# TWIN BUTTE
ENERGY LTD.

SECOND QUARTER 2013

# HIGHLIGHTS

| ($000's, except per share amounts) | Three months ended June 30 2013 | 2012 | % Change | Six months ended June 30 2013 | 2012 | % Change |
|---|---|---|---|---|---|---|
| **FINANCIAL** | | | | | | |
| Petroleum and natural gas sales | **98,497** | 70,173 | 40% | **170,261** | 142,670 | 19% |
| Funds flow (1) | **33,058** | 33,762 | -2% | **65,481** | 60,162 | 9% |
| Per share basic | **0.13** | 0.18 | -28% | **0.26** | 0.32 | -19% |
| Per share diluted | **0.13** | 0.17 | -24% | **0.26** | 0.32 | -19% |
| Net income (loss) | **(6,082)** | 29,340 | -121% | **(35,715)** | 44,323 | -181% |
| Per share basic | **(0.02)** | 0.15 | -113% | **(0.14)** | 0.23 | -161% |
| Per share diluted | **(0.02)** | 0.15 | -113% | **(0.14)** | 0.23 | -161% |
| Dividends declared | **12,028** | 8,648 | 39% | **24,008** | 17,272 | 39% |
| Dividends declared, Post DRIP | **10,543** | 8,648 | 22% | **21,271** | 17,272 | 23% |
| Capital expenditures (2) | **14,871** | 24,910 | -40% | **34,496** | 32,826 | 5% |
| Corporate acquisitions (2) | **–** | – | 0% | **–** | 203,000 | -100% |
| Net debt (3) | **193,750** | 124,459 | 56% | **193,750** | 124,459 | 56% |
| **OPERATING** | | | | | | |
| Average daily production | | | | | | |
| Crude oil (bbl per day) | **14,588** | 11,415 | 28% | **14,630** | 10,801 | 35% |
| Natural gas (Mcf per day) | **12,665** | 15,063 | -16% | **13,282** | 15,601 | -15% |
| Natural gas liquids (bbl per day) | **150** | 267 | -44% | **206** | 309 | -33% |
| Barrels of oil equivalent (boe per day, 6:1) | **16,849** | 14,193 | 19% | **17,050** | 13,710 | 24% |
| % Oil and NGLs | **87%** | 82% | 6% | **87%** | 81% | 7% |
| Average sales price | | | | | | |
| Crude oil ($ per bbl) | **69.87** | 62.83 | 11% | **59.77** | 66.87 | -11% |
| Natural gas ($ per Mcf) | **3.94** | 2.10 | 88% | **3.71** | 2.22 | 67% |
| Natural gas liquids ($ per bbl) | **88.51** | 83.29 | 6% | **81.85** | 87.10 | -6% |
| Barrels of oil equivalent ($ per boe, 6:1) | **64.24** | 54.33 | 18% | **55.17** | 57.18 | -4% |
| Operating netback ($ per boe) (4) | | | | | | |
| Petroleum and natural gas sales | **64.24** | 54.33 | 18% | **55.17** | 57.18 | -4% |
| Cash (loss) gain on derivative instruments | **0.01** | 6.91 | -100% | **5.67** | 4.59 | 24% |
| Royalties | **(13.39)** | (12.84) | -4% | **(11.25)** | (13.65) | 18% |
| Operating expenses | **(22.92)** | (17.19) | -33% | **(22.40)** | (17.88) | -25% |
| Transportation expenses | **(2.96)** | (2.26) | -31% | **(2.64)** | (2.36) | -12% |
| Operating netback | **24.98** | 28.95 | -14% | **24.55** | 27.88 | -12% |
| Wells drilled | | | | | | |
| Gross | **12.0** | 16.0 | -25% | **40.0** | 48.0 | -17% |
| Net | **12.0** | 14.5 | -17% | **40.0** | 36.2 | 10% |
| Success (%) | **100** | 93 | 8% | **93** | 97 | -4% |
| **COMMON SHARES** | | | | | | |
| Shares outstanding, end of period | **250,916,313** | 192,458,098 | 30% | **250,916,313** | 192,458,098 | 30% |
| Weighted average shares outstanding – diluted | **251,895,637** | 193,165,826 | 30% | **250,965,960** | 190,327,811 | 32% |

(1) Funds flow from operations and funds flow from operations netback are non-GAAP measures that represent the total and the average per boe, respectively, of cash provided by operating activities, before adjusting for changes in non-cash working capital items and expenditures on decommissioning liabilities.

(2) Corporate acquisitions is a non-GAAP measure and includes total consideration plus working capital deficiency acquired in a corporate acquisition. Capital expenditures is a non-GAAP measure calculated as the purchase or sale price of an asset, plus development capital expenditures added to PP&E. Corporate acquisitions are excluded from this measure.

(3) Net debt is a non-GAAP measure representing the total of bank indebtedness, accounts payables and accrued liabilities, cash dividend payable, less accounts receivables, deposits and prepaids.

(4) Operating netback is a non-GAAP measure calculated as the average per boe of the Company's oil and gas sales plus realized gains on derivatives, less royalties, operating and transportation expenses.

# REPORT TO SHAREHOLDERS

### HIGHLIGHTS OF TWIN BUTTE'S SECOND QUARTER 2013 ARE AS FOLLOWS:

- Continued demonstration of a disciplined business plan, supporting our sustainable dividend paying model with a payout ratio of 81 percent and a total payout ratio net of the DRIP and SDP of 77 percent in the second quarter 2013. For the six months ended June 30 the payout ratio was 89 percent and total payout ratio net of the DRIP and SDP was 85 percent. Since implementation of the Company's dividend in January 2012, $0.28 per share in dividends have been paid as at the end of June.
- Recorded quarterly production of 16,849 boe per day, an increase of 19 percent over the same period of 2012.
- Generated quarterly funds flow of $33.1 million, which strongly supported the dividend and capital program.
- Executed an organic net capital program of $14.9 million which included the drilling of 12 gross (12 net) wells, including 9 horizontal wells at a 100 percent success rate. The Company successfully sold $3.3 million (70 boe per day) in non-core assets in the quarter.
- Maintained a solid balance sheet with net debt at $193.8 million relative to the existing credit facility of $280 million, representing a run rate debt to cash flow of 1.5 years.

### CORPORATE

The second quarter of 2013 was dominated by strong improvements to the Company's heavy oil price . Pricing for the heavy oil benchmark WCS (Western Canadian Select) increased to average $76.82, up from $62.99 in the first quarter, as differentials contracted to average $19.16 from approximately $32.00 in the first quarter. In addition, the Company's blending costs were reduced in the second quarter to below $9.00 per barrel, improving the Company's netback price.

### FINANCIAL

Funds flow from operations for the second quarter were up approximately 2 percent from the first quarter as a result of stronger pricing, which was somewhat offset by hedges in place, an approximate 2 percent decrease in production volumes, higher royalties and operating costs. Capital spending for the second quarter was $14.9 million after netting $3.3 million of non-core property dispositions. This was significantly below the Company's budgeted $20 million. This lower level of spending due to extended spring break-up conditions led to a total payout ratio of only 77 percent in the second quarter as compared to our annual target range of 95-100 percent and as a result, the Company plans to increase capital spending in the third quarter and bring the annualized ratio back into the target range. As a result of the lower payout ratio, the Company's net debt was reduced from the first quarter to $193.8 million which provided a debt to annualized cash flow ratio of 1.5 at the end of the second quarter, and increased financial flexibility with the $280 million credit facility. With increased spending in the third quarter, it is anticipated that net debt will increase slightly over the remainder of 2013, but the Company's debt to run rate cash flow will remain at approximately 1.5 times.

Although hampered by difficult field operating conditions, the sale of 70 boe per day of non-core production, and unplanned turnarounds at our major heavy oil purchaser's facilities, the Company reported production of 16,849 boe per day, in the second quarter. With current production capability of approximately 16,400 boe per day, Twin Butte remains on track to achieve its forecasted 2013 production average of 16,100 – 16,400 boe per day.

Operating costs in the second quarter increased to just under $23.00 per boe, mainly as a result of unseasonable weather conditions which resulted in higher than normal trucking, road and lease maintenance, work-over expenses, and snow clearing costs. The Company spent over $2.00 per boe in the second quarter on these weather related costs. The Company expects operating costs in the range of $20.00 - $22.00 per boe for the balance of the year.

The contraction in oil price differentials in combination with relatively strong WTI pricing for the remainder of 2013, along with the Company's current hedge position, gives Twin Butte confidence in its 2013 cash flow forecast of $112 million. Our hedging program has and will continue to provide downside price protection and cash flow stability. Currently, the Company has approximately 63 percent of its oil volumes for the second half of 2013 hedged at an average WCS price of $75.19, and an additional 23 percent of oil volumes hedged at an average WTI price of $97.43. Twin Butte has approximately 65 percent of expected 2013 natural gas volumes hedged at a price of $4.50 per gj.

At the current annual dividend rate of $0.192 per share the Company continues to target a sustainable total (dividend and capital expenditure) payout ratio of less than 100 percent of cash flow on an annual basis. The Company does not anticipate any changes to its current dividend policy in the foreseeable future. The Company's Board of Directors has approved continuation of the existing dividend to the end of 2013.

## OPERATIONS

During the second quarter of 2013 due to break up and wet weather, Twin Butte was restricted to drilling 12 gross (12 net) wells, achieving a 100 percent success rate. The high success rate continues to demonstrate the predictable and repeatable potential of the Company's drilling inventory, which remains estimated to be over 700 net conventional heavy oil wells. The Company's drilling continues to focus within the core heavy oil fairway, and it is anticipated one hundred percent of Twin Butte's 2013 capital will be spent in this area.

As part of an ongoing effort to maintain and improve the Company's capital efficiencies, Twin Butte continues to expand its horizontal drilling inventory. Of the twelve wells drilled in the second quarter, nine were horizontal wells that continue to meet or surpass our capital efficiency and production criteria. The Company now anticipates upwards of 35 horizontal wells will be drilled in 2013, a trend that Twin Butte sees continuing in its heavy oil fairway. Although the initial focus is on enhancing well costs and initial productivity to maximize capital efficiency, reservoir modeling suggests the horizontals should achieve ultimate recoverable reserves that will lower overall decline rates and improve finding and development costs.

In the second quarter of 2013, Twin Butte drilled eight horizontal wells at Wildmere as follow up to two horizontal wells drilled in the first quarter. Four of the wells were brought on late in the second quarter, the fifth well commencing production in July and the last three commencing production in early August. Performance monitoring of the wells continues, but positive early results has led to the drilling of an additional eight wells thus far in the third quarter at Wildmere, all of which should be commencing production late in August.

At Frog Lake, the Company's most active area for the last number of years, one horizontal well was drilled in the second quarter on the south end of the lands. A three well horizontal drilling program is planned for early in the fourth quarter to focus on the exploitation of the Mannville formation. In late 2011, the Company drilled a horizontal Mannville well which after 16 months of production has proved the economic viability of a larger scale program.

At Primate in Western Saskatchewan, Twin Butte encountered additional reservoir performance issues in early July, as discussed in the July 15th press release. Current production on the property is approximately 1,400 bbls per day but as outlined in the July press release, the Company has modeled this property to exit 2013 at approximately 400 boe per day, which is under 3 percent of year end volumes.

Based on early success of the Company horizontal drilling program, and its growing inventory of horizontal locations, Twin Butte is confident its operational momentum and production growth will be reestablished over the next number of quarters. This will lead to further stability and potential increases in the Company's cash flow, and provide further sustainability of the Company's dividend.

To optimize the Company's heavy oil pricing, approximately 18 percent of its heavy barrels were transported via rail car in the second quarter. This marketing operation has generated an increase of approximately $6.00 to $8.00 per railed barrel net to the Company in the second quarter or an increase of approximately $1.45 per barrel on a corporate average. During the second quarter of 2013, Twin Butte completed construction of a cleaning/staging facility at Lashburn which will potentially allow increases of its rail car shipments to approximately 30 percent of oil volumes. Twin Butte remains focused on its hedging program to protect cash flow levels that will provide sustained positive corporate netbacks.

## OUTLOOK

Twin Butte will continue to execute its stated business plan in 2013. The Company believes its business plan of a sustainable dividend and moderate per share growth will attract investor interest over the long term. We remain committed to continually enhancing the Company's asset quality through organic growth and strategic acquisitions.

The Company remains on track to meet its previously reported operating and financial guidance of $112 million in cash flow and 16,100 – 16,400 boe per day of average production. The Company's level of capital expenditures, which are currently forecast to be $70 million net, will be monitored and potentially increased should actual cash flow less dividends increase.

Twin Butte remains in an enviable position in that it has a strong balance sheet, a predictable production profile and a current inventory of over 700 net heavy oil drilling locations. The Company's growing horizontal program has the ability to make a meaningful difference to corporate performance. Conventional heavy oil wells generate some of the top percentile return on investment of all plays in North America and the Company believes its current sizable drilling inventory has the ability to fuel the Company's dividend and moderate growth strategy for years to come.

A sustained pace of repeatable development drilling and disciplined capital spending will maximize capital efficiencies, economic returns and minimize payout times, providing visible sustainability to Twin Butte's dividend and anticipated Company growth.

Twin Butte approved a share dividend plan ("SDP") at the annual general shareholder meeting on May 15, 2013 and this plan is available to Canadian and most non-Canadian shareholders. This new plan will be run in conjunction with the dividend reinvestment plan ("DRIP") that was already in place and is only available to Canadian shareholders. The DRIP and the SDP allow shareholders to effectively receive their monthly Twin Butte dividends as Twin Butte shares at a 5% discount to the market price at the date of the dividend payment. For more information on the plans please consult the Twin Butte website at www.twinbutteenergy.com or your broker.

## ABOUT TWIN BUTTE

Twin Butte is a value oriented, intermediate producer with a significant and growing scalable and repeatable drilling inventory focused on large original oil in-place conventional heavy oil exploitation. With a stable low decline production base the Company is well positioned to live within cash flow while providing shareholders with a sustainable dividend and moderate per share production growth potential over the long term.

*(signed)*

Jim Saunders
President and C.E.O.

