

**CANADIAN PHOENIX RESOURCES CORP.**

Condensed Consolidated Interim Financial Statements (unaudited)

For the three months ended March 31, 2011

CANADIAN PHOENIX RESOURCES CORP.  
**Condensed Consolidated Interim Statements of Financial Position (unaudited)**  
**In Canadian dollars**

	March 31 2011	December 31 2010	January 1 2010
<b>Assets</b>			
<b>Current assets</b>			
Cash and cash equivalents (note 5)	79,831,032	75,018,593	459,207
Accounts receivable	97,654	118,247	3,187,076
Cash call deposits	-	-	1,280,912
Prepaid expenses	46,762	28,437	203,576
Assets held for sale (note 6)	1,074,143	-	-
	<b>81,049,591</b>	75,165,277	5,130,771
Restricted cash (note 5)	296,384	-	234,751
Exploration and evaluation properties (note 7)	-	-	7,012,000
Property, plant and equipment (note 8)	112,596	1,183,648	48,650,861
Equity investment	-	-	30,363,053
	<b>81,458,571</b>	76,348,925	91,391,436
<b>Liabilities</b>			
<b>Current liabilities</b>			
Accounts payable and accrued liabilities	471,845	715,512	6,277,269
Bank loan	-	-	9,979,259
Loan payable	-	-	1,660,000
Liabilities related to assets held for sale	779,174	-	-
	<b>1,251,019</b>	715,512	17,916,528
Asset retirement obligation (note 9)	-	777,231	5,633,736
Deferred income tax liability	-	-	3,183,872
	<b>1,251,019</b>	1,492,743	26,734,136
<b>Shareholders' equity</b>			
Share capital (note 11a)	149,733,948	139,252,062	119,397,580
Warrants (note 11c)	7,444,403	20,896,695	31,054,963
Contributed surplus (note 11b)	15,065,518	6,558,264	4,922,715
Non-controlling interest	-	-	17,996,050
Deficit	(92,036,317)	(91,850,839)	(108,714,008)
	<b>80,207,552</b>	74,856,182	64,657,300
	<b>81,458,571</b>	76,348,925	91,391,436

**Commitments & contingencies** (note 12)

**Subsequent events** (note 16)

See accompanying notes to the consolidated financial statements

**On behalf of the Board of Directors:**

*"Harry Knutson"*

Director

*"Daryl Clark"*

Director

# CANADIAN PHOENIX RESOURCES CORP.

## Condensed Consolidated Interim Statements of (Loss) Income and Comprehensive (Loss) Income For the three months ended March 31, 2011 and 2010 (unaudited)

In Canadian dollars

	2011	2010
<b>Revenue</b>		
Oil and natural gas sales	36,991	5,150,428
	<b>36,991</b>	5,150,428
<b>Expenses</b>		
Royalties	3,573	989,809
Operating costs	218,495	2,106,203
Depletion and depreciation (note 8)	27,792	2,608,713
Impairment of exploration and evaluation properties (note 7)	3,536	31,182
Bad debts (recovery) expense	(20,000)	39,000
Stock based compensation (note 10b)	-	793,460
General and administrative	258,664	1,351,740
Financing fees (note 9)	1,943	40,930
Interest expense	-	392,993
	<b>494,003</b>	8,354,030
<b>Net loss before other items</b>	<b>(457,012)</b>	<b>(3,203,602)</b>
<b>Other items</b>		
Interest income	271,534	-
Other income	-	121,885
Net income - equity investment	-	489,217
Gain on disposal of exploration and evaluation properties	-	4,980,000
<b>Net (loss) income before taxes</b>	<b>(185,478)</b>	<b>2,387,500</b>
Current income tax expense (note 10)	-	-
Future income tax expense (note 10)	-	(807,873)
	-	(807,873)
<b>Net (loss) income and comprehensive (loss) income</b>	<b>(185,478)</b>	<b>1,579,627</b>
Net loss and comprehensive loss attributed to shareholders of the Corporation	<b>(185,478)</b>	<b>(1,588,519)</b>
Net income and comprehensive income attributed to non-controlling interests	-	3,168,146
<b>Basic and diluted loss per share (note 11d)</b>	<b>0.00</b>	<b>(0.03)</b>

See accompanying notes to the consolidated financial statements

**CANADIAN PHOENIX RESOURCES CORP.**  
**Condensed Consolidated Interim Statements of Changes in Shareholders' Equity (unaudited)**  
**In Canadian dollars**

	Share Capital	Warrants	Contributed Surplus	Deficit	Subtotal	Non- Controlling Interest	Total
January 1, 2010	119,397,580	31,054,963	4,922,715	(108,714,008)	46,661,250	17,996,050	64,657,300
Net loss and comprehensive loss attributed to shareholders of the Corporation	-	-	-	(1,588,519)	(1,588,519)	-	(1,588,519)
Net income and comprehensive income attributed to non-controlling interests	-	-	-	-	-	3,168,146	3,168,146
Increase in percentage of subsidiary held by non-controlling interests	-	-	-	-	-	241,311	241,311
March 31, 2010	119,397,580	31,054,963	4,922,715	(110,302,527)	45,072,731	21,405,507	66,478,238
Net income and comprehensive income attributed to shareholders of the Corporation	-	-	-	18,451,688	18,451,688	-	18,451,688
Net loss and comprehensive loss attributed to non-controlling interests	-	-	-	-	-	(1,849,339)	(1,849,339)
Exercise of warrants	19,856,637	(10,158,268)	-	-	9,698,369	-	9,698,369
Shares cancelled	(2,155)	-	-	-	(2,155)	-	(2,155)
Stock-based compensation	-	-	1,635,549	-	1,635,549	-	1,635,549
Disposal of subsidiary	-	-	-	-	-	(19,556,168)	(19,556,168)
December 31, 2010	139,252,062	20,896,695	6,558,264	(91,850,839)	74,856,182	-	74,856,182
Net loss and comprehensive loss attributed to shareholders of the Corporation	-	-	-	(185,478)	(185,478)	-	(185,478)
Exercise of warrants	10,481,886	(4,945,038)	-	-	5,536,848	-	5,536,848
Expiry of warrants	-	(8,507,254)	8,507,254	-	-	-	-
<b>March 31, 2011</b>	<b>149,733,948</b>	<b>7,444,403</b>	<b>15,065,518</b>	<b>(92,036,317)</b>	<b>80,207,552</b>	<b>-</b>	<b>80,207,552</b>

See accompanying notes to the consolidated financial statements

**CANADIAN PHOENIX RESOURCES CORP.**  
**Condensed Consolidated Interim Statements of Cash Flows**  
**For the three months ended March 31, 2011 and 2010 (unaudited)**  
**In Canadian dollars**

	<b>2011</b>	<b>2010</b>
<b>Cash flow provided by (used in)</b>		
<b>Operating activities</b>		
Net (loss) income for the period	(185,478)	1,579,627
Adjustments for:		
Impairment of exploration and evaluation properties	3,536	31,182
Depletion and depreciation	27,792	2,608,713
Financing fees	1,943	40,930
Equity settled stock-based compensation	-	196,686
Future income tax expense	-	807,873
Net income - equity investment	-	(489,217)
Gain on disposal of exploration and evaluation properties	-	(4,980,000)
Bad debts (recovery) expense	(20,000)	39,000
	(172,207)	(165,206)
Interest income	(271,534)	-
Interest expense	-	392,993
Change in non-cash working capital - operating activities	(29,049)	91,495
	(472,790)	319,282
<b>Financing activities</b>		
Receipts from exercise of warrants	5,536,848	-
Repayment of bank loan	-	(9,979,259)
Interest paid	-	(172,826)
Change in non-cash working capital – financing activities	(223,179)	-
	5,313,669	(10,152,085)
<b>Investing activities</b>		
Proceeds from disposal of exploration and evaluation properties	-	20,748,791
Acquisition of exploration and evaluation properties and property, plant and equipment	(3,536)	(481,733)
Interest received	271,534	-
Movement in restricted cash	(296,384)	(217)
Change in non-cash working capital - investing activities	-	410,860
	(28,386)	20,677,701
<b>Increase in cash and cash equivalents</b>	<b>4,812,493</b>	<b>10,844,898</b>
<b>Cash and cash equivalents, beginning of the period</b>	<b>75,018,539</b>	<b>459,207</b>
<b>Cash and cash equivalents, end of the period</b>	<b>79,831,032</b>	<b>11,304,105</b>

See accompanying notes to the consolidated financial statements

## CANADIAN PHOENIX RESOURCES CORP.

Notes to the Condensed Consolidated Interim Financial Statements (unaudited)

For the three months ended March 31, 2011

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### 1. NATURE OF OPERATIONS

Canadian Phoenix Resources Corp. (the “Corporation”) is engaged in the exploration, development and production of petroleum and natural gas (“P&NG”) in Western Canada. The Corporation is registered in Alberta, and the address of its principal place of business is #3300-205 5<sup>th</sup> Ave SW, Calgary, Alberta. During 2010, the Corporation disposed of the majority of its productive assets, holding the proceeds from disposition in cash and cash equivalents, which the Corporation is seeking to redeploy in new productive assets.

### 2. STATEMENT OF COMPLIANCE

In conjunction with the Corporation’s annual audited consolidated financial statements to be issued under International Financial Reporting Standards (“IFRS”), as issued by the International Accounting Standards Board (“IASB”), for the year ended December 31, 2011, these condensed consolidated interim financial statements are the Corporation’s initial financial statements prepared under IFRS. Accordingly, they have been prepared in accordance with International Accounting Standard 34, *Interim Financial Reporting* (“IAS 34”) and are covered by International Financial Reporting Standard 1, *First-Time Adoption of IFRS* (“IFRS 1”). The recognition and measurement of certain balances and transactions, as well as certain disclosures in these financial statements may differ from the financial statements previously reported under Canadian generally accepted accounting principles (“Canadian GAAP”). Reconciliations from Canadian GAAP to IFRS for certain comparative periods, with explanations for significant differences, are included in note 4. These financial statements should be read in conjunction with the Company’s 2010 audited annual consolidated statements.

These financial statements are prepared using IFRSs in effect as at January 1, 2010. Significant accounting policies and the applicable basis of measurement used in the preparation of these financial statements are described in note 3. However, as new IFRS pronouncements and interpretations are issued by the IASB, the actual accounting standards and policies adopted as at December 31, 2011 may differ from those used herein.

These financial statements are presented in Canadian dollars, which is also the functional currency of the Corporation and all consolidated subsidiaries.

These financial statements were authorized by the Board of Directors on June 28, 2011.

### 3. ACCOUNTING POLICIES

The accounting policies set out below are the policies that the Corporation has adopted for its consolidated financial statements for the year ended December 31, 2011. These policies have been applied consistently to all periods presented in these financial statements and in preparing the opening IFRS consolidated statement of financial position as at January 1, 2010 for the purposes of the transition to IFRSs, unless otherwise indicated.

## CANADIAN PHOENIX RESOURCES CORP.

Notes to the Condensed Consolidated Interim Financial Statements (unaudited)

For the three months ended March 31, 2011

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### a) **Basis of consolidation**

The consolidated statement of financial position as at March 31, 2011 includes the Corporation's accounts and 100% of those for the following wholly-owned subsidiaries:

- CPH-Sarcee Corporation
- CPH-Investment Corporation

In addition to wholly-owned subsidiaries, these consolidated financial statements include the balances and results of entities over which the Corporation exercises control. Control is achieved where the Corporation has the power, directly or indirectly, to govern the financial and operating policies of an entity so as to obtain the benefits from its operations.

These financial statements include the financial results of all controlled entities from the date control commences until the date that control ceases. All transactions between consolidated entities are eliminated in the consolidation of these financial statements.

### b) **Basis of measurement**

These interim consolidated financial statements have been prepared on a historical cost basis except for the following material items in the consolidated statement of financial position:

- Liabilities for cash-settled share-based payment arrangements are measured at fair value; and
- Assets classified as held for sale are measured at fair value where carrying amount is higher than the fair value.

### c) **Business combinations**

#### i) Acquisition of control

Business combinations are accounted for using the acquisition method. The cost of an acquisition is measured as the total fair value of consideration given, determined on the date of acquisition, plus the amount of non-controlling interests, if any. In each acquisition for which a non-controlling interest exists, the Corporation measures the non-controlling interest in the acquiree either at its fair value or at the proportionate share of the acquiree's identifiable net assets held by non-controlling interests. Acquisition-related costs are recognized in profit or loss as incurred.

Any contingent consideration payable by the Corporation on an acquisition is recognized at its fair value at the acquisition date. Subsequent changes to the fair value of such contingent consideration result in adjustments to the cost of acquisition when they occur within the measurement period; all other subsequent changes to the fair value of contingent consideration may be recorded in profit or loss or other comprehensive income. Changes to the fair value of contingent consideration classified as equity are not recognized. The measurement period is the period from the date of acquisition to the date the Corporation obtains complete information about facts and circumstances that existed as of the acquisition date – and is subject to a maximum of one year.

Where a business combination is achieved in stages, the Corporation's previously held interests in the acquiree are re-measured to their fair value on the date the Corporation obtains control

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and the resulting gain or loss, if any, is recognized in profit and loss. Amounts arising from interests in the acquiree prior to the acquisition date that have previously been recognized in other comprehensive income are reclassified to profit or loss, where such treatment would be appropriate if that interest were disposed.

### ii) Goodwill

The Corporation measures goodwill at the acquisition date as the fair value of the consideration given plus any non-controlling interests, less the fair value of the identifiable assets acquired and liabilities assumed. When the difference is negative, a bargain purchase gain is recognized in profit and loss.

Subsequent to initial recognition, goodwill is tested for impairment and is carried at its historical cost, less accumulated impairment losses. Such impairment losses are recorded in profit and loss when recognized. Further discussion on impairment methodology is included in note 3j.

### iii) Non-controlling interests

Non-controlling interests in the net assets of consolidated subsidiaries are presented as a separate component of shareholders' equity. Subsequent to acquisition, the carrying amount of non-controlling interests reflects the initial measurement plus the proportionate share of any changes to the equity of the subsidiary attributable to non-controlling interests. Total comprehensive income is also attributed to non-controlling interests on a proportionate basis.

### iv) Changes in controlling interests and loss of control

Changes in the Corporation's interests in subsidiaries that do not result in a loss of control are accounted for as equity transactions. The carrying amounts of the Corporation's interests and the non-controlling interests are adjusted to reflect the changes in their relative interests in the subsidiaries. Any difference between the amount by which the non-controlling interests are adjusted and the fair value of any consideration paid or received is recognized directly in equity and attributed to the shareholders of the Corporation.

When the Corporation loses control of a subsidiary, the gain or loss on disposal is calculated as the fair value of consideration received plus the fair value of any retained interest, less the carrying value of net assets in the subsidiary including and any non-controlling interests. Amounts related to the subsidiary that were previously recognized in accumulated other comprehensive income are reclassified to retained earnings on the loss of control. The carrying value of any residual interest in the subsidiary is measured at its fair value on the date control is lost.

## **d) Investments in associates**

Investments for which the Corporation exerts significant influence over the investee, but does not hold a controlling interest, are accounted for using the equity method of accounting. These investments are initially recorded at cost which is adjusted for the Corporation's proportionate share of the profit or loss and other comprehensive income of these investees. The Corporation's consolidated statement of (loss) income and comprehensive (loss) income includes the Corporation's share of the profit or loss and other comprehensive income of

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equity-accounted investees, after adjustments to align the accounting policies with those of the Company, from the date that significant influence commences until the date that it ceases.

### **e) Jointly controlled operations and assets**

A significant portion of the Corporation's operating activities are conducted through unincorporated joint ventures with other parties. Under these arrangements, the Corporation proportionately contributes to the exploration, development and production costs of P&NG properties, and earns a proportionate share of any revenues generated from these properties. The Corporation records its proportionate share of any assets, liabilities, revenues or expenses related to these arrangements.

### **f) Financial instruments**

Financial instruments consist of financial assets and financial liabilities and are initially recognized at fair value net of transaction costs, if applicable. Measurement in subsequent periods depends on whether the financial instrument has been classified as "fair value through profit or loss", "loans and receivables", "available-for-sale", "held-to-maturity", or "financial liabilities measured at amortized cost" as follows:

#### **i) Financial assets**

Financial assets comprise cash and cash equivalents, accounts receivable and restricted cash. Cash and cash equivalents comprise cash held at financial institutions and bank short-term deposits with maturities of three months or less at the date of acquisition, and are measured at fair value through profit and loss. Accounts receivable are classified as loans and receivables and are recorded at amortized cost less any impairment. Restricted cash includes cash that has been designated for various operational or environmental reclamation purposes, and is measured at fair value through profit and loss.

