



**VERMILION ENERGY INC.**

**2012 AUDITED ANNUAL FINANCIAL STATEMENTS**

**FOR THE YEAR ENDED DECEMBER 31, 2012**

## MANAGEMENT'S REPORT TO SHAREHOLDERS

### Management's Responsibility for Financial Statements

The accompanying consolidated financial statements of Vermilion Energy Inc. are the responsibility of management and have been approved by the Board of Directors of Vermilion Energy Inc. The consolidated financial statements have been prepared in accordance with the accounting policies detailed in the notes to the consolidated financial statements and are prepared in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board. Where necessary, management has made informed judgements and estimates of transactions that were not yet completed at the balance sheet date. Financial information throughout the Annual Report is consistent with the consolidated financial statements.

Management ensures the integrity of the consolidated financial statements by maintaining high-quality systems of internal control. Procedures and policies are designed to provide reasonable assurance that assets are safeguarded and transactions are properly recorded, and that the financial records are reliable for preparation of the consolidated financial statements. Deloitte LLP, Vermilion's external auditors, have conducted an audit of the consolidated financial statements in accordance with Canadian generally accepted auditing standards and the standards of the Public Company Accounting Oversight Board (United States) and have provided their report.

The Board of Directors is responsible for ensuring that management fulfills its responsibility for financial reporting and internal control. The Board carries out this responsibility principally through the Audit Committee, which is appointed by the Board and is comprised entirely of independent Directors. The Committee meets periodically with management and Deloitte LLP to satisfy itself that each party is properly discharging its responsibilities and to review the consolidated financial statements, the Management's Discussion and Analysis and the external Auditor's Report before they are presented to the Board of Directors.

### Management's Report on Internal Control Over Financial Reporting

Management is responsible for establishing and maintaining an adequate system of internal control over financial reporting. Management conducted an evaluation of the effectiveness of the system of internal control over financial reporting based on the criteria established in "Internal Control – Integrated Framework" issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this evaluation, management has assessed the effectiveness of Vermilion's internal control over financial reporting as defined in Rule 13a-15 under the US Securities Exchange Act of 1934 and as defined in Canada by National Instrument 52-109, Certification of Disclosure in Issuers' Annual and Interim Filings. Management concluded that Vermilion's internal control over financial reporting was effective as of December 31, 2012. The effectiveness of Vermilion's internal control over financial reporting as of December 31, 2012 has been audited by Deloitte LLP, the Company's Independent Registered Chartered Accountants, who also audited the Company's consolidated financial statements for the year ended December 31, 2012.

*(Signed "Lorenzo Donadeo")*

Lorenzo Donadeo  
President & Chief Executive Officer

February 28, 2013

*(Signed "Curtis W. Hicks")*

Curtis W. Hicks  
Executive Vice President & Chief Financial Officer

**REPORT OF INDEPENDENT REGISTERED CHARTERED ACCOUNTANTS**

To the Board of Directors and Shareholders of Vermilion Energy Inc.

We have audited the accompanying consolidated financial statements of Vermilion Energy Inc. and subsidiaries (the "Company"), which comprise the consolidated balance sheets as at December 31, 2012 and 2011, and the consolidated statements of net earnings and comprehensive income, consolidated statements of changes in shareholders' equity and consolidated statements of cash flows for the years then ended, and notes to the consolidated financial statements.

*Management's Responsibility for the Consolidated Financial Statements*

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

*Auditor's Responsibility*

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards and the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

*Opinion*

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Vermilion Energy Inc. and subsidiaries as at December 31, 2012 and 2011, and their financial performance and their cash flows for the years then ended in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board.

*Other Matter*

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company's internal control over financial reporting as of December 31, 2012, based on the criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 28, 2013 expressed an unqualified opinion on the Company's internal control over financial reporting.

*(Signed "Deloitte LLP")*

Independent Registered Chartered Accountants

February 28, 2013  
Calgary, Canada

**REPORT OF INDEPENDENT REGISTERED CHARTERED ACCOUNTANTS**

To the Shareholders and Board of Directors of Vermilion Energy Inc.

We have audited the internal control over financial reporting of Vermilion Energy Inc. and subsidiaries (the "Company") as of December 31, 2012, based on the criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed by, or under the supervision of, the company's principal executive and principal financial officers, or persons performing similar functions, and effected by the company's board of directors, management, and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with International Financial Reporting Standards. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with International Financial Reporting Standards, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2012, based on the criteria established in Internal Control — Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We have also audited, in accordance with Canadian generally accepted auditing standards and the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements as of and for the year ended December 31, 2012 of the Company and our report dated February 28, 2013 expressed an unqualified opinion on those financial statements.

*(Signed "Deloitte LLP")*

Independent Registered Chartered Accountants

February 28, 2013  
Calgary, Canada

**CONSOLIDATED BALANCE SHEETS**  
 (THOUSANDS OF CANADIAN DOLLARS)

	Note	December 31, 2012	December 31, 2011
<b>ASSETS</b>			
<b>Current</b>			
Cash and cash equivalents	18	102,125	234,507
Accounts receivable		180,064	176,820
Crude oil inventory		25,719	13,885
Derivative instruments	14	2,086	186
Prepaid expenses		10,508	10,261
		<b>320,502</b>	<b>435,659</b>
Deferred taxes	10	193,354	175,545
Exploration and evaluation assets	6	117,161	92,301
Capital assets	5	2,445,240	2,031,682
		<b>3,076,257</b>	<b>2,735,187</b>
<b>LIABILITIES</b>			
<b>Current</b>			
Accounts payable and accrued liabilities		300,682	297,756
Dividends payable	11	18,836	18,322
Derivative instruments	14	8,484	11,568
Income taxes payable		27,709	36,407
Amount due pursuant to acquisition	8	-	127,131
		<b>355,711</b>	<b>491,184</b>
Derivative instruments	14	-	767
Long-term debt	9	642,022	373,436
Asset retirement obligations	7	371,063	310,531
Deferred taxes	10	288,815	227,668
		<b>1,657,611</b>	<b>1,403,586</b>
<b>SHAREHOLDERS' EQUITY</b>			
Shareholders' capital	11	1,481,345	1,368,145
Contributed surplus		69,581	56,468
Accumulated other comprehensive loss		(32,409)	(33,387)
Deficit		(99,871)	(59,625)
		<b>1,418,646</b>	<b>1,331,601</b>
		<b>3,076,257</b>	<b>2,735,187</b>

**APPROVED BY THE BOARD***(Signed "Kenneth Davidson")*

W. Kenneth Davidson, Director

*(Signed "Lorenzo Donadeo")*

Lorenzo Donadeo, Director

**CONSOLIDATED STATEMENTS OF NET EARNINGS AND COMPREHENSIVE INCOME**  
(THOUSANDS OF CANADIAN DOLLARS, EXCEPT SHARE AND PER SHARE AMOUNTS)

	Note	Year Ended	
		December 31, 2012	December 31, 2011
<b>REVENUE</b>			
Petroleum and natural gas sales		1,083,103	1,031,570
Royalties		(52,084)	(54,235)
<b>Petroleum and natural gas revenue</b>		<b>1,031,019</b>	<b>977,335</b>
<b>EXPENSES</b>			
Operating	22	178,442	162,384
Transportation		24,113	25,539
Equity based compensation	12	47,104	38,667
Loss on derivative instruments	14	6,986	31,340
Interest expense		27,586	24,967
General and administration	22	43,773	44,583
Foreign exchange loss		1,546	9,998
Other expense	4	8,751	1,155
Accretion	7	23,040	21,889
Depletion and depreciation	5, 6	295,943	236,708
Impairments	5	65,800	64,400
Gain on acquisition	4	(45,309)	-
		<b>677,775</b>	<b>661,630</b>
<b>EARNINGS BEFORE INCOME TAXES</b>		<b>353,244</b>	<b>315,705</b>
<b>INCOME TAXES</b>			
Deferred	10	(19,291)	(46,210)
Current		181,913	219,094
		<b>162,622</b>	<b>172,884</b>
<b>NET EARNINGS</b>		<b>190,622</b>	<b>142,821</b>
<b>OTHER COMPREHENSIVE INCOME (LOSS)</b>			
Currency translation adjustments		978	(1,810)
<b>COMPREHENSIVE INCOME</b>		<b>191,600</b>	<b>141,011</b>
<b>NET EARNINGS PER SHARE</b>			
Basic	13	1.94	1.57
Diluted		1.92	1.55
<b>WEIGHTED AVERAGE SHARES OUTSTANDING ('000s)</b>			
Basic	13	98,016	90,878
Diluted		99,294	92,272

**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
 (THOUSANDS OF CANADIAN DOLLARS)

	Note	Year Ended	
		December 31, 2012	December 31, 2011
<b>OPERATING</b>			
Net earnings		190,622	142,821
Adjustments:			
Accretion	7	23,040	21,889
Depletion and depreciation	5, 6	295,943	236,708
Impairments	5	65,800	64,400
Gain on acquisition	4	(45,309)	-
Unrealized (gain) loss on derivative instruments	14	(5,751)	3,040
Equity based compensation	12	47,104	38,667
Unrealized foreign exchange loss		4,350	11,022
Unrealized other expense		1,220	1,999
Deferred taxes	10	(19,291)	(46,210)
Asset retirement obligations settled	7	(13,739)	(23,071)
Changes in non-cash operating working capital	15	(47,409)	(4,173)
Cash flows from operating activities		496,580	447,092
<b>INVESTING</b>			
Drilling and development	5	(413,221)	(411,227)
Exploration and evaluation	6	(39,317)	(79,553)
Property acquisitions	4	(106,184)	(50,878)
Corporate acquisitions, net of cash acquired	4	(63,482)	-
Payment of amount due pursuant to acquisition	8	(134,307)	-
Changes in non-cash investing working capital	15	16,588	(6,068)
Cash flows used in investing activities		(739,923)	(547,726)
<b>FINANCING</b>			
Increase (decrease) in long-term debt	9	265,395	(150,001)
Issuance of senior unsecured notes	9	-	220,561
Issuance of shares pursuant to the dividend reinvestment plan	11	36,339	59,081
Cash dividends	11	(187,484)	(206,434)
Issuance of shares	11	-	252,004
Cash flows from financing activities		114,250	175,211
Foreign exchange loss on cash held in foreign currencies		(3,289)	(825)
Net change in cash and cash equivalents		(132,382)	73,752
Cash and cash equivalents, beginning of year		234,507	160,755
Cash and cash equivalents, end of year	18	102,125	234,507
Supplementary information for operating activities - cash payments			
Interest paid		30,792	18,907
Income taxes paid		190,611	242,249

**CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY**  
 (THOUSANDS OF CANADIAN DOLLARS)

		Shareholders'	Contributed	Accumulated Other Comprehensive	Retained	Total
	Note	Capital	Surplus	Loss	Earnings (Deficit)	Shareholders' Equity
Balances as at January 1, 2011		1,025,770	40,726	(31,577)	10,983	1,045,902
Net earnings		-	-	-	142,821	142,821
Currency translation adjustments		-	-	(1,810)	-	(1,810)
Equity based compensation expense		-	37,881	-	-	37,881
Dividends declared	11	-	-	-	(207,846)	(207,846)
Issuance of shares, net of deferred taxes	11	254,786	-	-	-	254,786
Issuance of shares pursuant to the dividend reinvestment plan	11	59,081	-	-	-	59,081
Vesting of equity based awards	11, 12	22,139	(22,139)	-	-	-
Share-settled dividends on vested equity based awards	11, 12	5,583	-	-	(5,583)	-
Shares issued for bonus plan	11	786	-	-	-	786
Balances as at December 31, 2011		1,368,145	56,468	(33,387)	(59,625)	1,331,601

		Shareholders'	Contributed	Accumulated Other Comprehensive	Deficit	Total
	Note	Capital	Surplus	Loss		Shareholders' Equity
Balances as at January 1, 2012		1,368,145	56,468	(33,387)	(59,625)	1,331,601
Net earnings		-	-	-	190,622	190,622
Currency translation adjustments		-	-	978	-	978
Equity based compensation expense		-	46,468	-	-	46,468
Dividends declared	11	-	-	-	(223,717)	(223,717)
Issuance of shares pursuant to the dividend reinvestment plan	11	72,058	-	-	-	72,058
Vesting of equity based awards	11, 12	33,355	(33,355)	-	-	-
Share-settled dividends on vested equity based awards	11, 12	7,151	-	-	(7,151)	-
Shares issued for bonus plan	11	636	-	-	-	636
Balances as at December 31, 2012		1,481,345	69,581	(32,409)	(99,871)	1,418,646

**DESCRIPTION OF EQUITY RESERVES**
**Shareholders' capital**

Represents the recognized amount for common shares when issued, net of equity issuance costs and deferred taxes.

**Contributed surplus**

Represents the recognized value of employee awards which are settled in shares. Once vested, the value of the awards is transferred to shareholders' capital.

**Accumulated other comprehensive loss**

Represents the cumulative income and expenses which are not recorded immediately in net earnings and are accumulated until an event triggers recognition in net earnings. The current balance consists of currency translation adjustments resulting from translating financial statements of subsidiaries with a foreign functional currency to Canadian dollars at period end rates.

**Retained earnings (deficit)**

Represents the cumulative net earnings less distributed earnings of Vermilion Energy Inc.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS  
FOR THE YEAR ENDED DECEMBER 31, 2012 AND 2011  
(TABULAR AMOUNTS IN THOUSANDS OF CANADIAN DOLLARS, EXCEPT SHARE AND PER SHARE AMOUNTS)**

**1. BASIS OF PRESENTATION**

Vermilion Energy Inc. (the "Company" or "Vermilion") is a corporation governed by the laws of the Province of Alberta and is actively engaged in the business of crude oil and natural gas exploration, development, acquisition and production.

These consolidated financial statements were approved and authorized for issuance by the Board of Directors of Vermilion on February 28, 2013.

**2. SIGNIFICANT ACCOUNTING POLICIES**

***Accounting Framework***

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB").

***Principles of Consolidation***

Subsidiaries that are directly controlled by the parent company or indirectly controlled by other consolidated subsidiaries are fully consolidated. Vermilion accounts for jointly controlled operations and jointly controlled assets by recognizing its share of assets, liabilities, income and expenses. All significant intercompany balances, transactions, income and expenses are eliminated upon consolidation.

Vermilion currently has no special purpose entities of which it retains control and accordingly the consolidated financial statements do not include the accounts of any such entities.

***Exploration and Evaluation Assets***

Vermilion accounts for exploration and evaluation of petroleum and natural gas property ("E&E") costs in accordance with IFRS 6 "Exploration for and Evaluation of Mineral Resources". Costs incurred are classified as E&E costs when they relate to exploring and evaluating a property for which the Company has the licence or right to explore and extract resources.

E&E costs related to each license or prospect area are initially capitalized within E&E assets. E&E costs that are capitalized may include costs of licence acquisitions, technical services and studies, seismic acquisitions, exploration drilling and testing, directly attributable overhead and administration expenses and, if applicable, the estimated costs of retiring the assets. Any costs incurred prior to the acquisition of the legal rights to explore an area are expensed as incurred.

E&E assets are not depleted and are carried at cost until technical feasibility and commercial viability of the area can be determined. The technical feasibility and commercial viability of extracting the reserves is considered to be determinable when proven and probable reserves are identified. If proven and probable reserves are identified as recoverable, the related E&E costs are reclassified to Petroleum and Natural Gas ("PNG") assets pending an impairment test. If reserves are not found within the license area or the area is abandoned, the related E&E costs are amortized over a period not greater than five years.

***Petroleum and Natural Gas Assets***

Vermilion recognizes PNG assets at cost less accumulated depletion, depreciation and impairment losses. Directly attributable costs incurred for the drilling of development wells and for the construction of production facilities are capitalized together with the discounted value of estimated future costs of asset retirement obligations. When components of PNG assets are replaced, disposed of, or no longer in use, they are derecognized.

Gains and losses on disposal of a component of PNG assets, including oil and gas interests, are determined by comparing the proceeds of disposal with the carrying amount of the component, and are recognized in net earnings.

***Depletion and Depreciation***

Vermilion classifies its assets into PNG depletion units, which are groups of assets or properties that are within a specific production area and have similar economic lives. The PNG depletion units represent the lowest level of disaggregation for which Vermilion accumulates costs for the purposes of calculating and recording depletion and depreciation.

The net carrying value of each PNG depletion unit is depleted using the unit of production method by reference to the ratio of production in the period to the total proven and probable reserves, taking into account the future development costs necessary to bring the applicable reserves into production. The reserve estimates are reviewed annually by management or when material changes occur to the underlying assumptions.

## 2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

For the purposes of the depletion calculations, oil and gas reserves are converted to a common unit of measure on the basis of their relative energy content based on a conversion ratio of six thousand cubic feet of natural gas to one barrel of oil equivalent.

Furniture and office equipment are recorded at cost and are depreciated on a declining-balance basis at rates ranging from 5% to 25% per year.

### **Impairment of Long-Lived Assets**

E&E assets are tested for impairment when reclassified to PNG assets or when indicators of impairment are identified. If indicators of impairment are identified, E&E assets are tested for impairment as part of the group of Cash Generating Units ("CGU's") attributable to the jurisdiction in which the exploration area resides.

PNG depletion units are aggregated into CGUs for impairment testing. The determination of CGU's is based on managements' judgement and represents the lowest level at which there are identifiable cash inflows that are largely independent of the cash inflows of other groups of assets or properties. CGUs are reviewed for indicators that the carrying value of the CGU may exceed its recoverable amount. If an indication of impairment exists, the CGU's recoverable amount is then estimated. A CGU's recoverable amount is defined as the higher of the fair value less costs to sell and its value in use. If the carrying amount exceeds its recoverable amount, an impairment loss is recorded to net earnings in the period to reduce the carrying value of the CGU to its recoverable amount.

For PNG assets and E&E assets, when there has been an impairment loss recognized, at each reporting date an assessment is performed as to whether the circumstances which led to the impairment loss have reversed. If the change in circumstances leads to the recoverable amount being higher than the carrying value after recognition of an impairment, that impairment loss is reversed, with such reversal not to exceed the depreciated value of the asset had no impairment loss been previously recognized.

### **Cash and Cash Equivalents**

Cash and cash equivalents include monies on deposit and short-term investments, which are comprised primarily of guaranteed investment certificates.

### **Crude Oil Inventory**

Inventories of crude oil, consisting of production for which title has not yet transferred to the buyer, are valued at the lower of cost or net realizable value. Cost is determined on a weighted-average basis and includes related operating expenses, royalties, and depletion.

### **Provisions and Asset Retirement Obligations**

Vermilion recognizes a provision or asset retirement obligation in the consolidated financial statements when an event gives rise to an obligation of uncertain timing or amount.

