# Condensed Interim Financial Statements

## For the three and nine months ended September 30, 2014

## (unaudited)

**Marquee Energy Ltd.**
**Condensed Interim Balance Sheets**
*(amounts in Canadian dollars)*
*(unaudited)*

| | Note | September 30, 2014 ($) | December 31, 2013 ($) |
|---|---|---|---|
| **Assets** | | | |
| Current Assets | | | |
| Cash | | **12,819,938** | - |
| Accounts receivable | **4** | **9,383,905** | 4,229,769 |
| Deposits and prepaid expenses | | **628,661** | 720,449 |
| Commodity Contracts | **15c** | **273,026** | - |
| Total current assets | | **23,105,530** | 4,950,218 |
| Exploration and evaluation assets | **5** | **31,982,424** | 26,599,921 |
| Property, plant and equipment | **6** | **215,534,740** | 206,411,136 |
| Deferred tax asset | | **6,328,000** | 1,195,000 |
| Total assets | | **276,950,694** | 239,156,275 |
| **Liabilities** | | | |
| Current Liabilities | | | |
| Bank debt | **7** | **58,238,533** | 63,008,179 |
| Accounts payable and accrued liabilities | | **19,333,281** | 15,066,033 |
| Flow-through share premium | | **1,342,658** | 1,739,055 |
| Commodity contracts | **15c** | **-** | 951,692 |
| Total current liabilities | | **78,914,472** | 80,764,959 |
| Decommissioning liabilities | **8** | **70,652,315** | 46,885,154 |
| Total liabilities | | **149,566,787** | 127,650,113 |
| **Shareholders' Equity** | | | |
| Share capital | **9** | **179,437,691** | 149,466,814 |
| Contributed surplus | **10c** | **9,330,153** | 8,319,504 |
| Deficit | | **(61,383,937)** | (46,280,156) |
| Total shareholders' equity | | **127,383,907** | 111,506,162 |
| Total liabilities and shareholders' equity | | **276,950,694** | 239,156,275 |
| Commitments | 14, 15c | | |
| Subsequent Events | 15c | | |

*The accompanying notes are an integral part of the condensed interim financial statements.*

Approved on behalf of the Board:

(signed) "Dennis Feuchuk"
*Director*

(signed) "Richard Alexander"
*Director*

**Marquee Energy Ltd.**
**Condensed Interim Statements of Loss and Comprehensive Loss**
*(amounts in Canadian dollars)*
*(unaudited)*

| | Note | **Three months ended September 30, 2014 ($)** | Three months ended September 30, 2013 ($) | **Nine months ended September 30, 2014 ($)** | Nine months ended September 30, 2013 ($) |
|---|---|---|---|---|---|
| **Revenue** | | | | | |
| Oil and natural gas sales | | **23,643,599** | 12,489,129 | **70,844,826** | 35,201,282 |
| Royalties | | **(3,095,787)** | (1,462,749) | **(8,390,561)** | (3,379,221) |
| Revenue, net of royalties | | **20,547,812** | 11,026,380 | **62,454,265** | 31,822,061 |
| Gain (loss) on disposition of oil and natural gas interests | **5,6,8** | **(20,119,258)** | (411,615) | **(19,456,600)** | 89,401 |
| Realized loss on settlement of commodity contracts | | **(441,379)** | (1,310,439) | **(3,120,270)** | (1,809,370) |
| Unrealized gain (loss) on commodity contracts | **15c** | **2,632,644** | (202,502) | **1,224,718** | (953,146) |
| Revenue before expenses | | **2,619,819** | 9,101,824 | **41,102,113** | 29,148,946 |
| **Expenses** | | | | | |
| Production and operating | | **5,521,299** | 3,768,588 | **19,773,585** | 10,672,969 |
| Transportation | | **1,528,626** | 858,641 | **4,653,244** | 2,845,848 |
| General and administrative | | **1,653,784** | 1,060,975 | **4,946,223** | 3,706,176 |
| Finance | **11** | **1,293,006** | 716,573 | **3,726,607** | 2,083,214 |
| Transaction costs | **3** | **-** | 225,000 | **572,683** | 225,000 |
| Stock-based compensation | **10c** | **408,403** | 74,379 | **825,582** | 372,572 |
| Depletion and depreciation | **6** | **8,750,805** | 4,378,487 | **24,096,032** | 13,259,064 |
| Exploration and evaluation expenditures | **5** | **827,824** | 36,456 | **2,342,323** | 575,720 |
| Total expenses | | **19,983,747** | 11,119,099 | **60,936,279** | 33,740,563 |
| Loss before income taxes | | **(17,363,928)** | (2,017,275) | **(19,834,166)** | (4,591,617) |
| Income tax expense (recovery) | | | | | |
| Capital tax | | **112,936** | 26,960 | **183,674** | 65,303 |
| Deferred | | **(4,222,649)** | (516,955) | **(4,914,059)** | (1,029,567) |
| Total income tax expense (recovery) | | **(4,109,713)** | (489,995) | **(4,730,385)** | (964,264) |
| **Loss and comprehensive loss for the period** | | **(13,254,215)** | (1,527,280) | **(15,103,781)** | (3,627,353) |
| Loss per share | | | | | |
| Basic | **12** | **(0.11)** | (0.03) | **(0.14)** | (0.07) |
| Diluted | **12** | **(0.11)** | (0.03) | **(0.14)** | (0.07) |

*The accompanying notes are an integral part of the condensed interim financial statements*

