Highlights

	Three months ended September 30, 2012	Three months ended September 30, 2011	Nine months ended September 30, 2012	Nine months ended September 30, 2011
Financial *($thousands, except per share amounts)*				
Petroleum and natural gas revenue	**25,506**	53,350	**95,542**	156,323
Funds generated from operations (1)	**10,619**	31,504	**41,579**	88,578
Per share – basic	**$0.11**	$0.31	**$0.41**	$0.87
Per share – diluted	**$0.11**	$0.31	**$0.41**	$0.86
Cash flow from operations (including changes in working capital) (1)	**6,355**	34,089	**36,783**	83,287
Per share – basic	**$0.06**	$0.33	**$0.36**	$0.81
Per share – diluted	**$0.06**	$0.33	**$0.36**	$0.80
Profit (loss) (2)	**(121,840)**	1,323	**(173,801)**	34,625
Per share – basic	**($0.19)**	$0.01	**($1.69)**	$0.34
Per share – diluted	**($0.19)**	$0.01	**($1.69)**	$0.33
Exploration and development expenditures	**9,698**	45,191	**55,214**	142,886
Proceeds from the sale of petroleum and natural gas properties	**(474)**	–	**89,653**	141,380
Working capital deficit (excluding convertible debentures) (3)	**9,521**	21,257	**9,521**	21,257
Convertible debentures	**–**	99,353	**–**	99,353
Bank indebtedness	**185,336**	125,196	**185,336**	125,196
Total debt, including working capital	**194,857**	245,806	**194,857**	245,806
Operations				
Average production				
Natural gas *(Mcf per day)*	**68,416**	72,303	**71,894**	67,040
Crude oil *(bbls per day)*	**873**	2,262	**1,330**	2,419
Natural gas liquids *(bbls per day)*	**799**	845	**877**	876
Sulphur *(tonnes per day)* (4)	**27**	48	**27**	57
Total *(BOE per day)*	**13,102**	15,206	**14,216**	14,525
Average sales price (5)				
Natural gas *($ per Mcf)*	**2.28**	4.27	**2.20**	4.36
Crude oil *($ per bbl)*	**87.19**	85.96	**93.91**	86.99
Natural gas liquids *($ per bbl)*	**58.40**	65.89	**63.52**	60.97
Sulphur *($ per tonne)*	**125.38**	138.02	**123.65**	119.35
Netback per BOE *($ per BOE)*				
Petroleum and natural gas sales (5)	**21.72**	37.35	**24.18**	38.94
Other income	**(0.06)**	–	**0.24**	–
Royalties	**(1.92)**	(2.98)	**(2.15)**	(4.05)
Operating expenses	**(6.80)**	(8.33)	**(7.52)**	(8.85)
Transportation	**(0.98)**	(1.19)	**(1.06)**	(1.10)
Operating netback	**11.96**	24.85	**13.69**	24.94
Wells drilled *(gross)*	**1**	15	**13**	40
Undeveloped land *(net acres)*	**132,273**	225,997	**132,273**	225,997

(1) The calculation of funds generated from operations and cash flow from operations for the three months ended September 30, 2012 excludes $2.3 million (2011 – $3.1 million) of interest expense which is classified as finance expense. Similarly, for the nine months ended September 30, 2012, $7.6 million (2011 – $8.7 million) of interest expense is classified as finance expense.

(2) Included in the net loss is an after tax impairment loss of $115.4 million for the three months ended September 30, 2012 and $149.8 million for the nine months ended September 30, 2012 (2011 – nil).

(3) Excluding assets held for sale and associated liabilities.

(4) A BOE conversion ratio has been calculated using a conversion rate of one tonne of sulphur to one barrel.

(5) Excludes the change in fair value of derivatives.

FAIRBORNE ENERGY LTD.

Management's Discussion and Analysis of Financial Condition and Results of Operations

The following Management Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") was prepared at, and is dated, November 5, 2012. This document is provided by the management of Fairborne Energy Ltd. ("Fairborne" or the "Company") to review third quarter 2012 activities and results as compared to the same period in the previous year, and should be read in conjunction with the unaudited interim consolidated financial statements including selected notes for the three and nine months ended September 30, 2012 and the audited consolidated financial statements including notes for the years ended December 31, 2011 and 2010. The MD&A should be read in conjunction with the Company's MD&A for the year ended December 31, 2011, as disclosure which is unchanged from the December 31, 2011 MD&A has not been duplicated herein. Additional information relating to Fairborne, including Fairborne's annual information form, is available on SEDAR at www.sedar.com

Nature of Business: *Fairborne is a growth-oriented exploration and production company. The Company maintains its head office in Calgary and is engaged in the business of exploring for, developing, acquiring and producing crude oil and natural gas in Western Canada. Fairborne follows a strategy of balancing risk and reward by focusing on opportunities by geographic area and prospect type. Within the selected areas, the Company develops a portfolio of exploration and development prospects in conjunction with an active acquisition strategy.*

Forward Looking Statements: *This document contains forward-looking statements including management's assessment of future plans and operations, the impact of property dispositions on future production, revenues, general and administrative expenses and bank indebtedness, plans to review capital expenditures budget in light of projected cash flows and expectations that the Company will have adequate liquidity to fund its financial liabilities and planned operations and activities may constitute forward-looking statements under applicable securities laws and necessarily involve risks including, without limitation, risks associated with oil and gas exploration, development, exploitation, production, marketing and transportation, loss of markets, volatility of commodity prices, currency fluctuations, imprecision of reserve estimates, environmental risks, competition from other producers, inability to retain drilling rigs and other services, incorrect assessment of the value of acquisitions, failure to realize the anticipated benefits of acquisitions, delays resulting from or inability to obtain required regulatory approvals and ability to access sufficient capital from internal and external sources. As a consequence, the Company's actual results may differ materially from those expressed in, or implied by, the forward looking statements. Forward looking statements or information are based on a number of factors and assumptions which have been used to develop such statements and information but which may prove to be incorrect. Although Fairborne believes that the expectations reflected in such forward-looking statements or information are reasonable, undue reliance should not be placed on forward looking statements because the Company can give no assurance that such expectations will prove to be correct. In addition to other factors and assumptions which may be identified in this document and other documents filed by the Company, assumptions have been made regarding, among other things: the impact of increasing competition; the general stability of the economic and political environment in which Fairborne operates; the ability of the Company to obtain qualified staff, equipment and services in a timely and cost efficient manner; drilling results; the ability of the operator of the projects which the Company has an interest in to operate the field in a safe, efficient and effective manner; Fairborne's ability to obtain financing on acceptable terms; field production rates and decline rates; the ability to replace and expand oil and natural gas reserves through acquisition, development or exploration; the timing and costs of pipeline, storage and facility construction and expansion; the ability of the Company to secure adequate product transportation; future oil and natural gas prices; currency, exchange and interest rates; the regulatory framework regarding royalties, taxes and environmental matters in the jurisdictions in which the Company operates; and Fairborne's ability to successfully market its oil and natural gas products. Readers are cautioned that the foregoing list of factors is not exhaustive. Additional information on these and other factors that could affect the Company's operations and financial results are included in reports on file with Canadian securities regulatory authorities and may be accessed through the SEDAR website (www.sedar.com) or at the Company's website (www.fairborne-energy.com).*

Furthermore, the forward looking statements contained in this document are made as at the date of this document and the Company does not undertake any obligation to update publicly or to revise any of the included forward looking statements, whether as a result of new information, future events or otherwise, except as may be required by applicable securities laws.