August 14, 2013

## Forward-Looking Statements

*In the interest of providing Twin Butte's shareholders and potential investors with information regarding Twin Butte, including management's assessment of the future plans and operations of Twin Butte, certain statements contained in this report constitute forward-looking statements or information (collectively "forward-looking statements") within the meaning of applicable securities legislation. Forward-looking statements are typically identified by words such as "anticipate", "continue", "estimate", "expect", "forecast", "may", "will", "project", "could", "plan", "intend", "should", "believe", "outlook", "potential", "target" and similar words suggesting future events or future performance. In particular but without limiting the foregoing, this report contains forward-looking statements pertaining to the following: the Company's expectations on well declines; future dividend levels; cash flow forecasts; the volumes and estimated value of Twin Butte's oil and natural gas reserves; the life of Twin Butte's reserves; the volume and product mix of Twin Butte's oil and natural gas production; future oil and natural gas prices; future operational activities; future results from operations and operating metrics, including future production growth and other matters set forth under the heading "Outlook" herein, including estimated budget levels and targeted pay-out ratio in respect of the payment of dividends. In addition, statements relating to "reserves" are deemed to be forward-looking statements as they involve the implied assessment, based on certain estimates and assumptions, that the reserves described exist in the quantities predicted or estimated and can be profitably produced in the future.*

*With respect to forward-looking statements contained in this report, Twin Butte has made assumptions regarding, among other things: future capital expenditure levels; future oil and natural gas prices and differentials between light, medium and heavy oil prices; results from operations including future oil and natural gas production levels; future exchange rates and interest rates; Twin Butte's ability to obtain equipment in a timely manner to carry out development activities; decline rates based on analogous information; our ability to market its oil and natural gas successfully to current and new customers; the impact of increasing competition; Twin Butte's ability to obtain financing on acceptable terms; and Twin Butte's ability to add production and reserves through our development and exploitation activities. Although Twin Butte believes that the expectations reflected in the forward looking statements contained in this report, and the assumptions on which such forward-looking statements are made, are reasonable, there can be no assurance that such expectations will prove to be correct. Readers are cautioned not to place undue reliance on forward-looking statements included in this report, as there can be no assurance that the plans, intentions or expectations upon which the forward-looking statements are based will occur. By their nature, forward-looking statements involve numerous assumptions, known and unknown risks and uncertainties that contribute to the possibility that the predictions, forecasts, projections and other forward-looking statements will not occur, which may cause Twin Butte's actual performance and financial results in future periods to differ materially from any estimates or projections of future performance or results expressed or implied by such forward-looking statements. These risks and uncertainties include, among other things, the following: further instability in the production volumes at the Company's Primate property; the risks associated with the oil and gas industry; commodity prices; operational risks in exploration; development and production; delays or changes in plans; risks associated with the uncertainty of reserve estimates; health and safety risks, and; the uncertainty of estimates and projections of production, costs and expenses. volatility in market prices for oil and natural gas; general economic conditions in Canada, the U.S. and globally; and the other factors described under "Risk Factors" in Twin Butte's most recently filed Annual Information Form available in Canada at www.sedar.com. The recovery and reserve estimates of Twin Butte's reserves provided herein are estimates only and there is no guarantee that the estimated reserves will be recovered. Readers are cautioned that this list of risk factors should not be construed as exhaustive.*

*The forward-looking statements contained in this report speak only as of the date of this report. Except as expressly required by applicable securities laws, Twin Butte does not undertake any obligation to publicly update or revise any forward looking statements, whether as a result of new information, future events or otherwise. The forward-looking statements contained in this report are expressly qualified by this cautionary statement.*

## Barrels of Oil Equivalent

*Barrels of oil equivalents (boe) may be misleading, particularly if used in isolation. A boe conversion ratio of 6 Mcf: 1 bbl (barrel) is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead. In addition, as the value ratio between natural gas and crude oil based on the current prices of natural gas and crude oil is significantly different from the energy equivalency of 6:1, utilizing a conversion on a 6:1 basis may be misleading as an indicated value.*

## Operating Netback

*The reader is also cautioned that this report contains the term operating netback, which is not a recognized measure under GAAP and is calculated as a period's sales of petroleum and natural gas, net of royalties less net production and operating expenses as divided by the period's sales volumes. Management uses this measure to assist them in understanding Twin Butte's profitability relative to current commodity prices and it provides an analysis tool to benchmark changes in operational performance against prior periods and to peers on a comparable basis. Readers are cautioned, however, that this measure should not be construed as an alternative to other terms such as net income determined in accordance with GAAP as a measure of performance. Twin Butte's method of calculating this measure may differ from other companies, and accordingly, they may not be comparable to measures used by other companies.*

## Analogous Information

*In this report, Twin Butte has provided certain information on the production profile and estimates of decline rates on its Primate property which is "analogous information" as defined by applicable securities laws. This analogous information is derived from publicly available information sources which the Company believes are predominantly independent in nature. Some of this data may not have been prepared by qualified reserves evaluators or auditors and the preparation of any estimates may not be in strict accordance with Canadian Oil & Gas Evaluation Handbook. Regardless, estimates by engineering and geo-technical practitioners may vary and the differences may be significant. Twin Butte believes that the provision of this analogous information is relevant to Twin Butte's activities and forecasting, given its property ownership in the area; however, readers are cautioned that there is no certainty that the forecasts provided herein based on analogous information will be accurate.*

## Future Oriented Financial Information

*This report, in particular the information in respect of anticipated cash flows, may contain Future Oriented Financial Information ("FOFI") within the meaning of applicable securities laws. The FOFI has been prepared by management of the Company to provide an outlook of the Company's activities and results and may not be appropriate for other purposes. The FOFI has been prepared based on a number of assumptions including the assumptions discussed under the heading "Forward-Looking Statements" and assumptions with respect to production rates and commodity prices. The actual results of operations of the Company and the resulting financial results may vary from the amounts set forth herein, and such variation may be material. The Company and its management believe that the FOFI has been prepared on a reasonable basis, reflecting management's best estimates and judgments.*

## Reader Advisory

*This MD&A contains non-GAAP financial measures and forward-looking statements and readers are cautioned that the MD&A should be read in conjunction with the Company's disclosure under "Non-GAAP Financial Measures" and "Forward-Looking Statements". Certain information regarding Twin Butte set forth in this report including management's assessment of the Company's future plans and operations, the effect on the Company and on shareholders of Twin Butte, production increases and future production levels contain forward-looking statements that involve substantial known and unknown risks and uncertainties. These forward-looking statements are subject to numerous risks and uncertainties, certain of which are beyond Twin Butte's control including, without limitation, the impact of general economic conditions, industry conditions, volatility of commodity prices, currency fluctuations, imprecision of reserve estimates, environmental risks, competition from other producers, lack of availability of qualified personnel, stock market volatility, and ability to access sufficient capital from internal and external sources. Twin Butte's actual results, performance or achievements may differ materially from those expressed in, or implied by, these forward-looking statements and, accordingly, no assurance can be given that any events anticipated by the forward-looking statements will transpire or occur, or if any of them do so, what benefits that Twin Butte will derive there from. Additional information on these and other factors that could affect Twin Butte's results are included in reports on file with Canadian securities regulatory authorities and may be accessed through the SEDAR website (www.sedar.com), or Twin Butte's website (www.twinbutteenergy.com). Furthermore, the forward-looking statements contained in this report are made as at the date of this report and Twin Butte does not undertake any obligation to update publicly or to revise any of the forward-looking statements, whether as a result of new information, future events or otherwise, except as may be required by applicable securities laws.*

# MANAGEMENT'S DISCUSSION AND ANALYSIS

Dated as of August 14, 2013

## INTRODUCTION

The following Management Discussion and Analysis ("MD&A") is management's assessment of Twin Butte Energy Ltd.'s ("Twin Butte" or the "Company") financial and operating results and should be read in conjunction with the message to shareholders and the interim financial statements of the Company for the three and six months ended June 30, 2013 and the audited financial statements and MD&A for the twelve months ended December 31, 2012. This MD&A is presented in Canadian dollars (except where otherwise noted). Additional information relating to the Company, including the Company's Annual Information Form can be found on www.sedar.com.

The Company's principal activity is the acquisition of, exploration for and the development and production of petroleum and natural gas properties in Western Canada.

**Non-GAAP Measures** – Certain measures in this document do not have a standardized meaning as prescribed by IFRS, such as operating netback, funds flow from operations, funds flow per share, payout ratio, total payout ratio, and net debt and therefore are considered non-GAAP measures. The Management's Discussion and Analysis ("MD&A") contains the term funds flow from operations or funds flow which should not be considered an alternative to, or more meaningful than, cash flow from operating activities as determined in accordance with IFRS as an indicator of the Company's performance. All references to funds flow from operations or funds flow throughout this report are based on cash flow from operating actives before changes in non-cash working capital and expenditures on decommissioning liabilities. The Company also presents funds flow from operations per share whereby per share amounts are calculated using weighted average shares outstanding consistent with the calculation of earnings per share. These measures may not be comparable to similar measures presented by other issuers. These measures have been described and presented in this document in order to provide shareholders and potential investors with additional information regarding the Company's liquidity and its ability to generate funds to finance its operations. Management's use of these measures has been disclosed further in this document as these measures are discussed and presented.

**Basis of Presentation** – The reporting and measurement currency is the Canadian dollar.

**boe Presentation** – Barrels of oil equivalent ("boe") may be misleading, particularly if used in isolation. A boe conversion rate of 6 Mcf to 1 bbl is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead. All boe conversions in the report are derived by converting gas to oil equivalent barrels at the ratio of six thousand cubic feet of gas to one barrel of oil.

## FORWARD-LOOKING STATEMENTS

Certain statements contained in this MD&A constitute forward-looking information within the meaning of securities laws. Forward-looking information may relate to our future outlook and anticipated events or results and may include statements regarding the future financial position, business strategy, budgets, projected costs, capital expenditures, financial results, taxes and plans and objectives of or involving Twin Butte. Particularly, statements regarding our future operating results and economic performance are forward-looking statements. In some cases, forward-looking information can be identified by terms such as "may", "will", "should", "expect", "plan", "anticipate", "believe", "intend", "estimate", "predict", "potential", "continue" or other similar expressions concerning matters that are not historical facts.

These statements are based on certain factors and assumptions regarding expected growth, results of operations, performance and business prospects and opportunities. While we consider these assumptions to be reasonable based on information currently available to us, they may prove to be incorrect.

Forward looking-information is also subject to certain factors, including risks and uncertainties that could cause actual results to differ materially from what we currently expect. These factors include risk associated with oil and gas exploration, production, marketing, and transportation such as loss of market, volatility of commodity prices, currency fluctuations, imprecision of reserve estimates, environmental risk, and competition from other producers and ability to access sufficient capital from internal and external resources.

Other than as required under securities laws, we do not undertake to update this information at any particular time.

All statements, other than statements of historical fact, which address activities, events, or developments that Twin Butte expects or anticipates will or may occur in the future, are forward-looking statements within the meaning of applicable securities laws. These statements are subject to certain risks and uncertainties, and may be based on estimates or assumptions that could cause actual results to differ materially from those anticipated or implied.

Further, the forward-looking statements contained in this MD&A are made as of the date hereof, and the Company does not undertake any obligation to update publicly or to revise any of the included forward-looking statements, as a result of new information, future events or otherwise, except as may be required by applicable securities laws. The Company's forward-looking statements are expressly qualified in their entirety by this cautionary statement. Certain risk factors associated with these forward-looking statements include, but are not limited to, the following:

- Fluctuations in natural gas, condensate, NGL's, and crude oil production levels;
- Twin Butte's inability to successfully market its natural gas, condensate, NGL's, and crude oil;
- Lower than expected market prices for natural gas, condensate, NGL's, and crude oil;
- Adverse changes in foreign currency exchange rates and/or interest rates;
- Uncertainties associated with estimating reserves;
- Competition for capital, asset acquisitions, undeveloped lands, and skilled personnel;
- Operational hazards characteristic of the oil and gas industry such as: geological and drilling problems; and well production, pipeline, and mechanical difficulties;
- Lower than envisaged success in the finding and development of reserves and/or higher than expected costs;
- Adverse changes in general economic conditions in Western Canada, Canada more generally, North America or globally;
- Adverse weather conditions;
- The inability of Twin Butte to obtain financing on favorable terms, or at all;
- Adverse impacts from the actions of competitors;
- Adverse impacts of actions taken and/or policies established by governments or regulatory authorities including changes to tax laws, incentive programs, royalty calculations, and environmental laws and regulations; and
- Reliance on natural gas and NGL processing, pipeline, and storage infrastructure not operated by Twin Butte, the availability of which is essential to Twin Butte's sales and marketing activities.

Additional information relating to Twin Butte, including Twin Butte's financial statements can be found on SEDAR at www.sedar.com or the Company's website at www.twinbutteenergy.com.

## PETROLEUM AND NATURAL GAS SALES

Twin Butte realized the following sales, production volumes, and commodity prices:

| | Three months ended June 30 | | Six months ended June 30 | |
|---|---|---|---|---|
| | **2013** | 2012 | **2013** | 2012 |
| **Sales** *($000's)* | | | | |
| Heavy oil | **$ 88,026** | $ 60,127 | **$ 148,666** | $ 119,882 |
| Light & Medium oil | **4,721** | 5,137 | **9,613** | 11,575 |
| Natural gas | **4,544** | 2,885 | **8,931** | 6,317 |
| Natural gas liquids | **1,206** | 2,024 | **3,051** | 4,896 |
| Total petroleum and natural gas sales | **$ 98,497** | $ 70,173 | **$ 170,261** | $ 142,670 |
| **Average Daily Production** | | | | |
| Heavy oil (bbl/day) | **13,974** | 10,669 | **13,932** | 10,019 |
| Light & medium oil (bbl/day) | **614** | 746 | **698** | 782 |
| Natural gas (Mcf/day) | **12,665** | 15,063 | **13,282** | 15,601 |
| Natural gas liquids (bbl/day) | **150** | 267 | **206** | 309 |
| Total (boe/d) | **16,849** | 14,193 | **17,050** | 13,710 |
| % oil and liquids production | **87%** | 82% | **87%** | 81% |
| **Average Twin Butte Realized Commodity Prices** (1) | | | | |
| Heavy oil ($ per bbl) | **69.22** | 61.93 | **58.95** | 65.74 |
| Light & Medium oil ($ per bbl) | **84.48** | 75.67 | **76.09** | 81.35 |
| Natural gas ($ per Mcf) | **3.71** | 2.10 | **3.94** | 2.22 |
| Natural gas liquids ($ per bbl) | **88.51** | 83.29 | **81.85** | 87.10 |
| Barrels of oil equivalent ($ per boe, 6:1) | **64.24** | 54.33 | **55.17** | 57.18 |

(1) The average selling prices reported are before realized derivative instrument gains/losses and transportation charges.

| | | | | |
|---|---|---|---|---|
| **Benchmark Pricing** | | | | |
| WTI crude oil (US$ per bbl) | **94.22** | 93.49 | **94.30** | 98.21 |
| Edmonton crude oil (Cdn$ per bbl) | **93.03** | 84.42 | **90.84** | 88.56 |
| WCS crude oil (Cdn$ per bbl) | **77.91** | 72.23 | **71.04** | 77.48 |
| AECO natural gas (Cdn$ per Mcf) (2) | **3.35** | 1.80 | **3.19** | 1.92 |
| Exchange rate (US$/Cdn$) | **1.02** | 1.01 | **1.02** | 1.00 |

(2) The AECO natural gas price reported is the average daily spot price.