**Marquee Energy Ltd.**

**Condensed Interim Statements of Changes in Shareholders' Equity**

*(amounts in Canadian dollars)*

*(unaudited)*

| | Note | Share Capital ($) | Contributed Surplus ($) | Deficit ($) | Total Shareholders' Equity ($) |
|---|---|---|---|---|---|
| Balance at January 1, 2013 | | 127,014,715 | 7,665,208 | (43,267,254) | 91,412,669 |
| Stock-based compensation related to stock options | | - | 508,429 | - | 508,429 |
| Normal course issuer bid | | (34,854) | 27,704 | - | (7,150) |
| Net loss for the period | | - | - | (3,627,353) | (3,627,353) |
| Balance at September 30, 2013 | | 126,979,861 | 8,201,341 | (46,894,607) | 88,286,595 |
| Balance at January 1, 2014 | | 149,466,814 | 8,319,504 | (46,280,156) | 111,506,162 |
| Issued for cash | 9 | 20,125,242 | - | - | 20,125,242 |
| Issued on asset acquisition | 3 | 10,827,649 | - | - | 10,827,649 |
| Issued on exercise of stock options | 9 | 42,000 | (15,900) | | 26,100 |
| Share issue costs | 9 | (1,024,014) | - | - | (1,024,014) |
| Stock-based compensation related to stock options | 6,10c | - | 1,026,549 | - | 1,026,549 |
| Net loss for the period | | - | - | (15,103,781) | (15,103,781) |
| **Balance at September 30, 2014** | | **179,437,691** | **9,330,153** | **(61,383,937)** | **127,383,907** |

*The accompanying notes are an integral part of the condensed interim financial statements*

**Marquee Energy Ltd.**
**Condensed Interim Statements of Cash Flows**
*(amounts in Canadian dollars)*
*(unaudited)*

| | Note | **Three months ended September 30, 2014 ($)** | Three months ended September 30, 2013 ($) | **Nine months ended September 30, 2014 ($)** | Nine months ended September 30, 2013 ($) |
|---|---|---|---|---|---|
| **Cash flows from (used in) operating activities** | | | | | |
| Income (loss) for the period | | **(13,254,215)** | (1,527,280) | **(15,103,781)** | (3,627,353) |
| Adjustments for: | | | | | |
| Amortization of other liabilities | | **(7,800)** | (7,800) | **(23,400)** | (23,400) |
| Depletion and depreciation expense | 6 | **8,750,805** | 4,378,487 | **24,096,032** | 13,259,064 |
| Stock based compensation expense | 10c | **408,403** | 74,379 | **825,582** | 372,572 |
| (Gain) loss on disposition of oil and natural gas interests | 5,6,8 | **20,119,258** | 411,615 | **19,456,600** | (89,401) |
| Unrealized (gain) loss on commodity contracts | | **(2,632,644)** | 202,502 | **(1,224,718)** | 953,146 |
| Accretion of decommissioning liabilities | 11 | **399,199** | 88,722 | **1,028,111** | 259,673 |
| Exploration and evaluation expenditures | 5 | **827,824** | 36,456 | **2,342,323** | 575,720 |
| Deferred income tax expense (recovery) | | **(4,222,649)** | (516,955) | **(4,914,059)** | (1,029,567) |
| Decommissioning expenditures | 8 | **(53,685)** | (59,750) | **(54,961)** | (121,580) |
| Changes in non-cash working capital | 13 | **(2,731,242)** | (152,882) | **(6,181,191)** | 679,556 |
| Net cash from operating activities | | **7,603,254** | 2,927,494 | **20,246,538** | 11,208,430 |
| **Cash flows from (used in) investing activities** | | | | | |
| Exploration and evaluation asset expenditures | 5 | **(5,707,222)** | (1,253,616) | **(9,347,028)** | (3,213,639) |
| Property, plant and equipment expenditures | 6 | **(17,483,183)** | (7,230,861) | **(31,013,537)** | (15,403,519) |
| Asset acquisitions | 3,5,6 | **(205,337)** | - | **(2,219,916)** | - |
| Proceeds on disposition of exploration and evaluation assets | 5 | **-** | 42,500 | **50,000** | 140,937 |
| Proceeds on disposition of property, plant, and equipment | 6 | **15,199,277** | 2,320,070 | **15,678,046** | 3,007,700 |
| Changes in non-cash working capital | 13 | **10,393,140** | 5,522,367 | **5,409,491** | (406,179) |
| Net cash from (used in) investing activities | | **2,196,675** | (599,540) | **(21,442,944)** | (15,874,700) |
| **Cash flows from (used in) financing activities** | | | | | |
| Proceeds from bank debt, net of repayments | | **2,993,909** | (2,320,804) | **(4,769,646)** | 4,673,420 |
| Proceeds from issuance of share capital | 9 | **26,100** | - | **20,151,342** | - |
| Share issue costs | | **-** | - | **(1,365,352)** | - |
| Repurchase of common shares | | **-** | (7,150) | **-** | (7,150) |
| Net cash from (used in) financing activities | | **3,020,009** | (2,327,954) | **14,016,344** | 4,666,270 |
| Change in cash | | **12,819,938** | - | **12,819,938** | - |
| Cash, beginning of period | | **-** | - | **-** | - |
| **Cash, end of period** | | **12,819,938** | - | **12,819,938** | **-** |

*The accompanying notes are an integral part of the condensed interim financial statements*

**1. General business description**

Marquee Energy Ltd. ("Marquee" or the "Company") is engaged in the acquisition of, exploration for, development of and production of oil and natural gas. Marquee Energy Ltd. is a publicly traded company on the TSX Venture Exchange under the symbol "MQL.V", and on the United States OTC Markets ("OTCQX") under the symbol "MQLXF", incorporated and domiciled in Canada. The Company's operations are in Alberta and Saskatchewan. The address of business of the Company is Suite #1700, 500 – 4th Avenue SW, Calgary, Alberta, Canada, T2P 2V6. These condensed interim financial statements were approved and authorized for issuance by the Board of Directors on November 13, 2014.

**2. Basis of preparation**

(a) Statement of compliance

The condensed interim financial statements of the Company have been prepared in accordance with International Accounting Standard (IAS) 34, "Interim Financial Reporting" using accounting policies consistent with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB). Certain information and disclosures normally included in the Annual Financial Statements prepared in accordance with IFRS have been condensed or omitted. These condensed interim financial statements should be read in conjunction with the Company's audited annual financial statements as at and for the year ended December 31, 2013 and the notes thereto.

The financial statements have been prepared on a historical cost basis, except as detailed in the accounting policies disclosed in note 3 of the Company's audited consolidated financial statements for the year ended December 31, 2013. All accounting policies and methods of computation followed in the preparation of these condensed interim financial statements are consistent with those of the previous financial year, except as detailed in note 2(b) "Changes in accounting policies" in these financial statements. There have been no changes to the use of estimates or management's judgments since December 31, 2013.

On January 1, 2014, the Company's wholly owned subsidiary was amalgamated with the Company.

