Highlights

(000s except per share and per unit amounts)	Three months ended December 31, 2013	2012	% Change	Twelve months ended December 31, 2013	2012	% Change
Financial ($)						
Production revenue [1]	**28,483**	21,939	30	**105,617**	75,650	40
Comprehensive income (loss)	**(827)**	666	(224)	**(2,613)**	(17,673)	(85)
Per share, basic and diluted	**(0.00)**	(0.00)	-	**(0.01)**	(0.10)	(90)
Funds flow from operations, excluding termination fee [2]	**14,855**	11,564	28	**51,312**	30,377	69
Funds flow from operations [2]	**14,855**	11,603	28	**51,312**	33,724	52
Per share, basic and diluted	**0.07**	0.06	17	**0.25**	0.19	32
Production volumes						
Natural gas (Mcf/d)	**53,433**	47,125	13	**52,705**	47,137	12
Crude oil (bbls/d)	**838**	583	44	**792**	622	27
Natural gas liquids (bbls/d)	**651**	515	26	**607**	512	19
Total (boe/d)	**10,394**	8,951	16	**10,183**	8,990	13
Sales prices						
Natural gas, including realized hedges ($/Mcf)	**3.82**	3.49	9	**3.57**	2.67	34
Crude oil ($/bbl)	**87.37**	86.78	1	**91.81**	85.02	8
Natural gas liquids ($/bbl)	**49.54**	45.83	8	**46.63**	54.76	(15)
Total ($/boe)	**29.79**	26.64	12	**28.42**	22.99	24
Netback ($/boe)						
Price	**29.79**	26.64	12	**28.42**	22.99	24
Royalties	**(1.85)**	(1.88)	(1)	**(2.32)**	(1.45)	60
Transportation	**(1.62)**	(1.76)	(8)	**(1.60)**	(2.04)	(22)
Operating costs	**(7.33)**	(6.55)	12	**(7.66)**	(7.43)	3
Operating netback	**18.99**	16.45	15	**16.84**	12.07	40
General and administrative	**(1.65)**	(1.85)	(11)	**(1.95)**	(2.16)	(10)
Interest [5]	**(1.77)**	(0.49)	261	**(0.93)**	(0.61)	52
Cash netback	**15.57**	14.11	10	**13.96**	9.30	50
Capital expenditures ($)						
Capital expenditures	**51,578**	23,997	115	**117,909**	91,658	29
Net acquisitions (dispositions) [4]	**(47)**	644	(107)	**(2,675)**	(13,258)	(80)
Total capital expenditures	**51,531**	24,641	109	**115,234**	78,400	47
Net debt and working capital (deficiency) [3]	**(111,433)**	(45,869)	143	**(111,433)**	(45,869)	143
Weighted average shares outstanding Basic and diluted	**210,917**	194,224	9	**207,950**	178,209	17

(1) Production revenue is presented gross of royalties and includes realized gains (loss) on commodity contracts.

(2) Funds flow from operations is calculated as cash flow from operating activities before adjustments for decommissioning liabilities expenditures and net changes in non-cash working capital. For the three and twelve months ended December 31, 2012, funds flow from operations included a $39 and $3,347 termination fee (net of transaction costs) related to an unsuccessful acquisition.

(3) Net debt and working capital (deficiency) is calculated as cash and net working capital less commodity contract assets and liabilities, demand credit facilities, principal value of senior notes and excluding other liabilities.

(4) Represents the cash proceeds from the sale of assets and cash paid for the acquisition of assets, as applicable.

(5) Represents finance costs less amortization on transaction costs and accretion expense on senior notes and provisions.

Management's Discussion and Analysis

This Management's Discussion and Analysis ("MD&A") of the financial and operating results of Cequence Energy Ltd. ("Cequence" or the "Company") should be read in conjunction with the Company's audited consolidated financial statements (the "consolidated financial statements") and related notes for the years ended December 31, 2013 and 2012.

Additional information relating to the Company, including its MD&A for the prior year and the annual information form is available on SEDAR at www.sedar.com.

This MD&A is dated March 6th, 2014.