The estimated present value of the asset retirement obligation is recorded as a long term liability, with a corresponding increase in the carrying amount of the related asset. This increase is depleted with the related depletion unit and is allocated to a CGU for impairment testing. The liability recorded is increased each reporting period due to the passage of time and this change is charged to net earnings in the period as accretion expense. The asset retirement obligation can also increase or decrease due to changes in the estimated timing of cash flows, changes in the discount rate and/or changes in the original estimated undiscounted costs. Increases or decreases in the obligation will result in a corresponding change in the carrying amount of the related asset. Actual costs incurred upon settlement of the asset retirement obligation are charged against the asset retirement obligation to the extent of the liability recorded. Vermilion discounts the costs related to asset retirement obligations using the discount rate that reflects current market assessment of time value of money and risks specific to the liabilities that have not been reflected in the cash flow estimates. Vermilion applies discount rates applicable to each of the jurisdictions in which it has future asset retirement obligations. Asset retirement obligations are remeasured at each reporting period in order to reflect the discount rates in effect at that time.

A provision for onerous contracts is recognized when the expected benefits to be derived by Vermilion from a contract are lower than the unavoidable cost of meeting its obligations under the contract. The provision is measured at the lower of the expected cost of terminating the contract and the present value of the expected net cost of the remaining term of the contract. Before a provision is established, Vermilion first recognizes any impairment loss on assets associated with the onerous contract. For the periods presented in the consolidated financial statements there were no onerous contracts recognized.

### **Revenue Recognition**

Revenues associated with the sale of crude oil, natural gas and natural gas liquids are recorded when title passes to the customer. For the majority of Canadian oil and natural gas production, legal title transfers upon delivery to major pipelines. In Australia, oil is sold at the Wandoo B Platform. In the Netherlands, natural gas is sold at the plant gate. In France, oil is sold either when delivered to the refinery by pipeline or when delivered to the refinery via tanker.

## 2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

### **Financial Instruments**

Cash and cash equivalents are classified as held for trading and are measured at fair value. A gain or loss arising from a change in the fair value is recognized in net earnings in the period in which it occurs.

Accounts receivable are classified as loans and receivables and are initially measured at fair value and are then subsequently measured at amortized cost. The carrying value of accounts receivable approximates the fair value due to the short-term nature of these instruments.

Accounts payable and accrued liabilities, dividends payable, long-term debt and amount due pursuant to acquisition have been classified as other financial liabilities and are initially recognized at fair value and are subsequently measured at amortized cost. Transaction costs and discounts are recorded against the fair value of long-term debt on initial recognition.

All derivative instruments have been classified as held for trading and are measured at fair value. A gain or loss arising from a change in the fair value is recognized in net earnings in the period in which it occurs.

### **Equity Based Compensation**

Vermilion has long-term equity based compensation plans for directors, officers and employees of Vermilion and its subsidiaries. Equity based compensation expense is recognized in net earnings over the vesting period of the awards with a corresponding adjustment to contributed surplus. Upon vesting, the amount previously recognized in contributed surplus is reclassified to shareholders' capital.

The expense recognized is based on the grant date fair value of the awards and incorporates an estimate of the forfeiture rate based on historical vesting data. The grant date fair value of the awards is determined as the grant date closing price of Vermilion's common shares on the Toronto Stock Exchange, adjusted by the Company's estimate of the performance factor that will ultimately be achieved.

### **Per Share Amounts**

Net earnings per share is calculated using the weighted-average number of shares outstanding during the period. Diluted net earnings per share is calculated using the diluted weighted-average number of shares outstanding during the period. The diluted weighted-average number of shares is determined by considering whether equity based compensation plans, if converted during the year, would result in reduced net earnings per share.

The treasury stock method is used to determine the dilutive effect of equity based compensation plans. The treasury stock method assumes that the deemed proceeds related to unrecognized equity based compensation expense are used to repurchase shares at the average market price during the period. Equity based awards outstanding are included in the calculation of diluted net earnings per share based on estimated performance factors.

### **Foreign Currency Translation**

The consolidated financial statements are presented in Canadian dollars, which is Vermilion's reporting currency. As several of Vermilion's subsidiaries transact and operate primarily in countries other than Canada, they accordingly have functional currencies other than the Canadian dollar.

Transactions denominated in currencies other than the functional currency of the subsidiary are translated to the functional currency at the prevailing rates on the date of the transaction. Non-monetary assets or liabilities that result from such transactions are held at the prevailing rate on the date of the transaction. Monetary items denominated in non-functional currencies are translated to the functional currency of the subsidiary at the prevailing rate at the balance sheet date. All translations associated with currencies other than the respective functional currencies are recorded in net earnings.

Translation of all assets and liabilities from the respective functional currencies to the reporting currency are performed using the rates prevailing at the balance sheet date. The differences arising upon translation from the functional currency to the reporting currency are recorded as currency translation adjustments in other comprehensive loss and are held within accumulated other comprehensive loss until a disposal or partial disposal of a subsidiary. A disposal or partial disposal may give rise to a realized gain or loss, which is recorded in net earnings.

Within the consolidated group there are outstanding intercompany loans which in substance represent investments in certain subsidiaries. When these loans are identified as part of the net investment in a foreign subsidiary, any exchange differences arising on those loans are recorded to currency translation adjustments within other comprehensive loss until the disposal or partial disposal of the subsidiary.

## 2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

### **Income Taxes**

Deferred taxes are calculated using the liability method of accounting. Under this method, deferred tax is recognized for the estimated effect of any temporary differences between the amounts recognized on Vermilion's consolidated balance sheets and respective tax basis. This calculation uses enacted or substantively enacted tax rates that will be in effect when the temporary differences are expected to reverse. The effect of a change in tax rates on deferred taxes is recognized in net earnings in the period in which the related legislation is substantively enacted.

Vermilion is subject to current income taxes based on the tax legislation of each respective country in which Vermilion has operations.

### **Borrowing Costs**

Borrowing costs that are directly attributable to the acquisition or construction of an asset that necessarily takes a substantial period of time to prepare for its intended use are capitalized as part of the cost of that asset. Borrowing costs are capitalized by applying interest rates attributable to the project being financed and could include both general and/or specific borrowings. Interest rates applied from general borrowings are computed using the weighted average borrowing rate for the period.

### **Measurement Uncertainty**

The preparation of the consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities; disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses for the periods presented.

Key areas where management has made complex or subjective judgements include asset retirement obligations, assessment of impairment of long-lived assets and income taxes. Actual results could differ significantly from these and other estimates.

### **Asset Retirement Obligations**

Vermilion's asset retirement obligations are based on environmental regulations and estimates of future costs and the timing of expenditures. Changes in environmental regulations, the estimated costs associated with reclamation activities, the discount rate applied and the timing of expenditures could materially impact Vermilion's measurement of the obligations and, correspondingly, impact Vermilion's financial position and net earnings.

### **Assessment of Impairments**

Impairment tests are performed at a CGU level. CGUs are determined based on management's judgment of the lowest level at which there is identifiable cash inflows that are largely independent of the cash inflows of other groups of assets or properties. The factors used by Vermilion to determine CGUs may vary by country due to the unique operating and geographical circumstances in each country. However, in general, Vermilion will assess the following factors in determining whether a group of assets generate largely independent cash inflows: geographical proximity of the assets within a group to one another, geographical proximity of the group of assets to other groups of assets, homogeneity of the production from the group of assets and the sharing of infrastructure used to process and/or transport production.

The calculation of the recoverable amount of the CGUs is based on market factors, estimates of PNG reserves and future costs required to develop reserves. Vermilion's reserve estimates and the related future cash flows are subject to measurement uncertainty, and the impact on the consolidated financial statements of future periods could be material. Considerable management judgment is used in determining the recoverable amount of PNG assets, including determining the quantity of reserves, the time horizon to develop and produce such reserves and the estimated revenues and expenditures of such production.

### **Income Taxes**

Tax interpretations, regulations, and legislation in the various jurisdictions in which Vermilion and its subsidiaries operate are subject to change and interpretation. Such changes can affect the timing of the reversal of temporary tax differences, the tax rates in effect when such differences reverse and Vermilion's ability to use tax losses and other credits in the future. The Company's income tax filings are subject to audit by taxation authorities in numerous jurisdictions and the results of such audits may increase or decrease our tax liability. The determination of current and deferred tax amounts recognized in the consolidated financial statements was based on management's assessment of the tax positions, which includes consideration of their technical merits, communications with tax authorities and management's view of the most likely outcome.

Unless otherwise noted, as of January 1, 2013, Vermilion will be required to adopt the following standards and amendments as issued by the IASB.

### 3. CHANGES TO ACCOUNTING PRONOUNCEMENTS

The adoption of the following standards are not expected to have a material impact on Vermilion's consolidated financial statements:

#### *IFRS 9 "Financial Instruments"*

As of January 1, 2015, Vermilion will be required to adopt IFRS 9, as part of the first phase of the IASB's project to replace IAS 39, "Financial Instruments: Recognition and Measurement". The new standard replaces the current multiple classification and measurement models for financial assets and liabilities with a single model that has only two classification categories: amortized cost and fair value.

#### *IFRS 10 "Consolidated Financial Statements"*

IFRS 10 replaces Standing Interpretations Committee 12, "Consolidation - Special Purpose Entities" and the consolidation requirements of IAS 27 "Consolidated and Separate Financial Statements". The new standard replaces the existing risk and rewards based approaches and establishes control as the determining factor when determining whether an interest in another entity should be included in the consolidated financial statements.

#### *IFRS 11 "Joint Arrangements"*

IFRS 11 replaces IAS 31 "Interests in Joint Ventures". The new standard focuses on the rights and obligations of an arrangement, rather than its legal form. The standard redefines joint operations and joint ventures and requires joint operations to be proportionately consolidated and joint ventures to be equity accounted.

