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# 2012 Q2 MD&A

WestFire
ENERGY LTD

# Management's Discussion and Analysis

The following management discussion and analysis ("MD&A") of financial results is dated August 8, 2012, and should be read in conjunction with the accompanying unaudited interim financial statements and related notes for the three and six month periods ended June 30, 2012 and 2011 of WestFire Energy Ltd. ("WestFire" or the "Company") and its audited financial statements, related notes and MD&A for the year ended December 31, 2011. The interim financial statements have been prepared in accordance with International Accounting Standard ("IAS") 34. The reporting and the measurement currency is the Canadian dollar.

### DESCRIPTION OF THE BUSINESS

WestFire is a Calgary based energy company primarily focused on light oil and natural gas development and production in Alberta and west central Saskatchewan. Common shares of WestFire are listed on the Toronto Stock Exchange under the symbol WFE.

### STRATEGIC ALTERNATIVES PROCESS

Management and the Board of Directors of WestFire continue to believe there is significant value in WestFire's Viking light oil resource play that is not currently reflected in the Company's share price. The Board of Directors believes that the strategic alternatives process announced on December 19, 2011 continues to be the preferred method of enhancing shareholder value.

Consistent with WestFire's press release of December 19, 2011, the Company does not intend to disclose developments with respect to the ongoing strategic alternatives process unless and until the Board of Directors has approved a specific transaction or otherwise determines that disclosure is appropriate.

## RESULTS OF OPERATIONS

| **Financial** | **Three Months Ended June 30,** | | **Six Months Ended June 30,** | |
|---|---|---|---|---|
| ***($ thousands except share and production information)*** | **2012** | 2011 | **2012** | 2011 |
| **Petroleum and natural gas sales** | **64,025** | 21,377 | **117,511** | 35,062 |
| **Cash from operating activities** | **27,941** | 4,242 | **61,294** | 10,788 |
| **Funds flow from operations**[1] | **34,385** | 10,641 | **63,766** | 17,322 |
| **Per share – basic**[1] | **0.41** | 0.24 | **0.77** | 0.40 |
| **Per share – diluted**[1] | **0.41** | 0.23 | **0.77** | 0.40 |
| **Net earnings** | **17,506** | 4,387 | **18,685** | 2,518 |
| **Per share – basic** | **0.21** | 0.10 | **0.23** | 0.06 |
| **Per share – diluted** | **0.21** | 0.10 | **0.22** | 0.06 |
| **Expenditures on oil & gas properties** | **58,538** | 379,736 | **128,099** | 407,075 |
| **Net debt** | **175,493** | 58,204 | **175,493** | 58,204 |
| **Common and convertible non-voting shares** | | | | |
| **Outstanding – basic** | **82,968,941** | 82,968,941 | **82,968,941** | 82,968,941 |
| **Outstanding – diluted** | **83,060,830** | 83,534,442 | **83,080,058** | 83,582,100 |
| **Weighted average– basic** | **82,968,941** | 44,822,186 | **82,968,941** | 42,986,415 |
| **Weighted average– diluted** | **83,060,830** | 45,387,687 | **83,080,058** | 43,599,574 |
| **Sales Volumes** | | | | |
| **Oil and NGL (bbls per day)** | **8,291** | 2,243 | **7,212** | 1,961 |
| **Natural gas (Mcf per day)** | **19,548** | 6,392 | **17,918** | 6,485 |
| **Barrels of oil equivalent (boe per day)** [2] | **11,549** | 3,308 | **10,198** | 3,042 |

(1) The reader is referred to the section - "Non-IFRS Measurements".
(2) The reader is referred to the section - "Oil, Natural Gas Liquids and Natural Gas Conversions to Boe's".

In accordance with Canadian industry practice, production volumes, reserve volumes and revenues are reported on a Company interest basis (working interest plus royalty interest), before deduction of Crown and other royalties, unless otherwise indicated. The Company's results of operations are dependent on production volumes of crude oil, natural gas and natural gas liquids and the prices received for this production. Prices for these commodities have shown significant volatility during recent years and are determined by supply and demand factors, including weather, general economic conditions and changes in the Canadian/United States ("US") currency exchange rate.

In this MD&A, production and reserves information may be presented on a "barrel of oil equivalent" or "boe" basis with six thousand cubic feet ("mcf") of natural gas being equivalent to one barrel ("bbl") of crude oil or natural gas liquids. Boe's may be misleading, particularly if used in isolation. A boe conversion ratio of 6 mcf:1 bbl is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead. Given that the value ratio based on the current price of crude oil compared to natural gas is significantly different from the energy equivalency of 6:1, utilizing a conversion on a 6:1 basis may be misleading as an indication of value.