Basis of Presentation

The Financial Statements and comparative information have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB").

The reporting and the measurement currency is the Canadian dollar. For the purpose of calculating unit costs, natural gas is converted to a barrel of oil equivalent ("boe") using six thousand cubic feet of natural gas equal to one barrel of oil unless otherwise stated. The term barrel of oil equivalent (boe) may be misleading, particularly if used in isolation. A boe conversion ratio for gas of 6 Mcf:1 boe is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead.

For fiscal 2013, the ratio between the average price of West Texas Intermediate ("WTI") crude oil at Cushing and NYMEX natural gas was approximately 26:1 ("Value Ratio"). The Value Ratio is obtained using the 2013 WTI average price of $98.01 (US$/Bbl) for crude oil and the 2013 NYMEX average price of $3.73 (US$/MMbtu) for natural gas. This Value Ratio is significantly different from the energy equivalency ratio of 6:1 and using a 6:1 ratio would be misleading as an indication of value.

Unless otherwise stated and other than per unit items, all figures are presented in thousands.

Non-GAAP Measurements

Within the MD&A references are made to terms commonly used in the oil and gas industry, including operating netback, cash netback, net debt and working capital (deficiency) and funds flow from operations.

Operating and cash netback is not defined by IFRS in Canada and is referred to as a non-GAAP measure. Operating netback equals total revenue less royalties, operating costs and transportation costs. Cash netback equals the operating netback less general and administrative expenses and interest expense. Management utilizes these measures to analyze operating performance.

Net debt and working capital (deficiency) is a non-GAAP term that is calculated as cash and net working capital less commodity contract assets and liabilities, demand credit facilities, principal value of senior notes and excluding other liabilities. Cequence uses net debt and working capital deficiency as it provides an estimate of the Company's assets and obligations expected to be settled in cash.

Funds flow from operations is a non-GAAP term that represents cash flow from operating activities before adjustments for decommissioning liabilities expenditures and net changes in non-cash working capital. The Company evaluates its performance based on earnings and funds flow from operations. The Company considers funds flow from operations a key measure as it demonstrates the Company's ability to generate the cash flow necessary to fund future growth through capital investment and to repay debt. The Company's calculation of funds flow from operations may not be comparable to that reported by other companies. Funds flow from operations per share is calculated using the same weighted average number of shares outstanding used in the calculation of comprehensive income (loss) per share.

Non-GAAP financial measures do not have a standardized meaning prescribed by IFRS and are therefore unlikely to be comparable to similar measures presented by other issuers.

Selected Financial Information

A reconciliation of cash flow from operating activities to funds flow from operations and other selected financial information is as follows:

	Three months ended December 31,		Twelve months ended December 31,		
$(000s)	**2013**	2012	**2013**	2012	2011
Cash flow from operating activities	**9,317**	13,295	**43,823**	37,770	36,700
Decommissioning liabilities expenditures	**137**	80	**619**	904	955
Net change in non-cash working capital	**5,401**	(1,772)	**6,870**	(4,950)	4,607
Funds flow from operations	**14,855**	11,603	**51,312**	33,724	42,262
Per share, basic and diluted ($)	**0.07**	0.06	**0.25**	0.19	0.29
Production revenue	**28,483**	21,939	**105,617**	75,650	101,996
Comprehensive income (loss)	**(827)**	666	**(2,613)**	(17,673)	(20,158)
Per share, basic and diluted ($)	**(0.00)**	0.00	**(0.01)**	(0.10)	(0.14)
Total assets	**597,674**	519,324	**597,674**	519,324	491,365
Demand credit facilities	**22,763**	23,191	**22,763**	23,191	11,618
Senior notes – principal	**60,000**	–	**60,000**	–	–

Cequence recorded a comprehensive loss of $827 for the three months ended December 31, 2013 compared to income of $666 in 2012. The decrease is mainly due to unrealized losses on derivatives, increased interest expense on the senior notes and higher operating costs which more than offset increased production revenues due to higher production and pricing in 2013 compared to 2012.

