. Reconciliation of statement of financial position from Canadian GAAP to IFRS:

At the date of IFRS transition – January 1, 2010:

	Notes	Canadian GAAP	Effect of transition to IFRS	IFRS
<b>Assets</b>				
Trade and other receivables	\$	1,829	\$ -	\$ 1,829
Deposits and prepaid expenses		457	-	457
		2,286	-	2,286
Property, plant and equipment		35,622	(1,899)	33,723
Exploration and evaluation assets		-	1,899	1,899
	\$	37,908	\$ -	\$ 37,908
<b>Liabilities</b>				
Bank debt	\$	3,046	\$ -	\$ 3,046
Trade and other payables		3,777	-	3,777
		6,823	-	6,823
Decommissioning obligations		1,031	419	1,450
		7,854	419	8,273
<b>Equity</b>				
Share capital		35,732	(333)	35,399
Contributed surplus		3,152	-	3,152
Deficit		(8,830)	(86)	(8,916)
		30,054	(419)	29,635
	\$	37,908	\$ -	\$ 37,908

# SURE ENERGY INC.

Notes to Condensed Financial Statements, page 16

For the three months ended March 31, 2011 and 2010  
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At the end of the last reporting year under Canadian GAAP – December 31, 2010:

	Notes	Canadian GAAP	Effect of transition to IFRS	IFRS
<b>Assets</b>				
Trade and other receivables		\$ 3,110	\$ -	\$ 3,110
Deposits and prepaid expenses		853	-	853
		3,963	-	3,963
Property, plant and equipment		45,375	687	46,062
Exploration and evaluation assets		-	1,481	1,481
Deferred financing costs		2,179	-	2,179
		\$ 51,517	\$ 2,168	\$ 53,685
<b>Liabilities</b>				
Bank debt		\$ 440	\$ -	\$ 440
Trade and other payables		8,223	-	8,223
		8,663	-	8,663
Note facility		10,000	-	10,000
Decommissioning obligations		1,276	516	1,792
		19,939	516	20,455
<b>Equity</b>				
Share capital		37,615	(333)	37,282
Warrants		2,065	-	2,065
Contributed surplus		3,331	-	3,331
Deficit		(11,433)	1,985	(9,448)
		31,578	1,652	33,230
		\$ 51,517	\$ 2,168	\$ 53,685

# SURE ENERGY INC.

Notes to Condensed Financial Statements, page 17

For the three months ended March 31, 2011 and 2010  
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At the end of the last comparative quarter – March 31, 2010:

	Notes	Canadian GAAP	Effect of Transition to IFRS	IFRS
<b>Assets</b>				
Trade and other receivables		\$ 2,086	\$ -	\$ 2,086
Deposits and prepaid expenses		471	-	471
		2,557	-	2,557
Property, plant and equipment		36,063	(1,056)	35,007
Exploration and evaluation assets		-	1,899	1,899
		\$ 38,620	\$ 843	\$ 39,463
<b>Liabilities</b>				
Bank debt		\$ 4,928	\$ -	\$ 4,928
Trade and other payables		3,223	-	3,223
		8,151	-	8,151
Decommissioning obligations		1,075	429	1,504
		9,226	429	9,655
<b>Equity</b>				
Share capital		35,706	(333)	35,373
Contributed surplus		3,237	-	3,237
Deficit		(9,549)	747	(8,802)
		29,394	414	29,808
		\$ 38,620	\$ 843	\$ 39,463

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Notes to Condensed Financial Statements, page 18

For the three months ended March 31, 2011 and 2010  
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Reconciliation of condensed statement of income for the year ended December 31, 2010:

	Notes	Canadian GAAP	Effect of transition to IFRS	IFRS
Petroleum and natural gas revenues		\$ 13,063	\$ -	\$ 13,063
Royalties		(1,108)	-	(1,108)
		11,955	-	11,955
Production and operating		3,432	-	3,432
Transportation		645	-	645
Exploration and evaluation		-	602	602
General and administrative		1,328	143	1,471
Interest and financing charges		281	63	344
Depletion, depreciation and amortization		8,162	(3,302)	4,860
Impairment		-	423	423
Stock based compensation		710	-	710
		14,558	(2,071)	12,487
(Loss) income and comprehensive (loss) income for the year		\$ (2,603)	\$ 2,071	\$ (532)

Reconciliation of condensed statement of income for the three months ended March 31, 2010:

	Notes	Canadian GAAP	Effect of transition to IFRS	IFRS
Petroleum and natural gas revenues		\$ 3,073	\$ -	\$ 3,073
Royalties		(497)	-	(497)
		2,576	-	2,576
Production and operating		850	-	850
Transportation		139	-	139
Exploration and evaluation		-	46	46
General and administrative		333	34	367
Interest and financing charges		36	14	50
Depletion, depreciation and amortization		1,882	(927)	955
Stock based compensation		55	-	55
		3,295	(833)	2,462
(Loss) income and comprehensive (loss) income for the period		\$ (719)	\$ 833	\$ 114

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Notes to Condensed Financial Statements, page 19

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## Notes to reconciliations

### (a) IFRS 1 exemptions

These are the Company's first Condensed Interim Financial Statements for the first quarter of the period covered by the first annual financial statements presented in accordance with IFRS for the year ending December 31, 2011.

