



**November 10, 2010**

### **Fellow Shareholders**

Birchcliff is pleased to report its third quarter financial and operating results for the three and nine month periods ended September 30, 2010. Birchcliff had record average quarterly production of 13,109 boe/day which is the direct result of Phase I of our 100% owned and operated Pouce Coupe South Gas Plant ("**PCS Gas Plant**") reaching design capacity in the quarter.

During the third quarter, Birchcliff was focused on the construction of the Phase II expansion of our PCS Gas Plant and related infrastructure and the drilling and completion of the horizontal wells that will produce to that plant.

Birchcliff is pleased to announce that construction of Phase II of the PCS Plant has been completed slightly under budget. Phase II has recently commenced processing natural gas ahead of its originally scheduled December 1 start-up. We expect Phase II will be at full capacity in the near future. The Phase II expansion will increase design capacity from 30 mmcf per day to 60 mmcf per day. Birchcliff's expectation is that the increased natural gas production through the plant, together with increased oil volumes from our Worsley Light Oil Resource Play will allow Birchcliff to achieve its previously announced 2010 exit production rate of 18,500 to 19,500 boe/day.

The construction of Phases I and II of the PCS Gas Plant is estimated to have cost approximately \$77 million, including the infrastructure associated with the PCS Gas Plant, 47 kilometres of pipelines and the acid gas disposal well.

Now that we have invested this significant capital in the heart of our Montney/Doig Natural Gas Resource Play, we have the advantages of controlling our infrastructure and achieving low processing costs over the long term as we develop our core asset in the Pouce Coupe South area. In the face of current natural gas prices, being able to produce gas at the low end of the industry cost structure, gives Birchcliff a significant competitive advantage in its focus area.

Prior to the startup of the PCS Gas Plant, our production growth in the Pouce Coupe area was restricted by the lack of accessible processing capacity. Our investment in the PCS Gas Plant and the resulting 100% owned and operated processing capacity has now positioned us to increase our average production quarter over quarter in 2010. We expect to average approximately 16,000 boe/day in the fourth quarter of 2010 and we expect quarterly average production will increase in the first quarter of 2011.

## 2010 THIRD QUARTER RESULTS

### Production

Current production is slightly above 16,000 boe/day. Birchcliff has 6 (4.5 net) new standing Montney/Doig horizontal natural gas wells and 3 Worsley light oil wells that will be brought on production in the near future. As we bring the PCS Gas Plant up to full operating capacity and add new oil volumes from Worsley, our production will continue to grow and we expect to achieve our exit volume target of 18,500 to 19,500 boe/day.

Record third quarter production averaged 13,109 boe/day, (74% natural gas and 26% light oil and natural gas liquids) up 24% from 10,552 boe/day for the third quarter of 2009 and up 6% from 12,357 boe/day in the second quarter of 2010.

Our significant increase in production volumes over the past year is a result of Birchcliff's Montney/Doig horizontal natural gas drilling program in the Pouce Coupe area and its light oil drilling program in Worsley and not the result of acquisitions.

### Cash Flow and Earnings

Cash flow was \$24 million or \$0.19 per share for the third quarter of 2010, up 97% from \$12.2 million or \$0.10 per share in the third quarter of 2009. Net income during the third quarter was \$0.4 million as compared to a \$9 million loss during the third quarter of 2009. We are pleased that we continue to have earnings, especially in light of weak natural gas prices. This is in part reflective of the low cost nature of our asset base.

### Capital Expenditures and Drilling Results

During the third quarter of 2010, net capital spending aggregated \$93.8 million. The specific breakdown of our capital expenditure program is contained in the Capital Expenditure section of our Management's Discussion & Analysis contained herein.

Birchcliff was very busy with field operations during the quarter, including drilling, completion, equipping and tying in new wells in conjunction with the construction of Phase II of the PCS Gas Plant and construction of several other major infrastructure projects.

During the third quarter of 2010, Birchcliff drilled 27 (22.6 net) wells, all of which were cased, for a success rate of 100%. Drilling on our Montney/Doig Natural Gas Resource Play included 9 (7.8 net) horizontal natural gas wells and 1 (1.0 net) vertical New Pool Wildcat exploration well. Drilling on our Worsley Light Oil Resource Play included 4 (4.0 net) horizontal light oil wells and 1 (1.0 net) vertical light oil well.

We were also active at our Progress Doe Creek Oil Pool, drilling 4 (3.2 net) horizontal light oil wells and 6 (3.5 net) vertical light oil wells. At Pouce Coupe, Birchcliff has existing production in the Boundary Lake A & B pools. In the quarter we drilled our first 100% working interest horizontal light oil well in the Boundary Lake zone, utilizing multi-stage fracture stimulation technology. The early test results are positive. The last well of our third quarter program was a successful 100% working interest Gething vertical natural gas well, at Rycroft.

### **Operating Costs**

Operating costs for the third quarter were \$7.53 per boe as compared to \$7.81 in the second quarter of 2010 and \$9.03 in the first quarter of 2010. We expect operating costs per boe to continue to decline during the fourth quarter and during the first quarter of 2011 as we bring the expanded PCS Gas Plant up to full capacity.

### **Royalties**

It is noteworthy that our royalty rate has fallen to 8% in the third quarter of 2010 as compared to 11% for the same period in 2009 and 18% for the same period in 2008. We expect that our royalty rate will remain low as we focus on those wells that benefit most from incentives associated with the New Alberta Royalty programs including the Alberta Natural Gas Deep Drilling Program.

### **Indebtedness**

At September 30, 2010, the amount outstanding under Birchcliff's bank credit facilities was approximately \$281.2 million. Birchcliff's working capital deficiency as at September 30, 2010 was \$38.7 million, for total debt of \$319.9 million. The working capital deficiency does not reduce the amount Birchcliff can draw under its credit facilities.

Birchcliff is pleased to announce that it has recently received approval from its Bank Syndicate to increase its bank facilities to \$375 million, providing Birchcliff with more financial flexibility in light of recent weak commodity prices. We expect to further increase our credit facilities pursuant to the normal credit review process in the spring of 2011, assuming the increase in proved producing reserves and future commodity prices estimated in our year-end independent reserves evaluation are consistent with our internal estimates.

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

### **Land**

Birchcliff continues to have a substantial undeveloped land base in the Peace River Arch, which at September 30, 2010 was comprised of 480,917 (437,169 net) acres, as compared to 434,614 (390,827 net) acres at June 30, 2010.

Birchcliff has a high average working interest in its undeveloped land base (91%), which reflects our long standing strategy of acquiring high working interest undeveloped land proximal to our operated high working interest production base.

## **OPERATIONS UPDATE**

Currently, Birchcliff has 2 rigs working. The first rig is in the Progress area drilling our first Halfway horizontal light oil well (67% working interest), which we intend to complete using multi-stage fracture stimulation technology. The second rig is in the Worsley area focused on our light oil resource play drilling both vertical and horizontal wells.

## Montney/Doig Natural Gas Resource Play Update

In the third quarter of 2010, Birchcliff's activities on the Montney/Doig Natural Gas Resource Play included the drilling of 9 (7.8 net) horizontal natural gas wells utilizing multi-stage fracture stimulation technology.

Birchcliff has completed the drilling of the additional Montney/Doig horizontal natural gas wells that are required to fill Phase II of the PCS Gas Plant and is at various stages of completion, equipping and tying-in of these wells.

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

Birchcliff's general drilling strategy for the Montney/Doig Natural Gas Resource Play to date has been focused on exploration and delineation wells. In 2010 Birchcliff's strategy has expanded to include detailed development, infill drilling, and reservoir management. This development strategy comes in parallel with the commissioning of our PCS Gas Plant, allowing increased processing control and capacity in our area. Specifics of the strategy include pad drilling of multiple wells from a single surface location, infill drilling at 300 meter interwell distances and evaluation of further reductions in spacing to determine what the ultimate optimal interwell spacing should be to maximize reserve capture.

Pad drilling has many advantages, primarily capital cost reductions on a per well basis. It has also allowed us to cost effectively drill wells continuously through break up when road bans would usually prevent us from continuing operations.

During 2010, through drilling operations, Crown land sales and private land acquisitions Birchcliff continued its strategy to expand its footprint on this Montney/Doig Natural Gas Resource Play. At year end 2009, reserves had been attributed to 63.4 net sections of lands on the Montney/Doig Natural Gas Resource Play, of which 14.2 net sections had reserves attributed to both the Basal Doig/Upper Montney zone and the Middle/Lower Montney zone.

As of November 10, 2010, Birchcliff's internal estimate of lands that it expects to have reserves attributed to at year end 2010 has grown based on the acquisition of new lands and operations completed to date by 11.9 net sections, to 75.3 net sections. Birchcliff expects that 15.6 net sections of these lands are expected to have reserves attributed to both the Basal Doig/Upper Montney and Middle/Lower Montney zones at year end.

As well, to date in 2010, Birchcliff has significantly expanded its trend land holdings on the Montney/Doig Natural Gas Resource Play by 40 net sections to a total of 143.7 net sections. Trend land is land Birchcliff believes has a high likelihood of extending this play based on technical information including geological and geophysical data.

In total, Birchcliff has 219.0 net sections of prospective land to develop which includes 15.6 net sections with two stratigraphic zones that are prospective. Assuming 4 wells per section, this totals 938.4 net potential Montney/Doig natural gas horizontal drilling locations on this resource play with only 46 (38.6 net) horizontal wells drilled to the end of September 30, 2010. Drilling plans for 2010 for the Montney/Doig Natural Gas Resource Play include 13 (10.6 net) Basal Doig/Upper Montney horizontal wells, 10 (8.2 net) Middle/Lower Montney horizontal wells, for a total of 23 (18.8 net) horizontal wells and 1 (1.0 net) vertical exploration well.

### **Pouce Coupe South Gas Plant Update**

#### Phase III Expansion

Birchcliff's proposed Phase III expansion of the PCS Gas Plant is designed to add an additional 60 mmcf per day of processing capacity, for a total processing capacity of 120 mmcf per day. Birchcliff has now received the regulatory approvals for the construction of Phase III of the PCS Gas Plant.

In view of the current low natural gas price environment, the Directors will consider the timing of the commencement of construction of the Phase III expansion in the second quarter of 2011.

### **Worsley Light Oil Resource Play Update**

The Worsley property continues its strong production performance. Our successful expansion of the waterflood, application of horizontal drilling and multi-stage fracture stimulation technology, multi-lateral horizontal wells, continued reserve growth and high netback production, all contribute to production and reserves growth from this high quality asset.

Drilling activities at Worsley in the third quarter of 2010 consisted of 5 (5.0 net) wells. To date in 2010, Birchcliff has drilled 10 (10.0 net) Charlie Lake wells consisting of 9 (9.0 net) horizontal wells and 2 (2.0 net) vertical wells and 1 (1.0 net) successful Leduc exploration well. In aggregate, Birchcliff plans to drill 17 (16.7 net) light oil wells at Worsley in 2010.

### **New Resource Play Update**

The oil and gas industry throughout North America has seen a very rapid advancement in its technical understanding, operational optimization and production related to shale gas, tight gas, shale oil and tight oil resource plays. Specifically, in Birchcliff's core area of the Peace River Arch, numerous industry competitors have announced significant developments on a number of different resource plays. There have been significant lands posted and acquired in the Peace River Arch area as well as numerous new wells drilled and completed, targeting these new plays. Birchcliff continues to spend significant time and capital analyzing and evaluating various new resource plays in the Peace River Arch. To date in 2010, Birchcliff has acquired 141,207 (139,991 net) acres of land (approximately 219 net sections) that we believe are prospective for one or more these new resource plays. As is consistent with our corporate strategy, Birchcliff has acquired several large contiguous blocks at 100% working interest. Some of these lands are also prospective for the Montney/Doig Natural Gas Resource Play or the Worsley Light Oil Resource Play. We are early in the development of these new resource plays, however, based on the high level of industry activity and our internal technical evaluation, we are optimistic about their potential value.

## ROYALTIES

The new Alberta Royalty programs: Natural Gas Deep Drilling Program (“**NGDDP**”), Shale Gas Program, Horizontal Gas Program and Horizontal Oil Program announced in May, 2010 all have significant positive impact to Birchcliff.

The new Alberta NGDDP is particularly advantageous to Birchcliff. The NGDDP effectively reduces Birchcliff’s royalty rates on approximately 80% of our future Montney/Doig horizontal natural gas wells to 5% during the time when the wells have their highest productivity and cash flow. Depending on total measured depth (which includes the length of the horizontal portion of the well), the royalty credits could have a value of up to \$2.8 million per well. It is obvious that this new royalty program together with the permanent 5% royalty on the first 0.5 bcf of natural gas produced, significantly improves the economics of our Montney/Doig Natural Gas Resource Play. Birchcliff expects to capitalize on these new royalty programs by investing its available capital in those wells which maximize the benefit of the Alberta Royalty incentive programs.

## SUMMARY OF 2010 ACCOMPLISHMENTS

Our results to date in 2010 include:

- significant growth in our production
- significant increase in our proven developed producing reserves
- material proved plus probable reserve additions
- material reduction in operating costs per boe
- excellent drilling and production results on our Montney/Doig Natural Gas Resource Play, expanding potential horizontal drilling locations to over 900
- excellent drilling and production results on our Worsley Light Oil Resource Play
- positive waterflood response in the Worsley light oil pool
- construction and start-up of Phases I and II of the PCS Gas Plant
- receipt of regulatory approvals to construct Phase III of the PCS Gas Plant
- the significant reduction in royalty rates as a result of the New Alberta Royalty incentive programs
- significant land acquisitions on both of our producing resource plays
- establishment of a large contiguous land base with potential shale/tight oil and shale/tight natural gas opportunities

## 2011 UPDATE

Birchcliff expects to announce its 2011 Budget, 2010 Reserve Additions, 2010 Finding and Development Costs, 2010 Unaudited Financial Results and provide an Operational Update in late February 2011.

Currently, we are engaged in the 2011 budget planning process with the expectation of a 2011 capital expenditure program approximately equal to 2011 cash flow.

## OUTLOOK

Birchcliff remains very confident that its two highly focused, high working interest, low cost, repeatable, sustainable long term growth resource plays in the Peace River Arch area of Alberta offer tremendous upside value to our shareholders.

The Montney/Doig Natural Gas Resource Play continues to be one of the most active geological plays in North Western Alberta and Birchcliff is in the heart of the play.

Since December 1, 2007, Birchcliff has drilled 48 (40.0 net) Montney/Doig horizontal natural gas wells. As a result, we have developed in house expertise with respect to the full cycle exploration, exploitation and development of the Montney/Doig Natural Gas Resource Play. We also believe that technology advances will continue to reduce our finding and development costs and increase our reserve recovery factors.