Non-GAAP and Additional GAAP Measures: *This document contains funds generated from operations which is an additional GAAP measure presented in the consolidated financial statements. The Company uses funds generated from operations as a key measure to demonstrate the Company's ability to generate funds to repay debt and fund future capital investment. This document contains the terms "funds generated from operations per share", "cash flow from operations per share", "net debt" and "netbacks" which are non-GAAP financial measures. The Company uses these measures to help evaluate its performance. These non-GAAP financial measures do not have any standardized meaning prescribed by GAAP and are therefore unlikely to be comparable to similar measures presented by other issuers. The Company uses net debt (bank indebtedness plus negative working capital or less positive working capital, excluding convertible debentures) as an alternative measure of outstanding debt. The Company considers corporate netbacks a key measure as it demonstrates its profitability relative to current commodity prices. Netbacks which have no GAAP equivalent are calculated on a BOE basis by deducting royalties, operating costs, and transportation from petroleum and natural gas sales. Fairborne also presents funds generated from operations per share and cash flow from operations per share and such per share amounts are calculated using weighted average shares outstanding consistent with the calculation of profit (loss) per share.*

BOE Conversions: *Barrel of oil equivalent ("BOE") amounts may be misleading, particularly if used in isolation. A BOE conversion ratio has been calculated using a conversion rate of one tonne of sulphur to one barrel and six thousand cubic feet of natural gas to one barrel. This conversion ratio of six thousand cubic feet of natural gas to one barrel is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead. Given that the value ratio based on the current price of crude oil as compared to natural gas is significantly different from energy equivalency of 6:1; utilizing a conversion on a 6:1 basis may be misleading as an indication of value.*

Strategic Property Dispositions

In March 2012, Fairborne's Board of Directors initiated a process to identify, examine and consider strategic alternatives with the view to enhancing shareholder value. In August 2012, the Company entered into two agreements for the divestiture of certain dry natural gas assets for gross proceeds of $189 million. The assets disposed of included the Company's greater Marlboro area (Marlboro, McLeod and Westerose) and the Company's shallow gas/coal bed methane assets in the Clive area, which together represented production of approximately 8,700 BOE per day (95% natural gas), 23.1 MMBOE of proved reserves and 32.8 MMBOE of proved plus probable reserves (93% natural gas) as evaluated by GLJ Petroleum Consultants Ltd. ("GLJ") at December 31, 2011, mechanically updated to remove production from January 1, 2012 to July 1, 2012. Both transactions closed on October 1, 2012 with gross proceeds of $189 million (net proceeds of $183.7 million) applied against outstanding bank indebtedness. As a result of the sale agreements, the assets and liabilities subject to disposition were classified as assets and liabilities associated with held for sale at September 30, 2012 and an impairment of $154.3 million was recognized in the third quarter to reduce the carrying value of the assets to fair value less costs to sell.

Third Quarter 2012 Financial Results

Production

	Three months ended September 30,		Nine months ended September 30,	
	2012	2011	**2012**	2011
Natural gas *(Mcf per day)*	**68,416**	72,303	**71,894**	67,040
Crude oil *(bbls per day)*	**873**	2,262	**1,330**	2,419
Natural gas liquids *(bbls per day)*	**799**	845	**877**	876
Sulphur *(tonnes per day)* [(1)]	**27**	48	**27**	57
Total *(BOE per day)*	**13,102**	15,206	**14,216**	14,525
Natural gas % of production	**87%**	79%	**84%**	77%

(1) A BOE conversion ratio has been calculated using a conversion rate of one tonne of sulphur to one barrel.

Third quarter 2012 production of 13,102 BOE per day reflected a full quarter impact of the property dispositions completed in May 2012 which included crude oil properties with production of approximately 800 barrels per day. In addition, the Company's Wild River property (approximately 1,000 BOE per day) remained shut in until early September 2012 in response to continued low natural gas prices.

Natural gas production of 68.4 MMcf per day during the third quarter of 2012 was 3% lower than the preceding second quarter of 2012 (70.5 MMcf per day) and 5% lower than the comparative third quarter of 2011 (72.3 MMcf per day). Natural gas production at the Company's Wild River property was shut in through most of the second and third quarters of 2012. In addition, decline rates on new wells brought on production in late 2011 and early 2012 also reduced daily production compared to the prior year.

Crude oil and NGL production of 1,672 bbls per day for the third quarter of 2012 reflected the impact of property dispositions completed in the second quarter. Despite additional NGL production from a successful drilling program, overall oil and NGL production was reduced as a result of natural declines.

Sulphur production in the third quarter also reflected the continued shut in of production on the Company's Wild River property until September 2012.

Subsequent to the end of the third quarter, Fairborne completed two separate property dispositions which represented approximately two-thirds (8,700 BOE per day) of the Company's average production. Future production will be significantly impacted by this disposition.

Commodity Prices & Risk Management Activities

	Three months ended September 30, 2012	2011	Nine months ended September 30, 2012	2011
Average Prices (1)				
Natural gas *($ per Mcf)*	**2.28**	4.27	**2.20**	4.36
Crude oil *($ per bbl)*	**87.19**	85.96	**93.91**	86.99
Natural gas liquids *($ per bbl)*	**58.40**	65.89	**63.52**	60.97
Sulphur *($ per tonne)*	**125.38**	138.02	**123.65**	119.35
BOE *($ per BOE)*	**21.55**	37.20	**24.07**	38.74
Benchmark Prices				
AECO Daily Index *(Cdn$ per Mcf)*	**2.28**	3.66	**2.12**	3.77
AECO Monthly Index *(Cdn$ per Mcf)*	**2.19**	3.72	**2.18**	3.74
Edmonton par *(Cdn$ per bbl)*	**91.04**	92.26	**86.40**	94.76
Nymex Calendar Average *(US$ per bbl)*	**92.22**	89.76	**96.21**	95.46

(1) Excludes the change in fair value of derivatives.

Risk Management – Physical Sales Contracts

Fairborne's risk management strategy is based on the following objectives:

- protect shareholder return on investment;
- reduce risk exposure in budgeted annual funds flow projections; and
- help ensure transaction economics on acquisitions.

Financial instruments may be utilized by the Company to manage its exposure to commodity price fluctuations, foreign currency and interest rates. The Company's policy is not to utilize financial instruments for trading or speculative purposes.

Natural Gas

Natural gas prices recovered slightly in the third quarter of 2012 with average AECO Daily index prices up 24% from the second quarter. Despite a small recovery in natural gas prices, Fairborne's realized natural gas price for the third quarter of 2012 was still 47% lower than the prior year consistent with market prices. An average of 33,247 Mcf per day was sold under fixed price physical sales and derivative contracts during the third quarter of 2012 representing 49% of the Company's natural gas production. Risk management activities decreased the Company's natural gas revenue by an estimated $0.7 million in the third quarter of 2012 which had the effect of decreasing Fairborne's realized natural gas price by $0.12 per Mcf to $2.28 per Mcf.

The following table summarizes the outstanding fixed price physical sales and derivative contracts for natural gas, including contracts outstanding at September 30, 2012 as well as contracts entered into after September 30, 2012:

	Q4/2012
Participating Swaps	
Volume *(Mcf per day)*	**14,028**
Average Floor Price *($ per Mcf)*	**$2.06**

Conversion factor: 1 Mcf = 1.135 GJ

At September 30, 2012, Fairborne had no natural gas contracts that were accounted for as derivative contracts.

Crude Oil

During the third quarter of 2012, Fairborne had an average of 300 bbls per day of crude oil under fixed price physical sales and derivative contracts, representing 34% of crude oil production. Risk management activities, including option costs for puts purchased during the quarter, increased the Company's crude oil revenue by $0.3 million ($4.27 per bbl) in the third quarter. Fairborne's realized crude oil price of $87.19 per bbl in the third quarter of 2012 was comparable to the same period in 2011, reflecting the impact of corporate hedging activities which offset decreases in market prices.

The following table summarizes the outstanding fixed price physical sales and derivative contracts on crude oil, including contracts outstanding at September 30, 2012 as well as contracts entered into after September 30, 2012:

	Q4/2012
Swaps	
Volume (bbls per day)	300
Average Price ($CDN per bbl)	$104.11

At September 30, 2012, Fairborne had one crude oil swap that was accounted for as derivative contract and the mark-to-market value of this contract was recorded as an asset of $0.5 million.