**Oil and gas production**

| | Three Months Ended June 30, | | | Six Months Ended June 30, | | |
|---|---|---|---|---|---|---|
| | **2012** | 2011 | **Change** | **2012** | 2011 | **Change** |
| **Sales volumes** | | | | | | |
| **Crude oil (bbls per day)** | **7,178** | 2,153 | **233%** | **6,199** | 1,864 | **233%** |
| **Natural gas liquids ("NGL") (bbls per day)** | **1,113** | 90 | **1,137%** | **1,013** | 97 | **944%** |
| **Natural gas (Mcf per day)** | **19,548** | 6,392 | **206%** | **17,918** | 6,485 | **176%** |
| **Total daily production (boe per day)** | **11,549** | 3,308 | **249%** | **10,198** | 3,042 | **235%** |
| **Liquids as a percentage of total** | **71.8%** | 67.8% | | **70.7%** | 64.5% | |
| **Sulphur sales (tonnes per day)** | **15** | - | | **70** | - | |

| | Three Months Ended June 30, | | | Six Months Ended June 30, | | |
|---|---|---|---|---|---|---|
| | **2012** | 2011 | **Change** | **2012** | 2011 | **Change** |
| **Production by area (boe per day)** | | | | | | |
| **Redwater/Provost** | **5,696** | 1,463 | **289%** | **5,024** | 1,093 | **360%** |
| **Kaybob/Bigstone** | **2,615** | - | **100%** | **2,256** | - | **100%** |
| **West central Saskatchewan** | **1,186** | 422 | **181%** | **1,048** | 418 | **151%** |
| **Lloydminster** | **848** | 480 | **77%** | **667** | 532 | **25%** |
| **Alberta gas** | **1,042** | 853 | **22%** | **1,086** | 911 | **19%** |
| **Other** | **162** | 90 | **80%** | **117** | 88 | **33%** |
| **Total daily production** | **11,549** | 3,308 | **249%** | **10,198** | 3,042 | **235%** |

WestFire's production for the three months ended June 30, 2012 (the "Quarter") averaged 11,549 boe per day, and consisted of 6,346 bbls per day of light oil, 832 bbls per day of heavy oil, 1,113 bbls per day of natural gas liquids and 19,548 Mcf (3,258 boe) per day of natural gas. Production for the Quarter was 249 percent higher than the 3,308 boe per day recorded in the same period in 2011. The increase in production as compared to the same period in 2011 is primarily due to the production additions from the Orion Oil and Gas Corporation ("Orion") acquisition on June 30, 2011 and the Viking asset acquisition in the fourth quarter of 2011, with the balance of production growth coming from the Company's successful 2011 and 2012 drilling program.

WestFire's production for the six months ended June 30, 2012 averaged 10,198 boe per day, and consisted of 5,553 bbls per day of light oil, 646 bbls per day of heavy oil, 1,013 bbls per day of natural gas liquids and 17,918 Mcf (2,986 boe) per day of natural gas. Production for the first half of 2012 was 235 percent higher than the 3,042 boe per day recorded in the same period in 2011. The increase in production as compared to the same period in 2011 is primarily due to the production additions from the Orion acquisition on June 30, 2011 and the Viking asset acquisition in the fourth quarter of 2011, with the balance of production growth coming from the Company's successful 2011 and 2012 drilling program.

**Price risk management**

The Company from time to time may enter into crude oil and natural gas financial contracts to manage the volatility of commodity prices. WestFire's policy is to hedge no more than 50 percent of budgeted net after royalty volumes using a combination of fixed swaps and price collars, under contract terms not exceeding 24 months with only investment grade counterparties.

The fair market value of the Company's risk management financial contracts and resulting gain (loss) are as follows:

| *($ thousands)* | **Three Months Ended June 30,** | | **Six Months Ended June 30,** | |
|---|---|---|---|---|
| | **2012** | 2011 | **2012** | 2011 |
| **Current asset (liability)** | **10,749** | (2,098) | **10,749** | (2,098) |
| **Non-current asset** | **3,586** | 185 | **3,586** | 185 |
| **Total asset (liability)** | **14,335** | (1,913) | **14,335** | (1,913) |
| **Unrealized gain** | **25,489** | 3,601 | **20,247** | 97 |
| **Realized gain (loss)** | **682** | (139) | **(533)** | 115 |
| **Gain on risk management contracts** | **26,171** | 3,462 | **19,714** | 212 |

The following table describes the contracts outstanding as at June 30, 2012;

| | **Volume** | **$/bbl or $/GJ** | **Term** | |
|---|---|---|---|---|
| **Type** | **(bbls/d)** | **(Cdn $)** | **From** | **To** |
| Costless Collar (WTI) | 200 | $95.00-$115.85 | January 2012 | December 2012 |
| Swap (WTI) | 200 | $90.60 | January 2012 | December 2012 |
| Swap (WTI) | 500 | $105.10 | April 2012 | December 2012 |
| Swap (WTI ) | 500 | $91.25 | July 2012 | December 2012 |
| Costless Collar (WTI) | 500 | $85.00-$95.05 | July 2012 | December 2012 |
| Swap (WTI ) | 500 | $92.75 | July 2012 | December 2012 |
| Costless Collar (WTI) | 100 | $85.00-$97.90 | July 2012 | December 2012 |
| Costless Collar (WTI) | 400 | $85.00-$99.15 | July 2012 | December 2012 |
| Swap (WTI) | 500 | $106.40 | July 2012 | December 2012 |
| Swap (WTI) | 500 | $105.10 | January 2013 | June 2013 |
| Costless Collar (WTI) | 400 | $85.00-$109.05 | January 2013 | September 2013 |
| Swap (WTI) | 600 | $97.05 | January 2013 | December 2013 |
| Swap (WTI) | 1,600 | $100.30 | January 2013 | December 2013 |

Absent the above-noted contracts, the effects of changes in commodity prices on net income for the six months ended June 30, 2012 are summarized in the following table:

| Commodity | Price Change | Net income change |
|---|---|---|
| Oil and NGL ($/bbl) | +/- $1.00 | $ 1,113 |
| Natural gas ($/Mcf) | +/- $0.10 | $ 326 |