(b) Changes in accounting policies

- On January 1, 2014, the Company adopted IFRS Interpretations Committee (IFRIC) 21, "Levies" which provides guidance on accounting for levies in accordance with the requirements of IAS 37, "Provisions, Contingent Liabilities and Contingent Assets". The interpretation clarifies that an entity is to recognize a liability for a levy when the activity that triggers the payment occurs. The interpretation also clarifies that a levy liability is to be accrued progressively only if the activity that triggers payment occurs over a period of time, in accordance with the relevant legislation. The adoption of this interpretation had no impact on the Company's financial statements.
- On January 1, 2014, the Company adopted the amended IAS 36, "Impairment of Assets". The amendments reduce the circumstances in which the recoverable amount of cash generating units, "CGUs", is required to be disclosed and clarifies the disclosures required when an impairment loss has been recognized or reversed in the period. The retrospective adoption of these amendments will only impact the Company's disclosures in the notes to the financial statements in periods when an impairment loss or impairment reversal is recognized.
- On January 1, 2014, the Company adopted several narrow-scope amendments to a total of nine standards issued by the IASB in December 2013. The adoption of these amendments had no impact on the financial statements.

The Company will be required to adopt each of these new standards in future years:

Financial Instruments

- IFRS 9, "Financial Instruments" provides a comprehensive new standard for accounting for all aspects of financial instruments. It includes a logical model for classification and measurement, a single, forward-looking 'expected-loss' impairment model and a substantially reformed approach to hedge accounting. The new standard is effective for years beginning on or after January 1, 2018. The Company has not determined the impact of the new standard on its financial statements.

Revenue Recognition

- IFRS 15, "Revenue from Contracts with Customers" provides a comprehensive new standard for recognition, measurement and disclosure of revenue from contracts with customers, excluding contracts within scope of the standards on leases, insurance contracts and financial instruments. It specifies how and when to recognize revenue as well as requiring entities to provide more informative and relevant disclosure. The new standard is effective for years beginning on or after January 1, 2017. The Company has not determined the impact of the standard on its financial statements.

## 3. Asset Acquisitions

### (i) 2014

On March 6, 2014, the Company completed a transaction to acquire certain oil and natural gas properties from a non-arm's length party, as one of the Company's directors is also a director of the company from which the properties were acquired. The asset acquisition allowed the Company to acquire undeveloped land, as well as additional production, in its core Michichi area. The Company issued 13,705,888 common shares at $0.79 per common share (closing price on March 6, 2014) as well as paid $999,579 in cash consideration. Costs associated with the transaction of $572,683 are included in transaction costs in the statement of income (loss).

The value attributed to the property, plant and equipment acquired was determined with reference to an engineering report prepared by third party reserve evaluators using proved reserves discounted at approximately 20%. The value attributed to the exploration and evaluation assets was determined with reference to recent undeveloped land acquisitions in close proximity to the Michichi oil and natural gas interests.

During the three month period ended June 30, 2014, measurement period adjustments subsequent to the acquisition date resulted in an increase to property, plant and equipment by $751,239 and an increase to the cash consideration by $751,239. These adjustments represent new information relating to estimates originally made in the preliminary determination of values. The Company does not anticipate any further adjustments in subsequent periods.

*(amounts in Canadian dollars)*

The following table summarizes the net assets acquired and liabilities assumed. The fair value of the common shares issued approximates the fair value of the net assets acquired.

| **Purchase price allocation** | ($) |
|---|---|
| Fair value of net assets acquired: | |
| Exploration and evaluation assets | 2,638,029 |
| Property, plant, and equipment | 26,996,205 |
| Deferred tax asset | 274,000 |
| Decommissioning liabilities | (18,081,006) |
| Net assets acquired | 11,827,228 |
| **Costs of acquisition:** | |
| Cash consideration | 999,579 |
| Common shares issued (13,705,888 shares at $0.79 [1] per common share) | 10,827,649 |
| Total consideration | 11,827,228 |

[1] Based on the closing price of Marquee shares on March 6, 2014

The revenues and net incomes since the closing dates of the acquisition and proforma consolidated revenues and net incomes giving effect to the acquisition as if it had occurred on January 1 are not practicable to determine. The operations of the assets acquired are not managed as a separate business unit or division of the Company as all of the properties acquired were in similar existing property areas.

**(ii) 2013**

On December 31, 2013, the Company completed a transaction to acquire substantially all of the Western Canadian oil and natural gas interests of Sonde Resources Corp. (“Sonde”) through the acquisition of Sonde’s wholly-owned subsidiary. The asset acquisition allowed the Company to acquire key infrastructure in its core Michichi area as well as additional production and undeveloped lands. The Company issued 21,182,491 common shares at $0.80 per common share (closing price December 31, 2013) as well as paid $17,845,304 in cash consideration. Costs associated with the transaction of $1,836,285 were included in transaction costs in the statement of income (loss) for the year ended December 31, 2013.

During the three month period ended June 30, 2014, measurement period adjustments subsequent to the acquisition date resulted in an increase to deferred tax asset by $6,860,000 with a corresponding realization of a bargain purchase gain of $6,860,000 recorded in the statement of income (loss) for the year ended December 31, 2013. The adjustment relates to additional resource tax pools received by the Company as a result of the acquisition that were not previously accounted for. The Company does not anticipate any further adjustments in subsequent periods.

The following table summarizes the net assets acquired and liabilities assumed. The fair value of the common shares issued and the cash consideration given approximates the fair value of the net assets acquired.