Sulphur

The Company's average realized sulphur price in the third quarter of 2012 was $125.38 per tonne, compared to $138.02 in the third quarter of 2011.

Petroleum and Natural Gas Revenue

	Three months ended September 30,		Nine months ended September 30,	
($thousands except as noted)	2012	2011	2012	2011
Petroleum and natural gas sales:				
Natural gas	14,360	28,410	43,379	79,726
Crude oil	7,007	17,895	34,221	57,439
Natural gas liquids	4,290	5,121	15,260	14,580
Sulphur	315	610	907	1,858
Total	25,972	52,036	93,767	153,603
Per BOE	$21.55	$37.20	$24.07	$38.74
Other petroleum and natural gas revenue items:				
Change in fair value of derivatives	(607)	1,103	416	1,899
Other income	(69)	–	931	–
Royalty income	210	211	428	821
Total	(466)	1,314	1,775	2,720
Total petroleum and natural gas revenue	25,506	53,350	95,542	156,323
Per BOE	$21.16	$38.14	$24.53	$39.42

Fairborne's petroleum and natural gas sales of $26.0 million for the third quarter of 2012, represented a decrease of 13% from the preceding second quarter of 2012 ($29.9 million) and a 50% decrease from the $52.0 million reported in the third quarter of 2011. The drop in petroleum and natural gas sales was primarily attributed to lower natural gas prices and the disposition of oil properties in the second quarter of 2012.

Natural gas sales of $14.4 million increased 11% from the second quarter of 2012 ($13.0 million) with an increase in natural gas market prices partially offset by lower natural gas production. Compared to 2011 ($28.4 million), natural gas sales for the third quarter of 2012 were 49% lower as a result of decreases in both natural gas market prices and average daily production. Crude oil sales of $7.0 million in the third quarter of 2012 were 40% lower than the preceding second quarter of 2012 ($11.7 million) and 61% lower than the prior year ($17.9 million) as a result of property dispositions and lower realized crude oil prices. Despite reduced commodity prices, NGL sales only decreased 16% compared to the prior year as increased NGL production from the Company's liquid rich property at Harlech largely offset natural declines.

Petroleum and natural gas revenue for the fourth quarter of 2012 and beyond will be significantly impacted by the October 2012 property dispositions which included approximately two-thirds of the Company's daily production.

Other revenue items include royalty income, which decreased in 2012 as a result of lower natural gas prices and the change in fair value (mark-to-market) of derivative contracts. The $0.6 million decrease recorded in the third quarter of 2012 (2011 – increase of $1.1 million) reflected both the changes in the unrealized value of existing contracts as well as a reduction for amounts realized on contracts that settled during the period. Fairborne's risk management program, including derivative contracts and physical sales contracts, decreased the Company's realized revenue by an estimated $0.4 million in the third quarter of 2012, compared to an increase of $1.7 million in the third quarter of 2011.

Royalties

	Three months ended September 30,		Nine months ended September 30,	
($thousands except as noted)	**2012**	2011	**2012**	2011
Crown	**1,540**	2,109	**5,811**	9,603
Freehold and overriding	**770**	2,057	**2,562**	6,443
Total	**2,310**	4,166	**8,373**	16,046
Crown *(% of P&NG sales)*	**5.9%**	4.1%	**6.2%**	6.2%
Freehold and overriding *(% of P&NG sales)*	**3.0%**	3.9%	**2.7%**	4.2%
Total *(% of P&NG sales)*	**8.9%**	8.0%	**8.9%**	10.4%
Per BOE	**$1.92**	$2.98	**$2.15**	$4.05

Fairborne recorded $2.3 million of royalties during the third quarter of 2012, representing a royalty rate of 8.9%, higher than the preceding second quarter rate of 7.4% which included royalty adjustments resulting from the Crown's annual recalculation of allowable deductions and credits. Compared to the prior year (Q3 2011 – 8.0%), royalty rates were marginally higher with third quarter 2011 royalties reduced by credits received for royalty holiday wells.

Production and Operating Costs

	Three months ended September 30,		Nine months ended September 30,	
($thousands except as noted)	**2012**	2011	**2012**	2011
Operating costs				
Natural gas	**7,118**	8,669	**23,219**	26,177
Oil and NGLs	**1,074**	2,991	**6,101**	8,940
Transportation costs	**1,185**	1,662	**4,118**	4,353
Total	**9,377**	13,322	**33,438**	39,470
Operating costs, per BOE	**$6.80**	$8.33	**$7.52**	$8.85
Transportation costs, per BOE	**$0.98**	$1.19	**$1.06**	$1.10
Production and operating costs, per BOE	**$7.78**	$9.52	**$8.58**	$9.95

Cost reductions realized from the operation of the Company's Marlboro gas plant as well as the shut in and disposition of properties with operating costs in excess of the corporate average, continued to reduce average operating costs in the third quarter of 2012. Fairborne's operating costs of $8.2 million ($6.80 per BOE) during the third quarter of 2012 were 9% lower than the second quarter of 2012 ($7.48 per BOE) and 18% lower than the third quarter of 2011 ($8.33 per BOE).

Transportation costs of $1.2 million ($0.98 per BOE) for the third quarter of 2012 include clean oil trucking, trucking of natural gas liquids, certain third party fuel charges and transportation and fuel costs associated with the usage of natural gas pipelines. Transportation costs in the third quarter of 2012 were comparable to the preceding second quarter of 2012 ($1.6 million) and the third quarter of 2011 ($1.7 million).

Operating Netbacks

	Three months ended September 30,		Nine months ended September 30,	
($ per BOE)	**2012**	2011	**2012**	2011
Petroleum and natural gas sales *(1)*	**21.55**	37.20	**24.07**	38.74
Other income	**(0.06)**	–	**0.24**	–
Royalty income	**0.17**	0.15	**0.11**	0.20
Royalties	**(1.92)**	(2.98)	**(2.15)**	(4.05)
Operating costs	**(6.80)**	(8.33)	**(7.52)**	(8.85)
Transportation	**(0.98)**	(1.19)	**(1.06)**	(1.10)
Operating netback	**11.96**	24.85	**13.69**	24.94

(1) Excludes the change in fair value of derivatives

Fairborne's operating netback of $11.96 per BOE was 14% lower than the second quarter of 2012 ($13.94 per BOE) and 52% lower when compared to the third quarter of 2011 ($24.85 per BOE), reflecting the disposition of higher netback crude oil properties, partially offset by reduced operating costs.

General and Administrative ("G&A") Expenses

	Three months ended September 30,		Nine months ended September 30,	
($thousands except as noted)	**2012**	2011	**2012**	2011
G&A expenses, net of recoveries	**3,807**	3,255	**11,736**	10,330
Compensation costs	**223**	584	**871**	1,946
Total G&A expenses	**4,030**	3,839	**12,607**	12,276
G&A expenses, net of recoveries, per BOE	**$3.16**	$2.32	**$3.01**	$2.61
Compensation costs, per BOE	**$0.19**	$0.42	**$0.22**	$0.49

Fairborne continued to record higher than historical G&A expenses in the third quarter of 2012 due to costs incurred as part of the strategic review process, including staff retention costs, professional services and special committee costs. G&A expenses of $3.8 million ($3.16 per BOE) for the third quarter of 2012 were 17% higher than the comparative third quarter of 2011 ($3.3 million).

Concurrent with the strategic property dispositions in October 2012, the Company undertook a series of cost reductions which will reduce future G&A expenses. Cost reduction steps included staff reductions, pay reductions, office space consolidation and other scalable reductions based on the Company's smaller size.

Compensation expense of $0.2 million in the third quarter of 2012 was comparable to the preceding second quarter of 2012 ($0.1 million) and 62% lower than the third quarter of 2011 ($0.6 million) as a result of above average stock option forfeitures during 2012.