#### *IFRS 12 "Disclosure of Interests in Other Entities"*

IFRS 12 provides comprehensive disclosure requirements on interests in other entities, including joint arrangements, associates, and special purpose entities. The new disclosures are intended to assist financial statement users in evaluating the nature, risks and financial effects of an entity's interest in subsidiaries and joint arrangements.

#### *IFRS 13 "Fair Value Measurement"*

IFRS 13 provides a common definition of fair value within IFRS. The new standard provides measurement and disclosure guidance and applies when another IFRS requires or permits an item to be measured at fair value, with limited exceptions.

### 4. BUSINESS COMBINATION

#### **Property acquisition:**

On January 19, 2012, Vermilion acquired, through its wholly owned subsidiaries, working interests in six producing fields located in the Paris and Aquitaine basins in France, for total consideration of \$106.1 million before closing adjustments. The acquired working interests expanded Vermilion's existing interests and was a natural addition to the Company's existing France asset base.

The acquired assets include land, wells, facilities, and inventory located in the Company's core producing basins in France. The fair value of the acquired identifiable assets and liabilities assumed at the date of acquisition was \$151.4 million. A gain of \$45.3 million was recognized as a result of an increase in the fair value of the acquired petroleum and natural gas reserves from the time when the acquisition was negotiated to the acquisition date. The increase resulted from a change in the underlying commodity price forecasts used to determine the fair value of the acquired reserves.

The acquisition has been accounted for as a business combination with the fair value of the assets acquired and liabilities assumed at the date of acquisition summarized as follows:

<b>(\$M)</b>	<b>Consideration</b>
Cash paid to vendor	106,115
<b>Total consideration</b>	<b>106,115</b>
<b>(\$M)</b>	<b>Allocation of Consideration</b>
Petroleum and natural gas assets	206,191
Asset retirement obligations assumed	(27,518)
Deferred tax liabilities	(23,151)
Acquired non-cash working capital deficiencies	(4,098)
Net assets acquired	151,424
Gain on acquisition	(45,309)
<b>Net assets acquired, net of gain on acquisition</b>	<b>106,115</b>

#### 4. BUSINESS COMBINATION (Continued)

Transfer taxes associated with this acquisition totalling \$8.5 million have been excluded from the consideration and have been recognized as an expense in the year ended December 31, 2012, within "Other expense" in the consolidated statements of net earnings and comprehensive income.

The results of operations from the assets acquired have been included in Vermilion's consolidated financial statements beginning January 19, 2012 and have contributed revenues of \$104.9 million and operating income of \$93.4 million for the year ended December 31, 2012.

Had the acquisition occurred on January 1, 2012, management estimates that consolidated revenues would have increased by an additional \$6.6 million and consolidated operating income would have increased by \$4.8 million for the year ended December 31, 2012. In determining the pro-forma amounts, management has assumed that the fair value adjustments, determined provisionally, that arose at the date of acquisition would have been the same if the acquisition had occurred on January 1, 2012. It is impracticable to derive all amounts necessary to determine the increase to net earnings from the acquired working interests as operations were immediately merged with Vermilion's operations.

##### Corporate acquisition:

On December 21, 2012, Vermilion acquired, through its wholly owned subsidiaries, 100% of the shares of ZaZa Energy France S.A.S for total consideration of \$74.9 million. The acquired company holds operating interests covering approximately 24,300 acres with 100% working interests in the Saint Firmin, Chateaufrenard, Courtenay, Chuelles, and Charmottes fields in the Paris Basin. The acquired company expands Vermilion's existing operations in France and is aligned with Vermilion's objective to consolidate assets within the Company's core operating areas.

The acquisition has been accounted for as a business combination with the fair value of the assets acquired and liabilities assumed at the date of acquisition summarized as follows:

(\$M)	Consideration
Cash paid to vendor	74,947
<b>Total consideration</b>	<b>74,947</b>

(\$M)	Allocation of Consideration
Petroleum and natural gas assets	136,297
Asset retirement obligations assumed	(22,623)
Deferred tax liabilities	(40,046)
Cash acquired	11,465
Acquired non-cash working capital	(10,146)
<b>Net assets acquired</b>	<b>74,947</b>

The results of operations from the assets acquired have been included in Vermilion's consolidated financial statements beginning December 21, 2012 and have contributed revenues of \$0.8 million and operating income of \$0.6 million for the year ended December 31, 2012.

Had the acquisition occurred on January 1, 2012, management estimates that consolidated revenues would have increased by an additional \$29.9 million and consolidated operating income would have increased by \$23.4 million for the year ended December 31, 2012. In determining the pro-forma amounts, management has assumed that the fair value adjustments, determined provisionally, that arose at the date of acquisition would have been the same if the acquisition had occurred on January 1, 2012. It is impracticable to derive all amounts necessary to determine the increase to net earnings from the acquired working interests as operations were immediately merged with Vermilion's operations.

## 5. CAPITAL ASSETS

The following table reconciles the change in Vermilion's capital assets:

(\$M)	Petroleum and Natural Gas Assets	Furniture and Office Equipment	Total Capital Assets
<b>Balance at January 1, 2011</b>	1,802,422	17,130	1,819,552
Additions	408,810	2,417	411,227
Property acquisitions	50,878	-	50,878
Borrowing costs capitalized	9,923	-	9,923
Changes in estimate for asset retirement obligations	45,267	-	45,267
Depletion and depreciation	(228,562)	(4,414)	(232,976)
Impairments	(64,400)	-	(64,400)
Effect of movements in foreign exchange rates	(7,727)	(62)	(7,789)
<b>Balance at December 31, 2011</b>	2,016,611	15,071	2,031,682
Additions	407,973	5,248	413,221
Transfers from exploration and evaluation assets	10,528	-	10,528
Property acquisitions	206,260	-	206,260
Corporate acquisitions	136,297	-	136,297
Borrowing costs capitalized	9,994	-	9,994
Changes in estimate for asset retirement obligations	1,334	-	1,334
Depletion and depreciation <sup>1</sup>	(289,194)	(5,165)	(294,359)
Impairments	(65,800)	-	(65,800)
Effect of movements in foreign exchange rates	(3,882)	(35)	(3,917)
<b>Balance at December 31, 2012</b>	2,430,121	15,119	2,445,240
Cost	2,427,848	30,148	2,457,996
Accumulated depletion and depreciation	(411,237)	(15,077)	(426,314)
<b>Carrying amount at December 31, 2011</b>	2,016,611	15,071	2,031,682
Cost	3,260,772	35,268	3,296,040
Accumulated depletion and depreciation	(830,651)	(20,149)	(850,800)
<b>Carrying amount at December 31, 2012</b>	2,430,121	15,119	2,445,240

<sup>1</sup> Depletion and depreciation above excludes depletion recorded as a component of crude oil inventory.

### Depletion and depreciation rates

PNG assets (unit of production method)

Furniture and office equipment (declining balance at rates of 5% to 25%)

### Capitalized overhead and borrowing costs

During the year ended December 31, 2012, Vermilion capitalized \$4.8 million (2011 - \$4.5 million) of overhead costs directly attributable to PNG activities and \$10.0 million (2011 - \$9.9 million) of borrowing costs associated with the unwinding of the discount on the amount due pursuant to the Corrib acquisition (Note 8).

### Impairments

On a quarterly basis, Vermilion performs an assessment as to whether any CGUs have indicators of impairment. When indicators of impairment are identified, Vermilion assesses the recoverable amount of the applicable CGU based on the estimated fair value less costs to sell as at the reporting date. The estimated fair value takes into account the most recent commodity price forecasts, expected production and estimated costs of development.

During the years ended December 31, 2011 and 2012, Vermilion performed quarterly assessments as to whether any cash generating units ("CGU") had indicators of impairment.

For the three months ended December 31, 2011 and March 31, 2012, Vermilion recorded an impairment charge of \$64.4 million and \$65.8 million, respectively, related to conventional deep natural gas and shallow coal bed methane gas plays. These impairment charges were a result of declines in the price forecasts for natural gas in Canada which decreased the expected cash flows from the CGU's.

**5. CAPITAL ASSETS (Continued)**

Benchmark prices used in the December 31, 2011 and March 31, 2012 calculations of recoverable amounts were determined by multiplying the mix of oil, natural gas and NGLs inherent in the reserves of the conventional deep natural gas and shallow coal bed methane CGUs by the price forecasts for each year. The blended price per barrel of oil equivalent (BOE) forecasts were:

<b>\$/BOE</b>	<b>March 31, 2012</b>	<b>December 31, 2011</b>
2012	27.01	31.28
2013	33.46	34.91
2014	35.78	37.12
2015	38.23	39.52
2016	40.68	41.95
2017	43.13	44.34
2018	45.61	45.82
2019	46.53	46.79
2020	47.51	47.72
2021	48.44	48.71
Average increase thereafter	2.0%	2.0%

**6. EXPLORATION AND EVALUATION ASSETS**

The following table reconciles the change in Vermilion's exploration and evaluation assets:

<b>(\$M)</b>	<b>Exploration and Evaluation Assets</b>
<b>Balance at January 1, 2011</b>	17,157
Additions	79,553
Depreciation	(3,732)
Effect of movements in foreign exchange rates	(677)
<b>Balance at December 31, 2011</b>	92,301
Additions	39,317
Transfers to petroleum and natural gas assets	(10,528)
Depreciation	(3,485)
Effect of movements in foreign exchange rates	(444)
<b>Balance at December 31, 2012</b>	117,161
Cost	96,773
Accumulated depreciation	(4,472)
<b>Carrying value at December 31, 2011</b>	92,301
Cost	125,165
Accumulated depreciation	(8,004)
<b>Carrying value at December 31, 2012</b>	117,161

## 7. ASSET RETIREMENT OBLIGATIONS

The following table reconciles the change in Vermilion's asset retirement obligations:

(\$M)	Asset Retirement Obligations
<b>Balance at January 1, 2011</b>	267,389
Additional obligations recognized	8,612
Changes in estimates for existing obligations	(4,364)
Obligations settled	(23,071)
Accretion	21,889
Changes in discount rates	41,019
Effect of movements in foreign exchange rates	(943)
<b>Balance at December 31, 2011</b>	310,531
Additional obligations recognized	55,228
Changes in estimates for existing obligations	(26,560)
Obligations settled	(13,739)
Accretion	23,040
Changes in discount rates	22,807
Effect of movements in foreign exchange rates	(244)
<b>Balance at December 31, 2012</b>	371,063

Vermilion has estimated the net present value of its asset retirement obligations to be \$371.1 million as at December 31, 2012 (December 31, 2011 - \$310.5 million) based on a total undiscounted future liability, after inflation adjustment, of \$1.3 billion (December 31, 2011 - \$1.2 billion). These payments are expected to be made between 2013 and 2061. Vermilion calculated the present value of the obligations using discount rates between 5.8% and 7.5% (2011 - between 6.3% and 7.6%) to reflect the market assessment of the time value of money as well as risks specific to the liabilities that have not been included in the cash flow estimates. Inflation rates used in determining the cash flow estimates were between 1.4% and 2.5% (2011 - between 1.5% and 2.6%).

