



**MANAGEMENT'S DISCUSSION AND ANALYSIS**

FOR THE THREE AND SIX MONTHS ENDED  
JUNE 30, 2011

# Alberta Oilsands Inc.

## Management's Discussion and Analysis

### June 30, 2011

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This management's discussion and analysis (the "MD&A") dated August 23, 2011 of Alberta Oilsands Inc. ("Alberta Oilsands", "AOS" or the "Company") is reported in Canadian dollars and should be read in conjunction with the unaudited interim financial statements of the Company as at and for the three and six months ended June 30, 2011 and the Canadian GAAP audited financial statements and management's discussion and analysis of AOS for the years ended December 31, 2010 and 2009 together with the accompanying notes.

Additional information relating to Alberta Oilsands including management's discussion and analysis ("MD&A") of financial condition and results of operations and annual information form for the prior year and its vision, strategies and operations, is available on SEDAR at [www.sedar.com](http://www.sedar.com) and on the Company's website at [www.aboilsands.ca](http://www.aboilsands.ca).

The financial data included in this MD&A is in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB") and interpretations of the International Financial Reporting Interpretations Committee ("IFRIC") that are expected to be effective or available for early adoption by the Company as at December 31, 2011, the date of the Company's first annual reporting under IFRS. The effective date of the transition to IFRS was January 1, 2010. The transition to IFRS has been reflected by restating previously reported financial statements for 2010. Previously, the Company's financial statements were prepared under Canadian generally accepted accounting principles ("GAAP"). The adoption of IFRS does not impact the underlying economics of the Company's operations or its cash flows. Note 16 to the interim financial statements contains a detailed description of the Company's adoption of IFRS, including a reconciliation of the financial statements previously prepared under GAAP to those under IFRS.

**BOE Presentation** – Production information is commonly reported in units of barrels of oil equivalent ("boe"). For purposes of computing such units, natural gas is converted to equivalent barrels of oil using a conversion factor of six thousand cubic feet ("mcf") to one barrel of oil ("bbl"). This conversion ratio of 6:1 is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead. Such disclosure of boe may be misleading, particularly if used in isolation. Readers should be aware that historical results are not necessarily indicative of future performance.

**Special Note Regarding Non-IFRS and Non-GAAP Measures** – This MD&A includes references to certain financial measures, as described below, which do not have standardized meanings prescribed by either GAAP or IFRS, however, as these measures are commonly used in the oil and gas industry, the Company believes that their inclusion is useful to investors and they are measures that the Company uses to evaluate its performance. Investors are cautioned that these non-GAAP and non-IFRS measures should not be construed as an alternative to the measures calculated in accordance with IFRS or GAAP as, given their non-standardized meanings; they are unlikely to be comparable to similar measures presented by other issuers. The term "field netback" is defined as petroleum and natural gas sales less royalties and less production and transportation costs. The term "funds from (used in) operations", defined as the cash flow from operating activities, before the change in non-cash working capital and abandonment expenditures, should not be considered an alternative to, or more meaningful than, cash flow from operating activities or net income (loss) as determined in accordance with IFRS as an indicator of performance. The Company's determination of funds from operations may not be comparable to that reported by other companies. See the reconciliation of cash flow per IFRS to funds from (used in) operations on page 9 of this MD&A.

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**Forward-looking Statements and Information** – Certain information regarding Alberta Oilsands set forth in this report, including management's assessment of Alberta Oilsands' future plans, operations, properties, production and prospects contains forward-looking information and statements that involve substantial known and unknown risks and uncertainties. In some cases, forward-looking information and statements can be identified by terminology such as "may", "will", "should", "intends", "expects", "projects", "plans", "anticipates", "targets", "believes", "strives", "estimates", "continues", "designed", "objective", "maintain", "schedule" and similar expressions or statements that certain events or conditions "may" or "will" occur. In particular, this MD&A contains forward-looking statements and information with respect to: (i) possible *in-situ* development (including the timing of such development) on the Company's oil sands properties, including in respect of pilot projects and further development in respect of its Clearwater project area and the joint development of its Hangingstone East/Halfway Creek project area with its pooling partner; (ii) expectations regarding future development costs and the ability to fund such costs; (iii) future values that may be attributable to the Company's oil and gas properties; (iv) the ability of the current working capital levels of the Company to maintain future capital expenditures, including required flow-through expenditures; (v) the Company's projected capital budget; (vi) successful results from the Company's core drilling programs; (vii) crude oil, natural gas and bitumen production levels; (viii) the continued economic viability of the Company's projects; (ix) a regulatory regime and local community environment that will be conducive to the Company completing its projects (including environmental regulation and royalty rates); (x) the ability of the Company to meet its obligations (including future financial obligations) under the pooling agreement that it has entered into in respect of its Hangingstone East/Halfway Creek project area; (xi) projections of market prices and costs and the demand for the commodities the Company produces or intends to produce; and (xii) expectations regarding capital expenditures and exploration activities and the timing and funding in respect thereof. Such forward-looking statements and information are based on the opinions, assumptions and estimates of management at the date the statements are made, and are subject to a variety of risks and uncertainties and other factors that could cause actual events or results to differ materially from those projected in the forward-looking statements and information. Certain of these assumptions and risks are discussed in greater detail below and throughout this MD&A. The Company undertakes no obligation to update such forward-looking statements or information if circumstances or management's estimates or opinions should change, unless required by law.

With respect to forward-looking statements and information contained in this MD&A, the Company has made assumptions regarding, among other things: (i) future prices for crude oil, natural gas, bitumen and refined products and that the demand for such products will continue to increase globally, especially in emerging markets; (ii) future currency and interest rates; (iii) future economic conditions; (iv) the Company's ability to generate sufficient cash flow from operations and access capital markets or strategic partners to meet its future obligations and to fund future projects; (v) the Company's ability to obtain required regulatory approvals in respect of its properties and proposed projects in a timely fashion; (vi) a continued favourable legal and regulatory framework and local community environment representing royalties, taxes and environmental matters where the Company conducts its business; and (vii) the Company's ability to obtain qualified staff and equipment in a timely and cost-efficient manner. In addition, the Company has made certain other assumptions in respect of the timing and feasibility of certain of its oil sands projects; see "Oil sands Risks" in this MD&A.

