



VERMILION ENERGY INC.

FINANCIAL STATEMENTS

FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2012

## DISCLAIMER

Certain statements included or incorporated by reference in this document may constitute forward looking statements or financial outlooks under applicable securities legislation. Such forward looking statements or information typically contain statements with words such as "anticipate", "believe", "expect", "plan", "intend", "estimate", "propose", or similar words suggesting future outcomes or statements regarding an outlook. Forward looking statements or information in this document may include, but are not limited to:

- capital expenditures;
- business strategies and objectives;
- reserve quantities and the discounted present value of future net cash flows from such reserves;
- petroleum and natural gas sales;
- future production levels (including the timing thereof) and rates of average annual production growth;
- exploration plans;
- development plans;
- acquisition and disposition plans and the timing thereof;
- operating and other expenses, including the payment of future dividends;
- royalty rates;
- the timing of regulatory proceedings and approvals;
- the timing of first commercial natural gas from the Corrib field; and
- estimate of Vermilion's share of the expected natural gas production from the Corrib field.

Such forward looking statements or information are based on a number of assumptions all or any of which may prove to be incorrect. In addition to any other assumptions identified in this document, assumptions have been made regarding, among other things:

- the ability of Vermilion to obtain equipment, services and supplies in a timely manner to carry out its activities in Canada and internationally;
- the ability of Vermilion to market crude oil, natural gas liquids and natural gas successfully to current and new customers;
- the timing and costs of pipeline and storage facility construction and expansion and the ability to secure adequate product transportation;
- the timely receipt of required regulatory approvals;
- the ability of Vermilion to obtain financing on acceptable terms;
- foreign currency exchange rates and interest rates;
- future crude oil, natural gas liquids and natural gas prices; and
- Management's expectations relating to the timing and results of exploration and development activities.

Although Vermilion believes that the expectations reflected in such forward looking statements or information are reasonable, undue reliance should not be placed on forward looking statements because Vermilion can give no assurance that such expectations will prove to be correct. Financial outlooks are provided for the purpose of understanding Vermilion's financial strength and business objectives and the information may not be appropriate for other purposes. Forward looking statements or information are based on current expectations, estimates and projections that involve a number of risks and uncertainties which could cause actual results to differ materially from those anticipated by Vermilion and described in the forward looking statements or information. These risks and uncertainties include but are not limited to:

- the ability of management to execute its business plan;
- the risks of the oil and gas industry, both domestically and internationally, such as operational risks in exploring for, developing and producing crude oil, natural gas liquids and natural gas;
- risks and uncertainties involving geology of crude oil, natural gas liquids and natural gas deposits;
- risks inherent in Vermilion's marketing operations, including credit risk;
- the uncertainty of reserves estimates and reserves life;
- the uncertainty of estimates and projections relating to production and associated expenditures;
- potential delays or changes in plans with respect to exploration or development projects or capital expenditures;
- Vermilion's ability to enter into or renew leases on acceptable terms;
- fluctuations in crude oil, natural gas liquids and natural gas prices, foreign currency exchange rates and interest rates;
- health, safety and environmental risks;
- uncertainties as to the availability and cost of financing;
- the ability of Vermilion to add production and reserves through exploration and development activities;
- general economic and business conditions;
- the possibility that government policies or laws may change or governmental approvals may be delayed or withheld;
- uncertainty in amounts and timing of royalty payments;
- risks associated with existing and potential future law suits and regulatory actions against Vermilion; and
- other risks and uncertainties described elsewhere in this document or in Vermilion's other filings with Canadian securities regulatory authorities.

The forward looking statements or information contained in this document are made as of the date hereof and Vermilion undertakes no obligation to update publicly or revise any forward looking statements or information, whether as a result of new information, future events or otherwise, unless required by applicable securities laws.

Natural gas volumes have been converted on the basis of six thousand cubic feet of natural gas to one barrel of oil equivalent. Barrels of oil equivalent (boe) may be misleading, particularly if used in isolation. A boe conversion ratio of six thousand cubic feet to one barrel of oil is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead.

