MANAGEMENT DISCUSSION AND ANALYSIS

SUMMARY OF FINANCIAL AND OPERATIONAL RESULTS				
	Three Months Ended June 30		**Six Months Ended June 30**	
(000'S Cdn. $ except per share amounts)	**2016**	2015	**2016**	2015
FINANCIAL				
Oil and gas revenue from continuing operations	**5,698**	9,572	**10,140**	17,015
Cash provided by operating activities	**2,625**	2,405	**2,398**	19,514
Funds from continuing operations [1]	**25**	2,292	**(1,426)**	14,539
Per share - basic [2]	**-**	0.13	**(0.07)**	0.81
Per share - diluted [2]	**-**	0.13	**(0.07)**	0.79
Cash and stock dividends paid	**-**	358	**-**	894
Net loss from continuing operations	**(1,823)**	(4,261)	**(7,664)**	(5,202)
Per share - basic [2]	**(0.09)**	(0.24)	**(0.39)**	(0.29)
Per share - diluted [2]	**(0.09)**	(0.24)	**(0.39)**	(0.29)
Net debt) [3]	**4,195**	56,635	**4,195**	56,635
Capital expenditures	**523**	1,382	**747**	5,152
Property dispositions	**(11,799)**	(1,677)	**(12,859)**	(1,677)
Common Share Trading Range				
High	**1.60**	5.60	**1.60**	6.72
Low	**1.05**	3.00	**0.87**	3.00
Close	**1.36**	3.13	**1.36**	3.13
Average daily volume	**16,381**	15,189	**16,883**	17,177
Shares outstanding - end of period	**19,423**	17,969	**19,423**	17,969
OPERATIONAL				
Daily production				
Heavy oil (bbl/d)	**6**	18	**5**	29
Medium oil and NGL's (bbl/d)	**1,375**	1,636	**1,435**	1,667
Natural gas (mcf/d)	**1,590**	4,963	**2,306**	4,991
Oil equivalent (boe/d @ 6:1)	**1,646**	2,481	**1,824**	2,527
Realized commodity prices ($Cdn.)				
Heavy oil (bbl)	**27.29**	45.32	**32.54**	43.17
Medium oil and NGL's (bbl)	**43.99**	57.37	**36.42**	49.16
Natural gas (mcf)	**1.23**	2.12	**1.42**	2.17
Oil equivalent (boe @ 6:1)	**38.04**	42.40	**30.54**	37.20
Netback ($ per boe)				
Revenue	**38.04**	42.40	**30.54**	37.20
Royalty	**(5.58)**	(5.33)	**(4.98)**	(6.56)
Operating and transportation	**(18.77)**	(18.62)	**(18.52)**	(19.74)
Operating netback per boe	**13.70**	18.45	**7.03**	10.89
General and administrative	**(6.89)**	(5.08)	**(6.69)**	(4.91)
Cash portion of share based compensation	**-**	(0.56)	**-**	(0.27)
Interest and other financing	**(8.28)**	(2.32)	**(5.58)**	(2.32)
Realized gain (loss) on risk management contracts	**(3.94)**	(0.28)	**(1.99)**	28.38
Other (FX and current tax)	**5.57**	(0.06)	**2.93**	0.02
Fund from operations per Boe	**0.16**	10.17	**(4.30)**	31.79

1 Funds from operations is not recognized by IFRS but it is used by the Company, investors, analysts, bankers and others to evaluate and compare oil and gas exploration, development and production entities. The Company determines funds from operations as net cash from operating activities before the net change in non-cash operating working capital, decommissioning obligations settled, exploration and evaluation expenses and transaction costs, if any. Funds from operations does not have a standardized measure prescribed by GAAP and therefore may not be comparable with the calculations of similar measures for other companies.

2 Funds from operations and net income (loss) per share basic are calculated based on the weighted average number of common shares outstanding during the respective periods. Funds from operations and net income (loss) per share diluted are calculated based on the weighted average number of common shares outstanding for the respective period adjusted for dilutive instruments (stock options and share awards).

3 Net debt includes bank borrowings, plus or minus working capital. Net debt excludes long term decommissioning obligations and risk management contracts (whether an asset or an obligation and whether classified as short or long term).

4 Funds from operations per Boe is funds from operations calculated on a Boe basis.

Q2 2016 Financial and Operating Highlights

Arrangement Agreement

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

Completion of the Arrangement will result in the shareholders of the Company and Lone Pine receiving common shares of a new corporation ("New Lone Pine") in substitution for their existing shares, with New Lone Pine in turn indirectly holding the combined undertakings of the Company and Lone Pine. Upon completion of the Arrangement, which is expected to occur in September 2016, former Lone Pine securityholders will hold 77% of the New Lone Pine shares and former Arsenal securityholders will hold 23% of the New Lone Pine shares. The precise ratio per share at which New Lone Pine shares are issued in substitution for Lone Pine shares and Arsenal shares will be based on these proportionate interests of 77% and 23%, respectively, and has been confirmed in the joint information circular issued by Lone Pine and Arsenal.

Implementation of the Arrangement will be subject to the approval of Arsenal shareholders and Lone Pine shareholders, respectively, at special meetings of both companies to be held in September 2016, by majorities of not less than two-thirds of the votes cast by Arsenal shareholders at the Arsenal meeting, and not less than two-thirds of the votes cast at the Lone Pine meeting by the common shareholders and the preferred shareholders of Lone Pine, in each case voting as a class.

Credit Facility

In January 2016, the Company's borrowing base was reviewed and determined to be $37.0 million. Since the current bank borrowings exceeded the borrowing base, the syndicate set the credit facility at $55.0 million. The credit facility included a $30.0 million Extendable Syndicated Credit Facility, a $10.0 million Extendable Operating Credit Facility and a $15.0 million Supplemental Credit Facility due May 26, 2016 (together the "Facility"). In February 2016, with crude price prices dropping further, National Bank and Alberta Treasury Branches ("ATB" or the "Agent") advised the Company that the borrowing base had been reviewed and recalculated at $26.0 million and became concerned with the ability of the Company to repay its bank borrowings. The syndicate therefore required an independent understanding of the Company's financial position and future business prospects and as a result, ATB engaged Ernst & Young ("E&Y") as a consultant to assist in assessing its position regarding the Company's indebtedness. In addition, ATB and E&Y discussed the appropriateness of the Company appointing a Chief Restructuring Officer ("CRO").

In response and in order to reduce the Company's indebtedness, the Company initiated a process to sell all or a portion of its US properties. In an attempt to further reduce bank indebtedness and as insurance against the possibility the US property sale would not close or generate proceeds sufficient enough to reduce bank indebtedness to acceptable levels, the Company solicited offers to sell some of its Canadian properties and received "expressions of interest" to sell approximately 450 boe/d of production in two property sales for gross proceeds (before adjustments) totaling approximately $12.0 million. Unfortunately, due to the decline in crude prices in February 2016 to levels not seen since 2003, a probable sale of the Company's US properties was terminated.

On May 23, 2016 with the recovery in crude prices, the Company reached an agreement to sell all of its US properties for gross proceeds (before adjustment) for US $34.0 million. The sale of the Company's US properties reduced bank debt by approximately Cdn. $42.3 million (before adjustments) to approximately Cdn. $9.3 million at May 31, 2016.

After the sale of the Company's US properties and in spite of the expressions of interest in the Canadian properties, the Company's syndicate of bankers demanded repayment of the entire Credit Facility by June 30, 2016. In that regard, the syndicate appointed a CRO effective June 1, 2016 to assist in assuring repayment of the entire credit facility. Failure to repay the entire Credit Facility by June 30, 2016 would result in an event of default and result in additional fees and higher interest rates and the initiation of a sales process by the CRO to ensure repayment by no later than August 31, 2016.

The Company entered into Purchase and Sales Agreements with the two parties interested in the two Canadian properties and closed the sales before the end of June generating gross proceeds (before adjustments) of $12.0 million. The Company repaid all of its bank borrowing before the June 30, 2016 deadline and was able to dismiss the CRO at that time After the US and Canadian property sales, the Company had its crude and interest rate risk management contracts outstanding representing a liability to the banking syndicate of approximately $1.7 million. On June 29, 2016, the Company closed its interest rate risk management contract at a cost of $522,290 thereby eliminating National Bank from the credit facility entirely as the crude risk management contracts were all placed with ATB. In total in Q2 2016l, the Company incurred approximately $729,000 of addition costs related to legal and advisory fees, syndicate fees and higher interest charges related to the Company's dealings on its credit facility with its banking syndicate.

ATB has agreed to leave the crude risk management contracts in-place as Lone Pine has agreed to assume the contracts and has agreed to an Operating Line of Credit of $1.0 million to be available "on approval" in order to aid the Company in case any liquidity issues arise before the Effective Date of the Arrangement.

Sale of Arsenal's US Oil and Natural Gas Properties

On May 26, 2016 the Company closed the sale of all of its U.S. oil and natural gas properties located in North Dakota for gross proceeds (before adjustments) of Cdn. $42.9 million (US $34.0 million). The operating income (revenue less royalties and operating and transportation expenses) from the US assets sold totaled $2.8 million for the six months ended June 30, 2016. The Company recorded a loss on the sale of Cdn. $10.6 million after recording a tax provision on the disposition of $3.5 million.