**Petroleum and natural gas sales**

| *($ thousands)* | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| | **2012** | 2011 | **2012** | 2011 |
| **Sales** | | | | |
| **Light oil** | **47,826** | 15,135 | **86,677** | 22,537 |
| **Heavy oil** | **4,785** | 3,230 | **7,657** | 6,544 |
| **Natural gas liquids** | **7,594** | 613 | **14,622** | 1,208 |
| **Natural gas** | **3,445** | 2,399 | **6,845** | 4,773 |
| **Sulphur** | **375** | - | **1,710** | - |
| **Total** | **64,025** | 21,377 | **117,511** | 35,062 |

Light oil sales increased 216 percent in the Quarter compared to the same period in 2011. The increase reflects an increase in volumes of 283 percent which was offset slightly by a 17 percent decrease in oil prices during the Quarter compared to the same period in 2011. Light oil sales increased 285 percent for the first half of 2012 compared to the same period in 2011. The increase is a result of a 326 percent increase in volumes offset by a 10 percent decrease in oil prices for the period.

Heavy oil sales increased 48% during the Quarter compared to the same period in 2011. The increase reflects a 68 percent increase in volumes which was offset by a 12 percent decline in prices over the same period in 2011. Heavy oil sales increased 17 percent for the first half of 2012 compared to the same period in 2011 due to a 15 percent increase in volumes combined with a one percent price increase.

NGL sales increased 1,140 percent in the Quarter compared to the same period in 2011. The increase reflects a 1,137 percent increase in volumes. The NGL prices remained constant in the Quarter compared to the same quarter in 2011. NGL sales increased 1,111 percent for the first half of 2012 compared to the same period in 2011. The increase is a result of a 944 percent increase in volumes combined with a 15 percent increase in NGL prices for the period.

Natural gas sales increased 44 percent in the Quarter over the same period in 2011. The increase reflects a 206 percent increase in volumes which was offset by a 53 percent decline in prices during the same period. Natural gas sales increased 43 percent for the first half of 2012 compared to the same period in 2011. The increase can be attributed to a volume increase of 176 percent partially offset by a decrease in natural gas prices of 48 percent.

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| | **2012** | 2011 | **2012** | 2011 |
| **WestFire average prices** | | | | |
| **Light oil ($/bbl)** | **82.82** | 100.32 | **85.77** | 95.51 |
| **Heavy oil ($/bbl)** | **63.22** | 71.72 | **65.10** | 64.51 |
| **Natural gas liquids ($/bbl)** | **74.95** | 74.94 | **79.30** | 68.82 |
| **Natural gas ($/mcf)** | **1.94** | 4.12 | **2.10** | 4.07 |
| **Sulphur ($/tonne)** | **138.88** | - | **134.28** | - |
| | | | | |
| **Benchmark pricing** | | | | |
| **WTI (US$/bbl)** | **93.49** | 102.94 | **98.21** | 98.33 |
| **US$/Cdn$ foreign exchange rate** | **0.991** | 1.038 | **0.995** | 1.025 |
| **WTI (Cdn$/bbl)** | **94.32** | 99.20 | **98.68** | 95.97 |
| **Natural gas – AECO Daily index (Cdn $/gj)** | **1.74** | 3.54 | **2.06** | 3.56 |

**Commodity prices**

Prices realized in the Quarter were lower than those realized in the same period in 2011, with the exception of NGLs which was consistent with the price realized during the second quarter of 2011. Light oil prices decreased 17 percent, heavy oil prices decreased 12 percent, and natural gas prices decreased 53 percent in the Quarter compared to the same quarter in 2011.

Prices realized in the first half of 2012 were higher for heavy oil and NGLs than those realized in the same period in 2011. Both light oil and natural gas prices realized were lower for the first half of 2012 than the same period in 2011. Heavy oil prices increased by one percent and NGL prices increased by 15 percent, while the realized price for light oil decreased by 10 percent and natural gas decreased by 48 percent.

Crude Oil Markets
For the six months ended June 30, 2012, the price of West Texas Intermediate (''WTI'') averaged US$98.21 per bbl or 0.1 percent lower than the US$98.33 per bbl average recorded in the same period in 2011. WTI prices for the Quarter averaged US$93.49 per bbl, or 9.2% lower than the prior quarter average of US$102.94 per bbl and 8.8% lower than the US$102.56 per bbl recorded in the same period in 2011.

The decrease in WTI prices during the first half of 2012 has been compounded by a widening of the price differential for Edmonton Light Sweet. The differential between WTI and Edmonton Light Sweet ("MSW") widened from an average discount of US$0.17 per bbl in the first six months of 2011 to an average discount of US$10.31 per bbl in the same period of 2012. During the Quarter, the WTI/MSW differential discount averaged US$10.12/bbl compared to an average premium of US$4.35/bbl recorded in the same period in 2011. The increase in the differential discount has been attributed to reduced demand due to refinery turnarounds, warmer winter weather reducing demand, export pipeline capacity limitations and outages.

Natural Gas Markets
For the six months ended June 30, 2012, AECO monthly index gas prices averaged $2.06 per gigajoule ("GJ"), a 42 percent decline from the $3.56 per GJ recorded in the period of 2011. AECO gas prices for the Quarter averaged $1.74 per GJ, or 27 percent decline from the $2.39 per GJ recorded in the prior quarter and 51% lower than the $3.54 per GJ recorded in the same period in 2011.