*(amounts in Canadian dollars)*

| **Purchase price allocation** | ($) |
|---|---|
| Fair value of net assets acquired: | |
| Exploration and evaluation assets | 7,441,228 |
| Property, plant, and equipment | 56,734,349 |
| Decommissioning liabilities | (29,228,941) |
| Deferred tax asset | 6,704,662 |
| Net assets acquired | 41,651,298 |
| Bargain purchase gain | (6,860,000) |
| Purchase consideration transferred | 34,791,298 |
| **Costs of acquisition:** | |
| Cash consideration | 17,845,304 |
| Common shares issued (21,182,491 shares at $0.80 [1] per share) | 16,945,994 |
| Total consideration | 34,791,298 |

[1] Based on the closing price of Marquee shares on December 31, 2013

## 4. Accounts Receivable

| | **September 30, 2014 ($)** | December 31, 2013 ($) |
|---|---|---|
| Oil and natural gas marketing companies | **8,457,285** | 3,526,756 |
| Joint interest partners and other | **862,683** | 379,833 |
| Government agencies | **63,937** | 323,180 |
| Total accounts receivable | **9,383,905** | 4,229,769 |

*(amounts in Canadian dollars)*

## 5. Exploration and evaluation assets

| **Cost** | **($)** |
|---|---|
| Balance, January 1, 2013 | 20,106,434 |
| Capital expenditures | 6,019,507 |
| Acquisition of exploration and evaluation assets | 7,441,228 |
| Transfers to property, plant and equipment | (1,787,130) |
| Exploration and evaluation costs expensed | (4,962,244) |
| Dispositions of exploration and evaluation assets | (217,874) |
| Balance, December 31, 2013 | 26,599,921 |
| Capital expenditures | 9,347,028 |
| Acquisition of exploration and evaluation assets | 3,828,029 |
| Transfers to property, plant and equipment (note 6) | (5,400,362) |
| Exploration and evaluation costs expensed | (2,342,323) |
| Dispositions of exploration and evaluation assets | (49,869) |
| **Balance, September 30, 2014** | **31,982,424** |

During the nine months ended September 30, 2014, the Company expensed certain costs previously capitalized as exploration and evaluation assets as the lease term of undeveloped lands expired in the amount of $2,342,323 (2013 – $575,720). These amounts have been included as exploration and evaluation expenditures in the statement of income (loss).

During the nine months ended September 30, 2014, the Company completed certain asset acquisitions with third parties to acquire undeveloped lands in the Company's core areas for total cash consideration of $1,190,000. In addition, the Company acquired $2,638,029 of exploration and evaluation assets as described in note 3(i).

During the nine months ended September 30, 2014, the Company disposed of undeveloped land for cash consideration of $50,000 (2013 - $140,937) resulting in a gain on disposition of $131 (2013 - loss of $76,937) included in the statement of income (loss).

*(amounts in Canadian dollars)*

## 6. Property, plant and equipment

| | Oil and natural gas interests ($) | Corporate assets ($) | Total ($) |
|---|---|---|---|
| **Cost** | | | |
| Balance, January 1, 2013 | 184,404,574 | 425,591 | 184,830,165 |
| Capital expenditures | 27,429,525 | 3,743 | 27,433,268 |
| Dispositions | (8,738,719) | - | (8,738,719) |
| Acquisition of oil and natural gas properties | 56,734,349 | - | 56,734,349 |
| Transfers from exploration and evaluation assets | 1,787,130 | - | 1,787,130 |
| Change in decommissioning liabilities | 5,038,906 | - | 5,038,906 |
| Balance, December 31, 2013 | 266,655,765 | 429,334 | 267,085,099 |
| Capital expenditures | 31,151,387 | 63,117 | 31,214,504 |
| Dispositions | (46,336,822) | - | (46,336,822) |
| Acquisition of oil and natural gas properties | 27,026,542 | - | 27,026,542 |
| Transfers from exploration and evaluation assets (note 5) | 5,400,362 | - | 5,400,362 |
| Change in decommissioning liabilities (note 8) | 6,491,526 | - | 6,491,526 |
| **Balance, September 30, 2014** | **290,388,760** | **492,451** | **290,881,211** |

| | | | |
|---|---|---|---|
| **Accumulated depletion and depreciation and impairments:** | | | |
| Balance, January 1, 2013 | (47,819,412) | (97,271) | (47,916,683) |
| Depletion and depreciation expense | (17,896,938) | (81,913) | (17,978,851) |
| Dispositions | 4,383,103 | - | 4,383,103 |
| Impairment loss, net of impairment reversals | 838,468 | - | 838,468 |
| Balance, December 31, 2013 | (60,494,779) | (179,184) | (60,673,963) |
| Depletion and depreciation expense | (24,035,267) | (60,765) | (24,096,032) |
| Dispositions | 9,423,524 | - | 9,423,524 |
| **Balance, September 30, 2014** | **(75,106,522)** | **(239,949)** | **(75,346,471)** |

| | | | |
|---|---|---|---|
| **Net book value:** | | | |
| At December 31, 2013 | 206,160,986 | 250,150 | 206,411,136 |
| **At September 30, 2014** | **215,282,238** | **252,502** | **215,534,740** |

During the three and nine months ended September 30, 2014, the Company capitalized salaries of $186,988 (2013 - $117,614) and $589,795 (2013 – $466,681) as well as related stock-based compensation expense for employees and consultants who performed services that were directly attributable to development activities of $115,835 (2013 - $16,464) and $200,967 (2013 - $135,857) for a nine month total of $790,762 (2013 - $602,538).

During the nine months ended September 30, 2014, the Company completed the acquisition of certain minor assets for cash consideration of $30,337 (2013 – nil). In addition, the Company acquired $26,996,205 of property, plant and equipment as described in note 3(i).

During the nine months ended September 30, 2014, the Company completed the sale of certain non-core properties for net proceeds of $1,769,214 (2013 – $3,007,700) and the sale of the Pembina CGU for net proceeds of $13,908,832 (2013 – nil). A $1,424,862 gain related to non-core dispositions (2013 – gain $166,338) and a $20,870,399 loss related to the Pembina disposition was recognized in the statement of income (loss).

Included in the non-core property dispositions was a disposition to a related party as one of the Company's directors is also a director of the company who purchased the non-core properties. Proceeds of disposition related to this transaction were $1,190,000 resulting in a $662,200 gain included in the statement of income (loss).

**7. Bank Debt**

At September 30, 2014, the Company has available a syndicated credit facility with two Canadian Chartered Banks. The credit facility is composed of a $70,000,000 revolving demand facility ("revolving loan") (December 31, 2013 - $75,000,000), a $10,000,000 operating facility ("operating loan") (December 31, 2013 – nil) and an acquisition/development demand loan ("A&D loan") of up to $15,000,000 (December 31, 2013 - $15,000,000).

