UNDERGROUND ENERGY CORPORATION
MANAGEMENT'S DISCUSSION & ANALYSIS

The following should be read in conjunction with the Unaudited Condensed Interim Financial Statements for the three months ended March 31, 2012 and 2011. The date of this discussion is May 23, 2012.

All amounts are expressed in US dollars unless otherwise indicated and are prepared in accordance with International Financial Reporting Standards ("IFRS").

Investors should read the "Forward-Looking Statements" section on page 23.

The information in this MD&A is organized under the following headings:

Page

EXECUTIVE SUMMARY

During Q1 of 2012 we discovered a new Monterey Shale fault block with our Chamberlin 4-2 well east of the Zaca oil field. We confirmed the new fault block with the Chamberlin 3-2 well in Q2 of 2012. Other previously untested Monterey fault blocks have been identified on our seismic surveys acquired in 2011, and we are mapping those structures in preparation for subsequent drilling.

Progress and Plans

2012 Look Back	
Q1	▪ Purchased 125 square miles of 3D seismic over our prospects in the San Joaquin Basin ▪ Processed and interpreted 40 miles of 2D seismic and 10 square miles of 3D seismic ▪ Re-permitted 2 drill pads at Zaca for 6 wells ▪ Drilled Chamberlin 4-2 at Zaca, which reached a depth of 6,653 feet – we encountered a number of zones with oil shows, including a 900 foot section, but, due to mechanical issues, suspended that well ▪ Raised $0.4 million via exercise of warrants

In early Q2 of 2012, we:

- Drilled and tested the Chamberlin 3-2 development well at Zaca, which reached a depth of 7,685 feet, with 1,700 feet of oil shows in multiple sections and more than 1,200 feet of continuous, strong oil shows

During the remainder of 2012, we expect to:

- Re-drill the previously suspended Chamberlin 4-2 well at Zaca into the upper Monterey fault block
- Permit, drill and complete as many wells at Zaca as are technically and financially prudent
- Continue to consolidate our land position in the Greater Zaca field area
- Commercialize one or more of our San Joaquin prospects
- Evaluate 2D and 3D seismic over our prospects
- Continue permitting exploration and development wells on our assets
- Consolidate our land position around our existing oil fields

COMPANY PROFILE

With our head office in Santa Barbara, California, USA, Underground Energy Corporation ("Underground", "UGE", "we", "us" "our" or the "Company") is primarily engaged in oil and gas exploration and production ("E&P"), focused on the prolific Monterey Shale play in California and on other emerging shale opportunities in the Western US.

The Company:

- Has producing wells at its Zaca and Burrel oil fields
- Has assembled a California-based, purpose-built team for exploitation of Western USA oil and gas resources
- Holds mineral rights to 68,524 net acres (69,291 as at December 31, 2011):
    - 30,450 net acres prospective in Monterey shales in Santa Maria and San Joaquin Basins:
        - Initial focus is conventional oil recovery from naturally fractured Monterey targets
        - 5-10 well initial drilling program underway
        - New play type discovery – 900 and 1,200 feet, respectively, of contiguous, quality oil shows from the first two new wells drilled at Zaca
    - 6,788 net acres of non-shale prospects in the San Joaquin Basin
    - 31,286 net acres in the Chainman, Elko and other emerging shale plays in Nevada

- GLJ Petroleum Consultants Ltd. ("GLJ") – who is independent of UGE – prepared a Reserves Evaluation of UGE's prospects in accordance with National Instrument 51-101 Standards of Disclosure for Oil and Gas Activities and the Canadian Oil and Gas Evaluation Handbook , which concluded that as of December 31, 2011 we have:

  0.566 million barrels of proved oil reserves

  1.479 million barrels of probable oil reserves

  2.045 million barrels of proven + probable oil reserves (2P)

  2.116 million barrels of possible oil reserves

  4.161 million barrels of proven + probable + possible oil reserves (3P)

STRATEGY

Our strategy is to grow shareholder value by de-risking our exploration assets and moving them into production. Our key initial focus is on the prolific Monterey Shale and other oil-prone shale plays in California and the Western US.

Key components of our strategy are to:

- Focus on drilling and producing from Zaca and other de-risked assets – this will give us the cash flow to fund further development and exploration;
- Identify high impact, large geologic trends that provide “room to run”, but that can be accessed at reasonable prices;
- Identify under-explored / under-exploited play and prospect concepts, including large resource plays;
- Aggregate prospective acreage in Western US – our area of expertise;
- De-risk prospects to drill-ready projects with appropriate evaluation, studies, and our High Definition seismic imaging and interpretation techniques;
- Utilize best environmental practices to secure necessary permits to drill and develop prospects;
- Drill and test prospects to further de-risk acreage;
- Grow primarily through the drill-bit;
- Maximize returns through use of the latest development / enhanced recovery technologies; and
- Consider joint ventures with value-adding partners in order to enter into new opportunities and to lay off risk.

Market and Infrastructure

When we realize production, our market will be the 18 operating California oil refineries, which in turn sell to a large market: the 37 million citizens of California. California currently imports over 63% of its crude oil requirements from outside the state, with the vast majority brought in on ocean-going tankers from Saudi Arabia, Latin America, and the Alaskan North Slope.