IFRS was applied retrospectively at the transition date with all adjustments to assets and liabilities as stated under Canadian GAAP taken to retained earnings unless certain exceptions and exemptions are applied.

IFRS 1, "First-Time Adoption of International Financial Reporting Standards", permitted first time adopters of IFRS a number of exemptions. The Company elected to utilize the following exemptions for first-time adoption of IFRS:

- (i) IFRS 1, First-Time Adoption of International Financial Reporting Standards, whereby the petroleum asset balance as determined under Canadian GAAP was allocated to the IFRS categories of exploration and evaluation assets and PP&E. Under the exemption, for assets in the development or production phases, the amount was allocated to the underlying IFRS transitional assets on a pro-rata basis using proved and probable reserve values as of the IFRS transition date. This resulted in a \$1.9 million increase in exploration and evaluation assets with a corresponding decrease in PP&E.
- (ii) IFRS 3, Business Combinations, which allows for an implementation of the IFRS business combination rules on a prospective basis, therefore, business combinations entered into prior to January 1, 2010 were not retrospectively restated;
- (iii) IFRS 2, Share-based payments, whereby stock options that vested prior to January 1, 2010 are not required to be retrospectively restated. Therefore, IFRS requirements apply only to those options that were unvested at the date of transition;
- (iv) IFRS 23, Borrowing Costs, whereby borrowing cost disclosures relating to qualifying assets are applied prospectively from the IFRS transition date.

### (b) Decommissioning obligations:

Under Canadian GAAP, decommissioning obligations were discounted at a credit adjusted risk free rate of 8 percent. Under IFRS the estimated cash flow to abandon and remediate the wells and facilities has been risk adjusted, therefore, the provision is discounted at a risk free rate of 4 percent. Upon transition to IFRS, this resulted in a \$0.4 million increase in the decommissioning obligations with a corresponding decrease in retained earnings.

Under Canadian GAAP, accretion of the discount was included in depletion and depreciation. Under IFRS it is included in interest and financing charges. Under Canadian GAAP, expenditures on remediation and abandonment were not included in changes in non-cash working capital as done under IFRS.

# SURE ENERGY INC.

Notes to Condensed Financial Statements, page 20

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(c) Flow-through shares:

For Canadian GAAP, equity is reduced for the value of the tax pools renounced to flow-through shareholders. Under IFRS, equity is reduced by the premium paid for the flow-through share versus a normal share. The Company issued 1.9 million flow-through shares in 2008. Share capital is approximately \$0.3 million less under IFRS than Canadian GAAP for this difference, with a corresponding increase to retained earnings.

(d) Depletion policy:

Upon transition to IFRS, the Company adopted a policy of depleting PP&E on a unit of production basis over proved and probable reserves. The depletion policy under Canadian GAAP was based on units of production over proved reserves. In addition, depletion was done on the Canadian cost centre under Canadian GAAP. IFRS requires depletion and depreciation to be calculated based on individual components (ie. fields or combinations thereof).

There was no impact of this difference on adoption of IFRS at January 1, 2010 as a result of the IFRS 1 election as discussed above.

For the year ended December 31, 2010, this resulted in a decrease to depletion of \$3.3 million (three months ended March 31, 2010 - \$0.9 million) with a corresponding change to PP&E. An impairment of \$0.4 million was also recorded for the year ended December 31, 2010.

(e) Directly attributable salaries and benefits:

Certain salaries and benefits were capitalized under Canadian GAAP and not under IFRS. For the year ended December 31, 2010, this resulted in an increase in general and administrative expenses of \$143,000 (three months ended March 31, 2010 - \$34,000) and a corresponding decrease in PP&E.

(f) Statement of cash flows:

Under Canadian GAAP, interest paid was classified as operating. Under IFRS, interest paid was classified as financing. For the year ended December 31, 2010 this resulted in an increase in net cash from operating activities of \$251,000 (three months ended March 31, 2010 - \$36,000) and a corresponding decrease to cash flows from financing activities.