Condensed Interim Consolidated Financial Statements
(Unaudited)

ARSENAL ENERGY INC.

For the three months ended March 31, 2016 and 2015

Arsenal Energy Inc.

Condensed Interim Consolidated Statements of Financial Position
(Unaudited)

(thousands of $Cdn)		**March 31, 2016**		**December 31, 2015**
Assets				
Current assets:				
Cash	$	406	$	2,561
Accounts receivable		3,801		5,453
Inventory		458		488
Prepaid expenses and deposits		382		668
		5,047		9,170
Reclamation deposit		195		208
Exploration and evaluation assets		1,114		1,114
Property, plant and equipment (note 4)		142,657		153,641
	$	149,013	$	164,133
Liabilities and Shareholders' Equity				
Current liabilities:				
Accounts payable and accrued liabilities	$	6,077	$	10,143
Bank loan (note 5)		14,000		15,000
Current portion of decommissioning obligations (note 6)		300		300
Incentive compensation liability		93		79
Risk management contracts (note 8)		297		296
		20,767		25,818
Bank loan (note 5)		37,746		37,464
Flow-through share premium		302		315
Risk management contracts (note 8)		250		320
Decommissioning obligations (note 6)		37,018		40,050
Deferred taxes		3,230		4,434
		99,313		108,401
Shareholders' Equity:				
Common shares (note 7)		155,988		155,988
Contributed surplus		11,824		11,668
Accumulated other comprehensive income		8,627		9,036
Deficit		(126,739)		(120,960)
		49,700		55,732
	$	149,013	$	164,133

Going concern (note 2(b))
Segmented information (note 11)

The notes are an integral part of these condensed interim consolidated financial statements.

Arsenal Energy Inc.

Condensed Interim Consolidated Statements of Loss and Comprehensive Income (Loss)
(Unaudited)
For the three months ended March 31,

(thousands of $Cdn, except per share amounts)	**2016**	**2015**
Revenues		
Oil and natural gas	$ 7,570	$ 13,866
Royalties	(1,667)	(3,569)
Net revenue	5,903	10,297
Realized gain (loss) on risk management contracts	(71)	13,128
Unrealized gain (loss) on risk management contracts	69	(12,196)
Net revenue after risk management	5,901	11,229
Expenses		
Operating and transportation	4,432	5,997
General and administrative	1,189	1,101
Exploration and evaluation	149	1,666
Interest and other financing	612	536
Depletion and depreciation	4,469	7,442
Gain on sale of property	(126)	-
Accretion of decommissioning obligations (note 6)	241	290
Share-based compensation	170	(988)
Foreign exchange loss (gain)	1,542	(3,220)
	12,678	12,824
Loss before income tax	(6,777)	(1,595)
Provision for (recovery of) income taxes		
Current	-	53
Deferred	(998)	(1,182)
	(998)	(1,129)
Net loss	**$ (5,779)**	**$ (466)**
Other comprehensive income (loss)		
Translation gain (loss) on foreign operations	(409)	3,024
Comprehensive income (loss)	**$ (6,188)**	**$ 2,558**
Net loss per share (note 7)		
Basic and diluted	$ (0.30)	$ (0.03)

The notes are an integral part of these condensed interim consolidated financial statements.

Arsenal Energy Inc.

Condensed Interim Consolidated Statements of Changes in Shareholders' Equity

(Unaudited)

(thousands)	Number of Shares	Share capital	Contributed surplus	Accumulated other comprehensive income (loss)	Deficit	Total Shareholders' equity
Balance December 31, 2014	17,877	$151,434	$11,388	$3,182	$(75,312)	$90,692
Net loss for the period	-	-	-	-	(466)	(466)
Dividends	20	71	-	-	(536)	(465)
Share-based compensation	-	-	186	-	-	186
Translation gain on foreign operations	-	-	-	3,024	-	3,024
Balance March 31, 2015	17,897	$151,505	$11,574	$6,206	$(76,314)	$92,971

(thousands)	Number of Shares	Share capital	Contributed surplus	Accumulated other comprehensive income (loss)	Deficit	Total Shareholders' equity
Balance December 31, 2015	19,423	$155,988	$11,668	$9,036	$(120,960)	$55,732
Net loss for the period	-	-	-	-	(5,779)	(5,779)
Share-based compensation	-	-	156	-	-	156
Translation loss on foreign operations	-	-	-	(409)	-	(409)
Balance March 31, 2016	19,423	$155,988	$11,824	$8,627	$(126,739)	$49,700

The notes are an integral part of these condensed interim consolidated financial statements.