Cequence recorded a comprehensive loss of $2,613 for the twelve months ended December 31, 2013 compared to a loss of $17,673 in 2012. The decrease in the Company's comprehensive loss for the twelve months ended December 31, 2013, was mainly attributable to higher operating netbacks due to increased production volumes and commodity prices. In addition, the Company's 2012 net loss was negatively impacted by impairments recognized on the Company's property and equipment, partially offset by gains realized on the sale of certain undeveloped land and the receipt of a termination fee on an unsuccessful acquisition.

Funds flow from operations was $14,855 and $51,312 for the three and twelve months ended December 31, 2013, respectively, compared to $11,603 and $33,724 in 2012. The increase in funds flow from operations was attributable to increased production volumes and higher natural gas prices compared to the comparative periods.

Results of Operations

PRODUCTION

Average production volumes, revenue and prices for the three and twelve months ended December 31, 2013 and 2012 are outlined below:

	Three months ended December 31,		Twelve months ended December 31,	
	2013	2012	**2013**	2012
Natural gas (Mcf/d)	**53,433**	47,125	**52,705**	47,137
Crude oil (bbls/d)	**838**	583	**792**	622
Natural gas liquids (bbls/d)	**651**	515	**607**	512
Total (boe/d)	**10,394**	8,951	**10,183**	8,990
Total production (boe)	**956,234**	823,492	**3,716,742**	3,290,340

Production for the three months and twelve months ended December 31, 2013 averaged 10,394 boe/d and 10,183 boe/d, respectively, compared to production of 8,951 boe/d and 8,990 boe/d in 2012. Higher average production resulted from production additions from the Company's drilling program. Cequence's average production of 10,183 boe/d was in line with its production guidance of 10,000 boe/d for the year ended December 31, 2013.

REVENUE

	Three months ended December 31,		Twelve months ended December 31,	
$(000s)	**2013**	2012	**2013**	2012
Revenue				
Natural gas	**19,237**	15,453	**67,650**	46,189
Realized gain (loss) on natural gas hedges	**(453)**	(334)	**1,103**	(161)
Total natural gas	**18,784**	15,119	**68,753**	46,028
Crude oil	**6,733**	4,651	**26,536**	19,367
Natural gas liquids	**2,966**	2,169	**10,328**	10,255
Total production revenue, gross of royalties	**28,483**	21,939	**105,617**	75,650
Average prices				
Natural gas ($/Mcf)	**3.91**	3.56	**3.52**	2.68
Realized natural gas hedge ($/Mcf)	**(0.09)**	(0.07)	**0.05**	(0.01)
Natural gas including hedge ($/Mcf)	**3.82**	3.49	**3.57**	2.67
Crude oil ($/bbl)	**87.37**	86.78	**91.81**	85.02
Natural gas liquids ($/bbl)	**49.54**	45.83	**46.63**	54.76
Average sales price before hedge ($/boe)	**30.26**	27.05	**28.12**	23.04
Average sales price including hedge ($/boe)	**29.79**	26.64	**28.42**	22.99
Benchmark pricing				
AECO-C spot (CDN$/Mcf)	**3.52**	3.19	**3.17**	2.38
WTI crude oil (US$/bbl)	**97.56**	88.17	**98.01**	94.14
Edmonton par price (CDN$/bbl)	**87.00**	84.97	**93.54**	86.91
US$/CDN$ exchange rate	**0.95**	0.99	**0.97**	0.99

Total production revenue, gross of royalties, was $28,483 in the fourth quarter of 2013 compared to $21,939 in 2012. The increase in revenue is attributable to the 12 percent increase in realized sales prices and 16 percent increase in production. For the twelve months ended December 31, 2013, production revenue, gross of royalties, increased 40 percent to $105,617 from $75,650 in the comparable period of 2012. The increase is a result of a 24 percent increase in realized sales prices and a 13 percent increase in production volumes.

PRICING

Cequence's production is approximately 86 percent natural gas and consequently, fluctuations in natural gas prices have a significant impact on the Company's revenue and funds flow. Canadian benchmark natural gas prices averaged $3.17 per mcf in 2013, an increase of 33 per cent from 2012 when AECO natural gas prices averaged $2.38 per mcf representing the lowest average annual price since 1998. AECO prices recovered in 2013 as inventory levels decreased in response to a colder North American winter and slowing growth in natural gas production.