At least once per year, Vermilion reviews its estimates of the expected costs to reclaim the net interest in its wells and facilities. The resulting changes are categorized as changes in estimates for existing obligations in the table above. The significant changes in the liability for the year ended December 31, 2012 relates primarily to the asset retirement obligations assumed in France pursuant to the acquisitions completed in the first and fourth quarters.

## 8. AMOUNT DUE PURSUANT TO ACQUISITION

On July 30, 2009, Vermilion completed the acquisition of an 18.5% non-operated interest in the Corrib gas field located off the northwest coast of Ireland. Pursuant to the terms of the acquisition agreement, Vermilion made a final payment to the vendor of US\$135 million on December 31, 2012.

As at December 31, 2011, this amount was classified as a current liability. The discount rate used to present value this obligation was 8%, which was Vermilion's best estimate of the interest rate that would result from an arm's length financing transaction associated with the purchase of these assets.

## 9. LONG-TERM DEBT

The following table summarizes Vermilion's outstanding long-term debt:

(\$M)	As At	
	Dec 31, 2012	Dec 31, 2011
Revolving credit facility	419,784	152,086
Senior unsecured notes	222,238	221,350
Long-term debt	642,022	373,436

### Revolving Credit Facility

At December 31, 2012, Vermilion had in place a bank revolving credit facility totalling \$950 million, of which approximately \$419.8 million was drawn. The facility, which matures in May of 2015, is fully revolving up to the date of maturity.

**9. LONG-TERM DEBT (Continued)**

The facility is extendable from time to time, but not more than once per year, for a period not longer than three years, at the option of the lenders and upon notice from Vermilion. If no extension is granted by the lenders, the amounts owing pursuant to the facility are repayable on the maturity date. This facility bears interest at a rate applicable to demand loans plus applicable margins. For the year ended December 31, 2012, the interest rate on the revolving credit facility was approximately 3.3% (2011 – 3.4%).

The amount available to Vermilion under this facility is reduced by outstanding letters of credit associated with Vermilion's operations totalling \$49.2 million as at December 31, 2012 (December 31, 2011 - \$3.7 million).

The facility is secured by various fixed and floating charges against the subsidiaries of Vermilion. Under the terms of the facility, Vermilion must maintain a ratio of total bank borrowings (defined as consolidated total debt), to consolidated net earnings before interest, income taxes, depreciation, accretion and other certain non-cash items of not greater than 4.0. In addition, Vermilion must maintain a ratio of consolidated total senior debt (consolidated total debt excluding unsecured and subordinated debt) to consolidated net earnings before interest, income taxes, depreciation, accretion and other certain non-cash items of not greater than 3.0.

As at December 31, 2012, Vermilion was in compliance with its financial covenants.

**Senior Unsecured Notes**

On February 10, 2011, Vermilion issued \$225.0 million of senior unsecured notes at par. The notes bear interest at a rate of 6.5% per annum and will mature on February 10, 2016. As direct senior unsecured obligations of Vermilion, the notes rank pari passu with all other present and future unsecured and unsubordinated indebtedness of the Company.

Vermilion may, at its option, prior to February 10, 2014, redeem up to 35% of the notes with net proceeds of equity offerings by the Company at a redemption price equal to 106.5% of the principal amount of the notes to be redeemed, plus accrued and unpaid interest, if any, to the applicable redemption date. Subsequently, Vermilion may, on or after February 10, 2014, redeem all or part of the notes at fixed redemption prices, plus, in each case, accrued and unpaid interest, if any, to the applicable redemption date. The notes were initially recognized at fair value net of transaction costs and are subsequently measured at amortized cost using an effective interest rate of 7.1%.

**10. INCOME TAXES**

The net deferred income tax liability at December 31, 2012 and 2011 is comprised of the following:

(\$M)	As At	
	Dec 31, 2012	Dec 31, 2011
Deferred income tax liabilities:		
Capital assets	(322,620)	(264,700)
Partnership income deferral	-	(27,316)
Asset retirement obligations	(45,362)	(47,056)
Basis difference of investments	(330)	(413)
Unrealized foreign exchange	(22,603)	(21,589)
Other	(11,502)	(2,026)
Deferred income tax assets:		
Derivative contracts	1,600	3,037
Capital assets	67,310	60,202
Non-capital losses	167,230	174,143
Cumulative eligible capital	-	4,618
Asset retirement obligations	69,359	68,977
Other	1,457	-
Net deferred income tax liability	(95,461)	(52,123)
Comprised of:		
Deferred income tax assets	193,354	175,545
Deferred income tax liability	(288,815)	(227,668)
Net deferred income tax liability	(95,461)	(52,123)

**10. INCOME TAXES (Continued)**

The provision for income tax differs from the amount that would have been expected if the reported earnings had been subject only to the statutory Canadian income tax rate of 25.0% (2011 - 26.5%), as follows:

(\$M)	Year Ended	
	Dec 31, 2012	Dec 31, 2011
Earnings before income taxes	353,244	315,705
Canadian corporate tax rate	25.0%	26.5%
Expected tax expense	88,311	83,662
Increase (decrease) in taxes resulting from:		
Petroleum resource rent tax rate (PRRT) differential <sup>1</sup>	44,605	61,010
Foreign tax rate differentials <sup>1,2</sup>	18,539	11,164
Equity based compensation expense	11,776	10,246
Amended returns and changes to estimated tax pools	(1,635)	(7,537)
Changes in statutory tax rates and the estimated reversal rates associated with temporary differences	7,506	(98)
Adjustment for uncertain tax positions	5,113	3,427
Gain on acquisition	(12,389)	-
Adjustment for share issuance costs	-	2,782
Other non-deductible items	796	8,228
Provision for income taxes	162,622	172,884

<sup>1</sup> In Australia, current taxes include both corporate income tax rates and PRRT. Corporate income tax rates are applied at a rate of 30% and PRRT is applied at a rate of 40%.

<sup>2</sup> The corporate tax rate is 34.4% in France, 46.0% in the Netherlands and 25.0% in Ireland.

**11. SHAREHOLDERS' CAPITAL**

The following tables reconcile the change in Vermilion's shareholders' capital:

Shareholders' Capital	Number of Shares	Amount (\$M)
<b>Balance as at January 1, 2011</b>	88,998,242	1,025,770
Issuance of shares, net of deferred taxes	5,370,000	254,786
Issuance of shares pursuant to the dividend reinvestment plan	1,323,482	59,081
Vesting of equity based awards	608,073	22,139
Share-settled dividends on vested equity based awards	114,487	5,583
Shares issued for bonus plan	15,851	786
<b>Balance as at December 31, 2011</b>	96,430,135	1,368,145
Issuance of shares pursuant to the dividend reinvestment plan	1,630,258	72,058
Vesting of equity based awards	904,210	33,355
Share-settled dividends on vested equity based awards	157,137	7,151
Shares issued for bonus plan	13,167	636
<b>Balance as at December 31, 2012</b>	99,134,907	1,481,345

Vermilion is authorized to issue an unlimited number of common shares with no par value.

**Dividends**

Dividends declared to shareholders for the year ended December 31, 2012 were \$223.7 million (December 31, 2011, \$207.8 million). Dividends are determined by the Board of Directors and are paid monthly. Vermilion has a dividend reinvestment plan which allows eligible holders of common shares to purchase additional common shares at a 5% discount to market by reinvesting their cash dividends. Subsequent to the end of the period and prior to the consolidated financial statements being authorized for issue on February 28, 2013, Vermilion declared dividends totalling \$39.7 million or \$0.20 per share for each of January and February of 2013.

**11. SHAREHOLDERS' CAPITAL (Continued)****Equity Issuance**

On November 28, 2011, Vermilion issued 5,370,000 common shares at \$49.00 per common share for gross proceeds of approximately \$263.1 million. The sale was completed on a bought deal basis and gross proceeds included partial exercise of the underwriters' over-allotment option. Net cash proceeds of \$252.0 million were received by Vermilion; including the impact of deferred taxes, \$254.8 million was recognized in Shareholder's capital.