Arsenal Energy Inc.

Condensed Interim Consolidated Statements of Cash Flows
(Unaudited)
For the three months ended March 31,

(thousands of $Cdn)	2016	2015
Operating Activities:		
Net loss for the period	$ (5,779)	$ (466)
Items not affecting cash:		
Unrealized (gain) loss on risk management contracts	(69)	12,196
Depletion and depreciation	4,469	7,442
Gain on sale of property	(126)	-
Accretion of decommissioning obligations (note 6)	241	290
Deferred income taxes	(998)	(1,182)
Share-based compensation	170	(988)
Unrealized foreign exchange loss (gain)	1,680	(3,198)
Decommissioning obligations settled (note 6)	(83)	(87)
Net change in non-cash working capital (note 10)	268	3,102
	(227)	17,109
Financing Activities:		
Bank loan advances (repayments)	290	(6,449)
Dividends paid	-	(465)
Net change in non-cash working capital items (note 10)	(37)	(134)
	253	(7,048)
Investing Activities:		
Property, plant and equipment	(896)	(6,671)
Proceeds on sale of property	1,060	-
Net change in non-cash working capital items (note 10)	(2,319)	(1,976)
	(2,155)	(8,647)
Foreign exchange gain (loss) on cash held in foreign currency	(26)	180
Change in cash during the period	(2,155)	1,594
Cash, beginning of period	2,561	2,573
Cash, end of period	$ 406	$ 4,167
The following are included in cash flow from operating activities:		
Interest paid in cash	582	505
Income taxes paid in cash	$ -	$ 405

The notes are an integral part of these condensed interim consolidated financial statements.

Notes to condensed interim consolidated financial statements *(Unaudited)*
(Tabular amounts in thousands except per share amounts)

1. Reporting entity:

Arsenal Energy Inc. ("Arsenal" or the "Company") is an oil and gas exploration, development and production Company based in Calgary, Alberta, Canada. The Company conducts its operations in the Western Canadian Sedimentary basin in Canada and the Williston basin in the United States. The condensed interim consolidated financial statements of the Company as at March 31, 2016 comprise the Company and its wholly owned subsidiaries, Arsenal Energy USA Ltd. and Arsenal Energy Holdings Ltd.; which were incorporated in the USA and Canada respectively. Arsenal's principle place of business is located at Suite 1900, 639 – 5th Avenue SW, Calgary Alberta, Canada, T2P 0M9.

2. Basis of preparation:

(a) Statement of compliance:

These condensed interim consolidated financial statements have been prepared by management in accordance with International Financial Reporting Standards ("IFRS") and International Accounting Standard (IAS) 34 *Interim Financial Reporting* as issued by the International Accounting Standards Board ("IASB") and were prepared using accounting policies consistent with IFRS. These condensed interim consolidated financial statements have been prepared following the same accounting policies and methods of computation as the consolidated financial statements and notes for the year ended December 31, 2015 and should be read in conjunction with the audited consolidated financial statements and notes for the year ended December 31, 2015. In the opinion of management, these condensed interim consolidated financial statements contain all adjustments necessary to present fairly Arsenal's financial position as at March 31, 2016 and the results of its operations and its cash flow for the three months then ended.

The condensed interim consolidated financial statements were authorized for issue by the Board of Directors on May 9, 2016.

(b) Going concern:

The Company's credit facility is based on the bank's determination of the Company's borrowing base utilizing the Company's risked reserves and the lenders assessment of future commodity prices. The facility was scheduled for review on November 30, 2015 which concluded subsequent to year-end on January 8, 2016. As a result of the review, the Company's credit facility was reduced to a borrowing base of $40 million and a supplemental facility of $15 million (from $60 million - $55 million extendible facility and $5 million supplemental). The supplemental facility of $15 million ($14 million at March 31, 2016), has a maturity date of May 26, 2016. The extendible credit facility has a revolving period of 364 days plus one year and therefore has been classified as long-term. On review, the extendible facility can be increased or reduced. If increased it can be utilized to reduce the supplemental facility. If decreased the Company has 60 days to repay any shortfall and if not repaid, would represent an event of default under the credit facility. The next review of the credit facility is scheduled to be completed by May 26, 2016.