The decrease in natural gas prices during the first half of 2012 has occurred due to significant natural gas production capacity additions in the U.S. over the past year, coupled with the negative impact on market demand from an unseasonably warm winter period. This has resulted in record high storage inventory levels in both the U.S. and Canada. Prices have rebounded somewhat since mid-June, as hot weather in the U.S. and coal-to-gas fuel switching has temporarily increased demand for gas to generate electricity to higher meet air conditioning needs, while U.S. gas production has flattened out due to a dramatic reduction in gas-directed drilling activity. As a result, the year-over-year gas storage inventory surplus has been steadily shrinking since spring.

**Crown and other royalties**

| | **Three Months Ended June 30,** | | **Six Months Ended June 30,** | |
|---|---|---|---|---|
| ***($ thousands)*** | **2012** | 2011 | **2012** | 2011 |
| **Crown** | **2,335** | 746 | **4,046** | 1,506 |
| **Freehold and overriding** | **3,479** | 831 | **6,647** | 1,461 |
| **Total Royalties** | **5,814** | 1,577 | **10,693** | 2,967 |
| **$ per boe** | **5.53** | 5.24 | **5.76** | 5.39 |
| **% of revenue** | **9.1%** | 7.4% | **9.1%** | 8.5% |

For the Quarter, total royalties increased 269 percent as compared to the same period in 2011. On a per boe basis, royalties increased six percent to $5.53 per boe compared to $5.24 in the second quarter of 2011. The increase in royalties is primarily attributed to higher royalty burdens on the Orion assets acquired in 2011.

Total royalties have increased 260 percent for the six months ended June 30, 2012 as compared to the same period in 2011. On a per boe basis, royalties increased seven percent to $5.76 per boe compared to $5.39 in the prior year. The increase in royalties is primarily attributed to higher royalty burdens on the Orion assets acquired in 2011.

**Operating expenses**

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| *($ thousands)* | **2012** | 2011 | **2012** | 2011 |
| **Total** | **16,128** | 4,181 | **28,895** | 8,529 |
| **$ per boe** | **15.35** | 13.89 | **15.57** | 15.49 |
| **% of revenue** | **25.2%** | 19.6% | **24.6%** | 24.3% |

Operating expenses for the Quarter increased 286 percent to $16,128 compared to $4,181 for the same period in 2011. On a per boe basis, operating expenses increased 11 percent to $15.35 compared to $13.89 for the second quarter of 2011. Operating expenses during the first half of 2012 increased 239 percent to $28,895 compared to $8,529 for the same period in 2011 while remaining consistent on a per boe basis. Operating expenses for the Quarter and year to date are higher than in the same periods in 2011 due primarily to startup costs of new on stream production. However, operating expenses on a per boe basis have declined six percent since the fourth quarter of 2011, benefiting from the addition of low cost production through the Company's drilling program in addition to continued cost efficiency measures that have been initiated over the first half of 2012.

**Transportation expenses**

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| *($ thousands)* | **2012** | 2011 | **2012** | 2011 |
| **Total** | **2,037** | 347 | **3,453** | 631 |
| **$ per boe** | **1.94** | 1.15 | **1.86** | 1.15 |
| **% of revenue** | **3.2%** | 1.8% | **2.9%** | 1.8% |

Transportation expenses increased 487 percent in the Quarter to $2,037 ($3,453 year to date) compared to $347 ($631 year to date 2011) in the same period in 2011. On a per boe basis, transportation expenses for the Quarter increased 68 percent to $1.94 from $1.15 in the same quarter in 2011, and year to date, increased 62 percent to $1.86 from $1.15 in 2011. Increased transportation expenses per boe for the Quarter and year to date over the same periods in 2011 are due to an increased oil volumes which are encumbered with higher average transportation rates related to infield trucking costs.

**Operating netbacks [1]**

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| *($ per boe)* | **2012** | 2011 | **2012** | 2011 |
| **Sales price** | **60.92** | 71.01 | **63.31** | 63.68 |
| **Realized derivative gains (loss)** | **0.65** | (0.46) | **(0.29)** | 0.21 |
| **Royalties** | **(5.53)** | (5.24) | **(5.76)** | (5.39) |
| **Operating expenses** | **(15.35)** | (13.89) | **(15.57)** | (15.49) |
| **Transportation expenses** | **(1.94)** | (1.15) | **(1.86)** | (1.15) |
| **Netbacks** | **38.75** | 50.27 | **39.83** | 41.86 |

[1] The reader is referred to the section - "Non-IFRS Measurements".

For the Quarter, operating netbacks have decreased by 23 percent over the same period in 2011 due to a decline in commodity prices and higher operating expenses, transportation expenses and royalties in the period.

Year to date, operating netbacks have decreased in 2012 by five percent over the same period in 2011 as a result of lower light oil prices and higher operating costs combined with increased royalties and current year losses on financial derivative contract settlements.