#### **ii) Financial liabilities**

Financial liabilities comprise accounts payable and accrued liabilities, and amounts due to related parties. All of these instruments are classified as financial liabilities measured at amortized cost using effective interest rate method. Under this classification, all cash flows from these instruments are discounted, where material, to their present value. Over time, this present value is accreted to the future value of remaining cash flows, and this accretion is recorded as interest expense.

### **g) Non-current assets held for sale**

Non-current assets, or disposal groups comprising assets and liabilities, that are expected to be recovered primarily through sale rather than through continuing use, are classified as held for sale. This condition is when the sale is highly probable and the asset or disposal group is available for immediate sale in its present condition subject only to terms that are usual and customary for sales of such assets. Management must be committed to the sale, which should be expected to qualify for recognition as a completed sale within one year from the date of classification as held for sale.

## CANADIAN PHOENIX RESOURCES CORP.

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Immediately before classification as held for sale, the assets, or components of a disposal group, are re-measured in accordance with the company's accounting policies. Thereafter, the assets, or disposal group, are measured at the lower of their carrying amount and fair value less cost to sell. Fair value is based on recent purchase offers, market transactions for similar assets, or appropriate valuation models.

Impairment losses on initial classification as held for sale and subsequent gains or losses on re-measurement are recognized in the consolidated statement of (loss) income and comprehensive (loss) income. Property, plant and equipment and intangible assets are no longer depreciated once classified as held for sale, but interest and other expenses attributable to the liabilities of a disposal group or asset held for sale is recognized.

### **h) Exploration and evaluation properties**

All costs directly associated with the exploration and evaluation ("E&E") of P&NG reserves, incurred after acquiring the legal right to explore, are capitalized as E&E properties. Costs incurred prior to acquiring the legal right to explore are recorded as an expense in the consolidated statement of (loss) income and comprehensive (loss) income for the period in which they were incurred. Capitalized E&E costs are those expenditures where technical feasibility and commercial viability has not been yet been determined and may include license and unproved property acquisition costs, geological and geophysical costs and costs of drilling exploratory wells.

Except for certain lease costs which may be amortized over the term of the lease, E&E costs are classified as intangible assets and are not depleted, but are rather assessed, quarterly, for impairment. Indicators of impairment would be when properties are known not to be technically feasible or commercially viable, or where the Corporation has no intention of further developing the properties. Impairments are recorded as an expense in the consolidated statement of (loss) income and comprehensive (loss) income in the period in which impairment has occurred. Further discussion on the Corporation's impairment methodology is included in note 3j.

When the technical feasibility and commercial viability of an E&E property is known, the property is subject to an impairment assessment and its residual carrying value is reclassified as property, plant and equipment.

### **i) Property, plant and equipment ("PP&E")**

#### **i) Measurement**

PP&E related to P&NG properties is initially recognized at cost which includes all costs directly associated with the development of P&NG reserves where technical feasibility and commercial viability is determined. Such costs include drilling costs of development wells, tangible costs of facilities and infrastructure construction, costs of optimization and enhanced recovery projects, proved property acquisition costs, asset retirement costs, transfers from E&E assets and borrowing costs relating to qualifying assets.

Expenditures on major maintenance repairs comprise the cost of replacement assets or parts of assets, inspection costs and overhaul costs. Where an asset or part of an asset that was separately depreciated is replaced and it is probable that future economic benefits associated

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Notes to the Condensed Consolidated Interim Financial Statements (unaudited)

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with the item will flow to the company, the expenditure is capitalized and the carrying amount of the replaced asset is derecognized. Inspection costs associated with major maintenance programs are capitalized and amortized over the period to the next inspection. Normal repairs and maintenance costs are recorded as an expense in the consolidated statement of (loss) income and comprehensive (loss) when incurred.

PP&E is subsequently carried at cost less accumulated depletion, depreciation, and any impairment. Gains and losses on disposals are determined by comparing disposal proceeds with the carrying amounts of assets sold and recognized in the consolidated statement of (loss) income and comprehensive (loss) and reported within interest and other income or expenses.

### ii) Depletion, depreciation and amortization

PP&E equipment relating to P&NG properties, including related facilities, are depleted and depreciated using the unit-of-production method over the proved reserves of the area. Where the Corporation intends to develop existing undeveloped, proved reserves, estimated future costs to develop proved reserves are included in costs subject to depletion, which are then depleted over total proved reserves. When the Corporation does not intend to develop existing undeveloped, proved reserves, the costs subject to depletion do not include future development costs, and the cost base is depleted over developed, proved reserves.

PP&E relating to the corporate office includes leasehold improvements and office and computer equipment. Leasehold improvements and office equipment are amortized using the declining balance method at a 20% rate per annum. Computer equipment is amortized using the declining balance method at a 30% rate per annum.

The estimates of useful lives of property, plant and equipment are reviewed quarterly and if, necessary, changes are accounted for prospectively.

### iii) Impairment

The carrying value of PP&E is reviewed for quarterly for impairment, in accordance with note 3j, or whenever events or changes in circumstances indicate the carrying value may not be recoverable.

### **j) Impairment of E&E properties, PP&E and goodwill**

If indicators exist that non-financial assets are impaired, an impairment test is carried out in which the carrying amounts of those assets are written down to their recoverable amount, which is the higher of fair value less costs to sell ("FVLCS") and value-in-use ("VIU"). For the purpose of impairment test, E&E, PP&E and goodwill are grouped together into the smallest group of assets (the "cash-generating unit" or "CGU"), which generate cash flows from continuing use that are largely independent of the cash flows of other assets or groups of assets.

VIU is determined by estimating the discounted future cash flows expected to be derived from continuing use of the assets. In determining FVLCS, recent market transactions are taken into account, if available. If no such transactions can be identified, an appropriate valuation model is used. These calculations are corroborated by valuation multiples or other available fair value indicators.

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Estimates of future cash flows used in the evaluation of impairment of assets are made using forecasts of commodity prices, market supply and demand, product margins and, in the case of P&NG properties, expected reserves volumes. The cash flows used in the impairment test are generally derived from the information contained in the reserve reports, which are prepared annually by independent qualified reserve evaluators and management's assumptions based on past experience.

Impairment losses are recognized in the consolidated statement of (loss) income and comprehensive (loss) and reported within depletion, depreciation and amortization. Impairment losses recognized in respect of a CGU are allocated first, to reduce the carrying amount of any goodwill allocated to the CGU and then to reduce the carrying amount of the other assets in the CGU.

An impairment loss in respect of goodwill is not reversed. In respect of other assets, impairment losses recognized in prior years are assessed at each reporting date for any indications that the loss has decreased or no longer exists. If the amount of the impairment loss decreases in a subsequent period and the decrease can be objectively related to an event occurring after the impairment was recognized, the impairment loss is reversed up to the original carrying value of the asset that would have been determined, net of depletion, depreciation and amortization, if no impairment loss had been recognized. Such reversal is recognized in depletion, depreciation and amortization reported in the consolidated statement of (loss) income and comprehensive (loss).

### **k) Asset retirement obligations**

The company recognizes an asset retirement obligation for abandoning P&NG wells, related facilities, removal of equipment from leased acreage and for returning such land to its original condition, in the period a well or related asset is drilled, constructed or acquired. The asset retirement is estimated at the present value of the estimated expected future cash outflows, discounted using a risk-free interest rate. The discounted obligation is initially capitalized as part of the carrying amount of the related property, plant and equipment and a corresponding liability is recognized.

Subsequent to initial recognition, the obligation is reviewed regularly by management, based upon current regulations, costs, technologies and industry standards, as well as to changes in the risk-free rate. The effects of changes resulting from revisions to the timing or the amount of the original estimate of the provision are reflected on a prospective basis, generally by adjustment to the carrying amount of the related property, plant and equipment. The accretion of the obligation is recorded as a financing cost in the consolidated statement of (loss) income and comprehensive (loss), and actual abandonment and reclamation expenditures are charged to the accumulated obligation as incurred and obligations related to properties disposed are removed.

The amount of the capitalized retirement obligation is depleted and depreciated on the same basis as the other capitalized property, plant and equipment.

### **l) Stock-based compensation**

Stock options granted by the Corporation to directors, officers, employees and consultants are measured at their fair values. Fair values of stock options issued are determined on their grant

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date, using the Black-Scholes option pricing model, and are recognized as an expense over the vesting periods of the options; a corresponding increase is recorded to contributed surplus.

When stock options are exercised, the cash proceeds along with the amount previously recorded as contributed surplus are recorded as share capital. When the right to receive options is forfeited before the options have vested, any expense previously recorded is reversed.

The fair value of stock appreciation rights granted by the Corporation is assessed at grant date and each reporting date. Stock appreciation rights are cash-settled instruments, with the cash settlement amount being the difference between the exercise price of the instrument and the Corporation's share price on the date of exercise. The fair value of each stock appreciation right is recorded as a liability, and is determined as the excess, if any, between the Corporation's share price on the assessment date and the exercise price of each right. The movement in value since the prior reporting period is recorded in the consolidated statement of (loss) income and comprehensive (loss), with a corresponding adjustment to the liability on the consolidated statement of financial position.

### **m) Share purchase warrants**

Warrants with the right to acquire common shares in the Corporation are typically issued through the Corporation's debt or equity financing activities. The fair values of these warrants are determined on their issuance date, using the Black-Scholes option pricing model, and are recorded as both a separate component of shareholders' equity and as a reduction in the values of related debt or share capital.

When share purchase warrants are exercised, the cash proceeds along with the amount previously recorded as a separate component of shareholders' equity are recorded as share capital. When share purchase warrants expire, the amount previously recorded as a separate component of shareholders' equity is reclassified to contributed surplus.

### **n) Share issue costs**

Costs incurred to issue shares, which may include cash or equity-settled payments, are accounted for as a reduction in share capital.

### **o) Flow-through shares**

Under Canadian income tax legislation, a company is permitted to issue flow-through shares whereby the company is obligated to incur qualifying expenditures and renounce the related income tax deductions to the investors. The qualifying expenditures incurred by the company primarily relate to P&NG exploration activities. Generally, due to transferring the benefit of tax deduction to the investors, the shares issued on flow-through basis are offered at prices higher than the prevailing quoted prices of the shares. Accordingly, the proceeds from issuance of these shares are allocated between share capital and the liability to incur the qualifying expenditures in lieu of the sale of tax deductions. The amounts allocated to share capital represents the quoted price of the existing shares whereas the liability represents the difference between the quoted price of the existing shares and the amount the investor pays for the shares. The liability is reversed when qualifying expenditures are renounced and reported within deferred income tax in the consolidated statement of (loss) income and comprehensive (loss).

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### **p) Revenue recognition**

Revenue from sales of oil, natural gas, natural gas liquids and all other products is recognized when the significant risks and rewards of ownership have been transferred, which is when title passes to the customer. This generally occurs when product is physically transferred into a pipe or when delivery is accepted by the customer. Recognized revenue is measured at the fair value of consideration received or receivable, net of discounts, custom duties and royalties paid in kind.

### **q) Income taxes**

Income tax provisions are recognized when it is considered probable that there will be a future outflow of funds to a taxing authority. In such cases, provision is made for the amount that is expected to be settled, where this can be reasonably estimated. This requires the application of judgment as to the ultimate outcome, which can change over time depending on facts and circumstances. A change in estimate of the likelihood of a future outflow and/or in the expected amount to be settled would be recognized in income in the period in which the change occurs.

Deferred tax assets or liabilities arising from temporary differences between the tax and accounting values of assets and liabilities, are recorded based on tax rates expected to be enacted when these differences are reversed. Deferred tax assets are recognized only to the extent it is considered probable that those assets will be recovered. This involves an assessment of when those deferred tax assets are likely to be realized, and a judgment as to whether or not there will be sufficient taxable profits available to offset the tax assets when they do reverse. This requires assumptions regarding future profitability and is therefore inherently uncertain. To the extent assumptions regarding future profitability change, there can be an increase or decrease in the amounts recognized in respect of deferred tax assets as well as in the amounts recognized in income in the period in which the change occurs.

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

### **r) Per share amounts**

Basic (loss) earnings per share is calculated by dividing net (loss) income attributable to shareholders of the Corporation by the weighted average number of common shares outstanding during the period. Diluted earnings per share is determined by adjusting the earnings or loss attributable to common shareholders and the weighted average number of common shares outstanding for the effects of dilutive instruments, which includes stock options and common share purchase warrants, as if their dilutive effect was at the beginning of the period. The calculation of the diluted number of common shares assumes that proceeds received from the exercise of "in-the-money" stock options and common share purchase warrants are used to purchase common shares of the Corporation at their average market price for the period. In periods that the Corporation reports a net loss, per share amounts are not presented on a diluted basis as the result would be anti-dilutive.

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s) **Judgments, estimates and measurement uncertainty**

The preparation of these financial statements requires management to make estimates and assumptions that affect the reported amounts and presentation of assets, liabilities, revenues, expenses and disclosures of contingencies and commitments. Although these estimates are based on management's expectations for the likely outcome, timing and amounts of events or transactions, actual results may differ from these expectations and the corresponding amounts and disclosures reported in these financial statements.

Areas where management is required to make significant estimations or where measurements are uncertain are as follows:

i. P&NG reserves

Using geological and engineering data, estimates of petroleum and natural gas reserves are determined. These reserves form the basis for the depletion of P&NG properties, which are depleted on a unit-of-production basis, as well as the impairment assessment of these properties.

The data used to determine reserves is based on drill results and production and reserve models, which are inherently imprecise. The Corporation engages a recognized reserves engineering firm, annually, to update its estimated petroleum and natural gas reserves based on new information such as additional drill results, long-term reservoir production, changes to expectations for the economic viability of reserves, and changes to property leases or intentions for property development. Changes to reserve estimates are applied prospectively, and could result in increases or decreases to future depletion expenses or the carrying value of these properties.

ii. Impairment of E&E and P&NG properties

In addition to estimates of P&NG reserves, management's impairment assessment, and the resulting carrying value of E&E and P&NG properties, is based on factors such as the future prices of oil and natural gas, future P&NG production costs, the timing and amount of future P&NG production, fair values and the costs to sell these properties, and expectations for the intended use of these properties.

These estimates are forward-looking and are therefore subject to change. Actual outcomes that differ from those estimated by management could result in future impairment expenses or impairment reversals, and increases or decreases to the carrying values of E&E or P&NG properties.

iii. Asset retirement obligation

The Corporation's provision for asset retirement obligations requires management to estimate the timing and amount of cash flows required to retire its P&NG assets. These cash flows are based on management assumptions for P&NG reserves and production, which determine the timing of reclamation expenditures, as well as expectations for the future costs and legal or constructive requirements for environmental reclamation.

Changes to either the timing or amount of the cash flows required for asset retirement, or to the discount rate used to record the present value of these cash flows, are considered prospectively.

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Such changes could increase or decrease the asset retirement obligation reported by the Corporation, and will ultimately result in changes to the total expense for environmental reclamation.

#### iv. Taxation

Tax provisions are recognized to the extent that it is probable that there will be a future outflow of funds to a taxation authority. Such provisions often require judgment on the treatment of certain taxation matter that may not have been reported to or assessed by the taxation authority at the date of these financial statements. Differences in judgment by the taxation authority could result in changes to actual taxes payable by the Corporation.

Deferred tax assets are recognized to the extent that certain taxable losses or deferred expenditures will be utilized by the Corporation to reduce future taxes payable. The amount of deferred tax assets recognized, if any, is based objective evidence that the Corporation will generate sufficient future taxable income to utilize these deferred assets, as well as the expected future tax rates that will apply to these assets. Changes to the Corporation's ability to generate sufficient taxable income or changes to enacted tax rates could result in the write-down of deferred tax assets, or the recognition of new deferred tax assets.

#### v. Stock-based compensation

The Corporation uses the Black-Scholes option pricing model to determine the fair value of stock options and share purchase warrants granted. This model requires management to estimate the volatility of the Corporation's future share price, expected lives of stock options and future dividend yields. Consequently, there is significant measurement uncertainty in the stock-based compensation expense reported.