Most Californian refineries were built to refine the heavier grades of crude oil typically found in the State. California is a net importer of crude oil and its oil production has been in decline for several years. As a result, the demand for California heavy oil has strengthened; and the above factors have resulted in an attractive price differential between heavy and light crude oil in California. For the past 18 months, California heavy oil has been selling at a premium to the West Texas Intermediate, or NYMEX, oil price.

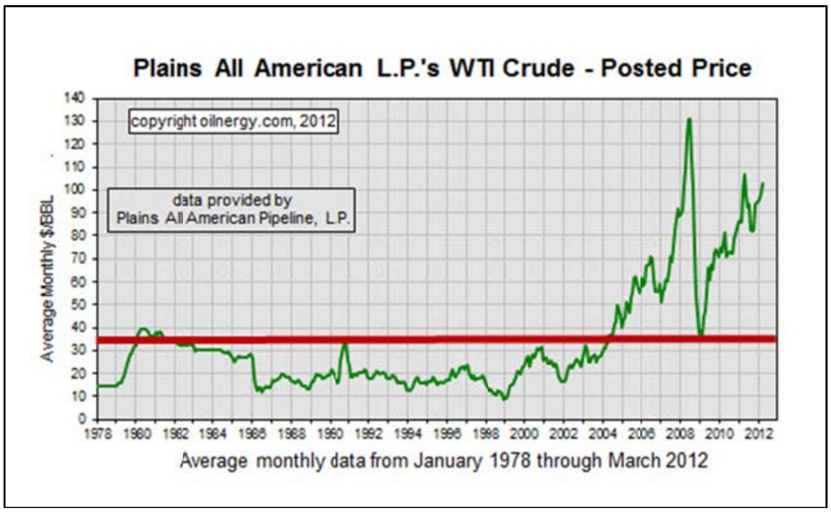
California has the oil industry infrastructure to handle very large volumes of heavy oil, whether self-produced or imported. There are major refinery centers in San Francisco and in the Los Angeles basin and smaller refineries in Santa Maria and Bakersfield. The oil produced in California will be consumed in California.

We are in the favorable position of (a) having our oil production located close to our customers, and (b) not having to incur cost or delays building infrastructure prior to selling our oil and gas.

Strategic Assumptions

The key assumptions that shape the Company's strategy and outlook are:

- We will find commercially viable oil, which can be recovered by conventional means as we drill-out the Zaca oil field
- Financial markets will be amenable to additional financing on acceptable terms
- The United States and Californian regulators will continue to permit the exploration and exploitation of oil resources
- World oil prices will remain above $35 per barrel



Uniqueness

The Company is unique in having:

- A highly competent, purpose-built, California-based exploration and development team, with a strong focus on exploration and exploitation targets in the Western US (see "Key Competencies" on page 8);
- Cross-disciplinary expertise in geological and geophysical sciences employing the application of advanced and innovative techniques in unconventional shale oil targets;
- A strong regulatory permitting and compliance team with a proven track record; and
- In-depth knowledge / relationships, which provide "early mover" access to other organic-rich shale formations in the Western US, ahead of the competition.

UGE is a leading practitioner of what we call Smart Oil, which is the future of oil development for our California and other operations. UGE integrates into its exploration, production and transportation methods, industry best practices and the latest environmental approaches. (see "Smart Oil" on page 13)

Competitive Advantages

Our competitive advantage derives from being one of the first companies to recognize that there are sizable economic opportunities in the underexplored and underexploited onshore Western US oil plays, that have yet to be explored and exploited using advanced approaches like: (a) High Definition ("HD") seismic techniques, (b) shale-specific drilling & completion techniques, (c) down-hole shale data acquisition, and (d) shale-fracture flow characterization. We capitalized on our "early mover" advantage by recruiting a California-based team with local experience and a proven track record of creating significant shareholder value. Our leadership team has many decades of California oil and gas experience.

Our second competitive advantage is our knowledge and understanding of how to deal effectively with local regulatory entities, which gives us the ability to develop additional lands both within existing oil fields and in new oil fields.

Thirdly, our HD seismic imaging and interpretation techniques enable us to rapidly evaluate our prospects in a manner that is cost effective with minimal environmental effects, which is attractive to both the landowners and regulators.

Fourthly, our permitting success has given us profile with landowners as an energy company with the competencies to successfully tackle the regulatory hurdles and turn their leases into producing oil fields.

Finally, becoming a public company gives us a higher profile with landowners, and gives us ready access to sources of capital not available to private companies. It will also give us a non-cash currency, in the form of our common stock, for use in both land aggregation and corporate transactions.

Industry and Economic Factors

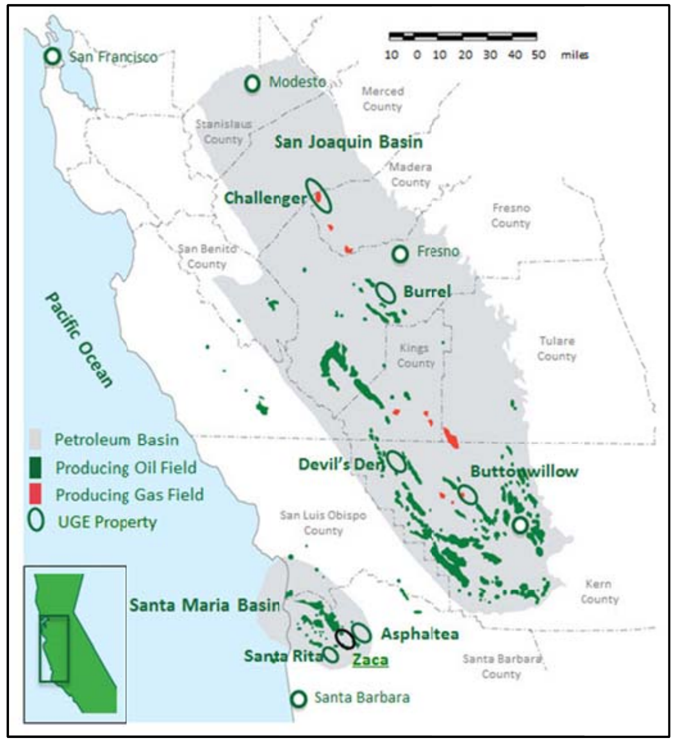
Industry and economic factors which may affect company performance include:

- Availability of oil field services – There may be increased oil exploration, resulting in delays and increased costs, due to a shortage of oil field services;
- Competition for prospective lands – We may experience increased competition and higher prices for prospective lands;
- Regulatory risk – (see Business Challenges, below); and
- Oil prices – (see Business Challenges, below).

Corporate Objectives

Our business objectives for the next twelve months are to:

- Build a solid production base and achieve positive cash flow from operating activities;
- Focus on developing and exploiting our leases on the Zaca oil field;
- Continue to develop other prospects;
- Continue engineering of enhanced recovery concepts;
- Identify and engineer infrastructure needs (e.g. water disposal, electricity, pipelines) to handle increased production at Zaca and other fields; and
- Continue to identify and hire quality people as we grow our management team, within our strategic framework.



Business Challenges

Our business challenges have been, and will continue to be:

- Exploitation risk – We will assess the reservoir characteristics of our prospects through interpretation of seismic data and drilling;
- De-risking – Expand and evolve our lease base to include exploitation and production opportunities;
- Financing – The financial climate may continue to make it challenging to source additional financing on acceptable terms to fund future operations;
- Regulatory risk – We may need to contend with changes in government permitting and taxation regimes; and
- Oil prices – There may be continued oil price volatility, resulting in economic uncertainty.

KEY COMPETENCIES

Underground has assembled a California-based, purpose-built team for exploitation of California and Western US oil and gas resources. Underground's team also has relevant experience in conventional and unconventional resource plays through projects in the North Sea, the Arabian Peninsula, the Alberta oil sands and North American Shale plays, specializing in the California Monterey.

UGE's management team has a strong understanding of California's oil and gas permitting and regulatory approval process. We seek to utilize best environmental practices to secure necessary permits to drill and develop prospects.

Brief resumes for each of the executives and directors are included in the section titled "Key Competencies" in our 2011 annual MD&A.

KEY RESOURCES

OUR PROPERTIES

The section titled “Key Resources” in our 2011 annual MD&A includes subsections which:

- Describe Naturally-Fractured Shale prospects in the United States
- Outline Monterey Shale – History and Recent Events
- Describe each of our properties

PRODUCTION

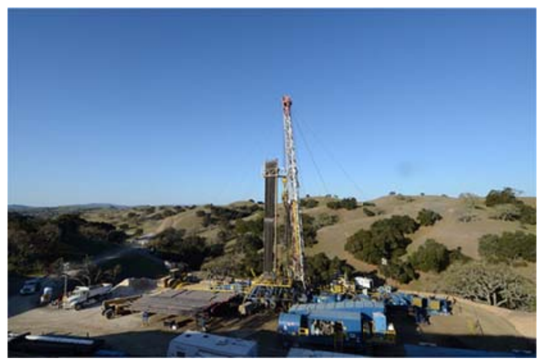
Our producing oil fields are:

Project	Location	% Int.	Net Acres	Operator	Comments
Zaca Extension	Santa Barbara Co.	80%	6,200	UGE	oil production; dev’t required
Burrel Deep	Fresno County	80%	602	UGE	oil production; dev’t required
			6,802		

Zaca Extension undeveloped land – 85% of the 6,200 net acre lease, noted above.

