

Condensed Interim Consolidated Financial Statements
(Unaudited)

ARSENAL ENERGY INC.

For the three and six months ended June 30, 2016 and 2015

Arsenal Energy Inc.

Condensed Interim Consolidated Statements of Financial Position
(Unaudited)

<i>(thousands of \$Cdn)</i>	June 30, 2016	December 31, 2015
Assets		
Current assets:		
Cash	\$ 4,050	\$ 2,561
Accounts receivable	2,747	5,453
Inventory	108	488
Prepaid expenses and deposits	317	668
Assets associated with discontinued operations (note 4)	644	-
	7,866	9,170
Reclamation deposit	-	208
Exploration and evaluation assets	1,114	1,114
Property, plant and equipment (note 5)	68,190	153,641
	\$ 77,170	\$ 164,133
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 4,569	\$ 10,143
Bank loan (note 6)	-	15,000
Current portion of decommissioning obligations (note 7)	100	300
Incentive compensation liability	106	79
Risk management contracts (note 9)	1,137	296
Liabilities associated with discontinued operations (note 4)	7,386	-
	13,298	25,818
Bank loan (note 6)	-	37,464
Flow-through share premium	302	315
Risk management contracts (note 9)	-	320
Decommissioning obligations (note 7)	25,180	40,050
Deferred taxes	-	4,434
	38,780	108,401
Shareholders' Equity:		
Common shares (note 8)	155,988	155,988
Contributed surplus	11,980	11,668
Accumulated other comprehensive income	-	9,036
Deficit	(129,578)	(120,960)
	38,390	55,732
	\$ 77,170	\$ 164,133
Going concern (note 2(b))		
Subsequent event (note 8(a))		

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

Arsenal Energy Inc.

Condensed Interim Consolidated Statements of Loss and Comprehensive Loss

(Unaudited)

	Three Months Ended June 30		Six Months Ended June 30	
(thousands of \$Cdn, except per share amounts)	2016	2015	2016	2015
Revenue				
Oil and natural gas	\$ 5,698	\$ 9,572	\$ 10,140	\$ 17,015
Royalties	(835)	(1,203)	(1,655)	(3,002)
Net revenue	4,863	8,369	8,485	14,013
Realized gain (loss) on risk management contracts	(590)	(62)	(661)	12,981
Unrealized loss on risk management contracts	(590)	(87)	(521)	(12,283)
Net revenue after risk management	3,683	8,220	7,303	14,711
Expenses				
Operating and transportation	2,811	4,204	6,150	9,030
General and administrative	1,032	1,147	2,221	2,248
Exploration and evaluation expenses	4	878	153	2,543
Interest and other financing charges	1,240	523	1,852	1,059
Depletion and depreciation	1,833	3,506	4,235	7,265
Accretion of decommissioning obligations	198	236	396	478
Share-based compensation (recovery)	168	202	338	(786)
Foreign exchange loss (gain)	104	525	1,646	(2,695)
Loss (gain) on sale of property	(1,884)	1,449	(2,011)	1,449
	5,506	12,670	14,980	20,591
Loss before income tax	(1,823)	(4,450)	(7,677)	(5,880)
Recovery of deferred income taxes	-	(189)	(13)	(678)
Loss from continuing operations	(1,823)	(4,261)	(7,664)	(5,202)
Income (loss) from discontinued operations (note 4)	(1,016)	832	(954)	1,307
Net loss	\$ (2,839)	\$ (3,429)	\$ (8,618)	\$ (3,895)
Other comprehensive income (loss)				
Translation gain (loss) on foreign operations prior to disposition	(38)	(489)	(447)	2,535
Reclassification of accumulated comprehensive income on disposition of foreign operations (note 4)	(8,589)	-	(8,589)	-
Comprehensive loss	\$ (11,466)	\$ (3,918)	\$ (17,654)	\$ (1,360)
Net income (loss) per share, basic and diluted (note 8)				
Continuing operations	\$ (0.09)	\$ (0.24)	\$ (0.39)	\$ (0.29)
Discontinued operations	\$ (0.05)	\$ 0.05	\$ (0.05)	\$ 0.07
Net loss	\$ (0.14)	\$ (0.19)	\$ (0.44)	\$ (0.22)

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)