**General and administration ("G&A") expenses**

| ($ thousands) | Three Months Ended June 30, 2012 | 2011 | Six Months Ended June 30, 2012 | 2011 |
|---|---|---|---|---|
| **Salaries and benefits** | **4,210** | 826 | **7,906** | 2,061 |
| **Other G&A expenses** | **2,109** | 3,528 | **3,804** | 4,134 |
| **Gross G&A expenses** | **6,319** | 4,354 | **11,710** | 6,195 |
| **Capitalized G&A expenses** | **(1,045)** | (164) | **(2,087)** | (575) |
| **Overhead recoveries** | **(792)** | (395) | **(1,942)** | (795) |
| **Net G&A expenses** | **4,482** | 3,795 | **7,681** | 4,825 |
| **$ per boe** | **4.26** | 12.61 | **4.14** | 8.76 |

G&A expenses for the Quarter increased by 18 percent to $4,482 from $3,795 in the second quarter of 2011 while on a per boe basis, G&A decreased 66 percent to $4.26 compared to $12.61 in 2011 due to a substantial increase in production over the same period. For the first half of 2012, G&A expenses increased 59 percent to $7,681 compared to $4,825 for the same period in 2011 while on a per boe basis, G&A expenses declined 53 percent to $4.14 from $8.76 in 2011. Increased administrative costs in the Quarter and year to date are attributed to higher staffing levels commensurate with the growth of the Company over the period. As at June 30, 2012, WestFire employed 51 full-time office staff and 16 consultants, compared to 24 full-time office staff at the same time in 2011. However on a per boe basis, G&A expenses have declined as a direct result of increased production coupled with ongoing improvements to administrative efficiencies.

**Finance charges**

| ($ thousands) | Three Months Ended June 30, 2012 | 2011 | Six Months Ended June 30, 2012 | 2011 |
|---|---|---|---|---|
| **Interest expense** | **2,162** | 641 | **3,316** | 795 |
| **Accretion expense** | **381** | 166 | **711** | 315 |
| **Finance charges** | **2,543** | 807 | **4,027** | 1,110 |

As at June 30, 2012, the Company's net debt (comprised of bank debt and working capital deficit) totaled $175,493 compared to net debt of $58,204 at June 30, 2011. The average debt level for the six months ended June 30, 2012 was $152,825 compared to $27,334 for the same period in 2011. The increased debt levels in the three and six month periods ended June 30, 2012 account for the 238 percent and 318 percent increase respectively from interest expense during the comparative 2011 periods.

Accretion expense increased by 129 percent and 125 percent during the three and six months ended June 30, 2012 respectively as compared to the same periods in 2011 due to the additional abandonment liabilities incurred from the Company's 2011 and 2012 drilling program in addition to the acquired abandonment obligation from the Orion Acquisition.

**Share-based compensation**

| ($ thousands) | Three Months Ended June 30, 2012 | 2011 | Six Months Ended June 30, 2012 | 2011 |
|---|---|---|---|---|
| **Gross share-based compensation** | **1,316** | 463 | **2,527** | 1,312 |
| **Less: capitalized** | **(296)** | (34) | **(597)** | (183) |
| **Net share-based compensation** | **1,020** | 429 | **1,930** | 1,129 |

The Company's stock option plan provides for granting of options to directors, employees and consultants to a maximum of 10 percent of the total issued and outstanding voting common shares of the Company. These options have a term of five years to expiry and have a three year vesting period from the date of grant. In accordance with the Company's accounting policy, WestFire capitalizes share-based compensation expenses associated with exploration and development activities. No options were issued in the first half of 2012, 86,500 options were forfeited and none were exercised. As at June 30, 2012, there were 4,762,635 options outstanding compared to 3,110,635 options at June 30, 2011. For the Quarter, share-based compensation increased 185 percent over the same period in 2011. For the first half of 2012, the Company's share-based compensation increased 93 percent compared to the same period in 2011. Variances are due to an increase in the number of stock options outstanding and the related timing of the expense recognition.

The following tables summarize the stock option activity through to the end of June 30, 2012;

| | Number Of Options | Weighted Average Exercise Prices |
|---|---|---|
| **Balance, December 31, 2010** | 3,118,967 | $ 6.22 |
| **Granted** | 1,977,500 | 7.57 |
| **Forfeited** | (217,333) | 7.42 |
| **Exercised** | (29,999) | 6.60 |
| **Balance, December 31, 2011** | 4,849,135 | $ 6.70 |
| **Forfeited** | (86,500) | 7.67 |
| **Balance, June 30, 2012** | 4,762,635 | $ 6.69 |

**Depletion and depreciation**

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| ***($ thousands)*** | **2012** | 2011 | **2012** | 2011 |
| **Depletion** | **29,401** | 6,942 | **50,965** | 11,923 |
| **Depreciation** | **66** | 24 | **118** | 49 |
| **Total** | **29,467** | 6,966 | **51,083** | 11,972 |
| **$ per boe** | **28.04** | 23.14 | **27.52** | 21.74 |

Depletion and depreciation ("D&D") expense for the Quarter increased 324 percent to $29,467 from $6,966 in the second quarter of 2011. For the first half of 2012, D&D expense increased 327 percent to $51,083 compared to $11,972 in 2011. The increase in depletion expense was due to the increased scale of operations as a result of corporate and asset acquisitions, combined with the Company's 2012 drilling program. The increase in depreciation expense related to the Company's furniture and fixtures is a result of leasehold improvements incurred during 2011. On a boe basis, D&D expense for the Quarter increased 21 percent to $28.04 from $23.14 in the second quarter of 2011 and 27 percent in first half of 2012 to $27.52 from $21.74 for the same period in 2011.