Our strategy has not changed, notwithstanding the weakness in commodity prices. We believe that we can economically find, develop and produce natural gas from the Montney/Doig geological zones at low costs. The new Alberta Deep Gas Royalty Programs are very significant to Birchcliff increasing the net present value of our future oil and natural gas reserves.

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

A key to our strategy of being a low cost producer is to own and operate our processing capacity and related infrastructure. The completion of Phases I and II of the PCS Gas Plant validate this strategy as operating costs per boe have fallen quarter over quarter.

I expect our record production levels to provide Birchcliff with meaningful cash flow in 2011 and beyond.

In five and a half years, we have established Birchcliff as a strong and growing intermediate oil and gas producer. Since the acquisition of our Worsley light oil pool in September, 2007, virtually all of our production growth has been achieved with the drill bit. As a result, Birchcliff is very comfortable that we can continue to replicate our excellent results.

I would like to take the opportunity to thank Mr. Seymour Schulich who continued to provide sage advice and support to our management team as natural gas prices deteriorated during the third quarter.

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

(signed) "A. Jeffery Tonken"

**A. Jeffery Tonken**

President and Chief Executive Officer

## FINANCIAL AND OPERATIONAL HIGHLIGHTS

	Three months ended September 30, 2010	Three months ended September 30, 2009	Nine months ended September 30, 2010	Nine months ended September 30, 2009
<b>OPERATING</b>				
Average daily production				
Light oil – barrels	2,973	2,698	3,017	2,897
Natural gas – thousands of cubic feet	57,924	45,210	51,238	49,367
NGLs – barrels	483	319	411	328
<b>Total – barrels of oil equivalent (6:1)</b>	<b>13,109</b>	<b>10,552</b>	<b>11,968</b>	<b>11,452</b>
Average sales price (\$ Canadian)				
Light oil – per barrel	76.44	70.00	77.54	60.57
Natural gas – per thousand cubic feet	3.79	3.20	4.34	4.13
NGLs – per barrel	68.30	57.00	71.29	52.01
<b>Total – barrels of oil equivalent (6:1)</b>	<b>36.60</b>	<b>33.32</b>	<b>40.60</b>	<b>34.61</b>
Undeveloped land				
Gross (acres)	480,917	402,543	480,917	402,543
Net (acres)	437,169	357,251	437,169	357,251
<b>NETBACK AND COST</b>				
(\$ per barrel of oil equivalent at 6:1)				
Petroleum and natural gas revenue	36.59	33.42	40.68	34.79
Royalties	(2.95)	(3.75)	(3.84)	(3.25)
Operating expense	(7.53)	(8.76)	(8.06)	(9.27)
Transportation and marketing expense	(2.60)	(2.35)	(2.60)	(2.38)
<b>Netback</b>	<b>23.51</b>	<b>18.56</b>	<b>26.18</b>	<b>19.89</b>
General and administrative expense, net	(0.74)	(2.99)	(1.60)	(2.54)
Interest expense	(2.85)	(3.01)	(2.92)	(2.45)
<b>Cash Flow Netback</b>	<b>19.92</b>	<b>12.56</b>	<b>21.66</b>	<b>14.90</b>
Depletion and depreciation expense	(15.68)	(22.05)	(16.15)	(21.82)
Accretion expense	(0.39)	(0.41)	(0.41)	(0.38)
Stock-based compensation expense	(2.35)	(1.42)	(2.47)	(2.58)
Amortization of deferred financing fees	(0.21)	(0.51)	(0.43)	(0.23)
Future income tax recovery (expense)	(0.94)	2.52	(1.19)	1.84
<b>Net Income (Loss)</b>	<b>0.35</b>	<b>(9.31)</b>	<b>1.01</b>	<b>(8.27)</b>
<b>FINANCIAL</b>				
Petroleum and natural gas revenue (\$000)	44,125	32,446	132,906	108,761
Cash flow from operations (\$000)	24,022	12,196	70,759	46,576
Per share – basic (\$)	0.19	0.10	0.57	0.40
Per share – diluted (\$)	0.19	0.10	0.55	0.40
Net income (loss) (\$000)	422	(9,039)	3,290	(25,868)
Per share – basic (\$)	-	(0.07)	0.03	(0.22)
Per share – diluted (\$)	-	(0.07)	0.03	(0.22)
Common shares outstanding				
End of period – basic	124,912,134	123,267,436	124,912,134	123,267,436
End of period – diluted	137,364,386	134,049,987	137,364,386	134,049,987
Weighted average shares for period – basic	124,872,806	122,914,069	124,506,757	116,124,704
Weighted average shares for period – diluted	127,253,296	124,523,458	127,547,499	117,462,899
Capital expenditures, net (\$000)	93,792	33,442	172,578 <sup>(1)(2)</sup>	57,322 <sup>(2)</sup>
Working capital deficiency (\$000)	38,749	16,757	38,749	16,757
Revolving credit facilities (\$000)	281,172	182,589	281,172	182,589
Total debt (\$000)	319,921	199,346	319,921	199,346

(1) Included as a reduction of net capital expenditures in the nine months ended September 30, 2010 are proceeds of \$17.5 million relating to the sale of a minor asset.

(2) Included as a reduction of net capital expenditures in the nine months ended September 30, 2010 is an expected recovery of \$9.9 million (September 30, 2009 - \$3.4 million) relating to the Alberta Drilling Royalty Credit Program.



## MANAGEMENT'S DISCUSSION AND ANALYSIS

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

The following Management's Discussion and Analysis ("**MD&A**") is dated November 10, 2010. The unaudited interim financial statements with respect to the three and nine months ended September 30, 2010 (the "**Reporting Periods**") as compared to the three and nine months ended September 30, 2009 (the "**Comparable Prior Periods**") and this MD&A have been prepared by management and approved by the Corporation's Audit Committee and Board of Directors. This MD&A should be read in conjunction with the unaudited financial statements of the Corporation and related notes for the Reporting Periods and the audited financial statements and related notes as at and for the years ended December 31, 2009 and 2008. All financial information has been prepared in accordance with Canadian Generally Accepted Accounting Principles ("**GAAP**") and all amounts are expressed in Canadian dollars unless otherwise stated.

## THIRD QUARTER OVERALL PERFORMANCE

### Production

Production in the third quarter of 2010 averaged 13,109 boe per day. This is a 24% increase from the 10,552 boe per day the Corporation averaged in the third quarter of 2009. This increase was achieved through the success of Birchcliff's capital drilling program and the processing of natural gas through Phase I of Birchcliff's 100% owned and operated Pouce Coupe South Natural Gas Plant ("**PCS Gas Plant**"), which reached design operating capacity of 30 mmcf per day in early August.

Production consisted of approximately 74% natural gas and 26% crude oil and natural gas liquids in the third quarter of 2010.

### Commodity Prices

Oil sales prices at the wellhead averaged \$76.44 per barrel in the third quarter of 2010, which is less than a 1% increase from \$76.24 per barrel the Corporation averaged in the second quarter of 2010 and a 9% increase from \$70.00 per barrel in the third quarter of 2009. Natural gas sales prices at the wellhead averaged \$3.79 per mcf in the third quarter of 2010, which is a 9% decrease from \$4.16 per mcf in the second quarter of 2010 and an 18% increase from \$3.20 per mcf in the third quarter of 2009. The prices received for Birchcliff's petroleum and natural gas sales are impacted by world events that dictate the level of supply and demand for oil and natural gas. Birchcliff currently does not have any commodity hedges in place and therefore is subject to fluctuations in commodity prices.

Canadian Edmonton Par oil prices averaged \$74.43 per barrel in the third quarter of 2010 as compared to \$75.18 per barrel in the second quarter of 2010 and \$71.50 per barrel in the third quarter of 2009. The AECO daily natural gas spot prices averaged \$3.54 per mcf in the third quarter of 2010 as compared to \$3.89 per mcf in the second quarter of 2010 and \$2.94 per mcf in the third quarter of 2009.

### Capital Expenditures

Capital expenditures in the third quarter of 2010 were \$93.8 million as compared to \$33.4 million in the third quarter of 2009. Birchcliff did not dispose of any assets during the third quarter of 2010 or 2009. Of the \$93.8 million in capital spent during the third quarter of 2010, approximately \$6.8 million was directed towards the Phase II expansion of the PCS Gas Plant and related infrastructure. Approximately \$39.2 million was spent drilling and completing new Montney/Doig horizontal wells that will be tied into the PCS Gas Plant throughout the third and fourth quarters of 2010 in order to utilize the total processing capacity of 60 mmcf per day. The remaining \$47.8 million in capital was spent acquiring land; expanding the

Montney Doig natural gas and Worsley light oil resource plays and related infrastructure; on minor acquisitions; and other projects. Further details of the Corporation's capital expenditures are set forth below in the table entitled "Capital Expenditures".

Construction of Phase II expansion of the PCS Gas Plant has been completed ahead of schedule and on budget. Phase II expansion is designed to double the processing capacity from 30 to 60 mmcf per day.

### **Cash Flow and Earnings**

Cash flow was \$24.0 million (\$0.19 per share) in the third quarter of 2010 as compared to \$12.2 million (\$0.10 per share) in the third quarter of 2009. The 97% increase in cash flow from the third quarter of 2009 resulted from a combination of factors, including increased average daily production, higher average oil and natural gas prices realized at the wellhead, and increased general and administrative overhead recoveries due to increased capital spending.

Cash flow netback per boe increased significantly from the Comparable Prior Periods to \$19.92 per boe and \$21.66 per boe for the three and nine month Reporting Periods. Aside from increased commodity prices, a significant factor in these increases was a 14% reduction in per boe operating costs during the third quarter of 2010 as a result of a greater proportion of Birchcliff's natural gas being processed through Phase I of the PCS Gas Plant and increased cost recoveries from processing joint interest third party gas at this plant.

Birchcliff recorded net income of \$0.4 million (\$NIL per share) for the third quarter of 2010 as compared to a net loss of \$9.0 million (\$0.07 loss per share) in the third quarter of 2009. The increase in net income from the third quarter of 2009 was mainly attributable to higher cash flow and lower depletion expense, and was offset by increases in non-cash stock-based compensation expense and future income tax expense reported during the third quarter of 2010.

## **OUTLOOK**

### **Production**

Birchcliff's 2010 exit production rate is expected to range between 18,500 and 19,500 boe per day based on the positive drilling and completion results achieved to date.

Birchcliff is focused on utilizing the full capacity of the PCS Gas Plant and providing sustainable average daily production rates into the first quarter of 2011.

### **Capital Expenditures**

Birchcliff spent \$172.6 million of net capital in the nine month Reporting Period. Of this, \$58.0 million was spent on the Corporation's oil and gas operations and related infrastructure and \$114.6 million was spent on the construction of Phases I and II of the PCS Gas Plant and related Montney/Doig horizontal natural gas wells that will all be tied into this gas plant during the fourth quarter of 2010. The Corporation expects its fourth quarter capital expenditures to be approximately \$55 million with \$30 million budgeted for oil and gas operations, related infrastructure and other projects, and approximately \$25 million for the completion of the Phase II expansion of the PCS Gas Plant and to drill, complete and tie-in related Montney/Doig horizontal natural gas wells. The Corporation's operating cash flow and revolving credit facilities will be used to fund the capital expenditures during the fourth quarter of 2010.

### **Cash Flow and Bank Debt**

Birchcliff's bank syndicate recently approved an increase of the existing revolving credit facilities to an aggregate limit of \$375 million from the current \$350 million. The \$375 million of credit facilities will provide Birchcliff with greater liquidity and financial flexibility to further develop its two major resource plays.

Notwithstanding the current low natural gas price environment, the Corporation does not foresee any liquidity issues with respect to the operation of its petroleum and natural gas business in the fourth

quarter of 2010 and throughout 2011. Birchcliff expects to meet all its future obligations as they become due. Management expects that Birchcliff's working capital deficiency will be lower in the fourth quarter of 2010 as compared to the current quarter as a result of reduced capital spending.

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

### Resource Plays and Infrastructure

Birchcliff has a very strong asset base with its two main resource plays, the Montney/Doig Natural Gas Resource Play and the Worsley Light Oil Resource Play. These properties provide the Corporation with a long term and operationally reliable cash flow base, the level of which is primarily dependent on commodity prices. The 100% owned and operated PCS Gas Plant is expected to enhance the value of the Montney/Doig Natural Gas Resource Play by increasing production growth, reducing operating costs per boe, and increasing Birchcliff's strategic control over the Pouce Coupe area. As of the date of this MD&A, Phases I and II of the PCS Gas Plant are operational and management expects that the PCS Gas Plant will reach full design capacity of 60 mmcf per day during the fourth quarter of 2010.

Birchcliff has initiated the steps to license a Phase III expansion of the PCS Gas Plant, which would double the design processing capacity by adding an additional 60 mmcf per day for a total throughput of up to 120 mmcf per day. Birchcliff has now received the regulatory approvals for the construction of Phase III of the PCS Gas Plant. In view of the current low natural gas price environment, the Directors will consider the timing of the commencement of construction of the Phase III expansion in the second quarter of 2011.

The extensive portfolio of development opportunities on the Montney/Doig Natural Gas Resource Play and the Worsley Light Oil Resource Play will provide low risk, long life future production additions that are readily available with the investment of additional capital. Birchcliff expects to be able to manage its lease expiries so that minimal lands will be lost.

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

### MAJOR TRANSACTIONS AFFECTING FINANCIAL RESULTS

On November 8, 2010, the Corporation was advised that each member of the bank syndicate approved an increase of the existing revolving credit facilities to an aggregate limit of \$375 million from \$350 million, subject to the signing of amending documentation.

On May 21, 2010, the Corporation's bank syndicate approved an increase of the revolving credit facilities to an aggregate limit of \$350 million from an aggregate limit of \$255 million and extended the conversion date of those facilities from May 21, 2010 to May 20, 2011. In conjunction with these changes, the \$50 million term credit facility was repaid and cancelled. The amended revolving credit facilities includes an increased credit limit for the extendible revolving term credit facility (the "**Syndicated Credit Facility**") of \$320 million from \$235 million and an increased credit limit for the extendible revolving working capital facility (the "**Working Capital Facility**") of \$30 million from \$20 million.

## LIQUIDITY

### Working Capital

The Corporation's working capital deficit (current assets minus current liabilities) increased to \$38.7 million at September 30, 2010 from \$20.3 million at December 31, 2009. The deficit at the end of the Reporting Period is mainly comprised of costs incurred from the construction of the Phase II expansion of the PCS Gas Plant and related infrastructure, and the drilling and completion of new Montney/Doig horizontal wells during the current quarter.