<i>(thousands)</i>	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	-	-	-	-	(3,895)	(3,895)
Dividends	32	119	-	-	(894)	(775)
Issued on exercise of options	60	398	(398)	-	-	-
Share-based compensation expensed	-	-	368	-	-	368
Translation gain on foreign operations	-	-	-	2,535	-	2,535
Balance June 30, 2015	17,969	\$151,951	\$11,358	\$5,717	\$(80,101)	\$88,925

<i>(thousands)</i>	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	-	-	-	-	(8,618)	(8,618)
Share-based compensation expensed	-	-	312	-	-	312
Translation loss on foreign operations prior to disposition	-	-	-	(447)	-	(447)
Reclassification of accumulated comprehensive income on disposition of foreign operations (note 4)	-	-	-	(8,589)	-	(8,589)
Balance June 30, 2016	19,423	\$155,988	\$11,980	\$ -	\$(129,578)	\$38,390

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

ARSENAL ENERGY INC.

Condensed Interim Consolidated Statements of Cash Flows
(Unaudited)

(thousands of \$Cdn)	Three months ended June 30		Six months ended June 30	
	2016	2015	2016	2015
Operating Activities:				
Net loss for the period from continuing operations	\$ (1,823)	\$ (4,261)	\$ (7,664)	\$ (5,202)
Items not affecting cash:				
Unrealized (gain) loss on risk management contracts	590	87	521	12,283
Depletion and depreciation	1,833	3,505	4,235	7,265
Accretion of decommissioning obligations	198	236	396	478
Deferred tax recovery	-	(189)	(13)	(678)
Share-based compensation	168	77	338	(911)
Unrealized foreign exchange loss (gain)	939	512	2,619	(2,688)
Loss (gain) on sale of property and equipment	(1,884)	1,447	(2,011)	1,449
Decommissioning obligations settled	17	(111)	(66)	(188)
Net change in non-cash working capital (note 10)	398	(2,678)	459	(876)
Continuing operations	436	(1,375)	(1,186)	10,932
Discontinued operations	2,189	3,780	3,584	8,582
Net cash from operating activities	2,625	2,405	2,398	19,514
Financing Activities:				
Bank loan	(52,553)	2,449	(52,263)	(4,000)
Dividends paid	-	(310)	-	(775)
Net change in non-cash working capital items (note 10)	-	-	(37)	(134)
Net cash from (to) financing activities	(52,553)	2,139	(52,300)	(4,909)
Investing Activities:				
Property, plant and equipment	(523)	(1,382)	(747)	(5,152)
Proceeds on disposition of properties	11,799	1,677	12,859	1,677
Net change in non-cash working capital items (note 10)	69	(375)	(2,855)	(3,102)
Continuing operations	11,345	(80)	9,257	(6,577)
Discontinued operations	42,595	(3,415)	42,528	(5,565)
Net cash from (to) investing activities	53,940	(3,495)	51,785	(12,142)
Change in cash during the period				
Continuing operations	(40,772)	684	(44,229)	(554)
Discontinued operations	44,784	365	46,112	3,017
	4,012	1,049	1,883	2,463
Foreign exchange gain (loss) on cash held in foreign currency	(368)	(45)	(394)	135
Cash, beginning of period	406	4,167	2,561	2,573
Cash, end of period	\$ 4,050	\$ 5,171	\$ 4,050	\$ 5,171
The following are included in cash flow from operating activities:				
Interest paid in cash	\$ 1,222	\$ 531	\$ 1,804	\$ 1,036
Income taxes paid in cash	\$ 34	\$ -	\$ 34	\$ 405

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

ARSENAL ENERGY INC.

For the three and six months ended June 30, 2016 and 2015

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. During the period ended June 30, 2016 the Company disposed of all the property plant and equipment, inventory, and royalties payable of its subsidiary Arsenal Energy USA Inc. The financial results of Arsenal Energy USA Inc. has been shown as discontinued operations. The condensed interim consolidated financial statements of the Company as at June 30, 2016 comprise the Company and its wholly owned subsidiaries, Arsenal Energy USA Inc. 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.

On June 23, 2016, The Company and Lone Pine Resources Canada Ltd. ("Lone Pine"), a privately-held oil and natural gas exploration and production company based in Calgary, Alberta, announced that they have entered into a definitive agreement (the "Arrangement Agreement") to effect a business combination by way of a plan of arrangement (the "Arrangement") under the *Business Corporations Act* (Alberta).