Depreciation and Amortization ("D&A")

($thousands except as noted)	Three months ended September 30, 2012	2011	Nine months ended September 30, 2012	2011
Depreciation and amortization	15,008	25,860	61,643	72,948
Impairment charges	154,300	–	200,300	–
Total depreciation and impairment	169,308	25,860	261,943	72,948
Depreciation and amortization per BOE	$12.45	$18.49	$15.83	$18.39
Impairment charges per BOE	$128.01	–	$51.42	–

Fairborne's third quarter depreciation and amortization expense was impacted by property dispositions resulting from the Company's strategic review process. Upon execution of the purchase and sale agreements for the disposition of the Company's Marlboro and shallow gas/CBM properties, the specific assets associated with these dispositions were reclassified from P&NG properties to assets held for sale and depreciation of these assets ceased. As a result, depreciation for the third quarter 2012 of $15.0 million ($12.45 per BOE) was lower than the preceding second quarter ($17.29 per BOE) and the comparative third quarter of 2011 ($18.49 per BOE).

In accordance with IFRS, the Company also performed an impairment test on the properties which were reclassified as assets held for sale and reduced the carrying value of the assets to the fair value less costs to sell as set out in the associated purchase and sale agreements. This resulted in a $154.3 million impairment charge in the third quarter of 2012.

Gain (Loss) on Disposition of Capital Assets

($thousands except as noted)	Three months ended September 30, 2012	2011	Nine months ended September 30, 2012	2011
Gain (loss) on disposition of P&NG assets	(474)	–	(2,393)	47,167
Gain (loss) on recognition of non-monetary transactions	–	–	295	517
Total gain (loss) on disposition of capital assets	(474)	–	(2,098)	47,684
Per BOE	($0.39)	–	($0.54)	$12.03

Gains and losses are recognized in net income on the disposal of an item of P&NG assets. The amount of the gain or loss is determined by comparing the proceeds from disposal with the carrying amount of the item. This includes transactions such as sales of assets, farm-outs, asset swaps and other non-monetary transactions. An incremental $0.5 million loss was recorded in the third quarter of 2012 as a result of adjustments to property dispositions completed during the first six months of 2012.

Finance Expense

($thousands except as noted)	Three months ended September 30, 2012	2011	Nine months ended September 30, 2012	2011
Interest expense	2,285	3,073	7,614	10,900
Accretion of asset retirement obligation	209	240	749	698
Impairment loss on trade receivable	5	–	327	117
Accretion of convertible debentures	–	647	–	1,789
Total finance expense	2,499	3,960	8,690	13,504
Per BOE	$2.07	$2.83	$2.23	$3.41

Fairborne recorded $2.5 million in finance expense in the third quarter of 2012, 23% lower than the preceding quarter (Q2 2012 – $3.2 million) and 37% lower than the third quarter of 2011 ($4.0 million). Compared to the prior year, the decrease is consistent with lower debt levels as well as the maturation and payment of the convertible debentures on December 31, 2011. The debentures were repaid with existing credit facilities that carry a lower interest rate than the convertible debentures.

Taxes

	Three months ended September 30, 2012	Three months ended September 30, 2011	Nine months ended September 30, 2012	Nine months ended September 30, 2011
Deferred taxes (reduction) *($thousands)*	**(40,652)**	880	**(57,806)**	15,138
Per BOE	**($33.73)**	$0.63	**($14.84)**	$3.82

Fairborne recorded a deferred tax reduction of $40.7 million in the third quarter of 2012 compared to deferred taxes of $0.9 million during the third quarter of 2011, both of which reflect a provision for future tax at tax rates expected to apply when the related temporary differences reverse.

Profit (Loss) and Funds Generated from Operations

($thousands except as noted)	Three months ended September 30, 2012	Three months ended September 30, 2011	Nine months ended September 30, 2012	Nine months ended September 30, 2011
Funds generated from operations	**10,619**	31,504	**41,579**	88,578
Per share – basic	**$0.11**	$0.31	**$0.41**	$0.87
Per share – diluted	**$0.11**	$0.31	**$0.41**	$0.86
Cash flow from operations (including changes in working capital)	**6,355**	34,089	**36,783**	83,287
Per share – basic	**$0.06**	$0.33	**$0.36**	$0.81
Per share – diluted	**$0.06**	$0.33	**$0.36**	$0.80
Profit (loss)	**(121,840)**	1,323	**(173,801)**	34,625
Per share – basic	**($1.19)**	$0.01	**($1.69)**	$0.34
Per share – diluted	**($1.19)**	$0.01	**($1.69)**	$0.33

BOE Analysis

Three months ended September 30,	2012		2011	
	($thousands)	*($ per BOE)*	*($thousands)*	*($ per BOE)*
Petroleum and natural gas revenue (1)	**25,506**	**21.16**	53,350	38.14
Royalties	**(2,310)**	**(1.92)**	(4,166)	(2.98)
Production and operating costs	**(9,377)**	**(7.78)**	(13,322)	(9.52)
Change in fair value of derivatives	**607**	**0.50**	(1,103)	(0.79)
General & administrative (2)	**(3,807)**	**(3.16)**	(3,255)	(2.32)
Funds generated from operations	**10,619**	**8.80**	31,504	22.53
Finance expense	**(2,499)**	**(2.07)**	(3,960)	(2.83)
Change in fair value of derivatives	**(607)**	**(0.50)**	1,103	0.79
Compensation expense – non-cash	**(223)**	**(0.19)**	(584)	(0.42)
Gain (loss) on disposition of capital assets	**(474)**	**(0.39)**	–	–
Depreciation and amortization	**(169,308)**	**(140.46)**	(25,860)	(18.49)
Deferred taxes (expense) reduction	**40,652**	**33.73**	(880)	(0.63)
Profit (loss)	**(121,840)**	**(101.08)**	1,323	0.95

(1) Including the change in fair value of derivatives (non-cash)
(2) Net of compensation expense (non-cash).

NINE MONTHS ENDED SEPTEMBER 30,	2012		2011	
	($thousands)	*($ per BOE)*	*($thousands)*	*($ per BOE)*
Petroleum and natural gas revenue (1)	**95,542**	**24.53**	156,323	39.42
Royalties	**(8,373)**	**(2.15)**	(16,046)	(4.05)
Production and operating costs	**(33,438)**	**(8.58)**	(39,470)	(9.95)
Change in fair value of derivatives	**(416)**	**(0.12)**	(1,899)	(0.48)
General & administrative (2)	**(11,736)**	**(3.01)**	(10,330)	(2.61)
Funds generated from operations	**41,579**	**10.67**	88,578	22.33
Finance expense	**(8,690)**	**(2.23)**	(13,504)	(3.41)
Change in fair value of derivatives	**416**	**0.12**	1,899	0.48
Compensation expense – non-cash	**(871)**	**(0.22)**	(1,946)	(0.49)
Gain (loss) on disposition of capital assets	**(2,098)**	**(0.54)**	47,684	12.03
Depreciation and amortization	**(261,943)**	**(67.25)**	(72,948)	(18.39)
Deferred taxes (expense) reduction	**57,806**	**14.84**	(15,138)	(3.82)
Profit (loss)	**(173,801)**	**(44.61)**	34,625	8.73

(1) Including the change in fair value of derivatives (non-cash)
(2) Net of compensation expense.

Fairborne reported funds generated from operations of $10.6 million ($8.80 per BOE) for the third quarter of 2012, a decrease of 66% when compared to the third quarter of 2011 ($31.5 million). The decrease in funds generated from operations reflects reduced daily production as well as the disposition of higher netback crude oil properties completed in the second quarter of 2012.