At September 30, 2010, the major components of Birchcliff's current assets were joint venture billings (55%) to be received from its partners and revenue (37%) to be received from its marketers in respect of September 2010 production which was subsequently received in October 2010. In contrast, current liabilities largely consisted of trade payables (63%) and accrued capital and operating costs (33%).

Birchcliff manages its working capital deficit using its cash flow and advances under its revolving credit facilities. The Corporation's working capital deficit does not reduce the amount available under the Corporation's revolving facilities, which have a combined limit of \$350 million at September 30, 2010 and \$375 million as of the date of this MD&A. The Corporation did not have any liquidity issues with respect to the operation of its petroleum and natural gas business during the Reporting Periods and Comparable Prior Periods.

### Bank Debt

The amount drawn under the Corporation's total credit facilities increased to \$284.6 million at September 30, 2010, with an aggregate limit of \$350 million as compared to \$206.4 million drawn at December 31, 2009, when the aggregate limit was \$305 million. The drawn amount is not reduced for unamortized costs and excludes letters of credit that have not been drawn upon. The amount outstanding on Birchcliff's total credit facilities at September 30, 2010 was \$281.2 million (December 31, 2009 – \$201.2 million), which is net of \$3.4 million (December 31, 2009 – \$5.2 million) in unamortized interest and fees.

Total debt (including working capital deficit) increased to \$319.9 million at September 30, 2010 from \$221.5 million at December 31, 2009. The increase in total debt from December 31, 2009 was primarily a result of \$119.3 million in total capital (before dispositions) expended during the nine month Reporting Period in excess of cash flow during that same period, offset by proceeds of \$17.5 million from the sale of a minor asset in March 2010. A significant portion of the funds drawn under the Corporation's credit facilities in the nine month Reporting Period was directed to Phases I and II of the PCS Gas Plant and related infrastructure, and Montney/Doig horizontal wells.

The following table shows the Corporation's total available credit at September 30, 2010 and December 31, 2009:

(\$000's)	September 30, 2010	December 31, 2009
<b>Maximum borrowing base limit<sup>(1)</sup>:</b>		
Revolving credit facilities	350,000	255,000
Non-revolving term credit facility <sup>(2)</sup>	-	50,000
	350,000	305,000
<b>Principal amount utilized:</b>		
Drawn revolving credit facilities	(284,610)	(206,387)
Outstanding letters of credit <sup>(3)</sup>	(2,922)	(2,739)
	(287,532)	(209,126)
<b>Total unused credit</b>	<b>62,468</b>	<b>95,874</b>

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

(2) Effective May 21, 2010, the Corporation repaid in full and cancelled the \$50 million non - revolving term credit facility.

(3) Letters of credit are issued to various service providers. No amounts were drawn on the letters of credit at September 30, 2010 and December 31, 2009.

The bank syndicate recently approved an increase to the Corporation's borrowing base limit on its revolving credit facilities, which is directly impacted by the value of its oil and natural gas reserves, to an aggregate limit of \$375 million from \$350 million. The increase in the borrowing base limit will provide Birchcliff with greater liquidity and financial flexibility to further develop its Montney/Doig natural gas resource play and Worsley light oil resource play.

The financial covenants applicable to the Corporation's credit facilities include a quarterly interest coverage ratio test, which is calculated as earnings before interest, taxes, stock-based compensation, depletion, depreciation and amortization ("**EBITDA**") over interest expense. The following table shows the interest coverage ratio at September 30, 2010 and December 31, 2009:

	September 30, 2010		December 31, 2009	
	Required	Actual	Required	Actual
Annualized EBITDA to interest coverage <sup>(1)</sup>	>3.5	8.5	>3.5	7.6

(1) Interest coverage ratio is calculated on a trailing four quarter basis.

The Corporation was compliant with all financial covenants applicable under its credit facilities as at and during the periods ended September 30, 2010 and December 31, 2009 and continues to be compliant with such covenants at the date hereof.

### Contractual Obligations

The Corporation enters into contractual obligations in the course of conducting its day-to-day business. The following table lists Birchcliff's estimated contractual obligations at September 30, 2010:

(\$000's)	< 1 Year	1 – 2 Years	3 – 5 Years	Thereafter
Accounts payable and accrued liabilities	77,086	-	-	-
Drawn revolving credit facilities <sup>(1)</sup>	-	-	284,610	-
Office leases <sup>(2)</sup>	803	3,214	9,885	9,716
Transportation and processing	887	7,278	22,955	3,640
<b>Total estimated contractual obligations<sup>(3)</sup></b>	<b>78,776</b>	<b>10,492</b>	<b>317,450</b>	<b>13,356</b>

(1) The revolving facilities consist of approximately \$5.6 million drawn on the Working Capital Facility and \$279 million drawn on the Syndicated Credit Facility at September 30, 2010.

(2) The Corporation is committed under an operating lease relating to its office premises, beginning December 1, 2007 and expiring on November 30, 2017. Birchcliff does not presently use all of the leased premises and has sublet approximately 24% of the excess space to an arms' length party on a basis that recovers all of the rental costs for the first five years. The Corporation is also committed to March 29, 2011 under an operating lease for another office premises that it does not use and has sublet to an arm's length party on a basis that recovers all of its rental costs.

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

### OUTSTANDING SHARE DATA

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

	Common Shares
<b>Balance at December 31, 2009</b>	<b>123,815,002</b>
Issue of common shares upon exercise of options	543,733
<b>Balance at March 31, 2010</b>	<b>124,358,735</b>
Issue of common shares upon exercise of options	433,401
<b>Balance at June 30, 2010</b>	<b>124,792,136</b>
Issue of common shares upon exercise of options	119,998
<b>Balance at September 30, 2010</b>	<b>124,912,134</b>

At November 4, 2010, there were outstanding 124,955,934 common shares, 9,405,320 stock options to purchase an equivalent number of common shares and 2,939,732 performance warrants to purchase an equivalent number of common shares.

## RESULTS OF OPERATIONS

### Petroleum and Natural Gas Revenues

Petroleum and Natural Gas (“P&NG”) revenues totaled \$44.1 million (\$36.59 per boe) for the three month Reporting Period and \$132.9 million (\$40.68 per boe) for the nine month Reporting Period as compared to \$32.4 million (\$33.42 per boe) and \$108.8 million (\$34.79 per boe) for the Comparable Prior Periods. The increase in aggregate and per boe P&NG revenues were a result of higher average commodity prices and increased average daily production during the Reporting Periods. The following table details Birchcliff’s P&NG revenues, production and sales prices by category for the Reporting Periods and Comparable Prior Periods:

	Three months ended September 30, 2010				Three months ended September 30, 2009			
	Total Revenue (\$000's)	Average Daily Production	%	Average \$/unit	Total Revenue (\$000's)	Average Daily Production	%	Average \$/unit
Light oil (bbls)	20,904	2,973	23	76.44	17,376	2,698	26	70.00
Natural gas (mcf)	20,199	57,924	74	3.79	13,299	45,210	71	3.20
Natural gas liquids (bbls)	3,033	483	3	68.30	1,673	319	3	57.00
<b>Total P&amp;NG sales</b>	<b>44,136</b>	<b>13,109</b>	<b>100</b>	<b>36.60</b>	<b>32,348</b>	<b>10,552</b>	<b>100</b>	<b>33.32</b>
Royalty revenue	(11)			(0.01)	98			0.10
<b>Total P&amp;NG revenue</b>	<b>44,125</b>			<b>36.59</b>	<b>32,446</b>			<b>33.42</b>

	Nine months ended September 30, 2010				Nine months ended September 30, 2009			
	Total Revenue (\$000's)	Average Daily Production	%	Average \$/unit	Total Revenue (\$000's)	Average Daily Production	%	Average \$/unit
Light oil (bbls)	63,862	3,017	25	77.54	47,900	2,897	25	60.57
Natural gas (mcf)	60,770	51,238	72	4.34	55,662	49,367	72	4.13
Natural gas liquids (bbls)	8,003	411	3	71.29	4,653	328	3	52.01
<b>Total P&amp;NG sales</b>	<b>132,635</b>	<b>11,968</b>	<b>100</b>	<b>40.60</b>	<b>108,215</b>	<b>11,452</b>	<b>100</b>	<b>34.61</b>
Royalty revenue	271			0.08	546			0.18
<b>Total P&amp;NG revenue</b>	<b>132,906</b>			<b>40.68</b>	<b>108,761</b>			<b>34.79</b>

### Commodity Prices

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

	Three months ended September 30, 2010	Three months ended September 30, 2009	Nine months ended September 30, 2010	Nine months ended September 30, 2009
Average natural gas sales price (\$/mcf)	3.79	3.20	4.34	4.13
Average AECO daily spot price (\$/mmbtu) <sup>(1)</sup>	3.54	2.94	4.13	3.78
<b>Positive differential</b>	<b>0.25</b>	<b>0.26</b>	<b>0.21</b>	<b>0.35</b>

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

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

## Royalties

Birchcliff recorded a royalty expense of \$3.6 million (\$2.95 per boe) for the three month Reporting Period and \$12.5 million (\$3.84 per boe) for the nine month Reporting Period as compared to a royalty expense of \$3.6 million (\$3.75 per boe) and \$10.2 million (\$3.25 per boe) for the Comparable Prior Periods. Royalties are paid to the Alberta Government and other land and mineral rights owners. The following table illustrates the Corporation's royalty expense for the Reporting Periods and Comparable Prior Periods:

	<b>Three months ended September 30, 2010</b>	Three months ended September 30, 2009	<b>Nine months ended September 30, 2010</b>	Nine months ended September 30, 2009
Oil & natural gas royalties (\$000's)	<b>3,561</b>	3,644	<b>12,545</b>	10,170
Oil & natural gas royalties (\$/boe)	<b>2.95</b>	3.75	<b>3.84</b>	3.25
Effective royalty rate (%) <sup>(1)</sup>	<b>8%</b>	11%	<b>9%</b>	9%

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

The decrease in the effective royalty rate from the three month Comparable Prior Period is largely due to production royalty incentives for a number of new Montney/Doig horizontal wells brought on production during the current quarter that are receiving a 5% royalty rate.

### *New Royalty and Drilling Incentives*

On July 9, 2009, the Government of Alberta approved an incentive royalty rate of 5% for the first year of production from each new conventional oil or gas well brought on production after April 1, 2009 and before March 31, 2011 up to a maximum of 50,000 barrels of oil or 500 million cubic feet of natural gas per well.

On September 15, 2009, the Government of Alberta approved a Drilling Royalty Credit ("**DRC**") incentive for new conventional oil and natural gas wells spud on or after April 1, 2009 and rig released before April 1, 2011. Birchcliff is entitled to a DRC of \$200 per meter drilled, up to a maximum of 50% of the aggregate Crown royalties paid by the Corporation during the incentive period. Included as a reduction of total capital in the nine month Reporting Period is an expected recovery of \$9.9 million in DRC's related to this incentive program. The recovery of DRC's is dependent on future commodity prices and the effect these prices have on the aggregate royalties paid by Birchcliff during the incentive period. Due to the low natural gas price environment, the Corporation may not be able to recover in full all the DRC's earned from its capital drilling program during the incentive period.

On March 11, 2010, the Alberta Government announced certain changes to the existing royalty framework based on the recommendations from the Investment Competiveness Review. As a result of the competitiveness review, the existing Alberta Royalty Framework ("**ARF**") will be adjusted to better reflect current industry conditions. The adjusted ARF will be effective for the January 2011 production month. Some of the highlights include:

- The current 5% front-end royalty rate on natural gas and conventional oil will become a permanent feature of the royalty system with the current time and volume limits as described above;
- The \$200 per meter drilling royalty credit program will continue to remain in place as legislated until March 31, 2011. Credits not used prior to January 1, 2011 and credits established by drilling on or after that date until March 31, 2011 will be offset from net royalties calculated using adjusted ARF rates;
- The maximum royalty rate for conventional and unconventional natural gas will be reduced from 50% to 36%. For conventional oil, the maximum royalty will be reduced from 50% to 40%; and
- The transitional royalty framework for oil and gas introduced in November 2008 will continue until December 31, 2013. Effective January 1, 2011, the government will not allow any new wells to

elect the transitional royalty rates, but it will allow an operator of wells for which transitional royalty rates have already been elected an option to switch to the new rates effective January 1, 2011.

On May 27, 2010, the Alberta Government finalized the new royalty curves for oil and natural gas wells. A number of new incentive programs were also introduced for unconventional resource exploration and the use of high-cost technologies. Some of the highlights include:

- Wells defined as a “horizontal gas well” will receive a lower upfront maximum royalty rate of 5% to account for the high cost of horizontal drilling. This horizontal gas new well royalty rate will apply for 18 producing months up to a maximum of 500 million cubic feet of gas equivalent production per well, and is retroactive for wells that were spud on or after May 1, 2010;
- Wells defined as a “horizontal oil well” will receive a lower upfront maximum royalty rate of 5% at the start of production to facilitate the recovery of investment costs prior to imposing a higher royalty rate. This horizontal oil new well royalty rate will apply to all products, with varying volume and production month limits set according to depth of the well, and is retroactive to wells that were spud on or after May 1, 2010; and
- The Natural Gas Deep Drilling Program (“NGDDP”) will become an ongoing feature of Alberta’s royalty regime. Vertical depth requirements under this program were adjusted from 2,500 meters to 2,000 meters and will be applied retroactively for wells that were spud on or after May 1, 2010. Wells that have producing intervals that exceed 2,000 meters of true vertical depth are eligible for a royalty credit adjustment. The royalty credit ranges from \$625 per meter to \$3,750 per meter drilled and depends on the type of well drilled and the depth ranges specified under the program.

The royalty incentive programs will create a lower cost structure for Birchcliff. Projects will have better economics under the new royalty framework as compared to the prior framework and therefore are more likely to be approved for capital spending during this current low natural gas commodity cycle. Birchcliff intends to focus its capital spending program in large part on its Montney/Doig natural gas resource play and Worsley light oil resource play to maximize the return available from these new Alberta incentive programs.