Financial Statements and Financial and Operating Results

As a result of the sale of all of the Company's US properties which were clearly distinguishable from an operational and financial perspective and represented a separate and distinctive cash-generating unit, the financial statements and the operational and financial data and information for the three and six months ended June 30, 2016 have been prepared and presented on the basis that the sale represented the sale of a separate and distinct line of business and has been accounted for as discontinued operations. Certain financial and operational information presented hereafter therefore has been adjusted to represent this accounting treatment and includes results for current and comparative periods from the Company's Canadian operations only, adjusted for the sales of Canadian properties from the closing dates onwards.

Funds from Continuing Operations

	Three Months Ended June 30			Six Months Ended June 30		
(000's Cdn. $)	**2016**	2015	% Change	**2016**	2015	% Change
Net cash from operating activities	**2,625**	2,405	9	**2,398**	19,514	(88)
Net cash from discontinued operations	**(2,189)**	(3,780)	(42)	**(3,584)**	(8,582)	(58)
Net cash from continuing operations	**436**	(1,375)	(132)	**(1,186)**	10,932	(111)
Exploration and evaluation expenses	**4**	878	(100)	**153**	2,543	(94)
Decommissioning obligations settled	**(17)**	111	(115)	**66**	188	(65)
Change in non-cash working capital	**(398)**	2,678	(115)	**(459)**	876	(152)
Funds from continuing operations	**25**	2,292	(99)	**(1,426)**	14,539	(110)
Per boe	**0.16**	10.17	(98)	**(4.30)**	31.79	(114)

For Q2 2016, funds from continuing operations dropped $2.3 million to total $24,648 or $0.16 per Boe versus $2.3 million or $10.17 per Boe for Q2 2015. For the six months ended June 30, 2016, funds used in operations totaled $1.4 million

($4.30 per Boe) down by $16.0 million when compared to the 2015 six month period. Lower commodity prices, down by 10% in Q2 2016 from Q2 2015 and by 18% in the 2016 six month period and lower production, down by 34% in Q2 2016 from Q2 2015 and by 28% in the current six month period versus the 2015 six month period, reduced operating margins by $2.1 million from Q2 2015 and by $2.6 million from the comparative six month period. The 2015 six month period included funds realized on crude risk management contracts of $13.1 million.

Funds From Operations

	Three Months Ended June 30			Six Months Ended June 30		
(000's Cdn. $)	**2016**	2015	% Change	**2016**	2015	% Change
Continuing operations	**25**	2,292	(99)	**(1,426)**	14,539	(110)
Discontinued operations	**(4,174)**	3,866	(208)	**(2,986)**	7,380	(140)
Funds from operations	**(4,149)**	6,158	(167)	**(4,412)**	21,919	(120)

Funds from operations has not been adjusted for general and administrative expenses nor for financing costs as a result of the sale of all of the Company's US properties nor for the sale of any Canadian properties. Should the Company continue operations as an alternative to shareholder approval of the Arrangement Agreement with Lone Pine, ongoing general and administrative expenses would be significantly reduced and interest and other financing expenses, as a result of the elimination of the Company's debt and credit facility, would either drop significantly or be eliminated.

Operating Netback

The operating netback for Q2 2016 increased 159% to $13.70 per Boe versus $5.29 per Boe in Q1 2016 but dropped 26% from $18.45 per Boe in Q2 2015. For the 2016 six month period, the operating netback dropped 35% to $7.03 per Boe versus $10.89 per Boe in the 2015 six month period. The average price received dropped 10% or $4.36 per Boe in Q2 2016 from Q2 2015 and by 18% or $6.66 per Boe in the current six month period versus the 2015 six month period.

Net Cash from Operating Activities

Net cash from operating activities in Q2 2016 totaled $2.6 million versus $2.4 million generated in Q2 2015 and for the six month ended June 30, 2016 totaled $2.4 million versus $19.5 million for the 2015 six month period. Changes in operating margins, exploration and evaluation expenses, funds realized on crude risk management contracts and foreign exchange and changes in non-cash working capital are largely responsible for these changes during the respective comparative periods. Funds realized on crude risk management contracts in the 2015 six month period totaled $13.1 million.

Production

Production for Q2 2016 averaged 1,646 Boe per day (84% crude oil and NGL and 16% natural gas) versus 2,481 Boe per day in Q2 2015 (67% crude oil and NGL and 33% natural gas). For the six months ended June 30, 2016, production averaged 1,824 Boe per day (79% crude oil and NGL and 21% natural gas) versus 2,527 Boe per day (67% crude oil and NGL and 33% natural gas) for the six months ended June 30, 2015.

Average production was down 34% from Q2 2015 and 28% from the 2015 six month period as properties have been sold, as uneconomic wells have been shut-in and as the wells experience normal declines. In addition, the Company has not undertaken any new development to replace reserves and production.

Net Debt

The Company's entered into 2016 with total debt of $53.8 million. As a result of property sales in both Canada and in the US, the Company's bank borrowings were entirely repaid resulting in no bank borrowings as at June 30, 2016.

Net Debt Reconciliation

(000's Cdn. $)	Six Months Ended June 30, 2016
Net debt as at December 31, 2015	53,816
Funds required by continuing operations	1,426
Funds required by non continuing operations	2,986
Additions to property, plant and equipment	747
Exploration and evaluation expenses	153
Decommissioning liabilities settled	66
Proceeds on sale of property	(12,859)
Foreign exchange loss (gain) on US cash held	395
Net cash generated from discontinued operations	(46,112)
Change in working capital and other items	3,577
Net debt as at June 30, 2016	4,195

Net debt includes bank borrowings, plus or minus working capital. Net debt excludes long term decommissioning obligations and risk management contracts (whether an asset or an obligation and whether classified as short or long term).

Net Loss

The Company recorded a net loss from continuing operations for the current quarter of $1.8 million ($0.09 per share basic and diluted) and for the six months ended June 30, 2016 recorded a loss of $7.7 million ($0.39 per share basic and diluted versus a loss of $4.3 million ($0.24 per share basic and diluted) in Q2 2015 and $5.2 million ($0.29 per share basic and diluted) in the 2015 six month period. Lower production and commodity prices in the current year periods resulted in lower margins when compared to prior periods and were primarily responsible for the increased loss in the current periods. However, in addition, interest and other financing charges during the current year period included higher interest rates and certain additional fees and charges related to the Company's credit facility.

Capital Expenditures

Capital expenditures on continuing operations for the six month ended June 30, 2016 to property, plant and equipment totaled $746,799 down from $5.2 million in the 2015 six month period. Expenditures in 2016 were incurred primarily on land purchases and on well equipment and facilities at Princess. The Company capitalized $230,000 of general and administrative expenditures during the current six month period versus $325,000 in the 2015 six month period.

Corporate Information

As of August 8, 2016, Arsenal has 19,494,623 common shares, 273,237 stock options and 650,389 share incentive (restricted and performance) awards convertible into common shares. Company's shares are listed and posted for trading on the Toronto Stock Exchange under the symbol "AEI" and in the US over the counter on the - OTCQX under the symbol "AEYIF".

In Canada, the Company operates under Arsenal Energy Inc. and had average production for Q2 2016 of 1,646 Boe per day. During Q2 2016, the Company sold approximately 480 boe of Canadian production and all of its US oil and natural gas properties. The Company maintains its 100% indirectly owned subsidiary Arsenal Energy U.S.A. Inc.

Basis of Presentation

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,
- 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.

Discontinued Operations

On May 26, 2016 the Company closed the sale of its U.S. oil and natural gas properties located in North Dakota, including its crude inventory, certain liabilities and all property, plant and equipment held by its subsidiary Arsenal Energy USA Inc. The disposition meets the criteria of Discontinued Operations. For the quarter ended June 30, 2016 these financial statements have been prepared in accordance with the requirement to show the effects of the discontinued operations separate from the continuing operations of the Company.

MD&A

The following is management's discussion and analysis ("MD&A") of Arsenal Energy Inc.'s ("Arsenal" or the "Company") unaudited operating and financial results for the three and six months ended June 30, 2016. It should be read in conjunction with the audited consolidated financial statements and related notes of the Company for the year ended December 31, 2015. Additional information regarding Arsenal's AIF and financial and operating results may be obtained on the internet at www.sedar.com.

Unless otherwise specified, all dollar amounts are stated in Canadian dollars, and all references to "dollars" or "$" are to Canadian dollars.

Tables may not add due to rounding. Percentage change has been calculated on exact numbers as opposed to rounded numbers as shown in the tables.

Certain prior period amounts may have been reclassified to conform to the current period's presentation.

This MD&A is dated August 8, 2016.

Forward-Looking Statements

Certain statements contained within the Management's Discussion and Analysis constitute forward looking statements. These statements relate to future events or future performance. All statements other than statements of historical fact may be forward looking statements. Forward looking statements are often, but not always, identified by the use of words such as 'seek', 'anticipate', 'budget', 'plan', 'continue', 'estimate', 'expect', 'forecast', 'may', 'will', 'propose', 'project', 'predict', 'potential', 'targeting', 'intend', 'could', 'might', 'should', 'believe' and similar expressions or the negative of these terms or other comparable terminology and are generally intended to identify forward looking statements. These statements involve known and unknown risks, certainties and uncertainties and other factors that may cause actual results or events to differ materially from those anticipated or expected in such forward looking statements.