Sales for the three months ended June 30, 2013 were $98.5 million, as compared to $70.2 million for the three months ended June 30, 2012, representing an increase of $28.3 million or 40%. Both production and the average realized commodity price increased from the prior period quarter, resulting in increased sales. Excluding the impact of derivative instruments, the average realized commodity price increased from $54.33 in the second quarter of 2012 to $64.24 during the second quarter of 2013. This 18% increase in realized price is due to a stronger Canadian heavy oil price environment, marked by narrowing WCS crude oil differentials. Compared to the prior year quarter, the WTI crude oil benchmark increased 1%, while the WCS benchmark increased 8%. Twin Butte also saw decreased blending costs as a result of reduced condensate pricing during the second quarter of 2013.

Production also increased from 14,193 boe/d in the three months ended June 30, 2012 to 16,849 boe/d for the three months ended June 30, 2013. This increase of 2,656 boe/d is due the Company's drilling program, as well as corporate and property acquisitions in 2012. Production gains were partially offset by previously reported reservoir performance issues at Primate and weather-related trucking restrictions across various properties in April. As the Company has not recently targeted gas-based drilling, natural gas sales have seen, and are expected to continue to see a steady decline from the comparative periods. Natural gas sales currently account for 13% of production volumes, and only 5% of sales revenue.

Revenues for the six months ended June 30, 2013 were $170.3 million, as compared to $142.7 million for the six months ended June 30, 2012, representing an increase of $27.6 million or 19%. This increase in revenue is attributed to a 24% production increase and an increase in oil and liquids weighting from 81% to 87%. Production increased from 13,710 boe/d in the six months ended June 30, 2012 to 17,050 boe/d in the comparable period in 2013. These increases were slightly offset by a decrease in average commodity prices in the first half of the six month period. The average realized commodity price before hedging decreased from $57.18 per boe in the six months ended June 30, 2012 to $55.17 per boe in the comparable period of 2013.

## ROYALTIES

| | Three months ended June 30 | | Six months ended June 30 | |
|---|---|---|---|---|
| *($000's except per boe amounts)* | **2013** | 2012 | **2013** | 2012 |
| Heavy Oil | **18,401** | 13,118 | **30,644** | 27,624 |
| Light & Medium oil | **1,777** | 2,634 | **2,944** | 5,015 |
| Natural Gas | **418** | 348 | **532** | (55) |
| NGLs | **(71)** | 483 | **593** | 1,473 |
| Total Royalties | **20,525** | 16,583 | **34,713** | 34,057 |
| Total royalties per boe | **13.39** | 12.84 | **11.25** | 13.65 |
| % of P&NG Sales | **21%** | 24% | **20%** | 24% |

Royalties for the three months ended June 30, 2013 were $20.5 million, as compared to $16.6 million for the three months ended June 30, 2012. As a percentage of sales, the average royalty rate for the second quarter of 2013 decreased to 21% compared to 24% in the second quarter of 2012, with oil averaging 22% and gas averaging 9%. Heavy oil royalty rates were consistent with the prior year quarter due to high benchmark commodity prices in May and the corresponding Government of Alberta crude oil royalty calculation input prices. Despite the Company's oil weighting increasing 6%, the decrease in royalties from the prior year quarter is due to decreasing rates for light & medium Oil, natural gas and NGLs, consistent with normal production declines across non-core properties.

Royalties for the six months ended June 30, 2013 were $34.7 million, as compared to $34.1 million for the six months ended June 30, 2012. As a percentage of revenues, the average royalty rate for the six month period ended June 30, 2013 was 20% compared to 24% for the comparative period in 2012. Despite the Company's oil weighting increasing 6% from the prior year, this rate decreased due to a reduction in the Government of Alberta crude oil royalty calculation heavy oil input prices in Q1 2013, which were set at a lower rate, resulting in lower royalties during the first part of the six month period. Further, light & medium oil, natural gas and NGLs also had decreasing rates, consistent with normal production declines across non-core properties.

## OPERATING & TRANSPORTATION EXPENSE

| | Three months ended June 30 | | Six months ended June 30 | |
|---|---|---|---|---|
| *($000's except per boe amounts)* | **2013** | 2012 | **2013** | 2012 |
| Operating expense | **35,148** | 22,197 | **69,122** | 44,607 |
| Transportation | **4,536** | 2,914 | **8,162** | 5,901 |
| Total operating & transportation expense | **39,684** | 25,111 | **77,284** | 50,508 |
| Operating expense per boe | **22.92** | 17.19 | **22.40** | 17.88 |
| Transportation expense per boe | **2.96** | 2.26 | **2.64** | 2.36 |
| Total per boe | **25.88** | 19.45 | **25.04** | 20.24 |

Operating expenses were $35.1 million or $22.92 per boe for the quarter ended June 30, 2013 as compared to $22.2 million or $17.19 per boe for the three months ended June 30, 2012. In comparison to the prior year quarter, the Company is facing overall cost pressure due to the increasing cost of propane and an oil-based well mix that requires increased workovers. Increases in the quarter were also due to repairs following heavy rain and snow run-off, as road repair and maintenance costs increased $1.64 per boe over the prior year quarter. These cost increases due to road repair and maintenance are related to unusually severe weather events, which, to date, have not occurred annually.

Operating expenses were $69.1 million or $22.40 per boe for the six months ended June 30, 2013, as compared to $44.6 million or $17.88 per boe for the six months ended June 30, 2012. The increase on an absolute dollar basis is mainly attributable to the production growth from higher operating cost acquisitions in 2012, combined with internal drilling successes. On a per boe basis, cost increases are related to overall cost pressures and weather events.

Transportation expenses for the three months ended June 30, 2013 were $4.5 million or $2.96 per boe compared to $2.9 million or $2.26 per boe in the prior year comparative quarter. On an absolute basis, the increase in transportation is in line with increasing production. On a per boe basis, transportation has increased due to road bans in place following heavy rain and snow run-off, which increased the number of trucks required to move the same amount of product.

Transportation expenses for the six months ended June 30, 2013 were $8.2 million or $2.64 per boe compared to $5.9 million or $2.36 per boe in the prior year comparative period. Increasing production contributed to this increase on an absolute basis, while heavy rain road bans caused the increase on a per boe basis.

The Company has combined operating and transportation costs of $25.88 per boe for the quarter, an increase from $19.45 per boe for the comparable period of 2012. This 33% increase is driven by both increases in operating and transportation costs. The Company targets all-in operating and transportation costs of $23.50 per boe for the balance of 2013.

## GENERAL AND ADMINISTRATIVE ("G&A") EXPENSES

| | Three months ended June 30 | | Six months ended June 30 | |
|---|---|---|---|---|
| *($000's except per boe amounts)* | **2013** | 2012 | **2013** | 2012 |
| G&A expense | **4,753** | 3,242 | **9,786** | 7,160 |
| Recoveries | **(724)** | (452) | **(1,452)** | (1,129) |
| Capitalized G&A expense | **(888)** | (766) | **(1,762)** | (1,564) |
| Total net G&A expense | **3,141** | 2,024 | **6,572** | 4,467 |
| Total net G&A expense per boe | **2.05** | 1.57 | **2.13** | 1.79 |
| Transaction expense | **–** | 264 | **55** | 2,224 |
| Transaction expense per boe | **–** | 0.20 | **0.02** | 0.89 |

General and administrative expenses, net of recoveries and capitalized G&A, were $3.1 million or $2.05 per boe for the current quarter as compared to $2.0 million or $1.57 per boe in the prior year comparative quarter. The Company incurred higher costs compared to the prior year quarter as a result of increased staff levels associated with the Company's increased level of operations, additional recruitment costs, and costs to implement the new stock dividend program. On a per boe basis, G&A increased at a greater rate than production, due to the quarter's production setbacks. Net G&A expense for the six month period ended June 30, 2013 was $6.6 million of $2.13 per boe, compared to $4.5 million of $1.79 per boe in the prior year comparative period.

The Company expects net G&A for 2013 to stay between $2.00 and $2.15 per boe. During 2012 the Company incurred transaction costs related to corporate and property acquisitions, specifically advisory, stock exchange, legal and bank fees related to the Emerge corporate acquisition.

## SHARE-BASED PAYMENT EXPENSE

| | Three months ended June 30 | | Six months ended June 30 | |
|---|---|---|---|---|
| *($000's except per boe amounts)* | **2013** | 2012 | **2013** | 2012 |
| Total | **1,204** | 1,101 | **2,575** | 1,946 |
| Total per boe | **0.79** | 0.85 | **0.83** | 0.78 |

During the three months ended June 30, 2013, the Company expensed $1.2 million in share-based payment expense as compared to $1.1 million in the three month period ended June 30, 2012. The Company granted 105,648 share awards, 76,993 performance share awards and nil stock options in the second quarter of 2013 as compared to 117,998 share awards in the second quarter of 2012. Total share awards forfeited due to employee departures were 165,602 in the quarter versus 244,987 awards forfeited in the second quarter last year.

During the six month period ended June 30, 2013, the Company expensed $2.6 million in stock-based compensation as compared to $1.9 million in the prior year comparative period. As this is the second year of the program, costs have increased due to expense related to both current year and prior year grants and dividend accumulation.

At June 30, 2013, the Company has 2,870,715 restricted share awards, 1,650,362 performance share awards and 887,434 options outstanding.

## FINANCE EXPENSE

| | Three months ended June 30 | | Six months ended June 30 | |
|---|---|---|---|---|
| *(000's except per boe amounts)* | **2013** | 2012 | **2013** | 2012 |
| Accretion on decommissioning provision | **598** | 443 | **1,153** | 682 |
| Interest and bank charges | **2,096** | 1,356 | **3,647** | 2,712 |
| Total finance expense | **2,694** | 1,799 | **4,800** | 3,394 |
| Accretion on decommissioning provision per boe | **0.39** | 0.34 | **0.38** | 0.27 |
| Interest and bank charges per boe | **1.37** | 1.05 | **1.18** | 1.09 |
| Total finance expense per boe | **1.76** | 1.39 | **1.56** | 1.36 |

For the three months ended June 30, 2013, finance charges were $2.7 million as compared to $1.8 million in the three month period ended June 30, 2012. This increase is due to increased average bank debt for the quarter, which was $182 million compared to $115 million in the prior year quarter, as well as annual bank fees. For the six months ended June 30, 2012, finance charges also increased and were $4.8 million as compared to $3.4 million in the prior year comparative period.

The Company's current interest charge on the operating line is bank prime of 3.0% plus a margin of 1.25% for a total rate of 4.25%. This is an increase over the first quarter of 2013's rate of 4.0%. After normalizing for annual bank fees, the effective interest rate for the quarter was 4.0%, as the Company utilized Bankers Acceptances to reduce the overall effective interest rate.

## DERIVATIVE ACTIVITIES

| | Three months ended June 30 | | Six months ended June 30 | |
|---|---|---|---|---|
| *(000's except per boe amounts)* | **2013** | 2012 | **2013** | 2012 |
| Realized gain (loss) | **7** | 8,928 | **9,548** | 11,459 |
| Cash gain (loss) - Swaptions | **–** | – | **7,943** | – |
| Unrealized gain (loss) | **(1,145)** | 31,856 | **(30,853)** | 35,736 |
| Gain (loss) on derivatives | **(1,138)** | 40,784 | **(13,362)** | 47,195 |
| Realized gain (loss) on derivatives per boe | **0.01** | 6.91 | **3.09** | 4.59 |
| Cash gain (loss) on derivatives per boe - Swaptions | **–** | – | **2.58** | – |
| Unrealized gain (loss) on derivatives per boe | **(0.75)** | 24.67 | **10.00** | 14.32 |
| Gain (loss) on derivatives per boe | **(0.74)** | 31.58 | **15.67** | 18.91 |

As part of the financial management strategy to protect cash flows available for the payment of dividends, the Company has adopted a commodity price and interest rate risk management program. The purpose of the program is to stabilize and hedge future cash flow against the unpredictable commodity price environment, with an emphasis on protecting downside risk. During the second quarter of 2013, Twin Butte entered into fixed price crude oil swaps for 2014 and 2015 production periods.

With derivative instruments, there is a risk that the counterparty could become illiquid or that Twin Butte may not have the actual sales volumes to offset the hedge position. To manage risk, the Company's counterparties on derivative instruments are major Canadian and international banks and the Company limits the maximum volumes hedged to approximately 70% of forecasted sales volumes in the next twelve months and 50% beyond one year.

The Company's total realized gain of $0.8 million for natural gas, and loss of $0.8 million for crude oil sales price derivatives combined for a net result of $nil ($0.01 per boe) for the three month period ended June 30, 2013, compared to a realized gain of $8.9 million ($6.91 per boe) for the prior quarter comparative period.

The Company realized total cash proceeds on financial derivatives in the amount of $17.5 million ($5.67 per boe) for the six month period ended June 30, 2013, comprised of a $9.6 million ($3.09 per boe) gain from fixed price swaps and $7.9 million ($2.58 per boe) in proceeds from crude oil swaptions sold. This compares to a realized gain on fixed price swaps of $11.5 million ($4.59 per boe) for the prior quarter comparative period. The fixed price swap realized gain in 2013 was split between a gain of $1.9 million for natural gas and $7.8 million for crude oil sales price derivatives, and a foreign exchange loss of $0.1 million during the quarter.

As at June 30, 2013, the Company has a net unrealized financial derivative liability in the amount of $11.6 million. The Company has recognized an unrealized loss on financial derivatives in the amount of $1.1 million for the three month period ended June 30, 2013 as compared to $31.9 million unrealized gain for the prior year comparative period. Unrealized losses at June 30, 2013 reflect strong forward WTI pricing at the end of the quarter in comparison to March 31, 2013.