### Operating Costs

Operating costs were \$9.1 million (\$7.53 per boe) for the three month Reporting Period and \$26.3 million (\$8.06 per boe) for the nine month Reporting Period as compared to \$8.5 million (\$8.76 per boe) and \$29.0 million (\$9.27 per boe) for the Comparable Prior Periods. The following table compares operating costs for the Reporting Periods and Comparable Prior Periods:

	Three months ended September 30, 2010		Three months ended September 30, 2009	
	(\$000's)	\$/boe	(\$000's)	\$/boe
Field operating costs	9,907	8.22	9,192	9.47
Recoveries	(1,548)	(1.29)	(936)	(0.97)
Field operating costs, net of recoveries	8,359	6.93	8,256	8.50
Expensed workovers and other	723	0.60	248	0.26
<b>Total operating costs</b>	<b>9,082</b>	<b>7.53</b>	<b>8,504</b>	<b>8.76</b>
	Nine months ended September 30, 2010		Nine months ended September 30, 2009	
	(\$000's)	\$/boe	(\$000's)	\$/boe
Field operating costs	29,128	8.92	31,566	10.10
Recoveries	(3,982)	(1.22)	(3,041)	(0.98)
Field operating costs, net of recoveries	25,146	7.70	28,525	9.12
Expensed workovers and other	1,171	0.36	470	0.15
<b>Total operating costs</b>	<b>26,317</b>	<b>8.06</b>	<b>28,995</b>	<b>9.27</b>

Field operating costs decreased by 14% and 13% on a per boe basis from the three and nine Comparable Prior Periods largely due to lower per boe processing costs achieved through Phase I of the PCS Gas Plant which commenced operations in April 2010 and has been operating at its design capacity



of 30 mmcf per day from early August to the end of the current quarter. Recoveries increased on a per boe basis from the Comparable Prior Periods mainly due to processing of third party gas through Phase I of the gas plant.

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

### Transportation and Marketing Expenses

Transportation and marketing expenses were \$3.1 million (\$2.60 per boe) for the three month Reporting Period and \$8.5 million (\$2.60 per boe) for the nine month Reporting Period as compared to \$2.3 million (\$2.35 per boe) and \$7.4 million (\$2.38 per boe) for the Comparable Prior Periods. These costs consist primarily of transportation costs.

### General and Administrative Expenses

Net General and Administrative (“G&A”) expenses were \$0.9 million (\$0.74 per boe) for the three month Reporting Period and \$5.2 million (\$1.60 per boe) for the nine month Reporting Period as compared to \$2.9 million (\$2.99 per boe) and \$7.9 million (\$2.54 per boe) for the Comparable Prior Periods. The components of G&A for the Reporting Periods and Comparable Prior Periods are as follows:

	Three months ended September 30, 2010		Three months ended September 30, 2009	
	(\$000's)	%	(\$000's)	%
Salaries, benefits and consultants	2,574	57	2,937	66
Other	1,936	43	1,524	34
G & A expense, gross	4,510	100	4,461	100
Overhead recoveries	(3,197)	(71)	(1,200)	(27)
Capitalized overhead	(424)	(9)	(357)	(8)
<b>G &amp; A expense, net</b>	<b>889</b>	<b>20</b>	<b>2,904</b>	<b>65</b>
<b>G &amp; A expense, net per boe</b>	<b>\$0.74</b>		<b>\$2.99</b>	

  

	Nine months ended September 30, 2010		Nine months ended September 30, 2009	
	(\$000's)	%	(\$000's)	%
Salaries, benefits and consultants	7,740	57	7,336	62
Other	5,792	43	4,583	38
G & A expense, gross	13,532	100	11,919	100
Overhead recoveries	(7,049)	(52)	(2,839)	(24)
Capitalized overhead	(1,243)	(9)	(1,149)	(10)
<b>G &amp; A expense, net</b>	<b>5,240</b>	<b>39</b>	<b>7,931</b>	<b>66</b>
<b>G &amp; A expense, net per boe</b>	<b>\$1.60</b>		<b>\$2.54</b>	

Net G&A expense decreased on a per boe basis from the Comparable Prior Periods mainly due to additional volumes added from Phase I of the PCS Gas Plant, and due to significant increases in overhead recoveries which is directly attributable to the increased capital spent in the Reporting Periods. Capital expenditures during the three and nine month Reporting Periods increased by 180% and 301% from the same periods in 2009.

The capitalization of costs in the “overhead recoveries” category reflects an industry standard charge per Authorization For Expenditure to capitalize engineering, land, accounting and operations time related to overhead costs spent on capital projects, whereas the “capitalized overhead” category reflects a portion of costs relating to Birchcliff’s exploration and geology department.

### Interest Expenses

Interest expense was \$3.4 million (\$2.85 per boe) for the three month Reporting Period and \$9.5 million (\$2.92 per boe) for the nine month Reporting Period as compared to \$2.9 million (\$3.01 per boe) and \$7.7 million (\$2.45 per boe) for the Comparable Prior Periods. The aggregate interest expense from the Comparable Prior Periods increased mainly due to higher average outstanding credit facilities during the Reporting Periods. The Corporation’s average outstanding credit facilities balance was approximately

\$255.3 million in the three month Reporting Period and approximately \$229.1 million in the nine month Reporting Period as compared to approximately \$192.3 million and \$212.2 million in the Comparable Prior Periods, calculated as the simple average of the month end amounts. Funds drawn from Birchcliff's credit facilities during the Reporting Periods were largely directed towards the PCS Gas Plant, related infrastructure and Montney/Doig horizontal wells.

The aggregate interest expense was also impacted by pricing margins that are used to determine Birchcliff's average effective interest rate. New lower pricing margins became applicable when the Corporation increased its revolving credit facilities limit to \$350 million in May 2010.

The effective rate applicable to the Working Capital Facility was 5.5% at the end of the Reporting Period as compared to 5.3% at the end of the Comparable Prior Period. The overall effective interest rates applicable to the bankers' acceptances issued under the Syndicated Credit Facility was 4.9% and 5.4% in the three and nine month Reporting Periods as compared to 4.9% and 3.9% in the Comparable Prior Periods. The effective interest rate applicable to the bankers' acceptances issued under the term credit facility was 5.9% in the nine month Reporting Period. During the nine month Reporting Period, the Corporation drew the full \$50 million term credit facility, which had higher pricing margins than the revolving credit facilities and was outstanding for most of the first quarter of 2010. No amounts were drawn on the term credit facility during the Comparable Prior Periods. The Corporation repaid in full and cancelled the \$50 million non-revolving term credit facility in May 2010.

#### Depletion, Depreciation and Accretion Expenses

Depletion, Depreciation and Accretion ("DD&A") expenses were \$19.4 million (\$16.07 per boe) for the three month Reporting Period and \$54.1 million (\$16.56 per boe) for the nine month Reporting Period as compared to \$21.8 million (\$22.46 per boe) and \$69.4 million (\$22.20 per boe) for the Comparable Prior Periods. DD&A expenses decreased on an aggregate and per boe basis mainly due to the reduced cost of adding significant proved reserves recorded during the fourth quarter of 2009 and the Reporting Periods, notwithstanding increased average daily production during the current periods. The components of DD&A for the Reporting Periods and Comparable Prior Periods are as follows:

	Three months ended September 30, 2010		Three months ended September 30, 2009	
	(\$000's)	\$/boe	(\$000's)	\$/boe
Depletion & depreciation	18,912	15.68	21,402	22.05
Accretion on asset retirement obligations	473	0.39	399	0.41
<b>Total DD&amp;A</b>	<b>19,385</b>	<b>16.07</b>	<b>21,801</b>	<b>22.46</b>

  

	Nine months ended September 30, 2010		Nine months ended September 30, 2009	
	(\$000's)	\$/boe	(\$000's)	\$/boe
Depletion & depreciation	52,771	16.15	68,206	21.82
Accretion on asset retirement obligations	1,338	0.41	1,174	0.38
<b>Total DD&amp;A</b>	<b>54,109</b>	<b>16.56</b>	<b>69,380</b>	<b>22.20</b>

DD&A is a function of the estimated proved reserve additions, the associated future development capital required to recover those proved reserves, the cost of petroleum and natural gas properties in the full cost pool attributable to those proved reserves and production in the period. At September 30, 2010, the Corporation excluded \$59.4 million (September 30, 2009 - \$42.4 million) from its full cost pool for undeveloped land acquired by Birchcliff.

### *Petroleum and Natural Gas Properties Impairment Test*

The Corporation follows the full cost method of accounting, which requires periodic review of capitalized costs to ensure that they do not exceed the recoverable value of the petroleum and natural gas properties and the fair value of the Corporation's assets.

Birchcliff performed an impairment test at September 30, 2010 on its petroleum and natural gas assets. Birchcliff determined its petroleum and natural gas assets were not impaired at September 30, 2010.

### **Stock-Based Compensation Expenses**

Birchcliff accounts for its stock-based compensation awards, namely stock options and performance warrants, using the fair value method. The related expense is recorded in the income statement over the vesting period.

The Corporation recorded a total non-cash stock-based compensation expense of \$2.8 million (\$2.35 per boe) for the three month Reporting Period and \$8.1 million (\$2.47 per boe) for the nine month Reporting Period as compared to \$1.4 million (\$1.42 per boe) and \$8.1 million (\$2.58 per boe) for the Comparable Prior Periods. Included in the total non-cash stock-based compensation expense in the nine month Comparable Prior Period was \$3.1 million relating to the extension of the performance warrants on May 28, 2009. Excluding the impact of the extension of the performance warrants, the non-cash stock-based compensation expense related to stock options was \$1.4 million and \$5.0 million in the three and nine month Comparable Prior Periods.

The increase in stock option expense from the Comparable Prior Periods was mainly due to the issuance of 2,311,300 options to directors, officers, and employees of Birchcliff at an exercise price of \$9.72 per common share in January 2010 as a result of Birchcliff's annual compensation review.

A summary of the Corporation's outstanding stock options at September 30, 2010 is presented below:

	Number	Weighted Average Exercise Price (\$)
<b>Outstanding, December 31, 2009</b>	<b>7,710,253</b>	<b>5.81</b>
Granted	2,852,300	9.62
Exercised	(543,733)	(4.25)
Forfeited	(126,401)	(6.31)
<b>Outstanding March 31, 2010</b>	<b>9,892,419</b>	<b>6.99</b>
Granted	207,500	9.70
Exercised	(433,401)	(4.56)
Forfeited	(143,000)	(8.54)
<b>Outstanding, June 30, 2010</b>	<b>9,523,518</b>	<b>7.13</b>
Granted	130,000	9.41
Exercised	(119,998)	(5.08)
Forfeited	(21,000)	(8.33)
<b>Outstanding, September 30, 2010</b>	<b>9,512,520</b>	<b>7.19</b>

On January 14, 2005, the Corporation issued 4,049,665 performance warrants with an exercise price of \$3.00 and an expiration date of January 31, 2010 to members of its executive team. On May 28, 2009, the outstanding performance warrants were amended following receipt of shareholder approval to extend the expiration date from January 31, 2010 to January 31, 2015. There remained outstanding and exercisable 2,939,732 performance warrants at September 30, 2010. Each stock option and performance warrant entitles the holder to purchase one common share at the exercise price.

### Deferred Financing Fees

In May 2009, the Corporation paid \$625,000 in financing fees to establish the one year non-revolving \$50 million term credit facility, and \$1.35 million to increase the aggregate limit of the revolving credit facilities to \$255 million and extend the conversion date of the revolving facilities from May 22, 2009 to May 21, 2010. In January 2010, the Corporation paid an additional \$250,000 in financing fees to extend the maturity date of the term credit facility from May 21, 2010 to May 21, 2011. In May 2010, the Corporation paid approximately \$1.0 million in financing fees to increase the aggregate limit of the revolving credit facilities to \$350 million and extend the conversion date of those facilities from May 21, 2010 to May 20, 2011.

The Corporation amortized to income approximately \$0.3 million (\$0.21 per boe) in deferred financing fees during the three month Reporting Period and \$1.4 million (\$0.43 per boe) for the nine month Reporting Period as compared to \$0.5 million (\$0.51 per boe) and \$0.7 million (\$0.23 per boe) for the Comparable Prior Periods.

### Income Taxes

Birchcliff recorded a future income tax expense of approximately \$1.1 million (\$0.94 per boe) for the three month Reporting Period and \$3.9 million (\$1.19 per boe) for the nine month Reporting Period as compared to a future income tax recovery of \$2.4 million (\$2.52 per boe) and \$5.7 million (\$1.84 per boe) for the Comparable Prior Periods. A future income tax expense was recorded in the Reporting Periods largely due to higher reported cash flow and offset by a reduction of DD&A expenses which resulted in net income in those periods. A future income tax recovery was recorded in the Comparable Prior Periods mainly as a result of low oil and natural gas prices which resulted in net losses during those periods.

## CAPITAL EXPENDITURES AND CAPITAL RESOURCES

### Capital Expenditures

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

Three months ended September 30, (\$000's)	2010	2009
Land	6,011	1,108
Seismic	605	410
Workovers and other	3,329	2,990
Drilling and completions <sup>(1)</sup>	62,372	9,586
Well equipment and facilities	18,647	15,773
Capitalized general and administrative expenses	424	357
<b>Total finding and development costs (F&amp;D)</b>	<b>91,388</b>	<b>30,224</b>
Acquisitions and Dispositions, net	2,051	3,019
<b>Total finding, development and acquisition costs (FD&amp;A)</b>	<b>93,439</b>	<b>33,243</b>
Administrative assets	353	199
<b>Total capital expenditures</b>	<b>93,792</b>	<b>33,442</b>

(1) Included in drilling and completions for the three months ended September 30, 2009 is an expected recovery of \$3.4 million related to the Alberta Drilling Royalty Credit Program. Birchcliff reduced its total estimated DRC recovery by \$2.0 million in the three months ended September 30, 2010 due to the low natural gas price environment.

<b>Nine months ended September 30, (\$000's)</b>	<b>2010</b>	<b>2009</b>
Land	17,738	1,684
Seismic	1,371	756
Workovers and other	7,476	3,601
Drilling and completions <sup>(1)</sup>	102,727	21,942
Well equipment and facilities	56,754	24,596
Capitalized general and administrative expenses	1,243	1,149
<b>Total finding and development costs (F&amp;D)</b>	<b>187,309</b>	<b>53,728</b>
Acquisitions and Dispositions, net <sup>(2)</sup>	(15,460)	3,049
<b>Total finding, development and acquisition costs (FD&amp;A)</b>	<b>171,849</b>	<b>56,777</b>
Administrative assets	729	545
<b>Total capital expenditures</b>	<b>172,578</b>	<b>57,322</b>

(1) Included in drilling and completions for the nine months ended September 30, 2010 is an expected recovery of \$9.9 million (September 30, 2009 - \$3.4 million) related to the Alberta Drilling Royalty Credit Program.

(2) On March 3, 2010, the Corporation sold a minor non-producing asset in the Kakut area of Alberta for \$17.5 million.