With respect to the forward-looking statements contained in the MD&A, Arsenal has made assumptions regarding: future commodity prices; the impact of royalty regimes and certain royalty incentives; the timing and the amount of capital expenditures; production of new and existing wells and the timing of new wells coming on-stream; future proved finding and development costs; future operating expenses including processing and gathering fees; the performance characteristics of oil and natural gas properties; the size of oil and natural gas reserves; the ability to raise capital and to continually add to reserves through exploration and development; the continued availability of capital, undeveloped land and skilled personnel; the ability to obtain equipment in a timely manner to carry out exploration and development activities; the ability to obtain financing on acceptable terms; the ability to add production through exploration and development activities; and the continuation of the current tax and regulation regimes.

We believe the expectations reflected in those forward looking statements are reasonable but no assurance can be given that these expectations will prove to be correct and such forward looking statements included in this MD&A should not be unduly relied upon. These statements speak only as of the date of this MD&A. The actual results could differ materially from those anticipated in these forward looking statements as a result of the risk factors set forth below and elsewhere in this MD&A: volatility in market prices for oil and natural gas; counterparty credit risk; access to capital; changes or fluctuations in production levels; liabilities inherent in oil and natural gas operations; uncertainties associated with estimating oil and natural gas reserves; competition for, among other things, capital, acquisitions of reserves, undeveloped lands and skilled personnel; stock market volatility and market valuation of Arsenal stock; geological, technical, drilling and processing problems; limitations on insurance; changes in environmental or legislation applicable to our operations, and our ability to comply with current and future environmental and other laws; changes in income tax laws or changes in tax laws and incentive programs relating to the oil and gas industry; and the other factors discussed under “Risk Factors” in this MD&A. Readers are cautioned that the foregoing lists of factors are not exhaustive. Additional information on these and other factors that could affect the Company’s operations and financial results are included in reports on file with Canadian securities regulatory authorities and may be accessed through the SEDAR website. The forward looking statements contained in this MD&A are expressly qualified by this cautionary statement. The forward-looking statements contained in this document speak only as of the date of this document and Arsenal does not assume any obligation to publicly update or revise them to reflect new events or circumstances, except as may be required pursuant to applicable securities laws.

Boe Presentation

For the purpose of calculating unit costs, natural gas is converted to a barrel of oil equivalent (“Boe” or “boe”) using six thousand cubic feet (“Mcf”) of natural gas to one barrel of oil equivalent unless otherwise stated. Boe may be misleading, particularly if used in isolation. A Boe conversion ratio of six Mcf to one barrel of oil equivalent is based on an energy equivalency method primarily at the burner tip and does not represent a value equivalency at the wellhead. (This conversion conforms to National Instrument 51-101). References to natural gas liquids (“NGL”) in this MD&A include condensate, propane, butane and ethane and one barrel of NGL is considered to be equivalent to one barrel of crude oil equivalent (Boe).

Non-GAAP Measures

Within the MD&A, references are made to terms having widespread use in the oil and gas industry in Canada. The measures discussed are widely accepted measures of performance and value within the industry, and are used by investors and analysts to compare and evaluate oil and gas exploration and producing entities.

“Funds from operations”, “Funds from operations per share”, “Operating netbacks per unit or per Boe”, “Netbacks per unit or per Boe”, “Net debt”, “Total debt” or “Bank debt” are not defined by IFRS in Canada and are regarded as non-GAAP measures.

Funds from operations is not recognized by IFRS but it is used by the Company, investors, analysts, bankers and others to evaluate and compare oil and gas exploration and producing entities. The Company determines funds from operations as net cash from operating activities before the net change in non-cash operating working capital, decommissioning obligations settled, exploration and evaluation expenses and transaction costs. The Company's banker uses funds from operations (adjusted for the above and for interest and other financing charges and income taxes) to measure debt to funds flow ratios that determine interest costs to the Company under its credit facility. Funds from operations are used to analyze the Company's performance, the ability of the business to generate the cash flow necessary to fund growth through capital investment and to repay bank debt. Funds from operations should not be considered as an alternative to, or more meaningful than net cash from operating activities as determined in accordance with IFRS as an indicator of the Company's performance. The Company's determination of funds from operations may not be comparable to that reported by other companies.

Funds from operations netback is funds from operations calculated on a Boe basis.

Operating income is calculated as revenue generated from oil and natural gas less royalties and operating and transportation expenses. Operating netback is operating income calculated on a Boe basis.

Boe production per day is calculated by dividing total production for the year or quarter by the number of days in the year or quarter as the case may be.

Net debt includes bank borrowings, plus or minus working capital. Net debt excludes long term decommissioning obligations and risk management contracts (whether an asset or an obligation and whether classified as short or long term).

Net Cash from Operating Activities and Funds from Continuing Operations

The following table compares net cash from operating activities to funds from operations for Q2 2016 to Q2 2015 and for the six months ended June 30, 2016 to the six months ended June 30, 2015:

	Three Months Ended June 30			**Six Months Ended June 30**		
(000's Cdn. $)	**2016**	2015	% Change	**2016**	2015	% Change
Net cash from operating activities	**2,625**	2,405	9	**2,398**	19,514	(88)
Net cash from discontinued operations	**(2,189)**	(3,780)	(42)	**(3,584)**	(8,582)	(58)
Net cash from continuing operations	**436**	(1,375)	(132)	**(1,186)**	10,932	(111)
Exploration and evaluation expenses	**4**	878	(100)	**153**	2,543	(94)
Decommissioning obligations settled	**(17)**	111	(115)	**66**	188	(65)
Change in non-cash working capital	**(398)**	2,678	(115)	**(459)**	876	(152)
Funds from continuing operations	**25**	2,292	(99)	**(1,426)**	14,539	(110)
Per boe	**0.16**	10.17	(98)	**(4.30)**	31.79	(114)

The following table provides a comparison of production per day for the previous eight quarters for continuing operations.

Production

	2016		2015				2014	
(Boe per day)	Q2	Q1	Q4	Q3	Q2	Q1	Q4	Q3
Continuing operations	1,646	2,003	2,168	2,380	2,481	2,574	2,990	2,950

The increases and decreases in the above periods in the early quarters relate primarily to the timing of drilling of high rate, high decline Princess horizontal wells. Production declines in recent quarters related to the lack of development and the shutting ion of uneconomic productions due to low commodity prices.

Production

Average Daily Production

	Three Months Ended June 30			Six Months Ended June 30		
	2016	2015	% Change	**2016**	2015	% Change
Heavy oil (bbls)	**6**	18	(69)	**5**	29	(84)
Medium oil and NGL's (bbls)	**1,375**	1,636	(16)	**1,435**	1,667	(14)
Natural gas (mcf)	**1,590**	4,963	(68)	**2,306**	4,991	(54)
Total Boe	**1,646**	2,481	(34)	**1,824**	2,527	(28)

Production for Q2 2016 averaged 1,646 Boe per day, a 34% decrease from 2,481 Boe per day in Q2 2015. Natural gas production was down 68% or 562 Boe per day due to the sale of Desan in Q1 2016 that produced 560 Boe per day in Q2 2015. Medium oil declined due primarily to normal well production declines and to the lack of new production being brought on-stream.

For the six months ended June 30, 2016, production averaged 1,824 Boe per day versus 2,527 Boe per day in the six months ended June 30, 2015. The decline of 703 Boe per day was primarily due the sale of Desan that contributed 437 Boe less production per day in 1H 2016 versus 1H 2015 and to uneconomic wells being shut-in and normal well production declines.

Production by Area

	Three Months Ended June 30					Six Months Ended June 30				
	2016		2015			**2016**		2015		
AREA	**Boe/d**	**% of Total**	Boe/d	% of Total	**% Change**	**Boe/d**	**% of Total**	Boe/d	% of Total	**% Change**
Galahad (light oil)	**82**	**5**	81	3	**1**	**85**	**5**	87	4	**(2)**
Princess (medium oil and gas)	**720**	**44**	916	37	**(21)**	**794**	**43**	919	36	**(14)**
Chauvin (medium oil and gas)	**236**	**14**	262	10	**(10)**	**240**	**13**	260	10	**(8)**
Provost (medium oil and gas)	**193**	**12**	256	10	**(25)**	**187**	**10**	283	11	**(34)**
Consort (medium oil and gas)	**52**	**3**	64	3	**(19)**	**56**	**3**	62	3	**(10)**
Evi (light oil)	**246**	**15**	225	9	**9**	**249**	**14**	218	9	**14**
Sold BC (gas)	**10**	**1**	560	23	**(98)**	**127**	**7**	564	22	**(77)**
Others	**107**	**6**	118	5	**(9)**	**86**	**5**	134	5	**(36)**
Total	**1,646**	**100**	2,481	**100**	**(34)**	**1,824**	**100**	2,527	100	**(28)**

Production declines in Q2 2016 from Q2 2015 at Princess relate primarily to natural well declines and lack of development activity, at Provost and Consort relate to natural well production declines and due to shutting in of uneconomic wells and at Desan as a result of the sale of the property in Q1 2016.

Production declines in 1H 2016 from 1H 2015 at Princess relate primarily to natural well declines and lack of development activity, at Provost and Consort relate to natural well production declines and to shutting in uneconomic wells and at Desan to the sale of the property in Q1 2016.