The revolving and operating loan can be used for general corporate purposes and capital expenditures, and bear interest at the Bank's prime rate plus an applicable margin (of 50 bps to 250 bps) determined by reference to the Company's net debt to cash flow ratio which is calculated as negative working capital, excluding the fair value of any commodity contracts, over annualized trailing quarterly cash flow from operating activities before working capital adjustments. At October 1, 2014 the rate is prime plus 100 bps.

The A&D loan can be used to acquire proved producing oil and natural gas reserves or for the development of proved non-producing or undeveloped oil and natural gas reserves. The availability of the loan is subject to the Bank's normal lending parameters and will bear interest at the Bank's prime rate plus an applicable margin (of 50 bps to 250 bps) plus an additional 50 bps per annum.

The credit facility is secured by a general assignment of book debts and a $150,000,000 demand debenture with a floating charge over all assets of the Company with an undertaking to provide fixed charges on the Company's producing petroleum and natural gas properties at the request of the bank. The next scheduled review for the credit facility is April 2015.

At September 30, 2014, the Company had drawn $49,938,533 on the revolving loan, $8,300,000 on the operating loan and $nil on the A&D loan. At September 30, 2014, the Company has a letter of guarantee outstanding for $800,000 for the Oil and Gas Orphan Fund of the Province of Saskatchewan which reduces the amount available under the operating loan.

The Company is subject to certain reporting and financial covenants that require:

- The Company to maintain a working capital ratio of at least 1:1 (for the purposes of the covenant, bank debt and the fair value of any commodity contracts are excluded and the unused portion of the operating and revolving loan is added to current assets); and

*(amounts in Canadian dollars)*

- The Company to not hedge greater than 70% of average daily production volumes, net of royalties, on a commodity by commodity basis, for the first year and 50% for the second and third years following the most recently ended fiscal quarter.

At September 30, 2014, the Company was in compliance with the working capital ratio covenant. The working capital ratio was 2.1 to 1.0 at September 30, 2014 (December 31, 2013 – 0.95 to 1.0).

## 8. Decommissioning liabilities

The Company's decommissioning liabilities are an estimate of the reclamation and abandonment costs arising from its ownership interest in oil and natural gas assets, including well sites, batteries and gathering systems. The total undiscounted cash flows required to settle the liabilities is approximately $124,400,000 at September 30, 2014 (December 31, 2013 - $94,815,000). The estimated net present value of the decommissioning liabilities was calculated using a risk-free rate between approximately 1% and 3% at September 30, 2014 (December 31, 2013 – between 1% and 3%).

During the nine months ended September 30, 2014, the Company recorded an $11,194 loss (2013 – nil) in the statement (loss) classified as gain (loss) on disposition of oil and natural gas assets representing the difference between the recorded provision and the actual costs incurred for abandonments of $54,961.

The following table summarizes changes in the decommissioning liabilities:

| | **September 30, 2014 ($)** | December 31, 2013 ($) |
|---|---|---|
| Decommissioning liabilities, beginning of period | **46,885,154** | 13,291,321 |
| New liabilities recognized (note 6) | **860,576** | 530,148 |
| Change in estimates [1] (note 6) | **5,630,950** | 4,508,758 |
| Liabilities assumed on acquisitions (note 3) | **18,081,006** | 29,228,941 |
| Liabilities settled on dispositions (note 6) | **(1,789,715)** | (845,752) |
| Abandonments performed | **(43,767)** | (182,448) |
| Accretion (note 11) | **1,028,111** | 354,186 |
| Decommissioning liabilities, end of period | **70,652,315** | 46,885,154 |

[1] Changes in the status of wells, discount rates and the estimates of costs of abandonment and reclamation are factors resulting in a change in estimate. The change in estimate for the year ended December 31, 2013 included $7.3 million of cost increases resulting from the application of Directive 11: License Liability Rating issued by the Alberta Energy Regulator, $2.4 million reduction related to the change in discount rates and $0.4 million reduction related to a change in estimated years to reclamation. For the nine month period ended September 30, 2014, the change in estimate included $1.7 million of cost increases resulting from additional information due to recent asset acquisitions and review of third party and internal information and an increase of $3.9 million related to the change in discount rates.

*(amounts in Canadian dollars)*

## 9. Share Capital

a) Authorized

Unlimited number of common shares with voting rights.
Unlimited number of preferred shares, issuable in series.

b) Issued

The following table summarizes the changes in common shares outstanding:

| | Number of Common Shares | Stated Amount ($) |
|---|---|---|
| Outstanding, January 1, 2013 | 54,661,156 | 127,014,715 |
| Repurchase of common shares | (15,000) | (34,854) |
| Common shares issued on asset acquisition | 21,182,491 | 16,945,994 |
| Flow-through common shares issued | 8,660,500 | 8,194,475 |
| Flow-through share premium | - | (2,132,125) |
| Share issue costs, net of tax effect of ($173,793) | - | (521,391) |
| Outstanding, December 31, 2013 | 84,489,147 | 149,466,814 |
| Common shares issued for cash | 22,115,650 | 20,125,242 |
| Common shares issued on asset acquisition (note 3) | 13,705,888 | 10,827,649 |
| Share issue costs, net of tax effect of ($341,338) | - | (1,024,014) |
| Common shares issued on exercise of stock options | 30,000 | 42,000 |
| **Outstanding, September 30, 2014** | **120,340,685** | **179,437,691** |

On May 2, 2014, the Company closed a bought-deal financing of 22,115,650 common shares at a price of $0.91 per common share resulting in net proceeds of $18.8 million.

*(amounts in Canadian dollars)*

## 10. Share-based payments

a) Stock option plan

Under the Company's stock option plan, the Company may grant options to its directors, officers, employees and consultants for up to 10% of the issued and outstanding common shares at the time of the option grant. The maximum number of common shares optioned to any one optionee during a twelve month period shall not exceed 5% (2% for consultants) of the outstanding common shares of the Company at the time of grant. Options granted under the plan have a five year term and have vesting periods as determined by the Company's directors at the date of grant. The exercise price of each option equals the market price of the Company's share of the date of grant.