### Capital Resources

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

<b>Three months ended September 30, (\$000's)</b>	<b>2010</b>	<b>2009</b>
Cash generated by operations	24,022	12,196
Changes in non-cash working capital from operations	3,678	3,497
Asset retirement expenditures	(136)	(36)
Equity issues, net of issue costs	610	1,921
Increase (decrease) in revolving credit facilities	44,924	(37,109)
Changes in non-cash working capital from investing	20,694	15,934
<b>Total capital resources</b>	<b>93,792</b>	<b>(3,597)</b>

<b>Nine months ended September 30, (\$000's)</b>	<b>2010</b>	<b>2009</b>
Cash generated by operations	70,759	46,576
Changes in non-cash working capital from operations	(3,916)	(2,271)
Asset retirement expenditures	(331)	(309)
Equity issues, net of issue costs	4,897	62,676
Increase (decrease) in revolving credit facilities	80,063	(28,129)
Deferred financing fees paid	(1,268)	(1,975)
Changes in non-cash working capital from investing	22,374	(19,171)
<b>Total capital resources</b>	<b>172,578</b>	<b>57,397</b>

## SUMMARY OF QUARTERLY RESULTS

The following is a summary of quarterly results of the Corporation for the eight most recently completed quarters:

Quarters Ended (\$000's, except for production, share and per share amounts)	September 30, 2010	June 30, 2010	March 31, 2010	December 31, 2009
Petroleum and natural gas production (boe per day)	13,109	12,357	10,407	10,515
Petroleum and natural gas commodity price at wellhead (\$ per boe)	36.60	39.45	47.12	43.23
Natural gas commodity price at wellhead (\$ per mcf)	3.79	4.16	5.34	4.81
Petroleum commodity price at wellhead (\$ per bbl)	76.44	76.24	80.03	75.01
Total petroleum and natural gas revenue	44,125	44,546	44,235	41,908
Total royalties	(3,561)	(3,621)	(5,363)	(5,172)
Total revenues, net	40,564	40,925	38,872	36,736
Total capital expenditures, net	93,792	43,083	35,703	44,368
Net income (loss)	422	215	2,653	1,616
Per share basic	-	-	\$0.02	\$0.01
Per share diluted	-	-	\$0.02	\$0.01
Cash generated by operations	24,022	23,825	22,912	20,900
Per share basic	\$0.19	\$0.19	\$0.18	\$0.17
Per share diluted	\$0.19	\$0.19	\$0.18	\$0.17
Book value of total assets	961,592	883,279	860,180	837,108
Non-revolving term credit facility	-	-	49,661	-
Revolving credit facilities	281,172	235,993	158,614	201,230
Total debt	319,921	250,370	232,287	221,521
Shareholders' equity	570,813	566,943	562,019	554,561
Common shares outstanding – end of period				
Basic	124,912,134	124,792,136	124,358,735	123,815,002
Diluted	137,364,386	137,255,386	137,190,886	134,464,987
Weighted average common shares outstanding				
Basic	124,872,806	124,548,932	124,095,074	123,538,213
Diluted	127,253,296	126,816,143	127,094,837	126,358,921

  

Quarters Ended (\$000's, except for production, share and per share amounts)	September 30, 2009	June 30, 2009	March 31, 2009	December 31, 2008
Petroleum and natural gas production (boe per day)	10,552	11,313	12,513	11,524
Petroleum and natural gas commodity price at wellhead (\$ per boe)	33.32	33.79	36.48	47.88
Natural gas commodity price at wellhead (\$ per mcf)	3.20	3.75	5.27	7.14
Petroleum commodity price at wellhead (\$ per bbl)	70.00	63.84	49.33	59.10
Total petroleum and natural gas revenue	32,446	34,917	41,398	51,034
Total royalties	(3,644)	2,118	(8,644)	(8,888)
Total revenues, net	28,802	37,035	32,754	42,146
Total capital expenditures, net	33,442	5,485	18,395	58,916
Net income (loss)	(9,039)	(7,128)	(9,701)	(355)
Per share basic	(\$0.07)	(\$0.06)	(\$0.09)	-
Per share diluted	(\$0.07)	(\$0.06)	(\$0.09)	-
Cash generated by operations	12,196	20,026	14,354	24,627
Per share basic	\$0.10	\$0.18	\$0.13	\$0.22
Per share diluted	\$0.10	\$0.18	\$0.13	\$0.22
Book value of total assets	796,338	819,142	800,959	814,823
Revolving credit facilities	182,589	219,361	228,867	211,586
Total debt	199,346	179,649	253,544	249,862
Shareholders' equity	549,239	535,917	496,276	507,371
Common shares outstanding – end of period				
Basic	123,267,436	122,807,637	112,542,635	112,395,970
Diluted	134,049,987	134,732,322	124,618,156	121,659,923
Weighted average common shares outstanding				
Basic	122,914,069	112,887,812	112,457,321	112,395,970
Diluted	124,523,458	113,817,095	112,801,866	116,859,500

## Discussion of Quarterly Results

Birchcliff's average production in the third quarter of 2010 was 13,109 boe per day, which is a 6% increase from 12,357 boe per day in the second quarter of 2010 and a 24% increase from 10,552 boe per day in the third quarter of 2009. These production gains were achieved through the success of Birchcliff's capital drilling program and processing of natural gas through Phase I of the PCS Gas Plant, which was operating at its design capacity of 30 mmcf per day from early August to the end of the current quarter.

Total capital expenditures in the third quarter of 2010 were \$93.8 million as compared to \$43.1 million in the second quarter of 2010 and \$33.4 million in the third quarter of 2009. Of the \$93.8 million in capital expended in the current quarter, approximately \$6.8 million (7%) was spent on the expansion of Phase II of the PCS Gas Plant and related infrastructure, and approximately \$39.2 million (42%) on the drilling and completion of new Montney/Doig horizontal wells that will be tied into the gas plant in the coming months in order to utilize the plant's total processing capacity of 60 mmcf per day. The remaining \$47.8 million in capital was spent on acquiring land; expanding the existing Montney/Doig natural gas and Worsley light oil resource plays; on minor acquisitions; and related infrastructure and other projects. Further details of the Corporation's capital expenditures are set forth in the table entitled "Capital Expenditures".

Cash flow generated by the Corporation in the third quarter of 2010 was \$24.0 million as compared to \$23.8 million in the second quarter of 2010 and \$12.2 million in the third quarter of 2009. Cash flow was slightly higher from the previous quarter mainly due to higher average daily production and increased G&A overhead recoveries, and offset by lower average petroleum and natural gas prices realized at the wellhead. The increase in cash flow as compared to the third quarter of 2009 was mainly attributed to higher average petroleum and natural gas prices realized at the wellhead, increased average daily production and increased G&A overhead recoveries.

Birchcliff recorded net income of \$0.4 million in the third quarter of 2010 as compared to net income of \$0.2 million in the second quarter of 2010 and net loss of \$9.0 million in the third quarter of 2009. The increase in net income from the third quarter of 2009 was mainly a result of higher cash flow and lower DD&A expenses reported during the current quarter, notwithstanding an increase in non-cash stock-based compensation expense and future income tax expense.

Total debt (including working capital deficit) increased to \$319.9 million at September 30, 2010 from \$250.4 million at June 30, 2010 and \$221.5 million at December 31, 2009. The increase in total debt was due to \$69.8 million and \$101.8 million in net capital expended during the three and nine month Reporting Periods in excess of cash flow during those same periods.

## MERGERS & ACQUISITIONS

The Corporation is primarily focused on growth through drill bit and does not have any current intention of pursuing any major acquisition or merger transaction. However, the Corporation as part of its normal business operations continues to review potential property acquisitions and dispositions, joint venture opportunities, and corporate mergers and acquisitions with the intention of completing such a transaction if acceptable terms can be negotiated. As a result, Birchcliff may at any time be involved in negotiations with other parties in respect of property acquisitions and dispositions, joint venture opportunities, and corporate mergers and acquisition opportunities.

## CONTROLS AND PROCEDURES

### Disclosure Controls

The Corporation has established and maintains disclosure controls and procedures that have been designed by, or under the supervision of, the Corporation's Chief Executive Officer and the Chief Financial Officer ("**Certifying Officers**") to provide reasonable assurance that information required to be disclosed by the Corporation in its annual filings, interim filings or other reports filed or submitted by it

under securities legislation is recorded, processed, summarized and reported within the time periods specified in the securities legislation and to ensure that information required to be disclosed by an issuer in its annual filings, interim filings or other reports filed or submitted under securities legislation is accumulated and communicated to the Corporation's management, including its Certifying Officers, as appropriate to allow timely decisions regarding required disclosure. Such disclosure controls and procedures are referred to as the "**Disclosure Controls and Procedures**".

The Certifying Officers have evaluated, or caused to be evaluated under their supervision, the effectiveness of the Corporation's Disclosure Controls and Procedures as at September 30, 2010 and have concluded that such Disclosure Controls and Procedures were effective as at that date to provide reasonable assurance that information required to be disclosed by the Corporation in its annual filings, interim filings or other reports filed or submitted by it under securities legislation is recorded, processed, summarized, and reported within the time periods specified in the securities legislation and that information required to be disclosed by the Corporation in its annual filings, interim filings or other reports filed or submitted under securities legislation is accumulated and communicated to the Corporation's management, including the Certifying Officers, as appropriate to allow timely decisions regarding required disclosure.

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

#### **Internal Controls over Financial Reporting**

The Corporation has established and maintains internal controls over financial reporting that have been designed by, or under the supervision of, the Corporation's Certifying Officers to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with GAAP applicable to the Corporation and reasonable assurance that all assets are safeguarded and transactions are appropriately authorized and recorded to facilitate the preparation of relevant, reliable and timely information. Such internal controls over financial reporting are herein referred to as "**ICFR**". The Certifying Officers have evaluated, or caused to be evaluated under their supervision, the effectiveness of the Corporation's ICFR as required by National Instrument 52-109, *Certification of Disclosure in Issuers' Annual and Interim Filings*. Based on that evaluation, the Certifying Officers concluded that the Corporation's ICFR was effective at September 30, 2010 for the purposes described above. It should be noted that a control system, including the Corporation's, no matter how well conceived, maintained and operated, can provide only reasonable, but not absolute, assurance that the objectives of the control system will be met and it should not be expected that the ICFR will prevent all errors and fraud.

#### **CHANGE IN ACCOUNTING POLICIES**

##### **Transition to International Financial Reporting Standards ("IFRS")**

In February 2008, the CICA's Accounting Standards Board confirmed that IFRS will replace Canadian GAAP in 2011 for profit-oriented Canadian publicly accountable enterprises. Birchcliff will be required to report its results in accordance with IFRS beginning in 2011. The Corporation has developed a plan to complete the transition to IFRS by January 1, 2011, including the preparation of 2010 required comparative information.

Birchcliff's transition plan includes training and development throughout the organization, and three key phases:



- *Phase 1 - Scoping and diagnostics*

Phase 1 involves performing a high level diagnostic analysis to identify areas that may be affected by the transition to IFRS. The results of this analysis are priority ranked according to complexity and the amount of time required to assess the impact of changes in transitioning to IFRS.

- *Phase 2 - Impact analysis and evaluation*

During Phase 2, items identified in Phase 1 are addressed according to the priority levels assigned to them. This phase involves analysis of policy choices allowed under IFRS and their impact on the financial statements. In addition, certain potential differences are further investigated to assess whether there may be a broader impact to Birchcliff's debt agreements, business processes or management reporting systems. The conclusion of the impact analysis and evaluation phase will require the Audit Committee of the Board of Directors to review and approve all accounting policy choices as proposed by management.

- *Phase 3 - Implementation*

Phase 3 involves implementation of all changes approved in Phase 2 and will include changes to information systems, business processes, modification of agreements and training of all staff who are impacted by the conversion.

During 2009, Birchcliff made significant progress on its transition plan, completing Phase 1 and moving into Phase 2, and conducting preliminary impact analysis of accounting policy alternatives. As anticipated in Birchcliff's transition plan, progress on the IFRS transition project was minimal in the first quarter of 2010 as Birchcliff's accounting resources were focused on year end reporting requirements.

During the second and third quarter of 2010, Birchcliff focused its efforts primarily on Phases 2 and 3 of the transition plan. Except for income taxes, management has finalized its IFRS accounting policies for significant impact areas and quantified the expected financial impact of these policies on the IFRS opening balance sheet at January 1, 2010 ("**Transition Date**"). Management expects to make its recommendations of the chosen IFRS accounting policies to the Audit Committee of the Board of Directors in the fourth quarter of 2010. Birchcliff has also implemented necessary changes to its business processes and information systems for significant areas of impact, with internal control requirements taken into account.

### **IFRS Accounting Policies with Significant Impact**

Birchcliff has determined the areas that will be most significantly affected by the adoption of IFRS. The areas identified as being significant have the greatest potential impact to the Corporation's financial statements or the greatest risk in terms of complexity to implement. The most significant areas include:

- Property, Plant and Equipment including;
  - Transition on date of adoption of IFRS
  - Exploration and Evaluation costs
  - Pre-exploration costs
  - Depletion, depreciation and amortization
- Cash-generating units and impairment testing
- Decommissioning liabilities (known as "asset retirement obligations" under GAAP)
- Stock-based compensation
- Income taxes

Each of these significant areas and the expected financial impact on the IFRS opening balance sheet is discussed in more detail below. All chosen IFRS accounting policies are subject to review and final approval by the Audit Committee of the Board of Directors. Birchcliff's analysis of the chosen IFRS accounting policies specifically considers the current IFRS standards that are in effect. As a result, any new or amended accounting standards that are issued by the IASB in future periods may impact our current assessment of the chosen IFRS accounting policies and the expected financial impact on transition to IFRS.

#### *Property, Plant & Equipment*

Property, Plant and Equipment ("**PP&E**") is the most significant area impacted by the adoption of IFRS. Under Canadian GAAP, Birchcliff follows the CICA's guideline on full cost accounting. IFRS has no equivalent guideline. In order to facilitate the transition to IFRS by full cost accounting companies, the IASB released additional exemptions for first-time adopters of IFRS in July 2009. Included in the amendments is an exemption which permits full cost accounting companies to allocate their existing PP&E net book value (full cost pool) using either reserve volumes or reserve values to the unit of account level upon transition to IFRS. Companies that elect to use this exemption on transition will need to decide whether to allocate based on reserve volumes or values using either proved or proved plus probable reserves. Without this exemption, the Corporation would have been required to retrospectively determine the carrying amount of oil and gas assets at the date of transition, or use the fair value or revaluation amount as the new deemed cost under IFRS. By using the exemption, the net book value of Birchcliff's PP&E at the date of transition to IFRS will be the same as it was under Canadian GAAP, subject to any potential IFRS impairments that are recognized at the date of transition. Birchcliff expects to use this exemption on transition to IFRS and allocate the existing net book value of its oil and gas full cost pool at the area level using proved plus probable reserve volumes.