If the Company does not fulfill its responsibilities as defined under the Arrangement Agreement, then a termination fee ranging from \$1.5 million to \$2.25 million may become payable to Lone Pine. If Lone Pine does not fulfill its responsibilities as defined under the Arrangement Agreement then a termination fee of \$1.5 million may become receivable by the Company. The Arrangement Agreement is scheduled to close in mid-September.

2. Basis of preparation:

(a) Statement of compliance:

These condensed interim consolidated financial statements have been prepared by management in accordance with 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 June 30, 2016 and the results of its operations and its net cash from operating activities for the three and six months then ended.

The condensed interim consolidated financial statements were authorized for issue by the Board of Directors on August 8, 2016.

(b) Going concern:

These financial statements have been prepared on a going concern basis which assumes that the Company will be able to discharge its obligations and realize its assets in the normal course of operations for the foreseeable future. During the six months ended June 30, 2016, the Company sold all of its U.S. oil and gas properties and selected Canadian oil and gas properties (see notes 4 and 5), eliminating the Company's bank debt on June 28, 2016.

There is a significant risk that funds from the Company's remaining oil and gas properties will not be sufficient to meet the Company's existing working capital deficiency. Specifically, uncertainties exist as to the Company's ability to continue as a going concern due to:

- Continued uncertainty as to the Company's ability to access and to expend sufficient capital to properly develop its identified reserves,

ARSENAL ENERGY INC.

June 30, 2016

- A working capital deficiency exists at June 30, 2016 totaling approximately \$5.4 million primarily related to an income tax liability arising from the Company's disposition of the U.S. assets. The Company currently does not have sufficient cash resources to satisfy this working capital deficiency, 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.

On June 23, 2016 the Company entered into a definitive agreement to effect a business combination by way of a plan of arrangement. The ability of the Company to continue as a going concern and to realize the carrying value of its assets and discharge its liabilities when due is dependent on the Company's ability to raise additional cash resources and/or the successful completion of the transaction with Lone Pine. There can be no guarantee that the Company could be successful at raising sufficient resources or that the transaction with Lone Pine will be completed. Should the going concern assumption not be appropriate and the Company is not able to realize its assets and settle its liabilities, the financial statements would require adjustments to the amounts and classifications of assets and liabilities and these adjustments could be significant.

(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 which are measured at fair value.

(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 Inc. 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.

This standard is effective January 1, 2018 with early adoption permitted.

(b) IFRS 9 – Financial Instruments.

This standard is effective January 1, 2018 with early adoption permitted if this standard is adopted in its entirety at the beginning of the adoption period.

(c) IFRS 16 – Leases.

This standard is effective January 1, 2019 with early adoption permitted if the new standards under IFRS 15 have also been adopted.

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

4. Discontinued operations and disposition:

On May 26, 2016 the Company closed the sale of its U.S. oil and natural gas properties located in North Dakota, including inventory, certain liabilities and all property, plant and equipment of the Company held by its subsidiary Arsenal Energy USA Inc. As the cash flows of the U.S. properties are clearly distinguished both operationally and for financial reporting purposes from the rest of the entity, the financial results of Arsenal Energy USA Inc. for both current and comparative periods have been presented separately as discontinued operations in the consolidated statements of loss and comprehensive loss and in the consolidated statements of cash flows.

ARSENAL ENERGY INC.

June 30, 2016

Summary of the disposition:

Proceeds of disposition	\$ 42,870
Transaction costs	<u>(527)</u>
Net proceeds	<u>42,343</u>
Net assets disposed	
Inventory	185
Property, plant and equipment	56,955
Accounts payable	(1,121)
Decommissioning obligation	<u>(6,608)</u>
	<u>49,409</u>
Loss on disposition before taxes	7,067
Income taxes on disposition	3,494
Loss on disposition after taxes	<u>\$ 10,561</u>