#### **t) Future changes in accounting standards**

The Corporation has reviewed new and revised accounting pronouncements that have been issued but are not yet effective and determined that the following may have an impact on its financial statements:

##### i. IAS 12 Income Taxes ("IAS 12")

IAS 12 was amended in December 2010 to remove subjectivity in determining on which basis an entity measures the deferred tax relating to an asset. The amendment introduces a presumption that an entity will assess whether the carrying value of an asset will be recovered through the sale of the asset. The amendment to IAS 12 is effective for reporting periods beginning on or after January 1, 2012. The company is currently evaluating the impact of this amendment to IAS 12 on its consolidated financial statements.

##### ii. IAS 28 Investments in Associates and Joint Ventures ("IAS 28")

IAS 28, which was amended in 2011, prescribes the accounting for investments in associates and sets out the requirements for the application of the equity method when accounting for investments in associates and joint ventures, eliminating a previously available alternative method for accounting for these investments. IAS 28 is effective for annual periods beginning on or after January 1, 2013. Earlier application is permitted. The Corporation is currently evaluating the impact of this amendment to IAS 28 on its consolidated financial statements;

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however, as it has accounted for investments in associates using the equity method rather than the now unavailable alternative, the impact of this new standard is not expected to be significant.

iii. IFRS 7 Financial Instruments: Disclosures (“IFRS 7”)

IFRS 7 was amended in October 2010 to provide additional disclosure on the transfer of financial assets including the possible effects of any residual risks that the transferring entity retains. These amendments are effective as of July 1, 2011. The Corporation is currently evaluating the impact of these amendments to IFRS 7 on its consolidated financial statements, but the impact, if any, is not expected to be significant.

iv. IFRS 9 Financial Instruments (“IFRS 9”)

IFRS 9 was issued in November 2009 and is the first step to replace current IAS 39, “Financial Instruments: Recognition and Measurement”. IFRS 9 uses a single approach to determine whether a financial asset is measured at amortized cost or fair value, replacing the multiple rules in IAS 39. The approach in IFRS 9 is based on how an entity manages its financial instruments in the context of its business model and the contractual cash flow characteristics of the financial assets. The new standard also requires a single impairment method to be used, replacing the multiple impairment methods in IAS 39. IFRS 9 is effective for annual periods beginning on or after January 1, 2013. The Corporation is currently evaluating the impact of IFRS 9 on its consolidated financial statements, but the impact, if any, is not expected to be significant.

v. IFRS 10 Consolidated Financial Statements (“IFRS 10”)

IFRS 10 establishes principles for the presentation and preparation of consolidated financial statements when an entity controls one or more other entities. IFRS 10 supersedes IAS 27 “Consolidated and Separate Financial Statements” and SIC-12 “Consolidation—Special Purpose Entities” and is effective for annual periods beginning on or after January 1, 2013. Earlier application is permitted. The Corporation is currently evaluating the impact of this standard on its consolidated financial statements.

vi. IFRS 11 Joint Arrangements (“IFRS 11”)

IFRS 11 establishes principles for financial reporting by parties to a joint arrangement. IFRS 11 supersedes current IAS 31 “Interests in Joint Ventures and SIC-13 Jointly Controlled Entities—Non-Monetary Contributions by Venturers” and is effective for annual periods beginning on or after January 1, 2013. Earlier application is permitted. The Corporation is currently evaluating the impact of this standard on its consolidated financial statements.

vii. IFRS 12 Disclosure of Interests in Other Entities (“IFRS 12”)

IFRS 12 applies to entities that have an interest in a subsidiary, a joint arrangement, an associate or an unconsolidated structured entity. IFRS 12 is effective for annual periods beginning on or after January 1, 2013. Earlier application is permitted. The Corporation is currently evaluating the impact of this standard on its consolidated financial statements.

viii. IFRS 13 Fair Value Measurements (“IFRS 13”)

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IFRS 13 defines fair value and sets out a single IFRS framework for fair value measurements and disclosures. IFRS 13 applies to other IFRSs that require or permit measurements or disclosures based on fair values, except in specified circumstances. IFRS 13 is to be applied for annual periods beginning on or after January 1, 2013. Earlier application is permitted. The Corporation is currently evaluating the impact of this standard on its consolidated financial statements.

#### 4. FIRST-TIME ADOPTION OF IFRS

As stated in note 2, these are the company's first interim consolidated financial statements prepared in accordance with IFRS. IFRS 1 requires the presentation of comparative information as at the January 1, 2010 ("transition date") and subsequent comparative periods as well as the consistent and retrospective application of IFRS accounting policies, although this standard provides mandatory exceptions and optional exemptions to the retrospective application of IFRS for certain areas. Additionally, IFRS 1 requires that the Company's to reconcile certain balances previously reported under Canadian GAAP to their IFRS balances reported herein.

##### **IFRS 1 mandatory exemptions and optional exemptions**

###### a) Deemed cost election for oil and gas properties

Under Canadian GAAP, the Corporation used the "full cost accounting" method of accounting for its P&NG properties. Under this method, all costs directly associated with the exploration, evaluation and development of these properties were capitalized. These costs attributed to proved reserves were pooled and depleted, on a unit-of-production basis, based on the Corporation's aggregate production and aggregate proved reserves, while costs attributed to unproved properties were only tested for impairment with any impairment recorded being added to the costs of proved reserves subject to depletion. Undepleted costs of proved reserves were assessed for impairment on an aggregate basis.

Under IFRS, the Corporation classifies capitalized costs attributed to unproved reserves as E&E properties, which are not subject to depletion, but are tested for impairment on a property-by-property basis. Any impairments are recorded as an expense as incurred. Costs related to proved reserves are depleted on a unit-of-production basis and assessed for impairment property-by-property.

To allocate the full cost of its proved P&NG properties, as determined under Canadian GAAP, to individual properties, the Corporation has availed of an IFRS 1 exemption from retrospectively allocating, depleting and impairing costs on a property-by-property basis. Instead, the Corporation deemed its January 1, 2010 cost of E&E properties to be the cost, as recorded under Canadian GAAP, of its unproved reserves. The Corporation allocated the total Canadian GAAP cost of proved reserves to individual properties on pro rata basis using the proved reserves on the transition date.

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b) Non-controlling interests

The Corporation has applied certain requirements of IAS 27, *Consolidated and Separate Financial Statements*, on a prospective basis from the transition date, rather than on a retrospective basis. These requirements include the attribution of total comprehensive income between the shareholders of the Corporation and non-controlling interests, and the treatment of changes in ownership of a subsidiary that do not result in loss of control as equity transactions.

c) Business combinations

IFRS 3, *Business Combinations*, has not been applied to business combinations occurring prior to the transition date.

d) Estimates

Where the application of IFRS has required management to make new estimates, such estimates were made based on information available as at the date to which the estimate relates, and do not incorporate the benefit of hindsight.

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**Reconciliations from Canadian GAAP to IFRS**

a) Consolidated Statement of Financial Position as at January 1, 2010

	As Reported Under Canadian GAAP	Reference (See Note 4f)	IFRS Adjustments	As Reported Under IFRS
<b>Assets</b>				
<b>Current assets</b>				
Cash and cash equivalents	459,207			459,207
Accounts receivable	4,467,988	i.	(1,280,912)	3,187,076
Cash call deposits	-	i.	1,280,912	1,280,912
Prepaid expenses	203,576			203,576
	5,130,771			5,130,771
Restricted cash	234,751			234,751
Exploration and evaluation properties	-	ii.	7,012,000	7,012,000
Property, plant and equipment	61,224,188	ii.	(12,573,327)	48,650,861
Equity investment	32,875,493	v.	(2,512,440)	30,363,053
	99,465,203		(8,073,767)	91,391,436
<b>Liabilities</b>				
<b>Current liabilities</b>				
Accounts payable and accrued liabilities	6,277,269			6,277,269
Bank loan	9,979,259		-	9,979,259
Loan payable	2,100,000	iv.	(440,000)	1,660,000
	18,356,528		(440,000)	17,916,528
Asset retirement obligation	4,850,525	iii.	783,211	5,633,736
Deferred income tax liability	3,363,475	iii.	(179,603)	3,183,872
	26,570,528		163,608	26,734,136
<b>Non-controlling interest</b>	18,229,659	i.	(18,229,659)	-
<b>Shareholders' equity</b>				
Share capital	119,397,580			119,397,580
Warrants	31,054,963			31,054,963
Contributed surplus	4,922,715			4,922,715
Non-controlling interest	-	i., iii.	17,996,050	17,996,050
Deficit	(100,710,242)	ii., iii., iv., v.	(8,003,766)	(108,714,008)
	54,665,016		9,992,284	64,657,300
	99,465,203		(8,073,767)	91,391,436

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b) Consolidated Statement of Financial Position as at March 31, 2010

	As Reported Under Canadian GAAP	Reference (See Note 4f)	IFRS Adjustments	As Reported Under IFRS
<b>Assets</b>				
<b>Current assets</b>				
Cash and cash equivalents	11,304,105			11,304,105
Restricted cash	234,968			234,968
Accounts receivable	3,217,248	i.	(32,441)	3,184,807
Cash call deposits	-	i.	32,441	32,441
Prepaid expenses	96,989			96,989
	14,853,310			14,853,310
Exploration and evaluation properties	-	ii.	-	-
Property, plant and equipment	38,015,776	ii.	(293,761)	37,722,015
Equity investment	33,392,049	v.	(2,539,779)	30,852,270
	86,261,135		(2,833,540)	83,427,595
<b>Liabilities</b>				
<b>Current liabilities</b>				
Accounts payable and accrued liabilities	5,402,946			5,402,946
Bank loan	-		-	-
Loan payable	2,100,000	iv.	(220,000)	1,880,000
	7,502,946		(220,000)	7,282,946
Asset retirement obligation	4,939,237	iii.	735,429	5,674,666
Deferred income tax liability	2,818,738	ii., iii.	1,173,007	3,991,745
	15,260,921		1,688,436	16,949,357
<b>Non-controlling interest</b>	19,856,689	i.	(19,856,689)	-
<b>Shareholders' equity</b>				
Share capital	119,397,580			119,397,580
Warrants	31,054,963			31,054,963
Contributed surplus	4,922,715			4,922,715
Non-controlling interest	-	i., ii., iii.	21,405,507	21,405,507
Deficit	(104,231,733)	ii., iii., iv., v.	(6,070,794)	(110,302,527)
	51,143,525		15,334,713	66,478,238
	86,261,135		(2,833,540)	83,427,595

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c) Consolidated Statement of Financial Position as at December 31, 2010

	<b>As Reported Under Canadian GAAP</b>	<b>Reference (See Note 4f)</b>	<b>IFRS Adjustments</b>	<b>As Reported Under IFRS</b>
<b>Assets</b>				
<b>Current assets</b>				
Cash and cash equivalents	75,018,593			<b>75,018,593</b>
Accounts receivable	118,247			<b>118,247</b>
Cash call deposits	-			-
Prepaid expenses	28,437			<b>28,437</b>
	<b>75,165,277</b>			<b>75,165,277</b>
Restricted cash	-			-
Exploration and evaluation properties	-			-
Property, plant and equipment	1,587,695	ii.	(404,047)	<b>1,183,648</b>
Equity investment	-			-
	<b>76,752,972</b>		<b>(404,047)</b>	<b>76,348,925</b>
<b>Liabilities</b>				
<b>Current liabilities</b>				
Accounts payable and accrued liabilities	715,512			<b>715,512</b>
Bank loan	-		-	-
Loan payable	-			-
	<b>715,512</b>			<b>715,512</b>
Asset retirement obligation	741,785	iii.	35,446	<b>777,231</b>
Deferred income tax liability	-			-
	<b>1,457,297</b>		<b>35,446</b>	<b>1,492,743</b>
<b>Non-controlling interest</b>	<b>-</b>			<b>-</b>
<b>Shareholders' equity</b>				
Share capital	139,252,062			<b>139,252,062</b>
Warrants	20,896,695			<b>20,896,695</b>
Contributed surplus	6,558,264			<b>6,558,264</b>
Non-controlling interest	-			-
Deficit	(91,411,346)	ii, iii.	(439,493)	<b>(91,850,839)</b>
	<b>75,295,675</b>		<b>(439,493)</b>	<b>74,856,182</b>
	<b>76,752,972</b>		<b>404,047</b>	<b>76,348,925</b>

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d) Consolidated Statement of Income and Comprehensive Income for the three months ended March 31, 2010

	As Reported Under Canadian GAAP	Reference (See Note 4f)	IFRS Adjustments	As Reported Under IFRS
<b>Revenue</b>				
Oil and natural gas sales	5,651,659	i.	(501,231)	<b>5,150,428</b>
	5,651,659		(501,231)	<b>5,150,428</b>
<b>Expenses</b>				
Royalties	1,491,040	i.	(501,231)	<b>989,809</b>
Operating costs	2,106,203			<b>2,106,203</b>
Depletion and depreciation	3,016,173	i., ii.	(407,460)	<b>2,608,713</b>
Impairment of property, plant, & equipment	-			-
Impairment of exploration and evaluation properties	-	ii.	31,182	<b>31,182</b>
Bad debts (recovery) expense	39,000			<b>39,000</b>
Stock based compensation	793,460			<b>793,460</b>
General and administrative	1,351,740			<b>1,351,740</b>
Financing fees	-	i., iii.	40,930	<b>40,930</b>
Interest expense	172,993	iv.	220,000	<b>392,993</b>
	8,970,609		(616,579)	<b>8,354,030</b>
<b>Net loss before other items</b>	<b>(3,318,950)</b>		115,348	<b>(3,203,602)</b>
<b>Other items</b>				
Interest income	-			-
Other income	121,885			<b>121,885</b>
Net income - equity investment	516,556	v.	(27,339)	<b>489,217</b>
Gain on disposal of exploration and evaluation properties	-	ii.	4,980,000	<b>4,980,000</b>
<b>Net income (loss) before taxes</b>	<b>(2,680,509)</b>		5,068,009	<b>2,387,500</b>
Current income tax expense	-			-
Future income tax recovery (expense)	544,737	ii., iii.	(1,352,610)	<b>(807,873)</b>
	544,737		(1,352,610)	<b>(807,873)</b>
<b>Non-controlling interest</b>	<b>(1,385,719)</b>	i., ii., iii.	1,385,719	-
<b>Net income (loss) and comprehensive income (loss)</b>	<b>(3,521,491)</b>	ii., iii., iv., v.	5,101,118	<b>1,579,627</b>
Net loss and comprehensive loss attributed to shareholders of the Corporation	-	i.	(1,588,519)	<b>(1,588,519)</b>
Net income and comprehensive income attributed to non-controlling interests	-	i.	3,168,146	<b>3,168,146</b>

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e) Consolidated Statement of Income and Comprehensive Income for the year ended December 31, 2010

	As Reported Under Canadian GAAP	Reference (See Note 4f)	IFRS Adjustments	As Reported Under IFRS
<b>Revenue</b>				
Oil and natural gas sales	8,437,953	i.	(1,002,462)	<b>7,435,491</b>
	8,437,953		(1,002,462)	<b>7,435,491</b>
<b>Expenses</b>				
Royalties	2,087,222	i.	(1,002,462)	<b>1,084,760</b>
Operating costs	3,825,218			<b>3,825,218</b>
Depletion and depreciation	4,499,005	i., ii.	(617,946)	<b>3,881,059</b>
Impairment of property, plant, & equipment	5,900,002	ii.	(4,999,324)	<b>900,678</b>
Impairment of exploration and evaluation properties	-	ii.	97,914	<b>97,914</b>
Bad debts expense	43,333			<b>43,333</b>
Stock based compensation	3,151,331			<b>3,151,331</b>
General and administrative	6,698,392			<b>6,698,392</b>
Financing fees	-	i., iii.	74,038	<b>74,038</b>
Interest expense	270,625	iv.	440,000	<b>710,625</b>
	26,475,128		(6,007,780)	<b>20,467,348</b>
<b>Net loss before other items</b>	(18,037,175)		5,005,318	<b>(13,031,857)</b>
<b>Other items</b>				
Interest income	277,198			<b>277,198</b>
Other income	124,123			<b>124,123</b>
Net loss - equity investment	(1,026,088)	v.	(27,339)	<b>(1,053,427)</b>
Gain on disposal of equity investment	12,841,983	v.	2,539,779	<b>15,381,762</b>
Gain on disposal of subsidiary	13,161,409	ii., iii.	(1,810,603)	<b>11,350,806</b>
Gain on disposal of exploration and evaluation properties	-	ii.	4,980,000	<b>4,980,000</b>
<b>Net income before taxes</b>	7,341,450		10,687,155	<b>18,028,605</b>
Current income tax expense	-			-
Future income tax recovery	1,500,737	ii., iii.	(1,347,366)	<b>153,371</b>
	1,500,737		(1,347,366)	<b>153,371</b>
<b>Non-controlling interest</b>	456,709	i., ii., iii	(456,709)	-
<b>Net income and comprehensive income</b>	9,298,896	ii., iii., iv., v.	8,883,080	<b>18,181,976</b>
Net income and comprehensive income attributed to shareholders of the Corporation	-	i.	16,863,169	<b>16,863,169</b>
Net income and comprehensive income attributed to non-controlling interests	-	i.	1,318,807	<b>1,318,807</b>

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### **f) IFRS reconciliation notes**

#### **i. Reclassifications**

For the three months ended March 31, 2010, \$88,712 in accretion expense has been reclassified from depletion and depreciation under Canadian GAAP to financing fees under IFRS. For the same period, \$501,231 of royalties paid in-kind has been reclassified from royalty expense under Canadian GAAP to a reduction in oil and natural gas sales under IFRS. For the year ended December 31, 2010, \$174,708 in accretion and \$1,002,462 in royalties were reclassified.