The following table summarizes the changes in the stock options outstanding:

| | Number | Weighted Average Exercise Price ($) |
|---|---|---|
| Outstanding, January 1, 2013 | 4,104,495 | 1.33 |
| Granted | 390,000 | 0.65 |
| Cancelled | (1,075,708) | 1.52 |
| Outstanding, December 31, 2013 | 3,418,787 | 1.20 |
| Granted | 7,140,000 | 1.00 |
| Exercised | (30,000) | 0.87 |
| Cancelled | (391,438) | 1.04 |
| **Outstanding, September 30, 2014** | **10,137,349** | **1.08** |
| **Exercisable at September 30, 2014** | **2,104,849** | **1.30** |

### (iii) 2014 Transactions

During the nine months ended September 30, 2014, the Company granted 7,140,000 options at a weighted average exercise price of $1.00 per option. 1,715,000 of the options granted vest one-quarter on each of the six, twelve, twenty-four and thirty-six month anniversaries from the grant date and have a five year term. 5,425,000 of the options granted vest one-quarter on each of the first, second, third and fourth anniversaries from the grant date and have a five year term.

*(amounts in Canadian dollars)*

The following table summarizes the expiry terms and exercise prices of the Company's outstanding stock options as at September 30, 2014:

| Outstanding Options | Weighted Average Exercise Price ($) | Weighted Average Remaining Contractual Term (years) | Number of Stock Options Exercisable |
|---:|---:|---:|---:|
| 84,420 | 5.44 | 1.2 | 84,420 |
| 176,679 | 1.60 | 1.3 | 176,679 |
| 941,250 | 1.26 | 2.2 | 708,750 |
| 245,000 | 1.48 | 2.4 | 183,750 |
| 60,000 | 1.24 | 4.9 | - |
| 3,935,000 | 1.17 | 4.9 | - |
| 40,000 | 1.06 | 4.7 | - |
| 100,000 | 1.04 | 4.7 | - |
| 110,000 | 0.87 | 3.8 | 42,500 |
| 160,000 | 0.98 | 2.9 | 120,000 |
| 1,050,000 | 0.94 | 3.1 | 262,500 |
| 70,000 | 0.90 | 3.1 | 35,000 |
| 390,000 | 0.83 | 4.5 | 97,500 |
| 2,385,000 | 0.80 | 4.3 | 250,000 |
| 185,000 | 0.68 | 3.4 | 92,500 |
| 205,000 | 0.62 | 4.2 | 51,250 |
| **10,137,349** | **1.08** | **4.1** | **2,104,849** |

*(amounts in Canadian dollars)*

b) Warrants

The following table summarizes the changes in the warrants outstanding:

| **Warrants** [1] | **Number** | **Weighted Average Exercise Price ($)** |
|---|---|---|
| Outstanding at January 1, 2013 | 1,679,835 | 1.59 |
| Granted | - | - |
| Outstanding at December 31, 2013 | 1,679,835 | 1.59 |
| Granted | - | - |
| **Outstanding at September 30, 2014** | **1,679,835** | **1.59** |
| **Exercisable at September 30, 2014** | **1,544,418** | **1.48** |

(1) Includes 406,250 Series II warrants

The following table summarizes the expiry terms and exercise prices of the Company's outstanding warrants as at September 30, 2014:

| **Outstanding Warrants** | **Exercise Price** | **Weighted Average Remaining Contractual Term (years)** | **Number of Warrants Exercisable** |
|---|---|---|---|
| 1,273,585 | $1.20 | 1.7 | 1,273,585 |
| 406,250 | $2.80 | 0.6 | 270,833 |
| **1,679,835** | **$1.59** | **1.4** | **1,544,418** |

(1) Series II warrants

c) Stock–based compensation expense

Compensation costs related to stock options of $408,403 for the three months ended September 30, 2014 (2013 - $74,379) and $825,582 for the nine months ended September 30, 2014 (2013 - $372,572) have been expensed. As well, for the three and nine months ended September 30, 2014, $115,835 (2013 - $16,464) and $200,967 (2013 - $135,857) has been capitalized to property, plant and equipment and have resulted in a corresponding increase in contributed surplus.

*(amounts in Canadian dollars)*

The fair value of stock options granted were estimated on the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions:

| | **September 30, 2014** | September 30, 2013 |
|---|---|---|
| Risk-free interest rate | **1.59%** | 1.64% |
| Expected volatility | **55%** | 66% |
| Expected life | **5 years** | 5 years |
| Expected dividend yield | **N/A** | N/A |
| Estimated forfeiture rate | **0%** | 0% |
| Fair value per option | **$0.49** | $0.38 |
| Stock price on grant date | **$1.00** | $0.68 |

Expected volatility was determined based on the Company's historical volatility and a comparison to other companies in the business of exploration for, development of production of oil and natural gas. A forfeiture rate of 0% was used when recording stock-based compensation as it is expected that all officers, directors, employees and consultants will continue with the Company over the vesting period.

## 11. Finance expense

| | **Three months ended September 30, 2014 ($)** | Three months ended September 30, 2013 ($) | **Nine months ended September 30, 2014 ($)** | Nine months ended September 30, 2013 ($) |
|---|---|---|---|---|
| **Finance expenses** | | | | |
| Accretion of decommissioning liabilities (note 8) | **399,199** | 88,722 | **1,028,111** | 259,673 |
| Interest expense on bank debt | **893,807** | 627,851 | **2,698,496** | 1,823,541 |
| Finance expense | **1,293,006** | 716,573 | **3,726,607** | 2,083,214 |

*(amounts in Canadian dollars)*

## 12. Income (loss) per share

The following table summarizes the common shares used in calculating basic and diluted income (loss) per share:

| **Weighted Average Common Shares Outstanding** | **Three months ended September 30, 2014** | Three months ended September 30, 2013 | **Nine months ended September 30, 2014** | Nine months ended September 30, 2013 |
|---|---|---|---|---|
| Basic | **120,337,750** | 54,648,602 | **107,173,316** | 54,656,925 |
| Diluted | **120,337,750** | 54,648,602 | **107,173,316** | 54,656,925 |

For the three and nine month periods ended September 30, 2014 and 2013, all warrants and options have been excluded from the calculation of diluted income (loss) per share as they would have been anti-dilutive.