Chamberlin 1-2 at Zaca

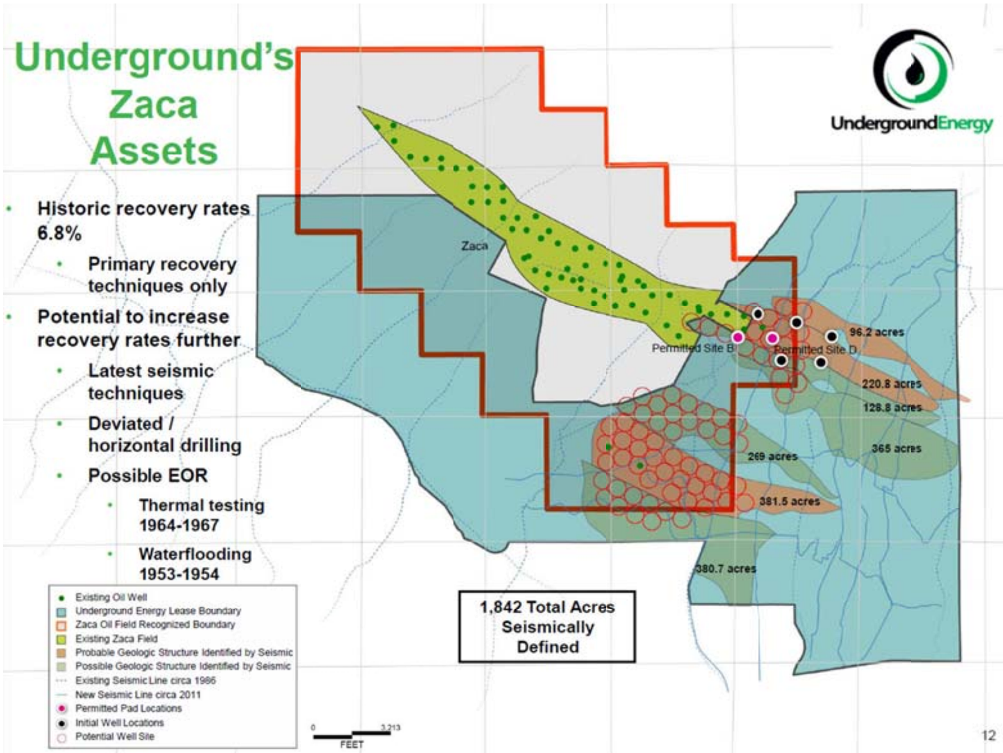
Drilling Chamberlin 4-2 at Zaca



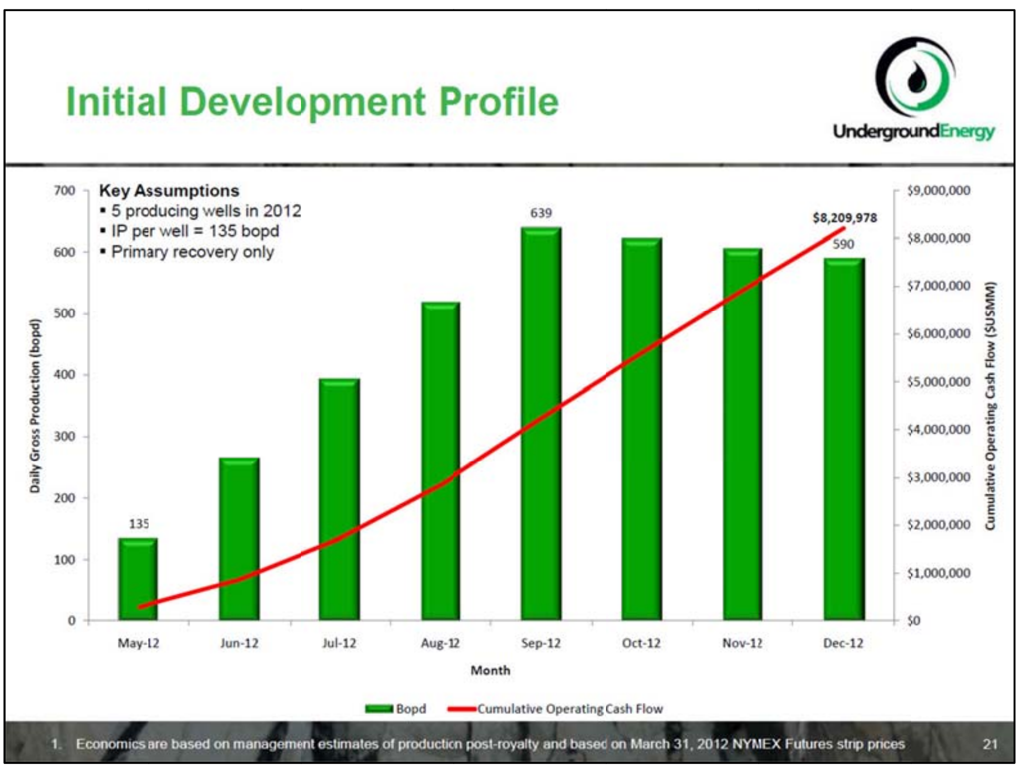
Gabriel 1-35 at Burrel Deep

Production Tanks at Burrel Deep

Zaca Assets



Initial Development Profile for Zaca



CALIFORNIA LAND

Our unexplored land holdings in California as of March 31, 2012 are:

Project	Location	% Int.	Net Acres	Operator	Comments
Asphaltea	Santa Barbara Co.	100%	5,850	UGE	prospect; appraisal required
AMI 1	San Joaquin Basin	75%	2,606	UGE	prospect; appraisal required
Santa Rita	Santa Barbara Co.	80%	974	UGE	prospect; appraisal required
Burrel	Fresno County	80%	7,440	UGE	prospect; appraisal required
Buttonwillow	Kern County	80%	1,156	UGE	prospect; appraisal required
Devil's Den	Kern County	65%	4,927	UGE	prospect; appraisal required
Pyramid Hills	Kern County	100%	695	UGE	prospect; appraisal required
Challenger	Madera County	70%	6,788	UGE	prospect; appraisal required
			30,436		

NEVADA LAND

Our unexplored land holdings in Nevada as of March 31, 2012 are:

Project	Location	% Int.	Net Acres	Operator	Comments
Bull Run	Elko County	100%	6,935	UGE	prospect; appraisal required
Dead Man	Elko County	100%	5,702	UGE	prospect; appraisal required
Coaldale	Esmeralda County	100%	8,974	UGE	prospect; appraisal required
Flat Top	Lincoln County	100%	7,083	UGE	prospect; appraisal required
Trap Springs	Nye County	100%	200	UGE	prospect; appraisal required
Blackburn West	Eureka County	100%	2,392	UGE	prospect; appraisal required
			31,286		