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

|  | Note | September 30,<br>2012 | December 31,<br>2011 |
|--|------|-----------------------|----------------------|
| <b>ASSETS</b>                            |      |                       |                      |
| <b>Current</b>                           |      |                       |                      |
| Cash and cash equivalents                |      | 223,445               | 234,507              |
| Accounts receivable                      |      | 135,771               | 176,820              |
| Crude oil inventory                      |      | 12,700                | 13,885               |
| Derivative instruments                   |      | 1,104                 | 186                  |
| Prepaid expenses                         |      | 12,534                | 10,261               |
|  |      | <b>385,554</b>        | <b>435,659</b>       |
| Deferred taxes                           |      | 192,414               | 175,545              |
| Exploration and evaluation assets        | 4    | 122,018               | 92,301               |
| Capital assets                           | 3    | 2,199,431             | 2,031,682            |
|  |      | <b>2,899,417</b>      | <b>2,735,187</b>     |
| <b>LIABILITIES</b>                       |      |                       |                      |
| <b>Current</b>                           |      |                       |                      |
| Accounts payable and accrued liabilities |      | 230,322               | 297,756              |
| Dividends payable                        | 7    | 18,759                | 18,322               |
| Derivative instruments                   |      | 10,297                | 11,568               |
| Income taxes payable                     |      | 52,670                | 36,407               |
| Amount due pursuant to acquisition       |      | 130,328               | 127,131              |
|  |      | <b>442,376</b>        | <b>491,184</b>       |
| Derivative instruments                   |      | 2,001                 | 767                  |
| Long-term debt                           | 6    | 492,669               | 373,436              |
| Asset retirement obligations             | 5    | 371,023               | 310,531              |
| Deferred taxes                           |      | 232,894               | 227,668              |
|  |      | <b>1,540,963</b>      | <b>1,403,586</b>     |
| <b>SHAREHOLDERS' EQUITY</b>              |      |                       |                      |
| Shareholders' capital                    | 7    | 1,462,878             | 1,368,145            |
| Contributed surplus                      |      | 51,096                | 56,468               |
| Accumulated other comprehensive loss     |      | (55,170)              | (33,387)             |
| Deficit                                  |      | (100,350)             | (59,625)             |
|  |      | <b>1,358,454</b>      | <b>1,331,601</b>     |
|  |      | <b>2,899,417</b>      | <b>2,735,187</b>     |

**APPROVED BY THE BOARD**

*("W. Kenneth Davidson")*

W. Kenneth Davidson, Director

*("Lorenzo Donadeo")*

Lorenzo Donadeo, Director

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

|  | Note | Three Months Ended |                  | Nine Months Ended |                  |
|--|------|--------------------|------------------|-------------------|------------------|
|  |      | Sept 30,<br>2012   | Sept 30,<br>2011 | Sept 30,<br>2012  | Sept 30,<br>2011 |
| <b>REVENUE</b>                                     |      |                    |                  |                   |                  |
| Petroleum and natural gas sales                    |      | 284,838            | 248,361          | 841,870           | 756,398          |
| Royalties  |      | (12,363)           | (13,483)         | (40,146)          | (39,230)         |
| <b>Petroleum and natural gas revenue</b>           |      | <b>272,475</b>     | <b>234,878</b>   | <b>801,724</b>    | <b>717,168</b>   |
| <b>EXPENSES</b>                                    |      |                    |                  |                   |                  |
| Operating  |      | 47,030             | 43,288           | 134,808           | 121,871          |
| Transportation                                     |      | 5,744              | 6,461            | 18,655            | 18,511           |
| Equity based compensation                          | 8    | 8,704              | 7,609            | 28,620            | 22,517           |
| Loss (gain) on derivative instruments              |      | 12,590             | (19,454)         | 10,223            | 15,460           |
| Interest expense                                   |      | 7,229              | 6,659            | 19,930            | 18,602           |
| General and administration                         |      | 12,669             | 11,375           | 34,885            | 34,830           |
| Foreign exchange loss (gain)                       |      | 6,330              | 1,930            | 17,878            | (13,724)         |
| Other (income) expense                             | 2    | (277)              | 786              | 8,291             | 1,942            |
| Accretion  | 5    | 5,891              | 5,378            | 16,921            | 16,096           |
| Depletion and depreciation                         | 3, 4 | 76,941             | 60,516           | 229,301           | 171,813          |
| Impairments  | 3    | -                  | -                | 65,800            | -                |
| Gain on acquisition                                | 2    | -                  | -                | (45,309)          | -                |
|  |      | <b>182,851</b>     | <b>124,548</b>   | <b>540,003</b>    | <b>407,918</b>   |
| <b>EARNINGS BEFORE INCOME TAXES</b>                |      | <b>89,624</b>      | <b>110,330</b>   | <b>261,721</b>    | <b>309,250</b>   |
| <b>INCOME TAXES</b>                                |      |                    |                  |                   |                  |
| Deferred   |      | (2,701)            | 3,008            | (30,832)          | (27,921)         |
| Current  |      | 61,527             | 42,880           | 158,845           | 164,107          |
|  |      | <b>58,826</b>      | <b>45,888</b>    | <b>128,013</b>    | <b>136,186</b>   |
| <b>NET EARNINGS</b>                                |      | <b>30,798</b>      | <b>64,442</b>    | <b>133,708</b>    | <b>173,064</b>   |
| <b>OTHER COMPREHENSIVE (LOSS) INCOME</b>           |      |                    |                  |                   |                  |
| Currency translation adjustments                   |      | (12,753)           | (4,577)          | (21,783)          | 17,174           |
| <b>COMPREHENSIVE INCOME</b>                        |      | <b>18,045</b>      | <b>59,865</b>    | <b>111,925</b>    | <b>190,238</b>   |
| <b>NET EARNINGS PER SHARE</b>                      |      |                    |                  |                   |                  |
| Basic  |      | 0.31               | 0.71             | 1.37              | 1.92             |
| Diluted  |      | 0.31               | 0.70             | 1.35              | 1.90             |
| <b>WEIGHTED AVERAGE SHARES OUTSTANDING ('000s)</b> |      |                    |                  |                   |                  |
| Basic  |      | 98,523             | 90,492           | 97,704            | 89,955           |
| Diluted  |      | 99,748             | 91,710           | 98,848            | 91,241           |