The Company has not undertaken any exploratory or development drilling and therefore has not been able to replace reserves or production.

Revenue

Prices - Before Commodity Contracts

	Three Months Ended June 30			Six Months Ended June 30		
($Cdn.)	**2016**	2015	% Change	**2016**	2015	% Change
Heavy oil per barrel	**27.29**	45.32	(40)	**32.54**	43.17	(25)
Medium oil and NGL's per barrel	**43.99**	57.37	(23)	**36.42**	49.16	(26)
Natural gas per mcf	**1.23**	2.12	(42)	**1.42**	2.17	(34)
Total per Boe	**38.04**	42.40	(10)	**30.54**	37.20	(18)

Reference Prices

	Three Months Ended June 30			Six Months Ended June 30		
	2016	2015	% Change	**2016**	2015	% Change
WTI Cushing, Oklahoma ($U.S./bbl)	**45.59**	57.94	(21)	**39.52**	53.29	(26)
Canadian Light Sweet ($Cdn./bbl)	**55.01**	68.88	(20)	**48.11**	61.08	(21)
Hardisty Heavy 12 API ($Cdn./bbl)	**37.51**	53.54	(30)	**29.19**	46.09	(37)
Hardisty Bow River 24.9 API ($Cdn./bbl)	**41.93**	57.49	(27)	**34.28**	50.30	(32)
AECO (30 day spot) ($Cdn./MMBtu)	**1.42**	2.67	(47)	**1.62**	2.71	(40)
Henry Hub NYMEX Close ($U.S./MMBtu)	**2.24**	2.74	(18)	**2.12**	2.77	(23)
Foreign exchange ($Cdn./$U.S.)	**1.29**	1.23	5	**1.33**	1.24	7

The Company sells crude oil under 30-day evergreen contracts. Natural gas production is sold in the spot market. The commodity prices received by the Company are generally reflective of the movement in commodity prices over the comparative periods.

The Company received $43.99 per Boe for its medium oil and NGL in the current quarter, a decrease of 23% versus Q2 2015. This decrease is in line with the Company's crude quality and market reference price changes in crude and the change in the US/Canadian dollar exchange rate. Hardisty Bow River stream (24.9 API), that is close (considering the changes in differentials) to the Company's medium quality crude in Canada, decreased 27% in Q2 2016 over Q2 2015. The Canadian dollar negated a part of this decrease as its value decreased 5% in value thereby increasing Canadian dollar sales prices. The price received for natural gas decreased 42% in Q2 2016 versus Q2 2015. The price received for natural gas tracks changes to the AECO price which was down 47% from Q2 2015.

The Company received an average price per Boe during Q2 2016 of $38.04 per Boe, a decrease of 10% from $42.40 per Boe received in Q2 2015. This decrease is attributed to the 21% decline, during the quarter, in the price of WTI, a decrease in Q2 2016 from Q2 2015 in the price of natural gas in both Canada (AECO) and the US (Henry Hub) of 47% and 18% respectively.

For the 2016 six month period, the Company received an average price of $30.54 per Boe versus $37.20 per Boe received in the six months ended June 30, 2015. This decrease generally corresponds to the decrease in the price of WTI of 26% over the six month period. In addition, natural gas prices declined in both Canada (AECO) and the US (Henry Hub) by 40% and 23% respectively.

Revenues

	Three Months Ended June 30			Six Months Ended June 30		
(000's Cdn. $)	**2016**	2015	% Change	**2016**	2015	% Change
Heavy oil	**14**	73	(81)	**28**	223	(88)
Medium oil and NGL's	**5,506**	8,540	(36)	**9,514**	14,831	(36)
Natural gas	**178**	958	(81)	**598**	1,961	(70)
Total	**5,698**	9,572	(40)	**10,140**	17,015	(40)
Gain (loss) on realized crude commodity contracts	**-**	-	-	**-**	13,069	100
Oil and gas revenue after realized crude commodity contracts	**5,698**	9,572	(40)	**10,140**	30,084	(66)
Revenue per boe before realized crude commodity contracts	**38.04**	42.40	(10)	**30.54**	37.20	(18)
Revenue per boe after realized crude commodity contracts	**38.04**	42.40	(10)	**30.54**	65.77	(54)

Oil and natural gas revenues totaled $5.7 million for Q2 2016 a decrease of 40% over Q2 2015 due to a 34% decrease in production and a 10% decrease in the average price received per Boe. For the six months ending June 30, 2016, revenues decreased 40% to $10.1 million versus $17.0 million in the 2015 six month period due to a 28% decrease in production and an 18% decrease in the average price received.

Financial Instrument Contracts

Financial instrument or risk management contracts are recorded in the consolidated financial statements at fair value at each reporting period with the change in fair value being recognized as an unrealized gain or loss.

During the quarter ended June 30, 2016, the Company recorded a net loss of $1.2 million on its financial instrument (commodity price and interest rate) contracts, of which $590,045 was a realized on the interest rate swap and $590,028 was unrealized on commodity price and interest rate contracts.

For the six months ended June 30, 2016, the Company recorded a net loss of $1.2 million on its financial instrument (commodity price and interest rate) contracts, of which $661,021 was realized on interest rate contracts and $521,404 ($1.1 million loss on crude swap contracts and $615,704 gain on interest rate contracts) was unrealized.

As at June 30, 2016, the Company has the following swap contracts for crude as follows:

($Cdn. unless otherwise noted)				
Commodity Sold	Volume Sold	Remaining Term	Pricing	Fair Value
Oil	200 bbl per day	October 1, 2016 - December 31, 2016	$56.65 CAD per bbl	(162)
Oil	200 bbl per day	July 1, 2016 - September 30, 2016	$42.55 US per bbl	(158)
Oil	400 bbl per day	July 1, 2016 - September 30, 2016	$41.55 US per bbl	(362)
Oil	400 bbl per day	July 1, 2016 - September 30, 2016	$39.60 US per bbl	(455)
				(1,137)

At June 30, 2016, the Company has recorded a current risk management liability relating to its crude contracts totaling $1.2 million. The position has been calculated based on a June 30, 2016 WTI strip price for Q3 2016 of approximately $49.20 (Canadian $63.50) per barrel.

Any future asset or liability recorded changes with changes to the price of West Texas Intermediate and with changes to the Canadian/US dollar exchange rate.

In order to mitigate the impact of future increases in interest rates on its bank indebtedness, the Company entered into a swap contract fixing the base interest rate on $30 million of banker's acceptance with an expiry date of February 13, 2018 at a strike price of 1.80%. With the sale of the Company's US and some of its Canadian properties and the repayment of its bank borrowings, the Company determined that it should monetize this interest rate swap. In June 2016, the Company expended $522,290 to terminate this contract.

Gains (Losses) on Risk Management Contracts

	Three Months Ended June 30			Six Months Ended June 30		
(000's Cdn. $)	**2016**	2015	% Change	**2016**	2015	% Change
Realized gain (loss)						
Commodity	**-**	-	-	**-**	13,069	100
Interest rate	**(590)**	(62)	(852)	**(661)**	(88)	(651)
Total	**(590)**	(62)	(852)	**(661)**	12,981	(105)
Unrealized gain (loss)						
Commodity	**(1,139)**	(178)	540	**(1,137)**	(11,824)	90
Interest rate	**549**	91	503	**616**	(459)	(234)
Total	**(590)**	(87)	(579)	**(521)**	(12,283)	(96)
Total gain (loss)						
Commodity	**(1,139)**	(178)	540	**(1,137)**	1,245	191
Interest rate	**(41)**	29	242	**(45)**	(547)	92
Total risk management contracts	**(1,180)**	(149)	(692)	**(1,182)**	698	269
Per Boe realized risk management contracts	**(3.94)**	(0.28)	(1,284)	**(1.99)**	28.38	107
Per Boe unrealized risk management contracts	**(3.94)**	(0.39)	(923)	**(1.57)**	(26.85)	94
	(7.89)	(0.67)	(1,078)	**(3.56)**	1.53	333

Royalties

	Three Months Ended June 30			Six Months Ended June 30		
(000's Cdn. $)	**2016**	2015	% Change	**2016**	2015	% Change
Heavy oil	**2**	7	(74)	**2**	20	(88)
Medium oil and NGL's	**846**	1,183	(29)	**1,665**	2,958	(44)
Natural gas	**(13)**	12	(201)	**(12)**	24	(152)
Total	**835**	1,203	(31)	**1,655**	3,002	(45)
Royalties per Boe	**5.58**	5.33	5	**4.98**	6.56	(24)

Percentage By Product

Oil and NGL's	**15**	14	11	**17**	20	(12)
Natural gas	**(7)**	1	(643)	**(2)**	1	(269)
Total	**15**	13	17	**16**	18	(7)

The Company’s overall royalty rate for Q2 2016 averaged 15% compared to 13% for Q2 2015. For the six months ended June 30, 2016, the royalty rate averaged 16% versus 18% for the six months ended June 30, 2015. Lower prices and lower well production generally contribute to lower royalty rates. In the current periods, while prices and production were lower, the royalty rate recoveries are due to adjustments to prior period royalties and to recording of gas cost allowance provision. Due to low prices, the natural gas royalty rate fluctuates as a result of small adjustments to prior periods or accruals.