In moving to IFRS, Birchcliff will be required to adopt different accounting policies for pre-exploration activities, exploration and evaluation costs, DD&A and the accounting for gains and losses on property dispositions, significant components of PP&E and other material non-monetary transactions.

Pre-exploration costs are costs incurred before the Corporation obtains the legal right to explore an area. Under Canadian GAAP, these costs are capitalized, while under IFRS, these costs must be expensed. At this time, Birchcliff does not anticipate that this accounting policy difference will have a significant impact on the IFRS financial statements.

During the Exploration and Evaluation ("**E&E**") phase, Birchcliff capitalizes costs incurred for these projects under Canadian GAAP. Under IFRS, the Corporation has the alternative to either continue capitalizing these E&E costs until technical feasibility and commercial viability of the project is determined or to expense these costs as incurred. Once technical feasibility and commercial viability of an E&E project is determined, the related costs (net of any impairment) are transferred to the Developing and Producing ("**D&P**") phase. If Birchcliff's policy choice is to continue capitalizing E&E project costs under IFRS, the Corporation has the alternative to either begin depleting the related costs when in the E&E phase or to deplete the costs once the project is in the D&P phase. Birchcliff has estimated its E&E assets at the date of transition to be immaterial. Birchcliff expects to capitalize E&E project costs as incurred and begin depleting the related costs once technical feasibility and commercial viability of an E&E project is established. Technical feasibility and commercial viability of an E&E project is established when at minimum proved reserves related to the project are identified.

Under Canadian GAAP, Birchcliff calculates its DD&A rate at the country cost centre level. Under IFRS, this rate will be calculated at a lower unit of account level. Under IFRS, the Corporation has the alternative to either continue depleting its assets over proved reserves (same as Canadian GAAP) or use another basis which more accurately reflects the useful life of Birchcliff's oil and gas assets. Birchcliff expects to calculate its DD&A rate at the area level and deplete its oil and gas assets over proved plus probable reserves on transition to IFRS.

Full cost accounting under Canadian GAAP requires that gains or losses on divestitures of properties are only recognized when the disposal would affect the DD&A rate by 20 percent or more. Under IFRS, there is no such exemption, and therefore Birchcliff will be required to recognize all gains and losses on property divestitures and derecognition of significant components of PP&E. There is no impact of adopting this IFRS accounting policy at January 1, 2010.

As a result of the additional exemptions released by the IASB in July 2009, the Corporation anticipates that all changes to its PP&E accounting policies will be adopted prospectively.

#### *Impairment Testing*

Under Canadian GAAP, the recoverable amount of Birchcliff's oil and gas assets under the first step of the impairment test is determined using undiscounted future cash flow from proved reserves. Under IFRS, the recoverable amount is calculated using discounted future cash flow from proved or proved plus probable reserves. In addition, impairment testing under Canadian GAAP is performed at the country cost centre level, while under IFRS it will be performed at a lower level referred to as a cash-generating unit. Canadian GAAP prohibits reversal of impairment losses. Under IFRS, if the conditions giving rise to impairment have reversed, impairment losses previously recorded would be partially or fully reversed to eliminate write-downs recorded. Birchcliff expects to adopt these changes in accounting policy prospectively.

Birchcliff expects it will have a single cash-generating unit at the date of transition. Birchcliff did not identify any impairment of its petroleum and natural gas assets under IFRS at January 1, 2010. The impairment calculation was performed using an after-tax discounted cash flow from proved plus probable reserves.

#### *Decommissioning Liabilities*

Under Canadian GAAP, the Corporation recognizes a liability for the estimated fair value of the future retirement obligations associated with PP&E. The fair value is capitalized and amortized over the same period as the underlying asset. Birchcliff estimates the liability based on the estimated costs to abandon and reclaim its net ownership interest in wells and facilities, including an estimate for the timing of the costs to be incurred in future periods. These cash outflows are discounted using a credit-adjusted risk free rate of 8% at December 31, 2009 under Canadian GAAP. Changes in the net present value of the future retirement obligation are expensed through accretion as part of DD&A. Under IFRS, these liabilities are known as "decommissioning liabilities" and are included in the scope of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. Decommissioning liabilities are calculated at each reporting period by estimating the risk-adjusted future cash outflows which are discounted using a risk-free rate. Changes in the net present value of the future retirement obligation are expensed through accretion as part of DD&A. Due to the change in the discount rate from a credit-adjusted rate to a risk-free rate, Birchcliff expects there will be a significant increase in the value of the decommissioning liability under IFRS as compared to Canadian GAAP.

As a result of adopting IAS 37, Birchcliff has estimated a \$12.0 million increase to decommissioning liability with the offset to retained earnings on transition to IFRS. Birchcliff's risk-adjusted future cash outflows were discounted using a risk-free rate of 4% at January 1, 2010.

#### *Stock-based Compensation*

IFRS 2 *Share-Based Payments* requires the expense related to share-based payments to be recognized as the options vest. For options with different vesting periods, each vesting tranche must be treated as a separate option grant which accelerates the expense recognition ("Graded Vesting Amortization") in comparison to Canadian GAAP which allows the expense to be recognized on a straight-line basis over the period the options vests. Birchcliff must also apply an estimated forfeiture rate at the initial grant date for each option tranche. The forfeiture rate is taken into account by adjusting the number of stock options expected to vest under each tranche and subsequently revising this estimate throughout the vesting

period, as necessary. When determining the fair value of each vesting tranche, Birchcliff will use an estimated option tranche life which reflects historical experiences in comparison to GAAP which allows the life of the option to equal the five year expiry period. Birchcliff anticipates stock-based compensation expense to be higher than under Canadian GAAP because of the graded vesting requirements of IFRS.

As a result of adopting IFRS 2, Birchcliff has estimated a \$2.5 million increase to contributed surplus with the offset to retained earnings at January 1, 2010. The increase is largely due to the accelerated expense recognition of vesting tranches under IFRS.

#### *Income Tax*

In transitioning to IFRS, the carrying amount of Birchcliff's deferred tax balances will be directly impacted by the tax effects resulting from changes required by the above IFRS accounting policy differences. Birchcliff is still determining the impact of the revised standard on its IFRS transition. Therefore, at this time the income tax impacts of the differences are not reasonably determinable.

#### **Changes to IFRS Accounting Standards**

Birchcliff's analysis of accounting policy differences specifically considers the current IFRS standards that are in effect. The Corporation will continue to monitor any new or amended accounting standards that are issued by the IASB in future periods.

#### **Internal Controls over Financial Reporting**

Birchcliff does not anticipate that the transition to IFRS will have a significant impact on its internal controls over financial reporting. The review of internal controls over financial reporting will be an ongoing process throughout 2010 to ensure that all changes in accounting policies include the appropriate additional business controls and procedures for future IFRS reporting requirements.

#### **Disclosure Controls and Procedures**

Birchcliff does not anticipate that the transition to IFRS will have a significant impact on its disclosure controls and procedures. Throughout the transition, Birchcliff will assess stakeholders' information requirements and will ensure that adequate and timely information is provided so that all stakeholders remain apprised.

#### **Education and Training**

All of the key individuals that are involved in financial reporting under Canadian GAAP have received IFRS training and are actively involved in the IFRS transition project. Birchcliff will continue to involve senior financial reporting personnel in the IFRS transition throughout 2010 and 2011. Other individuals affected by the change from Canadian GAAP to IFRS will be educated and trained during 2010 as Birchcliff identifies and calculates the specific dollar value of differences arising from the changes to our accounting policies.

#### **Information Systems**

Birchcliff has evaluated and implemented necessary changes to its information systems for significant areas of impact. Birchcliff's system updates were minimal, however, they were critical in order to allow for reporting of both Canadian GAAP and IFRS statements in 2010 as well as the updates required to track capital expenditures at a granular level for IFRS reporting in 2011 and thereafter.

#### **Impacts to our Business**

Birchcliff does not expect that the adoption of IFRS in 2011 will have a significant impact or influence on its business activities, operations or strategies going forward. Management will continue to closely monitor the impact of IFRS on its business activities during the fourth quarter of 2010.

## ADVISORIES

### **BOE Conversions**

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

### **Non-GAAP Measures**

This MD&A and the Corporation’s Quarterly and Annual Reports uses the terms “cash flow”, “netback”, “cash flow netback”, “operating netback”, “cash flow per share”, and “EBITDA”, which do not have standardized meanings prescribed by GAAP and therefore may not be comparable to measures by other companies where similar terminology is used. Cash flow appears as a separate line on the Corporation’s Statements of Cash Flows above “changes in non-cash working capital” and is reconciled to net income (loss) and comprehensive income (loss). Netback denotes petroleum and natural gas revenue less royalties, less operating expenses and less transportation and marketing expenses. Cash flow netback denotes net earnings plus non-cash items including future income tax expense (less any recovery), depletion, depreciation and accretion expense, unrealized losses from risk management contracts and foreign exchange (less unrealized gains), non-cash stock-based compensation expense and amortization of deferred financing fees. EBITDA denotes earnings before interest, taxes, stock-based compensation, depletion, depreciation and amortization.

### **Forward Looking Information**

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

In particular, this MD&A contains forward-looking information, including among other places, under the headings “Outlook” and “International Financial Reporting Standards”. This forward-looking information includes but is not limited to statements regarding: expected processing capacity of the PCS Gas Plant and its future expansion; overall production; planned drilling, exploration and development; planned 2010 capital spending and sources of funding; expected results from the Corporation’s portfolio of oil and gas assets; the quantity and development of oil and gas reserves; future net cash flows and discounted cash flows; expected operating, general administrative, services, environmental compliance costs and expenses; royalty rates and incentives; treatment under tax laws; expected ability to transition to new accounting standards and other expectations, beliefs, plans, goals, objectives, assumptions, information and statements about possible future events, conditions, results of operations or performance. The Corporation cannot guarantee future results, levels of activity, performance or achievements. Consequently, there is no representation by the Corporation that actual results achieved will be the same in whole or in part as those set out in the forward-looking information.

With respect to such forward-looking information the key assumptions on which the Corporation relies are: that future prices for crude oil and natural gas, future currency exchange rates and interest rates, and future availability of debt and equity financing will be at levels and costs that allow the Corporation to manage, operate and finance its business and develop its properties and meet its future obligations; that the regulatory framework in respect of royalties, taxes and environmental matters applicable to the Corporation will not become so onerous as to preclude the Corporation from viably managing, operating and financing its business and the development of its properties; that the Corporation will continue to be

able to identify, attract and employ qualified staff and obtain the outside expertise and specialized and other equipment it requires to manage, operate and finance its business and develop its properties; and various assumptions as to future prices for crude oil and natural gas, currency exchange rates, inflation rates, future well production rates, well drainage areas, success rates of future well drilling and future costs and availability of labour and services. With respect to estimates of reserves volumes and associated future net revenues and numbers of future wells to be drilled a key assumption is the validity of the commodity prices, currency exchange rates, future capital and operating costs and well production rates forecast by the Corporation's independent reserves evaluator. With respect to the number of future wells to be drilled a key assumption is the validity of the geological and other technical interpretations that have been performed by Birchcliff's technical staff and that indicate that commercially economic reserves can be recovered from Birchcliff's lands as a result of drilling such future wells.

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

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

**BIRCHCLIFF ENERGY LTD.**  
**BALANCE SHEETS**  
(Unaudited) (\$000's)

	September 30, 2010	December 31, 2009
<b>ASSETS</b>		
CURRENT		
Cash	140	140
Accounts receivable (Note 7)	35,530	29,665
Prepaid and other	2,667	4,635
	<u>38,337</u>	<u>34,440</u>
Deferred financing fees (Note 4)	-	245
Petroleum and natural gas properties and equipment (Note 3)	923,255	802,423
	<u>961,592</u>	<u>837,108</u>
<b>LIABILITIES</b>		
CURRENT		
Accounts payable and accrued liabilities	77,086	54,731
	<u>77,086</u>	<u>54,731</u>
Revolving credit facilities (Note 5)	281,172	201,230
Asset retirement obligations (Note 8)	26,745	24,713
Future income taxes	5,776	1,873
Commitments (Note 11)		
<b>SHAREHOLDERS' EQUITY</b>		
Share capital (Note 9)	548,704	541,593
Contributed surplus (Note 10)	26,166	20,315
Deficit	(4,057)	(7,347)
	<u>570,813</u>	<u>554,561</u>
	<u>961,592</u>	<u>837,108</u>

See accompanying notes to the financial statements.