Some of the risks that could affect the Company's future results and could cause results to differ materially from those expressed in the Company's forward-looking statements and information include:

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(i) the need to obtain required approvals and permits from regulatory authorities, including in respect of the Company's Clearwater Phase I Project Application (the "Clearwater Phase I Project Application") submitted on January 15, 2010 and the update (the "Clearwater Phase I Project Update") to the Clearwater Phase I Project Application submitted on December 22, 2010; (ii) the impact of competition; (iii) compliance with and liabilities under environmental laws and regulations; (iv) the uncertainties of estimates by the Company's independent consultants with respect to the Company's reserves and resources; (v) the volatility of prices for crude oil, natural gas, bitumen and refined product prices; (vi) general economic conditions in Canada and globally; (vii) changes to royalty regimes and government regulations regarding royalty payments; (viii) risks associated with exploring for, developing, producing, processing, storing and transporting crude oil, bitumen and natural gas; (ix) geological, technical, drilling and processing problems; (x) the Company's ability to hire and retain qualified staff with the skills necessary to continue development of the Company's projects; (xi) imprecision in estimating capital expenditures and operating expenses; (xii) imprecision in estimating the timing, costs and levels of production and drilling; (xiii) imprecision in estimates of future production capacity; (xiv) potential delays or changes in plans with respect to exploration and development projects or capital expenditures; (xv) changes to regulations and legislation applicable to the Company and the interpretation thereof including tax and environmental legislation and regulations in the jurisdictions in which the Company conducts its business; (xvi) the inability of the Company to obtain financing for its potential oil sands projects from capital markets, strategic joint venture partners or other sources on competitive terms, or at all; (xvii) unavailability of required equipment and services; (xviii) risks associated with the construction of the Company's projects, including labour and material shortages and incidents such as fires, blowouts, explosions, cratering, sour gas leaks and spills; and (xix) the other factors discussed under "Oil sands Development Risks" and "Business Risks and Uncertainties" in this MD&A.

Readers should be aware that historical results are not necessarily indicative of future performance. No assurance can be given that any events anticipated by the forward looking statements or information will transpire or occur, or if any of them do, what benefits Alberta Oilsands may derive therefrom.

Statements relating to "reserves" and "resources" are deemed to be forward-looking statements, as they involve the implied assessment, based on certain estimates and assumptions, that the described reserves or resources exist in the quantities predicted or estimated, and can be profitably produced in the future. There is no certainty that it will be commercially viable to produce any portion of the reserves or resources described in this MD&A. Additional information regarding the disclosure of reserves and resources and the assumptions relating to the reserves and resources of the Company are discussed under "Disclosure of Reserves and Resources" in this MD&A.

### **Basis of Presentation**

Alberta Oilsands Inc. is incorporated under the *Business Corporations Act* (Alberta) and is listed on the TSX Venture Exchange (the "TSXV"). The Company is involved in the production, exploration and development of resource properties. Prior to September 2010, the financial statements consolidated the accounts of the Company, its wholly-owned subsidiary, Platform Resources Inc. ("Platform"), and Platform's subsidiary Platform Resources (Kenya) Limited after the elimination of all inter-company transactions and balances. On September 9, 2010, Alberta Oilsands and Platform amalgamated.

The financial statements of the Company as at and for the three and six months ended June 30, 2011 have been prepared on a going concern basis which contemplates the realization of assets and the payment of liabilities in the ordinary course of business. Property and equipment is recognized in these

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financial statements in accordance with IFRS and the accounting policies outlined in note 3 of the unaudited interim financial statements as at and for the three months ended March 31, 2011. Accordingly, their carrying values represent costs incurred to date, net of write-downs, and do not necessarily reflect present or future values. The ability of the Company to continue as a going concern and the recoverability of amounts shown for the properties is dependent upon the existence of economically recoverable reserves and upon the Company's ability to obtain additional financing to continue the development of the Company's properties and generate funds therefrom and to meet current and future obligations. The financial statements do not reflect adjustments in the carrying values of the assets and liabilities, expenses and the balance sheet classifications that would be used if the going concern assumption were not appropriate. Such adjustments could be material.

### **Overview**

AOS is focused on the exploration and development of bitumen in the Athabasca oil sands trend of northeast Alberta. The Company's head office is in Calgary, Alberta, Canada and its common shares (the "Common Shares") trade on the TSXV under the symbol "AOS".

The Company's efforts during the second quarter of 2011 were focused on a number of areas in the Athabasca oil sands trend. The primary focus was the advancement of the Clearwater Phase I Project.

### **Highlights for the second quarter of 2011 include the following:**

- The 2010-2011 winter exploration activity at Clearwater consisted of 26 core holes, 6.7 kilometres of 2D and 1.3 square kilometres of 3D seismic surveys. The objectives of the Clearwater program were to prepare for the execution of Clearwater Phase I development and production activities and to collect the technical data required to prepare an application for the second phase of the development.
- The Company sold almost all of the remaining common shares of its equity investment in Africa Oil Corp for net cash proceeds of \$1.7 million in the second quarter for a total of \$5.6 million to date.
- On April 13, 2011, the Energy Resources Conservation Board ("ERCB") issued a first round of Supplemental Information Requests ("SIR") to AOS on the Clearwater Phase I Project Application. AOS submitted the responses to the SIR on August 4, 2011.
- On July 15, 2011, the Company completed a prospectus offering of 16,666,600 Common Shares at a price of \$0.30 per share for gross proceeds of approximately \$5.0 million.

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### Review of Operations

#### Oil Sands - Clearwater

AOS continued to take steps on the path to production at its first oil sands project at Clearwater. The Clearwater Solvent Low Pressure Steam Assisted Gravity Drainage (SLP-SAGD) Pilot Application, filed on January 15, 2010 with the ERCB, is for a Phase I Project that has a design production capacity of 4,500 barrels ("bbls") per day of bitumen through six horizontal SAGD well pairs. Subject to both regulatory approval and obtaining project financing, AOS expects to begin construction of the well pad and drilling of the horizontal well pairs soon thereafter. Phase II of the Clearwater project is planned for production capacity of 15,000 to 25,000 bbls per day of bitumen.