Operating and Transportation Expenses

	Three Months Ended June 30			Six Months Ended June 30		
(000's Cdn. $)	**2016**	2015	**% Change**	**2016**	2015	% Change
Heavy oil	**26**	54	(52)	**53**	215	(75)
Medium oil and NGL's	**2,499**	3,199	(22)	**4,944**	6,728	(27)
Natural gas	**286**	951	(70)	**1,152**	2,087	(45)
Total	**2,811**	4,204	(33)	**6,150**	9,030	(32)
Operating and transportation per Boe	**18.77**	18.62	1	**18.52**	19.74	(6)

Operating costs include direct field costs such as contract operating fees and Company labor and benefits, electricity, fuel, property taxes, routine workovers and maintenance, processing and water disposal charges and transportation costs. Transportation costs reflect the cost of delivering production to the custody transfer point of the purchaser.

On an absolute dollar basis, operating costs decreased in Q2 2016 by $1.4 million or 33% from Q2 2015 and by $2.9 million or 32% for the six months ended June 30, 2016 versus the comparative 2015 six month period. The reduction in operating costs to date is due to property sales, to cost savings on electricity and to the electrification of some well sites, lower service costs, the shutting in of high cost uneconomic wells and general operational efficiencies.

On a Boe basis, operating costs remained essentially the same (up 1%) in Q2 2016 to $18.77 per boe from $18.62 per boe in Q2 2015 and for the six months ended June 30, 2016 dropped 6% to $18.52 per Boe versus $19.74 per Boe for the six months ended June 30, 2015.

The operating and transportation expenses are affected by the allocation of fixed operating costs over production levels. In Q2 2016, production dropped by 34% and in the six month 2016 period by 28% over prior year comparable periods thus allocating fixed operating costs over a smaller production base thereby increasing costs on a Boe basis.

Operating Netback per Boe

($Cdn.)	Three Months Ended June 30 **2016**	2015	% Change	Six Months Ended June 30 **2016**	2015	% Change
Heavy oil						
Revenue	**27.29**	45.32	(40)	**32.54**	43.17	(25)
Royalty	**(3.60)**	(4.39)	(18)	**(2.84)**	(3.95)	(28)
Operating and transportation	**(51.08)**	(33.43)	53	**(61.85)**	(41.52)	49
Operating netback per barrel	**(27.39)**	7.50	(465)	**(32.14)**	(2.30)	1,299
Medium and light oil and NGL's						
Revenue	**43.99**	57.37	(23)	**36.42**	49.16	(26)
Royalty	**(6.76)**	(7.95)	(15)	**(6.37)**	(9.80)	(35)
Operating and transportation	**(19.97)**	(21.49)	(7)	**(18.93)**	(22.30)	(15)
Operating netback per barrel	**17.27**	27.93	(38)	**11.12**	17.05	(35)
Natural gas						
Revenue	**1.23**	2.12	(42)	**1.42**	2.17	(34)
Royalty	**0.09**	(0.03)	(415)	**0.03**	(0.03)	(211)
Operating and transportation	**(1.98)**	(2.10)	(6)	**(2.75)**	(2.31)	19
Operating netback per mcf	**(0.66)**	(0.01)	6,362	**(1.29)**	(0.17)	679
Boe						
Revenue	**38.04**	42.40	(10)	**30.54**	37.20	(18)
Royalty	**(5.58)**	(5.33)	5	**(4.98)**	(6.56)	(24)
Operating and transportation	**(18.77)**	(18.62)	1	**(18.52)**	(19.74)	(6)
Operating netback per Boe	**13.70**	18.45	(26)	**7.03**	10.89	(35)

Netback

The Q2 2016 operating netback from medium oil and NGL decreased $10.66 per barrel or 38% to $17.27 per barrel from $27.93 per barrel in Q2 2015 while the six month netback for 2016 declined by $5.93 per barrel or 35% to $11.12 per barrel from $17.05 per barrel for the 2015 six month period. Lower average crude prices, down by 23% in the quarter and by 26% in the current six month period were offset by lower operating expenses. Medium oil and NGL operating expenses decreased 7% in the current quarter and 15% in the current six month period from the prior year comparative period.

Since production from heavy oil is so low and operating expenses high, changes in production and the timing of incurring certain costs can cause a significant increase or decrease in the Boe costs per barrel and therefore periods are generally not comparable.

The Q2 2016 netback from natural gas decreased $0.65 per mcf from Q2 2015 due to lower prices that declined by 42% when compared to Q2 2015. The netback for both quarters was negative. For the six month 2016 period, natural gas prices decreased by $0.75 per mcf or by 34% to $1.42 per mcf reducing the netback from a loss of $0.17 per mcf to a loss of $1.29 per mcf as prices were low and operating costs on a Boe basis high. Low prices were instrumental in the Company’s decision to sell Desan in Q1 2016. Natural gas prices need to improve for the Company’s production to become economic.

Corporate Netback

Arsenal’s Q2 2016 average price decreased by 10% or by $4.36 per Boe to $38.04 per Boe from $42.40 per Boe received in Q2 2015 resulting in a reduced netback of $13.70 per Boe. For the six months ended June 30, 2016, the corporate netback decreased 35% to $7.03 per Boe due to a lower average price that declined by 18%.

General and Administrative Expenses

	Three Months Ended June 30			Six Months Ended June 30		
(000's Cdn. $)	**2016**	2015	% Change	**2016**	2015	% Change
Gross expenditures	**1,412**	1,876	(25)	**2,981**	3,638	(18)
Overhead recovery	**(225)**	(579)	(61)	**(530)**	(1,065)	(50)
Capitalized overhead	**(155)**	(150)	3	**(230)**	(325)	(29)
Net general and administrative expense	**1,032**	1,147	(10)	**2,221**	2,248	(1)
Gross general and administrative per boe	**9.43**	8.31	13	**8.98**	7.95	13
Net general and administrative per boe	**6.89**	5.08	36	**6.69**	4.91	36

Gross general and administrative expenditures were lower in Q2 2016 by $463,927 and lower in the 2016 six month period by $656,759 when compared to their respective 2015 periods. On a net basis, general and administrative expenses decreased in Q2 2016 over Q2 2015 by $114,938 and decreased by $27,123 in the 2016 six month period versus the 2015 six month period. With the reduction in the Company's funds from operations that has materialized from lower commodity prices and production, the Company initiated certain cost reductions including reducing the staff level, a movement to part time employees and consultants and a suspended any bonus provision or payment. These initiatives resulted in lower gross and net general and administrative costs.

As a result of property sales in 2015 and 2016 and the decision to defer drilling and capital projects as a result of low commodity prices and liquidity concerns, overhead recoveries has declined. Overhead capitalized has declined as a result of staff reductions and reduced explorations and evaluation expenses and to deferring drilling and other capital projects.

On a Boe basis, general and administrative expenditures for the current quarter increased to $9.43 per Boe from $8.31 per Boe in Q2 2015 and for the current six month period to $8.98 per Boe from $7.95 per Boe in the 2015 six month period. The increases in the respective periods are the result of lower production – down 34% and 28% in the respective periods and reduced overhead capitalized and expenditures related to the Arrangement Agreement.

Exploration and Evaluation Expenses

	Three Months Ended June 30			Six Months Ended June 30		
(000's Cdn. $)	**2016**	2015	% Change	**2016**	2015	% Change
Exploration and evaluation expenses	**4**	878	(100)	**153**	2,543	(94)
Per Boe	**0.03**	3.89	(99)	**0.46**	5.56	(92)

Arsenal expenses all pre-license costs, all seismic expenditures and all exploratory dry hole costs. Recoveries of these expenses are credited to exploration and evaluation expenses.

In 2016, the Company has, for liquidity purposes, significantly reduced its exploration and evaluation expenses. In 2015, the Company incurred certain seismic expenditures in Cessford, Provost and Princess, Alberta related to its prospect exploration and development program.

Property, Plant and Equipment Impairment

The carrying amounts of the Company's property, plant and equipment are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, then the assets fair value is estimated based on the greater of its value in use or its fair value less costs to sell.

An impairment loss is recognized if the carrying amount of an asset or its Cash Generating Unit ("CGU") exceeds its value in use or fair value less costs to sell. Impairment losses are recognized in profit or loss. Impairment losses recognized in respect of CGU's reduce the carrying amounts of the other assets in the unit (group of units) on a pro rata basis.

On June 30, 2016 and June 30, 2015, no indicators of impairments existed.

The fair value amount of the Company's CGU's are sensitive to changes in commodity prices. Impairment charges could be recorded in future periods should commodity prices decline. Alternatively, an improvement of commodity prices could reverse impairment charges recorded to date, less applicable depletion and depreciation charges.

Interest and Other Financing Expenses

	Three Months Ended June 30			Six Months Ended June 30		
(000's Cdn. $)	**2016**	2015	% Change	**2016**	2015	% Change
Interest and other financing charges	**1,240**	523	137	**1,852**	1,059	75
Per Boe	**8.28**	2.32	257	**5.58**	2.32	141

Interest and other financing charges include interest, bank charges and fees and other charges paid on the Company's credit facility, interest paid on the Company's unspent flow-through share obligation and other government and vendor charges.