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

|  | Note | Three Months Ended |                  | Nine Months Ended |                  |
|--|------|--------------------|------------------|-------------------|------------------|
|  |      | Sept 30,<br>2012   | Sept 30,<br>2011 | Sept 30,<br>2012  | Sept 30,<br>2011 |
| <b>OPERATING</b>   |      |                    |                  |                   |                  |
| Net earnings   |      | 30,798             | 64,442           | 133,708           | 173,064          |
| Adjustments:   |      |                    |                  |                   |                  |
| Accretion  | 5    | 5,891              | 5,378            | 16,921            | 16,096           |
| Depletion and depreciation   | 3, 4 | 76,941             | 60,516           | 229,301           | 171,813          |
| Impairments  | 3    | -                  | -                | 65,800            | -                |
| Gain on acquisition  | 2    | -                  | -                | (45,309)          | -                |
| Unrealized loss (gain) on derivative instruments                   |      | 10,721             | (27,247)         | (955)             | (6,725)          |
| Equity based compensation  | 8    | 8,704              | 7,609            | 28,620            | 22,517           |
| Unrealized foreign exchange loss (gain)                            |      | 6,740              | 1,260            | 18,223            | (13,952)         |
| Unrealized other expense   |      | -                  | 1,403            | 514               | 2,561            |
| Deferred taxes   |      | (2,701)            | 3,008            | (30,832)          | (27,921)         |
| Asset retirement obligations settled                               | 5    | (1,968)            | (4,269)          | (5,315)           | (15,512)         |
| Changes in non-cash operating working capital                      |      | 13,175             | (12,194)         | (14,003)          | (33,488)         |
| Cash flows from operating activities                               |      | 148,301            | 99,906           | 396,673           | 288,453          |
| <b>INVESTING</b>   |      |                    |                  |                   |                  |
| Drilling and development   | 3    | (96,212)           | (89,332)         | (262,064)         | (281,749)        |
| Exploration and evaluation   | 4    | (10,043)           | (45,449)         | (33,439)          | (56,780)         |
| Property acquisitions  | 2, 3 | -                  | -                | (106,184)         | (38,101)         |
| Changes in non-cash investing working capital                      |      | 28,376             | 23,322           | (1,408)           | 9,921            |
| Cash flows used in investing activities                            |      | (77,879)           | (111,459)        | (403,095)         | (366,709)        |
| <b>FINANCING</b>   |      |                    |                  |                   |                  |
| Increase (decrease) in long-term debt                              |      | 40,350             | 40,655           | 117,124           | (114,000)        |
| Issuance of senior unsecured notes                                 |      | -                  | -                | -                 | 220,561          |
| Issuance of shares pursuant to the dividend reinvestment plan      | 7    | -                  | 15,219           | 36,339            | 42,279           |
| Cash dividends   |      | (38,869)           | (51,545)         | (149,594)         | (153,657)        |
| Cash flows from (used in) financing activities                     |      | 1,481              | 4,329            | 3,869             | (4,817)          |
| Foreign exchange (loss) gain on cash held in foreign currencies    |      | (5,931)            | 2,658            | (8,509)           | 5,369            |
| Net change in cash and cash equivalents                            |      | 65,972             | (4,566)          | (11,062)          | (77,704)         |
| Cash and cash equivalents, beginning of period                     |      | 157,473            | 87,617           | 234,507           | 160,755          |
| Cash and cash equivalents, end of period                           |      | 223,445            | 83,051           | 223,445           | 83,051           |
| Supplementary information for operating activities - cash payments |      |                    |                  |                   |                  |
| Interest paid  |      | 11,775             | 10,063           | 25,701            | 16,558           |
| Income taxes paid  |      | 38,871             | 61,328           | 142,582           | 168,948          |