A delineation program for the new leases that enjoin the Clearwater East and West Project area was commenced in the fourth quarter of 2010. The full winter program comprised 24 core holes, 2 service wells and 2D and 3D seismic programs for Clearwater Phase I development. The Clearwater Phase I Project area is now delineated by a total of 25 core holes over 2 sections resulting in an average density of 12.5 wells per section. The seismic programs acquired 6.7 kilometres of 2D and 1.3 square kilometres of 3D data.

In December 2010, AOS filed an application update with the ERCB for a revised SLP-SAGD project at Clearwater. The objective of the update was to maximize bitumen recovery efficiency. The update comprised four main changes to the original application filed in January 2010.

1. The project horizontal SLP-SAGD well pairs were re-oriented from an east-to-west bearing to a direction along the south-to-north estuarine channel identified inside the Middle McMurray Formation.
2. The SLP SAGD well pairs were reconfigured:
  - a) The horizontal wellbore length was reduced from 800 to 600 metres
  - b) The spacing between well pairs was reduced from 100 metres to 75 metres
3. The well pairs will be placed at the bottom of the estuarine channel, approximately 15 metres above the Devonian base rock. The central processing facilities were re-located to the southeast Sec 21- T88 R8W4M to follow the wellheads in order to minimize surface footprint.
4. AOS requested a maximum operating pressure of 1,000 kPag (145 psig) supported by extensive geo-mechanical and reservoir simulation modeling.

The revised project and well pair reconfiguration for Clearwater Phase I is designed to optimize recovery efficiency, but did lead to a reduction in effective drainage volume as compared to the original application. The reduced volume translates to a reduced year-end probable and possible reserves assignment to the Phase I project area. The Revised Report assigned 12 MMbbls of probable reserves and 32 MMbbls of possible reserves with a total value of \$49.9 million (NPV<sub>10</sub>) for both the probable and possible reserves to Clearwater Phase I. The previous Ryder Scott report effective March 31, 2010, (which has been superseded as it applied to volumes from a different drainage area), assigned 16.3 MMbbls of gross lease probable and 51.3 MMbbls of gross lease possible reserves. A portion of the reduction in the reserves volume has been reclassified into the contingent resources category.

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On April 13, 2011, the ERCB issued a first round of SIR to AOS on the Clearwater Phase I Project Application. AOS submitted the responses to the SIR on August 4, 2011.

#### **Oil Sands - Hangingstone**

The contingencies which currently prevent the classification of the resource as reserves are the required core density, the estimates of capital costs required to render production economic, applicable regulatory considerations, pricing, specific supply costs, technological considerations, and/or other relevant factors.

The Company and its 50% joint venture partner have engaged a third party advisor to coordinate marketing our 100% working interest in the Hangingstone/Halfway Creek area. Proceeds of the sale would help fund the Company's core focus area, the Clearwater Phase I Project.

#### **Conventional Operations**

AOS produced an average of 85 boe/d in the second quarter of 2011, comprising 221 mcf/d of natural gas from Ladyfern and 32 boe/d from Ferrier with the balance from minor properties. This compares to 161 boe/d in the second quarter of 2010 and 98 boe/d in the first quarter of 2011. The Company has not added any conventional production since the Ladyfern well went on production in April 2009. For the quarter ended June 30, 2011, this well produced an average of 41 boe/d net to AOS versus 110 boe/d in the comparative 2010 quarter and 55 boe/d in the first quarter of 2011.

The unusually high operating expense at the Leduc property for the first quarter of 2011 was due primarily to repair costs of \$241,100 for a pipeline leak in the Leduc property which included soil remediation. The remediation has been completed and an insurance claim will be prepared which is expected to offset some of this expenditure.

AOS has petroleum and natural gas rights to 38,913 hectares of undeveloped lands in Alberta and British Columbia.

The cash flow from AOS' conventional operations will continue to be used to help meet the Company's funding needs. AOS is seeking opportunities to rationalize its conventional portfolio to maximize value from these assets and to focus its efforts in the oil sands.

#### **International Operations**

The sale and assignment of AOS' Kenyan assets to Africa Oil Corp. was for consideration of 2.5 million Africa Oil common shares and 1.5 million Africa Oil warrants, each of which was exercisable into one common share of Africa Oil at a price of \$1.50 per share. By the end of June 2011, the Company had sold virtually all of the 2.5 million Africa Oil common shares and exercised the 1.5 million warrants then sold the resulting shares. Net proceeds of approximately \$5.6 million was realized from the sale.

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**Financial and Operating Summary**

	Three months ended June 30		
	2011	2010	2009 <sup>(1)</sup>
<b>Statement of Operations and Deficit</b>			
Petroleum and natural gas sales (\$)	<b>492,487</b>	622,100	997,514
Petroleum and natural gas sales per boe (\$)	<b>63.50</b>	42.37	33.76
Daily sales volumes (boe 6:1)	<b>85</b>	161	325
Net loss for the period (\$)	<b>(1,390,263)</b>	(922,880)	(921,812)
Net loss per share – basic and diluted (\$)	<b>(0.01)</b>	(0.01)	(0.01)
<b>Statement of Cash Flows</b>			
Funds used in operations (\$) <sup>(1)</sup>	<b>(595,517)</b>	(750,452)	(34,242)
Cash flow used in operations (\$)	<b>(378,480)</b>	(700,101)	(811,087)
Capital expenditures (\$)	<b>3,712,859</b>	913,715	607,301
<b>Weighted average number of shares</b>			
<b>basic and diluted</b>	<b>138,950,457</b>	105,296,330	79,651,375

	Six months ended June 30		
	2011	2010	2009 <sup>(1)</sup>
<b>Statement of Operations and Deficit</b>			
Petroleum and natural gas sales (\$)	<b>947,027</b>	1,437,643	1,259,541
Petroleum & natural gas sales per boe (\$)	<b>57.19</b>	44.46	35.97
Daily sales volumes (boe 6:1)	<b>91</b>	179	193
Net loss for the period (\$)	<b>(2,524,573)</b>	(4,286,825)	(2,138,382)
Net loss per share – basic and diluted (\$)	<b>(0.02)</b>	(0.04)	(0.03)
<b>Statement of Cash Flows</b>			
Funds used in operations (\$) <sup>(1)</sup>	<b>(1,360,383)</b>	(1,127,572)	(1,144,558)
Cash flow used in operations (\$) <sup>(2)</sup>	<b>(1,203,882)</b>	(1,244,152)	(1,447,915)
Capital expenditures (\$)	<b>15,382,667</b>	5,331,685	7,781,089
<b>Total assets (\$)</b>	<b>70,496,160</b>	54,748,038	51,100,787
<b>Total liabilities (\$)</b>	<b>12,304,931</b>	8,006,953	7,577,791
<b>Shareholders' equity (\$)</b>	<b>58,191,229</b>	46,741,085	43,522,996
<b>Weighted average number of shares</b>			
<b>- basic and diluted</b>	<b>130,099,905</b>	105,277,780	79,651,375

(1) The quarterly results for 2009 have not been adjusted and reflect the results in accordance with GAAP.