Under Canadian GAAP, the Corporation deducted the portion of income and expenses attributable to non-controlling interests as an expense in the consolidated statement of (loss) income and comprehensive (loss) and the portion of net assets attributed to non-controlling interests was reported between liabilities and shareholders' equity on the consolidated statement of financial position. Under IFRS, non-controlling interests are not deducted from income, but income attributed to non-controlling interests is separately disclosed from income attributed to the Corporation's shareholders. Additionally, net assets attributed to non-controlling interests are presented as a component of shareholders' equity on the consolidated statement of financial position.

Under IFRS, the Corporation reports cash call deposits separately from accounts receivable. These amounts were aggregated when the Corporation reported under Canadian GAAP.

#### **ii. Exploration and evaluation properties and property, plant and equipment**

Under Canadian GAAP, the Corporation capitalized all costs related to the acquisition, exploration and development of its P&NG properties in a single cost pool. This cost pool was depleted on a unit-of-production basis over the Corporation's aggregate reserves, and was assessed for impairment as a whole. When properties were disposed, the carrying value of the cost pool was reduced by the amount of the proceeds received, and no gain or loss on disposal was recorded.

Under IFRS, the Corporation classifies assets for which no proved or feasible reserves have been determined as exploration and evaluation properties. These properties are not depleted, but are assessed for impairment on an individual property basis. Properties with proved and feasible reserves are classified as property, plant and equipment, and are individually depleted on a unit-of-production basis over the reserves of each property. When either exploration and evaluation properties or those classified as property, plant and equipment are disposed, the Corporation records a gain or loss on disposal for any difference between proceeds received and the carrying value of the property disposed.

Applying IFRS resulted in the following related changes to Corporation's consolidated financial statements:

#### *Reclassification*

\$7,012,000 was reclassified from property, plant and equipment to exploration and evaluation properties as at January 1, 2010.

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### *Impairment*

Property, plant and equipment as at January 1, 2010 was further reduced by \$5,561,327, with a corresponding increase to deficit, to reflect impairment of certain properties not recognized under Canadian GAAP. For the three months ended March 31, 2010, the Company recorded a \$31,182 impairment charge under IFRS, decreasing the carrying value of property, plant and equipment. For the year ended December 31, 2010, the application of IFRS resulted in a \$4,887,192 decrease to impairment expense than that recorded under Canadian GAAP.

### *Depletion*

Under IFRS, depletion of property, plant and equipment decreased by \$318,748 for the three months ended March 31, 2010 and by \$443,238 for the year ended December 31, 2010 compared with amounts reported under Canadian GAAP, with corresponding increases to property, plant and equipment as at March 31, 2010 and December 31, 2010.

### *Gain on disposal of exploration and evaluation properties*

Under IFRS, the Corporation recorded a \$4,980,000 gain on the disposal of certain exploration and evaluation properties for the three months ended March 31, 2010. Under Canadian GAAP, this amount was reported as a reduction to the carrying value of property, plant and equipment. Accordingly, property, plant and equipment as at March 31, 2010 increased by \$4,980,000 under IFRS compared with Canadian GAAP.

### *Impact on gain on disposal of subsidiary*

The differences in depletion and the gain on disposal of exploration and evaluation properties under IFRS resulted in differences to the carrying value of assets held by a subsidiary disposed in May 2010. Accordingly, the IFRS gain on sale of the subsidiary decreased by \$2,036,282 compared with that reported under Canadian GAAP.

### *Impact on income taxes, non-controlling interests and deficit*

As a result of the IFRS adjustments discussed above, deferred income tax recovery decreased by \$1,342,969 for the three months ended March 31, 2010 and by \$1,332,311 for the year ended December 31, 2010. Similarly, net of the impact on deferred income taxes, non-controlling interest as at March 31, 2010 increased by \$1,769,723 under IFRS. Under IFRS, the above items, including their impacts on deferred income taxes and non-controlling interests, resulted in increases to the Corporation's deficit of \$5,561,327 as at January 1, 2010, \$3,406,453 as at March 31, 2010, and \$404,047 as at December 31, 2010.

### iii. Asset retirement obligation

Under Canadian GAAP, the Corporation used a credit and inflation-adjusted rate to discount future reclamation expenditures to their present value. Once established, this rate was not adjusted and accretion was recorded as an expense to reflect the unwinding of this discounted amount. Under IFRS the Corporation uses a risk free rate prevailing on the date of each consolidated statement of financial position to discount its reclamation liability.

As a result of updating the rate used to discount future expenditures, the Corporation's asset retirement obligation under IFRS increased \$783,211 as at January 1, 2010, \$735,429 as at

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March 31, 2010 and \$35,446 as at December 31, 2010, compared with Canadian GAAP. Accretion expense decreased by \$47,782 for the three months ended March 31, 2010 and \$100,670 for the year ended December 31, 2010.

### *Impact on gain on disposal of subsidiary*

The differences in the asset retirement obligation and accretion expenses under IFRS resulted in differences to the carrying value of assets held by a subsidiary disposed of during 2010. Accordingly, the IFRS gain on sale of the subsidiary increased by \$225,679 compared with that reported under Canadian GAAP.

### *Impact on income taxes, non-controlling interests and deficit*

As a result of the IFRS adjustments to the Corporation's asset retirement obligation and accretion expense, deferred income tax recovery decreased by \$9,641 for the three months ended March 31, 2010 and by \$15,055 for the year ended December 31, 2010. Similarly, net of the impact on deferred income taxes, non-controlling interest under IFRS decreased by \$233,609 as at January 1, 2010 and by \$220,905 as at March 31, 2010. Under IFRS, the above items, including their impacts on deferred income taxes and non-controlling interests, resulted in increases to the Corporation's deficit of \$369,999 as at January 1, 2010, \$344,562 as at March 31, 2010, and \$35,446 as at December 31, 2010.

#### iv. Debt origination fees

In 2009, the Corporation paid origination fees related to a note payable. Under Canadian GAAP, the Corporation recorded these fees as an expense in the period they were incurred. Under IFRS, the Corporation records these amounts as a reduction of the carrying value of debt at origination, and amortizes them over the life of the debt facility using the effective interest rate method.

As a result of the change to the treatment of these deferred fees under IFRS, both the note payable and the Corporation's deficit decreased by \$440,000 as at January 1, 2010 and \$220,000 as at March 31, 2010. Interest expense increased by \$220,000 for the three months ended March 31, 2010 and by \$440,000 for the year ended December 31, 2010.

#### v. Equity investment

As at January 1, 2010, the Corporation held 58.1% of the voting shares of Marble Point Energy Limited ("Marble Point"), now Teine Energy Ltd. The Corporation sold its full interest in Marble Point during the second quarter of 2010.

Control over Marble Point was shared with another party, and the Corporation's interest has been recorded using the equity method of accounting under both Canadian GAAP and IFRS. However, certain adjustments have been made in the transition of Marble Point's financial statements to IFRS and the Corporation's share of these adjustments is reflected in its reconciliations between Canadian GAAP and IFRS. The most significant IFRS transition adjustments for Marble Point and their impacts on the Corporation's financial statements are as follows:

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### *Asset retirement obligation*

As discussed in Note 4f(iii), IFRS requires the use of a risk free interest rate prevailing on each balance sheet date when discounting an asset retirement obligation to its present value. Under IFRS, a lower interest rate was used to determine Marble Point's asset retirement obligation, which increased the value of the obligation attributed to the Corporation's interest in Marble Point by \$2,603,767 as at January 1, 2010. The lower interest rate under IFRS reduced the Corporation's share of financing fees by \$13,496, and as at March 31, 2010, the Corporation's share of the Marble Point's asset retirement obligation was \$2,590,271 more than under Canadian GAAP.

### *Long-term incentive plan*

Under Canadian GAAP, the value of a cash option feature of a long-term incentive plan was presented as a component of the plan liability. Under IFRS, the value attributed to this feature is presented as a component of equity. As a result, the Corporation's equity investment as at January 1, 2010 and March 31, 2010 increased by \$91,327 to reflect its share of the increase in Marble Point's equity.

### *Stock-based compensation*

Under Canadian GAAP, Marble Point recognized the fair value of stock-based compensation as an expense on a straight-line basis over the vesting period of the group of options granted. Under IFRS, the fair value attributed to options is recognized over the vesting period of each option. As a result, the Corporation's share of Marble Point's stock-based compensation expense for the three months ended March 31, 2010 increased by \$49,968, and the carrying value of the Corporation's equity investment decreased by the same amount as at March 31, 2010.

### *Gain on disposal of equity investment*

As a result of the Corporation's share of Marble Point's IFRS adjustments for the asset retirement obligation, compound financial instruments, stock-based compensation, and other insignificant adjustments, the carrying value of the Corporation's investment in Marble Point decreased by \$2,539,779 as at March 31, 2010. When the investment was disposed in the second quarter of 2010, the resulting gain on sale increased by the same amount under IFRS for the year ended December 31, 2010.

## **5. CASH AND CASH EQUIVALENTS AND RESTRICTED CASH**

Cash and cash equivalents comprise the following:

	<b>March 31 2011</b>	December 31 2010
	\$	\$
<b>Cash and cash equivalents</b>		
Operating account	<b>12,090,151</b>	7,518,488
Term deposit	<b>67,700,081</b>	67,500,105
	<b>79,790,232</b>	75,018,593

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The operating account and term deposits are held with chartered Canadian banks. The term deposits earn at fixed and variable interest rates, effectively bearing between 1.10% and 1.30% as at March 31, 2011, can be redeemed without penalty within 90 days of the original investment dates, and are not subject to valuation fluctuations.

As at March 31, 2011, the Corporation held \$0.3 million in cash restricted as security for a letter of credit held with a government authority for environmental reclamation. As at December 31, 2010, the Corporation had no restrictions on any cash balances.

**6. ASSETS AND LIABILITIES CLASSIFIED AS HELD FOR SALE**

The significant classes of assets and liabilities held for sale as at March 31, 2011 and December 31, 2010 are as follows:

	<b>March 31</b>	December 31
	<b>2011</b>	2010
	\$	\$
<b>Assets classified as held for sale</b>		
E&E properties	-	-
P&NG properties	<b>1,074,143</b>	-
	<b>1,074,143</b>	-
<b>Liabilities associated with assets classified as held for sale</b>		
Asset retirement obligation	<b>779,174</b>	-
	<b>779,174</b>	-

During 2010, the Corporation commenced a program to assess potential exit strategies for its remaining exploration and evaluation properties and P&NG properties. While management was committed to sell these assets, the timing of such disposals was uncertain. During the three months ended March 31, 2011 the Corporation has increased its efforts to dispose of these assets, which are expected to be disposed of within the next 12 months.

Subsequent to March 31, 2011, the Corporation received an offer, which it is currently in the process of finalizing, to dispose of its remaining E&E and P&NG properties, including the asset retirement obligations associated with these properties, to an unrelated party.

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**7. EXPLORATION AND EVALUATION PROPERTIES**

As at March 31, 2011, the Corporation does not intend to further explore these properties and has recorded a full impairment charge against any costs attributed to these properties. Further, the Corporation's remaining E&E properties have been reclassified as assets held for sale, further discussed in note 6.

	\$
<b>Cost</b>	
Balance, January 1, 2010	7,012,000
Additions	97,914
Disposals	(7,071,807)
Balance, December 31, 2010	38,107
Additions	3,536
Transferred to assets classified as held for sale	(41,643)
<b>Balance, March 31, 2011</b>	<b>-</b>
<b>Accumulated impairment</b>	
Balance, January 1, 2010	-
Additions	97,914
Disposals	(59,807)
Balance, December 31, 2010	38,107
Additions	3,536
Transferred to assets classified as held for sale	(41,643)
<b>Balance, March 31, 2011</b>	<b>-</b>
<b>Carrying value</b>	
January 1, 2010	7,012,000
December 31, 2010	-
<b>March 31, 2011</b>	<b>-</b>

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**8. PROPERTY, PLANT AND EQUIPMENT**

Movements in the Corporation's property, plant and equipment are as follows:

	P&NG Assets	Office Equipment	Total
	\$	\$	\$
<b>Cost</b>			
Balance, January 1, 2010	48,435,000	481,862	48,916,862
Additions	162,094	-	162,094
Disposals	(46,365,000)	(98,574)	(46,463,574)
Balance, December 31, 2010	2,232,094	383,288	2,615,382
Additions	30,882	-	30,822
Transferred to assets classified as held for sale	(2,262,976)	-	(2,262,976)
<b>Balance, March 31, 2011</b>	<b>-</b>	<b>383,288</b>	<b>383,288</b>
<b>Accumulated depletion, depreciation and impairment</b>			
Balance, January 1, 2010	-	266,001	266,001
Depletion and depreciation	3,848,915	32,141	3,881,056
Impairment	1,008,408	-	1,008,408
Disposals	(3,683,618)	(40,113)	(3,723,731)
Balance, December 31, 2010	1,173,705	258,029	1,431,734
Additions	15,128	12,663	27,791
Transferred to assets classified as held for sale	(1,188,833)	-	(1,188,833)
<b>Balance, March 31, 2011</b>	<b>-</b>	<b>270,692</b>	<b>270,692</b>
<b>Carrying value</b>			
January 1, 2010	48,435,000	215,861	48,650,861
December 31, 2010	1,058,389	125,259	1,183,648
<b>March 31, 2011</b>	<b>-</b>	<b>112,596</b>	<b>112,596</b>

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**9. ASSET RETIREMENT OBLIGATION**

The Corporation's asset retirement obligation is determined by discounting its portion of the estimated timing and amount of the future costs required to remediate, reclaim and abandon its P&NG wells. These costs have been estimated using an inflation rate of 2% and, as at March 31, 2011, have been discounted to their present value using a risk-free rate of 1%.

	\$
Balance, January 1, 2010	5,633,736
Liabilities disposed	(4,573,780)
Additional liabilities incurred	200,000
Reclamation expenditures	(10,797)
Changes to estimates	(545,965)
Accretion expense	74,039
Balance, December 31, 2010	777,231
Accretion expense	1,943
Reclassified as liabilities held for sale	(779,174)
<b>Balance, March 31, 2011</b>	<b>-</b>

As at March 31, 2011, the undiscounted value of cash flows required to settle the estimated asset retirement obligation is \$0.8 million, with expenditures expected to occur between 2011 and 2029.

As at March 31, 2011, the Corporation's remaining P&NG assets have been classified as held for sale. As such, liabilities related to these assets, which include asset retirement obligations, have also been classified as held for sale, as discussed in note 6.