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

|   | Note | Shareholders' Capital | Contributed Surplus | Accumulated Other Comprehensive Loss | Retained Earnings | Total Shareholders' Equity |
|---|------|-----------------------|---------------------|--------------------------------------|-------------------|----------------------------|
| Balances as at January 1, 2011                                |      | 1,025,770             | 40,726              | (31,577)                             | 10,983            | 1,045,902                  |
| Net earnings  |      | -                     | -                   | -                                    | 173,064           | 173,064                    |
| Currency translation adjustments                              |      | -                     | -                   | 17,174                               | -                 | 17,174                     |
| Equity based compensation expense                             |      | -                     | 21,731              | -                                    | -                 | 21,731                     |
| Dividends declared  |      | -                     | -                   | -                                    | (153,975)         | (153,975)                  |
| Issuance of shares pursuant to the dividend reinvestment plan | 7    | 42,279                | -                   | -                                    | -                 | 42,279                     |
| Vesting of equity based awards                                | 7, 8 | 22,139                | (22,139)            | -                                    | -                 | -                          |
| Share-settled dividends on vested equity based awards         | 7, 8 | 5,583                 | -                   | -                                    | (5,583)           | -                          |
| Shares issued for bonus plan                                  | 7    | 786                   | -                   | -                                    | -                 | 786                        |
| Balances as at September 30, 2011                             |      | 1,096,557             | 40,318              | (14,403)                             | 24,489            | 1,146,961                  |

|   | Note | Shareholders' Capital | Contributed Surplus | Accumulated Other Comprehensive Loss | Deficit   | Total Shareholders' Equity |
|---|------|-----------------------|---------------------|--------------------------------------|-----------|----------------------------|
| Balances as at January 1, 2012                                |      | 1,368,145             | 56,468              | (33,387)                             | (59,625)  | 1,331,601                  |
| Net earnings  |      | -                     | -                   | -                                    | 133,708   | 133,708                    |
| Currency translation adjustments                              |      | -                     | -                   | (21,783)                             | -         | (21,783)                   |
| Equity based compensation expense                             |      | -                     | 27,984              | -                                    | -         | 27,984                     |
| Dividends declared  | 7    | -                     | -                   | -                                    | (167,282) | (167,282)                  |
| Issuance of shares pursuant to the dividend reinvestment plan | 7    | 53,590                | -                   | -                                    | -         | 53,590                     |
| Vesting of equity based awards                                | 7, 8 | 33,356                | (33,356)            | -                                    | -         | -                          |
| Share-settled dividends on vested equity based awards         | 7, 8 | 7,151                 | -                   | -                                    | (7,151)   | -                          |
| Shares issued for bonus plan                                  | 7    | 636                   | -                   | -                                    | -         | 636                        |
| Balances as at September 30, 2012                             |      | 1,462,878             | 51,096              | (55,170)                             | (100,350) | 1,358,454                  |

**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 CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS  
FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2012 AND 2011  
(TABULAR AMOUNTS IN THOUSANDS OF CANADIAN DOLLARS, EXCEPT SHARE AND PER SHARE AMOUNTS, UNAUDITED)**

**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 condensed consolidated interim financial statements are in compliance with IAS 34, "Interim financial reporting" and have been prepared using the same accounting policies and methods of computation as Vermilion's consolidated financial statements for the year ended December 31, 2011. Accounting pronouncements that have been issued but have not yet been adopted are discussed in Note 3 of Vermilion's consolidated financial statements for the year ended December 31, 2011. These condensed consolidated interim financial statements should be read in conjunction with Vermilion's consolidated financial statements for the year ended December 31, 2011, which are contained within Vermilion's Annual Report for the year ended December 31, 2011 and are available on SEDAR at [www.sedar.com](http://www.sedar.com) or on Vermilion's website at [www.vermilionenergy.com](http://www.vermilionenergy.com).

These condensed consolidated interim financial statements were approved and authorized for issuance by the Board of Directors of Vermilion on October 31, 2012.

**2. BUSINESS COMBINATION**

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 previous France asset base and is well aligned with Vermilion's strategic objective to maintain and consolidate the Company's core operating areas to own and operate 100% of its assets.

The acquired assets include land, wells, facilities, and inventory located in the Company's core producing fields 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:

| (\$M)                      | Consideration  |
|----------------------------|----------------|
| Cash paid to vendor        | 106,115        |
| <b>Total consideration</b> | <b>106,115</b> |

| (\$M)  | Allocation of Consideration |
|--|-----------------------------|
| Petroleum and natural gas assets                       | 206,191                     |
| Asset retirement obligations assumed                   | (27,518)                    |
| Deferred tax liabilities                               | (23,151)                    |
| Acquired 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>              |

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 nine months ended September 30, 2012, within "Other expense" in the consolidated statements of net earnings and comprehensive income.