(2) AOS' method of calculating funds from operations may differ from that of other corporations and, accordingly, may not be comparable to measures used by other corporations. AOS calculates funds from operations by taking cash flow from operating activities as determined under IFRS or GAAP before the change in non-cash working capital related to operating activities and abandonment expenditures incurred. The Company uses this method as it believes the

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uncertainty surrounding the timing of collection, payment or incurrence of these items makes them less useful in evaluating AOS' operating performance. A summary of this reconciliation is as follows:

**Reconciliation of cash flow to funds used in operations**

	Three months ended June 30		
	2011	2010	2009 <sup>(1)</sup>
Cash flow used in operating activities (\$)	<b>(378,480)</b>	(700,101)	(811,087)
Change in non-cash working capital (\$)	<b>(217,037)</b>	(50,351)	776,845
Funds used in operations (\$)	<b>(595,517)</b>	(750,452)	(34,242)

**Reconciliation of cash flow to funds used in operations**

	Six months ended June 30		
	2011	2010	2009 <sup>(1)</sup>
Cash flow used in operating activities (\$)	<b>(1,203,882)</b>	(1,244,152)	(1,447,915)
Change in non-cash working capital (\$)	<b>(156,501)</b>	116,580	303,357
Funds used in operations (\$)	<b>(1,360,383)</b>	(1,127,572)	(1,144,558)

<b>Production</b>	Three months ended June 30		Six months ended June 30	
	2011	2010	2011	2010
Oil and NGL (bbls/day)	<b>42</b>	55	<b>43</b>	55
Natural gas (mcf/day)	<b>256</b>	638	<b>292</b>	743
boe/day (6:1)	<b>85</b>	161	<b>91</b>	179

Since the Company's focus is on its oil sands properties, there have been no additional wells added on its conventional properties. The last producing well added was the Ladyfern well in April 2009. Therefore, the Company's production continues to experience natural declines from its existing producing reserves.

	Three months ended June 30		Six months ended June 30	
	2011	2010	2011	2010
<b>Commodity prices</b>				
Oil and NGL (\$/bbl)	<b>100.67</b>	74.72	<b>92.67</b>	76.22
Natural gas (\$/mcf)	<b>4.42</b>	4.42	<b>4.35</b>	5.20
boe (\$/boe)	<b>63.50</b>	42.37	<b>57.19</b>	44.46
<b>Revenues (\$)</b>				
Oil and NGL	<b>389,294</b>	384,964	<b>716,893</b>	738,181
Natural gas	<b>103,193</b>	237,136	<b>230,134</b>	669,462
Total	<b>492,487</b>	622,100	<b>947,027</b>	1,437,643

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For the three and six months ended June 30, 2011, commodity prices increased for oil and natural gas liquids ("NGL") to \$100.67 and \$92.67 per bbl, as compared to \$74.72 and \$76.22 per bbl in the comparative periods of 2010 and \$84.67 per bbl in the first quarter of 2011. Gas prices were \$4.42 and \$4.35 per mcf for the 2011 periods versus \$4.42 and \$5.20 per mcf in the comparative periods in 2010 and \$4.29 per mcf in the first quarter of 2011.

The Company had a commodity contract for the period from November 1, 2009 to October 31, 2010. A realized loss of \$8,247 and \$19,317 was included in oil and natural revenue for the three and six months ended June 30, 2010. The contract was not renewed after October 31, 2010.

<b>Royalties and operating expenses</b>	Three months ended June 30		Six months ended June 30	
	<b>2011</b>	2010	<b>2011</b>	2010
Royalties (\$)	<b>20,622</b>	88,662	<b>90,623</b>	283,799
% of revenues	<b>4</b>	14	<b>10</b>	20
\$/boe	<b>2.66</b>	6.04	<b>5.47</b>	8.78
Production and transportation expenses (\$)	<b>234,057</b>	369,240	<b>644,006</b>	860,205
\$/boe	<b>30.18</b>	25.15	<b>38.89</b>	26.60

Royalties for the three and six months ended June 30, 2011 were 4% and 10% as compared to 16% for the first quarter of 2011 and 14% and 20% in the comparative periods in 2010. A prior year reduction in crown royalties in the amount of \$58,800 from capital cost allowance and processing adjustments primarily from the Ladyfern well was recognized in the second quarter of 2011. Excluding this adjustment, royalties would have remained consistent at 16%.

Production and transportation costs for the three and six months ended June 30, 2011 were \$234,057 (\$30.18 per boe) and \$644,006 (\$38.89 per boe) respectively as compared to \$369,240 (\$25.15 per boe) and \$860,205 (\$26.60 per boe) for the comparative periods in 2010. Operating costs continue to remain high for the Leduc property which consistently requires maintenance and repair expenditures due to the age of the equipment. There was a pipeline leak on the Leduc property which required soil remediation work to be done during the first quarter of 2011. The Company will be pursuing an insurance claim which is expected to offset some of these expenditures which totalled \$241,100 (\$27.39 per boe), however a provision for this claim has not been recorded at this time.