The following is a summary of derivatives as at June 30, 2013 and their related fair market values (unrealized gain (loss) positions):

### Crude Oil Sales Price Derivatives

| Daily barrel (bbl) quantity | Term of contract | WTI [1] Fixed price per bbl ($CAD) | Fixed written call price per bbl WTI [1] ($USD) | Fixed $ WCS [2] vs. bbl WTI [1] | Fair market value *$000's* |
|---|---|---|---|---|---|
| 4,500 | January 1, 2013 to December 31, 2013 | $96.75 | | | (3,005) |
| 2,000 | April 1, 2013 to December 31, 2013 | $95.00 | | | (1,216) |
| 3,500 | July 1, 2013 to September 30, 2013 | $96.67 | | | (1,456) |
| 2,000 | July 1, 2013 to December 31, 2013 | $97.80 | | | (1,303) |
| 2,000 | October 1, 2013 to December 31, 2013 | $94.55 | | | (878) |
| 3,000 | January 1, 2014 to December 31, 2014 | $95.00 | | | (532) |
| 5,000 | January 1, 2014 to June 30, 2014 | $96.56 | | | (133) |
| 1,000 | July 1, 2014 to September 30, 2014 | $96.00 | | | 98 |
| 4,500 | January 1, 2013 to December 31, 2013 | | | (20.57) | (708) |
| 2,000 | July 1, 2013 to December 31, 2013 | | | (22.38) | (912) |
| 4,500 | July 1, 2013 to September 30, 2013 | | | (21.78) | (2,167) |
| 1,000 | January 1, 2014 to December 31, 2014 | | | (22.00) | 126 |
| 2,000 | January 1, 2014 to June 30, 2014 | | | (19.55) | 1,277 |
| 2,000 | July 1, 2014 to December 31, 2014 | | | (21.85) | (31) |
| 1,000 | July 1, 2014 to September 30, 2014 | | | (22.00) | (14) |
| 1,000 | January 1, 2015 to December 31, 2015 | | | (19.75) | (191) |
| 3,300 | January 1, 2013 to December 31, 2013 | | $108.03 | | (280) |
| 1,300 | January 1, 2014 to December 31, 2014 | | $110.00 | | (560) |
| Crude oil fair value position | | | | | (11,885) |

(1) WTI represents posting price of West Texas Intermediate oil

(2) WCS represents the posting price of Western Canadian Select oil

**Crude Oil Swaption Derivative Contracts**

| Daily barrel (boe) quantity | Option contract expiry | Term of underlying WTI [1] fixed call | Fixed call price per bbl WTI [1] | Fair market value *$000's* |
|---|---|---|---|---|
| 2,000 | September 30, 2013 | January 1, 2014 to December 31, 2014 | $US 100.00 | $ (280) |
| 1,000 | December 31, 2013 | January 1, 2014 to December 31, 2014 | $US 100.00 | $ (372) |
| 2,000 | December 31, 2013 | January 1, 2014 to June 30, 2014 | $C 100.00 | $ (1,148) |
| Crude oil swaption fair value position | | | | $ (1,800) |

(1) WTI represents posting price of West Texas Intermediate oil

**Natural Gas Sales Price Derivatives**

| Daily giga-joule (GJ) quantity | Term of contract | Fixed price per GJ AECO Daily | Fair Market Value *$000's* |
|---|---|---|---|
| 7,800 | January 1, 2013 to December 31, 2013 | $4.50 | 2,096 |
| Natural gas fair value position | | | 2,096 |

## GAIN/LOSS ON DISPOSITIONS

During the three months ended June 30, 2013 the Company disposed of a minor property for net cash proceeds of $3.3 million which resulted in a loss of $7.5 million. No gains or losses on dispositions were recognized in the second quarter of 2012.

During the six months ended June 30, 2013 the Company disposed of minor properties for net cash proceeds of $7.3 million which resulted in a net loss of $3.6 million. In comparison, during the six months ended June 30, 2012, the Company disposed of two properties for net cash proceeds of $6.3 million which resulted in a gain of $3.0 million.

## DEPLETION, DEPRECIATION & IMPAIRMENT

| | Three months ended June 30 | | Six months ended June 30 | |
|---|---|---|---|---|
| *($000's except per boe amounts)* | **2013** | 2012 | **2013** | 2012 |
| Total | **30,332** | 23,212 | **60,974** | 43,631 |
| Total per boe | **19.78** | 17.97 | **19.76** | 17.49 |

For the three month period ended June 30, 2013, depletion and depreciation of capital assets was $30.3 million or $19.78 per boe compared to $23.2 million or $17.97 per boe for the prior year comparative period. On an absolute basis, this increase relates to increased production and an increased cost base for the quarter as compared to the prior year. The rate per boe has increased from the prior period quarter due to acquisitions in 2012 where the cost per boe was above the Company's historical cost base. This rate is, however, consistent with the first quarter of 2013, which was $19.73 per boe.

For the six month period ended June 30, 2013, depletion and depreciation of capital assets was $61.0 million or $19.76 per boe compared to $43.6 million of $17.49 per boe in the prior year comparative period.

No indicators of impairment for Property, Plant & Equipment (PP&E) or Exploration & Evaluation (E&E) assets were noted for the three and six months ended June 30, 2013.

## INCOME TAXES

Deferred tax amounted to a $2.6 million expense recovery for the three month period ended June 30, 2013 compared to $10.3 million of expense for the three month period ended June 30, 2012. This recovery is the result of losses on unrealized derivative contracts and synchronizing with our 2012 filed tax return.

Deferred tax expense for the six month period ended June 30, 2013 amounted to a $12.5 million recovery, as compared to $13.1 million expense for the prior year comparative period. This recovery is the result of losses on unrealized derivative contracts.

The Company has existing tax losses and pools of approximately $537 million at June 30, 2013. These income tax pools are deductible at various rates and annual deductions associated with the initial pools will decline over time.

## NET INCOME (LOSS) AND COMPREHENSIVE INCOME (LOSS)

| | Three months ended June 30 | | Six months ended June 30 | |
|---|---|---|---|---|
| *($000's except per share amounts)* | **2013** | 2012 | **2013** | 2012 |
| Net Income (loss) | **(6,082)** | 29,528 | **(35,715)** | 44,511 |
| Net Income (loss) per share | **(0.02)** | 0.15 | **(0.14)** | 0.23 |

Net and comprehensive income for the three month period ended June 30, 2013 was a net loss of $6.1 million, compared to net income of $29.5 million in the prior year comparative period. This decrease was due to a loss on disposition of $7.5 million and an unrealized mark-to-market hedging loss. Net and comprehensive income for the six month period ended June 30, 2013 was net loss of $35.7 million, compared to net income of $44.5 million in the prior year comparative period.

## QUARTERLY FINANCIAL SUMMARY

The following table highlights Twin Butte's performance for each of the past eight quarters:

| *($ 000, except per share amounts)* | **Q2 2013** | Q1 2013 | Q4 2012 | Q3 2012 | Q2 2012 | Q1 2012 | Q4 2011 | Q3 2011 |
|---|---|---|---|---|---|---|---|---|
| Average production (boe/d) | **16,849** | 17,254 | 17,531 | 13,752 | 14,193 | 13,228 | 7,695 | 7,599 |
| Petroleum and natural gas sales | **98,497** | 71,764 | 88,673 | 73,386 | 70,173 | 72,497 | 41,216 | 34,885 |
| Operating netback (per boe) (1) | **24.98** | 24.12 | 26.27 | 33.80 | 28.95 | 26.71 | 26.72 | 23.1 |
| Funds flow from operations (2) | **33,058** | 32,423 | 37,754 | 38,119 | 33,762 | 26,400 | 16,686 | 14,042 |
| Per share basic | **0.13** | 0.13 | 0.16 | 0.19 | 0.18 | 0.14 | 0.12 | 0.10 |
| Per share diluted | **0.13** | 0.13 | 0.16 | 0.19 | 0.17 | 0.14 | 0.12 | 0.10 |
| Net income (loss) | **(6,082)** | (29,633) | (5,381) | (7,411) | 29,529 | 14,983 | (37,047) | 7,522 |
| Per share basic | **(0.02)** | (0.12) | (0.02) | (0.04) | 0.15 | 0.08 | (0.27) | 0.05 |
| Per share diluted | **(0.02)** | (0.12) | (0.02) | (0.04) | 0.15 | 0.08 | (0.27) | 0.06 |
| Corporate acquisitions (3) | **–** | – | 134,972 | 88,369 | – | 203,000 | – | – |
| Capital expenditures (4) | **14,871** | 19,625 | 37,307 | 17,183 | 23,576 | 8,058 | 9,842 | 22,071 |
| Total assets | **790,056** | 815,040 | 845,261 | 690,240 | 588,893 | 583,439 | 340,664 | 370,472 |
| Net debt excluding financial derivatives | **193,750** | 200,542 | 201,703 | 146,843 | 124,459 | 126,466 | 77,169 | 83,857 |

(1) Operating netback is a non-GAAP measure calculated as the average per boe of the Company's oil and gas sales, realized gains (losses) on derivatives, less royalties, operating and transportation expenses.

(2) Funds flow from operations and funds flow from operations netback are non-GAAP measures that represent the total and the average per boe, respectively, of cash provided by operating activities, before adjusting for changes in non-cash working capital items and expenditures on decommissioning liabilities.

(3) Corporate acquisitions are a non-GAAP measure and include total consideration plus working capital deficiency acquired in a corporate acquisition.

(4) Capital expenditures are a non-GAAP measure, calculated as the purchase or sale price of an asset, plus development capital expenditures added to PP&E. Corporate acquisitions are excluded from this measure.

Quarterly variances in sales are connected to changes in production volumes and prices. In the first quarter of 2012, the Company added production volumes through the acquisition of Emerge Oil & Gas Inc.. The Company also completed the acquisition of Avalon Exploration Ltd. in Q2 2012, and Waseca Energy in Q4 2012, resulting in increased production into the second half of 2012. Volatile commodity prices in 2013 reduced sales in Q1, and increased sales in Q2, as prices rebounded.

Through its strategy to protect cash flows and maintain its dividend, Twin Butte hedges a relatively large percentage of production using financial derivatives. As such, commodity price swings in oil have a limited effect on funds flow from operations, as only current quarter realized cash gains or losses are included. Funds flow from operations grew with production throughout 2012, before setbacks at Primate in January.

Quarterly variances in net Income, however, are largely driven by non-cash items, such as unrealized gains or losses on derivatives, deferred tax expense or recovery, and gains or losses on asset acquisitions and dispositions. Losses in Q4 2011 relate to impairments in the Pincher Creek, Plains and Deep Basin CGUs. In Q2 2012, net income contains unrealized gains on derivatives. Conversely, in Q1 2013 the net loss was due to unrealized losses on derivatives. In the second quarter of 2013, the Company recorded further unrealized losses on derivatives, and a loss on the sale of a non-core asset.

## DIVIDENDS

In addition to the cash dividend and Dividend Reinvestment Program ("DRIP"), this quarter Twin Butte initiated a Stock Dividend Program ("SDP"). This program, available to both Canadian and non-Canadian investors, allows shareholders to choose to receive dividends in the form of shares of Twin Butte at a 5% discount to the current weighted average price in lieu of a cash dividend. For the three months ended June 30, 2013, Twin Butte paid cash dividends of $10.6 million and $1.4 million was invested in Twin Butte shares through the DRIP and SDP. For the six months ended June 30, 2013, Twin Butte paid cash dividends of $21.1 million and $2.9 million was invested in Twin Butte shares through the DRIP and SDP.

Cash dividends declared, for the three and six months ended June 30, 2013, which includes dividends declared and payable on June 30, 2013 and is net of the DRIP and SDP, were $10.5 million and $21.3 million, respectively.

## FUNDS FLOW FROM OPERATIONS (1), TOTAL PAYOUT RATIO (3), AND NETBACKS

Funds flow from operations and the payout ratio are non-GAAP measures. Funds flow from operations represents cash flow from operating activities adjusted for expenditures on decommissioning activities and changes in non-cash operating working capital. The payout ratio is calculated as dividends paid and capital expenditures (excluding corporate acquisitions) as a percentage of funds flow from operations. Twin Butte considers these to be key measures of performance as they demonstrate the Company's ability to generate the cash flow necessary to fund dividends and capital investment and ultimately, satisfy corporate strategy.

| | Three months ended June 30 | | Six months ended June 30 | |
|---|---|---|---|---|
| *(000's except per share amounts)* | **2013** | 2012 | **2013** | 2012 |
| Cash flow from operating activities | **40,755** | 31,591 | **69,324** | 60,066 |
| Expenditures on decommissioning liability | **707** | 114 | **1,244** | 157 |
| Change in non-cash working capital | **(8,404)** | 2,057 | **(5,087)** | (61) |
| Funds flow (1) | **33,058** | 33,762 | **65,481** | 60,162 |
| Funds flow per share | **0.13** | 0.18 | **0.26** | 0.32 |
| Dividends declared | **(12,028)** | (8,648) | **(24,008)** | (17,252) |
| Capital Expenditures (2) | **(14,871)** | (24,910) | **(34,496)** | (32,826) |
| Payout ratio (3) | **81%** | 99% | **89%** | 83% |
| Reinvested dividends (DRIP and SDP) | **1,485** | – | **2,737** | – |
| Cash dividends declared | **(10,543)** | (8,648) | **(21,271)** | (17,252) |
| Total payout ratio (net of DRIP and SDP) (3) | **77%** | 99% | **85%** | 83% |

(1) Funds flow from operations and funds flow from operations netback are non-GAAP measures that represent the total and the average per boe, respectively, of cash provided by operating activities, before adjusting for changes in non-cash working capital items and expenditures on decommissioning liabilities.

(2) Capital expenditures is a non-GAAP measure, calculated as the purchase or sale price of an asset, plus development capital expenditures. Corporate acquisitions are excluded from this measure.

(3) Payout ratio is a non-GAAP measure, calculated as the sum of dividends and capital expenditures, divided by funds flow from operations. Total Payout Ratio (net of DRIP and SDP) is the Payout ratio, adjusted for dividends paid or reinvested as stock. The DRIP program was initiated with the August dividend payment on September 17, 2012, and the SDP program was initiated in May 2013.

Twin Butte's corporate strategy aims to provide shareholders with long term total returns comprised of both income and moderate growth, with a focus on dividend sustainability. The Company targets 2–4% production growth and a total payout (net of DRIP and SDP) that will not exceed cash flow on an annual basis. The Company uses the total payout ratio to monitor performance, and will adjust capital expenditures to ensure that the total payout does not exceed cash flow, where required. For the three month period ended June 30, 2013, the total payout ratio was 77%. The year-to-date payout ratio for 2013 is 85%. Heavy rains and road restrictions caused drilling program delays in the second quarter of 2013, resulting in lower than expected capital expenditures. As work planned for Q2 2013 will be completed in Q3 2013, the Company currently expects Q3 2013 capital expenditures of $25-30 million.

Funds flow from operations for the three month period ended June 30, 2013 was $33.1 million, slightly below second quarter 2012 funds flow of $33.8 million. This represents $0.13 per diluted share compared to $0.18 per diluted share for the same quarter last year and consistent with $0.13 in the first quarter of 2013. The decrease in funds flow per share from the prior year quarter is due to the additional shares outstanding.