## 2. BUSINESS COMBINATION (Continued)

The results of operations from the assets acquired have been included in Vermilion's condensed consolidated interim financial statements beginning January 19, 2012, which contributed revenues of \$77.1 million and operating income of \$68.0 million for the nine months ended September 30, 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 nine months ended September 30, 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.

## 3. CAPITAL ASSETS

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

| (\$M)  | Petroleum and<br>Natural Gas Assets | Furniture and<br>Office Equipment | Total<br>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  | 359,169                             | 2,971                             | 362,140                 |
| Property acquisitions                                | 106,184                             | -                                 | 106,184                 |
| Borrowing costs capitalized                          | 7,515                               | -                                 | 7,515                   |
| Changes in estimate for asset retirement obligations | 30,183                              | -                                 | 30,183                  |
| Depletion and depreciation <sup>1</sup>              | (219,635)                           | (3,492)                           | (223,127)               |
| Impairments  | (65,800)                            | -                                 | (65,800)                |
| Effect of movements in foreign exchange rates        | (49,201)                            | (145)                             | (49,346)                |
| <b>Balance at September 30, 2012</b>                 | 2,185,026                           | 14,405                            | 2,199,431               |

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

Vermilion has not identified indicators of impairment or impairment reversal for any CGU's for the three months ended September 30, 2012 and therefore has not performed impairment testing calculations.

At March 31, 2012 and December 31, 2011, Vermilion performed assessments as to whether any cash generating units ("CGU") had indicators of impairment. When indicators of impairment are identified, Vermilion assesses the recoverable amount of each 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. For the three months ended March 31, 2012, Vermilion recorded an impairment charge of \$65.8 million related to conventional deep gas and shallow coal bed methane natural gas plays. The impairment charges were as a result of declines in the price forecasts for natural gas in Canada which decreased the expected cash flows from the CGU's.



### 3. CAPITAL ASSETS (Continued)

Benchmark prices used in the 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) was:

| Canada                      | \$/BOE |
|-----------------------------|--------|
| 2012                        | 27.01  |
| 2013                        | 33.46  |
| 2014                        | 35.78  |
| 2015                        | 38.23  |
| 2016                        | 40.68  |
| 2017                        | 43.13  |
| 2018                        | 45.61  |
| 2019                        | 46.53  |
| 2020                        | 47.51  |
| 2021                        | 48.44  |
| Average increase thereafter | 2.0%   |

### 4. EXPLORATION AND EVALUATION ASSETS

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

| (\$M)   | Exploration and Evaluation Assets |
|---|-----------------------------------|
| <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                                     | 33,439                            |
| Depreciation                                  | (2,613)                           |
| Effect of movements in foreign exchange rates | (1,109)                           |
| <b>Balance at September 30, 2012</b>          | 122,018                           |

### 5. 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             | 31,874                       |
| Obligations settled                           | (5,315)                      |
| Accretion                                     | 16,921                       |
| Changes in discount rates                     | 25,827                       |
| Effect of movements in foreign exchange rates | (8,815)                      |
| <b>Balance at September 30, 2012</b>          | 371,023                      |

## 6. LONG-TERM DEBT

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

| (\$M)                     | As At         |              |
|---------------------------|---------------|--------------|
|                           | Sept 30, 2012 | Dec 31, 2011 |
| Revolving credit facility | 270,653       | 152,086      |
| Senior unsecured notes    | 222,016       | 221,350      |
| Total long-term debt      | 492,669       | 373,436      |

### Revolving Credit Facility

At September 30, 2012, Vermilion had in place a bank revolving credit facility totalling \$950 million, of which approximately \$270.7 million was drawn. The facility, which matures in May of 2015, is fully revolving up to the date of maturity. The amount available to Vermilion under this facility is reduced by outstanding letters of credit associated with Vermilion's operations totalling \$10.8 million as at September 30, 2012 (December 31, 2011 - \$3.7 million).

As at September 30, 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%.

## 7. 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 | 1,224,609        | 53,590       |
| Vesting of equity based awards                                | 904,210          | 33,356       |
| Share-settled dividends on vested equity based awards         | 157,137          | 7,151        |
| Shares issued for bonus plan                                  | 13,167           | 636          |
| <b>Balance as at September 30, 2012</b>                       | 98,729,258       | 1,462,878    |

Dividends declared to shareholders for the nine months ended September 30, 2012 were \$167.3 million.

Subsequent to the end of the period and prior to the condensed consolidated interim financial statements being authorized for issue on October 31, 2012, Vermilion declared dividends totalling \$18.8 million or \$0.19 per share.