<b>Netbacks (\$/boe)</b>	Three months ended June 30		Six months ended June 30	
	<b>2011</b>	2010	<b>2011</b>	2010
Revenue	<b>63.50</b>	42.37	<b>57.19</b>	44.46
Royalties	<b>2.66</b>	6.04	<b>5.47</b>	8.78
Operating expenses	<b>30.18</b>	25.15	<b>38.89</b>	26.60
Field netbacks	<b>30.66</b>	11.18	<b>12.83</b>	9.08

**General and administrative expense**

General and administrative expenditures for the three and six months ended June 30, 2011 were \$855,755 and \$1,451,250 as compared to \$799,626 and \$1,285,385 in the comparative periods in 2010 and \$595,495 for the first quarter of 2011. Salaries in the amount of \$163,193 and \$291,006 related to individuals specifically involved in the oil sands properties were capitalized for the three and six months

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ended June 30, 2011. Expenditures increased in the second quarter of 2011 as a result of additional staff and related costs, preparation for IFRS, attempted disposition of conventional properties and increased legal and regulatory filing fees.

#### Share-based compensation

Share-based compensation expensed for the three and six months ended June 30, 2011 was \$90,595 and \$365,835 compared to \$62,599 and \$421,853 for the comparative periods in 2010. In addition, share based compensation that was capitalized to exploration and evaluation assets was \$55,452 and \$159,589 for the three and six months ended June 30, 2011 compared to \$13,543 and \$32,564 for the comparative periods in 2010. A total of 3,331,000 stock options were granted during the first half of 2011. Under IFRS, the calculation of share-based compensation is virtually the same as it was under GAAP, however the recognition of the expense is different. Under IFRS, the expense is recognized over the individual vesting periods for the graded vesting awards, resulting in more expense at the beginning of the recognition period, compared to GAAP where the Company recognized the expense on a straight-line basis through the date of full vesting.

#### Interest expense and financing costs

The Company paid an advisory fee of \$150,495 in the first quarter of 2011 in the pursuit of a potential financing commitment. The financing has not been completed. The balance of the interest expense relates to the accretion of the decommissioning liabilities.

#### Taxes

The deferred tax provision for the three and six months ended June 30, 2011 totaled \$303,231 and \$192,533 as compared to a reduction of \$244,551 and \$521,704 for the comparative 2010 periods. This 2011 amount was net of the deferred tax expense of \$520,499 relating to the reduction of the flow-through share premium liability.

Depletion, depreciation and impairment	Three months ended June 30		Six months ended June 30	
	2011	2010	2011	2010
Depletion and depreciation (\$)	<b>126,268</b>	246,596	<b>247,519</b>	588,584
Impairment (\$)	<b>256,792</b>	214,203	<b>325,816</b>	2,739,867
Total (\$)	<b>383,060</b>	460,799	<b>573,335</b>	3,328,451
\$/boe	<b>49.39</b>	31.38	<b>34.62</b>	102.93

Depletion and depreciation for the three and six months ended June 30, 2011 was \$126,268 and \$247,519 as compared to \$246,596 and \$588,584 for the comparative periods in 2010. Under IFRS the Company calculates depletion and depreciation on a component basis utilizing total proved plus probable reserves. Under previous GAAP, depletion was calculated using only total proved reserves applied to the full cost pool. On a going forward basis, the Company's depletion and depreciation is anticipated to be lower under IFRS than was previously reported under GAAP as a result of this change and the impairment write-downs that were taken under IFRS.

Under IFRS, the carrying value of cash generating units ("CGU's") is compared to the recoverable amount which is defined as the higher of the fair value less costs to sell or value in use (i.e. discounted

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cash flows). As a result, the Company recognized additional impairments under IFRS in the amounts of \$256,792 and \$325,816 for the three and six months ended June 30, 2011 and \$0.2 million and \$2.7 million for the three and six months ended June 30, 2010. These impairments related to the Company's conventional natural gas CGU's.

**Capital expenditures (\$)**

Capital spending is summarized as follows:

	Three months ended June 30		Six months ended June 30	
	2011	2010	2011	2010
<b>Oil sand properties</b>				
Land and lease rentals	59,458	55,874	85,890	82,306
Seismic	2,436,501	7,391	4,801,799	56,127
Drilling	793,451	420,554	9,701,943	2,371,361
Clearwater Phase I Application	251,746	218,158	573,179	599,169
Other	90,845	115,048	127,512	161,910
	<b>3,632,001</b>	817,025	<b>15,290,323</b>	3,270,873
<b>Conventional properties</b>				
Lease rentals and seismic	20,233	6,944	29,378	15,227
Drilling and completion	28,705	36,947	13,528	1,901,342
Tangible		43,617	9,719	134,540
	<b>48,938</b>	87,508	<b>52,625</b>	2,051,109
Office	31,920	9,182	39,719	9,703
<b>Total</b>	<b>3,712,859</b>	913,715	<b>15,382,667</b>	5,331,685

**Liquidity and financial position**

The Company commenced 2011 with a working capital position of \$8.6 million, which included the value of the Company's equity investment in Africa Oil.

During the six months ended June 30, 2011, the Company spent \$1.4 million on operating activities and \$15.4 million on capital expenditures. In March 2011, pursuant to a public offering, the Company issued 20 million common shares on a flow-through basis at a price of \$0.50 per share for net cash proceeds of \$9.1 million. In addition, during the first half of 2011, the Company sold virtually all of its Africa Oil shares for net cash proceeds of \$5.6 million. The working capital at June 30, 2011 was \$0.9 million.

As a result of the flow-through issues in November and December 2010, the Company received gross proceeds of \$6,560,800. These proceeds were spent on qualifying expenditures by the end of March 31, 2011.

From the March 2011 flow-through share financing the Company must spend the \$10 million proceeds on qualifying expenditures by the end of December 31, 2012. Approximately \$3.8 million has been spent as at June 30, 2011.

On July 19, 2011, the Company closed its prospectus offering of 16,666,600 Common Shares of the Company at a price of \$0.30 per Common Share for gross proceeds of approximately \$5.0 million.

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The Company continues to pursue alternate arrangements either from equity or debt financings, joint ventures or asset rationalizations to provide the funding required to continue its oil sands development, including its proposed Clearwater Phase I Project. The ability of the Company to recover the amounts shown for the properties is dependent upon the existence of economically recoverable reserves and upon the Company's ability to obtain additional financing to continue the development of the Company's properties and generate funds therefrom and to meet current and future obligations. Expenditures on the Clearwater Phase I Project will be kept to a minimum until regulatory approval and financing have been obtained. The Company's policy is to ensure that its cash investments are liquid and are invested in low risk products.