**Impairment loss**

At June 30, 2012, the recoverable amount for the Company's Cost Generating Unit ("CGUs") were estimated at their fair value based on the net present value of the after tax cash flows from oil and gas proved plus probable reserves as estimated by the Company's third party reserves evaluators discounted at rates between eight and ten percent. At June 30, 2012, it was determined that the net book value of two CGUs exceeded their recoverable amount which has resulted in the recognition of a $16,116 (2011 – nil) impairment loss in the Quarter. The impairment loss was attributed to the Company's natural gas weighted CGUs, Kaybob South and Alberta gas. As the recoverable amount of the CGUs are sensitive to decreases in commodity prices, further impairment losses could be recorded in future periods. Alternatively, an improvement of commodity prices or other economic factors could reverse a previously recognized impairment charge, net of related depletion charges.

**Net earnings and comprehensive income**

Net earnings and comprehensive income for the three months ended June 30, 2012 was $17,506 ($0.21 per diluted share) compared to a net earnings and comprehensive income for the same period in 2011 of $4,387 ($0.10 per diluted share). Net earnings and comprehensive income for the six months ended June 30, 2012 was $18,685 ($0.22 per diluted share) compared to a net earnings and comprehensive earnings for the same period in 2011 of $2,518 ($0.06 per diluted share). Net earnings for both the three and six month periods ended June 30, 2012 was impacted by the significant routine non-cash charge relating to depletion and depreciation of $29,467 and $51,083 respectively ($6,966 and $11,972 in 2011), an unrealized gain recorded on the change in fair value of the Company's financial derivative contracts totaling $25,489 and $20,247 respectively ($3,601 and $97 in 2011), and a non-routine gain on a farmout agreement totaling $11,373 which was earned in the Quarter, offset by an impairment loss of $16,116.

**LIQUIDITY AND CAPITAL RESOURCES**

During the Quarter, the Company secured an increase in its banking facility to $250 million. The banking facility is led by the Alberta Treasury Branches and including Canadian Imperial Bank of Commerce, The Toronto-Dominion Bank, The Bank of Nova Scotia and Wells Fargo Bank N.A., London Branch and is comprised of a $240 million syndicated credit facility and a $10 million operating facility. Both are revolving facilities with term-out provisions with the initial revolving period ending June 27, 2013. If the credit facilities are not renewed they will convert to 365-day term loans. The credit facilities bear interest at the prime rate, bankers' acceptance rate or LIBOR plus a spread determined by WestFire's debt-to-EBITDA ratio. WestFire's next semi-annual borrowing base review is presently scheduled for October 31, 2012.

As at June 30, 2012 WestFire had a working capital deficit of $0.5 million and total net debt of $175.5 million compared to a working capital deficit of $0.8 million and total net debt of $124.8 million as at December 31, 2011 and was 72 percent drawn on the Company's bank facility with $71.2 million of remaining borrowing capacity.

In addition to debt and equity markets, the Company entered into a farmout agreement with an industry partner on WestFire lands in the west central area of Saskatchewan in the second quarter of 2011, whereby the partner committed to drill, complete and equip (or abandon) thirty horizontal wells, on or before December 31, 2012. The arrangement provided that the farmee would pay seventy-five percent of the costs of the wells to earn, and be entitled to, fifty percent of WestFire's pre-farmout working interest in the farmout lands. The Company received $5.0 million as initial consideration under this agreement, which was recorded as deferred compensation on the statement of financial position until such time as the farmee satisfied its obligations under the farmout arrangement. During the Quarter, the farmee satisfied its obligations and as such, the deferred compensation was recognized in the income statement along with a non-cash gain of $11,373 relating to the disposition of WestFire's 50 percent interest in the farmout lands. The farmout agreement also included the disposition by the Company of half of its interest in two producing wells in the same area as the farmout lands for proceeds of $1.25 million, resulting in a loss on disposition of oil and gas properties of $201 for the period ended December 31, 2011.

The Company's investing activities for the Quarter and year to date consisted of expenditures on its capital program. Management anticipates that the Company will continue to have adequate liquidity to fund budgeted capital investments through a combination of cash flow, equity and debt.

**CAPITAL INVESTMENT**

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| ***($ thousands)*** | **2012** | 2011 | **2012** | 2011 |
| **Land** | **1,675** | 984 | **7,180** | 1,550 |
| **Geological and geophysical** | **999** | 650 | **1,833** | 1,018 |
| **Drilling and completions** | **30,374** | 14,173 | **83,715** | 36,510 |
| **Equipment and facilities** | **12,003** | 4,714 | **21,662** | 8,855 |
| **Office equipment** | **30** | 22 | **117** | 149 |
| **Total investing activities in oil and gas** | **45,081** | 20,543 | **114,507** | 48,082 |
| **PP&E additions from farmout** | **6,574** | - | **6,574** | |
| **Corporate acquisitions** | **(201)** | 353,773 | **(201)** | 353,773 |
| **Capitalized share-based compensation** | **296** | 34 | **597** | 183 |
| **Capitalized non-cash deferred compensation** | **143** | - | **353** | - |
| **Additions to asset retirement obligations** | **6,675** | 5,386 | **6,386** | 5,037 |
| **Capital expenditures** | **58,568** | 379,736 | **128,216** | 407,075 |

For the first half of 2012, WestFire drilled a total of 82 (72.9 net) Viking horizontal oil wells; 47 (43.4 net) wells at Redwater, Alberta, 24 (24.0 net) at Plato, Saskatchewan and 11 (5.5 net) wells at Lucky Hills, Saskatchewan, all with 100 percent success.