**APPROVED BY THE BOARD**

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

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

**BIRCHCLIFF ENERGY LTD.**  
**STATEMENTS OF NET INCOME (LOSS), COMPREHENSIVE INCOME (LOSS) AND RETAINED EARNINGS (DEFICIT)**  
**(Unaudited) (\$000's)**

	Three months ended September 30		Nine months ended September 30	
	2010	2009	2010	2009
<b>REVENUE</b>				
Petroleum and natural gas	44,125	32,446	132,906	108,761
Royalties	(3,561)	(3,644)	(12,545)	(10,170)
	40,564	28,802	120,361	98,591
<b>EXPENSES</b>				
Production	9,082	8,504	26,317	28,995
Transportation and marketing	3,137	2,284	8,506	7,413
General and administrative, net (Note 3)	889	2,904	5,240	7,931
Stock-based compensation (Note 10)	2,839	1,374	8,065	8,067
Depletion, depreciation and accretion (Notes 3 and 8)	19,385	21,801	54,109	69,380
Amortization of deferred financing fees (Notes 4 and 5)	255	494	1,392	706
Interest (Notes 4 and 5)	3,434	2,914	9,539	7,676
	39,021	40,275	113,168	130,168
<b>INCOME (LOSS) BEFORE TAXES</b>	<b>1,543</b>	<b>(11,473)</b>	<b>7,193</b>	<b>(31,577)</b>
<b>TAXES</b>				
Future income tax expense (recovery)	1,121	(2,434)	3,903	(5,709)
	1,121	(2,434)	3,903	(5,709)
<b>NET INCOME (LOSS) AND COMPREHENSIVE INCOME (LOSS)</b>	<b>422</b>	<b>(9,039)</b>	<b>3,290</b>	<b>(25,868)</b>
<b>RETAINED EARNINGS (DEFICIT), BEGINNING OF PERIOD</b>	<b>(4,479)</b>	<b>76</b>	<b>(7,347)</b>	<b>16,905</b>
<b>DEFICIT, END OF PERIOD</b>	<b>(4,057)</b>	<b>(8,963)</b>	<b>(4,057)</b>	<b>(8,963)</b>
Net income (loss) per common share				
basic	-	\$(0.07)	\$0.03	\$(0.22)
diluted	-	\$(0.07)	\$0.03	\$(0.22)
Weighted average common shares (Note 9)				
basic	124,872,806	122,914,069	124,506,757	116,124,704
diluted	127,253,296	122,914,069	127,547,499	116,124,704



**BIRCHCLIFF ENERGY LTD.**  
**STATEMENTS OF CASH FLOWS**  
(Unaudited) (\$000's)

	Three months ended September 30		Nine months ended September 30	
	2010	2009	2010	2009
<b>OPERATING</b>				
Net income (loss)	422	(9,039)	3,290	(25,868)
Adjustments for items not affecting cash:				
Depletion, depreciation and accretion	19,385	21,801	54,109	69,380
Stock-based compensation	2,839	1,374	8,065	8,067
Amortization of deferred financing fees	255	494	1,392	706
Future income taxes expense (recovery)	1,121	(2,434)	3,903	(5,709)
	24,022	12,196	70,759	46,576
Changes in non-cash working capital (Note 12)	3,678	3,497	(3,916)	(2,271)
Asset retirement expenditures incurred	(136)	(36)	(331)	(309)
	27,564	15,657	66,512	43,996
<b>FINANCING</b>				
Increase (decrease) in revolving credit facilities	44,924	(37,109)	80,063	(28,129)
Deferred financing fees paid	-	-	(1,268)	(1,975)
Issuance of share capital (Note 9)	610	1,921	4,897	65,371
Share issue costs (Note 9)	-	-	-	(2,695)
	45,534	(35,188)	83,692	32,572
<b>INVESTING</b>				
Purchase of petroleum and natural gas properties and equipment	(2,051)	(3,019)	(2,051)	(3,049)
Sale of petroleum and natural gas properties and equipment (Note 3)	-	-	17,511	-
Development of petroleum and natural gas properties and equipment	(91,741)	(30,423)	(188,038)	(54,273)
Changes in non-cash investing working capital (Note 12)	20,694	15,934	22,374	(19,171)
	(73,098)	(17,508)	(150,204)	(76,493)
<b>NET INCREASE (DECREASE) IN CASH</b>	-	(37,039)	-	75
<b>CASH, BEGINNING OF PERIOD</b>	140	37,179	140	65
<b>CASH, END OF PERIOD</b>	140	140	140	140
Cash interest paid	3,434	2,914	9,539	7,676
Cash taxes paid	-	-	-	-

See accompanying notes to the financial statements

## 1. BASIS OF PRESENTATION

Birchcliff Energy Ltd. (“**Birchcliff**” or the “**Corporation**”) was a private company, incorporated under the *Business Corporations Act* (Alberta) on July 6, 2004 as 1116463 Alberta Ltd. The name was changed from 1116463 Alberta Ltd. to Birchcliff Energy Ltd. on September 10, 2004. The address of the Corporation’s registered office is 500, 630 - 4th Avenue, S.W., Calgary, Alberta, Canada T2P 0J9.

The Corporation is engaged in the exploration for and the development, production and acquisition of, petroleum and natural gas reserves in Western Canada. Birchcliff trades on the Toronto Stock Exchange under the symbol “BIR”. Birchcliff’s financial year end is December 31.

The interim financial statements of Birchcliff Energy Ltd. have been prepared by management in accordance with accounting principles generally accepted in Canada and are unaudited. The interim financial statements have been prepared following the same accounting policies and methods of computation as the audited financial statements for the period ended December 31, 2009. The disclosures which follow do not include all disclosures required for the annual financial statements. These unaudited interim financial statements should be read in conjunction with the audited financial statements and notes thereto for the year ended December 31, 2009.

## 2. CHANGES IN ACCOUNTING POLICIES

### Future Accounting Policy Changes

#### *Section 1582 Business Combinations*

In January 2009, the CICA issued Handbook Section 1582 *Business Combinations* that replaces the Section 1581 of the same name. Under the new standard, the purchase price used in a business combination is based on the fair value of shares exchanged at the market price at acquisition date. Under the current standard, the purchase price used is based on the market price of shares for a reasonable period before and after the date the acquisition is agreed upon and announced. In addition, the new standard generally requires all acquisition costs to be expensed while current standards allow for the capitalization of these costs as part of the purchase price. This new standard also addresses contingent liabilities, which will be required to be recognized at fair value on acquisition, and subsequently remeasured at each reporting period until settled. The current standard requires only contingent liabilities that are due to be recognized. The new standard requires any negative goodwill to be recognized as a charge to earnings rather than the current standard which reduces the fair value of non-current assets in the purchase price allocation. The new standard applies prospectively to business combinations on or after January 1, 2011 with earlier application permitted. The Corporation does not intend to early adopt the new standard.

### Convergence of Canadian GAAP with International Financial Reporting Standards (“IFRS”)

In 2006, the Accounting Standards Board (“**AcSB**”) ratified a strategic plan to converge Canadian Generally Accepted Accounting Principles (“**GAAP**”) with IFRS by 2011 for public reporting entities. On February 13, 2008 the AcSB confirmed that IFRS will replace Canadian GAAP for public companies beginning January 1, 2011. The adoption date of January 1, 2011 will require the restatement, for comparative purposes, of amounts reported by Birchcliff for the year ended December 31, 2010, including the opening balance sheet as at January 1, 2010.

### 3. PETROLEUM AND NATURAL GAS PROPERTIES AND EQUIPMENT

(\$000's)		September 30, 2010	
	Cost	Accumulated Depletion and Depreciation	Net Book Value
Petroleum and natural gas assets	1,272,293	(350,851)	921,442
Office furniture, equipment & other	4,145	(2,332)	1,813
	<b>1,276,438</b>	<b>(353,183)</b>	<b>923,255</b>

  

(\$000's)		December 31, 2009	
	Cost	Accumulated Depletion and Depreciation	Net Book Value
Petroleum and natural gas assets	1,099,420	(298,560)	800,860
Office furniture, equipment & other	3,415	(1,852)	1,563
	<b>1,102,835</b>	<b>(300,412)</b>	<b>802,423</b>

At September 30, 2010, the cost of petroleum and natural gas assets includes \$59.4 million (December 31, 2009 – \$44.9 million) relating to unproved properties which have been excluded from costs subject to depletion and depreciation. Birchcliff capitalized general and administrative costs directly related to exploration and development activities of approximately \$0.4 million and \$1.2 million in the three and nine months ended September 30, 2010 (September 30, 2009 – \$0.4 million and \$1.1 million).

On March 3, 2010, the Corporation completed and closed the sale of a minor non-producing asset in the Kakut area of Alberta for \$17.5 million. The proceeds from the sale were used to reduce the cost of petroleum and natural gas assets at September 30, 2010. No gain or loss was recorded on the sale.

On September 15, 2009, the Government of Alberta approved a drilling royalty incentive for new conventional oil and natural gas wells drilled on or after April 1, 2009, but before April 1, 2011. Included as a reduction of petroleum and natural gas assets at September 30, 2010 is an expected recovery of \$16.3 million (December 31, 2009 – \$6.3 million) related to the Alberta Drilling Royalty Credit Program.

### 4. NON-REVOLVING TERM CREDIT FACILITY

On May 21, 2009, the Corporation entered into a \$50 million non-revolving one year term credit facility (the “**Term Facility**”). The Term Facility is provided by a syndicate of banks (the “**Syndicate**”). The Corporation paid approximately \$625,000 in financing fees to the Syndicate to establish the one year Term Facility. In January 2010, the Corporation paid an additional \$250,000 in financing fees to extend the maturity date of this facility from May 21, 2010 to May 21, 2011. As no amounts were drawn on the Term Facility at December 31, 2009, approximately \$245,000 in unamortized fees was shown as a non-current asset on the balance sheet. Effective May 21, 2010, the Corporation cancelled and terminated the non-revolving Term Facility. The increased funds available from the revolving credit facilities as described in Note 5 were used to repay the full \$50 million outstanding under the Term Facility.

During the three and nine months ended September 30, 2010, the Corporation fully amortized to income approximately \$NIL million and \$0.5 million (September 30, 2009 – \$0.2 million and \$0.2 million) in deferred financing fees applicable to Term facility. The overall effective interest rate applicable to the bankers’ acceptances issued under this facility was 5.9% during the nine months ended September 30, 2010.

## 5. REVOLVING CREDIT FACILITIES

(\$000's)	September 30, 2010	December 31, 2009
Syndicated credit facility	279,000	192,000
Working capital facility	5,610	14,387
<b>Drawn revolving credit facilities</b>	<b>284,610</b>	<b>206,387</b>
Unamortized prepaid interest on bankers' acceptances	(2,787)	(4,627)
Unamortized deferred financing fees	(651)	(530)
<b>Revolving credit facilities, net</b>	<b>281,172</b>	<b>201,230</b>

Effective May 21, 2010, Birchcliff amended its agreement with its bank syndicate which increased the Corporation's existing revolving credit facilities limit from \$255 million to an aggregate limit of \$350 million. The revolving credit facilities consist of an extendible revolving term credit facility with an authorized limit of \$320 million (the "**Syndicated Credit Facility**") and an extendible revolving working capital facility with an authorized limit of \$30 million (the "**Working Capital Facility**"). The Corporation paid approximately \$1.0 million in financing fees to the Syndicate to extend the conversion date of the revolving credit facilities from May 21, 2010 to May 20, 2011. These fees have been deferred and netted against the amounts drawn under this facility and are being amortized to income over the one year extension period. During the three and nine months ended September 30, 2010, the Corporation amortized to income approximately \$0.3 million and \$0.9 million (September 30, 2009 – \$0.3 million and \$0.5 million) in deferred financing fees applicable to this facility.

At September 30, 2010, the effective interest rate applicable to the Working Capital Facility was 5.5% (September 30, 2009 – 5.3%). The overall effective interest rates applicable to the bankers' acceptances issued under the Syndicated Credit Facility was 4.9% and 5.4% in the three and nine months ended September 30, 2010 (September 30, 2009 – 4.9% and 3.9%).

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

### **Syndicated Credit Facility**

The Syndicated Credit Facility has a conversion date of May 20, 2011 and a maturity date which is two years after the conversion date. Birchcliff may request an extension of the conversion date with such an extension not exceeding 364 days, in order to maintain the revolving Syndicated Credit Facility. If the conversion date of the Syndicated Credit Facility is not extended, then on the conversion date, the revolving Syndicated Credit Facility will convert to a term loan whereby all principal and interest will be required to be repaid at the maturity date.

### **Working Capital Facility**

The Working Capital Facility has a conversion date of May 20, 2011 and a maturity date which is two years after the conversion date. Birchcliff may request an extension of the conversion date with such an extension not exceeding 364 days, in order to maintain the revolving Working Capital Facility. If the Syndicate does not grant an extension of the conversion date, then upon four months after the expiry of the conversion date, the revolving Working Capital Facility will

convert to a term loan whereby all principal and interest will be required to be repaid at the maturity date.

## 6. CAPITAL MANAGEMENT

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

There were no changes in the Corporation's approach to capital management throughout 2009 and during the nine months ended September 30, 2010. The following table shows the Corporation's total available credit at September 30, 2010 and December 31, 2009:

(\$000's)	September 30, 2010		December 31, 2009	
<b>Maximum borrowing base limit<sup>(1)</sup>:</b>				
Revolving credit facilities	350,000		255,000	
Non-revolving term credit facility <sup>(2)</sup>	-		50,000	
	350,000		305,000	
<b>Principal amount utilized:</b>				
Drawn revolving credit facilities	(284,610)		(206,387)	
Outstanding letters of credit <sup>(3)</sup>	(2,922)		(2,739)	
	(287,532)		(209,126)	
<b>Total unused credit</b>	<b>62,468</b>		<b>95,874</b>	

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

(2) Effective May 21, 2010, the Corporation repaid in full and cancelled the \$50 million non - revolving term credit facility.

(3) Letters of credit are issued to various service providers. No amounts were drawn on the letters of credit at September 30, 2010 and December 31, 2009.

The financial covenants applicable to the Corporation's credit facilities include a quarterly interest coverage ratio test, which is calculated as earnings before interest, taxes, stock-based compensation, depletion, depreciation and amortization ("**EBITDA**") over interest expense. The following table shows the interest coverage ratio at September 30, 2010 and December 31, 2009:

	September 30, 2010		December 31, 2009	
	Required	Actual	Required	Actual
Annualized EBITDA to interest coverage <sup>(1)</sup>	>3.5	<b>8.5</b>	>3.5	7.6

(1) Interest coverage ratio is calculated on a trailing four quarter basis.

The Corporation was compliant with all financial covenants under its credit facilities as at and during the periods ended September 30, 2010 and December 31, 2009.

The capital structure of the Corporation is as follows:

(\$000's)	September 30, 2010	December 31, 2009	Change %
Total shareholders' equity <sup>(1)</sup>	570,813	554,561	3%
Total shareholders' equity as a % of total capital	64%	71%	
Working capital deficit <sup>(2)</sup>	38,749	20,291	
Drawn revolving credit facilities	284,610	206,387	
Total debt	323,359	226,678	43%
Total debt as a % of total capital	36%	29%	
<b>Total capital</b>	<b>894,172</b>	<b>781,239</b>	<b>14%</b>

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

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

During the nine months ended September 30, 2010, total shareholders' equity increased due to the exercise of options (Note 10) and an increase in reported net income for the period. Total debt increased during the nine months ended September 30, 2010 largely due to \$101.8 million of net capital spent in excess of cash flow during that period.

## 7. FINANCIAL INSTRUMENTS & RISK MANAGEMENT CONTRACTS

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

### Credit Risk

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

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

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

(\$000's)	September 30, 2010	December 31, 2009
Marketers	14,067	16,607
Joint venture partners	20,921	12,984
Other	542	74
<b>Total receivables</b>	<b>35,530</b>	<b>29,665</b>

At September 30, 2010, approximately 16% of the Corporation's significant individual accounts receivable was due from one marketer (December 31, 2009 – 17%, one marketer). For the nine months ended September 30, 2010, the Corporation received 13%, 43%, 13%, 14% and 11% of its revenue, respectively, from five core marketers. The Corporation received the majority of its revenue for the nine months ended September 30, 2009 from four marketers, who individually

accounted for 37%, 10%, 10% and 25%, respectively. Typically, Birchcliff's maximum credit exposure from its marketer is revenue from two months of commodity sales. Receivables from marketers are normally collected on the 25th day of the month following production. Birchcliff mitigates the credit risk associated with these by establishing marketing relationships with credit worthy purchasers, obtaining guarantees from their ultimate parent companies and obtaining letters of credit as appropriate. The Corporation historically has not experienced any material collection issues with its marketers.