## 13. Supplemental cash flows information

Changes in non-cash working capital is comprised of:

| | **Three months ended September 30, 2014 ($)** | Three months ended September 30, 2013 ($) | **Nine months ended September 30, 2014 ($)** | Nine months ended September 30, 2013 ($) |
|---|---|---|---|---|
| Source/(use) of cash: | | | | |
| Accounts receivable | **425,453** | 400,354 | **(5,154,136)** | 1,096,554 |
| Deposits and prepaid expenses | **38,398** | (61,833) | **91,788** | 72,741 |
| Accounts payable and accrued liabilities | **7,198,047** | 5,030,964 | **4,290,648** | (895,648) |
| Changes in non-cash working capital | **7,661,898** | 5,369,485 | **(771,700)** | 273,647 |
| | | | | |
| Related to operating activities | **(2,731,242)** | (152,882) | **(6,181,191)** | 679,556 |
| Related to investing activities | **10,393,140** | 5,522,367 | **5,409,491** | (406,179) |
| Changes in non-cash working capital | **7,661,898** | 5,369,485 | **(771,700)** | 273,377 |

The following are included in cash flows from operating activities:

| | **Three months ended September 30, 2014 ($)** | Three months ended September 30, 2013 ($) | **Nine months ended September 30, 2014 ($)** | Nine months ended September 30, 2013 ($) |
|---|---|---|---|---|
| Capital taxes paid in cash | **112,936** | 26,960 | **183,674** | 65,303 |
| Interest paid in cash | **893,807** | 627,851 | **2,698,496** | 1,823,541 |

The $12,819,938 in the cash balance outstanding at the end of September 30, 2014 was a held in a non-interest bearing account.

*(amounts in Canadian dollars)*

**14. Commitments**

a) Office Lease

The Company has rental commitments, exclusive of operating costs, related to leased office premises, as follows:

| | ($) |
|---|---|
| 2014 | 74,000 |
| 2015 | 110,000 |
| **Total** | **184,000** |

b) Flow-through shares

On November 26, 2013, the Company issued 8,000,500 flow-through common shares on a Canadian Exploration Expense ("CEE") flow-through basis at $0.95 per CEE flow-through common share for total proceeds of $7,600,475. At September 30, 2014, the Company had a remaining obligation of $5,102,000 as the majority of costs spent in the nine-month period ended September 30, 2014 related to capital expenditures that did not qualify as renounceable CEE for flow-through share purposes. These funds are to be expended no later than December 31, 2014.

**15. Financial risk management**

The Board of Directors has overall responsibility for the establishment and oversight of the Company's risk management framework. The Board has implemented and monitors compliance with risk management policies.

The Company's activities expose it to a variety of financial risks including credit risk, liquidity risk and market risk and how they arise. This note presents changes to information about the Company's exposure to each of the above risks, the Company's objectives, policies and processes for measuring and managing risk since December 31, 2013.

(a) Credit risk

Credit risk is the risk of a financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its contractual obligations.

*Accounts receivable*

The Company's accounts receivable are from companies in the oil and natural gas industry and are subject to normal industry credit risks. Credit risks arise principally from the amounts owing to the Company from purchasers of the Company's oil and natural gas production (oil and natural gas marketers), joint interest partners and government agencies and are subject to normal industry credit risk.

*(amounts in Canadian dollars)*

The Company's accounts receivable are aged as follows:

| | **September 30, 2014 ($)** | December 31, 2013 ($) |
|---|---|---|
| Current (less than 90 days) | **9,286,701** | 4,229,769 |
| Past due (more than 90 days) | **97,204** | - |
| | **9,383,905** | 4,229,769 |

The carrying amount of $12,819,938 of cash and $9,383,905 of accounts receivable represents the maximum credit exposure and management believes all receivables will be collected. Management manages credit risk exposure related to cash by selecting financial institutions with high credit ratings and given these credit ratings does not expect any counterparty to fail to meet its obligations.

In addition, the Company is subject to credit risk associated with possible non-performance by counterparties related to the commodity contracts of $273,026.

(b) Liquidity risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they are due.

The Company expects to repay its financial liabilities in the normal course of operations and to fund future operational and capital requirements through operating cash flows. The Company may need to conduct equity issues or review alternate debt facilities if liquidity risks increase in a given period. The Company also has a credit facility to facilitate the management of liquidity risk. See note 7 for credit facility disclosure. The Company is required to meet certain financial commitments as described in notes 14 and 15(c). The Company believes it has sufficient funds to meet its foreseeable obligations by actively monitoring its credit facilities through use of the revolving loan, operating loan and the A&D loan, coordinating payment and revenue cycles each month, and an active hedge program to mitigate commodity price risk and secure cash flows.

The Company's financial liabilities, excluding derivatives, on the balance sheet consist of accounts payable and accrued liabilities and bank debt. As at September 30, 2014, the Company had $20,900,000 available under its operating and revolving loans for general corporate use and $15,000,000 available under its A&D loan for acquisition or development of proved oil and natural gas interests as described in note 7.

At September 30, 2014 the Company was in compliance with the working capital ratio covenant. The working capital ratio was 2.1 to 1.0 (December 31, 2013 – 0.95 to 1.0 resulting in a breach of the covenant). The Bank had provided a waiver for the working capital covenant breach at December 31, 2013.

The following details the Company's financial liabilities excluding derivatives, all balances due under one year:

| | **September 30, 2014 ($)** | December 31, 2013 ($) |
|---|---|---|
| Accounts payable and accrued liabilities | **19,333,281** | 15,066,033 |
| Bank debt | **58,238,533** | 63,008,179 |
| | **77,571,814** | 78,074,212 |

*(amounts in Canadian dollars)*

(c) Market risk

Market risk is the risk that changes in market prices, such as commodity prices, interest rates, and foreign exchange rates will affect the Company's profit or loss, or the value of financial instruments. There have been no changes to the Company's policies for managing market risks since December 31, 2013.

*Interest rate risk*

Interest rate risk is the risk that future cash flows will fluctuate as a result of changes in market interest rates. The Company is exposed to interest rate fluctuations on its credit facility, which bears a floating rate of interest. A 1% change in the interest rate on the bank debt would have a $109,000 impact on net income (loss) for the three month period ended September 30, 2014 (2013 - $79,000) and a $328,000 impact on net income (loss) for the nine month period ended September 30, 2014 (2013 - $237,000).