OUTLOOK

BUSINESS OUTLOOK

Trends we perceive include:

- The Monterey Shale in California is a world class reservoir rock

> "The largest shale oil formation is the Monterey/Santos play in southern California, which is estimated to hold 15.4 billion barrels or 64 percent of the total shale oil resources shown in Table 1 [Table 1 is an estimate of undeveloped technically recoverable shale oil resources remaining in discovered shale plays as of January 1, 2009]. The Monterey shale play is the primary source rock for the conventional oil reservoirs found in the Santa Maria and San Joaquin Basins in southern California. The next largest shale oil plays are the Bakken and Eagle Ford, which are assessed to hold approximately 3.6 billion barrels and 3.4 billion barrels of oil, respectively."
>
> **Source:** p.4, *Review of Emerging Resources: U.S. Shale Gas and Shale Oil Plays*, U.S Energy Information Administration, July 2011

- Advanced techniques – like HD seismic imaging and interpretation techniques, shale-specific drilling and completion techniques, down hole data acquisition, and shale-fracture flow characterization – will likely enable exploitation of billions of barrels of shale oil in the continental US
- Re-emphasis of onshore Californian oil will reduce California's dependence on Foreign Oil

> 63% of the oil used in California is imported. 13% is imported from Alaska. The remaining 50% is imported from Saudi Arabia – 15%, Ecuador – 11%, Iraq – 8%, Columbia – 4%, Brazil – 3%, Angola – 2%, Russia – 2%, Canada – 2%, and Others – 3%. (**Source:** energyalmanac.ca.gov)
>
> California is paying a premium for this imported oil, versus the price paid by the majority of Americans.
>
> Imported oil comes to California via oil tanker, which has higher environmental risks than producing the oil, in California, where it will be consumed.

Future prospects for the Company's performance include:

- We expect to produce oil from Zaca and from our other newly acquired assets
- We expect to acquire additional high quality shale reservoir targets in California and throughout North America at reasonable prices

Assumptions upon which management's assessment of future prospects is based include:

- We will find commercially viable oil which is recoverable by conventional means as we drill-out the Zaca Extension oil field
- The Santa Maria Basin, San Joaquin Basin and Nevada's Great Basin are underexploited in comparison to other North American basins
- We can acquire additional high quality exploration targets at reasonable prices

Factors that can impact the outlook presented above include:

- Exploration risk – Drilling may fail to confirm that moveable crude oil is present and can be produced economically
- Financing risk – (see "Business Challenges" section, on page 7 above)
- Regulatory risk – (see "Business Challenges" section, on page 7 above)

SMART OIL

UGE is a leading practitioner of what we call Smart Oil, which is the future of oil development for our California and other operations. UGE integrates into its exploration, production and transportation methods, industry best practices and the latest environmental approaches.

The end-result of Smart Oil is an enduring social, environmental and economic business model, for example:

- For exploration, UGE uses an innovative 2-D and 3-D seismic information gathering system that minimizes environmental impact. Use of this system has reduced permitting schedules from several months to a few weeks.
- UGE will use available alternative sources of energy to fulfill our power needs, while minimizing our environmental footprint.
- UGE is investigating, and will seek regulatory approval for, cost- and energy-efficient methods of transport.

PERFORMANCE ANALYSIS

FINANCIAL HIGHLIGHTS

	As at March 31, 2012	As at December 31, 2011	
Cash and cash equivalents	**11,208,820**	14,646,951	
Oil & natural gas interests*	**7,257,060**	4,778,378	
Exploration and evaluation assets	**6,019,011**	5,377,653	
Total assets	**27,234,190**	27,519,369	
Total equity	**22,465,387**	23,827,733	
	3 months ended March 30, 2012	3 months ended March 31, 2011	% Change
Oil and natural gas revenue	**163,538**	–	NM
Net loss	**(2,550,702)**	(714,250)	257%
Net loss per share – basic	**(0.01)**	(0.01)	–
Average sales (BOE/d))	**30**	–	NM
Average price ($/BOE)	**103.39**	–	NM
Netback ($/BOE)	**(44.70)**	–	NM
Average Brent oil price ($/BOE)	**118.60**	105.43	12%

* Oil & natural gas interests is a portion of PP&E (see note 5 of financial statements)

NM – not meaningful. BOE/d – barrels of oil equivalent per day. $/BOE – Dollars per barrel of oil equivalent.

Cash and Cash Equivalents

As a development stage company, we constantly consume cash for our operating activities and for our investing activities. During Q1 shareholders provided financial support by exercising 2,024,100 warrants, resulting in the receipt of $438,750. Subsequent to March 31, 2012, investors exercised 475,173 warrants, resulting in the receipt of $103,000 by the Company.

Oil & Natural Gas Interests

Oil & natural gas interests increased by approximately $2,480,000 during Q1, due primarily to drilling and geological & geophysical development at Zaca.

Exploration and Evaluation Assets

Exploration and Evaluation ("E&E") assets increased by approximately $640,000 during Q1. The $1,025,000 of additions to E&E assets during the quarter were due primarily to geological, geophysical investigations and seismic surveys of $610,000 at Devil's Den and of $255,000 at other prospects; $90,000 of lease acquisitions at AMI 1; and of $70,000 annual lease payments on various projects. The additions were offset by $385,000 of impairments, which are discussed in the "Results of Operations" section below.