## 8. EQUITY BASED COMPENSATION PLAN

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

| Number of Awards | 2012      | 2011      |
|------------------|-----------|-----------|
| Opening balance  | 1,750,055 | 1,683,776 |
| Granted          | 649,860   | 566,425   |
| Vested           | (596,423) | (434,150) |
| Forfeited        | (140,158) | (65,996)  |
| Closing balance  | 1,663,334 | 1,750,055 |

The fair value of a VIP award is determined on the grant date at the closing price of Vermilion's common shares on the Toronto Stock Exchange, adjusted by the estimated 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 nine months ended September 30, 2012, the awards granted had a weighted average fair value of \$60.08 (2011 - \$47.05).

## 9. SEGMENTED INFORMATION

Vermilion's chief operating decision maker measures financial performance of the business by assessing operating income, 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. Expenses that are assessed by the chief operating decision maker on a consolidated basis are excluded from the determination of operating income. The following amounts include transactions between segments, which are recorded at fair value at the date of recognition.

| (\$M)                                   | Three Months Ended Sept 30, 2012 |          |             |           |         | Total    |
|---|----------------------------------|----------|-------------|-----------|---------|----------|
|   | Canada                           | France   | Netherlands | Australia | Ireland |          |
| Drilling and development                | 53,658                           | 10,416   | 5,257       | 9,721     | 17,160  | 96,212   |
| Exploration and evaluation              | 10,043                           | -        | -           | -         | -       | 10,043   |
| <b>Operating Income (Loss)</b>          |                                  |          |             |           |         |          |
| Oil and gas sales to external customers | 71,268                           | 102,369  | 30,386      | 80,815    | -       | 284,838  |
| Royalties                               | (7,081)                          | (5,282)  | -           | -         | -       | (12,363) |
| Revenue from external customers         | 64,187                           | 97,087   | 30,386      | 80,815    | -       | 272,475  |
| Realized loss on derivative instruments | (274)                            | (1,360)  | -           | (235)     | -       | (1,869)  |
| Transportation expense                  | (2,005)                          | (1,840)  | -           | -         | (1,899) | (5,744)  |
| Operating expense                       | (13,420)                         | (12,351) | (3,870)     | (17,389)  | -       | (47,030) |
| Operating income (loss)                 | 48,488                           | 81,536   | 26,516      | 63,191    | (1,899) | 217,832  |
| Corporate income taxes                  | 36                               | 21,051   | 9,614       | 8,083     | -       | 38,784   |
| PRRT                                    | -                                | -        | -           | 22,743    | -       | 22,743   |
| Current income taxes                    | 36                               | 21,051   | 9,614       | 30,826    | -       | 61,527   |

## 9. SEGMENTED INFORMATION (Continued)

| (\$M)                                   | Three Months Ended Sept 30, 2011 |          |             |           |         | Total    |
|---|----------------------------------|----------|-------------|-----------|---------|----------|
|   | Canada                           | France   | Netherlands | Australia | Ireland |          |
| Drilling and development                | 55,838                           | 8,623    | 596         | 2,549     | 21,726  | 89,332   |
| Exploration and evaluation              | 37,155                           | 183      | 8,111       | -         | -       | 45,449   |
| <b>Operating Income (Loss)</b>          |                                  |          |             |           |         |          |
| Oil and gas sales to external customers | 61,903                           | 80,845   | 29,883      | 75,730    | -       | 248,361  |
| Royalties                               | (8,351)                          | (5,132)  | -           | -         | -       | (13,483) |
| Revenue from external customers         | 53,552                           | 75,713   | 29,883      | 75,730    | -       | 234,878  |
| Realized loss on derivative instruments | (186)                            | (3,327)  | -           | (4,280)   | -       | (7,793)  |
| Transportation expense                  | (1,641)                          | (2,567)  | -           | -         | (2,253) | (6,461)  |
| Operating expense                       | (13,473)                         | (14,281) | (3,991)     | (11,543)  | -       | (43,288) |
| Operating income (loss)                 | 38,252                           | 55,538   | 25,892      | 59,907    | (2,253) | 177,336  |
| Corporate income taxes                  | 467                              | 13,696   | 2,571       | 7,865     | -       | 24,599   |
| PRRT                                    | -                                | -        | -           | 18,281    | -       | 18,281   |
| Current income taxes                    | 467                              | 13,696   | 2,571       | 26,146    | -       | 42,880   |