**Share Capital**

**Common shares**

The Company commenced 2011 with 118,915,457 Common Shares outstanding. During the first half of 2011, 35,000 stock options were exercised and 20,000,000 Common Shares were issued resulting in 138,950,457 Common Shares outstanding as at June 30, 2011. As a result of the prospectus that was closed on July 19, 2011 the Common Shares outstanding as at the date of this MD&A were 155,617,057.

**Stock options**

The following is a continuity of stock options:

	June 30, 2011		December 31, 2010	
	Number of options	Weighted average exercise price (\$)	Number of options	Weighted average exercise price (\$)
Opening	6,852,323	\$ 0.46	5,527,156	\$ 0.47
Granted	3,331,000	0.40	3,880,000	0.39
Exercised	(35,000)	0.13	(694,832)	0.18
Expired/forfeited	(140,000)	(0.52)	(1,860,001)	0.44
Closing	10,008,323	\$ 0.44	6,852,323	\$ 0.46

The following summarizes information about stock options outstanding as at June 30, 2011:

Range of exercise prices	Number outstanding	Weighted average remaining contractual life (years)	Options outstanding weighted average exercise price	Number Exercisable	Options exercisable weighted average exercise price
\$ 0.13	1,294,667	2.46	\$ 0.13	1,294,667	\$ 0.13
\$ 0.14 – \$ 0.37	1,631,000	2.21	0.34	1,114,331	0.35
\$ 0.38 – \$ 0.61	6,313,000	4.06	0.41	3,254,824	0.43
\$ 0.62 – \$ 1.47	517,656	1.50	1.04	517,656	1.04
\$ 1.48 – \$ 2.21	252,000	1.00	2.09	252,000	2.09
	10,008,323	3.34	\$ 0.44	6,433,478	\$ 0.47

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Of the total options outstanding, 7,515,500 are held by directors, officers and management.

**Warrants**

The following is a continuity of warrants:

	Warrants	Value	Weighted average exercise price
Balance, December 31, 2010	23,671,250	\$ 864,327	\$ 0.60
Issued	1,200,000	132,022	0.50
Expired	(650,000)	(35,068)	0.50
Balance, June 30, 2011	24,221,250	\$ 961,281	\$ 0.59

In March 2011, pursuant to the public offering the Company issued 1,200,000 warrants to the underwriter. Each warrant entitles the holder to acquire one Common Share at an exercise price of \$0.50 per share until March 21, 2014. In April 2011, 650,000 warrants at an exercise price of \$0.50 per share expired.

As at June 30, 2011 there were 24,221,250 warrants outstanding, all of which were exercisable. In July 2011, 2,000,000 warrants exercisable at \$1.00 per share expired which decreased the warrants outstanding to 22,221,250 as at the date of this MD&A.

**Contractual Obligations and Commitments**

**Flow-through expenditures**

During November and December 2010, the Company raised \$6,560,800 through the sale of common shares issued on a flow-through basis. The Company renounced the tax benefits of these proceeds to the investors effective December 31, 2010. As at March 31, 2011, all of the proceeds had been incurred on qualifying expenditures in the oil sands properties.

In March 2011, the Company raised \$10 million through the sale of common shares issued on a flow-through basis. The tax benefits of these proceeds will be renounced to the investors effective December 31, 2011 and the Company has until December 31, 2012 to incur the \$10 million of qualifying expenditures. As at June 30, 2011, approximately \$3.8 million has been incurred on qualifying expenditures.

**Other commitments**

The Company has granted a three percent (3%) gross overriding royalty, which is subject to certain adjustments, on all production from the Hangingstone property.

In July 2009, the Company signed a Gross Overriding Royalty, Access and Cooperation Agreement (the "Agreement") with the Fort McMurray Airport Authority ("FMAA"). In consideration for the FMAA granting access rights, the Company granted to the FMAA a two percent (2%) gross overriding royalty on the petroleum substances produced from the specified lands. In addition, the Company granted the FMAA 2,000,000 warrants entitling the holder to one Common Share at a price of \$0.50 per share until

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November 2012 and 2,000,000 warrants entitling the holder to one Common Share at a price of \$1.00 per share until July 2011. These latter warrants expired unexercised.

**Off-Balance Sheet arrangements**

The Company has no off-balance sheet arrangements.

**Related party transaction**

The Company had the following related party transaction:

During the three and six months ended June 30, 2011, the Company was charged \$118,051 and \$128,969 (June 30, 2010 – \$146,908 and \$154,308) in legal fees by legal firms in which an officer of the Company is a partner. These costs are included in general and administrative expense, business development and share issue costs. Included in accounts payable at June 30, 2011 is \$118,051 (December 31, 2010 – \$162,368) due to a legal firm.

This transaction was conducted in the normal course of operations, on commercial terms established and agreed to by the parties. All outstanding balances are unsecured and are expected to be settled by cash payment within three months of the reporting date.

**Selected Historical Financial Information (\$)**

	<b>IFRS</b>			
	2011		2010	
	2ND QUARTER	1ST QUARTER	4TH QUARTER	3RD QUARTER
			RESTATED	
Petroleum and natural gas revenue	492,487	454,540	514,172	501,367
Net income (loss)	(1,390,263)	(1,134,310)	(1,859,047)	2,173,243
Net income (loss) per share – basic and diluted	(0.01)	(0.01)	(0.02)	0.02
Funds used in operations	(595,517)	(764,866)	(144,863)	(1,271,701)
Cash flow used in operations	(378,480)	(825,402)	(182,787)	(1,200,459)
Capital expenditures	3,712,859	11,669,808	3,480,017	1,096,505

	<b>IFRS</b>		<b>GAAP</b>	
	2010		2009	
	2ND QUARTER	1ST QUARTER	4TH QUARTER	3RD QUARTER
	RESTATED			
Petroleum and natural gas revenue	622,100	815,543	826,073	894,316
Net loss	(922,880)	(3,363,945)	(1,035,940)	(486,157)
Net loss per share – basic and diluted	(0.01)	(0.03)	(0.01)	(0.01)
Funds from (used in) operations	(750,452)	(377,120)	(776,513)	98,124
Cash flow (used in) from operations	(700,101)	(544,051)	(932,314)	399,091
Capital expenditures	913,715	4,417,970	3,202,536	1,651,024

The Company does not expect to invest material additional capital towards development and exploration of its conventional assets. Consequently, natural declines at stable commodity prices will result in quarter

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over quarter reducing revenues and cash flow. The Company's investment in capital and operations on its oil sands assets is expected to accelerate in the last half of 2011, subject to the availability of project financing.