Net Loss

Net Loss increased by $1,835,000 compared to the same quarter last year, and is discussed in the "Results of Operations" section below.

Netback

Combined netback of $(44.70) per BOE is comprised of $19.92 per BOE at Burrel Deep and $(255.31) per BOE at Zaca, where we operated a single well using a 24/7 contract operator and rental production equipment which had been used by the former operator. Zaca netbacks should improve substantially as we bring more Zaca wells on line and transition to company personnel and to company owned equipment.

PRODUCTION HIGHLIGHTS

	Quarter Ended			
	March 31 2012	Dec. 31 2011	Sept. 30 2011	June 30 2011
Average Daily Production[1]				
Light and Medium Crude Oil (Bbl/d)	23	25	–	–
Heavy Crude Oil (Bbl/d)	7	8		
Gas (Mcf/d)	–	30	–	–
NGLs (Bbl/d)	–	–	–	–
Combined (BOE/d)	30	38	–	–
Average Price Received				
Light and Medium Crude Oil ($/bbl)	$108.47	$110.92	–	–
Heavy Crude Oil ($/bbl)	$98.33	$93.99		
Gas ($/Mcf)	–	$1.82	–	–
NGLs ($/bbl)	–	–	–	–
Combined ($/BOE)	$104.52	$93.88	–	–
Royalties Paid				
Light and Medium Crude Oil ($/bbl)	$21.40	$21.88	–	–
Heavy Crude Oil ($/bbl)	$2.75	$2.82		
Gas ($/Mcf)	–	$0.36	–	–
NGLs ($/bbl)	–	–	–	–
Combined ($/BOE)	$17.02	$15.16	–	–
Production Costs (includes transportation)				
Light and Medium Crude Oil ($/bbl)	$67.16	$46.82	–	–
Heavy Crude Oil ($/bbl)	$344.22	$410.27		
Gas ($/Mcf)	–	$5.73	–	–
NGLs ($/bbl)[2]	–	–	–	–
Combined ($/BOE)	$132.20	$122.76	–	–
Netback Received ($/BOE)[3]				
Light and Medium Crude Oil ($/bbl)	$19.92	$42.22	–	–
Heavy Crude Oil ($/bbl)	$(255.31)	$(319.10)		
Gas ($/Mcf)	–	$(4.27)	–	–
NGLs ($/bbl)	–	–	–	–
Combined ($/BOE)	$(44.70)	$(44.04)	–	–

Notes:

1. Before deduction of royalties.
2. NGL volumes are derived from natural gas production and, as such, all the related operating costs are attributed to the production of natural gas.
3. Netbacks are calculated by subtracting royalties and production costs from revenues.

RESULTS OF OPERATIONS

	Three Months Ended March 31 2012	2011
Oil revenues	**163,538**	–
Other income	**–**	47,925
Revenues	**163,538**	47,925
Production and operating expense	**411,593**	–
Exploration and evaluation expense	**570,099**	279,904
Administrative expense	**1,723,183**	470,949
Net finance expense (income)	**748**	11,322
Share of loss of equity accounted investments	**8,617**	–
Net loss	**2,550,702**	714,250

Net Loss increased by $1,835,000 compared to the same quarter last year due to the shift in the profile of our activities from early stage exploration to development and lower risk exploration.

- Administrative Expense increased by $1,250,000 compared to the same quarter last year primarily due to $380,000 non-cash stock-based compensation; $285,000 increased personnel time allocated to administrative functions; $260,000 warrant liability mark-to-market adjustment; and $230,000 increased audit and legal fees due to being a publicly listed company.

- Production and Operating Expense increased by $410,000 compared to the same quarter last year primarily due to $330,000 lease operating expenses, which will come into line with oil revenues as we increase production and rationalize operations on the producing properties acquired in Q4 of 2011; and $55,000 G&A expenditures by the recently formed production and operating department.

- Exploration and Evaluation ("E&E") Expense increased by $290,000 compared to the same quarter last year primarily due to the $370,000 impairment of certain of the Challenger natural gas prospects acquired as part of a "package deal" when we bought all the California prospects from another oil company; offset by an $80,000 reduction in professional fees and other costs as resources were concentrated on developing lower-risk oil fields, versus the early stage exploration of the same quarter last year.

- Oil Revenues increased by $165,000 compared to the same quarter last year due to oil production from the Zaca and Burrel Deep oil wells.

QUARTERLY RESULTS OF OPERATIONS

	For the three months ended March 31 2012	Dec 31 2011	Sept 30 2011	June 30 2011	March 31 2011	Dec 31 2010	Sept 30 2010	June 30 2010
Net loss	2,550,702	3,805,215	4,476,953	1,168,560	714,250	804,639	321,967	558,252
Net loss per share – basic	(0.01)	(0.02)	(0.03)	(0.01)	(0.01)	(0.01)	(0.01)	(0.01)
Net loss per share – diluted	(0.01)	(0.02)	(0.03)	(0.01)	(0.01)	(0.01)	(0.01)	(0.01)

CAPITAL EXPENDITURES

The Company's intention is to use equity issues and operating cash flow to fund: the acquisition of mineral and surface rights; the use of advanced exploration techniques; and the drilling, completion and tie-in of oil and gas wells.