As the Company's forecast of funds from operations is estimated to be insufficient to fully retire the supplemental facility by the maturity date, the Company has taken steps to sell all or a portion of its US properties and various non-core properties in Canada. In addition, the Company has deferred capital spending and initiated addition reductions in costs and expenses. While these steps have been initiated, there is no certainty that they will be successful, or that the funds generated will be sufficient to reduce the bank debt to an amount the Company can support with its retained assets.

Uncertainties exist as to the Company's ability to continue as a going concern exist due to:

- A $14 million scheduled repayment of the supplemental facility on May 26, 2016. The Company does not currently have sufficient funds to repay this amount;
- On March 10, 2016, the Company applied for its annual extension of the Term Out Date noted in the extendible credit facility. Under the terms of the facility, the lenders have 30 days to respond and in the event such lenders do not respond within the 30 day period, the lenders shall be deemed to have advised the Company that it is not prepared to make an offer to the Company to extend its Term Out Date. The Company has not received any response to its March 10, 2016 request for extension either at the 30 day deadline or to date. If the Term Out Date is not extended, the Term Maturity Date of the facility is May 26, 2017 at which time the full balance will be due;
- There is uncertainty as to the determination of the borrowing base that will be provided by the lenders in May 2016. In the event the Company has a borrowing base shortfall and is unable to repay the amount within 60 days, this would represent an event of default under the credit facility which could result in all outstanding amounts being payable on demand;
- There is risk that the Company will not be able to comply with the financial covenant in 2016. Compliance is impacted by the undrawn debt which is at risk. In the event the Company has a covenant violation, this would represent an event of default under the credit facility which could result in all outstanding amounts being payable on demand; and
- The Company is committed to expend $2.0 million in 2016 on qualifying expenditures by December 31, 2016 to satisfy the requirements of the flow-through share issuance completed in 2015.

As a result of the above matters, there is a material uncertainty as to the Company's ability to continue as a going concern.

(c) Basis of measurement:

The condensed interim consolidated financial statements have been prepared on the historical cost basis except for the derivative financial instruments and short term incentive compensation liability.

(d) Functional and presentation currency:

These condensed interim consolidated financial statements are presented in Canadian dollars, which is the parent company's functional currency. Arsenal's subsidiary Arsenal Energy USA Ltd. has a U.S. dollar functional currency.

3. New accounting policies:

The International Accounting Standards Board has issued new standards and amendments to existing standards.

(a) IFRS 15 – Revenue from Contracts and Customers

(b) IFRS 9 – Financial Instruments

(c) IFRS 16 - Leases

These changes are not yet adopted by the Company and the effects on our consolidated financial statements are being assessed.

4. Property, plant and equipment:

Cost or deemed cost		Total
Balance at December 31, 2014	$	329,393
Additions		19,587
Capitalized general and administration		715
Divestitures		(4,931)
Decommissioning obligations incurred		619
Change in decommissioning obligations		(5,328)
Foreign currency translation		27,429
Balance at December 31, 2015	$	367,484
Additions		821
Capitalized general and administration		75
Decommissioning obligations incurred		136
Divestitures		(9,525)
Foreign currency translation		(10,725)
Balance at March 31, 2016	$	348,266

Accumulated depletion and depreciation		Total
Balance at December 31, 2014	$	123,073
Depletion and depreciation provision		26,632
Divestitures		(1,620)
Impairment		55,816
Foreign currency translation		9,942
Balance at December 31, 2015	$	213,843
Depletion and depreciation provision		4,415
Divestitures		(5,697)
Foreign currency translation		(6,952)
Balance at March 31, 2016	$	205,609

NBV	Total
Balance at December 31, 2015	153,641
Balance at March 31, 2016	142,657

In March, 2016, the Company sold the assets in British Columbia for proceeds of $1.1 million. This disposition resulted in a gain on sale of $126,000.