**10. INCOME TAXES**

Income tax expense for the three months ended March 31, 2011 and 2010 comprises the following:

	2011	2010
	\$	\$
Current portion of income tax expense	-	-
Deferred income tax expense	-	807,873
	-	807,873

As at March 31, 2011, no objective evidence exists to indicate that the deferred benefits from taxable losses incurred in the three months then ended will be realized. As such, no deferred income tax recovery has been reported.

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**11. SHAREHOLDERS' EQUITY**

**a) Share capital**

*Authorized*

Unlimited number of common voting shares with no par value

Unlimited number of preferred shares with no par value

*Issued and outstanding*

	<b>Number of Common Shares</b>	<b>Assigned Value</b>
		<b>\$</b>
Outstanding, January 1, 2010	46,252,495	119,397,580
Issued on exercise of warrants, net of transaction costs	7,787,767	19,856,637
Cancelled	(1,022)	(2,155)
Outstanding, December 31, 2010	54,039,240	139,252,062
Issued on exercise of warrants, net of transaction costs	4,429,478	10,481,886
<b>Outstanding, March 31, 2011</b>	<b>58,468,718</b>	<b>149,733,948</b>

During the three months ended March 31, 2011, 4,429,478 common shares were issued as a result of the exercise of common share purchase warrants. Total cash proceeds, net of transaction costs, from the exercise of these warrants were \$5,536,848 and an additional \$4,945,038 in fair value attributed to these warrants has been reclassified from warrants to share capital.

**b) Stock-based compensation**

The expenses recorded for stock-based compensation for the three months ended March 31, 2011 and 2010 comprise the following:

	<b>2011</b>	2010
	<b>\$</b>	<b>\$</b>
Fair value of stock options recognized	-	196,686
Payments for stock appreciation rights	-	596,774
<b>Total stock-based compensation</b>	<b>-</b>	<b>793,460</b>

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*Stock options*

Pursuant to the Corporation's stock option plan, the aggregate number of shares that may be reserved for issuance under the plan shall not exceed 10% of the Corporation's issued and outstanding common shares. The number of options granted, as well as their vesting terms, contractual lives and exercise prices are at the discretion of the Board of Directors, provided that the exercise price is not less than the market price of the common shares on the grant date.

Changes to stock options outstanding during 2010 and 2011 are as follows:

	Number of options	Weighted average exercise price \$
Outstanding, January 1, 2010	122,400	3.13
Forfeited	(97,600)	4.12
Granted	2,460,000	1.29
Outstanding, December 31, 2010	2,484,800	1.31
<b>Outstanding, March 31, 2011</b>	<b>2,484,800</b>	<b>1.31</b>

The following table summarizes the terms of stock options outstanding and exercisable as at March 31, 2011:

Options Outstanding			Options Exercisable	
Weighted Average Exercise Price \$	Number of Options Outstanding	Weighted Average Remaining Contractual Life Years	Weighted Average Exercise Price \$	Number of Options Outstanding
1.28	2,310,000	4.4	1.28	2,310,000
1.40	150,000	4.7	1.40	150,000
3.13	24,800	1.9	3.13	24,800
<b>1.31</b>	<b>2,484,800</b>	<b>4.4</b>	<b>1.31</b>	<b>2,484,800</b>

*Stock appreciation rights*

During the year ended December 31, 2009, the Corporation created a Stock Appreciation Rights Plan ("Plan") under which, stock appreciation rights ("SARs") to certain directors and officers the Corporation. On August 27, 2010, the SARs Plan was terminated by the Corporation's Board of Directors, resulting in the immediate exercise of all remaining unexercised SARs.

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c) Warrants

Changes to warrants outstanding during 2010 and 2011 are as follows:

	Number of Warrants	Weighted Average Exercise Price	Weighted Average Fair Value per Warrant	Total Value
		\$	\$	\$
Outstanding, December 31, 2009	28,169,735	1.25	1.10	31,054,963
Exercised	(7,787,767)	1.25	1.30	(10,158,268)
Outstanding, December 31, 2010	20,381,968	1.29	1.03	20,896,695
Exercised	(4,429,478)	1.25	1.12	(4,945,038)
Expired	(4,681,042)	2.50	1.82	(8,507,254)
<b>Outstanding, March 31, 2011</b>	<b>11,271,448</b>	<b>2.50</b>	<b>0.66</b>	<b>7,444,403</b>

The following table summarizes the terms of warrants outstanding and exercisable as at March 31, 2011:

Exercise price	Number of Warrants Outstanding	Weighted Average Remaining Contractual Life	Number of Exercisable Warrants
\$		Years	
2.50	10,688,607	0.5	10,688,607
2.50	582,841	0.5	582,841
<b>2.50</b>	<b>11,271,448</b>	<b>0.5</b>	<b>11,271,448</b>

d) Per share amounts

Weighted average per share amounts for the three months ended March 31, 2011 and 2010 are calculated as follows:

	2011	2010
<b>\$ - unless otherwise stated</b>		
<b>Numerator</b>		
Net loss and comprehensive loss attributed to shareholders of the Corporation	(185,478)	(1,561,180)
<b>Denominator</b>		
Weighted average number of shares outstanding, basic and diluted	58,092,165	46,252,320
<b>Loss per share, basic and diluted</b>	<b>0.00</b>	<b>(0.03)</b>

Diluted weighted average shares outstanding for the three months ended March 31, 2011 excludes the impact of 11,271,448 warrants and 2,484,800 stock options outstanding as at March 31, 2011, as well as the dilutive effect of 4,429,478 warrants outstanding during the period prior to their exercise. These items have been excluded from the calculation of diluted loss per share, as their inclusion is anti-dilutive in periods when a loss is incurred. Similarly,

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28,169,735 warrants and 24,800 stock options outstanding as at March 31, 2010 are excluded from the calculation of diluted loss per share for the three months ended March 31, 2010.

### 12. COMMITMENTS & CONTINGENCIES

#### a) Management services agreement

The Corporation is party to a management services agreement for the provision certain executive and administrative functions at a rate of \$10,000 per month. The agreement expires in December 2012 and is renewed on an annual basis thereafter, but can be cancelled on two months' notice. The counter-party to the agreement is related to the Corporation (see note 13).

#### b) Indemnifications

From time to time, the Corporation may be involved in litigation or have claims sought against it in the normal course of business operations. As at or subsequent to March 31, 2010, the Corporation is unaware of any claims or actions that would materially affect its reported financial position or results from operations.

Under the terms of certain agreements and the by-laws of the Corporation, the Corporation indemnifies individuals who have acted at the request of the Corporation to be a director and/or officer to the extent permitted by law, against any and all damages, liabilities, costs, charges or expenses suffered by or incurred by the individuals as a result of their service.

### 13. RELATED PARTY TRANSACTIONS

During the three months ended March 31, 2011 the Corporation recorded an expense of \$38,640 for consulting services provided by Michael Atkinson and Harry Knutson, two directors of the Corporation, or to parties related to these directors. The fees were for management and business development services provided in the normal course of business, and have been measured at an exchange amount also considered to be equivalent to the amount that would have been paid to an unrelated third party. As at March 31, 2011, \$7,840 of related amounts is included in accounts payable and accrued liabilities.

In December 2010, the Corporation entered into a management services agreement with Ionic Management Corp. for services provided by the Chief Financial Officer of the Corporation and other administrative services. Ionic Management Corp. is related through affiliation with the Chief Financial Officer and Michael Atkinson. For the three months ended March 31, 2011, the Corporation recorded an expense of \$32,611 for such services. As at March 31, 2011, \$10,631 is included in accounts payable and accrued liabilities.

### 14. FINANCIAL INSTRUMENTS

#### Fair value of financial instruments

The Corporation's financial instruments as at March 31, 2011 consist of cash and cash equivalents, accounts receivable, and accounts payable and accrued liabilities. The carrying values of all of the Corporation's financial instruments are equal to their fair values. The fair values of financial instruments are allocated between three levels of a fair value hierarchy,

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based on the degree of certainty around the fair values. The levels and the valuation techniques used to value financial instruments are as follows:

### *Level 1 - Quoted prices in active markets for identical assets*

Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities.

### *Level 2 - Significant other observable inputs*

Quoted prices in markets that are not active, quoted prices for similar assets or liabilities in active markets, or inputs that are observable, either directly or indirectly, for substantially the full term of the asset or liability.

### *Level 3 - Significant unobservable inputs*

Significant reliance is placed on unobservable prices, supported by little or no market activity.

As at March 31, 2011, all financial instruments held by the Corporation were considered to be Level 1 financial instruments whose fair values approximate their carrying values.

## **Classification of financial instruments**

All financial assets (except for cash and cash equivalents which are classified as held for trading) are classified as either loans or receivables and are accounted for on an amortized cost basis. All financial liabilities are classified as other liabilities. There are no financial assets on the consolidated statement of financial position that have been designated as available-for-sale. There have been no changes to the aforementioned classifications during the three months ended March 31, 2011.

## **Financial instrument risk management**

The nature of these instruments and its operations expose the Corporation to market risks and credit risks. The Corporation manages its exposure to these risks by operating in a manner that minimizes this exposure. While management monitors and administers these risks, the Board of Directors of the Corporation has the overall responsibility for the establishment and oversight of the Corporation's risk management framework.

### **a) Market risks**

Market risks to which the Corporation is exposed include unfavorable movements in commodity prices, interest rates, and foreign exchange rates. As at March 31, 2011, the Corporation has disposed of most of its producing assets and holds a significant cash position. Consequently, its exposure to these risks has been significantly reduced, but as the Corporation redeploys its cash, exposure to these risks may increase. The objective of the Group is to mitigate exposure to these risks while maximizing returns.

#### *Commodity price risk*

The Corporation is exposed to adverse consequences such as declining revenue and asset recoverability in the event of declining oil and gas prices. The Corporation manages commodity

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price risk by updating and monitoring forecast cash flows and profitability and taking appropriate actions as needed. To date, the Corporation has not used hedging strategies, such as forward oil and natural gas sale contracts to lock-in prices with respect to future deliveries, to counter commodity price risk, but it may do so in the future.

### *Interest rate risk*

As at March 31, 2011, the Corporation's exposure to movements in interest rates was limited to potential decreases in interest income from variable rate interest income on its cash and cash equivalents. The Corporation mitigates its exposure to this risk by holding its cash and cash equivalents in a combination of fixed and variable interest rate accounts, held with three Canadian chartered banks. As at March 31, 2011, \$40.1 million of the Corporation's cash and cash equivalents were held in fixed interest rate accounts, and \$39.7 million was held in variable interest rate accounts, based on Canadian prime rates. Based on these allocations, an immediate and prolonged 1% decrease in market interest rates would result in a \$0.4 decrease in pre-tax interest income over a 12-month period, and an immediate and prolonged 1% increase in market interest rates would result in a \$0.4 million increase in pre-tax interest income over a 12-month period.

### *Foreign exchange risk*

Although the Corporation's P&NG revenues are denominated in Canadian dollars, the underlying market prices of these commodities are quoted in United States dollars, exposing the Corporation to fluctuations in the exchange rate between the Canadian and the United States dollar. The Corporation does not make any significant foreign currency denominated payments. Management monitors foreign exchange rate movements, but as at March 31, 2011 the Corporation had no currency hedging contracts in place to manage foreign exchange risk and no such contracts have been utilized during 2011.

### **b) Credit risk**

Credit risk is the risk of default on payment by counterparties to financial assets held by the Corporation. Virtually all of the Corporation's accounts receivables are concentrated with a limited number of customers and joint venture partners in the oil and gas industry. Management considers this concentration of credit risk to be acceptable, as customers are major industry participants, and receivables from partners are protected by effective industry standard legal remedies. The Corporation requires cash calls from its partners on major field projects in advance of commencement.

Consolidated accounts receivable as at March 31, 2011 were \$0.1 million, net of a \$0.2 million provision for bad debts on one account.

The maximum exposure to credit risk is therefore represented by the carrying amount of accounts receivable on the consolidated statement of financial position. In the immediate future, it is not expected that the Corporation's exposure to credit risk will be significant, until such time as cash is redeployed in new P&NG assets.

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### **e) Concentration risk**

Concentration risk is the risk that a significant proportion of the Corporation's cash and cash equivalents are held with one financial institution, exposing the Corporation to the risk that this institution may not have the liquidity to honour withdrawals or redemptions of the Corporation's funds. Concentration risk is managed by placing cash and cash equivalents between several chartered Canadian banks.

As at March 31, 2011, the largest holding of cash and cash equivalents with one financial institution was \$40.1 million.

## **15. CAPITAL MANAGEMENT**

The Corporation's objectives when managing capital is to safeguard its ability to continue as a going concern, so that it can continue to provide returns for shareholders and benefits for other stakeholders. The Corporation defines capital as shareholder equity and working capital. The Board of Directors does not establish quantitative return on capital criteria for management; but rather promotes year-over-year sustainable profitable growth.

As at March 31, 2011, the Corporation's focus is to convert its remaining P&NG assets to cash at values that maximize shareholder value, while preserving the base of its cash and cash equivalents available for redeployment to producing assets. Notwithstanding the aforementioned focus, there have been no changes in the Group's capital management strategies and processes during 2011.

The Corporation has no externally imposed capital requirements and there are no external financial covenants to which the Corporation must adhere as at March 31, 2011.

## **16. SUBSEQUENT EVENTS**

### *Assets and liabilities held for sale*

In May 2011, the Corporation received a purchase offer for substantially all of its remaining E&E properties and P&NG assets, and the sale of these assets would relieve the Corporation of the related asset retirement obligation. Total consideration to the Corporation pursuant to the purchase offer is \$200,000, which is approximately equal to the carrying values of these assets, net of the related reclamation liabilities. Management expects that this sale will be finalized in the third quarter of 2011.

**CANADIAN PHOENIX RESOURCES CORP.**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**For the three months ended March 31, 2011**

**INTRODUCTION**

This management discussion and analysis ("MD&A") of financial position and results of operation of Canadian Phoenix Resources Corp. (the "Corporation") is prepared as at June 28, 2011 and should be read in conjunction with the Corporation's unaudited condensed consolidated interim financial statements and related notes as at and for the three months ended March 31, 2011 and with the Corporation's audited consolidated financial statements as at and for the years ended December 31, 2010 and 2009.

In conjunction with the Corporation's annual audited consolidated financial statements to be issued under International Financial Reporting Standards ("IFRS"), as issued by the International Accounting Standards Board ("IASB"), for the year ended December 31, 2011, the condensed consolidated interim financial statements as at and for the three months ended March 31, 2011 are the Corporation's initial financial statements prepared under IFRS. Accordingly, they have been prepared in accordance with International Financial Reporting Standard ("IFRS") 1, "First-time Adoption of International Financial Reporting Standards" and with International Accounting Standard 34, "Interim Financial Reporting", as issued by the International Accounting Standards Board. Previously, the company prepared its interim and annual consolidated financial statements in accordance with Canadian generally accepted accounting principles ("Canadian GAAP"). Unless otherwise noted, 2010 comparative information contained in this MD&A has been prepared in accordance with IFRS. The transition from Canadian GAAP to IFRS has not affected the Company's operations, strategic decisions and cash flow, but has resulted in certain accounting policy changes and adjustments to numbers previously reported under Canadian GAAP. These policy changes and adjustments are discussed under the "Changes in Accounting Policies and Transition to IFRS" section, herein.

Additional information relating to the Corporation, including Annual Information Forms, Management Information Circulars, NI 51-101 oil and gas disclosures, material change reports, and previous interim and annual financial statements are available on the System for Electronic Document Analysis and Retrieval ("SEDAR") at [www.sedar.com](http://www.sedar.com).

*Forward-looking statements*

This MD&A includes certain statements that constitute forward-looking statements or forward-looking information (collectively, "forward-looking information") within the meaning of applicable securities laws. These statements may appear throughout this MD&A and include the views of management and the Corporation's directors on areas including but not limited to the Corporation's expected future financial position, financial and operational results, the execution of the Company's business strategy, access to capital, and the outcomes of uncertain events. When used in this MD&A, words such as "believe," "anticipate," "project," "intend," "expect," "may," "will," "plan," "attempts," "seeks," and similar expressions are intended to identify these forward-looking statements.

Forward-looking statements are based on current expectations which themselves may be based on significant judgment and estimates. Also, the actual outcomes of forward looking statements are dependent on a number of risks and uncertainties. These risks and uncertainties, many of which are beyond the control of the Corporation, include the impact of general economic conditions and specific industry conditions, volatility of commodity prices, currency fluctuations, imprecision of reserve estimates, environmental risks, competition from other producers, stock market volatility and ability to generate sustainable future earnings.