Interest and other financing fees increased 137% in Q2 2016 from Q2 2015 and 75% for the current six month period from the 2015 six month period due primarily to the costs related to the syndicate's requirement to appoint a CRO, to legal and advisory fees associated with the syndicate's borrowing base review and the revised and amended credit facility and to higher syndicate fees and higher interest rates charged. This resulted in an additional $729,000 in costs in Q2 2016. For Q2 2016, the average daily borrowing balance was $35.1 million versus $56.1 million for Q2 2015.

For the six months ended June 30, 2016, interest and other financing charges were up by 75% due to a factors as noted above. The average daily borrowing balance for the six months in 2016 was $43.9 million versus $54.3 million for the 2015 six month period.

Interest rates on the Operating Credit Facility range from Canadian or US prime plus 1.00% to 3.50% on prime based loans and on the Syndicated Credit Facility range from the base rate plus 2.00% to 4.50% on bankers' acceptances and on Libor based loans. The increment is determined based on the Company's debt to cash flow ratio as calculated under the provisions of the agreement. Interest rates on the Supplemental Credit Facility are 2% higher that on the Syndicated Credit Facility. Borrowings of $12.0 million on the Supplemental Credit Facility commenced on May 28, 2015.

On June 1, 2016, interest rates on all borrowings were increased by 2.00%.

Depletion and Depreciation

	Three Months Ended June 30			Six Months Ended June 30		
(000's Cdn. $)	**2016**	2015	% Change	**2016**	2015	% Change
Depletion and depreciation	**1,833**	3,506	(48)	**4,235**	7,265	(42)
Per boe	**12.24**	15.53	(21)	**12.76**	15.88	(20)

On an absolute dollar basis, depletion and depreciation in Q2 2016 decreased 48% from Q2 2015 to $1.8 million and decreased 42% in the 2016 six month period to 4.2 million versus the 2015 six month period. This decreases are attributed primarily to a 34% and 28% decrease in average production during the current comparative periods due to property sales and natural depletion, to lower estimated abandonment and reclamation costs and to positive 2015 year end reserve additions.

On a Boe basis, depletion and depreciation decreased 21% to $12.24 per Boe in Q2 2016 versus $15.53 per Boe in Q2 2015 and for the six month 2016 period decreased 20% to $12.76 per Boe versus $15.88 per Boe in the 2015 six month period. The decrease in the current periods is related to lower estimated abandonment and reclamation costs and to positive 2015 year end reserve additions.

Accretion

	Three Months Ended June 30			Six Months Ended June 30		
(000's Cdn. $)	**2016**	2015	% Change	**2016**	2015	% Change
Accretion	**198**	236	(16)	**396**	478	(17)
Per boe	**1.32**	1.05	26	**1.19**	1.04	14

Accretion is the increase or decrease, in the reporting period, in the present value of the Company's decommissioning liabilities. Accretion also includes additional expenditures incurred to decommission well sites and facilities over and above the estimate contained in the decommissioning liability provision.

Accretion for the first six months of 2016 decreased by 17% from the first six months in 2015 due to lower estimated abandonment and reclamation costs to dispositions and to positive 2015 year end reserve additions. In addition, the 2015 six month period included expenditures to decommission certain wells over and above the decommissioning provision recorded.

Share-based Compensation

	Three Months Ended June 30			Six Months Ended June 30		
(000's Cdn. $)	**2016**	2015	% Change	**2016**	2015	% Change
Share-based compensation expense (recovery)						
Cash portion	-	125	(100)	-	125	(100)
Non-cash portion	**168**	77	119	**338**	(911)	(137)
	168	202	(17)	**338**	(786)	(143)
Share-based compensation expense (recovery)						
Cash portion - $ per Boe	-	0.56	(100)	-	0.27	(100)
Non-cash portion - $ per Boe	**1.12**	0.34	230	**1.02**	(1.99)	(151)
$ Per boe	**1.12**	0.90	25	**1.02**	(1.72)	(159)

The Company has determined that, in certain circumstances, it will cash settle stock options and a portion of the Company's share awards. The Company has recorded an incentive (share-based) compensation liability of $105,600 related to these cash settled instruments. Currently no options are in the money.

As a result of changes to the Company's share price, the Company is required to revalue or re-measure the fair market value of the Company's incentive compensation liability at the end of each reporting period. The adjustment (up or down) to the liability is recorded in the statement of income. The change in fair value of the Company's shares resulted in an expense related to share-based compensation in the current quarter of $168,448 resulting in a six month period expense of $338,208. No share-based compensation has been capitalized during 2016 or 2015.

At June 30, 2016, the Company had 273,237 options outstanding and vested at a weighted average strike price of $4.44 per share. The Company has discontinued the granting of options under the Option Plan.

At June 30, 2016 the Company had 172,999 restricted share awards and 105,999 performance share awards issued under the Share Incentive Plan approved by shareholders in 2014.

On July 1, 2016, the Company issued an additional 463,000 restricted awards to directors, officers and employees.

On July 4, 2016, 128,237 restricted and performance awards issued in 2014 and 2015 vested or were forfeited resulting in the issuance of 71,647 common shares and a payment to the Receiver General representing tax withholding of $79,379.

Foreign Exchange

	Three Months Ended June 30			Six Months Ended June 30		
(000's Cdn. $)	**2016**	2015	% Change	**2016**	2015	% Change
Realized loss (gain)	**(835)**	13	(6,642)	**(973)**	(10)	10,137
Unrealized loss (gain)	**939**	512	83	**2,619**	(2,685)	(198)
Total foreign exchange loss (gain)	**104**	525	80	**1,646**	(2,695)	161
Foreign exchange per Boe realized loss (gain)	**(5.57)**	0.06	9,960	**(2.93)**	(0.02)	(14,003)
Foreign exchange per Boe unrealized loss (gain)	**6.27**	2.27	(177)	**7.89**	(5.87)	234
	0.70	2.32	70	**4.96**	(5.89)	184

Foreign exchange gains and losses are recognized based the changes in Canadian and US dollar exchange rate and on the timing of the funding and the repayments of funds advanced from the Company and its US operating subsidiary and the timing of incurring and repaying US denominated borrowings.

During the current quarter, the Company repaid all of its US bank borrowings recognizing a realized foreign exchange gain on the repayment.

Sale of Properties

	Three Months Ended June 30			Six Months Ended June 30		
(000's Cdn. $)	**2016**	2015	% Change	**2016**	2015	% Change
(Gain) loss on sale of property	**(1,884)**	1,449	(230)	**(2,011)**	1,449	(239)
Per boe	**(12.57)**	**6.42**	(296)	**(6.06)**	**3.17**	(291)

In Q2 2015, the Company sold properties recording a loss on the sale of $1.4 million.

In Q1 2016, the Company sold its Desan, BC property for gross proceeds of $1.1 million, recognizing a gain on the sale of $126,336.

In Q2, 2016, the Company sold two Canadian properties, the non-core west portion of the Company's Princess property and its property at Chauvin for gross proceeds of $3.3 million and $8.7 million respectively recognizing a net gain of $1.9 million on the sales.

Provision for Income Taxes

	Three Months Ended June 30			Six Months Ended June 30		
(000's Cdn. $)	**2016**	2015	% Change	**2016**	2015	% Change
Current tax expense	-	-	-	**-**	-	-
Deferred tax expense	-	(189)	(100)	**(13)**	(678)	(98)
Total	-	(189)	(100)	**(13)**	(678)	(98)
$ Per Boe - current	-	-	-	-	-	-
$ Per Boe - deferred	-	(0.84)	(100)	**(0.04)**	(1.48)	(97)
$ Per boe - Total	-	(0.84)	(100)	**(0.04)**	(1.48)	(97)

The Company has not recorded any recovery of income tax as the Company has accumulated losses from operations and has tax pools in excess of $85 million at June 30, 2016. The Company has recognized a portion of the premium related to the issuance of flow-through shares in 2015. The Company incurred flow-through expenditures in the 2016 six month period of approximately $135,425 recognizing $13,173 of the recorded premium. The Company has a long term liability (flow-through share issue premium) of $302,004 related to approximately $2.0 million of remaining qualifying expenditures required to be incurred by December 31, 2016.