**12. EQUITY BASED COMPENSATION**

The following table summarizes the number of awards outstanding under the Vermilion Incentive Plan ("VIP"):

<b>Number of Awards</b>	<b>2012</b>	<b>2011</b>
Opening balance	1,750,055	1,683,776
Granted	681,383	566,425
Vested	(596,423)	(434,150)
Forfeited	(145,061)	(65,996)
Closing balance	1,689,954	1,750,055

The grant date fair value of the awards is determined as the grant date closing price of Vermilion's common shares on the Toronto Stock Exchange, adjusted by the Company's estimate of the performance factor that will ultimately be achieved. Dividends, which notionally accrue to the awards during the vesting period, are not included in the determination of grant date fair values. For the year ended December 31, 2012, the awards granted had a weighted average fair value of \$61.08 (2011 - \$47.05).

The performance factor is determined by the Board of Directors after consideration of a number of key corporate performance measures including, but not limited to, shareholder return, capital efficiency metrics, production and reserves growth and safety performance.

The expense recognized is based on the grant date fair value of the awards and incorporates an estimate of forfeiture rate based on historical vesting data. For the year ended December 31, 2012, Vermilion incorporated an estimated forfeiture rate of 5.37% (2011 - 5.29%). Equity based compensation expense of \$46.5 million was recorded during the year ended December 31, 2012 (2011 - \$37.9 million) related to the VIP.

**13. PER SHARE AMOUNTS**

Basic and diluted net earnings per share have been determined based on the following:

<b>(\$M except per share amounts)</b>	<b>Year Ended</b>	
	<b>Dec 31, 2012</b>	<b>Dec 31, 2011</b>
Net earnings [1]	190,622	142,821
Basic weighted average shares outstanding [2]	98,016	90,878
Dilutive impact of equity based award plans	1,278	1,394
Diluted weighted average shares outstanding [3]	99,294	92,272
Basic earnings per share (([1] ÷ [2]))	1.94	1.57
Diluted earnings per share (([1] ÷ [3]))	1.92	1.55

**14. DERIVATIVE INSTRUMENTS**

The nature of Vermilion's operations results in exposure to fluctuations in commodity prices, interest rates and foreign currency exchange rates. Vermilion monitors and, when appropriate, uses derivative financial instruments to manage its exposure to these fluctuations. All transactions of this nature entered into by Vermilion are related to an underlying financial position or to future crude oil and natural gas production. Vermilion does not use derivative financial instruments for speculative purposes. Vermilion has elected not to designate any of its derivative financial instruments as accounting hedges and thus accounts for changes in fair value in net earnings at each reporting period. Vermilion has not obtained collateral or other security to support its financial derivatives as management reviews the creditworthiness of its counterparties prior to entering into derivative contracts.

During the normal course of business, Vermilion may enter into fixed price arrangements to sell a portion of its production or purchase commodities for operational use. Vermilion does not apply fair value accounting on these contracts as they were entered into and continue to be held for the sale of production or operational use in accordance with the Company's expected requirements.

**14. DERIVATIVE INSTRUMENTS (Continued)**

The following table summarizes Vermilion's outstanding risk management positions as at December 31, 2012:

<b>Risk Management - Oil</b>	<b>Funded Cost (US \$/bbl)</b>	<b>bbls/d</b>	<b>Strike Price(s) US \$/bbl</b>
<b>Swap - WTI</b>			
January 2013 - June 2013 <sup>1</sup>	-	1,000	101.18
January 2013 - December 2013	-	2,000	93.04
<b>Collar - WTI</b>			
January 2013 - March 2013	-	650	85.00 - 97.65
April 2013 - June 2013	-	250	88.00 - 109.43
<b>Collar - Dated Brent</b>			
January 2013 - March 2013	-	1,550	103.97 - 118.81
January 2013 - March 2013	1.00	250	95.00 - 132.15
January 2013 - June 2013	-	2,000	90.00 - 105.28
January 2013 - December 2013	-	3,500	96.14 - 107.34
April 2013 - June 2013	-	250	105.00 - 114.65
July 2013 - December 2013	-	500	95.00 - 109.10

<sup>1</sup> The counterparties to the swaps have the option on June 28, 2013 to extend the swap to December 31, 2013 at the contracted volume and price.

The following table reconciles the change in the fair value of Vermilion's derivative instruments:

<b>(\$M)</b>	<b>Year Ended</b>	
	<b>Dec 31, 2012</b>	<b>Dec 31, 2011</b>
Fair value of contracts, beginning of year	(12,149)	(9,109)
Reversal of opening unrealized loss on contracts settled during the year	12,149	8,494
Realized loss on contracts settled during the year	(12,737)	(28,300)
Unrealized loss during the year on contracts outstanding at the end of the year	(6,398)	(11,534)
Net payment to counterparties on contract settlements during the year	12,737	28,300
Fair value of contracts, end of year	(6,398)	(12,149)
Comprised of:		
Current derivative asset	2,086	186
Current derivative liability	(8,484)	(11,568)
Non-current derivative liability	-	(767)
Fair value of contracts, end of year	(6,398)	(12,149)

The loss on derivative instruments for 2012 and 2011 are comprised of the following:

<b>(\$M)</b>	<b>Year Ended</b>	
	<b>Dec 31, 2012</b>	<b>Dec 31, 2011</b>
Realized loss on contracts settled during the year	12,737	28,300
Reversal of opening unrealized loss on contracts settled	(12,149)	(8,494)
Unrealized loss during the year on contracts outstanding at year-end	6,398	11,534
Loss on derivative instruments	6,986	31,340

**15. SUPPLEMENTAL CASH FLOW INFORMATION**

Changes in non-cash working capital is comprised of the following:

(\$M)	Year Ended	
	Dec 31, 2012	Dec 31, 2011
Changes in:		
Accounts receivable	(818)	(29,491)
Crude oil inventory	(11,661)	(3,178)
Prepaid expenses	2,375	425
Accounts payable and accrued liabilities and income taxes payable	(18,836)	22,282
Movements in foreign exchange rates	(1,881)	(279)
Changes in non-cash working capital	(30,821)	(10,241)
Changes in non-cash operating working capital	(47,409)	(4,173)
Changes in non-cash investing working capital	16,588	(6,068)
Changes in non-cash working capital	(30,821)	(10,241)

**16. SEGMENTED INFORMATION**

Vermilion has operations principally in Canada, France, the Netherlands, Australia and Ireland. Vermilion's operating activities in each country relate solely to the exploration, development and production of petroleum and natural gas. Vermilion's chief operating decision maker reviews the financial performance of the Company by assessing the operating income of each country individually. Operating income is a profit or loss measure defined by Vermilion as oil and gas sales to external customers less royalties and production costs, which include realized losses on derivative instruments, transportation expense and operating expense.

The following segment information has been prepared by segregating the results into the geographic areas in which Vermilion operates. The following amounts include transactions between segments, which are recorded at fair value at the date of recognition.

(\$M)	Year Ended December 31, 2012					
	Canada	France	Netherlands	Australia	Ireland	Total
Total assets	1,178,264	868,300	156,620	296,169	576,904	3,076,257
Drilling and development	236,634	47,382	21,052	49,389	58,764	413,221
Exploration and evaluation	39,045	-	272	-	-	39,317
<b>Operating Income (Loss)</b>						
Oil and gas sales to external customers	304,202	388,410	123,528	266,963	-	1,083,103
Royalties	(31,667)	(20,417)	-	-	-	(52,084)
Revenue from external customers	272,535	367,993	123,528	266,963	-	1,031,019
Realized loss on derivative instruments	(1,337)	(10,152)	-	(1,248)	-	(12,737)
Transportation expense	(8,321)	(8,236)	-	-	(7,556)	(24,113)
Operating expense	(55,418)	(54,907)	(19,149)	(48,968)	-	(178,442)
Operating income (loss)	207,459	294,698	104,379	216,747	(7,556)	815,727
Corporate income taxes	1,582	63,006	25,648	31,607	-	121,843
PRRT	-	-	-	60,070	-	60,070
Current income taxes	1,582	63,006	25,648	91,677	-	181,913

## 16. SEGMENTED INFORMATION (Continued)

(\$M)	Year Ended December 31, 2011					Total
	Canada	France	Netherlands	Australia	Ireland	
Total assets	1,285,138	514,952	164,171	280,211	490,715	2,735,187
Drilling and development	261,101	53,611	13,859	20,653	62,003	411,227
Exploration and evaluation	64,597	3,923	11,033	-	-	79,553
<b>Operating Income (Loss)</b>						
Oil and gas sales to external customers	259,854	324,090	116,227	331,399	-	1,031,570
Royalties	(34,980)	(19,255)	-	-	-	(54,235)
Revenue from external customers	224,874	304,835	116,227	331,399	-	977,335
Realized loss on derivative instruments	(1,539)	(12,040)	-	(14,721)	-	(28,300)
Transportation expense	(6,599)	(10,118)	-	-	(8,822)	(25,539)
Operating expense	(51,473)	(46,922)	(17,487)	(46,502)	-	(162,384)
Operating income (loss)	165,263	235,755	98,740	270,176	(8,822)	761,112
Corporate income taxes	508	65,964	18,149	35,398	-	120,019
PRRT	-	-	-	99,075	-	99,075
Current income taxes	508	65,964	18,149	134,473	-	219,094

## Reconciliation of operating income to net earnings

(\$M)	Year Ended	
	Dec 31, 2012	Dec 31, 2011
Operating income	815,727	761,112
Equity based compensation	(47,104)	(38,667)
Unrealized gain (loss) on derivative instruments	5,751	(3,040)
Interest expense	(27,586)	(24,967)
General and administration	(43,773)	(44,583)
Foreign exchange loss	(1,546)	(9,998)
Other expense	(8,751)	(1,155)
Accretion	(23,040)	(21,889)
Depletion and depreciation	(295,943)	(236,708)
Impairments	(65,800)	(64,400)
Gain on acquisition	45,309	-
Earnings before income taxes	353,244	315,705
Income taxes	(162,622)	(172,884)
Net earnings	190,622	142,821

Vermilion has two major customers with revenues in excess of 10% within the France and Netherlands segments. Sales to the major customer in the France segment for year ended December 31, 2012 were \$380.6 million (2011 - \$232.0 million). All sales in the Netherlands segment were to one customer.