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The Corporation's actual results, performance or achievements could differ materially from those expressed in, or implied by these forward-looking statements, and accordingly, no assurance can be given that any events, situations or outcomes indicated in these forward-looking statements will transpire or what benefits or liabilities to the Corporation will arise from these outcomes. Accordingly, readers of this MD&A are cautioned against placing undue reliance on forward-looking statements. Unless required by law, the Corporation will not update or revise any forward-looking statements contained in this MD&A to reflect actual results, and differences between actual results or outcomes and those indicated in forward-looking statements herein will not be publicly announced with reference to these forward-looking statements.

**BUSINESS PROFILE AND STRATEGY**

Historically, the Corporation's business strategy has been to consolidate undervalued oil and gas assets in the Western Canadian Sedimentary Basin, while also being involved in the exploration, development and operation of oil and natural gas properties in certain high-potential, multi-zone areas in Western Canada. Following this strategy, the Corporation strived to maintain a risk balance between exploration, development and operational projects, combined with the strategic acquisition of assets that met its business parameters.

In mid-2009, the Corporation constituted a Special Committee of independent directors to investigate and evaluate strategic alternatives available to the Corporation, including opportunities to divest certain of its oil and gas assets. During 2010, the Corporation disposed of its controlling interest in Serrano Energy Ltd ("Serrano") and in its equity investment in Marble Point Energy Limited ("Marble Point"), substantially increasing its cash position.

Management is currently assessing alternatives to redeploy the Corporation's cash into the oil and gas sector such as direct acquisitions of exploration-stage or producing oil and gas properties with the objective of earning production revenues, and exploration projects with the objective of earning royalty streams. With prices for natural gas being well below pre-recession levels, management has not identified any suitable investments to date that would provide shareholder value; however, with oil prices rebounding in 2010 and into 2011, management remains optimistic that an appropriate investment alternative will be identified, although the timing and nature of such an investment is uncertain.

**NON-IFRS MEASUREMENTS**

The following terms are used in this MD&A, but do not have any standardized meaning prescribed by IFRS and therefore might not be comparable with similarly described measures for other companies. The Corporation defines these terms as follows:

- "Funds from operations" are cash flows from operating activities, excluding related changes in non-cash working capital.
- "Netbacks" equal total oil and gas sales, less royalties and operating costs.

Funds from operations and netbacks may be presented as a total amount, on a per share basis, or on a per barrel of oil equivalent ("boe") basis. Measurements on a boe basis are used to present all petroleum and natural gas ("P&NG") measures in uniform units which are calculated using a conversion rate of six thousand cubic feet of natural gas to one barrel of oil ("6:1") based on an energy equivalency conversion method primarily applicable at the burner tip and does not

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represent a value equivalency at the wellhead. Readers are cautioned not to view non-IFRS measures as alternatives to financial measures calculated in accordance with IFRS.

**FIRST QUARTER 2011 FINANCIAL HIGHLIGHTS AND FINANCIAL POSITION**

The following table highlights certain aspects of the Corporation's financial performance and position as at and for the three months ended March 31, 2011. This information should be read in conjunction with the "Results of Operations" section of this MD&A.

	<b>For the three months ended</b>	
	<b>March 31</b>	
	<b>2011</b>	<b>2010</b>
Total P&NG production (boe)	<b>1,243</b>	89,569
Average daily P&NG production (boe)	<b>14</b>	995
Average realized price of oil (\$/boe)	<b>79.21</b>	63.75
Average realized price of natural gas (\$/mcf)	<b>3.97</b>	5.28
Oil and natural gas sales, gross of in-kind royalties	<b>52</b>	5,652
Netbacks	<b>(185)</b>	2,055
Netbacks (\$/boe)	<b>(149)</b>	23
Net interest income (expense)	<b>272</b>	(393)
Net income - equity investment	<b>-</b>	489
Impairment of exploration and evaluation properties	<b>(4)</b>	(31)
Gain on disposal of exploration and evaluation property	<b>-</b>	4,980
Net (loss) and comprehensive (loss) income	<b>(185)</b>	1,580
Net loss and comprehensive loss attributed to shareholders of the Corporation	<b>(185)</b>	(1,588)
Basic and diluted loss per share	<b>0.00</b>	(0.03)
Weighted average number of shares	<b>58,092,165</b>	46,252,320
Funds (used in) from operations	<b>(473)</b>	319
Capital expenditures	<b>4</b>	482
	<b>As at</b>	<b>As at</b>
	<b>March 31</b>	<b>December 31</b>
	<b>2011</b>	<b>2010</b>
Cash on hand	<b>79,831</b>	75,019
Working capital surplus	<b>79,799</b>	75,633
Assets held for sale, net of related liabilities	<b>295</b>	-
Total assets	<b>81,459</b>	76,349
Asset retirement obligation	<b>-</b>	777
Common shares outstanding	<b>58,468,718</b>	54,039,240
Fully diluted common shares outstanding <sup>1</sup>	<b>72,225,006</b>	76,906,008

<sup>1</sup> Fully diluted common shares outstanding is calculated based on the full exercise of all share purchase warrants and stock options outstanding as at the reported date.

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The decrease in production of oil and natural gas sales during the first quarter of 2011 compared with 2010 reflects negligible levels of production from its remaining oil and gas assets following the disposals of Serrano in the second quarter of 2010. During the first quarter of 2010, 87,418 boe of the total 89,569 boe production was from Serrano; excluding the impact of Serrano, the corporation produced 2,151 boe in the first quarter of 2010. Production from the Corporation's remaining assets in the first quarter of 2011 declined from their 2010 as certain wells have been shut-in or did not operate due to poor economic feasibility during the first three months of 2011.

Although oil prices were higher during the first quarter of 2011 compared with the same period in 2010, declines in gas prices and the loss of Serrano-related production led to overall decreases in oil and natural gas sales for the three months ended March 31, 2011 compared with the same period in 2010. Operating costs in the first quarter of 2011 were lower than in 2010, owing to the inclusion of Serrano's operations in 2010. However, certain fixed maintenance and other operating costs in the first quarter of 2011 exceeded oil and natural gas sales resulting in a negative netback of \$0.2 million for 2011 compared with a positive netback of \$2.1 million for the first quarter of 2010.

Coupled with the impacts of \$0.3 million in general and administrative expenditures, which were off-set by \$0.3 million in interest income, the lower netback in 2011 led to a net and comprehensive loss of \$0.2 million for the first quarter of 2011 compared with net and comprehensive income of \$1.6 million for 2010. Likewise, the Corporation incurred negative operating cash flows of \$0.5 million in the first quarter of 2011 compared with positive operating cash flows of \$0.3 million in 2010.

As a result of cash proceeds from the exercise of common share purchase warrants in the first quarter of 2011, the Corporation's cash and cash equivalents were increased from \$75.0 million as at December 31, 2010 to which increased to over \$79.8 million as at March 31, 2011. As at June 28, 2011, the Corporation held \$79.6 million in cash and cash equivalents.

As at March 31, 2011, the Corporation classified all of its exploration and evaluation properties and P&NG assets as held for sale, reflecting management's intention to sell these assets and that a sale is likely to occur in the next year. As such, these assets will no longer be depleted, but will be valued at their fair value less costs to sell. Likewise, the asset retirement obligation related to these assets has also been classified as held for sale. The net carrying value of these assets is \$295 thousand, which is consistent with recent purchase offers received by the Corporation.

## **OUTLOOK**

The Corporation's ability to generate future net income is primarily dependent on the successful redeployment of cash into new assets or revenue streams. As discussed under the "Business and Profile" section, herein, management has assessed a number of potential investment opportunities, but none have met the key criterion of increasing shareholder value. Management will continue to assess investment opportunities through 2011, but the timing for reinvesting in new oil and gas assets or revenue streams is uncertain, as is the exact form that such a transaction will take. Until such a transaction transpires, it is expected that oil and gas revenues from existing assets, as well as related operational activities, will remain low.

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**OPERATIONAL REVIEW**

**Petroleum and natural gas revenue**

<i>(\$ thousands, except as indicated)</i>	<b>For the three months ended March 31</b>	
	<b>2011</b>	<b>2010</b>
<b>Revenue, excluding in-kind royalties</b>		
Heavy oil	-	5,569
Light oil	32	26
Natural gas	20	57
	<b>52</b>	<b>5,652</b>
<b>Production volumes and prices</b>		
Total production (boe)	<b>1,243</b>	89,569
Average daily production (boe)	<b>14</b>	995
Average realized selling price – oil (\$/bbl)	<b>79.21</b>	63.75
Average realized selling price – natural gas (\$/mcf)	<b>3.97</b>	5.28

Prior to the disposal of the Corporation's controlling interest in Serrano in May 2010, the majority of the Corporation's revenue came from sales of heavy oil produced by Serrano. Without the benefit of Serrano's operations, production and revenues are significantly lower for the three months ended March 31, 2011 compared with the same period in 2010. Excluding the impact of Serrano's heavy oil production, sales of light oil and natural gas from the Corporation's remaining interests are slightly lower in the first quarter of 2011 than in 2010 because some wells were shut-in during 2011. Additionally, approximately 70% of the Corporation's boe production during the first quarter of 2011 was natural gas, so decreases to market prices for natural gas led to overall decreases in revenues despite increases to market prices for light oil.

**Royalties**

The Corporation pays royalties to the governing bodies in the jurisdictions in which it produces, as well as to land holders and other industry participants. Royalties, including in-kind royalties incurred for production in the three months ended March 31, 2011 and 2010 are as follows:

<i>(\$ thousands, except as indicated)</i>	<b>For the three months ended March 31</b>	
	<b>2011</b>	<b>2010</b>
Total royalty expense	<b>19</b>	1,491
Average royalty expense (\$/boe)	<b>15.28</b>	16.65

For the three months ended March 31, 2011, the Corporation's royalty expense per boe decreased from \$16.65 in the same period of 2010 to \$15.28, reflecting lower per unit revenues subsequent to the disposal of Serrano, as the Corporation's weighting of natural gas revenues increased.

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**Operating costs**

<i>(\$ thousands, except as indicated)</i>	<b>For the three months ended March 31</b>	
	<b>2011</b>	2010
Total operating costs	<b>218</b>	2,106
Average operating costs (\$/boe)	<b>175.32</b>	23.51

Total operating costs for the three months ended March 31, 2011 were lower than for the same period in 2010 as a result of a significant decrease in production following the disposal of Serrano. However, as production declined and certain fixed operating costs remained, operating costs per unit of production increased from \$23.51 per boe in 2010 to \$175.32 per boe in 2011.

**General and administrative (“G&A”) expenses**

<i>(\$ thousands, except as indicated)</i>	<b>For the three months ended March 31</b>	
	<b>2011</b>	2010
Total G&A expenses	<b>258</b>	1,352
Total stock-based compensation	-	794
Average G&A expenses and stock-based compensation (\$/boe)	<b>216.71</b>	22.37

Following the Corporation’s disposal of its Serrano operations, G&A costs decreased significantly as a result of smaller back-office support required to administer day-to-day operations. Total G&A expense for the three months ended March 31, 2011 comprised \$104 thousand in consulting fees and salaries for executive, accounting, land and administrative personnel; \$70 thousand for legal, transfer agent and audit fees; and \$84 thousand in other office and administrative costs.

During the three months ended March 31, 2010, the Corporation incurred \$197 thousand in stock-based compensation related to its Serrano operations, and \$597 thousand related to stock appreciation rights. No equivalent charges were incurred in 2011.

As the rates of G&A and stock-based compensation are not directly related to levels of P&NG production, these costs are higher on a per boe basis for the three months ended March 31, 2011 compared with 2010, reflecting a significant decrease in production.

**Impairment, depletion and depreciation**

<i>(\$ thousands, except as indicated)</i>	<b>For the three months ended March 31</b>	
	<b>2011</b>	2010
Total impairment of exploration and evaluation properties and property, plant and equipment	<b>4</b>	31
Total depletion and depreciation	<b>28</b>	2,609
Average impairment, depletion and depreciation (\$/boe)	<b>22.52</b>	29.13

The Corporation records depletion on its P&NG property, plant and equipment on a unit-of-production basis. Following the disposal of Serrano in the second quarter of 2010, levels of production were lower for the three months ended March 31, 2011 compared with 2010, resulting

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in a decrease in the depletion and depreciation charge for the corresponding period. Additionally, impairments to certain properties recorded throughout 2010 resulted in a smaller depletable base for the first three months of 2011 compared with that of 2010. Consequently, the Corporation's average depletion charge per boe decreased from \$29.13 for the first quarter of 2010 to \$22.52 for the first quarter of 2011.

As at March 31, 2011, all remaining exploration and evaluation properties and P&NG property, plant and equipment was classified as held for sale. Immediately prior to this classification, assets were assessed for impairment, with a \$4 thousand impairment being recorded to amounts previously classified as exploration and evaluation properties, bringing the carrying value of related properties to \$nil. A \$31 thousand charge was recorded in the first quarter of 2010 for the same properties.

**Interest and financing expense**

<i>(\$ thousands, except as indicated)</i>	<b>For the three months ended March 31</b>	
	<b>2011</b>	<b>2010</b>
Financing costs	<b>2</b>	41
Interest expense	-	393
	<b>2</b>	434

Financing costs for the three months ended March 31, 2011 and 2010 is made up of accretion on the Corporation's asset retirement obligation. This expense was higher in the first quarter of 2010 than in 2011 due to the retirement obligation for Serrano prior to its disposal in the second quarter of 2010.

Interest expense recorded for the first quarter of 2010 is made up of cash interest charges and the amortization of deferred financing costs related to a note payable and bank debt facility outstanding during the quarter. Both were repaid during 2010, so no equivalent charges were incurred during the first quarter of 2011.

**Other income (expenses)**

<i>(\$ thousands, except as indicated)</i>	<b>For the three months ended March 31</b>	
	<b>2011</b>	<b>2010</b>
Interest income	<b>272</b>	-
Bad debts recovery (expense)	<b>20</b>	(39)
Gain on disposal of exploration and evaluation properties	-	4,980
Net income – equity investment	-	489
Other income	-	122
	<b>292</b>	5,552

Following the disposals of Serrano and Marble Point in the second quarter of 2010 and the exercise of warrants in the fourth quarter of 2010 and first quarter of 2011, the Corporation's cash position as at March 31, 2011 was \$79.8 million. The Corporation keeps its cash in operating and term-deposit accounts earning between 1.10% and 1.30%, and interest revenue was \$0.3 million for the first quarter of 2011.

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During the first quarter of 2010, Serrano disposed of its Blackrod exploration and evaluation property. The Corporation recorded a \$5.0 million gain on the disposal of this asset. In the same quarter, the Corporation recorded \$0.5 million in income from its equity investment in Marble Point. Marble Point was disposed in the second quarter of 2010, so no equivalent amount has been earned in 2011.

**Income taxes**

<i>(\$ thousands, except as indicated)</i>	<b>For the three months ended March 31</b>	
	<b>2011</b>	<b>2010</b>
Current income tax expense	-	-
Future income tax expense	-	808
	-	808

Future income taxes for the three months ended March 31, 2010 relates primarily to the gain on disposal of the Blackrod exploration and evaluation property by Serrano. For income tax purposes, no taxable gain is recorded, but the proceeds from disposal reduce the balances of certain tax pools.

Consistent with prior periods, no tax benefits have been recorded for losses incurred by the Corporation or for the benefits of its tax pools, as it is not more likely than not that any future income tax benefits from these amounts would be realized from the Corporation's remaining properties.

The Corporation's tax pools at March 31, 2011 totaled \$63.0 million on a gross basis and are allocated as follows:

<b>Tax pool</b>	<b>Value (\$ thousands)</b>
Canadian oil and gas property expenses	4,041
Canadian development expenses	805
Canadian exploration expenses	6,669
Undepreciated capital costs	3,714
Non-capital loss carry-forwards	26,434
Capital loss carry-forwards	19,838
Share issuance costs	1,546

A full valuation allowance has been recognized against the future tax-effected benefit from these pools as it is not more likely than not that these benefits will be realized through future taxable income. At such a point when the Corporation demonstrates the ability to earn taxable income on a consistent basis, this valuation allowance may be partially or fully reversed.