### Outlook

AOS' growth strategy is to develop through joint-venture, financial partnerships and strategic capital transactions, oil sands assets of a scale that represent strong growth leverage to a company of AOS' size. The Company believes that this strategy will expedite conversion of its bitumen resources to production and cash flow.

Management believes that the fundamentals for oil sands will remain strong over the foreseeable future, recognizing there could also be periods of correction. Energy demand continues to grow globally and the entry of several Asian national companies in Alberta's oil sands industry indicates the growing importance of this resource in the world energy supply equation. Recent events in the Middle East accentuate the need for an alternative supply source from a stable region of the world, specifically as the United States, which is the largest market for Canadian oil supply, reconsiders its strategic energy partners.

The intensive level of industry activity in the oil sands creates challenges for all industry competitors in securing qualified personnel, supplies and services over the next few years. Activity in the oil sands sector was strong this past winter season and is expected to further intensify. Concurrent with increased demand for services and qualified personnel there will likely be increases in labour, supply and material costs. AOS management is cognizant of this and has considered strategies to adapt.

Over the next few months, the Company is expecting to complete front-end engineering and design for this phase. Procurement of long-lead items is expected to commence closer to project approval. To enable Phase I construction and commissioning, the Company will need to raise approximately \$150 million of capital.

AOS expects to progress with technical and consultation work on Phase I in anticipation of ERCB approval. This includes interpreting the results of the winter core-hole program and the 3D seismic to confirm the Phase I well placements. These results will also be used to plan Phase II, for which environmental work commenced in the first quarter of 2011. The Phase II reservoir scoping stage is expected to conclude in early 2012 and may include further delineation during the 2011-2012 drilling season, subject to an appropriate level of capital funding. The Company expects to provide a resource update based on the winter drilling activity during the fourth quarter of 2011.

The Hangingstone property has been assigned contingent resources to a level that justifies a viable project. Further delineation and engineering work will be required to advance this asset to project application status. The Company and its 50% joint venture partner have engaged a third party advisor to market their 100% working interest in this property.

Preliminary planning has commenced to explore AOS' Algar Lake and Grand Rapids oil sands leases. Algar Lake comprises 51 sections and the three 1950s-vintage vertical wells drilled on the lease indicate significant *in situ* bitumen volumes. There is also potential for heavy oil "cold-flow" (or non-thermally-assisted) production, which if viable and approved would considerably reduce the capital requirement and facility complexity during primary recovery. The objective of the Algar Lake exploration plan is to confirm available resource volumes and evaluate further AOS bitumen development potential. The initial Algar Lake exploration plan calls for approximately 20 to 30 bitumen core holes and 30 contingent locations.

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Two historical core holes in the Grand Rapids area indicate significant potential for significant *in situ* bitumen volumes. The Grand Rapids area has been more active and recent core holes on offsetting lands have been used to generate the Grand Rapids exploration plan. The exploration in Grand Rapids is intended to provide a first estimate of oil sands development potential on the 18 sections of oil sands rights and would comprise approximately 10 core holes and 15 contingent locations. Execution of the Algar Lake and Grand Rapids exploration programs is subject to obtaining appropriate levels of capital funding. With successful programs at the Grand Rapids and Algar Lake leases, these areas may also support project proposals similar to Clearwater.

Management's focus over the next year will comprise the following: guide the necessary activities to facilitate the Clearwater Phase I Project Application to approval, secure sufficient development funding for Clearwater Phase I, secure the personnel and contracts to execute and construct the Clearwater Phase I Project, secure the approvals, equipment and services to execute the planned exploration programs at Grand Rapids and Algar Lake, and rationalize the conventional oil and natural gas assets.

### **Oil Sands Development Risks**

In assessing the feasibility of potential oil sands projects and in estimating the value of and the projected start-up dates for pilot projects and commercial *in-situ* operations in the Company's Clearwater project areas, management has made numerous assumptions including that the Company will be able to obtain regulatory approval (including in respect of applicable environmental matters) and other required third-party approvals in a timely manner; that the regulatory framework representing government policy, royalties, taxes and environmental matters will continue to support such projects; that the Company will be able to generate sufficient cash flow, access capital markets on competitive terms or find strategic partners in order to enable it to fund such projects; that future prices for crude oil, bitumen and refined products will continue to be at levels which support such projects; that the results from the Company's core drilling programs will be favourable; that the Company's independent resource estimates are accurate; that the Company will be able to obtain qualified staff and equipment in a timely and cost-efficient manner; and that the Company will be able to address issues raised by the community. In the event such assumptions are not accurate, this could have an adverse effect on the ability of the Company to commence such projects within the noted timelines, or at all. For more information see "Forward-looking Statements and Information" in this MD&A. There is no certainty that it will be commercially viable to produce any portion of the resources described in this MD&A. For important information regarding the disclosure of resource estimates, including the definition of "contingent resources", see "Disclosure of Reserves and Resources" in this MD&A.

### **Business Risks and Uncertainties**

For an overview of the risks and uncertainties which may affect the Company and its business and operations, see "Forward-looking Statements and Information" in this MD&A and the annual information form for the year ended December 31, 2010 which can be found under the Company's profile at [www.sedar.com](http://www.sedar.com). The risks and uncertainties as contained in such documents are not the only ones facing the Company. Additional risks and uncertainties not presently known to the Company or that the Company currently considers immaterial may also impair the business and operations of the Company and cause the price of the securities of the Company to decline. If any of these risks actually occur, the Company's business may be harmed and the financial condition and results of operation may suffer significantly. In that event, the trading price of the shares could decline and holders of Common Shares

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may lose all or part of their investment. Prospective investors should review such risks with their legal and financial advisors.

An investment in the securities of the Company is suitable only for purchasers who are aware of such risks and who have the ability and willingness to accept the risk of total loss of their invested capital.

### **Disclosure of Reserves and Resources**

"proved reserves" means those reserves that can be estimated with a high degree of certainty to be recoverable. It is likely that the actual remaining quantities recovered will exceed the estimated proved reserves.