Realized natural gas prices for the three months ended December 31, 2013 were $3.91 per mcf, up 10 percent from the comparable period in 2012. Realized natural gas prices for the twelve months ended December 31, 2013 were $3.52 per Mcf, up 31 percent from the comparable period in 2012. Realized natural gas prices for the twelve months ended December 31, 2013 are above benchmark prices as much of the Company's natural gas sells at a premium to AECO due to the heat content of the gas.

Oil prices for the fourth quarter of 2013 were $87.37 per barrel, up 1 percent from the same time period in 2012. Oil prices for the twelve months ended December 31, 2013 were $91.81 per barrel, up 8 percent from the comparable period in 2012.

Natural gas liquids prices for the three months ended December 31, 2013 were $49.54 per barrel, up 8 percent from the same time period in 2012. Natural gas liquids prices for the twelve months ended December 31, 2013 were $46.63 per barrel, down 15 percent from 2012. The decline in average realized natural gas liquids prices is due to an increase in ethane and propane production as a percentage of the natural gas liquid mix from prior year. Ethane and propane have the lowest realized price and value of all natural gas liquids.

Since June 30, 2012, a significant portion of the Company's natural gas production from its Simonette property is shipped to the Aux Sable NGL extraction and fractionation plant in Channahon, IL. Cequence continues to sell unprocessed rich natural gas at AECO and participates in the revenue from the natural gas liquids extracted at the Aux Sable facility and sold in the US market. As a component of this processing arrangement additional ethane and propane volumes were extracted from the Company's raw natural gas.

COMMODITY PRICE MANAGEMENT

	Three months ended December 31,		Twelve months ended December 31,	
$(000s)	**2013**	2012	**2013**	2012
Realized gain (loss) on commodity contracts	**(453)**	(335)	**1,103**	(161)
Unrealized gain (loss) on commodity contracts	**(3,769)**	1,490	**(3,713)**	757
Total	**(4,222)**	1,155	**(2,610)**	596

Cequence has a commodity price risk management program which provides the Company flexibility to enter into derivative and physical commodity contracts to protect future cash flows for planned capital expenditures.

For 2014, Cequence has hedged approximately 50 percent (30,000 GJ/d) of its forecasted natural gas production volumes net of royalties at an average AECO price of $3.44 per GJ or approximately $3.98 per mcf based on the historical heat content of the Company's natural gas.

The fair value of the commodity contracts outstanding at December 31, 2013 was a current liability of $2,880 and a non-current liability of $76 (December 31, 2012 – current asset of $694 and a non-current asset of $63).

ROYALTY EXPENSE

	Three months ended December 31,		Twelve months ended December 31,	
$(000s)	**2013**	2012	**2013**	2012
Crown	**550**	951	**4,672**	2,862
Freehold / Overriding	**1,219**	595	**3,943**	1,900
	1,769	1,546	**8,615**	4,762
As a % of revenue, before hedging activity				
Crown	**2**	4	**4**	4
Freehold / Overriding	**4**	3	**4**	2
	6	7	**8**	6
Per unit of production ($/boe)				
Crown	**0.57**	1.15	**1.26**	0.87
Freehold / Overriding	**1.28**	0.73	**1.06**	0.58
	1.85	1.88	**2.32**	1.45

Royalty expense for the three months ended December 31, 2013 was $1,769 or 6 percent of revenue compared to $1,546 or 7 percent of revenue in 2012. Royalty expense for the twelve months ended December 31, 2013 was $8,615 or 8 percent of revenue compared to $4,762 or 6 percent of revenue in 2012. Crown royalties as a percentage of revenue are low in both 2012 and 2013 due to low natural gas prices and royalty rates of 5 percent on initial production from new horizontal wells. Freehold and overriding royalties have increased from 2012 as much of the Company's drilling activity in 2013 was conducted on lands with gross overriding royalties. Royalties as a percentage of revenue are slightly lower than the Company's guidance of approximately 9 percent for the year ended December 31, 2013.