*Commodity price risk*

Commodity price risk is the risk that the fair value of financial instruments or future cash flows will fluctuate as a result of changes in commodity prices. The nature of the Company's operations results in exposure to fluctuations in commodity prices.

As at September 30, 2014, the Company had the following commodity contracts outstanding:

| Type | Notional Volumes | Price | Index | Term |
|---|---|---|---|---|
| Swap | 2,000 GJs/day | CAD $3.50/GJ | AECO-5A | Apr.01, 2014 to Dec.31, 2014 |
| Swap | 400 bbl/day | CAD $96.00/bbl | WTI-NYMEX | Jul.01, 2014 to Dec.31, 2014 |
| Swap | 3,000 GJs/day | CAD $3.7525/GJ | AECO-5A | Jan.01, 2014 to Dec.31, 2014 |
| Swap | 400 bbl/day | CAD ($21.30)/bbl | WCS vs NGX and Net Energy Index | Feb.01, 2014 to Dec.31, 2014 |
| Put [1] | 4,000 GJs/day | CAD $4.00/GJ | AECO-7A | Mar. 01, 2014 to Dec. 31, 2014 |
| Swap | 1,500 GJs/day | CAD $4.28/GJ | AECO-5A | Mar. 01, 2014 to Dec. 31, 2014 |
| Swap | 500 bbl/day | CAD $104.90/bbl | WTI-NYMEX | Mar. 01, 2014 to Dec. 31, 2014 |
| Swap | 4,000 GJs/day | CAD $4.465/GJ | AECO-5A | Jan.01, 2015 to Mar.31, 2015 |
| Swap | 500 bbl/day | CAD $104.00/bbl | WTI-NYMEX | Jan.01, 2015 to Mar.31, 2015 |
| Swap | 250 bbl/day | CAD $103.00/bbl | WTI-NYMEX | Jan.01, 2015 to Jun.30, 2015 |
| Swap | 500 bbl/day | CAD $105.00/bbl | WTI-NYMEX | Apr.01, 2015 to Jun.30, 2015 |

(1) The put contract is subject to a monthly premium fee of approximately $32,000.

Subsequent to September 30, 2014, the Company entered into the following commodity contract:

*(amounts in Canadian dollars)*

| Type | Notional Volumes | Price | Index | Term |
|---|---|---|---|---|
| Swap | 300 bbl/day | CAD ($20.70)/bbl | WCS vs NGX and Net Energy Index | Jan.01, 2015 to Mar. 31, 2015 |

At September 30, 2014, the commodity contracts had a fair value of $273,026 (December 31, 2013 – negative $951,692) resulting in an unrealized gain for the nine month period ended September 30, 2014. For the nine month period ended September 30, 2014, a $1.00bbl/$0.10GJ increase/(decrease) in commodity prices would have a negative/(positive) impact of $300,000 on net loss (September 30, 2013 - $230,000).

(d) Capital management

The Company's capital management policy is to maintain a strong capital base that optimizes the Company's ability to grow, maintain investor and creditor confidence and to provide a platform to create value for its shareholders. In order to maintain or adjust the capital structure, the Company may issue shares, amend, revise or renew the terms of the existing credit facility and adjust its capital spending to manage its current and projected capital structure. The Company considers its capital structure to include shareholders' equity and bank debt. There have been no changes to the Company's capital management policies during the period ended September 30, 2014.

The Company monitors capital based on two financial ratios: net debt to annualized funds flow and working capital ratio. The net debt to annualized funds flow represents the time period it would take to pay off the debt if no further capital expenditures were incurred and if funds flow from operating activities remained constant. This ratio is calculated as net debt, defined as outstanding bank debt plus or minus net working capital (excluding fair value of commodity contracts and flow-through share premiums), divided by cash flow from operating activities before changes in non-cash working capital ("funds flow from operating activities").

The Company's strategy is to monitor the ratio and the ratio can, and will, fluctuate based on the timing of property transactions, commodity prices and on the mix of exploratory and development drilling.

*Net debt to annualized funds flow*

The following table summarizes the Company's net debt to annualized funds flow calculation:

| | **September 30, 2014 ($)** | December 31, 2013 ($) |
|---|---|---|
| Current assets (excluding commodity contracts) | **22,832,504** | 4,950,218 |
| Accounts payable and accrued liabilities | **(19,333,281)** | (15,066,033) |
| Bank debt | **(58,238,533)** | (63,008,179) |
| Net debt | **(54,739,310)** | (73,123,994) |

| | **Nine months ended September 30, 2014 ($)** | Year ended December 31, 2013 ($) |
|---|---|---|
| Funds flow from operating activities | **26,427,729** | 10,555,764 |
| Annualized | **35,236,972** | 10,555,764 |
| Net debt to annualized funds flow | **1.6** | 6.9 |

As at September 30, 2014, the Company's ratio of net debt to funds flow was 1.6 to 1 (December 31, 2013 – 6.9 to 1). The decrease in the ratio at September 30, 2014 was a result of an increase in funds flow from operating activities related to the asset acquisitions completed December 31, 2013 and March 6, 2014 and a decline in the outstanding bank debt related to the issuance of common shares completed May 2, 2014 and the sale of the Pembina assets on September 30, 2014.

The Company's share capital is not subject to external restrictions but the amount of the bank facility is determined by the lenders and based on the lenders' borrowing base models which are based on independent valuation of the Company's oil and gas reserves. The credit facility is also subject to certain financial and other covenants as described in note 7.

*Working capital ratio*

Under the credit facility (note 7), the Company is required to maintain a working capital ratio of greater than 1:1 defined as the ratio of current assets (including undrawn available credit on the revolving portion of the facility and excluding the fair value of the commodity contracts) divided by current liabilities (less the current portion of bank debt and the fair value of the commodity contracts). At December 31, 2013, the Company was in default of the working capital ratio covenant and the Bank provided a waiver for the covenant breach. The working capital covenant at September 30, 2014 was 2.1 to 1.0 (December 31, 2013 – 0.95 to 1.0). The working capital ratio increased at September 30, 2014 as the Company paid down debt with funds sourced from the share capital financing completed during the current period and the sale of the Pembina assets on September 30, 2014.