## 17. COMMITMENTS

Vermilion had the following future commitments associated with its operating leases as at December 31, 2012:

(\$M)	Less than 1 year	1 - 3 years	4 - 5 years	After 5 years	Total
Payments by period	15,552	28,318	23,204	69,554	136,628

In addition, Vermilion has various other commitments associated with its business operations; none of which, in management's view, are significant in relation to Vermilion's financial position.

**18. CASH AND CASH EQUIVALENTS**

Cash and cash equivalents was comprised of the following:

(\$M)	Dec 31, 2012	Dec 31, 2011
Money on deposit with banks	78,396	220,158
Short-term investments	23,729	14,349
Cash and cash equivalents	102,125	234,507

**19. CAPITAL DISCLOSURES**

Vermilion defines capital as net debt (a non-standardized measure, which is defined by management as long-term debt as shown on the consolidated balance sheets plus net working capital) and shareholders' capital.

In managing capital, Vermilion reviews whether fund flows from operations (a non-standardized measure, defined by management as cash flows from operating activities before changes in non-cash operating working capital and asset retirement obligations settled), is sufficient to pay for all capital expenditures, dividends and abandonment and reclamation expenditures. To the extent that the forecasted fund flows from operations is not expected to be sufficient in relation to these expenditures, Vermilion will evaluate its ability to finance any excess with debt, an issuance of equity or by reducing some or all categories of expenditures to ensure that total expenditures do not exceed available funds.

Additionally, Vermilion monitors the ratio of net debt to fund flows from operations. Vermilion typically strives to maintain a ratio of net debt to fund flows from operations near 1.0. In a commodity price environment where prices trend higher, Vermilion may target a lower ratio and conversely, in a lower commodity price environment, the acceptable ratio may be higher. At times, Vermilion will use its balance sheet to finance acquisitions and, in these situations, Vermilion is prepared to accept a higher ratio in the short term but will implement a plan to reduce the ratio to acceptable levels within a reasonable period of time, usually considered to be no more than 12 to 18 months. This plan could potentially include an increase in hedging activities, a reduction in capital expenditures, an issuance of equity or the utilization of excess fund flows from operations to reduce outstanding indebtedness.

The following table calculates Vermilion's ratio of net debt to fund flows from operations:

(\$M except as indicated)	Year Ended	
	Dec 31, 2012	Dec 31, 2011
Long-term debt	642,022	373,436
Current liabilities	355,711	491,184
Current assets	(320,502)	(435,659)
Net debt [1]	677,231	428,961
Cash flows from operating activities	496,580	447,092
Changes in non-cash operating working capital	47,409	4,173
Asset retirement obligations settled	13,739	23,071
Fund flows from operations [2]	557,728	474,336
Ratio of net debt to fund flows from operations ([1] ÷ [2])	1.2	0.9

The ratio of net debt to fund flows from operations was higher in the current year as compared to the prior year primarily as a result of an increase in net debt. The increase in net debt was the result of the two acquisitions that occurred in France during the first and fourth quarter of 2012 and capital expenditures pertaining to the Ireland assets, which are currently under development.

Vermilion is subject to certain externally imposed capital requirements under its revolving credit facility. During the periods covered by these consolidated financial statements, Vermilion continued to comply with these requirements.

## 20. FINANCIAL INSTRUMENTS

### Classification of Financial Instruments

The following table summarizes information relating to Vermilion's financial instruments as at December 31, 2012 and December 31, 2011:

Class of financial instrument	Consolidated balance sheet caption	Accounting designation	Related caption on Statement of Net Earnings	As at December 31, 2012		As at December 31, 2011		Fair value measurement hierarchy
				Carrying value (\$M)	Fair value (\$M)	Carrying value (\$M)	Fair value (\$M)	
Cash	Cash and cash equivalents	HFT	Gains and losses on foreign exchange are included in foreign exchange loss	102,125	102,125	234,507	234,507	Level 1
Receivables	Accounts receivable	LAR	Gains and losses on foreign exchange are included in foreign exchange loss and impairments are recognized as general and administration expense	180,064	180,064	176,820	176,820	Not applicable
Derivative assets	Derivative instruments	HFT	Loss on derivative instruments	2,086	2,086	186	186	Level 2
Derivative liabilities	Derivative instruments	HFT	Loss on derivative instruments	(8,484)	(8,484)	(12,335)	(12,335)	Level 2
Payables	Accounts payable and accrued liabilities Dividends payable	OTH	Gains and losses on foreign exchange are included in foreign exchange loss	(319,518)	(319,518)	(316,078)	(316,078)	Not applicable
Payables	Amount due pursuant to acquisition	OTH	Gains and losses on foreign exchange are included in foreign exchange loss	-	-	(127,131)	(127,131)	Not applicable
Long-term debt	Long-term debt	OTH	Interest expense	(642,022)	(656,315)	(373,436)	(383,275)	Not applicable

The accounting designations used in the above table refer to the following:

HFT – Classified as “Held for trading” in accordance with International Accounting Standard 39 “Financial Instruments: Recognition and Measurement”. These financial assets and liabilities are carried at fair value on the consolidated balance sheets with associated gains and losses reflected in net earnings.

LAR – “Loans and receivables” are initially recognized at fair value and subsequently are measured at amortized cost. Impairments and foreign exchange gains and losses are recognized in net earnings.

OTH – “Other financial liabilities” are initially recognized at fair value net of transaction costs directly attributable to the issuance of the instrument and subsequently are measured at amortized cost. Interest is recognized in net earnings using the effective interest method. Foreign exchange gains and losses are recognized in net earnings.

Level 1 – Fair value measurement is determined by reference to unadjusted quoted prices in active markets for identical assets or liabilities.

Level 2 – Fair value measurement is determined based on inputs other than unadjusted quoted prices that are observable, either directly or indirectly.

Level 3 – Fair value measurement is based on inputs for the asset or liability that are not based on observable market data.

### Determination of Fair Values

The level in the fair value hierarchy into which the fair value measurements are categorized is determined on the basis of the lowest level input that is significant to the fair value measurement.

Fair values for derivative assets and derivative liabilities are determined using pricing models incorporating future prices that are based on assumptions which are supported by prices from observable market transactions and are adjusted for credit risk.

The carrying value of receivables approximate their fair value due to their short maturities.

The carrying value of long-term debt outstanding on the revolving credit facility approximates its fair value due to the use of short-term borrowing instruments at market rates of interest.

## 20. FINANCIAL INSTRUMENTS (Continued)

The amount due pursuant to acquisition was determined by calculating the expected value of the future payment due to the vendor based on management's best estimates associated with the timing of first commercial gas and discounting of the resulting amount. The discount rate which would be used to present value this obligation as at December 31, 2011 would not differ significantly from the discount rate originally used.

The fair value of the senior unsecured notes changes in response to changes in the market rates of interest payable on similar instruments and was determined with reference to prevailing market rates for such instruments.

### Nature and Extent of Risks Arising From Financial Instruments

Vermilion is exposed to the following types of risks in relation to its financial instruments:

#### *Credit risk:*

Vermilion extends credit to customers and may, from time-to-time, be due amounts from counterparties in relation to derivative instruments. Accordingly, there is a risk of financial loss in the event that a counterparty fails to discharge its obligation. For transactions that are financially significant, Vermilion reviews third-party credit ratings and may require additional forms of security. Cash held on behalf of the Company by financial institutions is also subject to credit risk.

#### *Liquidity risk:*

Liquidity risk is the risk that Vermilion will encounter difficulty in meeting obligations associated with its financial liabilities. Vermilion does not consider this to be a significant risk as its financial position and available committed borrowing facility provide significant financial flexibility and allow Vermilion to meet its obligations as they come due.

#### *Currency risk:*

Vermilion conducts business in foreign currencies in addition to Canadian dollars and accordingly is subject to currency risk associated with changes in foreign exchange rates in relation to cash and cash equivalents, receivables, payables and derivative assets and liabilities. The impact related to working capital is somewhat mitigated as a result of the offsetting effects of foreign exchange fluctuations on assets and liabilities. Vermilion monitors its exposure to currency risk and reviews whether the use of derivative financial instruments is appropriate to manage potential fluctuations in foreign exchange rates. During 2012, Vermilion did not use derivative financial instruments to manage potential fluctuations in foreign exchange rates.

#### *Commodity price risk:*

Vermilion uses derivative financial instruments as part of its risk management program to mitigate the effects of changes in commodity prices on future cash flows. Changes in the underlying commodity prices impact the fair value and future cash flows related to these derivatives.

#### *Interest rate risk:*

Vermilion's long-term debt is comprised of borrowings under the revolving credit facility and the Company's senior unsecured notes. Borrowings under the revolving credit facility bear interest at market rates plus applicable margins and as such changes in interest rates could result in an increase or decrease in the amount Vermilion pays to service this debt. The senior unsecured notes bear interest at a fixed 6.5% interest rate and as such, changes in prevailing interest rates would affect the fair value of these notes. However, as Vermilion does not intend to settle this debt prior to maturity, the notes are carried at amortized cost and changes in fair value do not affect the Company's net earnings.

The nature of these risks and Vermilion's strategy for managing these risks has not changed significantly from the prior period.