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**Attribution of net (loss) income and comprehensive (loss) income**

<i>(\$ thousands, except as indicated)</i>	<b>For the three months ended March 31</b>	
	<b>2011</b>	<b>2010</b>
Net loss and comprehensive loss attributed to shareholders of the Corporation	<b>(185)</b>	(1,588)
Net income and comprehensive income attributed to non-controlling interests	-	3,168
<b>Net (loss) income and comprehensive (loss) income</b>	<b>(185)</b>	<b>1,580</b>

During the three months ended March 31, 2010, income earned by Serrano, which included a \$5.0 million gain on sale of the Blackrod property, was attributed to between the Corporation's controlling interest and non-controlling interest. Following the disposal of Serrano in the second quarter of 2010, all consolidated net (loss) income and comprehensive (loss) income is attributed to shareholders of the Corporation.

**QUARTERLY HIGHLIGHTS**

<i>(\$ thousands, except as indicated)</i>	<b>Q1 2011</b>	<b>Q4 2010</b>	<b>Q3 2010</b>	<b>Q2 2010</b>	<b>Q1 2010</b>	<b>Q4 2009<sup>1</sup></b>	<b>Q3 2009<sup>1</sup></b>	<b>Q2 2009<sup>1</sup></b>
<b>Revenues</b>								
Oil and natural gas sales, net of royalties	33	63	74	2,053	4,161	5,793	3,736	3,175
Interest income, net of interest expense	272	147	124	(311)	(393)	(333)	(390)	(86)
<b>Expenses</b>								
Operating costs	218	344	98	1,277	2,106	2,170	1,681	1,349
Depletion, depreciation and impairment	32	956	70	1,214	2,640	3,294	3,089	11,279
General and administrative costs and stock-based compensation	207	505	1,960	5,240	5,145	2,012	1,482	2,517
Financing fees	2	2	3	28	41	1,027	891	-
Net (loss) income – equity investment	-	-	-	(1,543)	489	(2,144)	(2,330)	(836)
Income tax recovery (expense)	-	-	-	961	(808)	81	827	593
Net (loss) income and comprehensive (loss) income	(185)	(1,563)	(1,970)	20,136	1,580	(5,583)	(4,576)	(11,083)
Basic and diluted (loss) income loss per share – attributable to shareholders of the Corporation	0.00	(0.03)	(0.04)	0.47	(0.03)	(0.66)	0.00	(0.01)
Working capital surplus (deficiency)	79,799	75,633	67,152	65,844	7,570	(13,226)	(11,395)	(11,533)

<sup>1</sup> 2009 amounts are presented in accordance with Canadian GAAP and have not been adjusted for the impacts of IFRS. Additionally, per share amounts reported in 2009 are based on shares outstanding prior to a 25:1 share consolidation in the fourth quarter of 2009. All amounts reported for 2010 and 2011 have been prepared in accordance with IFRS and are based on post-share consolidation shares outstanding.

Oil and natural gas sales, net of royalties decreased throughout 2010 and into the first quarter of 2011, compared with 2009, as a result of the disposals of assets held by Serrano in May 2010 and an increase in the number of remaining wells being shut-in. This decrease in production activity has generally led to corresponding decreases in operating costs and depletion and depreciation. Additionally, due to the disposals of Serrano and Marble Point and decreases in the number of

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remaining producing wells, the Corporation's operations have simplified, resulting in a general decline in general and administrative costs.

In the second quarter of 2010, the Corporation recorded \$28.5 million in total gains from the dispositions of Serrano and Marble Point, which resulted in a profitable second quarter of 2010. Additionally, the net proceeds of \$69.4 million from these disposals were used to repay loans payable at December 31, 2009. Consequently, interest income on the cash balance, net of interest expense on the loans payable, has increased in the second half of 2010 and the first quarter of 2011.

**LIQUIDITY & SOURCES OF CAPITAL**

The Corporation's working capital consists of accounts receivable, cash and cash equivalents, offset by accounts payable. As at March 31, 2011 there was a surplus in working capital of \$79.8 million, including cash and cash equivalents of \$79.8 million. In addition, the Corporation had \$63.0 million in total tax pools available reduce future taxable income, although no benefit has been recognized for these pools.

The Corporation's working capital surplus is in excess of immediate and near term operating requirements, and enables the Corporation to consider a number of alternatives to reinvest in the oil and gas sector. If required, the Board will seek conventional and alternative methods of financing to enable the Corporation to acquire assets or participate in other investments in the oil and gas sector, but it is not expected that the Corporation will require additional financing in the near term.

**Share capital**

During the first quarter of 2011, the Corporation issued 4,429,478 common shares by way of exercise of common share purchase warrants and an additional 4,681,042 warrants expired. As at March 31, 2011 and the date of this report, the Corporation had 58,468,718 common shares outstanding, 2,485,800 stock options outstanding and 11,271,118 common share purchase warrants outstanding.

**Contractual obligations, commitments and contingencies**

In the normal course of business, the Corporation may enter into various contractual obligations, which could include the following:

- management or professional services agreements;
- royalty agreements;
- processing agreements;
- right of way agreements; and
- lease obligations for office premises and equipment.

Effective December 1, 2010, the Corporation entered into an agreement with a related party for the provision of services filled by the Corporation's Interim Chief Financial Officer and Corporate Secretary, as well as certain administrative support. The term of this agreement is two years, automatically renewing on an annual basis thereafter, although it can be cancelled on two months' notice. Monthly fees payable under this agreement are \$10,000, and all related expenses

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are reimbursed by the Corporation.

The Corporation's operating lease for office space is renewed on a month-month basis at a cost of approximately \$4,000 per month.

The Corporation has no other capital or operating commitments and management is unaware of any contingent liabilities to which the Corporation is exposed.

**RELATED PARTY TRANSACTIONS**

During the three months ended March 31, 2011 the Corporation recorded an expense of \$38,640 for consulting services provided by Michael Atkinson and Harry Knutson, two directors of the Corporation, or to parties related to these directors. The fees were for management and business development services provided in the normal course of business, and have been measured at an exchange amount also considered to be equivalent to the amount that would have been paid to an unrelated third party. As at March 31, 2011, \$7,840 of related amounts is included in accounts payable and accrued liabilities.

As described under the heading "Contractual obligations, commitments and contingencies" section herein, the Corporation is party to a management services agreement for services provided by the Corporation's Interim Chief Financial Officer, Corporate Secretary and for other administrative services. The counterparty to the agreement is Ionic Management Services, which is related through affiliation with the Interim Chief Financial Officer and Michael Atkinson. For the first quarter ended March 31, 2011, the Corporation recorded an expense of \$32,611 with a \$10,631 in accounts payable as at March 31, 2011 for such services.

**OFF BALANCE SHEET ARRANGEMENTS**

Disclosure is required regarding all off-balance sheet arrangements such as transactions, agreements or contractual arrangements with unconsolidated entities, structured finance entities, special purpose entities or variable interest entities that are reasonably likely to materially affect the liquidity of or the availability of, or requirements for, capital resources. The Corporation had no such off-balance sheet arrangements as at March 31, 2011.

**FINANCIAL INSTRUMENTS AND RISK MANAGEMENT**

The Corporation is engaged in the exploration, development and production of crude oil and natural gas. The oil and gas business is inherently risky and there is no assurance that hydrocarbon reserves will be discovered and economically produced. The Corporation is exposed to a number of business risks, some of which are beyond its control, as are all companies in the oil and natural gas exploration and production industry. These risks can be categorized as operational, regulatory, liquidity, credit, and market risks.

**Operational risks**

Operational risks include the risk that P&NG exploration activities may not yield any exploitable reserves, or that any such reserves identified by the Corporation cannot be economically developed. Specific related risks include the risks that:

- required land rights are not obtained or maintained;

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- reservoir production is not effectively managed;
- production processes and costs are not effectively managed;
- the Corporation may not be able to market its P&NG production; and
- skilled and qualified personnel cannot be hired or retained.

The Corporation manages these risks by entering into projects with partners who have the internal expertise, experience and ability to oversee successful exploration and development activities. In addition, the Corporation outsources certain activities to recognized industry experts for certain marketing, engineering and land functions.

**Regulatory risks**

The exploration, development and extraction of P&NG reserves is managed by various levels of government, which oversee issues such as land management and environmental reclamation. There is a risk that the Corporation may face penalties or lawsuits should it not adhere to government regulations. To mitigate this risk, the Corporation hires third-party consultants to monitor environmental regulations and develop or manage programs to help the Corporation comply with current environmental legislation. The Corporation has also put in place a corporate safety program and a site-specific emergency response program to help manage these risks.

Increased public and political concern regarding climate change issues will likely result in increased regulation regarding emissions standards. Given that the Corporation produces hydrocarbons, such regulation may not only cause the Corporation to alter its growth strategy and operating practices, but could also result in additional costs and taxes associated with climate change regulation. Climate change matters and their potential impact on the Corporation are monitored by management, through frequent consultation the Corporation's with legal counsel.

**Liquidity risk**

Liquidity risk is the risk that the Corporation may not be able to meet its financial obligations as they come due. This risk has historically been managed by closely monitoring its financial position and forecasting future cash flows on at least a monthly basis, such that an additional need for capital can be identified as soon as possible. As the oil and gas industry is very capital intensive, the majority of the Corporation's spending was historically related to capital expenditure programs. The objective of the Corporation is to prudently spend its capital while maintaining its credit reputation amongst its suppliers. The Corporation attempts to maintain aged payables of less than 90 days.

At and for the three months ended March 31, 2011, the Corporation did not have significant levels of production from its remaining oil and gas assets or near-term operating obligations. Cash and cash equivalents of \$79.8 million far exceeded accounts payable and accrued liabilities of \$0.5 million and other financial obligations. Under its current level of operations, liquidity risk is not considered significant; however, should the Corporation acquire new oil and gas assets or revenue streams, this risk may increase.

**Market risks**

Market risks to which the Corporation is exposed include unfavorable movements in commodity prices, interest rates, and foreign exchange rates. As at March 31, 2011, the Corporation has disposed of most of its producing assets and holds a significant cash position. Consequently, its

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exposure to these risks has been significantly reduced, but as the Corporation redeploys its cash, exposure to these risks may increase. The objective of the Group is to mitigate exposure to these risks while maximizing returns.

*Commodity price risk*

The Corporation is exposed to adverse consequences such as declining revenue and asset recoverability in the event of declining oil and gas prices. The Corporation manages commodity price risk by updating and monitoring forecast cash flows and profitability and taking appropriate actions as needed. To date, the Corporation has not used hedging strategies, such as forward oil and natural gas sale contracts to lock-in prices with respect to future deliveries, to counter commodity price risk, but it may do so in the future.

*Interest rate risk*

As at March 31, 2011, the Corporation's exposure to movements in interest rates was limited to potential decreases in interest income from variable rate interest income on its cash and cash equivalents. The Corporation mitigates its exposure to this risk by holding its cash and cash equivalents in a combination of fixed and variable interest rate accounts, held with three Canadian chartered banks. As at March 31, 2011, \$40.1 million of the Corporation's cash and cash equivalents were held in fixed interest rate accounts, and \$39.7 million was held in variable interest rate accounts, based on Canadian prime rates. Based on these allocations, an immediate and prolonged 1% decrease in market interest rates would result in a \$0.4 decrease in pre-tax interest income over a 12-month period, and an immediate and prolonged 1% increase in market interest rates would result in a \$0.4 million increase in pre-tax interest income over a 12-month period.

*Foreign exchange risk*

Although the Corporation's P&NG revenues are denominated in Canadian dollars, the underlying market prices of these commodities are quoted in United States dollars, exposing the Corporation to fluctuations in the exchange rate between the Canadian and the United States dollar. The Corporation does not make any significant foreign currency denominated payments. Management monitors foreign exchange rate movements, but as at March 31, 2011 the Corporation had no currency hedging contracts in place to manage foreign exchange risk and no such contracts have been utilized during 2011.

**Credit risk**

Credit risk is the risk of default on payment by counterparties to financial assets held by the Corporation. Virtually all of the Corporation's accounts receivables are concentrated with a limited number of customers and joint venture partners in the oil and gas industry. Management considers this concentration of credit risk to be acceptable, as customers are major industry participants, and receivables from partners are protected by effective industry standard legal remedies. The Corporation requires cash calls from its partners on major field projects in advance of commencement.

Consolidated accounts receivable as at March 31, 2011 were \$0.1 million, net of a \$0.2 million provision for bad debts on one account.

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The maximum exposure to credit risk is therefore represented by the carrying amount of accounts receivable on the consolidated statement of financial position. In the immediate future, it is not expected that the Corporation's exposure to credit risk will be significant, until such time as cash is redeployed in new P&NG assets.

**Concentration risk**

Concentration risk is the risk that a significant proportion of the Corporation's cash and cash equivalents are held with one financial institution, exposing the Corporation to the risk that this institution may not have the liquidity to honour withdrawals or redemptions of the Corporation's funds. Concentration risk is managed by placing cash and cash equivalents between several chartered Canadian banks.

As at March 31, 2011, the largest holding of cash and cash equivalents with one financial institution was \$40.1 million.

**CRITICAL ACCOUNTING POLICIES AND MEASUREMENT UNCERTAINTY**

**Critical accounting policies**

The Corporation's accounting policies are discussed in detail in Note 3 of the unaudited condensed consolidated interim financial statements as at and for the three months ended March 31, 2011, but critical accounting policies are as follows:

i. Financial instruments

Financial instruments consist of financial assets and financial liabilities and are initially recognized at fair value net of transaction costs, if applicable. Measurement in subsequent periods depends on whether the financial instrument has been classified as "fair value through profit or loss", "loans and receivables", "available-for-sale", "held-to-maturity", or "financial liabilities measured at amortized cost" as follows:

*Financial assets*

Financial assets comprise cash and cash equivalents, accounts receivable and restricted cash. Cash and cash equivalents comprise cash held at financial institutions and bank short-term deposits with maturities of three months or less at the date of acquisition, and are measured at fair value through profit and loss. Accounts receivable are classified as loans and receivables and are recorded at amortized cost less any impairment. Restricted cash includes cash that has been designated for various operational or environmental reclamation purposes, and is measured at fair value through profit and loss.

*Financial liabilities*

Financial liabilities comprise accounts payable and accrued liabilities, and amounts due to related parties. All of these instruments are classified as financial liabilities measured at amortized cost using effective interest rate method. Under this classification, all cash flows from these instruments are discounted, where material, to their present value. Over time, this present value is accreted to the future value of remaining cash flows, and this accretion is recorded as interest expense.

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ii. Non-current assets held for sale

Non-current assets, or disposal groups comprising assets and liabilities, that are expected to be recovered primarily through sale rather than through continuing use, are classified as held for sale. This condition is when the sale is highly probable and the asset or disposal group is available for immediate sale in its present condition subject only to terms that are usual and customary for sales of such assets. Management must be committed to the sale, which should be expected to qualify for recognition as a completed sale within one year from the date of classification as held for sale.

Immediately before classification as held for sale, the assets, or components of a disposal group, are re-measured in accordance with the company's accounting policies. Thereafter, the assets, or disposal group, are measured at the lower of their carrying amount and fair value less cost to sell. Fair value is based on recent purchase offers, market transactions for similar assets, or appropriate valuation models.

Impairment losses on initial classification as held for sale and subsequent gains or losses on re-measurement are recognized in the consolidated statement of (loss) income and comprehensive (loss) income. Property, plant and equipment and intangible assets are no longer depreciated once classified as held for sale, but interest and other expenses attributable to the liabilities of a disposal group or asset held for sale is recognized.

iii. Exploration and evaluation properties

All costs directly associated with the exploration and evaluation ("E&E") of P&NG reserves, incurred after acquiring the legal right to explore, are capitalized as E&E properties. Capitalized E&E costs are those expenditures where technical feasibility and commercial viability has not been yet been determined and may include license and unproved property acquisition costs, geological and geophysical costs and costs of drilling exploratory wells.