Net Loss from Continuing Operations per Boe

($Cdn.)	Three Months Ended June 30 **2016**	2015	Six Months Ended June 30 **2016**	2015
Oil and gas revenue	38.04	42.40	30.54	37.20
Royalties	(5.58)	(5.33)	(4.98)	(6.56)
Operating and transportation	(18.77)	(18.62)	(18.52)	(19.74)
Operating netback per Boe	**13.70**	18.45	**7.03**	10.89
Realized gain (loss) on risk management contracts	(3.94)	(0.28)	(1.99)	28.38
Realized gain on foreign exchange	5.57	(0.06)	2.93	0.02
General and administrative	(6.89)	(5.08)	(6.69)	(4.91)
Share-based compensation - cash portion	-	(0.56)	-	(0.27)
Interest and other financing charges	(8.28)	(2.32)	(5.58)	(2.32)
Funds from (used in) continuing operations netback	**0.16**	10.17	**(4.30)**	31.79
Unrealized loss on risk management contracts	(3.94)	(0.39)	(1.57)	(26.85)
Unrealized gain (loss) on foreign exchange	(6.27)	(2.27)	(7.89)	5.87
Depletion and depreciation	(12.24)	(15.53)	(12.76)	(15.88)
Accretion	(1.32)	(1.05)	(1.19)	(1.04)
Exploration and evaluation - directly expensed	(0.03)	(3.89)	(0.46)	(5.56)
Gain (loss) on sale of property and equipment	12.57	(6.42)	6.06	(3.17)
Share-based compensation -- non-cash portion	(1.12)	(0.34)	(1.02)	1.99
Deferred income tax	-	0.84	0.04	1.48
Net loss from contiuning operations	**(12.17)**	(18.87)	(23.09)	(11.37)

Net Cash from Operating Activities, Funds from Operations and Net Income(Loss)

(000's Cdn. $ except per share amounts)	Three Months Ended June 30 **2016**	2015	Change	Six Months Ended June 30 **2016**	2015	Change
Net cash from continued operating activities	**2,625**	2,405	9	**2,398**	19,514	(88)
Net cash from continuing operating activities	**436**	(1,375)	(132)	**(1,186)**	10,932	(111)
Funds from (required by) continuing operations	**25**	2,292	(99)	**(1,426)**	14,539	(110)
Per share						
Basic	**-**	0.13	(100)	**(0.07)**	0.81	(109)
Diluted	**-**	0.13	(100)	**(0.07)**	0.79	(109)
Funds from (required by) discontinued operations	**(4,174)**	3,866	(208)	**(2,986)**	7,380	(140)
Per share						
Basic	**(0.21)**	0.22	(200)	**(0.15)**	0.41	(137)
Diluted	**(0.21)**	0.22	(200)	**(0.15)**	0.41	(137)
Loss from continuing operations	**(1,823)**	(4,261)	57	**(7,664)**	(5,202)	47
Per share						
Basic	**(0.09)**	(0.24)	61	**(0.39)**	(0.29)	36
Diluted	**(0.09)**	(0.24)	61	**(0.39)**	(0.29)	36
Income (loss) from discontinued operations	**(1,016)**	832	222	**(954)**	1,307	(173)
Per share						
Basic	**(0.05)**	0.05	215	**(0.05)**	0.07	(168)
Diluted	**(0.05)**	0.05	215	**(0.05)**	0.07	(168)

Funds from continuing operations (after realized commodity contract losses) for Q2 2016 totaled $24,648 ($ nil per share basic and diluted) versus funds from continuing operations in Q2 2015 of $2.3 million ($0.13 per share basic and diluted). For the six months ended June 30, 2016, funds required by continuing operations totaled $1.4 million ($0.07 per share basic and diluted) versus funds from continuing operations in the 2015 six month period of $14.5 million ($0.81 per share basic and $0.79 per share diluted). Both commodity prices and production decreased in both current periods from their comparative 2015 periods. In Q2 2016, the Company incurred additional expenditures related to due diligence and the Arrangement Agreement and in the 2015 six month period realized $13.1 million on the monetization of crude risk management contracts.

The Company recorded a net loss from continuing operations for the current quarter of $1.8 million ($0.09 per share basic and diluted) and for the six months ended June 30, 2016 recorded a loss of $7.7 million ($0.39 per share basic and diluted versus a loss of $4.3 million ($0.24 per share basic and diluted) in Q2 2015 and $5.2 million ($0.29 per share basic and diluted) in the 2015 six month period. Lower production and commodity prices in the current year periods resulted in lower margins when compared to prior periods and were primarily responsible for the increased loss in the current periods.

Weighted Average Shares Outstanding

	Three Months Ended June 30			**Six Months Ended June 30**		
(000's Cdn. $ except per share amounts)	**2016**	**2015**	Change	**2016**	**2015**	Change
For Net (Loss) / Income Purposes						
Basic	19,423	17,907	8	19,423	17,896	9
Diluted	19,423	17,907	8	19,423	17,896	9
For Funds from Operations Purposes						
Basic	19,423	17,907	8	19,423	17,896	9
Diluted	19,702	18,302	8	19,702	18,291	8

Summary of Quarterly Results

Q2 2016 includes financial and operating results and information based on continuing operations only and therefore is not comparable to prior quarters.

	2016		2015				2014	
(000's Cdn. $)	**Q2**	Q1	Q4	Q3	Q2	Q1	Q4	Q3
Production (Boe)								
Total	**149,788**	278,239	307,102	329,812	349,956	366,349	436,245	445,997
Per day	**1,646**	3,058	3,338	3,585	3,846	4,071	4,742	4,848
Oil and gas revenue	**5,698**	7,570	11,529	13,382	16,305	13,866	25,283	33,322
Funds (used in) from operations	**25**	(263)	2,531	5,906	6,159	15,760	16,906	14,995
Per share - basic ($)	**-**	(0.01)	0.13	0.31	0.34	0.88	0.98	0.89
- diluted ($)	**-**	(0.01)	0.13	0.30	0.34	0.87	0.95	0.88
Net income (loss)	**(1,823)**	(5,779)	(26,499)	(13,586)	(3,429)	(466)	15,367	9,622
Per share - basic ($)	**(0.09)**	(0.30)	(1.37)	(0.71)	(0.19)	(0.03)	0.89	0.57
- diluted ($)	**(0.09)**	(0.30)	(1.37)	(0.71)	(0.19)	(0.03)	0.81	0.57
Total assets	**77,170**	149,013	164,133	207,409	226,773	230,571	236,424	223,262
Total debt (1)	**4,195**	53,169	53,816	52,339	56,635	57,229	65,198	81,230
Shares outstanding	**19,423**	19,423	19,423	19,376	17,969	17,897	17,877	16,974

(1) Includes bank debt and working capital but excludes risk management contracts whether current or long term assets or liabilities.

Arsenal's quarterly results have fluctuated significantly in the past eight quarters due to a variety of factors that include commodity price and production swings, the changes in the posted differentials, the timing of drilling and completions particularly in the US and in Alberta at Princess, property impairments, the rationalization of properties and operating costs and in the past few quarters and to the shutting in of some oil and natural gas production due to low prices.

Liquidity and Capital Resources

The Company's credit facility was amended on June 1, 2016. The amendment determined a borrowing base of $6 million and a supplemental facility of $5 million (from $55 million - $40 million extendible facility and $15 million supplemental). The amendment also required a full repayment of outstanding debts by June 30, 2016. The Company repaid the balance in full on June 28, 2016. A third amending agreement has provided a credit facility of $1 million in the form of an operating facility that is available for liquidity purposes to fund any cash deficiencies required to closing of the Arrangement Agreement and which requires the lender's prior approval prior to advancement.

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,

- 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.

Capital Management

Currently, the Company considers its capital structure to include working capital and shareholders' equity as it does not currently have access to a continuing line of credit. The Company has no bank debt and therefore manages its capital base primarily on its working capital position as equity for junior exploration and production companies is limited and specific.

The Company monitors, through its annual budgeting and quarterly forecasting process, its ability to undertake capital projects based on its working capital position and considering the risk reward profile of any exploration and development projects, its production profile and the economic indicators in the market including commodity prices and foreign exchange rates. It then determines its capital budget and what, if any, additional initiatives may need to be implemented.

Working capital includes short term decommissioning obligations but excludes risk management contracts (whether an asset or an obligation). Funds from operations is calculated as net cash from operating activities, before changes in non-cash working capital, decommissioning obligations settled, exploration and evaluation expenses and transaction costs from the Company's most recent quarter multiplied by four. The annualized funds from operations is further adjusted, if required, for large one-time items included in the recent quarter.

Net Debt Reconciliation

(000's Cdn. $)	Six Months Ended June 30, 2016
Net debt as at December 31, 2015	53,816
Funds required by continuing operations	1,426
Funds required by non continuing operations	2,986
Additions to property, plant and equipment	747
Exploration and evaluation expenses	153
Decommissioning liabilities settled	66
Proceeds on sale of property	(12,859)
Foreign exchange loss (gain) on US cash held	395
Net cash generated from discontinued operations	(46,112)
Change in working capital and other items	3,577
Net debt as at June 30, 2016	4,195

Net debt includes bank borrowings, plus or minus working capital. Net debt excludes long term decommissioning obligations and risk management contracts (whether an asset or an obligation and whether classified as short or long term).

The Company's share capital is not subject to external restrictions.

With decreasing commodity prices and the recent decreases and the eventual elimination of the Company's credit facility, the Company has had to adjust its approach to capital management during the current quarter to a much more conservative approach with limited capital spending.

Dividends

In August 2013, the Board of Directors adopted a dividend policy, approving a quarterly dividend payment to shareholders of approximately 10% of the Company's trailing cash flow as adjusted for significant one-time cash inflows or outflows and current economic conditions, factors and expectations.

In June 2014, shareholders approved a special resolution authorizing certain amendments to the Articles of the Company to permit the payment of share dividends on common shares to shareholders electing to receive dividends in common shares of the Company.