Summary of the results of discontinued operations:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Oil and natural gas revenues	\$ 2,932	\$ 6,733	\$ 6,060	\$ 13,156
Royalties	<u>(766)</u>	<u>(1,914)</u>	<u>(1,613)</u>	<u>(3,683)</u>
Net revenue	<u>2,166</u>	<u>4,819</u>	<u>4,447</u>	<u>9,473</u>
Expenses (recoveries)				
Operating and transportation	566	990	1,658	2,079
Depletion, depreciation and accretion	1,566	3,410	3,676	7,140
Income taxes	<u>(922)</u>	<u>(413)</u>	<u>(1,905)</u>	<u>(1,053)</u>
	<u>1,210</u>	<u>3,987</u>	<u>3,429</u>	<u>8,166</u>
Income from regular operations	956	832	1,018	1,307
Reclassification of accumulated comprehensive income on disposition of foreign operations	8,589	-	8,589	-
Loss on disposition	<u>(10,561)</u>	<u>-</u>	<u>(10,561)</u>	<u>-</u>
Income (loss) from discontinued operations	<u>\$ (1,016)</u>	<u>\$ 832</u>	<u>\$ (954)</u>	<u>\$ 1,307</u>

There are certain assets and liabilities relating to the disposed operations that are not part of the continuing operations and are summarized here.

Assets and liabilities of discontinued operations:

Assets:	
Accounts receivable	\$ 644
Liabilities:	
Accounts payable and accrued liabilities	\$ 1,623
Current tax payable	5,763
	<u>\$ 7,386</u>

ARSENAL ENERGY INC.

June 30, 2016

5. 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		1,925
Capitalized general and administration		230
Divestitures		(205,627)
Change in decommissioning obligations		196
Foreign currency translation		(10,716)
Balance at June 30, 2016	\$	153,492
Accumulated depletion and depreciation		Total
Balance at December 31, 2014	\$	123,073
Depletion and depreciation expense		26,632
Divestitures		(1,620)
Impairment		55,816
Foreign currency translation		9,942
Balance at December 31, 2015	\$	213,843
Depletion and depreciation expense		7,600
Divestitures		(129,199)
Foreign currency translation		(6,942)
Balance at June 30, 2016	\$	85,302
NBV		Total
Balance, at December 31, 2015	\$	153,641
Balance, at June 30, 2016	\$	68,190

In March 2016 the Company sold its non-core assets in British Columbia for proceeds of \$1.1 million that resulted in a gain of \$104 thousand. In June 2016 the Company sold certain non-core assets in the Princess area for proceeds of \$3.3 million (loss of \$244 thousand) and assets in the Chauvin/Ribstone area for proceeds of \$8.6 million (gain of \$2.1 million).

6. Bank loan:

In January the credit agreement was amended to reduce the extendible facility to \$40 million and adjusted the Supplemental to \$15 million, for a total available credit facility of \$55 million. The Supplemental had a maturity date of May 26, 2016. In March 2016 the Company sold properties for proceeds \$1.1 million which were applied to the Supplemental, effectively reducing it to \$14 million. In May 2016 the Company sold its U.S. assets for net proceeds of \$42.3 million, at which time the Supplemental was fully paid and the total bank debt was reduced to approximately \$9.3 million.

After the sale of the U.S. properties the Company's credit facility was amended to provide an amended total facility of \$11.0 million with repayment required by June 30, 2016. In the event full repayment was not made then the Company would have been considered in default with full repayment required by August 31, 2016.

ARSENAL ENERGY INC.

June 30, 2016

In June 2016 the Company completed additional asset sales in Canada which provided net proceeds of \$11.9 million. These proceeds were used to fully repay the bank loans. Subsequent to the full repayment the credit agreement was amended to remove the syndication agreement and for the operating lender to provide an operating facility of \$1.0 million. Drawdowns on the operating facility require the prior approval of the operating lender. There are no drawdowns of the operating facility as at June 30, 2016.

7. Decommissioning obligations:

	Six months ended June 30, 2016	Year ended December 31, 2015
Beginning of period	\$ 40,350	\$ 44,729
Obligations settled	(66)	(1,587)
Obligations incurred	196	619
Change in estimates	-	(5,328)
Obligations removed on sale of property	(15,234)	(462)
Accretion of decommissioning obligations	439	1,108
Foreign currency translation	(405)	1,271
End of period	\$ 25,280	\$ 40,350
Expected to be incurred within one year	\$ 100	\$ 300
Expected to be incurred beyond one year	\$ 25,180	\$ 40,050

8. Share capital:

At June 30, 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

The Company grants restricted and performance share awards to directors, officers and employees that vest as to one-third on each of the first, second and third anniversary dates of the grant. On June 19, 2016 the first vesting of the share incentive awards occurred. The payout multiplier for the Performance Awards was calculated at 1.5 based on the Company's ranking in the 2nd quartile based on overall shareholder return versus a peer group. On June 18, 2016 issued additional Restricted and Performance Share Awards.