Except for certain lease costs which may be amortized over the term of the lease, E&E costs are classified as intangible assets and are not depleted, but are rather tested annually for impairment. When the technical feasibility and commercial viability of an E&E property is known, the property is subject to an impairment assessment and its residual carrying value is reclassified as property, plant and equipment.

iv. Property, plant and equipment ("PP&E")

*Measurement*

PP&E related to P&NG properties is initially recognized at cost which includes all costs directly associated with the development of P&NG reserves where technical feasibility and commercial viability is determined. Such costs include drilling costs of development wells, tangible costs of facilities and infrastructure construction, costs of optimization and enhanced recovery projects, proved property acquisition costs, asset retirement costs, transfers from E&E assets and borrowing costs relating to qualifying assets.

Expenditures on major maintenance repairs comprise the cost of replacement assets or parts of assets, inspection costs and overhaul costs. Where an asset or part of an asset that was separately depreciated is replaced and it is probable that future economic benefits associated with the item will flow to the company, the expenditure is capitalized and the carrying amount of the replaced

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asset is derecognized. Inspection costs associated with major maintenance programs are capitalized and amortized over the period to the next inspection. Normal repairs and maintenance costs are recorded as an expense in the consolidated statement of (loss) income and comprehensive (loss) when incurred.

PP&E is subsequently carried at cost less accumulated depletion, depreciation, and any impairment. Gains and losses on disposals are determined by comparing disposal proceeds with the carrying amounts of assets sold and recognized in the consolidated statement of (loss) income and comprehensive (loss) and reported within interest and other income or expenses.

*Depletion, depreciation and amortization*

PP&E equipment relating to P&NG properties, including related facilities, are depleted and depreciated using the unit-of-production method over the proved reserves of the area. Where the Corporation intends to develop existing undeveloped, proved reserves, estimated future costs to develop proved reserves are included in costs subject to depletion, which are then depleted over total proved reserves. When the Corporation does not intend to develop existing undeveloped, proved reserves, the costs subject to depletion do not include future development costs, and the cost base is depleted over developed, proved reserves.

*Impairment*

The carrying value of PP&E is reviewed for impairment for quarterly. If indicators exist that non-financial assets are impaired, an impairment test is carried out in which the carrying amounts of those assets are written down to their recoverable amount, which is the higher of fair value less costs to sell and value-in-use.

v. Asset retirement obligations

The company recognizes an asset retirement obligation for abandoning P&NG wells, related facilities, removal of equipment from leased acreage and for returning such land to its original condition, in the period a well or related asset is drilled, constructed or acquired. The asset retirement is estimated at the present value of the estimated expected future cash outflows, discounted using a risk-free interest rate. The discounted obligation is initially capitalized as part of the carrying amount of the related property, plant and equipment and a corresponding liability is recognized.

Subsequent to initial recognition, the obligation is reviewed regularly by management, based upon current regulations, costs, technologies and industry standards, as well as to changes in the risk-free rate. The effects of changes resulting from revisions to the timing or the amount of the original estimate of the provision are reflected on a prospective basis, generally by adjustment to the carrying amount of the related property, plant and equipment. The accretion of the obligation is recorded as a financing cost in the consolidated statement of (loss) income and comprehensive (loss), and actual abandonment and reclamation expenditures are charged to the accumulated obligation as incurred and obligations related to properties disposed are removed.

The amount of the capitalized retirement obligation is depleted and depreciated on the same basis as the other capitalized property, plant and equipment.

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vi. Stock-based compensation

Stock options granted by the Corporation to directors, officers, employees and consultants are measured at their fair values. Fair values of stock options issued are determined on their grant date, using the Black-Scholes option pricing model, and are recognized as an expense over the vesting periods of the options; a corresponding increase is recorded to contributed surplus.

When stock options are exercised, the cash proceeds along with the amount previously recorded as contributed surplus are recorded as share capital. When the right to receive options is forfeited before the options have vested, any expense previously recorded is reversed.

The fair value of stock appreciation rights granted by the Corporation is assessed at grant date and each reporting date. Stock appreciation rights are cash-settled instruments, with the cash settlement amount being the difference between the exercise price of the instrument and the Corporation's share price on the date of exercise. The fair value of each stock appreciation right is recorded as a liability, and is determined as the excess, if any, between the Corporation's share price on the assessment date and the exercise price of each right. The movement in value since the prior reporting period is recorded in the consolidated statement of (loss) income and comprehensive (loss), with a corresponding adjustment to the liability on the consolidated statement of financial position.

vii. Income taxes

Tax provisions are recognized when it is considered probable that there will be a future outflow of funds to a taxing authority. In such cases, provision is made for the amount that is expected to be settled, where this can be reasonably estimated. This requires the application of judgment as to the ultimate outcome, which can change over time depending on facts and circumstances. A change in estimate of the likelihood of a future outflow and/or in the expected amount to be settled would be recognized in income in the period in which the change occurs.

Deferred tax assets or liabilities arising from temporary differences between the tax and accounting values of assets and liabilities, are recorded based on tax rates expected to be enacted when these differences are reversed. Deferred tax assets are recognized only to the extent it is considered probable that those assets will be recovered. This involves an assessment of when those deferred tax assets are likely to be realized, and a judgment as to whether or not there will be sufficient taxable profits available to offset the tax assets when they do reverse. This requires assumptions regarding future profitability and is therefore inherently uncertain. To the extent assumptions regarding future profitability change, there can be an increase or decrease in the amounts recognized in respect of deferred tax assets as well as in the amounts recognized in income in the period in which the change occurs.

**Measurement uncertainty**

Management is required to make estimates and assumptions that affect the reported amounts and presentation of assets, liabilities, revenues, expenses and disclosures of contingencies and commitments. Although these estimates are based on management's expectations for the likely outcome, timing and amounts of events or transactions, actual results may differ from these expectations and the corresponding amounts and disclosures reported in these financial statements.

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Areas where management is required to make significant estimations or where measurements are uncertain are as follows:

i. P&NG reserves

Using geological and engineering data, estimates of petroleum and natural gas reserves are determined. These reserves form the basis for the depletion of P&NG properties, which are depleted on a unit-of-production basis, as well as the impairment assessment of these properties.

The data used to determine reserves is based on drill results and production and reserve models, which are inherently imprecise. The Company engages a recognized reserves engineering firm, annually, to update its estimated petroleum and natural gas reserves based on new information such as additional drill results, long-term reservoir production, changes to expectations for the economic viability of reserves, and changes to property leases or intentions for property development. Changes to reserve estimates are applied prospectively, and could result in increases or decreases to future depletion expenses or the carrying value of these properties.

ii. Impairment of E&E and P&NG properties

In addition to estimates of P&NG reserves, management's impairment assessment, and the resulting carrying value of E&E and P&NG properties, is based on factors such as the future prices of oil and natural gas, future P&NG production costs, the timing and amount of future P&NG production, fair values and the costs to sell these properties, and expectations for the intended use of these properties.

These estimates are forward-looking and are therefore subject to change. Actual outcomes that differ from those estimated by management could result in future impairment expenses or impairment reversals, and increases or decreases to the carrying values of E&E or P&NG properties.

iii. Asset retirement obligation

The Corporation's provision for asset retirement obligations requires management to estimate the timing and amount of cash flows required to retire its P&NG assets. These cash flows are based on management assumptions for P&NG reserves and production, which determine the timing of reclamation expenditures, as well as expectations for the future costs and legal or constructive requirements for environmental reclamation.

Changes to either the timing or amount of the cash flows required for asset retirement, or to the discount rate used to record the present value of these cash flows, are considered prospectively. Such changes could increase or decrease the asset retirement obligation reported by the Corporation, and will ultimately result in changes to the total expense for environmental reclamation.

iv. Taxation

Tax provisions are recognized to the extent that it is probable that there will be a future outflow of funds to a taxation authority. Such provisions often require judgment on the treatment of certain taxation matter that may not have been reported to or assessed by the taxation authority at the date of these financial statements. Differences in judgment by the taxation authority could result in changes to actual taxes payable by the Corporation.

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Deferred tax assets are recognized to the extent that certain taxable losses or deferred expenditures will be utilized by the Corporation to reduce future taxes payable. The amount of deferred tax assets recognized, if any, is based objective evidence that the Corporation will generate sufficient future taxable income to utilize these deferred assets, as well as the expected future tax rates that will apply to these assets. Changes to the Corporation's ability to generate sufficient taxable income or changes to enacted tax rates could result in the write-down of deferred tax assets, or the recognition of new deferred tax assets.

v. Stock-based compensation

The Corporation uses the Black-Scholes option pricing model to determine the fair value of stock options and share purchase warrants granted. This model requires management to estimate the volatility of the Corporation's future share price, expected lives of stock options and future dividend yields. Consequently, there is significant measurement uncertainty in the stock-based compensation expense reported.

**CHANGES IN ACCOUNTING POLICIES AND TRANSITION TO IFRS**

On January 1, 2011, the Corporation adopted IFRS for financial reporting purposes, using a transition date of January 1, 2010. The unaudited condensed consolidated interim financial statements as at and for the three months ended March 31, 2011, including required comparative information, have been prepared in accordance with IFRS 1, First-time Adoption of International Financial Reporting Standards, and with International Accounting Standard ("IAS") 34, Interim Financial Reporting, as issued by the International Accounting Standards Board ("IASB"). Previously, the company prepared its interim and annual consolidated financial statements in accordance with Canadian GAAP.

**Changes in accounting policies**

The transition to IFRS necessitated certain changes to the Corporation's accounting policies that resulted in differences between amounts previously reported under Canadian GAAP and those reported under IFRS.

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A comprehensive reconciliation between Canadian GAAP and IFRS balances is provided in Note 4 of the unaudited condensed consolidated interim financial statements as at and for the three months ended March 31, 2011, but the following table provides a summary of the IFRS changes to the Company's 2010 loss before income taxes:

<i>(\$ thousands, except as indicated)</i>	<b>Three months ended March 31 2010</b>	<b>Year ended December 31 2010</b>
Net (loss) income before taxes under Canadian GAAP	(2,681)	7,341
IFRS gain on disposal of exploration and evaluation properties (note i.)	4,980	4,980
Decrease in depletion and impairment under IFRS (note i.)	288	5,346
Decrease in gain on sale of subsidiary under IFRS (notes i. and ii.)	-	(1,811)
Decrease in financing fees under IFRS (note ii.)	48	101
Increase in interest expense under IFRS (note iii)	(220)	(440)
Decrease in net income – equity investment under IFRS (note iv)	(27)	(27)
Increase in gain on disposal of equity investment under IFRS (note iv)	-	2,539
Income tax (expense) recovery under IFRS	(808)	153
<b>Net loss and comprehensive loss, per IFRS</b>	<b>1,580</b>	<b>18,182</b>

i. Exploration and evaluation properties and property, plant and equipment

Under Canadian GAAP, the Corporation capitalized all costs related to the acquisition, exploration and development of its P&NG properties in a single cost pool. This cost pool was depleted on a unit-of-production basis over the Corporation's aggregate reserves, and was assessed for impairment as a whole. When properties were disposed, the carrying value of the cost pool was reduced by the amount of the proceeds received, and no gain or loss on disposal was recorded.

Under IFRS, the Corporation classifies assets for which no proved or feasible reserves have been determined as exploration and evaluation properties. These properties are not depleted, but are assessed for impairment on an individual property basis. Properties with proved and feasible reserves are classified as property, plant and equipment, and are individually depleted on a unit-of-production basis over the reserves of each property. When either exploration and evaluation properties or those classified as property, plant and equipment are disposed, the Corporation records a gain or loss on disposal for any difference between proceeds received and the carrying value of the property disposed.

The adoption of IFRS resulted in the Corporation recording a gain on the disposal of the Blackrod property by Serrano that had not been recorded under Canadian GAAP. In addition, calculating depletion and conducting assessments for impairment on individual properties resulted in differences in depletion and impairment recorded under IFRS. In turn, this led to changes in the carrying value of the Serrano subsidiary and the gain recorded on its disposal in the second quarter of 2010.

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ii. Asset retirement obligation

Under Canadian GAAP, the Corporation used a credit and inflation-adjusted rate to discount future reclamation expenditures to their present value. Once established, this rate was not adjusted and accretion was recorded as an expense to reflect the unwinding of this discounted amount. Under IFRS the Corporation uses a risk free rate prevailing on the date of each consolidated statement of financial position to discount its reclamation liability.

Using a risk free rate prevailing on each balance sheet date resulted in adjustments to the carrying value Corporation's asset retirement obligation and accretion expense – reported as a financing fee – during 2010. Prior to its disposal in the second quarter of 2010, a portion of the Corporation's consolidated asset retirement obligation was held by Serrano, and the IFRS adjustment to the carrying value of the related obligation resulted in changes to the gain on the sale of this subsidiary.

iii. Debt origination fees

In 2009, the Corporation paid origination fees related to a note payable. Under Canadian GAAP, the Corporation recorded these fees as an expense in the period they were incurred. Under IFRS, the Corporation records these amounts as a reduction of the carrying value of debt at origination, and amortizes them over the life of the debt facility using the effective interest rate method.

iv. Equity investment

The corporation accounted for its investment in Marble Point using the equity method. As such, the financial statements of Marble Point must also be in compliance with IFRS, and any transitional adjustments to Marble Point's net and comprehensive income will be reflected in the Corporation's proportionate share.

Significant adjustments to Marble Point's financial statements under IFRS are owing to:

- Changes in the discount rate used to discount its asset retirement obligation, similar to the adjustments made by the Corporation, discussed under note ii, above;
- Differences in the recognition of stock-based compensation. Under Canadian GAAP, Marble Point recognized the fair value of stock-based compensation as an expense on a straight-line basis over the vesting period of the group of options granted. Under IFRS, the fair value attributed to options is recognized over the vesting period of each option.
- The reclassification of a compound financial instrument. Under Canadian GAAP, the value of a cash option feature of a long-term incentive plan was presented as a component of the plan liability. Under IFRS, the value attributed to this feature is presented as a component of equity.

As a result of these and other insignificant adjustments, the carrying value of the Corporation's share in Marble Point's net assets decreased under IFRS as at the date of the disposal of the investment, resulting in a larger gain on disposal under IFRS than that reported under Canadian GAAP.

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**Other impacts from the transition to IFRS**

Cash flow classification

Under Canadian GAAP, the Corporation reported cash flows for interest paid on loans payable as cash flows from operating activities. Under IFRS, the Corporation reports these cash flows as financing activities. As a result, \$0.2 million and \$0.3 million in related cash payments have been reclassified from cash flows from operating activities to cash flows from financing activities for the three months ended March 31, 2010 and the year ended December 31, 2010, respectively.

There have been no other changes to operating, investing or financing cash flows as a result of the transition to IFRS.

Other impacts

The transition to IFRS has only resulted in adjustments to the Corporation's accounting policies and cash flow classification, and there have been no changes to accounting systems, processes or to the Corporation's operations.

**DISCLOSURE CONTROLS AND PROCEDURES**

On November 23, 2007, the ASC and the securities commissions in the other jurisdictions in which the Corporation is registered exempted Venture Issuers from certifying disclosure controls and procedures as well as Internal Controls over Financial Reporting. As the Corporation is a Venture Issuer, it is now required to file "basic certificates", which it has done for the three months ended March 31, 2011.

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**ADDITIONAL INFORMATION**

Further information on the Corporation can be found on SEDAR's website at [www.sedar.com](http://www.sedar.com) and Corporation's website at [www.canadian-phoenix.com](http://www.canadian-phoenix.com)

**CORPORATE DIRECTORY**

**DIRECTORS & OFFICERS:**

**Michael Atkinson**  
President & CEO  
Director

**Harry Knutson**  
Chairman & Director

**Daryl Clark**  
Director

**Bryce Rhodes**  
Director

**John Downes, CA**  
Interim Chief Financial Officer

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**CORPORATE WEB SITE:**

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**Borden Ladner Gervais LLP**  
Calgary, Alberta

**AUDITORS:**

**Deloitte & Touche LLP**  
Calgary, Alberta

**RESERVE ENGINEERS:**

**GLJ Petroleum Consultants**  
Calgary, Alberta

**BANKER:**

**National Bank of Canada**  
Calgary, Alberta

**REGISTRAR & TRANSFER AGENT:**

**Computershare Trust Company of Canada**  
Calgary, Alberta

**STOCK EXCHANGE LISTING:**

TSX Venture Exchange: Symbol "CXP"

**COMMON SHARES OUTSTANDING:**

58,468,718

**COMMON SHARES OUTSTANDING:**

(Fully diluted if all stock options and warrants  
are exercised as of the date of this report)

72,224,966