Dividend History

Year	Declaration Date	Record Date	Payment Date	Dividend Per Common Share Cdn. $	Common Shares Outstanding	Total Value Returned To Shareholders Cdn. $	Cash	Shares Issued
2013	August 7	August 15	August 30	0.060	16,069,586	964,175	964,175	-
	November 6	November 15	November 29	0.060	16,069,586	964,175	964,175	-
2014	February 11	February 21	February 28	0.060	16,090,119	965,407	965,407	-
	May 6	May 16	May 30	0.065	16,074,419	1,044,838	1,044,838	-
	August 6	August 18	August 28	0.070	16,886,485	1,182,054	966,209	21,044
	November 4	November 14	November 28	0.070	16,938,028	1,185,661	1,013,684	21,294
2015	February 9	February 17	February 27	0.030	17,877,272	536,318	465,325	19,489
	May 4	May 15	May 29	0.020	17,896,761	357,935	309,716	12,708
	August 4	August 14	August 28	0.020	19,332,706	386,687	319,201	67,486
	November 2	November 13	November 27	0.020	19,375,680	387,515	323,929	63,586

Share Capital

Common Shares

(000's)	Six Months Ended June 30, 2016 Shares	$	Year Ended December 31, 2015 Shares	$
Balance - beginning of period	**19,423**	**155,988**	**17,877**	151434
Issued under private placements	**-**	**-**	**1,364**	**4,619**
Share issue costs	**-**	**-**	**-**	**(713)**
Issued pursuant to share dividend program	**-**	**-**	**122**	**250**
Issued on vesting of Share Award Incentive Plan	**-**	**-**	**60**	**398**
Balance - end of period	**19,423**	**155,988**	19,423	155,988

In February (19,489) and in May (12,325) of 2015, the Company issued 31,814 common shares in relation to the share dividend program.

In June 2015, the Company issued 59,460 commons shares pursuant to the Company's Share Award Incentive Plan (see below).

On July 12, 2015 the Company closed a "bought deal' private placement and issued 778,460 common shares at a price of $3.15 per common share and 585,700 flow-through common shares at a price of $3.70 per flow-through common share for gross proceeds of $4.6 million.

The Company used the proceeds of the common share portion of the Offering to pay down existing indebtedness to position the Company to take advantage of property dispositions by competitors in its core areas and will use the proceeds of the flow-through common shares to incur eligible Canadian Exploration Expenses on its core properties and renounce such expenses to subscribers of these shares effective for the 2015 tax year. The expenses must be incurred by December 31, 2016.

In July 2016, the Company issued 71,647 common shares pursuant to the Company's Share Award Incentive Plan.

Options

(000's)	Six Months Ended June 30, 2016	Year Ended December 31, 2015
Balance - beginning of period	**618**	1,014
Cancelled (forfeited or expired unexerecised)	**(345)**	(396)
Balance - end of period	**273**	618

In May 2014, the Company implemented a Share Award Incentive Plan and discontinued any further grants of options under the option plan. All current outstanding options will expire at the end of their respective term.

All options outstanding as at June 30, 2016 have vested and are out-of-the-money.

Share Awards Incentive Plan

(000's)	Six Months Ended June 30, 2016 Restricted	Performance	Year Ended December 31, 2015 Restricted	Performance
Balance - beginning of period	**189**	**175**	127	115
Awards issued	-	-	124	117
Cancelled (forfeited or expired unexerecised)	**(79)**	**(46)**	(22)	(22)
Adjustment for dividends	-	-	1	1
Adjustment for performance factor	-	-	-	20
Vested and converted into common shares	-	-	(25)	(35)
Vested and paid in cash	-	-	(16)	(21)
Balance - end of period	**110**	**129**	189	175

In July 2016, the Company issued 71,647 common shares that included the annual vesting of restricted and performance share awards issued in June 2014 and 2015 and the performance factor attributed to the performance share awards.

At June 30, 2016, the Company has 19,422,976 common shares outstanding, 273,237 options outstanding at a weighted average price of $4.44 per share and 172,999 restricted share rights and 105,999 performance share rights awarded under the Share Award Incentive Plan outstanding.

As of the date of this MD&A, the Company has 19,494,623 common shares outstanding, 273,237 options outstanding and 650,393 restricted and performance awards outstanding convertible into common shares.

Capital Expenditures

Due to credit facility reductions and restrictions and low commodity prices, the Company has had a very limited capital expenditures program. Capital expenditures on continuing operations for the six month ended June 30, 2016 to property, plant and equipment totaled $746,799 down from $5.1 million in the 2015 six month period. Expenditures in 2016 were incurred primarily on land purchases and on well equipment and facilities at Princess. The Company capitalized $230,000 of general and administrative expenditures during the current six month period versus $325,000 in the 215 six month period.

Property, Plant and Equipment Expenditures

	Three Months Ended June 30		Six Months Ended June 30	
(000's Cdn. $)	**2016**	2015	**2016**	2015
Land	**36**	-	**118**	209
Drilling and completions	**1**	339	**67**	1,763
Capitalized general and administrative	**155**	150	**230**	325
Production equipment, facilities and tie-ins	**331**	893	**332**	2,855
Other	**60**	17	**196**	576
Total property plant and equipment additions	**583**	1,399	**943**	5,728
Non-cash additions	**(60)**	(17)	**(196)**	(576)
Total Property, Plant and Equipment Expenditures	**523**	1,382	**747**	5,152

Property Dispositions

	Three Months Ended June 30		Six Months Ended June 30	
(000's Cdn. $)	**2016**	2015	**2016**	2015
Total Property Dispositions	**(11,799)**	(1,677)	**(12,859)**	(1,677)

Exploration and Seismic Expenses

	Three Months Ended June 30		Six Months Ended June 30	
(000's Cdn. $)	**2016**	2015	**2016**	2015
Seismic expenditures	**4**	846	**153**	2,511
Other	**-**	32	**-**	32
Total Exploration and Seismic Expenses	**4**	878	**153**	2,543

Decommissioning Obligations

The following table presents the reconciliation of the beginning and ending aggregate carrying amount of the decommissioning obligations associated with the Company's retirement of oil and gas properties:

(000's Cdn. $)	**Six Months Ended June 30, 2016**	Year Ended December 31, 2015
Total decommissioning obligations at beginning of year	**40,350**	44,729
Obligations settled	**(66)**	(1,587)
Discontinued operations	**(6,970)**	-
Obligations disposed of on property sales	**(8,626)**	(462)
Obligations incurred	**136**	619
Change in estimate	**60**	(5,328)
Foreign currency translation	**-**	1,271
Accretion expense	**396**	1,108
Total decommissioning obligations at end of period	**25,280**	40,350
Recorded as folows:		
Decommissioning obligations to be incurred within one year	**100**	300
Decommissioning obligations to be incurred beyond one year	**25,180**	40,050
Total decommissioning obligations at end of period	**25,280**	40,350

Commitments and Contingencies

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. The Company has determined that it is likely the Arrangement Agreement will be completed and that the settlement of a termination fee is unlikely

In the ordinary course of business, the Company enters into various contractual obligations, including the following:

- purchase of services
- royalty agreements
- operating agreements
- transporting, processing and treating agreements
- right-of-way and road use agreements
- lease obligations for office space, office equipment and automotive equipment
- flow-through share expenditure agreements
- banking agreement
- hedging contracts

All such contractual obligations reflect market conditions at the time of contract and do not involve related parties

Outstanding lawsuits

Various lawsuits have been filed against the Company for incidents which arose in the ordinary course of business. In the opinion of management and legal counsel, the outcome of the lawsuits, now pending, are not material to the Company's operations. Should any loss result from the resolution of these claims, such loss will be charged to operations in the period of resolution.

Future 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.

Disclosure Controls and Procedures

There were no changes in disclosure controls and procedures during the interim period commencing April 1, 2016 and ending June 30, 2016.

Internal Controls over Financial Reporting

The Chief Executive Officer and Chief Financial Officer of Arsenal are responsible for designing internal controls over financial reporting or causing them to be designed and providing supervision in order to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with IFRS. Utilizing the Committee of Sponsoring Organizations of the Treadway Commission (“COSO”) Internal Control – Integrated Framework (2013), Arsenal’s management has evaluated, or caused to be evaluated under their supervision, the design and effectiveness of internal controls over financial reporting.

While Arsenal’s Chief Executive Officer and Chief Financial Officer believe the Company’s internal controls and procedures provide a reasonable level of assurance that they are reliable, an internal control system cannot prevent all errors and fraud. It is management’s belief that any control system, no matter how well conceived or operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met.

During the design assessment certain material weaknesses in internal controls over financial reporting were identified, as follows:

• Management is aware that there is a lack of segregation of duties due to the small number of employees dealing with general administrative and financial matters. However, management believes that at this time the potential benefits of adding employees to clearly segregate duties do not justify the costs associated with such increase;

• Many of Arsenal’s information systems are subject to general control deficiencies including a lack of effective controls over spreadsheets, access and documentation. The Company expects that these deficiencies will continue into the future; and

• Arsenal does not have full-time in-house personnel to address all complex and non-routine financial and tax issues that may arise. It is not deemed as economically feasible at this time to have such personnel. Arsenal relies on external experts for review and advice on complicated financial and tax issues and for tax planning, tax provision and compilation of corporate tax returns.

These weaknesses in internal controls over financial reporting result in a more than remote likelihood that a material misstatement would not be prevented or detected. Management and the Board of Directors work to mitigate the risk of material misstatement; however, management and the Board do not have reasonable assurance that this risk can be reduced to a remote likelihood of a material misstatement. There were no changes in internal controls over financial reporting during the interim period commencing April 1, 2016 and ending June 30, 2016.