Oil and Natural Gas Interests

Below is a summary of the oil and natural gas interests portion of property plant & equipment additions:

	3 months ended March 31, 2012	12 months ended December 31, 2011
Acquisition and lease rentals additions	**61,398**	3,528,293
Geology and seismic additions	**367,445**	1,009,804
Drilling and completions	**1,876,534**	–
Facilities additions	**166,420**	255,312
Decommissioning obligations	**20,610**	–
Additions to oil and natural gas interests	**2,492,407**	4,793,409
Depletion and depreciation	**(13,725)**	(15,031)
Change to oil and natural gas interests	**2,478,682**	4,778,378
Oil and natural gas interests beginning of period	**4,778,378**	–
Oil and natural gas interests at end of period	**7,257,060**	4,778,378

Here is a recap of our oil and natural gas interests by oil field:

	As at March 31, 2012	As at December 31, 2011
Burrel Deep	**2,490,664**	2,478,910
Zaca	**4,766,396**	2,299,468
Total oil and natural gas interests	**7,257,060**	4,778,378

Exploration and Evaluation Assets

Below is a summary of our explorations and evaluation ("E&E") asset additions:

	3 months ended March 31, 2012	12 months ended December 31, 2011
Acquisition and lease rentals additions	**164,060**	3,390,546
Geology and seismic additions	**862,646**	2,007,943
Other additions	**–**	33,824
Additions to E&E assets	**1,026,706**	5,432,313
Divestitures	**–**	(2,075)
Impairments and expiries	**(385,348)**	(496,082)
Change to E&E assets	**641,358**	4,934,156
E&E assets beginning of period	**5,377,653**	443,497
E&E assets at end of period	**6,019,011**	5,377,653

Here is a recap of our exploration and evaluation assets by project:

	As at March 31, 2012	As at December 31, 2011
Asphaltea	**2,299,717**	2,283,404
AMI 1	**681,800**	574,193
Burrel	**163,264**	102,720
Devil's Den	**1,165,126**	505,858
Challenger	**488,843**	832,857
Buttonwillow	**301,994**	296,538
Pyramid Hills	**133,887**	125,317
Santa Rita Hills	**103,295**	97,493
California E&E assets	**5,337,926**	4,818,380
Blackburn West	**279,889**	197,263
Bull Run	**79,620**	73,055
Coaldale	**100,892**	93,191
Dead Man Creek	**141,441**	128,056
Flat Top	**70,040**	58,517
Trap Springs	**9,203**	9,191
Nevada E&E assets	**681,085**	559,273
Total E&E assets	**6,019,011**	5,377,653

LIQUIDITY & CAPITAL RESOURCES

As a development stage company we constantly consume cash for our operating activities and for our investing activities. We will need to obtain additional financing in order to meet our business objectives.

During Q1 shareholders provided financial support by exercising 2,024,100 warrants, resulting in the receipt of $438,750. Subsequent to March 31, 2012, investors exercised 475,173 warrants, resulting in the receipt of $103,000 by the Company.

In order to maintain our rights under various petroleum leaseholds held as of March 31, 2012 we are required to pay our share of minimum lease payments of approximately $1,000,000 per annum.

In order to meet our obligations under office lease agreements, we are required to make lease payments of approximately $210,000 in the remainder of 2012, and $250,000 in 2013.

TRANSACTIONS WITH RELATED PARTIES

The only payments made to directors and officers during the three month period ending March 31, 2012 were for compensation and expense reimbursement. Current liabilities as at March 31, 2012 included $1,021,249 payable to directors and officers of the Company.

The Company's relationship with its former subsidiary, Careaga Sand and Asphalt Company, is described in note 6 of the Audited Consolidated Financial Statements for the year ended December 31, 2011. There have been no changes in that relationship since December 31, 2011.

The Company's relationships with EQ Energy LLC and Subset Energy, LLC are described in note 7 of the Audited Consolidated Financial Statements for the year ended December 31, 2011. There have been no changes in those relationships since December 31, 2011.

OFF BALANCE SHEET ARRANGEMENTS

The Company has not entered into any off-balance sheet arrangements such as guarantee contracts, contingent interests in assets transferred to unconsolidated entities, derivative financial obligations, or with respect to any obligation under a variable interest equity arrangement.

CHANGES IN ACCOUNTING POLICIES

The accounting policies we follow are described in note 3 of the Audited Consolidated Financial Statements for the year ended December 31, 2011. There have been no changes to our accounting policies since December 31, 2011.

NON-GAAP MEASURES

Certain measures in this document do not have any standardized meanings as prescribed by IFRS and therefore are considered non-GAAP measures.

Netback per Barrel of Oil Equivalent ("BOE") is calculated by subtracting royalties per unit and production costs per unit from average price received. Netback per BOE is a non-GAAP measure and it is commonly used by oil and gas companies to illustrate the unit contribution of each BOE produced.

- Average price received is calculated by dividing oil and natural gas revenue by the gross sales volume during the period.
- Royalties per unit is calculated by dividing royalties paid by the gross sales volume during the period.
- Production costs per unit is calculated by dividing production costs by the gross sales volume during the period.

"Production costs" is similarly a non-GAAP measure that represents lease operating expenses – including downhole expenses, oil/water/gas separation expenses, water clarification and disposal expenses, gas dehydration expenses, gas gathering and compression expenses, site and road operating expenses, transportation expenses, severance and ad valorem taxes, and general production and operations expenses – for producing wells. The Company believes that production costs is a useful supplemental measure to analyze operating performance and to illustrate the unit cost of each barrel produced.