### Summarized Quantitative Data Associated with the Risks Arising from Financial Instruments

#### *Credit risk:*

As at December 31, 2012, Vermilion's maximum exposure to receivable credit risk was \$182.2 million (December 31, 2011 - \$177.0 million) which is the aggregate value of receivables and derivative assets at the balance sheet date. Vermilion's receivables are due from counterparties that have investment grade third party credit ratings or, in the absence of the availability of such ratings, have been satisfactorily reviewed by Vermilion for creditworthiness. Additionally, cash and cash equivalents consist of moneys on deposit and short-term investments which may be subject to counterparty credit risk. Vermilion mitigates this risk by transacting with North American institutions with high third party credit ratings.

As at the balance sheet date the amount of financial assets that were past due or impaired was not material.

#### *Liquidity risk:*

Vermilion's derivative financial instruments settle on a monthly basis.

**20. FINANCIAL INSTRUMENTS (Continued)**

The following table summarizes Vermilion's undiscounted non-derivative financial liabilities and their contractual maturities as at December 31, 2012 and December 31, 2011:

(\$M)	Due in one month	Later than one month and not later than three months	Later than three months and not later than one year	Later than one year and not later than five years
December 31, 2012	109,312	209,783	423	644,784
December 31, 2011	115,594	206,777	131,002	377,087

*Market risk:*

Vermilion's financial instruments are exposed to currency risk related to changes in foreign currency denominated financial instruments and commodity price risk related to outstanding derivative positions. The following table summarizes what the impact on comprehensive income before tax would be for the year ended December 31, 2012 and 2011 given changes in the relevant risk variables that Vermilion considers were reasonably possible at the balance sheet date. The impact on comprehensive income before tax associated with changes in these risk variables for assets and liabilities that are not considered financial instruments are excluded from this analysis. This analysis does not attempt to reflect any interdependencies between the relevant risk variables.

Risk (\$M)	Description of change in risk variable	December 31, 2012 Before tax effect on comprehensive income Increase (decrease)
Currency risk - Euro to Canadian	<b>Increase</b> in strength of the Canadian dollar against the Euro by 5% over the relevant closing rates on December 31, 2012	(6,476)
	<b>Decrease</b> in strength of the Canadian dollar against the Euro by 5% over the relevant closing rates on December 31, 2012	6,476
Currency risk - US \$ to Canadian	<b>Increase</b> in strength of the Canadian dollar against the US\$ by 5% over the relevant closing rates on December 31, 2012	(1,971)
	<b>Decrease</b> in strength of the Canadian dollar against the US\$ by 5% over the relevant closing rates on December 31, 2012	1,971
Currency risk - AUD \$ to Canadian	<b>Increase</b> in strength of the Canadian dollar against the AUD\$ by 5% over the relevant closing rates on December 31, 2012	(1,167)
	<b>Decrease</b> in strength of the Canadian dollar against the AUD\$ by 5% over the relevant closing rates on December 31, 2012	1,167
Commodity price risk	<b>Increase</b> in relevant oil reference price within option pricing models used to determine the fair value of financial derivative positions by US\$5.00/bbl at December 31, 2012	(12,908)
	<b>Decrease</b> in relevant oil reference price within option pricing models used to determine the fair value of financial derivative positions by US\$5.00/bbl at December 31, 2012	12,296
Interest rate risk	<b>Increase</b> in average Canadian prime interest rate by 100 basis points during the year ended December 31, 2012	(2,007)
	<b>Decrease</b> in average Canadian prime interest rate by 100 basis points during the year ended December 31, 2012	2,007

**20. FINANCIAL INSTRUMENTS (Continued)**

Risk (\$M)	Description of change in risk variable	December 31, 2011	
		Before tax effect on comprehensive income Increase (decrease)	
Currency risk - Euro to Canadian	<b>Increase</b> in strength of the Canadian dollar against the Euro by 5% over the relevant closing rates on December 31, 2011		(1,825)
	<b>Decrease</b> in strength of the Canadian dollar against the Euro by 5% over the relevant closing rates on December 31, 2011		1,825
Currency risk - US \$ to Canadian	<b>Increase</b> in strength of the Canadian dollar against the US\$ by 5% over the relevant closing rates on December 31, 2011		6,035
	<b>Decrease</b> in strength of the Canadian dollar against the US\$ by 5% over the relevant closing rates on December 31, 2011		(6,035)
Currency risk - AUD \$ to Canadian	<b>Increase</b> in strength of the Canadian dollar against the AUD\$ by 5% over the relevant closing rates on December 31, 2011		(59)
	<b>Decrease</b> in strength of the Canadian dollar against the AUD\$ by 5% over the relevant closing rates on December 31, 2011		59
Commodity price risk	<b>Increase</b> in relevant oil reference price within option pricing models used to determine the fair value of financial derivative positions by US\$5.00/bbl at December 31, 2011		(6,964)
	<b>Decrease</b> in relevant oil reference price within option pricing models used to determine the fair value of financial derivative positions by US\$5.00/bbl at December 31, 2011		6,372

Reasonably possible changes in natural gas prices would not have had a material impact on comprehensive income for the years ended December 31, 2012 and 2011.

**21. RELATED PARTY DISCLOSURES**

The compensation of directors and management are reviewed annually by the independent Governance and Human Resources Committee against industry practices for oil and gas companies of similar size and scope.

The following table summarizes the compensation of directors and other members of key management personnel during the years ended December 31, 2012 and December 31, 2011:

(\$M)	Year Ended	
	Dec 31, 2012	Dec 31, 2011
Short-term benefits	6,545	5,185
Share-based payments	15,428	10,616
	<b>21,973</b>	<b>15,801</b>
Number of individuals included in the above amounts	<b>19</b>	<b>15</b>

**22. WAGES AND BENEFITS**

Included in operating expenses and general and administrative expenses for the year ended December 31, 2012 were \$45.3 million and \$30.9 million of wages and benefits, respectively (2011 – \$37.8 million and \$29.8 million, respectively).

## DIRECTORS

Larry J. Macdonald <sup>1,2,3,4,5</sup>  
Chairman & CEO, Point Energy Ltd.  
Calgary, Alberta

W. Kenneth Davidson <sup>2,3</sup>  
Toronto, Ontario

Lorenzo Donadeo  
Calgary, Alberta

Claudio A. Ghersinich <sup>2,4,5</sup>  
Executive Director, Carrera Investments Corp.  
Calgary, Alberta

Joseph F. Killi <sup>2,3</sup>  
Chairman, Parkbridge Lifestyle Communities Inc.  
Vice Chairman, Realex Properties Corp.  
Calgary, Alberta

Loren M. Leiker <sup>5</sup>  
Houston, Texas

William F. Madison <sup>2,4,5</sup>  
Sugar Land, Texas

Timothy R. Marchant <sup>3,4,5</sup>  
Calgary, Alberta

<sup>1</sup> Chairman of the Board

<sup>2</sup> Audit Committee

<sup>3</sup> Governance and Human Resources Committee

<sup>4</sup> Health, Safety and Environment Committee

<sup>5</sup> Independent Reserves Committee

## ANNUAL AND SPECIAL MEETING

May 1, 2013 at 1:30 p.m.

The Ballroom  
Metropolitan Centre  
333 – 4th Avenue S.W.  
Calgary, Alberta

## OFFICERS AND KEY PERSONNEL

### CANADA

Lorenzo Donadeo, P.Eng.  
President & Chief Executive Officer

John D. Donovan, F.C.A.  
Executive Vice President Business Development

Curtis W. Hicks, C.A.  
Executive Vice President & CFO

Anthony Marino, P.Eng.  
Executive Vice President & COO

Mona Jasinski, M.B.A., C.H.R.P.  
Executive Vice President People

Terry Hergott, CMA  
Vice President Marketing

Daniel Goulet, P.Eng.  
Director Corporate HSE

Cameron A. Hercus, MSc  
Director Exploration and New Growth

Michael Kaluza, P.Eng.  
Director Canada Business Unit

Dean N. Morrison, CFA  
Director Investor Relations

Mike Prinz  
Director Information Technology

Gerardo Rivera  
Director Strategy and Portfolio Management

Robert (Bob) J. Engbloom, LL.B.  
Corporate Secretary

### EUROPE

Gerard Schut, P.Eng.  
Vice President European Operations

David Burghardt, P.Eng.  
Interim Managing Director France Business Unit

Neil Wallace  
Managing Director Netherlands Business Unit

### AUSTRALIA

Bruce D. Lake, P.Eng.  
Managing Director Australia Business Unit

## AUDITORS

Deloitte LLP  
Calgary, Alberta

## BANKERS

The Toronto-Dominion Bank  
Calgary, Alberta

Bank of Montreal  
Calgary, Alberta

The Bank of Nova Scotia  
Calgary, Alberta

Royal Bank of Canada  
Calgary, Alberta

Canadian Imperial Bank of Commerce  
Calgary, Alberta

National Bank of Canada  
Calgary, Alberta

Alberta Treasury Branches  
Calgary, Alberta

Citibank N.A., Canadian Branch  
Citibank Canada  
Calgary, Alberta

Wells Fargo Bank N.A., London Branch  
London, England

La Caisse Centrale Desjardins du Québec  
Montréal, Quebec

HSBC Bank Canada  
Calgary, Alberta

JPMorgan Chase Bank, N.A., Toronto Branch  
Toronto, Ontario

## EVALUATION ENGINEERS

GLJ Petroleum Consultants Ltd.  
Calgary, Alberta

## LEGAL COUNSEL

Norton Rose Canada LLP  
Calgary, Alberta

## TRANSFER AGENT

Computershare Trust Company of Canada

## STOCK EXCHANGE LISTINGS

The Toronto Stock Exchange ("VET")  
The New York Stock Exchange ("VET")

## INVESTOR RELATIONS

Dean Morrison, Director Investor Relations