Fairborne's $121.8 million loss for the third quarter of 2012 (Q3 2011 – profit of $1.3 million) reflects the $154.3 million impairment recognized on assets held for sale at the end of the quarter. Similarly, the loss of $173.8 million ($44.61 per BOE) for the nine months ended September 30, 2012 includes a total impairment charge of $200.3 million, compared to the profit of $34.6 million for the same time period in 2011 which included a $47.7 million gain recorded on 2011 property dispositions.

Liquidity and Capital Resources

Capital Expenditures

P&NG assets have been divided into intangible exploration assets ("E&E assets") and petroleum and natural gas properties and equipment ("development assets").

Petroleum and Natural Gas Properties and Equipment

	THREE MONTHS ENDED SEPTEMBER 30,		NINE MONTHS ENDED SEPTEMBER 30,	
($thousands)	**2012**	2011	**2012**	2011
Development expenditures				
Land and property acquisitions	**115**	1,374	**912**	6,505
Geological and geophysical	**28**	(54)	**28**	4,187
Drilling and completions	**8,873**	29,226	**45,583**	87,406
Well equipment and facilities	**313**	7,231	**6,946**	35,156
Turnarounds and overhauls	**142**	286	**933**	775
Corporate assets	**3**	100	**147**	418
Total development expenditures	**9,474**	38,163	**54,549**	134,447
Acquisitions and Dispositions				
Proceeds from sale of petroleum and natural gas properties	**474**	–	**(87,117)**	(141,380)

During the third quarter of 2012, Fairborne's development expenditures totaled $9.5 million with capital expenditures financed through funds generated from operations. In the third quarter of 2012, $0.6 million of general and administrative costs were capitalized to development assets which included $0.5 million of directly attributable G&A costs and $0.1 million related to stock based compensation costs.

Fairborne spent $8.9 million on drilling and completion activities in the third quarter of 2012 which included drilling one (1.0 net) gas well on the Company's Harlech property. Tangible development expenditures of $0.3 million during the three months ended September 30, 2012 included the tie-in of wells at the Company's Marlboro and Harlech properties.

Intangible Exploration Assets

	Three months ended September 30,		Nine months ended September 30,	
($thousands)	**2012**	2011	**2012**	2011
Exploration expenditures				
Land and seismic	**20**	1	**461**	1,178
Exploratory drilling and completions	**204**	7,027	**204**	7,261
Total exploration expenditures	**224**	7,028	**665**	8,439
Dispositions				
Proceeds from sale of exploration properties	**–**	–	**(2,536)**	–

E&E assets include projects that are pending determination of technical feasibility and economic viability, primarily concentrated on the Company's Harlech property.

Assets Held for Sale

During the third quarter, the Company entered into separate agreements to dispose of its interests in two development assets, the Marlboro property and shallow gas/CBM properties. Upon execution of the purchase and sale agreements for the disposition of these properties, the carrying values associated with these properties were reclassified from P&NG properties to assets held for sale. Liabilities of $12.0 million and bank indebtedness of $183.7 million associated with these properties were also reclassified as liabilities and bank indebtedness associated with assets held for sale. In accordance with accounting standards, an impairment of $154.3 million was recorded during the third quarter in order to reduce the carrying value of the assets held for sale to an amount equal to fair value less costs to sell. Both property dispositions were completed on October 1, 2012 with net proceeds of $183.7 million applied against bank indebtedness.

Working Capital and Bank Indebtedness

At September 30, 2012, Fairborne had drawn $185.3 million (December 31, 2011 – $228.3 million) against its credit facilities and had a working capital deficit (excluding assets held for sale and associated liabilities) of $9.5 million (December 31, 2011 – $32.8 million). Property dispositions during the first nine months of 2012 generated net proceeds of $89.7 million which were applied against outstanding bank debt. Year to date capital expenditures of $55.2 million have been financed from funds generated from operations of $41.6 million with the balance financed through bank debt.

At September 30, 2012, $183.7 million of bank indebtedness was reclassified to current liabilities associated with assets held for sale in respect of two separate property dispositions resulting from Fairborne's strategic review process. On October 1, 2012 Fairborne closed both dispositions, generating net proceeds of $183.7 million which were applied against outstanding bank debt.

Concurrent with the October 1st property dispositions, Fairborne's credit facilities were reduced to $80 million including a $70 million extendible revolving term credit facility and a $10 million demand operating credit facility. The extendible revolving term facility is available on a revolving basis until May 26, 2013 (364 day facility) at which time it may be extended, at the lenders option. If the revolving period is not extended, the undrawn portion of the facility will be cancelled and the amount outstanding would convert to a 365 day non-revolving term facility. The amounts outstanding under the non-revolving term facility are required to be repaid at the end of the term facility being May 26, 2014. Interest payable on amounts drawn under the facilities is at the prevailing bankers' acceptance rates plus stamping fees, lenders' prime rate or LIBOR rates plus applicable margins, depending on the form of borrowing by the Company. The margins and stamping fees vary from 1.00% to 3.75% depending on financial statement ratios and the form of borrowing. The credit facilities are secured by a general security agreement and a first ranking floating charge on the assets of the Company. The facility is subject to a semi-annual valuation of Fairborne's petroleum and natural gas assets. The Company anticipates it will have adequate liquidity to fund its financial liabilities as they come due. Fairborne has no defaults or breaches on its bank debt or any of its financial liabilities.

Fairborne actively manages its capital structure. In order to reduce outstanding bank indebtedness in light of low natural gas prices, the Company completed several non-core property dispositions in 2011 and the second quarter of 2012. In addition, the Company undertook a comprehensive strategic review process which resulted in two large asset dispositions including the Marlboro property and shallow gas/CBM properties, both of which closed on October 1, 2012. Proceeds from all dispositions were applied against bank indebtedness.

The Company's objective when managing capital is to maintain a flexible capital structure which will allow it to execute on its capital investment program, including investing in oil and gas activities which may or may not be successful. As well, through periods of extreme market fluctuations, the Company strives to maintain flexibility and liquidity in its capital structure. As a result, Fairborne continually works to balance the proportion of debt and equity in its capital structure to take into account the level of risk being incurred in its capital expenditures. With depressed share prices continuing into 2012, the ability to issue additional shares has been restricted.

In order to maintain or adjust the capital structure, Fairborne considers various factors including: its forecasted debt to forecasted funds from operations ratio while attempting to finance an acceptable investment program including incremental investment and acquisition opportunities; the current level of bank credit available from the banking syndicate; the level of bank credit that may be obtainable from the banking syndicate as a result of reserve growth; the availability of other sources of debt with different characteristics than the existing bank debt; the sale of assets; limiting the size of the investment program; and the availability of new common equity financing if available on acceptable terms. In the midst of financial uncertainty, the Company will continually re-evaluate its capital expenditure program in light of projected cash flows.

Shareholders' Equity

The Company is authorized to issue an unlimited number of common shares and an unlimited number of preferred shares, issuable in series.

The following table provides a summary of outstanding common shares and stock options at the dates indicated:

(thousands)	October 31, 2012	September 30, 2012	December 31, 2011
Common shares	102,594	102,594	102,594
Stock options	6,417	6,868	7,740
Weighted average common shares (1)			
Basic	n/a	102,594	102,563
Diluted	n/a	102,594	102,563

(1) Weighted average common shares outstanding are for the twelve months ended December 31, 2011 and for the nine months ended September 30, 2012.

Off-Balance Sheet Arrangements

Fairborne has no off-balance-sheet arrangements.

Business Environment and Risk

The business risks the Company is exposed to are those inherent in the oil and gas industry as well as those governed by the individual nature of Fairborne's operations. Geological and engineering risks, the uncertainty of discovering commercial quantities of new reserves, commodity prices, interest rate and foreign exchange risks, competition and government regulations – all of these govern the businesses and influence the controls and management at the Company. Fairborne manages these risks by:

- attracting and retaining a team of highly qualified and motivated professionals who have a vested interest in the success of the Company;
- operating properties in order to maximize opportunities;
- employing risk management instruments to minimize exposure to volatility of commodity prices, interest rate and foreign exchange rates;
- maintaining a strong financial position; and
- maintaining strict environmental, safety and health practices.