| (\$M)                                   | Nine Months Ended September 30, 2012 |          |             |           |         | Total     |
|---|--------------------------------------|----------|-------------|-----------|---------|-----------|
|   | Canada                               | France   | Netherlands | Australia | Ireland |           |
| Total assets                            | 1,270,547                            | 674,355  | 138,630     | 286,960   | 528,925 | 2,899,417 |
| Drilling and development                | 157,680                              | 26,424   | 13,157      | 24,132    | 40,671  | 262,064   |
| Exploration and evaluation              | 33,390                               | -        | 49          | -         | -       | 33,439    |
| <b>Operating Income (Loss)</b>          |                                      |          |             |           |         |           |
| Oil and gas sales to external customers | 226,726                              | 300,708  | 92,268      | 222,168   | -       | 841,870   |
| Royalties                               | (24,266)                             | (15,880) | -           | -         | -       | (40,146)  |
| Revenue from external customers         | 202,460                              | 284,828  | 92,268      | 222,168   | -       | 801,724   |
| Realized loss on derivative instruments | (1,335)                              | (9,274)  | -           | (569)     | -       | (11,178)  |
| Transportation expense                  | (6,399)                              | (6,382)  | -           | -         | (5,874) | (18,655)  |
| Operating expense                       | (40,904)                             | (41,208) | (13,436)    | (39,260)  | -       | (134,808) |
| Operating income (loss)                 | 153,822                              | 227,964  | 78,832      | 182,339   | (5,874) | 637,083   |
| Corporate income taxes                  | 1,323                                | 49,671   | 24,546      | 24,833    | -       | 100,373   |
| PRRT                                    | -                                    | -        | -           | 58,472    | -       | 58,472    |
| Current income taxes                    | 1,323                                | 49,671   | 24,546      | 83,305    | -       | 158,845   |

## 9. SEGMENTED INFORMATION (Continued)

| (\$M)                                   | Nine Months Ended September 30, 2011 |          |             |           |         |           |
|---|--------------------------------------|----------|-------------|-----------|---------|-----------|
|   | Canada                               | France   | Netherlands | Australia | Ireland | Total     |
| Total assets                            | 1,101,924                            | 555,024  | 141,667     | 268,525   | 500,952 | 2,568,092 |
| Drilling and development                | 171,290                              | 41,117   | 11,732      | 9,448     | 48,162  | 281,749   |
| Exploration and evaluation              | 44,915                               | 3,754    | 8,111       | -         | -       | 56,780    |
| <b>Operating Income (Loss)</b>          |                                      |          |             |           |         |           |
| Oil and gas sales to external customers | 177,512                              | 241,383  | 82,474      | 255,029   | -       | 756,398   |
| Royalties                               | (24,804)                             | (14,426) | -           | -         | -       | (39,230)  |
| Revenue from external customers         | 152,708                              | 226,957  | 82,474      | 255,029   | -       | 717,168   |
| Realized loss on derivative instruments | (1,207)                              | (9,472)  | -           | (11,506)  | -       | (22,185)  |
| Transportation expense                  | (4,627)                              | (7,163)  | -           | -         | (6,721) | (18,511)  |
| Operating expense                       | (39,503)                             | (35,541) | (12,346)    | (34,481)  | -       | (121,871) |
| Operating income (loss)                 | 107,371                              | 174,781  | 70,128      | 209,042   | (6,721) | 554,601   |
| Corporate income taxes                  | 1,291                                | 48,226   | 11,718      | 25,338    | -       | 86,573    |
| PRRT                                    | -                                    | -        | -           | 77,534    | -       | 77,534    |
| Current income taxes                    | 1,291                                | 48,226   | 11,718      | 102,872   | -       | 164,107   |

### Reconciliation of operating income to net earnings

| (\$M)  | Three Months Ended |               | Nine Months Ended |               |
|--|--------------------|---------------|-------------------|---------------|
|  | Sept 30, 2012      | Sept 30, 2011 | Sept 30, 2012     | Sept 30, 2011 |
| Operating income                                 | 217,832            | 177,336       | 637,083           | 554,601       |
| Equity based compensation                        | (8,704)            | (7,609)       | (28,620)          | (22,517)      |
| Unrealized (loss) gain on derivative instruments | (10,721)           | 27,247        | 955               | 6,725         |
| Interest expense                                 | (7,229)            | (6,659)       | (19,930)          | (18,602)      |
| General and administration                       | (12,669)           | (11,375)      | (34,885)          | (34,830)      |
| Foreign exchange (loss) gain                     | (6,330)            | (1,930)       | (17,878)          | 13,724        |
| Other income (expense)                           | 277                | (786)         | (8,291)           | (1,942)       |
| Accretion  | (5,891)            | (5,378)       | (16,921)          | (16,096)      |
| Depletion and depreciation                       | (76,941)           | (60,516)      | (229,301)         | (171,813)     |
| Impairments                                      | -                  | -             | (65,800)          | -             |
| Gain on acquisition                              | -                  | -             | 45,309            | -             |
| Earnings before income taxes                     | 89,624             | 110,330       | 261,721           | 309,250       |
| Income taxes                                     | (58,826)           | (45,888)      | (128,013)         | (136,186)     |
| Net earnings                                     | 30,798             | 64,442        | 133,708           | 173,064       |