"probable reserves" means those additional reserves that are less certain to be recovered than proved reserves. It is equally likely that the actual remaining quantities recovered will be greater or less than the sum of the estimated proved plus probable reserves.

"possible reserves" means those additional reserves that are less certain to be recovered than probable reserves. There is a 10 percent (10%) probability that the actual remaining quantities recovered will be greater or less than the sum of the estimated proved plus probable plus possible reserves.

"resources" are quantities of petroleum that are estimated to exist originally in naturally occurring accumulations, including the quantity of petroleum that is estimated, as of a given date, to be contained in known accumulations, prior to production, plus those estimated quantities in accumulations yet to be discovered.

"contingent resources" are defined as those quantities of petroleum estimated, on a given date, to be potentially recoverable from known accumulations using established technology or technology under development, but which are not currently considered to be commercially recoverable due to one or more contingencies. Contingencies may include factors such as economic, legal, environmental, political and regulatory matters or a lack of markets. It is also appropriate to classify as "contingent resources" the estimated discovered recoverable quantities associated with a project in the early project stage.

"undiscovered resources" are defined as that portion of undiscovered petroleum initially-in-place which is estimated, as of a given date, not to be recoverable by future development projects. A portion of these quantities may become recoverable in the future as commercial circumstances change or technological developments occur; the remaining portion may never be recovered due to the physical/chemical constraints represented by subsurface interaction of fluids and reservoir rocks.

There is no certainty that it will be commercially viable for the Company to produce any portion of the resources detailed in this MD&A. The high level of uncertainty associated with the Company's possible recovery of any of these reserves or resources is the result of various risks and uncertainties including: current uncertainties around the specific scope and timing of the development of the Company's oil sands properties; the ability of the Company to finance any potential oil sands projects; proposed reliance on technologies that have not yet been demonstrated to be commercially applicable in oil sands applications; lack of regulatory approvals; the ability of the Company to obtain community support, the uncertainty regarding marketing plans for production from the subject areas; and improved estimation of project costs. There are a number of inherent risks and contingencies associated with such development, including commodity price fluctuations, project costs and those other risks and contingencies discussed in

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more detail in "Business Risks and Uncertainties" and "Forward-looking Statements and Information" in this MD&A.

Estimates of reserves and resources contained in this MD&A for individual properties may not reflect the same confidence level as estimates of resources for all properties, due to the effects of aggregation.

**Contingent resources do not constitute, and should not be confused with, reserves.**

### **Critical Accounting Estimates**

The Company adopted IFRS effective January 1, 2011. As a result the Company's financial results for the three and six months ended June 30, 2011 and the comparative periods are reported under IFRS while selected historical data before 2010 continues to be reported under GAAP. (Refer to note 16 of the interim condensed financial statements for the Company's assessment of the impacts of the transition to IFRS).

**Readers are cautioned that the preliminary statement of financial position prepared for adoption of IFRS as at January 1, 2010 has not been audited at this time and may still be subject to change.**

#### New and pending accounting pronouncements

IFRS 9 - *Financial Instruments* was issued in November 2009 and addresses the classification and measurement of financial assets. This new standard reduces the number of categories and measurement options for financial assets. This new standard also amends the measurement of equity instruments whereas these instruments are either recognized at fair value through profit or loss or at fair value through other comprehensive income. This standard must be applied for years beginning January 1, 2013. The Company has not yet reviewed the impact of this standard.

IFRS 10 *Consolidated Financial Statements* was issued in May 2011. IFRS 10 provides a single model to be applied in the control analysis for all investees, including entities that currently are Special Purpose Entities in the scope of SIC-12. In addition, the consolidation procedures are carried forward substantially unmodified from IAS 27 (2008). This standard is effective for annual periods beginning on or after January 1, 2013, with early adoption permitted.

IFRS 11 *Joint Arrangements* was issued in May 2011. Under IFRS 11, joint arrangements are classified as either joint operations or joint ventures. IFRS 11 essentially carves out of previous jointly controlled entities, those arrangements which although structured through a separate vehicle, such separation is ineffective and the parties to the arrangement have rights to the assets and obligations for the liabilities and are accounted for as joint operations in a fashion consistent with jointly controlled assets/operations under IAS 31. In addition, under IFRS 11 joint ventures are stripped of the free choice of equity accounting or proportionate consolidation; these entities must now use the equity method. Upon application of IFRS 11, entities which had previously accounted for joint ventures using proportionate consolidation shall collapse the proportionately consolidated net asset value (including any allocation of goodwill) into a single investment balance at the beginning of the earliest period presented. The investment's opening balance is tested for impairment in accordance with IAS 28 (2011) and IAS 36 *Impairment of Assets*. Any impairment losses are recognized as an adjustment to opening retained earnings at the beginning of the earliest period presented. This standard is effective for annual periods beginning on or after January 1, 2013.

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IFRS 12 *Disclosure of Interests in Other Entities* was issued in May 2011. IFRS 12 contains the disclosure requirements for entities that have interests in subsidiaries, joint arrangements (i.e. joint operations or joint ventures), associates and/or unconsolidated structured entities. Interests are widely defined as contractual and non-contractual involvement that exposes an entity to variability of returns from the performance of the other entity. The required disclosures aim to provide information in order to enable users to evaluate the nature of, and the risks associated with, an entity's interest in other entities, and the effects of those interests on the entity's financial position, financial performance and cash flows. This standard is effective for annual periods beginning on or after January 1, 2013.

IFRS 13 Fair Value Measurement was issued in May 2011. IFRS 13 replaces the fair value measurement guidance contained in individual IFRSs with a single source of fair value measurement guidance. It defines fair value as 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, i.e. an exit price. The standard also establishes a framework for measuring fair value and sets out disclosure requirements for fair value measurements to provide information that enables financial statement users to assess the methods and inputs used to develop fair value measurements and, for recurring fair value measurements that use significant unobservable inputs (Level 3), the effect of the measurements on profit or loss or other comprehensive income. This standard is effective for annual periods beginning on or after January 1, 2013.

The Company intends to adopt these new IFRS standards prospectively in its financial statements for the annual period beginning on January 1, 2013. The extent of the impact of adoption of these new IFRS standards have not yet been determined.