The following table summarizes netbacks for the past eight quarters on a barrel of oil equivalent basis:

| *($ per boe)* | **Q2 2013** | Q1 2013 | Q4 2012 | Q3 2012 | Q2 2012 | Q1 2012 | Q4 2011 | Q3 2011 |
|---|---|---|---|---|---|---|---|---|
| Petroleum and natural gas sales | **64.24** | 46.21 | 54.98 | 58.01 | 54.33 | 60.23 | 58.22 | 49.90 |
| Royalties | **(13.39)** | (9.14) | (9.83) | (11.40) | (12.84) | (14.52) | (11.42) | (11.30) |
| Cash gain (loss) on financial derivatives | **0.01** | 11.26 | 4.83 | 8.02 | 6.91 | 2.10 | (1.16) | 2.65 |
| Operating expense | **(22.92)** | (21.88) | (19.73) | (18.38) | (17.19) | (18.62) | (16.96) | (16.25) |
| Transportation expense | **(2.96)** | (2.33) | (2.82) | (2.45) | (2.26) | (2.48) | (1.96) | (1.90) |
| Operating netback (1) | **24.98** | 24.12 | 27.43 | 33.80 | 28.95 | 26.71 | 26.72 | 23.10 |
| General and administrative expense | **(2.05)** | (2.21) | (2.07) | (2.22) | (1.57) | (2.03) | (2.18) | (2.04) |
| Transaction costs | **–** | (0.03) | (0.76) | (0.62) | (0.20) | (1.63) | – | – |
| Interest and bank charges | **(1.37)** | (1.00) | (1.18) | (1.00) | (1.05) | (1.13) | (0.97) | (0.98) |
| Funds flow from operations (2) | **21.56** | 20.88 | 23.42 | 29.96 | 26.13 | 21.92 | 23.57 | 20.08 |

(1) Operating netback is a non-GAAP measure calculated as the average per boe of the Company's oil and gas sales, realized gains (losses) on derivatives, less royalties, operating and transportation expenses.

(2) Funds flow from operations is a non-GAAP measure that represents the total of funds provided by operating activities, before adjusting for changes in non-cash working capital items and expenditures on decommissioning liabilities.

## CAPITAL EXPENDITURES AND PP&E ADDITIONS

| | Three months ended June 30 | | Six months ended June 30 | |
|---|---|---|---|---|
| *($000's)* | **2013** | 2012 | **2013** | 2012 |
| Land acquisition | **1,041** | 1,201 | **1,051** | 1,076 |
| Geological and geophysical | **554** | 78 | **1,055** | 226 |
| Drilling and completions | **10,830** | 6,894 | **27,345** | 16,763 |
| Equipping and facilities | **4,816** | 1,665 | **10,571** | 4,555 |
| Other | **888** | 1,333 | **1,762** | 2,795 |
| **Development capital** | **18,129** | 11,171 | **41,784** | 25,415 |
| Property acquisitions - Cash paid | **–** | 14,181 | **–** | 14,181 |
| Property dispositions - Cash received | **(3,258)** | (442) | **(7,288)** | (6,770) |
| **Capital expenditures** (1) | **14,871** | 24,910 | **34,496** | 32,826 |
| Net other additions to PP&E (2) | **(13,667)** | (3,082) | **(2,362)** | 5,532 |
| Corporate acquisition additions to PP&E | **–** | – | **–** | 203,000 |
| **Total net additions to PP&E** | **1,204** | 21,828 | **32,134** | 241,358 |

(1) Capital expenditures is a non-GAAP measure and is defined as the total cash consideration paid or received for property acquisitions and dispositions, plus development and exploration capital expenditures. This measure is used by management to calculate the Payout and Total Payout Ratios.

(2) Net other additions to PP&E reconciles the Non-GAAP Capital Expenditures measure to the IFRS measure of capital additions, and is the net adjustments made to account for the assets purchased under IFRS 3 - Business Combinations, assets sold for cash, reclassification of E&E assets, and corresponding changes in PP&E due to changes in the decommissioning liability.

During the second quarter of 2013, the Company invested $18.1 million on development capital. The Company's development capital expenditures for the quarter were focused on heavy oil areas, with successful drilling of 8 (8.0 net) oil wells at Wildmere; 2 (2.0 net) wells at Swimming; and 1 (1.0 net) well at each of Rush Lake and Frog Lake South. Capital expenditures this quarter also consisted of $1 million in crown land purchases.

The Company completed property dispositions for cash proceeds of $3.3 million during the quarter and did not complete any property or corporate acquisitions. For the six months ended June 30, 2013, the Company completed property dispositions for cash proceeds of $7.3 million. While no property or corporate transactions occurred in the second quarter of 2012, for the six months ended June 30, 2012, the Company completed the corporate acquisition of Emerge, as well as property dispositions for proceeds of $6.8 million.

### Drilling Results

| Three months ended June 30 | 2013 | | 2012 | |
|---|---|---|---|---|
| | **Gross** | **Net** | Gross | Net |
| Crude oil | **12** | **12** | 15 | 13.5 |
| Dry and abandoned | **–** | **–** | 1 | 1.0 |
| Total | **12** | **12** | 16 | 14.5 |
| Success rate (%) | | **100%** | | 93% |

| Six months ended June 30 | 2013 | | 2012 | |
|---|---|---|---|---|
| | **Gross** | **Net** | Gross | Net |
| Crude oil | **37** | **37** | 47 | 35.2 |
| Dry and abandoned | **3** | **3** | 1 | 1.0 |
| Total | **40** | **40** | 48 | 36.2 |
| Success rate (%) | | **93%** | | 97% |

### Undeveloped Land

The Company's undeveloped land holdings significantly increased from the second quarter of 2012, mainly through acquisitions. In the second quarter of 2013, conversions from drilling, dispositions and expiries were greater than purchases and the net balance reduced total undeveloped land.

| As at June 30 | 2013 | 2012 |
|---|---|---|
| Gross Acres | **855,974** | 299,369 |
| Net Acres | **320,216** | 235,708 |

## LIQUIDITY AND CAPITAL RESOURCES

The Company evaluates its ability to carry on business as a going concern on a quarterly basis, with the key indicator being whether the non-GAAP measure, funds flow from operations, will be sufficient to cover all obligations. Funds flow is calculated as cash provided by operating activities, before adjusting for changes in non-cash working capital items and expenditures on decommissioning liabilities. The Company also reviews capital expenditures on an on-going basis to ensure that funds flow will provide adequate funding. In cases where funds flow is not adequate, the Company may adjust capital expenditures to manage debt levels. Diligent monitoring of funds flow from operations, as well as debt levels, allows Twin Butte to maintain a significant undrawn portion of $105 million on the Company's dedicated credit facility of $280 million.

As at June 30, 2013 the Company's dedicated facility consisted of a revolving line of credit of $255 million and an operating line of credit of $25 million, available on an annual revolving basis. The annual credit facility review was completed in May 2013 and the expiry of the current annual revolving period is April 29, 2014. This facility is extendible at the request of the Company for a further 364 days, subject to approval of the lenders and is repayable one year after the expiry of the revolving period if not extended. The credit facility is with a syndicate of four Canadian chartered or international banks and provides that advances may be made by way of Canadian prime rate and U.S. base rate loans, bankers' acceptances, LIBOR Loans, or standby letters of credit/guarantees. Covenants on this facility include a current ratio of 1:1, which is adjusted to include the undrawn portion of the credit facility as a current asset. Due to the significant undrawn portion on the credit facility, as well as positive cash provided by operating activities, the Company believes it has the ability to meet its current obligations.

Interest rates on Canadian prime rate loans fluctuate based on revised pricing grid and range from Bank of Canada ("bank") prime plus 1% to bank prime plus 2.5%, depending upon the Company's debt to EBITDA ratio for the preceding twelve months in categories ranging from one to greater than three times. A debt to EBITDA ratio of less than one has interest payable at the bank's prime lending rate plus 1%. A debt to EBITDA ratio greater than three has interest payable at the bank's prime lending rate plus 2.5%. The borrowing base of the facility is determined based on, among other things, the Company's current reserve report, results of operations, current and forecasted commodity prices and the current economic environment. The Company's credit facility is subject to semi-annual review by the bank and is secured by a debenture and a general security agreement covering all assets of the Company.

In the management of capital, the Company includes working capital and total net debt (defined as the sum of current assets and current liabilities including bank indebtedness and cash dividend payable less financial derivatives) in the definition of capital. The Company's share capital is not subject to external restrictions; however, its credit facility value is based primarily on its petroleum and natural gas reserves and there are covenants Twin Butte must comply with. Twin Butte is not in default in relation to this agreement and was not required to make any repayments.

At June 30, 2013 the Company had $175 million drawn on its credit facility and total net debt of $194 million. The Company confirms there are no off-balance sheet financing arrangements.

## SHARE CAPITAL

In the second quarter of 2013, 435,671 vested share awards and 44,084 vested performance share awards were exercised, resulting in the issuance of 479,755 shares. For the six months ended June 30, 2013, 747,301 vested share awards and 552,197 performance share awards were exercised, resulting in the issuance of 1,299,498 shares. As of August 14, 2013 the Company has 251,242,633 Common Shares, 870,434 stock options and 5,670,485 share awards, including reinvested dividends, outstanding.

## CONTRACTUAL OBLIGATIONS AND CONTINGENCIES

The Company enters into short term contractual obligations in the normal course of business, including purchase of assets and services, operating agreements, transportation commitments, sales commitments, royalty obligations, lease rental obligations and employee agreements. These obligations are of a recurring, consistent nature and impact cash flows in an ongoing manner.

Twin Butte also has long-term contractual obligations and commitments. The Company is responsible for the retirement of long-lived assets related to its oil and gas properties at the end of their useful lives. Twin Butte has recognized a liability of $96.5 million (December 31, 2012 – $89.0 million) based on current legislation and estimated costs. Actual costs may differ from those estimated due to changes in legislation or actual costs.

Additional contractual obligations and commitments are as follows:

| As at June 30, 2013 | Less than one year | One to three years | Three to five years | Total |
|---|---|---|---|---|
| Derivative liability | 15,261 | 1,109 | – | 16,370 |
| Bank indebtedness – principal (1) | – | 175,209 | – | 175,209 |
| Bank indebtedness – interest | 7,008 | 7,008 | – | 14,016 |
| Other (2) | 1,146 | 2,351 | 2,033 | 5,530 |
| | 23,415 | 185,677 | 2,033 | 211,125 |

(1) Repayment of this principal amount in one to three years is based on the revolving debt agreement currently in place and does not consider the annual review for extension. The next review is scheduled for April 2014, at which Management fully expects the facility to be extended.

(2) Other includes contractual obligations and commitments for office rent and equipment.

The Company has income tax filings that are subject to audit and potential reassessment. The findings may impact the tax liability of the Company. The final results are not reasonably determinable at this time and management believes that it has adequately provided for current and deferred income taxes.

Twin Butte is also involved in various claims and litigation arising in the normal course of business. While the outcome of these matters is uncertain and there can be no assurance that such matters will be resolved in the Company's favor, the Company does not currently believe that the outcome of adverse decisions in any pending or threatened proceedings related to these and other matters would have a material adverse impact on its financial position, results of operations or liquidity.

## RELATED PARTY TRANSACTIONS

During the three month period ended June 30, 2013, the Company incurred costs totaling $1.0 million ($1.1 million – June 30, 2012) for oilfield services and legal counsel rendered by three companies of which an officer and director of Twin Butte is a director. During the six month period ended June 30, 2013, the Company incurred related party costs totaling $3.1 million ($3.4 million – June 30, 2012).

These costs were incurred in the normal course of business and were recorded at the amount exchanged between the parties. As at June 30, 2013, the Company had $0.7 million ($4.3 million – December 31, 2012) included in accounts payable and accrued liabilities related to these transactions.

## SUBSEQUENT EVENTS

### Crude Oil Sales Price Derivative Contracts

Subsequent to June 30, 2013 the Company entered into several crude oil price derivatives. The average barrels and prices for these contracts are as follows:

| Daily barrel (bbl) quantity | Term of contract | WTI (1) Fixed price per bbl ($CAD) |
|---|---|---|
| 500 | January 1, 2014 to June 30, 2014 | $ 98.60 |
| 2,250 | July 1, 2014 to September 30, 2014 | $ 97.68 |
| 1,500 | October 1, 2014 to December 31, 2014 | $ 96.10 |

(1) WTI represents posting price of West Texas Intermediate oil

## CRITICAL ACCOUNTING ESTIMATES

The preparation of 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, and differences could be material. 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.

### Estimates and assumptions

Information about significant areas of estimation uncertainty in applying accounting policies that have the most significant effect on the amounts recognized in the annual Financial Statements for the year ended December 31, 2012 and specifically include in the following annual notes:

- Note 5 – valuation of financial instruments;
- Note 8 – valuation of property and equipment;
- Note 10 – measurement of decommissioning provision;
- Note 11 – measurement of share-based compensation; and
- Note 16 – income tax expense.

The Company's significant areas of estimation uncertainty have not changed during the period. In accordance with new standards adopted, the Company has provided additional estimation and assumption disclosure regarding the valuation of financial instruments in Note 4 to the interim financial statements for the three and six months ended June 30, 2013.

### Judgments

In the process of applying the Company's accounting policies, management makes judgments, apart from those involving estimates, which may have a significant effect on the amounts recognized in the financial statements. Management's areas of judgment have not significantly changed from the annual financial statements for the year ended December 31, 2012.

### New standards and interpretations not yet adopted

There were no new or amended standards issued during the three and six months ended June 30, 2013 that are applicable to the Company in future periods. A description of standards and interpretations that will be adopted by the Company in future periods can be found in the notes to the annual Financial Statements for the year ended December 31, 2012.

The accounting policies followed in these condensed consolidated interim financial statements are consistent with those of the previous financial year, except as described below.

*Changes in accounting policies*

The Company has adopted the following new and revised standards, along with any consequential amendments, effective January 1, 2013. These changes were made in accordance with the applicable transitional provisions.

*ii)* *IFRS 10 Consolidated Financial Statements* replaces IAS 27 Consolidated and Separate Financial Statements and SIC 12 Consolidation – Special Purpose Entities. IFRS 10 revises the definition of control and focuses on the need to have power and variable returns for control to be present. Adoption did not result in any change in consolidation status, as the Company does not have subsidiaries or investees.

*iii)* *IFRS 11 Joint Arrangements* requires a company to classify its interest in a joint arrangement as a joint venture or joint operation. Joint ventures will be accounted for using the equity method of accounting whereas for a joint operation the company will recognize its share of the assets, liabilities, revenue and expenses of the joint operation. IFRS 11 supersedes IAS 31 Interests in Joint Ventures, and SIC-13 Jointly Controlled Entities—Non-monetary Contributions by Venturers. The Company has analyzed its joint arrangements and concluded that the adoption of IFRS 11 did not result in any changes in the accounting for its joint arrangements.

*iiv)* *IFRS 12 Disclosure of Interest in Other Entities* replaces the disclosure requirements previously included in IAS 27, IAS 31, and IAS 28 Investments in Associates. It sets out the extensive disclosure requirements relating to an entity's interests in subsidiaries, joint arrangements, associates and unconsolidated structured entities. The Company assessed its interests in other entities on January 1, 2013 and determined that no additional disclosure was necessary.