Controls and Procedures

Disclosure Controls and Procedures

Fairborne's Chief Executive Officer and Chief Financial Officer have designed or caused to be designed under their supervision, disclosure controls and procedures to provide reasonable assurance that (i) material information relating to the Company is made known to Fairborne's Chief Executive Officer and Chief Financial Officer by others, particularly during the period in which the annual and interim filings are being prepared; and (ii) information required to be disclosed by the Company 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 period specified in securities legislation.

Internal Controls over Financial Reporting

Fairborne's Chief Executive Officer and Chief Financial Officer have designed or caused to be designed under their supervision, internal controls over financial reporting to provide reasonable assurance regarding the reliability of the Company's financial reporting and the preparation of financial statements for external purposes in accordance with IFRS.

No material changes in Fairborne's internal controls over financial reporting were identified during the three months ended September 30, 2012, that have materially affected, or are reasonably likely to materially affect, the Company's internal controls over financial reporting.

It should be noted that a control system, including Fairborne's disclosure and internal controls and procedures, no matter how well conceived, 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 disclosure and internal controls and procedures will prevent all errors or fraud.

Quarterly Financial Information

The following is a summary of select financial information for the quarterly periods indicated:

	Q3/2012	Q2/2012	Q1/2012	Q4/2011
Financial *($thousands, except per share amounts)*				
Petroleum and natural gas revenue	**25,506**	31,571	38,465	49,443
Funds generated from operations	**10,619**	12,898	18,062	27,050
Per share – basic	**$0.11**	$0.12	$0.18	$0.26
Per share – diluted	**$0.11**	$0.12	$0.18	$0.26
Cash flow from operations (including changes in working capital)	**6,355**	11,972	18,456	34,820
Per share – basic	**$0.06**	$0.12	$0.18	$0.34
Per share – diluted	**$0.06**	$0.12	$0.18	$0.34
Loss	**(121,840)**	(44,721)	(7,240)	(108,889)
Per share – basic	**($1.19)**	($0.44)	($0.07)	($1.06)
Per share – diluted	**($1.19)**	($0.44)	($0.07)	($1.06)
Total assets	**605,020**	767,731	928,885	918,287
Working capital deficit (1)	**9,521**	8,078	32,902	32,767
Bank indebtedness	**185,336**	183,105	253,541	228,341
Total debt, including working capital	**194,857**	191,183	286,443	261,108
Operations				
Average production				
Natural gas *(Mcf per day)*	**68,416**	70,485	76,821	75,803
Crude oil *(bbls per day)*	**873**	1,262	1,860	2,036
Natural gas liquids *(bbls per day)*	**799**	946	886	811
Sulphur *(tonnes per day)*	**27**	7	46	58
Total *(BOE per day)*	**13,102**	13,962	15,596	15,539

(1) Excluding assets held for sale and associated liabilities.

	Q3/2011	Q2/2011	Q1/2011	Q4/2010
Financial *($thousands, except per share amounts)*				
Petroleum and natural gas revenue	53,350	54,442	48,531	56,904
Funds generated from operations	31,504	27,241	29,833	34,372
Per share – basic	$0.31	$0.27	$0.29	$0.34
Per share – diluted	$0.31	$0.26	$0.29	$0.34
Cash flow from operations (including changes in working capital)	34,089	24,102	25,096	39,194
Per share – basic	$0.33	$0.24	$0.24	$0.38
Per share – diluted	$0.33	$0.23	$0.24	$0.38
Profit (loss)	1,323	652	32,650	(8,247)
Per share – basic	$0.01	$0.01	$0.32	($0.08)
Per share – diluted	$0.01	$0.01	$0.31	($0.08)
Total assets	1,050,898	1,052,932	1,039,135	1,072,064
Working capital deficit (surplus) (excluding convertible debentures)	21,257	(21,673)	47,175	17,743
Convertible debentures	99,353	98,706	98,135	97,564
Bank indebtedness	125,196	152,227	101,774	206,331
Total debt, including working capital	245,806	229,260	247,084	321,638
Operations				
Average production				
Natural gas *(Mcf per day)*	72,303	65,171	63,550	71,845
Crude oil *(bbls per day)*	2,262	2,287	2,710	2,946
Natural gas liquids *(bbls per day)*	845	766	1,020	1,028
Sulphur *(tonnes per day)*	48	56	67	62
Total *(BOE per day)*	15,206	13,971	14,388	16,010

Interim Consolidated Statements of Financial Position

(unaudited)

(thousands of Canadian dollars)		September 30, 2012	December 31, 2011
Assets			
Current assets			
Cash and cash equivalents		$ 243	$ 188
Accounts receivable		13,152	28,144
Derivative asset	*(Note 11)*	456	40
Prepaid expenses and deposits		4,620	4,906
Assets held for sale	*(Note 2, 9)*	195,693	–
Total current assets		214,164	33,278
Petroleum and natural gas properties and equipment	*(Note 2)*	359,040	851,322
Intangible exploration assets	*(Note 3)*	31,816	33,687
Total capital assets		390,856	885,009
		$ 605,020	$ 918,287
Liabilities			
Current liabilities			
Accounts payable and accrued liabilities		$ 27,992	$ 66,045
Liabilities associated with assets held for sale	*(Note 6)*	11,955	–
Bank indebtedness associated with assets held for sale	*(Note 5)*	183,738	–
Total current liabilities		223,685	66,045
Bank indebtedness	*(Note 5)*	1,598	228,341
Provisions	*(Note 6)*	5,642	19,330
Deferred taxes		18,974	76,780
Total non-current liabilities		26,214	324,451
Total liabilities		249,899	390,496
Equity			
Common shares		537,116	537,116
Contributed surplus		39,327	38,196
Deficit		(221,322)	(47,521)
Total equity		355,121	527,791
		$ 605,020	$ 918,287

See accompanying notes which are an integral part of these interim consolidated financial statements.

Interim Consolidated Statements of Operations and Comprehensive Income (Loss)

(unaudited)

		For the three months ended September 30, 2012	2011	For the nine months ended September 30, 2012	2011
(thousands of Canadian dollars except per share amounts)					
Revenue					
Petroleum and natural gas		$ 25,506	$ 53,350	$ 95,542	$ 156,323
Royalties		(2,310)	(4,166)	(8,373)	(16,046)
		23,196	49,184	87,169	140,277
Expenses					
Production and operating		9,377	13,322	33,438	39,470
General and administrative		4,030	3,839	12,607	12,276
Depreciation and amortization	*(Note 2,4)*	169,308	25,860	261,943	72,948
Results from operating activities		(159,519)	6,163	(220,819)	15,583
Gain (loss) on disposition of capital assets		(474)	–	(2,098)	47,684
Finance expense	*(Note 10)*	(2,499)	(3,960)	(8,690)	(13,504)
Profit (loss) before taxes		(162,492)	2,203	(231,607)	49,763
Deferred taxes (reduction)		(40,652)	880	(57,806)	15,138
Profit (loss) and comprehensive income (loss)		$ (121,840)	$ 1,323	$ (173,801)	$ 34,625
Profit (loss) per share	*(Note 7)*				
Basic		$ (1.19)	$ 0.01	$ (1.69)	$ 0.34
Diluted		$ (1.19)	$ 0.01	$ (1.69)	$ 0.33

See accompanying notes which are an integral part of these interim consolidated financial statements.