WestFire's net capital expenditures were $45.0 million during the Quarter. Year to date, the Company has invested $114.5 million representing 74 percent of its budgeted annual capital program of $155 million. Year to date, a total of $101.4 million was invested into the development of the Viking with $65.5 million at Redwater, $31.3 million at Plato and $4.6 million Lucky Hills. Another $2.5 million was invested at Kaybob South, $5.7 million in non-core properties and $4.9 million into Crown land acquisitions at Plato.
Currently, WestFire is taking a pause from drilling to allow for the required annual maintenance and recertification of drilling rigs and will utilize this time to fine tune its capital program prior to re-commencing drilling activities in August.

**SUMMARY OF QUARTERLY RESULTS**

| | 2012 | | 2011 | | | | 2010 | |
|---|---|---|---|---|---|---|---|---|
| *($ thousands, except per share amounts)* | Q2 | Q1 | Q4 | Q3 | Q2 | Q1 | Q4 | Q3 |
| Petroleum and natural gas sales [(1)] | 64,025 | 53,486 | 56,192 | 51,568 | 21,377 | 13,685 | 13,367 | 9,957 |
| Net earnings (loss) [(1)] | 17,506 | 1,179 | (66,612) | 11,427 | 4,387 | (1,869) | (4,436) | (2,304) |
| Net earnings (loss) per share | | | | | | | | |
| – basic | 0.21 | 0.01 | (0.80) | 0.14 | 0.10 | (0.05) | (0.11) | (0.06) |
| – diluted | 0.21 | 0.01 | (0.80) | 0.14 | 0.10 | (0.05) | (0.11) | (0.06) |

(1) *Third quarter 2010* - For the third quarter of 2010, petroleum and natural gas sales increased from the second quarter of 2010 as a result of new production from drilling and acquisitions. The net loss was higher than the previous quarter due to increased depletion expense resulting from increased production and increased operating expenses as a result of the payment of property taxes paid to various municipalities in which WestFire operates during the third quarter of 2010.

*Fourth quarter 2010* - Revenues for the fourth quarter of 2010 were significantly higher than the third quarter due to higher crude oil and NGL prices combined with higher volumes. The higher net loss was due to an increase in the loss on risk management contracts combined with higher depletion expense resulting from increased production.

*First quarter 2011* - Revenues for the first quarter of 2011 were consistent with the fourth quarter of 2010. The lower net loss compared to third quarter of 2010 is due to the loss on risk management contracts and an increase in depletion and depreciation expense.

*Second quarter 2011* – Revenue in the second quarter of 2011 was higher than the first quarter of 2011 due to increased production from an active drilling program. The higher revenue in the quarter resulted in net earnings as compared to a net loss in the prior quarter.

*Third quarter 2011* – Revenues for the third quarter of 2011 increased over previous quarter due to acquisition of Orion and the addition of 5,146 boe per day of production. The increase in net earnings correlates with the increase in revenues for the same period.

*Fourth quarter 2011* – Revenue for the fourth quarter of 2011 increased from the previous quarter as a result of higher production and higher crude oil and NGL prices. The net loss for the fourth quarter 2011 was the result of an unrealized loss on the risk management contracts and an impairment loss of $73,633 relating to two of the Company's CGUs.

*First quarter 2012* - Revenue for the first quarter of 2012 was lower than the fourth quarter of 2011 as a result of an unscheduled shut-down of a third-party operated gas plant facility which resulted in the shut-in of approximately 2,650 boe of Kaybob production for 28 days.

*Second quarter 2012* – Revenue for the second quarter of 2012 increased from the previous quarter as a result of higher production volumes which were offset slightly by declining prices. The net earnings for the Quarter include a $26,171 gain on risk management contracts, $11,373 gain from farmout agreement and an impairment loss of $16,116.

**DISCLOSURE CONTROLS AND PROCEDURES**

The Chief Executive Officer ("CEO") and the Chief Financial Officer ("CFO") have designed, or caused to be designed under their supervision, disclosure controls and procedures ("DC&P) and internal controls over financial reporting ("ICOFR") as defined in National Instrument 52-109 Certification of Disclosure in Issuer's Annual and Interim Filings in order to provide reasonable assurance regarding the reliability of financial reporting and the preparation of the financial statements for external purposes in accordance with IFRS.

The DC&P have been designed to provide reasonable assurance that material information relating to WestFire is made known to the CEO and CFO by others and that information required to be disclosed by the Company in its annual filings, interim filings or other reports filed or submitted by WestFire under securities legislation is recorded, processed, summarized and reported within the time periods specified in securities legislation. The Company's CEO and CFO have concluded, based on their evaluation as of the end of the period covered by the interim filings that the Company's disclosure controls and procedures are effective to provide reasonable assurance that material information related to the issuer, is made known to them by others within the Company.

The CEO and CFO are required to cause the Company to disclose any change in the Company's ICOFR that occurred during the most recent interim period that has materially affected, or is reasonably likely to materially affect, the Company's ICOFR. No changes in ICOFR were identified during such period that have materially affected or are reasonably likely to materially affect, the Company's ICOFR.