*iv)* *IFRS 13 Fair Value Measurement* is a comprehensive standard for fair value measurement and disclosure requirements for use across all IFRS standards. The new standard clarifies that fair value is the price that would be received to sell an asset, or paid to transfer a liability in an orderly transaction between market participants, at the measurement date. It also establishes disclosures about fair value measurement. Under existing IFRS, guidance on measuring and disclosing fair value is dispersed among the specific standards requiring fair value measurements and in many cases does not reflect a clear measurement basis or consistent disclosures. The Company adopted IFRS 13 on January 1, 2013 on a prospective basis. The adoption of IFRS 13 did not require any adjustments to the valuation techniques used by the Company to measure fair value and did not result in any measurement adjustments as at January 1, 2013. The Company has complied with the disclosure requirements of IFRS 13 in Note 4 – Financial Instruments, as applicable to interim financial statements in accordance with IAS 34.

## ASSESSMENT OF BUSINESS RISKS

The following are the primary risks associated with the business of Twin Butte. These risks are similar to those affecting other companies competing in the conventional oil and natural gas sector. Twin Butte's financial position and results of operations are directly impacted by these factors and include:

### Operational risk associated with the production of oil and natural gas:

- Reserve risk in respect to the quantity and quality of recoverable reserves;
- Exploration and development risk of being able to add new reserves economically;
- Market risk relating to the availability of transportation systems to move the product to market;
- Commodity risk as crude oil and natural gas prices fluctuate due to market forces;
- Financial risk such as volatility of the Canadian/US dollar exchange rate, interest rates and debt service obligations;
- Environmental and safety risk associated with well operations and production facilities;

- Changing government regulations relating to royalty legislation, income tax laws, incentive programs, operating practices and environmental protection relating to the oil and natural gas industry; and
- Continued participation of Twin Butte's lenders.

**Twin Butte seeks to mitigate these risks by:**

- Acquiring properties with established production trends to reduce technical uncertainty as well as undeveloped land with development potential;
- Maintaining a low cost structure to maximize product netbacks and reduce impact of commodity price cycles;
- Diversifying properties to mitigate individual property and well risk;
- Maintaining product mix to balance exposure to commodity prices;
- Conducting rigorous reviews of all property acquisitions;
- Monitoring pricing trends and developing a mix of contractual arrangements for the marketing of products with creditworthy counterparties;
- Maintaining a hedging program to hedge commodity prices with creditworthy counterparties;
- Adhering to the Company's safety program and adhering to current operating best practices;
- Keeping informed of proposed changes in regulations and laws to properly respond to and plan for the effects that these changes may have on our operations;
- Carrying industry standard insurance;
- Establishing and maintaining adequate resources to fund future abandonment and site restoration costs; and
- Monitoring our joint venture partners' obligations to us and cash calling for capital projects to limit the Company's credit risk.

## DISCLOSURE CONTROLS AND INTERNAL CONTROLS OVER FINANCIAL REPORTING

Disclosure controls and procedures have been designed to provide reasonable assurance that information required to be disclosed by the Company is recorded, processed, summarized and reported within the time periods specified under the Canadian securities law.

Twin Butte's Chief Executive Officer and Chief Financial Officer have concluded, based on their evaluation, that the disclosure controls and procedures as of June 30, 2013 are effective and provide reasonable assurance that material information related to the Company is made known to them by others within Twin Butte.

Twin Butte's Chief Executive Officer and Chief Financial Officer are responsible for establishing and maintaining internal controls over financial reporting ("ICFR"). They have, as at June 30, 2013, designed ICFR or caused it to be designed under their supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with IFRS. The control framework Twin Butte's officers used to design the ICFR is the Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations.

Twin Butte's Chief Executive Officer and Chief Financial Officer are required to disclose any change in the internal controls over financial reporting that occurred during our most recent reporting period that has materially affected, or is reasonably likely to affect, the Company's internal controls June 30, 2013 that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

It should be noted that a control system, including Twin Butte's disclosure and internal controls and procedures, no matter how well conceived or operated, can provide only reasonable, not absolute, assurance that the objectives of the control system will be met and it should not be expected that the disclosure and internal controls and procedures will prevent all errors or fraud.

# BALANCE SHEET

| *(unaudited - Cdn$ thousands)* | *Note* | **June 30, 2013** | December 31, 2012 |
|---|---|---|---|
| **ASSETS** | | | |
| **Current Assets** | | | |
| Accounts receivable | | **$ 41,029** | $ 42,497 |
| Deposits and prepaid expenses | | **6,232** | 4,233 |
| Derivative assets | *4* | **4,620** | 32,022 |
| | | **51,881** | 78,752 |
| **Non-current assets** | | | |
| Derivative assets | *4* | **161** | – |
| Exploration and evaluation | *5* | **59,010** | 65,779 |
| Property and equipment | *6* | **647,602** | 669,328 |
| Goodwill | | **31,402** | 31,402 |
| | | **$ 790,056** | $ 845,261 |
| **LIABILITIES AND SHAREHOLDERS' EQUITY** | | | |
| **Current Liabilities** | | | |
| Accounts payable and accrued liabilities | | **$ 61,787** | $ 60,822 |
| Dividend payable | | **4,015** | 3,350 |
| Derivative liabilities | *4* | **15,261** | 2,821 |
| | | **81,063** | 66,993 |
| **Non-current liabilities** | | | |
| Derivative liabilities | *4* | **1,109** | 1,994 |
| Bank indebtedness | *7* | **175,209** | 184,261 |
| Deferred taxes | | **18,988** | 31,521 |
| Decommissioning provision | *8* | **96,452** | 88,991 |
| | | **372,821** | 373,760 |
| **Shareholders' Equity** | | | |
| Share capital | *9* | **529,057** | 523,226 |
| Contributed surplus | | **7,873** | 7,624 |
| Deficit | | **(119,695)** | (59,349) |
| | | **417,235** | 471,501 |
| | | **$ 790,056** | $ 845,261 |

Commitments and contingencies (note 14)

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

# STATEMENT OF INCOME (LOSS) AND COMPREHENSIVE INCOME (LOSS)

| *(unaudited - Cdn$ thousands except per share amounts)* | *Note* | Three months ended June 30 **2013** | 2012 | Six months ended June 30 **2013** | 2012 |
|---|---|---|---|---|---|
| Petroleum and natural gas sales | | **$ 98,497** | $ 70,173 | **$ 170,261** | $ 142,670 |
| Royalties | | **(20,525)** | (16,583) | **(34,713)** | (34,057) |
| **Revenues** | | **$ 77,972** | $ 53,590 | **$ 135,548** | $ 108,613 |
| **Expenses** | | | | | |
| Operating | | **35,148** | 22,197 | **69,122** | 44,607 |
| Transportation | | **4,536** | 2,914 | **8,162** | 5,901 |
| General and administrative | *10* | **3,141** | 2,024 | **6,572** | 4,467 |
| Transaction costs | | **–** | 264 | **55** | 2,224 |
| Share-based payments | *9* | **1,204** | 1,101 | **2,575** | 1,946 |
| Finance expense | *11* | **2,694** | 1,799 | **4,800** | 3,394 |
| Loss (gain) on derivatives | *4* | **1,138** | (40,783) | **21,304** | (47,195) |
| Exploration and evaluation expense | *5* | **960** | 1,199 | **6,595** | 2,156 |
| Loss (gain) on disposition of property and equipment | *6* | **7,504** | – | **6,845** | (2,997) |
| Loss (gain) on disposition of exploration asset | *5* | **–** | – | **(3,208)** | – |
| Negative goodwill | | **–** | – | **–** | (6,991) |
| Depletion and depreciation | *6* | **30,332** | 23,212 | **60,974** | 43,631 |
| | | **86,657** | 13,927 | **183,796** | 51,143 |
| **Income (loss) before income taxes** | | **(8,685)** | 39,663 | **(48,248)** | 57,470 |
| Deferred tax expense (recovery) | | **(2,603)** | 10,323 | **(12,533)** | 13,147 |
| **Net income (loss) and comprehensive income (loss)** | | **$ (6,082)** | $ 29,340 | **$ (35,715)** | $ 44,323 |
| **Net Income (Loss) per share $** | | | | | |
| Basic | *9* | **(0.02)** | 0.15 | **(0.14)** | 0.23 |
| Diluted | *9* | **(0.02)** | 0.15 | **(0.14)** | 0.23 |

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

# STATEMENT OF CASH FLOWS

| *(unaudited - Cdn$ thousands)* | *Note* | Three months ended June 30 2013 | 2012 | Six months ended June 30 2013 | 2012 |
|---|---|---|---|---|---|
| Cash provided by (used in): | | | | | |
| **OPERATING ACTIVITIES:** | | | | | |
| Net income (loss) | | **$ (6,082)** | $ 29,340 | **$ (35,715)** | $ 44,323 |
| Adjustments for items not involving cash: | | | | | |
| Depletion and depreciation | *6* | **30,332** | 23,212 | **60,974** | 43,631 |
| Deferred tax expense (recovery) | | **(2,603)** | 10,323 | **(12,533)** | 13,147 |
| Unrealized (gain) loss on derivatives | *4* | **1,145** | (31,856) | **30,852** | (35,735) |
| Finance expenses | *11* | **2,694** | 1,799 | **4,800** | 3,394 |
| Interest paid | *11* | **(2,096)** | (1,356) | **(3,647)** | (2,712) |
| Share-based payments | *9* | **1,204** | 1,101 | **2,575** | 1,946 |
| Exploration and evaluation expenses | *5* | **960** | 1,199 | **6,595** | 2,156 |
| Gain on disposition of exploration asset | *5* | **–** | – | **(3,208)** | – |
| Loss (gain) on disposition of property and equipment | *6* | **7,504** | – | **6,845** | (2,997) |
| Negative goodwill | | **–** | – | **–** | (6,991) |
| Cash premiums on derivatives | *4* | **–** | – | **7,943** | – |
| Expenditures on decommissioning provision | *8* | **(707)** | (114) | **(1,244)** | (157) |
| Changes in non-cash working capital | *12* | **8,404** | (2,057) | **5,087** | 61 |
| | | **40,755** | 31,591 | **69,324** | 60,066 |
| **FINANCING ACTIVITIES** | | | | | |
| Increase (decrease) in bank indebtedness | *7* | **(13,427)** | (2,439) | **(9,052)** | (22,697) |
| Issuance of share capital on exercise of stock options | *9* | **–** | 13 | **–** | 112 |
| Dividends paid | | **(10,651)** | (8,642) | **(21,104)** | (14,383) |
| | | **(24,078)** | (11,068) | **(30,156)** | (36,968) |
| **INVESTING ACTIVITIES** | | | | | |
| Expenditures on property and equipment | | **(16,684)** | (19,777) | **(39,888)** | (31,283) |
| Expenditures on exploration and evaluation assets | | **(1,445)** | (1,267) | **(1,896)** | (1,539) |
| Proceeds on disposition of property and equipment | *6* | **3,258** | 442 | **3,818** | 6,355 |
| Proceeds on disposition of exploration and evaluation assets | *5* | **(20)** | 67 | **3,450** | 482 |
| Changes in non-cash working capital | *12* | **(1,786)** | 12 | **(4,652)** | 2,887 |
| | | **(16,677)** | (20,523) | **(39,168)** | (23,098) |
| Change in cash | | **$ –** | $ – | **$ –** | $ – |
| Cash and cash equivalents, beginning and end of period | | **$ –** | $ – | **$ –** | $ – |

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

## STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY

| | | Three months ended June 30 | | Six months ended June 30 | |
|---|---|---|---|---|---|
| *(unaudited - Cdn$ thousands)* | *Note* | **2013** | 2012 | **2013** | 2012 |
| **Share capital** | | | | | |
| Balance, beginning of period | | **$ 526,625** | $ 365,130 | **$ 523,226** | $ 227,520 |
| Common shares issued for Emerge acquisition | | **–** | – | **–** | 134,264 |
| Common shares issued pursuant to the DRIP and SDP | *9* | **1,360** | – | **2,863** | – |
| Common shares issued under employee and option plan | *9* | **1,072** | 1,928 | **2,968** | 5,274 |
| Balance, end of period | | **$ 529,057** | $ 367,058 | **$ 529,057** | $ 367,058 |
| **Contributed surplus** | | | | | |
| Balance, beginning of period | | **$ 7,441** | $ 5,139 | **$ 7,624** | $ 7,506 |
| Share-based payments for awards exercised | | **(1,073)** | (246) | **(2,969)** | (2,613) |
| Share-based payments for awards granted | | **1,505** | – | **3,218** | – |
| Balance, end of period | | **$ 7,873** | $ 4,893 | **$ 7,873** | $ 4,893 |
| **Deficit** | | | | | |
| Balance, beginning of period | | **$ (101,585)** | $ (47,271) | **$ (59,349)** | $ (53,630) |
| Dividends | | **(12,028)** | $ (8,646) | **$ (24,631)** | $ (17,270) |
| Net income (loss) and comprehensive income (loss) | | **(6,082)** | 29,340 | **(35,715)** | 44,323 |
| Balance, end of period | | **$ (119,695)** | $ (26,577) | **$ (119,695)** | $ (26,577) |

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

For the periods ended June 30, 2013 and 2012 (Unaudited)

*All tabular amounts are in thousands of Canadian dollars except as otherwise indicated.*

## NOTE 1. BUSINESS AND STRUCTURE OF TWIN BUTTE

Twin Butte Energy Ltd. ("Twin Butte" or "the Company") is a dividend paying oil and natural gas exploration, development and production company with properties located in Western Canada. Twin Butte is domiciled and incorporated in Canada under the Business Corporations Act (Alberta). Twin Butte's head office address is 410, 396 – 11th Avenue SW, Calgary, Alberta, Canada. The Company's primary listing is on the Toronto Stock Exchange under the symbol "TBE".

## NOTE 2. BASIS OF PRESENTATION

The Company prepares its condensed interim financial statements in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB") applicable to the preparation of interim financial statements, including IAS 34, Interim Financial Reporting. The Company has consistently applied the same accounting policies throughout all periods presented in the notes to the audited annual financial statements for the year ended December 31, 2012, except as identified in note 3. Certain disclosures included in the notes to the audited annual financial statements have been condensed in the following note disclosures or have been disclosed on an annual basis only. The condensed interim financial statements should be read in conjunction with the annual financial statements for the year ended December 31, 2012.

These financial statements have been prepared on the historical cost basis, except as disclosed in the significant accounting policies in Note 3 of the annual financial statements for the year ended December 31, 2012. They are presented in Canadian dollars, which is the Company's functional currency.

These financial statements were approved and authorized for issue by the Board of Directors on August 14, 2013.