Interim Consolidated Statements of Changes in Equity

(unaudited)

		2012			2011		
FOR THE NINE MONTHS ENDED SEPTEMBER 30,		NUMBER		AMOUNT	NUMBER		AMOUNT
(thousands of Canadian dollars)		*(thousands)*			*(thousands)*		
Common shares							
Balance, beginning of period		**102,594**	**$**	**537,116**	102,506	$	536,812
Issued on exercise of stock options		**–**		**–**	85		290
Balance, end of period		**102,594**	**$**	**537,116**	102,591	$	537,102
Equity portion of convertible debentures							
Balance, beginning and end of period			**$**	**–**		$	2,964
Contributed surplus							
Balance, beginning of period			**$**	**38,196**		$	31,988
Equity based compensation	*(Note 8)*			**1,131**			2,685
Stock options exercised				**–**			(248)
Balance, end of period			**$**	**39,327**		$	34,425
Retained earnings (deficit)							
Balance, beginning of period			**$**	**(47,521)**		$	26,743
Profit (loss)				**(173,801)**			34,625
Balance, end of period			**$**	**(221,322)**		$	61,368
Total Equity							
Balance, end of period			**$**	**355,121**		$	635,859

See accompanying notes which are an integral part of these interim consolidated financial statements.

Interim Consolidated Statements of Cash Flows

(unaudited)

FOR THE NINE MONTHS ENDED SEPTEMBER 30, *(thousands of Canadian dollars)*		2012	2011
Operating activities			
Profit (loss)		$ (173,801)	$ 34,625
Adjustments for:			
Depreciation and amortization	*(Note 2,4)*	261,943	72,948
Deferred taxes (reduction)		(57,806)	15,138
Change in fair values of derivatives	*(Note 11)*	(416)	(1,899)
Finance expense (including accretion)	*(Note 10)*	8,690	13,504
(Gain) loss on disposition of capital assets		2,098	(47,684)
Stock based compensation	*(Note 8)*	871	1,946
Funds generated from operations		41,579	88,578
Change in non-cash working capital	*(Note 9)*	(4,032)	(5,074)
Asset retirement expenditures	*(Note 6)*	(764)	(217)
Net cash from operating activities		36,783	83,287
Financing activities			
Bank indebtedness		(43,005)	(81,135)
Interest paid		(7,265)	(9,210)
Issuance of common shares		–	42
Net cash used in financing activities		(50,270)	(90,303)
Investing activities			
Expenditures on petroleum and natural gas properties	*(Note 2)*	(54,549)	(134,447)
Expenditures on exploration assets	*(Note 3)*	(665)	(8,439)
Proceeds from sale of petroleum and natural gas properties		89,653	141,380
Change in non-cash working capital	*(Note 9)*	(20,897)	8,734
Net cash from investing activities		13,542	7,228
Change in cash and cash equivalents		55	212
Cash and cash equivalents, beginning of period		188	319
Cash and cash equivalents, end of period		$ 243	$ 531

See accompanying notes which are an integral part of these interim consolidated financial statements.

Selected Notes to the Interim Consolidated Financial Statements

FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2012 *(unaudited)*

(tabular amounts are stated in thousands and thousands of Canadian dollars except per share amounts)

1. Basis of Presentation

Fairborne Energy Ltd. (the "Company" or "Fairborne") is a resource-based company engaged in the exploration for and the development and production of natural gas, natural gas liquids and crude oil in Western Canada.

These interim consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") applicable to the preparation of interim financial statements, including IAS 34. The Company has consistently applied the same accounting policies throughout all periods presented. These financial statements should be read in conjunction with the consolidated financial statements and notes thereto for the year ended December 31, 2011.

The consolidated financial statements were authorized by the Board of Directors on November 6, 2012.

2. Petroleum and Natural Gas Properties and Equipment

Resource Properties and Equipment		FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2012	FOR THE YEAR ENDED DECEMBER 31, 2011
Cost			
Balance, beginning of period		$ 1,176,362	$ 1,109,728
Additions		54,402	172,654
Non-monetary additions		300	6,164
Asset retirement obligation additions		165	3,640
Capitalized stock-based compensation		260	984
Non-monetary dispositions		(5)	(6,914)
Dispositions		(201,290)	(109,894)
Reclassified as held for sale		(461,812)	–
Balance, end of period		$ 568,382	$ 1,176,362
Accumulated depreciation and impairment losses			
Balance, beginning of period		$ (327,179)	$ (99,519)
Depreciation		(61,342)	(98,633)
Dispositions		110,375	17,973
Impairment losses	(Note 4)	(200,300)	(147,000)
Reclassified as held for sale		267,119	–
Balance, end of period		$ (211,327)	$ (327,179)
Net book value, end of period		$ 357,055	$ 849,183

Corporate Assets	For the nine months ended September 30, 2012	For the year ended December 31, 2011
Cost		
Balance, beginning of period	$ 5,291	$ 4,600
Additions	147	691
Balance, end of period	$ 5,438	$ 5,291
Accumulated depreciation and impairment losses		
Balance, beginning of period	$ (3,152)	$ (2,794)
Depreciation	(301)	(358)
Balance, end of period	$ (3,453)	$ (3,152)
Net book value, end of period	$ 1,985	$ 2,139

	September 30, 2012	December 31, 2011
Petroleum and natural gas properties and equipment – cost	$ 573,820	$ 1,181,653
Petroleum and natural gas properties and equipment – accumulated depreciation	(214,780)	(330,331)
Petroleum and natural gas properties and equipment – net book value	$ 359,040	$ 851,322

The depreciation and impairment of property plant and equipment, and any reversal thereof, are recognized in depreciation and amortization in the statement of operations.

In August 2012, the Company entered into two separate agreements to dispose of assets located in Southern and Central Alberta. As a result, $194.7 million of PP&E assets associated with the dispositions were reclassified to assets held for sale and were written down to the estimated disposal proceeds, net of costs. Both property dispositions were completed on October 1, 2012 with net proceeds of $183.7 million applied against outstanding bank indebtedness.

3. Intangible Exploration Assets

	For the nine months ended September 30, 2012	For the year ended December 31, 2011
Cost		
Balance, beginning of period	$ 33,687	$ 15,732
Additions	665	16,005
Dispositions	(2,536)	–
Non-monetary additions	–	2,765
Non-monetary dispositions	–	(815)
Balance, end of period	$ 31,816	$ 33,687

4. Impairment of Assets

As a result of reclassifying assets held for sale related to the property dispositions in Southern and Central Alberta, Fairborne recorded a $154.3 million impairment charge in the consolidated statement of operations for the nine months ended September 30, 2012.

During the second quarter of 2012, a triggering event also arose on two of Fairborne's CGUs. The recoverable amount of the CGUs tested for impairment is based on the higher of the value in use and fair value less costs to sell. Fairborne calculated the estimated value in use to complete the impairment test. Value in use was determined using the net present value of cash flows from proven and probable oil and gas reserves of the respective CGU with a discount rate of 5% for the Manitoba/Saskatchewan CGU and 10% for the Deep Basin CGU. Also included in the fair value calculation was an estimate of the fair value of Fairborne's undeveloped land holdings.

The following commodity price estimates were used in the fair value calculations:

July 1, 2012:

YEAR	WTI Oil *($U.S./bbl)*	Foreign Exchange Rate	Edmonton Light Crude Oil *($Cdn/bbl)*	AECO Gas *($Cdn/mmbtu)*
2012	91.57	0.98	83.47	2.47
2013	90.00	0.98	86.73	3.44
2014	95.00	0.98	95.92	3.90
2015	100.00	0.98	101.02	4.36
2016	100.00	0.98	101.02	4.82
2017	100.00	0.98	101.02	5.28
2018	101.35	0.98	102.40	5.68
2019	103.38	0.98	104.47	5.80
2020	105.45	0.98	106.58	5.91
2021	107.56	0.98	108.73	6.03
Escalate thereafter 2.0% per year				

Using the estimated value in use, and given the decrease in estimated future natural gas prices from December 31, 2011 to June 30, 2012 it was determined the Deep Basin CGU had a book value that exceeded its fair value by $46.0 million. Accordingly, an impairment loss was recorded in the three months ended June 30, 2012.