FINANCIAL INSTRUMENTS

a) Fair values

The Company's financial instruments consist of cash and cash equivalents, accounts receivable, and accounts payable and accrued liabilities. The fair values of these financial instruments approximate their carrying value due to their short-term nature.

b) Credit risk

Credit risk is the risk of loss if a customer or party to a financial instrument fails to meet its commercial obligations. The Company's maximum credit risk exposure is limited to the carrying value of its investments, accounts receivable and cash and cash equivalents. At March 31, 2012, the Company had accounts receivable of $536,585 and cash and cash equivalents of $11,208,820, which consisted of balances with US banks. Management believes that the credit risk with respect to accounts receivables and cash and cash equivalents is not material.

c) Commodity price risk

The Company's operations are expected to eventually result in exposure to fluctuations in prices of commodities including oil, natural gas and natural gas liquids. At this time, the Company has minimal production and therefore there is no need for the Company to engage in commodity price risk management. However, management continuously monitors commodity prices and will utilize instruments to manage exposure to these risks when it deems necessary.

d) Interest rate risk

The Company has no short or long-term interest bearing debt and therefore is only exposed to interest rate risk through its cash holdings. The Company manages its exposure to interest rate risk by depositing the majority of its funds in a US bank savings account.

RISKS

The Company is subject to various risks and uncertainties, including:

- Oil and gas exploration, development and production activities may not be successful and carry a risk of loss
- Unconventional shale oil and gas resource plays carry additional risks and uncertainties
- Additional financing may not be available on acceptable terms
- We may be affected by changes in government rules and regulations
- We may encounter operational problems and labor and equipment shortages
- We are dependent on a small management team
- There may be defects in title

These risks and uncertainties and their possible impact together with mitigation plans are discussed more fully in the section titled “Risks” in our 2011 annual MD&A.

OTHER ITEMS

OUTSTANDING SHARE DATA

Ordinary Shares

Authorized capital is an unlimited number of ordinary shares without par value.

204,651,652 ordinary shares are issued and outstanding (March 31, 2012 – 204,176,479; December 31, 2011 – 202,152,379).

Warrants

115,553,870 warrants are outstanding (March 31, 2012 – 116,278,163; December 31, 2011 – 118,440,663):

Exercise price	Number of warrants outstanding at period end	Expiry date
(in thousands of warrants)		
CAD 0.15	3,200	May 21, 2015
USD 0.217	3,053	April 7 to December 18, 2012
USD 0.217	57,490	January 20 to September 30, 2013
USD 0.289	394	August 17, 2013
USD 0.405	44,114	August 17, 2013
USD 0.434	8,027	August 17, 2013
Total as of March 31, 2012	116,278	

Share Options

19,590,608 share options are outstanding (March 31, 2012 – 16,949,950; December 31, 2011 – 15,449,950):

	Outstanding		Exercisable	
Exercise price	Number of options	Weighted average contractual life (years)	Number of options	Weighted average contractual life (years)
(in thousands of options)				
Time-based share options:				
$0.14	5,859	8.21	4,786	7.73
$0.19	519	6.31	519	6.31
$0.28	7,925	9.20	2,658	9.20
$0.29	917	6.92	917	6.92
Total as of March 31, 2012	15,220	8.83	8,880	8.25
Market-based share options:				
$0.10	1,730	5.50	-	n/a
Total as of March 31, 2012	1,730	5.50	-	n/a

SUBSEQUENT EVENTS

Exercise of Warrants

Subsequent to March 31, 2012, investors exercised 475,173 warrants, resulting in the issuance of 475,173 common shares and the receipt of $103,000 by the Company.

Grant of Options

Subsequent to March 31, 2012, the Company issued 2,665,658 time based options; 2,390,658 with a three year term to employees who selected options rather than a cash incentive bonus and 275,000 with a ten year term to new employees. Each option entitles the holder to acquire one common share at an exercise price of $0.284.

ADDITIONAL INFORMATION

Our 2011 annual MD&A and our 2011 Annual Information Form (AIF) can be found at www.sedar.com.

Additional information about UGE and its business activities is available at www.ugenergy.com.

Forward-Looking Statements

Certain information contained herein may constitute forward-looking statements under applicable securities laws. Forward-looking statements look into the future and provide an opinion as to the effect of certain events and trends on the business. Forward-looking statements are based on the estimates and opinions of the Company's management at the time the statements were made. Readers are cautioned not to place undue reliance on these statements as the Company's actual results, performance or achievements may differ materially from any future results, performance or achievements expressed or implied by such forward-looking statements if known or unknown risks, uncertainties or other factors affect the Company's business, or if the Company's estimates or assumptions prove inaccurate. Therefore, the Company cannot provide any assurance that forward-looking statements will materialize.

The Company assumes no obligation to update forward-looking statements should circumstances or management's estimates change.

The material assumptions that were applied in making the forward-looking statements in this MD&A include: execution of the Company's existing plans for each of its projects, which may change due to changes in the views of the Company or if new information arises which makes it prudent to change such plans; and execution of the Company's plans to seek out additional opportunities in the natural resource sector, which are dependent in part on global economic conditions and upon the prices of commodities and natural resources.