## NOTE 3. SIGNIFICANT ACCOUNTING POLICIES

There were no new or amended standards issued during the three and six months ended June 30, 2013 that are applicable to the Company in future periods. A description of standards and interpretations that will be adopted by the Company in future periods can be found in the notes to the annual Financial Statements for the year ended December 31, 2012.

The accounting policies followed in these condensed consolidated interim financial statements are consistent with those of the previous financial year, except as described below.

### Changes in accounting policies

The Company has adopted the following new and revised standards, along with any consequential amendments, effective January 1, 2013. These changes were made in accordance with the applicable transitional provisions.

*ii)* *IFRS 10 Consolidated Financial Statements* replaces IAS 27 Consolidated and Separate Financial Statements and SIC 12 Consolidation – Special Purpose Entities. IFRS 10 revises the definition of control and focuses on the need to have power and variable returns for control to be present. Adoption did not result in any change in consolidation status, as the Company does not have subsidiaries or investees.

*iii)* *IFRS 11 Joint Arrangements* requires a company to classify its interest in a joint arrangement as a joint venture or joint operation. Joint ventures will be accounted for using the equity method of accounting whereas for a joint operation the company will recognize its share of the assets, liabilities, revenue and expenses of the joint operation. IFRS 11 supersedes IAS 31 Interests in Joint Ventures, and SIC-13 Jointly Controlled Entities—Non-monetary Contributions by Venturers. The Company has analyzed its joint arrangements and concluded that the adoption of IFRS 11 did not result in any changes in the accounting for its joint arrangements.

iiv) *IFRS 12 Disclosure of Interest in Other Entities* replaces the disclosure requirements previously included in IAS 27, IAS 31, and IAS 28 Investments in Associates. It sets out the extensive disclosure requirements relating to an entity's interests in subsidiaries, joint arrangements, associates and unconsolidated structured entities. The Company assessed its interests in other entities on January 1, 2013 and determined that no additional disclosure was necessary.

iv) *IFRS 13 Fair Value Measurement* is a comprehensive standard for fair value measurement and disclosure requirements for use across all IFRS standards. The new standard clarifies that fair value is the price that would be received to sell an asset, or paid to transfer a liability in an orderly transaction between market participants, at the measurement date. It also establishes disclosures about fair value measurement. Under existing IFRS, guidance on measuring and disclosing fair value is dispersed among the specific standards requiring fair value measurements and in many cases does not reflect a clear measurement basis or consistent disclosures. The Company adopted IFRS 13 on January 1, 2013 on a prospective basis. The adoption of IFRS 13 did not require any adjustments to the valuation techniques used by the Company to measure fair value and did not result in any measurement adjustments as at January 1, 2013. The Company has complied with the new disclosure requirements of IFRS 13 in Note 4 – Financial Instruments, as applicable to interim financial statements in accordance with IAS 34.

## NOTE 4. FINANCIAL INSTRUMENTS

Financial instruments of the Company include accounts receivable, deposits, accounts payable and accrued liabilities, bank indebtedness, dividends payable, and derivative assets and liabilities. As at June 30, 2013, there were no differences between the carrying amounts reported on the Balance Sheet and the estimated fair values of these financial instruments due to the short terms to maturity and the floating interest rate on the bank indebtedness.

Derivative assets and liabilities are carried at fair value and are measured on a recurring basis. The fair values of derivatives are determined using a Level 2 valuation model, where pricing inputs other than quoted prices in an active market are used. These pricing inputs include quoted forward prices for commodities, foreign exchange rates, volatility and discounting, all of which can be observed or corroborated in the marketplace. The Company's policy is to recognize transfers into and out of fair value hierarchy levels as of the date of the event or change in circumstances that caused the transfer. During the three and six months ended June 30, 2013, there were no transfers between levels 1, 2 or 3.

### (a) Price and currency risk

The table below summarizes the realized and unrealized gain (loss) on derivatives:

| | Three months ended June 30 | | Six months ended June 30 | |
|---|---|---|---|---|
| | **2013** | 2012 | **2013** | 2012 |
| Realized gain (loss) | **7** | 8,927 | **9,548** | 11,460 |
| Unrealized gain (loss) | **(1,145)** | 31,856 | **(30,852)** | 35,735 |
| Gain (loss) on derivatives | **(1,138)** | 40,783 | **(21,304)** | 47,195 |

During the six months ended June 30, 2013, the Company also realized $7.9 million of cash premiums received for selling crude oil swaption derivative contracts (June 30, 2012 - $nil). A crude oil swaption contract is an option that allows the holder to exercise and enter into a fixed price crude oil derivative contract.

### Derivative Position

| As at | June 30, 2013 | December 31, 2012 |
|---|---|---|
| Current asset | **4,620** | 32,022 |
| Non-current asset | **161** | – |
| Current liability | **(15,261)** | (2,821) |
| Non-current liability | **(1,109)** | (1,994) |
| Net derivative asset (liability) position | **(11,589)** | 27,207 |

### Derivative Summary

| As at | June 30, 2013 | December 31, 2012 |
|---|---|---|
| Crude oil sales price derivatives | **(11,885)** | 22,915 |
| Crude oil swaption derivatives | **(1,800)** | – |
| Natural gas sales price derivatives | **2,096** | 4,292 |
| Net derivative asset (liability) position | **(11,589)** | 27,207 |

### Crude Oil Sales Price Derivatives

| Daily barrel (bbl) quantity | Term of contract | WTI(1) Fixed price per bbl ($CAD) | Fixed written call price per bbl WTI (1) ($USD) | Fixed $ WCS (2) vs. bbl WTI (1) | Fair market value $000's |
|---|---|---|---|---|---|
| 4,500 | January 1, 2013 to December 31, 2013 | $ 96.75 | | | (3,005) |
| 2,000 | April 1, 2013 to December 31, 2013 | $ 95.00 | | | (1,216) |
| 3,500 | July 1, 2013 to September 30, 2013 | $ 96.67 | | | (1,456) |
| 2,000 | July 1, 2013 to December 31, 2013 | $ 97.80 | | | (1,303) |
| 2,000 | October 1, 2013 to December 31, 2013 | $ 94.55 | | | (878) |
| 3,000 | January 1, 2014 to December 31, 2014 | $ 95.00 | | | (532) |
| 5,000 | January 1, 2014 to June 30, 2014 | $ 96.56 | | | (133) |
| 1,000 | July 1, 2014 to September 30, 2014 | $ 96.00 | | | 98 |
| 4,500 | January 1, 2013 to December 31, 2013 | | | (20.57) | (708) |
| 2,000 | July 1, 2013 to December 31, 2013 | | | (22.38) | (912) |
| 4,500 | July 1, 2013 to September 30, 2013 | | | (21.78) | (2,167) |
| 1,000 | January 1, 2014 to December 31, 2014 | | | (22.00) | 126 |
| 2,000 | January 1, 2014 to June 30, 2014 | | | (19.55) | 1,277 |
| 2,000 | July 1, 2014 to December 31, 2014 | | | (21.85) | (31) |
| 1,000 | July 1, 2014 to September 30, 2014 | | | (22.00) | (14) |
| 1,000 | January 1, 2015 to December 31, 2015 | | | (19.75) | (191) |
| 3,300 | January 1, 2013 to December 31, 2013 | | $ 108.03 | | (280) |
| 1,300 | January 1, 2014 to December 31, 2014 | | $ 110.00 | | (560) |
| Crude oil fair value position | | | | | (11,885) |

(1) WTI represents posting price of West Texas Intermediate oil

(2) WCS represents the posting price of Western Canadian Select oil

### Crude Oil Swaption Derivative Contracts

| Daily barrel (boe) quantity | Option contract expiry | Term of underlying WTI (1) fixed call | Fixed call price per bbl WTI (1) | Fair market value $000's |
|---|---|---|---|---|
| 2,000 | September 30, 2013 | January 1, 2014 to December 31, 2014 | $US 100.00 | $ (280) |
| 1,000 | December 31, 2013 | January 1, 2014 to December 31, 2014 | $US 100.00 | (372) |
| 2,000 | December 31, 2013 | January 1, 2014 to June 30, 2014 | $C 100.00 | (1,148) |
| Crude oil swaption fair value position | | | | $ (1,800) |

(1) WTI represents posting price of West Texas Intermediate oil

### Natural Gas Sales Price Derivatives

| Daily giga-joule (GJ) quantity | Term of contract | Fixed price per GJ AECO Daily | Fair Market Value $000's |
|---|---|---|---|
| 7,800 | January 1, 2013 to December 31, 2013 | $4.50 | 2,096 |
| Natural gas fair value position | | | 2,096 |

### (b) Capital management

Twin Butte's capital structure as at June 30, 2013 and December 31, 2012 is as follows:

| | **June 30, 2013** | Dec 31, 2012 |
|---|---|---|
| Bank indebtedness | **175,209** | 184,261 |
| Working capital deficit (surplus) (1) | **18,541** | 17,442 |
| Net debt (2) | **193,750** | 201,703 |
| Shareholders' Equity | **417,235** | 471,501 |
| Net Debt to Equity (2) | **0.46** | 0.43 |

(1) Working capital deficit (surplus) is a non-GAAP measure that includes accounts receivables, deposits and prepaid expenses, accounts payable, and accrued liabilities, and dividend payable.

(2) Net debt and net debt to equity are non-GAAP measures. Net debt is defined as the sum of current assets and current liabilities, including bank indebtedness, less financial derivatives, whereas net debt to equity is the ratio of net debt compared to equity.

As at June 30, 2013, the Company utilized $175 million of its dedicated credit facility. The working capital deficit of $18.5 million and bank debt of $175.2 million resulted in $193.8 million of net debt (December 31, 2012 - $201.7 million). The Company strives to maintain a debt to equity level below 0.50. The debt to equity levels at June 30, 2013 and December 31, 2012 were below this level, at 0.46 and 0.43, respectively.

## NOTE 5. EXPLORATION AND EVALUATION ASSETS

| | |
|---|---|
| Balance at January 1, 2012 | $ 17,044 |
| Acquisitions | 54,305 |
| Transferred to property, plant and equipment (note 6) | (49) |
| Dispositions | (483) |
| Exploration and evaluation expense - land expiries | (5,038) |
| Balance at December 31, 2012 | $ 65,779 |
| Acquisitions and purchases | 2,048 |
| Transferred to property, plant and equipment (note 6) | (966) |
| Dispositions | (1,256) |
| Exploration and evaluation expense - land expiries | (6,595) |
| **Balance at June 30, 2013** | **$ 59,010** |

Exploration and evaluation ("E&E") assets consist of the Company's land and exploration projects which are pending the determination of technical feasibility and commercial viability. In the six month period ended June 30, 2013, expense of $6.6 million was recognized ($2.2 million – June 30, 2012) for current and future land expiries for which management has neither budgeted nor planned further exploration.

During the six months ended June 30, 2013, Twin Butte completed the sale of several non-core E&E assets in Alberta for net proceeds of $3.5 million ($nil – June 30, 2012). A $3.2 million gain was recognized on these transactions.

## NOTE 6. PROPERTY AND EQUIPMENT

| Cost: | Oil & gas properties | Office equipment | Total |
|---|---|---|---|
| Balance at December 31, 2011 | $ 387,109 | $ 219 | $ 387,328 |
| Additions | 93,455 | – | 93,455 |
| Acquisitions | 406,000 | – | 406,000 |
| Changes in decommissioning provision | 13,737 | – | 13,737 |
| Transfers from E&E assets (note 5) | 49 | – | 49 |
| Disposals | (8,015) | – | (8,015) |
| Balance at December 31, 2012 | $ 892,335 | $ 219 | $ 892,554 |
| Additions | 40,480 | – | 40,480 |
| Acquisitions | – | – | – |
| Changes in decommissioning provision | 8,623 | – | 8,623 |
| Transfers from E&E assets (note 5) | 966 | – | 966 |
| Disposals | (17,935) | – | (17,935) |
| **Balance at June 30, 2013** | **$ 924,469** | **$ 219** | **$ 924,688** |
| **Accumulated depletion, depreciation and impairment losses:** | | | |
| Balance at December 31, 2011 | $ 110,630 | $ 219 | $ 110,849 |
| Depletion and depreciation expense | 99,471 | – | 99,471 |
| Impairment expense | 17,237 | – | 17,237 |
| Disposals | (4,331) | – | (4,331) |
| Balance at December 31, 2012 | $ 223,007 | $ 219 | $ 223,226 |
| Depletion and depreciation expense | 60,974 | – | 60,974 |
| Impairment expense | – | – | – |
| Disposals | (7,114) | – | (7,114) |
| **Balance at June 30, 2013** | **$ 276,867** | **$ 219** | **$ 277,086** |
| **Net Carrying Value:** | | | |
| December 31, 2012 | 669,328 | – | 669,328 |
| **June 30, 2013** | **647,602** | **–** | **647,602** |

There were no indicators of PP&E impairment as of June 30, 2013. The Company capitalized $1.8 million of general and administrative expenses ($1.6 million – June 30, 2012) and $0.6 million of share based compensation expenses ($1.2 million – June 30, 2012) directly related to development and production activities for the six months ended June 30, 2013.

Future development costs on proved plus probable undeveloped reserves of $264.3 million as at June 30, 2013 are included in the calculation of depletion ($200.0 million – June 30, 2012).

During the three months ended June 30, 2013, Twin Butte completed the sale of a non-core property for net proceeds of $3.3 million ($0.4 million – June 30, 2012). A $ 7.5 million loss was recognized on this transaction ($nil – June 30, 2012).

During the six months ended June 30, 2013, Twin Butte completed the sale of non-core properties for net proceeds of $3.8 million ($6.4 million – June 30, 2012). A $6.8 million loss was recognized on these transactions ($3.0 million gain – June 30, 2012).

## NOTE 7. BANK INDEBTEDNESS

At June 30, 2013, the Company's dedicated bank facility consists of a revolving line of credit of $255 million and an operating line of credit of $25 million, extendible annually at the request of the Company for a further 364 days, subject to approval of the lenders and repayable one year after the expiry of the revolving period. The credit facility is with a syndicate of four Canadian chartered or international banks and provides that advances may be made by way of Canadian prime rate and U.S. base rate loans, bankers' acceptances, LIBOR Loans, or standby letters of credit/ guarantees. The annual credit facility review was completed in May 2013, with the current revolving period scheduled for expiry on April 29, 2014.

Interest rates are based on the Bank of Canada prime rate, plus 1% to 2.5% as determined by a pricing grid using the Company's debt to earnings before interest, taxes, depreciation, and amortization (EBITDA) ratio for the preceding four quarters. The bank currently charges prime plus 1.25%. The effective rate for three months ended June 30, 2013 was 4.0% (3.5% – March 31, 2012), after normalizing for the $280,000 annual renewal fee. As at June 30, 2013, the Company's facility was not in default.