It should be noted a control system, including the Company's DC&P and ICOFR, no matter how well conceived or operated, can provide only reasonable, not absolute, assurance that the objective of the control system will be met and it should not be expected that DC&P and ICOFR will prevent all errors or fraud.

**OUTLOOK**

The Company remains on target to exceed its annual 2012 average production guidance of 9,750 boepd through the continued execution of its $155 million capital budget. The budget is expected to generate average production of 9,750 boe per day, which represents a per share production growth of approximately 30 percent over 2011. WestFire's 2012 production mix is targeted to be 71 percent crude oil and liquids and 29 percent natural gas. Based on current strip commodity prices and exchange rates, the Company's capital program is expected to be funded from funds flow from operations, thereby allowing WestFire to maintain its prudent financial strategy and sound balance sheet.

**ADDITIONAL INFORMATION**

Additional information regarding the Company and its business and operations, including the annual information form ("AIF") is available on the Company's profile at www.sedar.com. Copies of the AIF can also be obtained by contacting the Company at WestFire Energy Ltd. 1400, 440 – 2nd Avenue S.W., Calgary, Alberta, Canada T2P 5E9 or by e-mail at jholmgren@westfireenergy.com. This information is also accessible on the Company's web site at www.westfireenergy.com.

## LEGAL ADVISORIES

***Oil, Natural Gas Liquids ("NGL's), and Natural Gas - Conversions to Boe's***

*The calculation of barrels of oil equivalent ("boe") is based on a conversion ratio of six thousand cubic feet of natural gas to one barrel of oil to estimate relative energy content and does not represent a value equivalency at the wellhead. Boe's may be misleading, particularly if used in isolation.*

***Non-IFRS measurements***

*Readers are cautioned that this MD&A contains the term funds flow from operations which should not be considered an alternative to, or more meaningful than, cash provided by operating activities or net earnings as determined in accordance with IFRS as an indicator of WestFire's performance. The reconciliation between funds flow from operations and cash provided by operating activities is as follows:*

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| ***($ thousands)*** | **2012** | 2011 | **2012** | 2011 |
| *Cash provided by operating activities* | **27,941** | 4,242 | **61,294** | 10,788 |
| *Change in non-cash working capital* | **6,444** | 6,399 | **2,472** | 6,534 |
| *Funds flow from operations* | **34,385** | 10,641 | **63,766** | 17,322 |

*WestFire also presents funds flow from operations per share, whereby funds flow from operations is divided by the weighted average number of shares outstanding to determine per share amounts. Netbacks are also presented, which represents WestFire's revenue per boe, less per boe royalties, operating expenses and transportation expenses, in order to determine the amount of funds generated by each boe produced. WestFire calculates net debt as current liabilities less current assets, excluding the current portion of future tax assets.*

***Forward-looking statements***

*In the interest of providing WestFire shareholders and potential investors with information regarding the Company, including management's assessment of WestFire's future plans and operations, certain statements contained in this MD&A constitute forward-looking statements or information (collectively referred to herein as "forward-looking statements") within the meaning of the "safe harbor" provisions of applicable securities legislation. Forward-looking statements are typically identified by words such as "anticipate", "believe", "expect", "plan", "intend", "forecast", "target", "project" or similar words suggesting future outcomes or statements regarding an outlook.*

*Readers are cautioned not to place undue reliance on forward-looking statements, as there can be no assurance that the plans, intentions or expectations upon which they are based will occur. By their nature, forward-looking statements involve numerous assumptions, known and unknown risks and uncertainties, both general and specific, that contribute to the possibility that the predictions, forecasts, projections and other forward-looking statements will not occur, which may cause WestFire's actual performance and financial results in future periods to differ materially from any estimates or projections of future performance or results expressed or implied by such forward-looking statements.*

*These risks and uncertainties include, among other things: volatility of and assumptions regarding oil and gas prices; fluctuations in currency and interest rates; product supply and demand; market competition; risks inherent in WestFire's marketing operations, including credit risks; imprecision of reserve estimates and estimates of recoverable quantities of oil, natural gas and liquids; WestFire's ability to replace and expand oil and gas reserves; risks associated with technology; its ability to generate sufficient cash from operations to meet its current and future obligations; WestFire's ability to access external sources of debt and equity capital; the timing and the costs of well and pipeline construction; WestFire's ability to secure adequate product transportation; changes in environmental and other regulations or the interpretations of such regulations; political and economic conditions; terrorist threats; risks associated with potential future lawsuits and regulatory actions made against WestFire; WestFire's ability to utilize all of its tax pools and investment tax credits; other risks and uncertainties described from time to time in the reports and filings made with securities regulatory authorities by WestFire disclosure intentions with respect to strategic alternative review process and; the outcome of the Company's strategic alternatives process.*

*Statements relating to "reserves" are deemed to be forward-looking statements, as they involve the implied assessment, based on certain estimates and assumptions that the resources and reserves described exist in the quantities predicted or estimated, and can be profitably produced in the future. Although WestFire believes that the expectations represented by such forward-looking statements are reasonable, there can be no assurance that such expectations will prove to be correct. Readers are cautioned that the foregoing list of important factors is not exhaustive. Furthermore, the forward-looking statements contained in this MD&A are made as of the date of this MD&A, and WestFire 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 required by law. The forward-looking statements contained in this MD&A are expressly qualified by this cautionary statement.*