At September 30, 2010, approximately \$0.3 million or 1% of Birchcliff's total accounts receivable are aged over 120 days and considered past due. The majority of these accounts are due from various joint venture partners. Birchcliff attempts to mitigate the risk from joint venture receivables by obtaining pre-approval of significant capital expenditures. However, the receivables are from participants in the oil and natural gas sector, and collection of the outstanding balances is dependent on industry factors such as commodity price fluctuations, escalating costs and the risk of unsuccessful drilling. In addition, further risk exists with joint venturers' as disagreements occasionally arise that increase the potential for non-collection. The Corporation does not typically obtain collateral from oil and natural gas marketers or joint venturers', however, the Corporation does have the ability to withhold production from joint venturers' in the event of non-payment.

Should Birchcliff determine that the ultimate collection of a receivable is in doubt, it will provide the necessary provision in its allowance for doubtful accounts with a corresponding charge to income. If the Corporation subsequently determines an account is uncollectible, the account is written off with a corresponding charge to the allowance for doubtful accounts. Birchcliff did not have an allowance for doubtful accounts balance at September 30, 2010 and December 31, 2009.

### **Liquidity Risk**

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

All of the Corporation's contractual financial liabilities are to be settled in cash. Typically, the Corporation ensures that it has sufficient cash on demand to meet expected operational expenses, including the servicing of financial obligations. To achieve this objective, the Corporation prepares annual capital expenditure budgets, which are approved by the Board of Directors and are regularly reviewed and updated as considered necessary. Petroleum and natural gas production is monitored weekly and is used to provide monthly current cash flow estimates. Further, the Corporation utilizes authorizations for expenditures on both operated and non operated projects to manage capital expenditure. The Corporation also attempts to match its payment cycle with collection of oil and natural gas revenue on the 25th of each month.

To facilitate the capital expenditure program, the Corporation has reserve-based credit facilities which are reviewed semi-annually by the lender. The principal amount utilized under the Corporation's credit facilities at September 30, 2010 was \$287.5 million (December 31, 2009 – \$209.1 million) and \$62.5 million (December 31, 2009 – \$95.9 million) in unused credit was available at the end of the period to fund future obligations.

The following table lists the contractual obligations of the Corporation's financial liabilities at September 30, 2010:

(\$000's)	< 1 Year	1 – 2 Years	3 – 5 Years	Thereafter
Accounts payable and accrued liabilities	77,086	-	-	-
Drawn revolving credit facilities	-	-	284,610	-
<b>Total financial liabilities</b>	<b>77,086</b>	<b>-</b>	<b>284,610</b>	<b>-</b>

### Market Risk

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

#### *Commodity Price Risk*

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

The Corporation may attempt to mitigate commodity price risk through the use of financial derivatives such as commodity price risk management contracts. Birchcliff had no risk management contracts in place as at or during the periods ended September 30, 2010 and December 31, 2009. The Corporation actively monitors the market to determine whether any additional commodity price risk management contracts are warranted.

#### *Foreign Currency Risk*

Foreign currency risk is the risk that future cash flows will fluctuate as a result of changes in foreign currency exchange rates. The exchange rate effect cannot be quantified but generally an increase in the value of the CDN dollar as compared to the US dollar will reduce the prices received by Birchcliff for its petroleum and natural gas sales. The Corporation had no forward exchange rate contracts in place as at or during the periods ended September 30, 2010 and December 31, 2009.

#### *Interest Rate Risk*

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

A 1% change in the CDN prime interest rate during the three and nine months ended September 30, 2010 would have increased (decreased) net income (loss) and comprehensive income (loss) by approximately \$0.6 million and \$1.7 million (September 30, 2009 – \$0.5 million and \$1.6 million), assuming that all other variables remain constant. A sensitivity of 1% is considered reasonable given the current level of the bank prime rate and market expectations for future movements. The Corporation considers this risk to be limited and thus does not hedge its interest rate risk.



The Corporation had no interest rate swap contracts in place as at or during the periods ended September 30, 2010 and December 31, 2009.

### Fair Value of Financial Instruments

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

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

Assessment of the significance of a particular input to the fair value measurement requires judgment and may affect the placement within the fair value hierarchy level. The carrying value and fair value of financial instruments at September 30, 2010 is disclosed below by financial instrument category, as well as any related loss or interest expense for the period:

(\$000's)	Carrying Value	Fair Value	Loss	Interest Expense
<b>Assets Held for Trading</b>				
Cash <sup>(1)</sup>	140	140	-	-
<b>Loans and Receivables</b>				
Trade and other receivables <sup>(2)</sup>	35,530	35,530	-	-
<b>Other Liabilities</b>				
Accounts payable and accrued liabilities <sup>(2)</sup>	77,086	77,086	-	-
Drawn revolving credit facilities <sup>(3)</sup>	284,610	284,610	-	9,539

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

(2) Trade and other receivables and accounts payable and accrued liabilities are reported at amortized cost. Due to the short term nature of trade and other receivables and accounts payable and accrued liabilities, their carrying values approximate their fair values.

(3) The Corporation's revolving facilities bear interest at a floating rate and accordingly the fair market value approximates the carrying value before the carrying value is reduced for any remaining unamortized costs as described in Note 5.

## 8. ASSET RETIREMENT OBLIGATIONS

The Corporation's asset retirement obligations result from net ownership interests in petroleum and natural gas properties and equipment including well sites, gathering systems and processing facilities. Birchcliff estimates the total undiscounted amount of cash flows required to settle its asset retirement obligations at September 30, 2010 to be approximately \$75.8 million (December 31, 2009 – \$70.1 million) which will be incurred between 2010 and 2061. A credit-adjusted risk-free interest rate of 8% and an inflation rate of 2% were used to calculate the fair value of the asset retirement obligation.

A reconciliation of the asset retirement obligations is provided below:

(\$000's)	September 30, 2010	December 31, 2009
Balance, January 1	24,713	21,223
Obligations incurred	949	475
Obligations acquired, net	76	17
Changes in estimate	-	1,846
Accretion expense	1,338	1,758
Actual expenditures incurred	(331)	(606)
<b>Ending balance</b>	<b>26,745</b>	<b>24,713</b>

## 9. SHARE CAPITAL

### (a) Authorized:

Unlimited number of voting common shares  
 Unlimited number of non-voting preferred shares

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

### (b) Issued:

	Number of Common Shares	Amount (\$000's)
<b>Balance, December 31, 2009</b>	<b>123,815,002</b>	<b>541,593</b>
Issued upon exercise of stock options	543,733	3,337
<b>Balance, March 31, 2010</b>	<b>124,358,735</b>	<b>544,930</b>
Issued upon exercise of stock options	433,401	2,852
<b>Balance, June 30, 2010</b>	<b>124,792,136</b>	<b>547,782</b>
Issued upon exercise of stock options	119,998	922
<b>Balance, September 30, 2010</b>	<b>124,912,134</b>	<b>548,704</b>

The weighted average diluted common shares outstanding for the three and nine months ended September 30, 2010 excludes 2,838,700 of stock options that are anti-dilutive during those periods. The basic and diluted weighted average common shares outstanding are the same for the three and nine months ended September 30, 2009 as the Corporation reported net losses during those periods. The average market value of the Corporation's shares for the purpose of calculating the dilutive effect of stock options and performance warrants was based on average quoted market prices for the period that the options and warrants were outstanding.

## 10. STOCK-BASED COMPENSATION

### Stock Options

The Corporation has established a stock-based compensation plan whereby officers, directors, employees, and consultants may be granted options to purchase common shares at a fixed price not less than the fair market value of the stock at the time of grant, subject to certain conditions. Stock options granted under this plan vest over a three year period at the rate of one-third on each anniversary date of the stock option grant. All stock options granted are for a five year term. The Corporation is authorized to issue stock options for a maximum of 10% of the issued and outstanding common shares pursuant to the Amended and Restated Stock Option Plan.

In order to calculate the compensation expense, the fair value of the stock options is estimated using the Black-Scholes option-pricing model that takes into account, as of the grant date: exercise price, expected life, current price, expected volatility, expected dividends and risk-free interest rates.

During the three and nine months ended September 30, 2010, the Corporation recorded \$2.8 million and \$8.1 million (September 30, 2009 - \$1.4 million and \$5.0 million) of non-cash stock-based compensation expense and a corresponding increase to contributed surplus related stock options issued and outstanding during the period.

At September 30, 2010, the Corporation's Amended and Restated Stock Option Plan permitted the grant of options in respect of a maximum 12,491,213 (September 30, 2009 – 12,326,744) common shares. At September 30, 2010, there remained available for issuance options in respect of 2,978,693 (September 30, 2009 – 4,483,925) common shares. A summary of the Corporation's outstanding stock options for the nine months ended September 30, 2010 is presented below:

	Number	Weighted Average Exercise Price (\$)
<b>Outstanding, December 31, 2009</b>	<b>7,710,253</b>	<b>5.81</b>
Granted	2,852,300	9.62
Exercised	(543,733)	(4.25)
Forfeited	(126,401)	(6.31)
<b>Outstanding March 31, 2010</b>	<b>9,892,419</b>	<b>6.99</b>
Granted	207,500	9.70
Exercised	(433,401)	(4.56)
Forfeited	(143,000)	(8.54)
<b>Outstanding June 30, 2010</b>	<b>9,523,518</b>	<b>7.13</b>
Granted	130,000	9.41
Exercised	(119,998)	(5.08)
Forfeited	(21,000)	(8.33)
<b>Outstanding, September 30, 2010</b>	<b>9,512,520</b>	<b>7.19</b>

The weighted average assumptions used in calculating the fair values are set forth below:

	September 30, 2010	December 31, 2009
Risk-free interest rate	2.5%	2.0%
Expected maturity (years)	5.0	5.0
Expected volatility	60.6%	63.5%
Dividend yield	-	-
Fair value per option	\$5.13	\$3.02

A summary of the stock options outstanding and exercisable under the plan at September 30, 2010 is presented below:

Exercise Price		Awards Outstanding			Awards Exercisable		
Low	High	Quantity	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Quantity	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price
\$3.00	\$6.00	4,039,620	2.69	\$4.76	2,085,927	2.16	\$4.47
\$6.01	\$9.00	2,177,200	2.91	\$7.59	966,199	2.29	\$7.33
\$9.01	\$12.00	3,107,900	4.29	\$9.70	99,399	2.84	\$10.74
\$12.01	\$14.25	187,800	2.78	\$13.07	125,200	2.78	\$13.07
		<b>9,512,520</b>	<b>3.26</b>	<b>\$7.19</b>	<b>3,276,725</b>	<b>2.24</b>	<b>\$5.83</b>

### Performance Warrants

On January 14, 2005, as part of the Corporation's initial restructuring to become a public entity, the Corporation issued 4,049,665 performance warrants with an exercise price of \$3.00 and an expiration date of January 31, 2010 to members of its executive team. Each performance warrant entitles the holder to purchase one common share at the exercise price. Because the performance conditions were fulfilled in 2005, resulting in the performance warrants vesting, the full amount of the related compensation expense was recorded in net income in that year. The fair value of each performance warrant was determined on the date of the grant using the Black-Scholes option-pricing model. On May 28, 2009, the Corporation's outstanding performance warrants were amended to extend the expiration date from January 31, 2010 to January 31, 2015. The Corporation recorded non-cash stock-based compensation expense of \$3.1 million relating to the extension of the performance warrants for the nine months ended September 30, 2009.

No performance warrants were issued or exercised during the nine months ended September 30, 2010 and twelve months ended December 31, 2009. At September 30, 2010, there remained outstanding and exercisable 2,939,732 performance warrants.

### Contributed Surplus Continuity

	<i>\$000's</i>
<b>Balance, December 31, 2009</b>	<b>20,315</b>
Stock-based compensation expense – stock options <sup>(1)</sup>	2,495
Exercise of stock options	(1,027)
<b>Balance, March 31, 2010</b>	<b>21,783</b>
Stock-based compensation expense – stock options <sup>(1)</sup>	2,731
Exercise of stock options	(874)
<b>Balance, June 30, 2010</b>	<b>23,640</b>
Stock-based compensation expense – stock options <sup>(1)</sup>	2,839
Exercise of stock options	(313)
<b>Balance, September 30, 2010</b>	<b>26,166</b>

(1) Included in the stock-based compensation expense is the non-cash impact of forfeitures during the period.

**11. COMMITMENTS**

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

Year	\$000's
2010	803
2011	3,214
2012	3,223
2013	3,331
2014	3,331
Thereafter	9,716

The Corporation is also committed to March 29, 2011 under an operating lease for another office premises that it does not use and has sublet to an arm's length party on a basis that recovers all of its rental costs.

**12. SUPPLEMENTARY CASH FLOW INFORMATION**

The following table details the components of non-cash working capital:

(\$000's)	Three months ended September 30		Nine months ended September 30	
	2010	2009	2010	2009
Provided by (used in)				
Accounts receivable	(3,041)	(2,863)	(5,865)	10,243
Prepaid and other	267	715	1,968	(1,896)
Accounts payable and accrued liabilities	27,146	21,579	22,355	(29,789)
	<b>24,372</b>	<b>19,431</b>	<b>18,458</b>	<b>(21,442)</b>
Provided by (used in)				
Operating	3,678	3,497	(3,916)	(2,271)
Investing	20,694	15,934	22,374	(19,171)
	<b>24,372</b>	<b>19,431</b>	<b>18,458</b>	<b>(21,442)</b>





**OFFICERS**

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President & Chief Executive  
Officer

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Vice President, Exploration &  
Chief Operating Officer

Bruno P. Geremia, C.A.  
Vice President & Chief Financial  
Officer

David M. Humphreys, R.E.T  
Vice President, Operations

Karen A. Pagano, P. Eng.  
Vice President, Engineering

James W. Surbey, B. Eng., LLB  
Vice President, Corporate  
Development

**DIRECTORS**

Larry A. Shaw  
Chairman of the Board  
Calgary, Alberta

Gordon W. Cameron  
Independent Businessman  
Calgary, Alberta

Werner A. Siemens  
Independent Businessman  
Calgary, Alberta

A. Jeffery Tonken  
President & Chief  
Executive Officer  
Birchcliff Energy Ltd.  
Calgary, Alberta

**SOLICITORS**

Borden Ladner Gervais LLP  
Calgary, Alberta

**AUDITORS**

Deloitte & Touche LLP  
Chartered Accountants  
Calgary, Alberta

**RESERVES  
EVALUATOR**

AJM Petroleum Consultants  
Calgary, Alberta

**BANKERS**

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

**TRANSFER AGENT**

Olympia Trust Company  
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**STOCK EXCHANGE  
LISTING**

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Symbol: BIR

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