## NOTE 8. DECOMMISSIONING PROVISION

Decommissioning obligations are based on the Company's net ownership in wells and facilities, and management's best estimate of future costs to abandon and reclaim those wells and facilities as well as an estimate of the future timing of the costs to be incurred.

The Company has estimated the present value of its total decommissioning provision to be $96.5 million at June 30, 2013 ($89.0 million – December 31, 2012), based on a total future liability of $142.6 million ($127.7 million – December 31, 2012). Payments to settle the obligations occur over the operating lives of the underlying assets and are estimated to be from 2 to 50 years, with the majority of costs to be incurred after 2025. A risk free rate of 2.5% and an inflation rate of 2% (2.5% and 2% – December 31, 2012) were used to calculate the present value of the decommissioning provision.

Changes to the decommissioning provision are as follows:

| | **Period ended June 30, 2013** | Year ended Dec 31, 2012 |
|---|---|---|
| Decommissioning provision, beginning of period | **88,991** | 38,401 |
| Liabilities incurred | **1,755** | 3,195 |
| Liabilities settled | **(1,244)** | (1,140) |
| Liabilities acquired from acquisitions | **41** | 36,748 |
| Liabilities reduced from dispositions | **(1,071)** | (378) |
| Effect of change in risk free rate (1) | **–** | 16,187 |
| Revisions in estimated cash outflows | **6,827** | (5,645) |
| Accretion of decommissioning provision | **1,153** | 1,623 |
| Decommissioning provision, end of period | **96,452** | 88,991 |

(1) For 2012, these amounts relate to the revaluation of acquired decommissioning liabilities at the end of the period using a risk-free discount rate. At the date of acquisition, acquired decommissioning liabilities are valued using a credit adjusted risk-free discount rate.

## NOTE 9. SHAREHOLDERS' EQUITY

### Authorized

The Company has authorized an unlimited number of voting Common Shares and an unlimited number of Preferred Shares without nominal or par value.

| | Number of common shares *(000's)* | Share capital $ |
|---|---|---|
| Balance at December 31, 2011 | 135,419 | 227,520 |
| Common shares issued pursuant to corporate acquisitions | 108,915 | 287,737 |
| Common shares issued under share award plan | 3,271 | 6,052 |
| Common shares issued under option plan | 102 | 241 |
| Common shares issued pursuant to the DRIP | 636 | 1,676 |
| Other | -31 | – |
| Balance at December 31, 2012 | 248,312 | 523,226 |
| Common shares issued under share award plan | 1,299 | 2,968 |
| Common shares issued pursuant to the DRIP and SDP | 1,305 | 2,863 |
| **Balance at June 30, 2013** | **250,916** | **529,057** |

During the six months ended June 30, 2013, 1,299,490 share awards and nil options were exercised by employees, resulting in the granting of 1,299,490 shares.

The total number of shares reserved for Share-based payments is 25,091,600 (24,831,200 – December 31, 2012). As at June 30, 2013 there were 4,521,077 common share awards, including reinvested dividends (4,199,716 – December 31, 2012) and 887,101 (895,434 – December 31, 2012) options outstanding under the plans or a total of 2% of outstanding shares.

Dividends declared during the six months ended June 30, 2013 totaled $24.6 million ($17.3 million – June 30, 2012), equivalent to $0.10 per weighted-average share ($0.09 per weighted average share – June 30, 2012). Of these dividends declared, $2.6 million were reinvested in shares through the dividend reinvestment program ("DRIP"), and $0.1 million were declared through the Stock Dividend Program ("SDP"). Initiated in May 2013, the SDP allows shareholders to choose to receive dividends in the form of shares of Twin Butte at a 5% discount to the current weighted average price in lieu of a cash dividend.

### Share-based payments

#### (a) Share award plan

Share awards may be granted to employees, officers, directors and service providers, and the Board has reserved up to 10% of outstanding Common Shares less outstanding options for issuance to eligible participants. A portion of share awards are granted with a performance factor feature, where upon vesting, the value of the share award is multiplied by a factor between 0 and 2. Annual performance factors are set by the board of directors and dependent on the performance of the Company relative to pre-defined corporate performance measures for the period. All share awards are managed under the Share Award Incentive Plan and have a maximum term of 5 years and vest in equal one-third increments on each anniversary of the grant. Share awards are measured at fair value at the date of grant determined in reference to the Company's share price on grant date, and the resulting share-based payment expense is recognized on a graded-vesting basis over the related vesting period.

The following table sets forth a reconciliation of outstanding share awards and related dividend and performance factor activity through June 30, 2013:

| | Restricted share awards | Weighted average fair value at grant date | Performance share awards | Weighted average fair value at grant date |
|---|---|---|---|---|
| Outstanding at January 1, 2012 | – | $ – | – | $ – |
| Converted from options | 4,638,938 | 1.27 | – | – |
| Granted | 1,603,529 | 2.53 | 1,224,734 | 2.54 |
| Granted – Performance factor | – | – | 429,754 | 2.54 |
| Reinvested dividends | 199,931 | 1.96 | 63,271 | 2.50 |
| Vested and converted to common shares | (3,534,870) | 1.16 | – | – |
| Forfeited | (425,571) | 2.41 | – | – |
| Outstanding at December 31, 2012 | 2,481,957 | $ 2.17 | 1,717,759 | $ 2.54 |
| Granted | 1,182,088 | 2.53 | 532,335 | 2.53 |
| Reinvested dividends | 125,517 | 2.31 | 67,809 | 2.56 |
| Vested and converted to common shares | (747,301) | 1.83 | (552,197) | 2.48 |
| Forfeited | (171,546) | 2.57 | (115,344) | 2.64 |
| **Outstanding at June 30, 2013** | **2,870,715** | **$ 2.40** | **1,650,362** | **$ 2.53** |

Twin Butte recorded share-based payment expense of $1.2 million for the three months ended June 30, 2013 (June 30, 2012 – $1.1 million). Share-based payment expense for the six months ended June 30, 2013 was $2.6 million (June 30, 2012 – $1.9 million).

A 15% forfeiture rate were used to estimate the Company's share-based payment expense for the three months ended June 30, 2013 (June 30, 2012 – 35%).

### (b) Stock option plan

Following the initiation of the Share Award Plan in January 2012, there have been no further stock options granted and remaining outstanding options will be either exercised or forfeited. Stock options have a maximum term of five years and vest in equal one-third increments on each anniversary of the grant. Stock options were measured at fair value on the date of the grant using a Black-Scholes option pricing model, and the resulting share-based payment expense is recognized on a graded-vesting basis over the related vesting period.

As at December 31, 2012, there were 895,434 options outstanding at a weighted average exercise price of $2.65. In the three and six months ended June 30, 2013, no stock options were granted or exercised, and 8,333 stock options were forfeited at a weighted average exercised price of $2.40. As at June 30, 2013 there were 887,434 options outstanding at a weighted average exercise price of $2.65. There were 490,901 options exercisable as at June 30, 2013 (242,033 – June 30, 2012) at an average exercise price of $2.63 per share ($2.44 – June 30, 2012). The following table outlines the weighted average exercise price and weighted average years to expiry of all outstanding options:

| | **June 30, 2013** | | | December 31, 2012 | | |
|---|---|---|---|---|---|---|
| Exercise Price | **Number of Options Outstanding** | **Weighted Average Exercise Price $** | **Weighted Average Years to Expiry** | Number of Options Outstanding | Weighted Average Exercise Price $ | Weighted Average Years to Expiry |
| $0.92 – 1.24 | **10,000** | **0.98** | **1.40** | 10,000 | 0.98 | 1.89 |
| $1.25 – 1.51 | **11,667** | **1.31** | **1.76** | 11,667 | 1.31 | 2.26 |
| $1.52 – 3.32 | **865,434** | **2.68** | **2.90** | 873,767 | 2.68 | 3.39 |
| | **887,101** | **2.65** | **3.12** | 895,434 | 2.65 | 3.36 |

### Net Income (loss) Per Share

The following table sets forth the details of the computation of basic and diluted net income per share:

| | Three months ended June 30 | | Six months ended June 30 | |
|---|---|---|---|---|
| | **2013** | 2012 | **2013** | 2012 |
| Net income (loss) for the period | **$ (6,082)** | $ 29,340 | **$ (35,715)** | $ 44,323 |
| Weighted average number of basic shares *(000's)* | **250,422** | 192,023 | **249,870** | 188,881 |
| Effect of dilutive securities: | | | | |
| Stock options and share awards *(000's)* | **–** | 1,143 | **–** | 1,447 |
| Weighted average number of diluted shares *(000's)* | **250,422** | 193,166 | **249,870** | 190,328 |
| Net income (loss) per share basic ($) | **(0.02)** | 0.15 | **(0.14)** | 0.23 |
| Net income (loss) per share diluted ($) | **(0.02)** | 0.15 | **(0.14)** | 0.23 |

Diluted income per share amounts reflect the potential dilution that could occur if stock options were exercised and share awards were converted. The treasury stock method is used to determine the dilutive effect, whereby any proceeds from the exercise and the amount of compensation expense, if any, attributed to future services not yet recognized, are assumed to be used to purchase common share at the average market price during the periods.

Due to the net loss for the period, share awards and stock options have been excluded from the calculation of diluted net income (loss) for the period, as the impact would have been anti-dilutive. In the three and six months ended June 30, 2013 and 2012, outstanding stock options and share awards were the only potentially dilutive instruments.

## NOTE 10. GENERAL & ADMINISTRATION ("G&A") EXPENSE

| | Three months ended June 30 | | Six months ended June 30 | |
|---|---|---|---|---|
| | **2013** | 2012 | **2013** | 2012 |
| Staff salaries and benefits | **$ 2,901** | $ 1,891 | **$ 6,053** | $ 4,041 |
| Rent and insurance | **195** | 352 | **491** | 741 |
| Office and other costs | **1,657** | 999 | **3,242** | 2,378 |
| Capitalized G&A | **(888)** | (766) | **(1,762)** | (1,564) |
| Capitalized overhead recoveries | **(724)** | (452) | **(1,452)** | (1,129) |
| | **$ 3,141** | $ 2,024 | **$ 6,572** | $ 4,467 |

## NOTE 11. FINANCE EXPENSE

| | Three months ended June 30 | | Six months ended June 30 | |
|---|---|---|---|---|
| | **2013** | 2012 | **2013** | 2012 |
| Accretion on decommissioning provision | **$ 598** | $ 443 | **$ 1,153** | $ 682 |
| Interest and bank charges | **2,096** | 1,356 | **3,647** | 2,712 |
| Total | **$ 2,694** | $ 1,799 | **$ 4,800** | $ 3,394 |

## NOTE 12. SUPPLEMENTAL CASH FLOW INFORMATION

| | Three months ended June 30 | | Six months ended June 30 | |
|---|---|---|---|---|
| | **2013** | 2012 | **2013** | 2012 |
| Changes in non-cash working capital: | | | | |
| Accounts receivable | **$ (541)** | $ 963 | **$ 1,468** | $ 7,143 |
| Deposits and prepaid expenses | **(490)** | 407 | **(1,998)** | (628) |
| Accounts payable and accrued liabilities | **7,649** | (950) | **965** | (909) |
| Dividends Payable | **18** | 12 | **665** | 2,875 |
| | **$ 6,636** | $ 432 | **$ 1,100** | $ 8,481 |
| Changes in non-cash working capital relating to: | | | | |
| Operating activities | **$ 8,404** | $ (2,057) | **$ 5,087** | $ 61 |
| Financing activities | **18** | 12 | **665** | 2,887 |
| Investing activities | **(1,786)** | 2,477 | **(4,652)** | 5,533 |
| | **$ 6,636** | $ 432 | **$ 1,100** | $ 8,481 |

## NOTE 13. RELATED PARTY TRANSACTIONS

During the three month period ended June 30, 2013, the Company incurred costs totaling $1.0 million ($1.1 million – June 30, 2012) for oilfield services and legal counsel rendered by three companies of which an officer and director of Twin Butte is a director. During the six month period ended June 30, 2013, the Company incurred related party costs totaling $3.1 million ($3.4 million – June 30, 2012).

These costs were incurred in the normal course of business and were recorded at the amount exchanged between the parties. As at June 30, 2013, the Company had $0.7 million ($4.3 million – December 31, 2012) included in accounts payable and accrued liabilities related to these transactions.

## NOTE 14. COMMITMENTS AND CONTINGENCIES

Contractual obligations and commitments for base office rent and equipment are as follows:

| *($ thousands)* | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | thereafter |
|---|---|---|---|---|---|---|---|
| | 555 | 1,182 | 1,173 | 1,175 | 1,196 | 498 | – |

## NOTE 15. SUBSEQUENT EVENTS

### Crude Oil Sales Price Derivative Contracts

Subsequent to June 30, 2013 the Company entered into several crude oil price derivatives. The average barrels and prices for these contracts are as follows:

| Daily barrel (bbl) quantity | Term of contract | WTI [1] Fixed price per bbl ($CAD) |
|---|---|---|
| 500 | January 1, 2014 to June 30, 2014 | $ 98.60 |
| 2,250 | July 1, 2014 to September 30, 2014 | $ 97.68 |
| 1,500 | October 1, 2014 to December 31, 2014 | $ 96.10 |

(1) WTI represents posting price of West Texas Intermediate oil

# CORPORATE INFORMATION

## OFFICERS

Jim Saunders
*President & Chief Executive Officer*

Bob Bowman
*Vice President, Operations*

Neil Cathcart
*Vice President, Business Development*

Claude Gamache
*Vice President, Geosciences*

Bruce W. Hall
*Chief Operating Officer*

Gordon Howe
*Vice President, Land*

Preston Kraft
*Vice President, Engineering*

R. Alan Steele
*Vice President, Finance & CFO*

## BOARD OF DIRECTORS

David Fitzpatrick (1) (3)
*Chairman of the Board*

Jim Brown (1) (3)

John Brussa (3)

Tom Greschner (2)

Jim Saunders

Warren Steckley (1) (2)

William A. (Bill) Trickett (2)

Member of:

(1) Audit Committee
(2) Reserves Committee
(3) Compensation, Nominating and Governance Committee

## HEAD OFFICE

Twin Butte Energy Ltd.
410, 396 - 11 Ave. SW
Calgary AB T2R 0C5
Phone: 403-215-2045
Fax: 403-215-2055
www.twinbutteenergy.com

## AUDITORS

PricewaterhouseCoopers LLP
Chartered Accountants
Calgary, AB

## BANKERS

National Bank of Canada
Calgary, AB

## SOLICITORS

Burnet, Duckworth & Palmer LLP
Calgary, AB

## ENGINEERS

McDaniel & Associates Consultants Ltd.
Calgary, AB

## REGISTRAR & TRANSFER AGENT

Valiant Trust Company
Calgary, AB

## STOCK EXCHANGE LISTING

TSX
Trading Symbol "TBE"

TWIN BUTTE
ENERGY LTD.