5. Bank Indebtedness

At September 30, 2012, the Company had a $205 million extendible revolving term credit facility and a $15 million demand operating credit facility available from a syndicate of Canadian chartered banks, subject to the banks' semi-annual valuation of Fairborne's petroleum and natural gas properties. On October 1, 2012 and concurrent with the closing of two property dispositions, the Company's lending syndicate revised the Company's borrowing base to $80 million on substantially the same terms. Net proceeds of $183.7 million were applied to bank debt on October 1, 2012 which is presented as bank indebtedness associated with assets held for sale at September 30, 2012.

At October 1, 2012, the Company's $80 million extendible facility consists of a $70 million revolving term credit facility and a $10 million demand operating credit facility available from a syndicate of Canadian chartered banks, subject to the banks' semi-annual valuation of Fairborne's petroleum and natural gas properties. The extendible revolving term facility is available on a revolving basis until May 27, 2013 (364 day facility) at which time it may be extended, at the lenders option. If the revolving period is not extended, the undrawn portion of the facility will be cancelled and the amount outstanding will convert to a 365 day non-revolving term facility. The amounts outstanding under the non-revolving term facility are required to be repaid at the end of the term facility being May 27, 2014. Interest payable on amounts drawn under the facilities is at the prevailing bankers' acceptance rates plus stamping fees, lenders' prime rate or LIBOR rates plus applicable margins, depending on the form of borrowing by the Company. The margins and stamping fees vary from 1.00% to 3.75% depending on financial statement ratios and the form of borrowing. The credit facilities are secured by a general security agreement and a first ranking floating charge on the assets of the Company. At September 30, 2012, letters of credit totaling $2.1 million were outstanding.

6. Provisions

A reconciliation of provisions is provided below:

	For the nine months ended September 30, 2012	For the year ended December 31, 2011
Asset retirement obligation, beginning of period	$ 13,344	$ 12,730
Provisions made	165	891
Provisions used	(764)	(902)
Accretion	749	932
Change in estimate	–	3,468
Disposals	(1,405)	(3,775)
Reclassified as liabilities associated with assets held for sale	(6,447)	–
Asset retirement obligation, end of period	5,642	13,344
Other provisions	5,508	5,986
Reclassified as liabilities associated with assets held for sale	(5,508)	–
Balance, end of period	$ 5,642	$ 19,330

7. Profit (Loss) per Share

The following table summarizes the weighted average common shares used in calculating profit (loss) per share:

	For the three months ended September 30, 2012	2011	For the nine months ended September 30, 2012	2011
Numerator				
Profit (loss) for the period – basic & diluted	$ (121,840)	$ 1,323	$ (173,801)	$ 34,625
Denominator				
Weighted average shares – basic	102,594	102,579	102,594	102,553
Stock options	–	509	–	908
Denominator for diluted profit per share	102,594	103,088	102,594	103,461
Basic profit (loss) per share	$ (1.19)	$ 0.01	$ (1.69)	$ 0.34
Diluted profit (loss) per share	$ (1.19)	$ 0.01	$ (1.69)	$ 0.33

Excluded from the diluted number of shares for the period ended September 30, 2012 is the effect of 6.9 million stock options as they are anti-dilutive to the net loss. Excluded from the diluted number of shares for the period ended September 30, 2011 is the effect of convertible debentures (7.4 million shares) and 4.1 million stock options.

8. Equity Based Compensation

Stock based compensation expense of $1.1 million (September 30, 2011 – $2.7 million) was recognized in the period. Of this amount, stock based compensation costs of $0.3 million (September 30, 2011 – $0.7 million) were capitalized during the period.

9. Supplemental Cash Flow Information

The following table sets forth the changes in non-cash working capital:

For the nine months ended September 30,	2012	2011
Change in receivables	$ 14,992	$ 3,506
Change prepaid expenses and deposits	286	641
Change in accounts payable and accrued liabilities	(39,207)	(487)
Receivable reclassified as asset held for sale	(1,000)	–
	$ (24,929)	$ 3,660
Operating	$ (4,032)	$ (5,074)
Investing	$ (20,897)	$ 8,734

10. Finance Expense

	For the three months ended September 30, 2012	2011	For the nine months ended September 30, 2012	2011
Interest on bank indebtedness	$ 2,285	$ 1,448	$ 7,614	$ 6,025
Accretion of asset retirement obligation	209	240	749	698
Impairment loss on trade receivables	5	–	327	117
Interest on convertible debentures	–	1,625	–	4,875
Accretion of convertible debentures	–	647	–	1,789
Finance expenses recognized in profit and loss	$ 2,499	$ 3,960	$ 8,690	$ 13,504

11. Commodity Contracts

Fairborne has a risk management program whereby the Company sells forward a portion of its future production through fixed price physical sales contracts with customers.

a) Commodity Contracts Recorded at Fair Value:

At September 30, 2012, certain contracts have been recorded on the statement of financial position at their estimated fair value as a $0.5 million asset (December 31, 2011 – asset of $40,000). The change in the fair value has been recorded in petroleum and natural gas revenue.

Crude Oil:

	Volume *(bbls per day)*	Price *(CDN$ per bbl)*
Swap		
Oct 1, 2012 – Dec 31, 2012	300	$104.11

b) Commodity Contracts not Recorded at Fair Value:

The following contracts outstanding at September 30, 2012 have been entered into for the purpose of physical delivery of a non-financial item; therefore, the physical delivery contracts are not fair valued. Settlements on these contracts are included in petroleum and natural gas revenue as they occur.

Natural Gas:

	Volume *(GJs per day)*	Price *(CDN$ per GJ)*	Settlement Index
Participating Swaps *(1)*			
Oct 1, 2012 – Oct 31, 2012	5,000	$1.840 + 50%	AECO C Monthly
Oct 1, 2012 – Oct 31, 2012	5,000	$1.835 + 50%	AECO C Monthly
Oct 1, 2012 – Oct 31, 2012	7,500	$1.850 + 50%	AECO C Monthly
Oct 1, 2012 – Oct 31, 2012	5,000	$1.805 + 50%	AECO C Monthly
Oct 1, 2012 – Oct 31, 2012	5,000	$1.850 + 50%	AECO C Monthly
Oct 1, 2012 – Oct 31, 2012	5,275	$1.760 + 50%	AECO C Monthly
Oct 1, 2012 – Dec 31, 2012	5,000	$1.780 + 50%	AECO C Monthly

(1) The settlement price for the participating swaps is the contract price plus 50% of any excess of market price over contract price.

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GLJ Petroleum Consultants Ltd.

Bankers

Royal Bank of Canada
National Bank of Canada
Alberta Treasury Branch
Union Bank

Legal Counsel

Burnet, Duckworth & Palmer LLP

Stock Exchange Listing

The Toronto Stock Exchange
Trading Symbol: **FEL**

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President and CEO
Cypress Capital Management Ltd.

Robert B. Hodgins
Investor and Corporate Director

Johannes J. Nieuwenburg
General Partner
KERN Partners Ltd.

Carl J. Tricoli
Founder, Co-President
and Managing Partner
Denham Capital Management LP

Steven R. VanSickle
President and CEO
Fairborne Energy Ltd.

General Information

Shareholders and interested investors are encouraged to visit our web site: http://www.fairborne-energy.com Historical public documents, corporate information, latest presentation material and press releases are all available. Filings also available at: www.sedar.com

Corporate Governance

A system of corporate governance for Fairborne has been established to provide the Board of Directors, management and shareholders of the Company with effective governance. A more detailed discussion of corporate governance is available in the Information Circular for the Annual Meeting of Shareholders.

Officers

Steven R. VanSickle
President
and Chief Executive Officer

David L. Summers
Chief Operating Officer

Aaron G. Grandberg
Chief Financial Officer

David S. Cymbalisty
Vice President
Engineering

Scott W. Hadley
Vice President
Exploration

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