Changes in the share awards are summarized in the following table:

Share awards	Number of Restricted Awards	Number of Performance Awards	Total Share Awards
Balance at December 31, 2014	127	115	242
Granted	124	117	241
Adjustment for dividends	1	1	2
Adjustment for performance factor	-	20	20
Vested and converted to common shares	(25)	(35)	(60)
Vested and paid in cash	(16)	(21)	(37)
Cancelled or forfeited	(22)	(22)	(44)
Balance at December 31, 2015	189	175	364
Cancelled or forfeited	(39)	(46)	(85)
Balance at June 30, 2016	150	129	279

Subsequent to June 30, 2016 a vesting occurred in which the Company settled 109 thousand share awards, 60 thousand of which were settled in shares (32 thousand restricted share awards and 28 thousand performance share awards) and 49 thousand were settled in cash (26 thousand restricted share awards and 23 thousand performance share awards).

ARSENAL ENERGY INC.

June 30, 2016

Subsequent to June 30, 2016 the Company issued 463 thousand restricted share awards.

Stock option plan

The Company discontinued grants under the stock option plan in 2014. The remaining stock options outstanding are summarized in the following table:

Stock options	Number of Options	Weighted average exercise price
Balance at December 31, 2014	1,014	\$ 6.61
Cancelled, expired or forfeited	(396)	8.02
Balance at December 31, 2015	618	5.70
Cancelled, expired or forfeited	(345)	6.71
Balance at June 30, 2016	273	\$ 4.44
Exercisable at June 30, 2016	273	\$ 4.44

(b) Loss per share

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

	Three months ended June 30		Six months ended June 30	
	2016	2015	2016	2015
Weighted average shares outstanding:				
Basic and diluted	19,423	17,907	19,423	17,896

In computing diluted income per share for the six months ended June 30, 2016, 550 thousand (2015- 1.1 million) stock options and share awards were excluded from the dilution calculations as they were anti-dilutive.

9. Risk management and financial instruments:

As a result of the repayment of the debt the Company correspondingly settled its interest rate risk management contracts. The realized loss on settlement of these contracts was \$545 thousand is included in the realized loss on risk management contracts.

The Company had the following commodity price risk management contracts in place as at June 30, 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	\$ (158)
Oil	400 bbl per day	July 1, 2016 – September 30, 2016	\$41.55 USD per bbl	(362)
Oil	400 bbl per day	July 1, 2016 – September 30, 2016	\$39.60 USD per bbl	(455)
Oil	200 bbl per day	October 1, 2016 – December 31, 2016	\$56.65 CAD per bbl	(162)
				\$ (1,137)

ARSENAL ENERGY INC.

June 30, 2016

10. Supplemental cash flow information:

	Three months ended June 30		Six months ended June 30	
	2016	2015	2016	2015
Continuing operations:				
Change in non-cash working capital items:				
Accounts receivable	\$ (643)	\$ (1,286)	\$ 309	\$ 1,044
Prepaid expenses and deposits	65	(281)	268	(121)
Inventory	53	(42)	59	16
Accounts payable and accrued liabilities	992	(1,444)	(3,069)	(5,051)
	467	(3,053)	(2,433)	(4,112)
Amounts related to operating activities	398	(2,678)	459	(876)
Amounts related to financing activities	-	-	(37)	(134)
Amounts related to investing activities	69	(375)	(2,855)	(3,102)
	\$ 467	\$ (3,053)	\$ (2,433)	\$ (4,112)
Discontinued operations:				
Change in non-cash working capital items:				
Accounts receivable	\$ 990	\$ (839)	\$ 2,252	\$ 812
Prepaid expenses and deposits	194	191	371	198
Inventory	111	(1)	80	33
Accounts payable and accrued liabilities	4,938	1,772	4,342	2,131
	6,233	1,123	7,045	3,174
Amounts related to operating activities	207	(115)	6,574	1,185
Amounts related to investing activities	605	1,238	471	1,989
	\$ 812	\$ 1,123	\$ 7,045	\$ 3,174