## 10. CAPITAL DISCLOSURES

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

| (\$M except as indicated)  | Three Months Ended |               | Nine Months Ended |               |
|--|--------------------|---------------|-------------------|---------------|
|  | Sept 30, 2012      | Sept 30, 2011 | Sept 30, 2012     | Sept 30, 2011 |
| Long-term debt   | 492,669            | 409,096       | 492,669           | 409,096       |
| Current liabilities  | 442,376            | 333,817       | 442,376           | 333,817       |
| Current assets   | (385,554)          | (275,546)     | (385,554)         | (275,546)     |
| Net debt [1]   | 549,491            | 467,367       | 549,491           | 467,367       |
| Cash flows from operating activities                                   | 148,301            | 99,906        | 396,673           | 288,453       |
| Changes in non-cash operating working capital                          | (13,175)           | 12,194        | 14,003            | 33,488        |
| Asset retirement obligations settled                                   | 1,968              | 4,269         | 5,315             | 15,512        |
| Fund flows from operations   | 137,094            | 116,369       | 415,991           | 337,453       |
| Annualized fund flows from operations [2]                              | 548,376            | 465,476       | 554,655           | 449,937       |
| Ratio of net debt to annualized fund flows from operations ([1] ÷ [2]) | 1.0                | 1.0           | 1.0               | 1.0           |

The ratio of net debt to annualized fund flows from operations was 1.0 for all periods presented.

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

## 11. FINANCIAL INSTRUMENTS

### 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 nine months ended September 30, 2012 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   | September 30, 2012<br>Before tax effect on comprehensive income<br>Increase (decrease) |
|------------------------------------|--|--|
| Currency risk - Euro to Canadian   | Increase in strength of the Canadian dollar against the Euro by 5% over the relevant closing rates on September 30, 2012   | (5,751)  |
|                                    | Decrease in strength of the Canadian dollar against the Euro by 5% over the relevant closing rates on September 30, 2012   | 5,751  |
| Currency risk - US \$ to Canadian  | Increase in strength of the Canadian dollar against the US\$ by 5% over the relevant closing rates on September 30, 2012   | 1,703  |
|                                    | Decrease in strength of the Canadian dollar against the US\$ by 5% over the relevant closing rates on September 30, 2012   | (1,703)  |
| Currency risk - AUD \$ to Canadian | Increase in strength of the Canadian dollar against the AUD\$ by 5% over the relevant closing rates on September 30, 2012  | (1,421)  |
|                                    | Decrease in strength of the Canadian dollar against the AUD\$ by 5% over the relevant closing rates on September 30, 2012  | 1,421  |
| Commodity price risk               | Increase 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 September 30, 2012 | (9,497)  |
|                                    | Decrease 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 September 30, 2012 | 9,039  |

## 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

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

## ABBREVIATIONS

|        |  |
|--------|--|
| bbl(s) | barrel(s)  |
| mbbls  | thousand barrels   |
| bbls/d | barrels per day  |
| mcf    | thousand cubic feet  |
| mmcf   | million cubic feet   |
| bcf    | billion cubic feet   |
| mcf/d  | thousand cubic feet per day  |
| mmcf/d | million cubic feet per day   |
| boe    | barrels of oil equivalent of natural gas and crude oil on the basis of one boe for six mcf of natural gas              |
| mboe   | thousand barrels of oil equivalent   |
| mmboe  | million barrels of oil equivalent  |
| boe/d  | barrels of oil equivalent per day  |
| NGLs   | natural gas liquids  |
| WTI    | West Texas Intermediate, the reference price paid in U.S. dollars at Cushing, Oklahoma for crude oil of standard grade |
| AECO   | the daily average Alberta natural gas price as traded on the Natural Gas Exchange                                      |
| \$M    | thousand dollars   |
| \$MM   | million dollars  |
| PRRT   | Petroleum Resource Rent Tax, a profit based tax levied on petroleum projects in Australia                              |
| GAAP   | Canadian Generally Accepted Accounting Principles or, alternatively, IFRS  |
| IFRS   | International Financial Reporting Standards or, alternatively, GAAP  |

## OFFICERS AND KEY PERSONNEL

### CANADA

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

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Executive Vice President Business Development

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

Anthony (Tony) 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 Production and Operations

Cameron A. Hercus, MSc  
Director Exploitation and New Growth

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.  
Managing Director (Acting) Europe

### AUSTRALIA

Bruce D. Lake, P.Eng.  
Managing Director  
Vermilion Oil & Gas Australia Pty Ltd.

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Calgary, Alberta

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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

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London, England

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Computershare Trust Company of Canada

**STOCK EXCHANGE LISTING**  
The Toronto Stock Exchange  
Symbol: VET  
US OTC  
Symbol: VEMTF

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