5. Bank loan:

The credit facility is subject to a semi-annual borrowing base review or redetermination in the event of a material adverse effect. The next scheduled review is May 26, 2016.

At March 31, 2016, total debt available under the credit facility amounted to $54.0 million (December 31, 2015 - $55.0 million) of which $51.7 million (December 31, 2015 – $52.5 million) was outstanding. Total credit available under the credit facility consisted of a $40 million syndicated facility (December 31, 2015 - $40 million) and a $14 million supplemental facility (December 31, 2015 - $15 million). The supplemental facility was reduced by $1 million to reflect repayment due to the sale of property. At March 31, 2016 there was $16.0 million of US dollar ($20.8 million Canadian $ equivalent) denominated borrowings under the credit facility (December 31, 2015 - $5.0 million US dollar and $6.9 million Canadian dollar equivalent).

Interest on the $40 million syndicated facility for Bankers' Acceptances ("BA") and LIBOR loans bear interest at the BA or LIBOR rate plus a margin ranging from 2.0% to 4.5% per annum, and for interest on the $10 million operating facility bears interest at the agent's prime interest rate plus an applicable margin ranging from 1.0% to 3.5% per annum. A standby fee ranging from 0.50% to 1.125% per annum is charged on the unutilized portion of the credit facility. Interest on the supplemental facility is at a margin of 2.00% higher than the corresponding rate for the syndicated facility.

The Company's credit facility has a financial covenant that, without the written consent of the lenders, would result in a breach of the agreement. The Company cannot permit the adjusted working capital ratio, as defined in the agreement, to fall to below 1. At March 31, 2016, the Company was in compliance with this covenant with a working capital ratio of 1.13.

6. Decommissioning obligations:

		Three months ended March 31, 2016		Year ended December 31, 2015
Beginning of period	$	40,350	$	44,729
Obligations settled		(83)		(1,587)
Obligations incurred		136		619
Change in estimates		-		(5,328)
Obligations removed on sale of property		(2,894)		(462)
Accretion of decommissioning obligations		241		1,108
Foreign currency translation		(432)		1,271
End of period	$	37,318	$	40,350
Expected to be incurred within one year	$	300	$	300
Expected to be incurred beyond one year	$	37,018	$	40,050

7. Share capital:

At March 31, 2016, the Company was authorized to issue an unlimited number of common shares with the holders of common shares being entitled to one vote per share.

(a) Share based payments

Share award incentive plan

During the three months ended March 31, 2016 there were no grants or vesting of share awards and 21,667 share awards were cancelled. As at March 31, 2016 there were 341,998 share awards outstanding.

Share option plan

During the period there were no grants and no exercises. 67,600 options were cancelled and 50,000 options expired. As at March 31, 2016 there were 500,237 options outstanding with a weighted average strike price of $5.17 and 431,064 options exercisable at a weighted average strike price of $5.35.

(b) Loss per share

The following table shows the weighted average number of common and diluted shares.

	Three months ended March 31, 2016	Three months ended March 31, 2015
Weighted average shares outstanding:		
Basic and diluted	19,423	17,884

In computing diluted income per share for the period ended March 31, 2016, 827,235 (2015- 1,172,037) share awards and options were excluded from the dilution calculations as they were anti-dilutive.

8. Risk management and financial instruments:

Interest rate risk

The Company had the following interest rate risk management contract in place as at March 31, 2016.

Subject of Contract	Remaining Term	National Quantity	Reference	Strike Price	Option Traded	Fair Value
30 day BA rate	April 1, 2016- – February 13, 2018	$30,000,000	CAD – BA – CDOR	1.80%	Swap	($549)

Commodity price risk

The Company had the following commodity risk management contracts in place as at March 31, 2016.

($Cdn. unless otherwise noted)

Commodity Sold	Volume Sold	Remaining Term	Pricing	Fair Value
Oil	200 bbl per day	July 1, 2016 – September 30, 2016	$42.55 USD per bbl	$ 13
Oil	400 bbl per day	July 1, 2016 – September 30, 2016	$41.55 USD per bbl	(22)
Oil	200 bbl per day	October 1, 2016 – December 31, 2016	$56.65 Cdn$ per bbl	11
				$ 2

9. Capital management:

The Company considers its capital structure to include working capital, the credit facility and shareholders' equity. The Company manages its capital base primarily on its net debt to annualized funds from operations ratio and its net debt to equity ratio The Company continually monitors, through its annual budgeting and quarterly forecasting process, the risk reward profile of its exploration and development projects, its production profile and the economic indicators in the market including commodity prices, interest rates and foreign exchange rates. It then determines increases or decreases to its capital budget and what, if any, additional initiatives may need to be implemented.

Net debt as at March 31,		2016		2015
Working capital deficiency [1]		(1,423)		(3,678)
Bank loan		(51,746)		(53,551)
Net debt [5]		(53,169)		(57,229)
Annualized funds from operations [2,3,4]	$	9,000		63,041
Net debt to annualized funds from operations ratio		5.91		0.91
Shareholders' equity	$	49,700	$	92,971
Net debt to equity		1.07		0.62

1 Excludes the value of risk management contracts and the current portion of the bank loan.
2 Excludes exploration and evaluation expenses.
3 Based on the last quarter's funds from operations annualized, adjusted, if required, for large one-time items included in the recent quarter and significant forecasted changes to production and commodity prices.
4 Management uses funds from operations before changes in non-cash working capital and annualized funds from operations to analyze operating performance and leverage. Funds flow as presented does not have any standardized meaning prescribed by IFRS and therefore it may not be comparable to the calculation of similar measures for other entities. Funds flow as presented is not intended to represent operating cash flow or operating profits for the period nor should it be viewed as an alternative to cash flow provided by operating activities, net earnings or loss or other measures of financial performance calculated in accordance with IFRS.
5 Net debt is used by Management to analyze leverage. Net debt does not have any standardized meaning prescribed by IFRS and therefore these terms may not be comparable with the calculation of similar measures for other entities.

10. Supplemental cash flow information:

Three months ended March 31,		2016		2015
Change in non-cash working capital items:				
Accounts receivable	$	1,611	$	3,981
Prepaid expenses and deposits		282		166
Inventory		(25)		93
Accounts payable and accrued liabilities		(3,956)		(3,248)
		(2,088)		992
Amounts relating to operating activities		268		3,102
Amounts relating to financing activities		(37)		(134)
Amounts relating to investing activities		(2,319)		(1,976)
	$	(2,088)	$	992

11. Segmented information:

A portion of the Company's assets and revenues are earned in the United States and Canada, and are monitored as an identifiable reporting segment by management. Business risks and economic indicators are similar across both geographical regions.

March 31, 2016 (000's Cdn. $)	Canada	U.S.	Total
Oil and gas revenue	4,442	3,128	7,570
Operating income [1]	283	1,188	1,471
Funds from (to) operations [2]	349	(612)	(263)
Loss before income taxes	(4,046)	(2,731)	(6,777)
Loss after income taxes	(4,032)	(1,747)	(5,779)
Exploration and evaluation assets	1,114	-	1,114
Property, plant and equipment	85,037	57,620	142,657
Property, plant and equipment expenditures	224	672	896
Property, plant and equipment divestitures	1,060	-	1,060
Exploration and evaluation expenditures	-	-	-

March 31, 2015 (000's Cdn. $)	Canada	U.S.	Total
Oil and gas revenue	7,443	6,423	13,866
Operating income [1]	817	3,483	4,300
Funds from operations [2]	13,707	2,053	15,760
Income (loss) before income taxes	30	(1,625)	(1,595)
Income (loss) after income taxes	519	(985)	(466)
Exploration and evaluation assets	3,639	-	3,639
Property, plant and equipment	109,794	105,089	214,883
Property, plant and equipment expenditures	3,770	2,901	6,671
Property, plant and equipment divestitures	-	-	-
Exploration and evaluation expenditures	-	-	-

(1) Defined as oil and gas revenues less royalties, operating costs and transportation. Operating income does not have any standardized meaning prescribed by IFRS and therefore this term may not be comparable with the calculation of for other entities.
(2) Defined as operating income less general and administrative expenses, interest and financing, plus or minus realized foreign exchange gains or losses expenses. Funds from operations does not have any standardized meaning prescribed by IFRS and therefore this terms may not be comparable with the calculation for other entities.