TRANSPORTATION EXPENSE

	Three months ended December 31,		Twelve months ended December 31,	
$(000s)	**2013**	2012	**2013**	2012
Transportation ($)	**1,550**	1,449	**5,957**	6,702
Per unit of production ($/boe)	**1.62**	1.76	**1.60**	2.04

Transportation expense for the three months ended December 31, 2013 was $1.62 per boe, a decrease of 8 percent from the comparative period in 2012. For the twelve months ended December 31, 2013, transportation expense decreased to $1.60 per boe from $2.04 per boe in the comparative period in 2012. The decrease is due to lower transportation rates on marketing contracts which were renewed in late 2012. Transportation expense per boe is within the Company's guidance of approximately $1.50 to $1.75 per boe for the year ended December 31, 2013.

OPERATING COSTS

	Three months ended December 31,		Twelve months ended December 31,	
$(000s)	**2013**	2012	**2013**	2012
Operating costs ($)	**7,007**	5,397	**28,472**	24,440
Per unit of production ($/boe)	**7.33**	6.55	**7.66**	7.43

For the three months ended December 31, 2013, operating costs increased to $7.33 per boe from $6.55 per boe in the comparative period in 2012. Operating costs for the twelve months ended December 31, 2013 were $7.66 per boe compared to $7.43 per boe for the same period in 2012. The increase in fourth quarter operating costs can be attributed to increased chemical costs for sour production handling and cost escalation in non-core properties due to workovers and declining production.

For the three and twelve month periods ended December 31, 2013 operating costs in the Company's primary operating area of Simonette were significantly lower than corporate operating costs. For the twelve months ended December 31, 2013 Simonette operating costs were $5.33 per boe, compared to operating costs of $12.16 per boe in the Company's other properties. Simonette currently comprises 66 percent of corporate production and has been the focus of the Company's capital expenditures and production growth for the past three years.

OPERATING NETBACK

	Three months ended December 31,		Twelve months ended December 31,	
($/boe)	**2013**	2012	**2013**	2012
Production revenue [1]	**29.79**	26.64	**28.42**	22.99
Royalty expense	**(1.85)**	(1.88)	**(2.32)**	(1.45)
Transportation expense	**(1.62)**	(1.76)	**(1.60)**	(2.04)
Operating costs	**(7.33)**	(6.55)	**(7.66)**	(7.43)
Operating netback, $/boe	**18.99**	16.45	**16.84**	12.07
Operating netback, excluding realized hedges, $/boe	**19.46**	16.86	**16.54**	12.13

(1) Production revenue is presented gross of royalties and includes realized gain (loss) on commodity contracts.

Cequence's netback for the three months ended December 31, 2013 increased 15 percent to $18.99 per boe from $16.45 per boe in 2012. For the twelve months ended December 31, 2013, the netback increased to $16.84 per boe from $12.07 per boe in the comparative period in 2012. The increase in 2013 operating netbacks is mainly due to increased production revenue due to higher production volumes and commodity prices in 2013 compared to 2012.

GENERAL AND ADMINISTRATIVE EXPENSES

	Three months ended December 31,		Twelve months ended December 31,	
$(000s)	**2013**	2012	**2013**	2012
G&A expenses ($)	**1,575**	1,519	**7,266**	7,105
Per unit of production ($/boe)	**1.65**	1.85	**1.95**	2.16

Total general and administrative ("G&A") costs for the three and twelve months ended December 31, 2013 were consistent with the prior year as the size and nature of the business have not changed significantly. G&A per boe has decreased in the three and twelve month periods primarily as a result of increased production volumes. The Company's G&A expenses per boe for the year ended December 31, 2013 is slightly lower than expectations of approximately $2.00 to $2.25 per boe.

FINANCE COSTS

	Three months ended December 31,		Twelve months ended December 31,	
$(000s)	**2013**	2012	**2013**	2012
Interest expense on credit facilities	**355**	404	**2,105**	2,000
Interest expense on senior notes	**1,334**	–	**1,334**	–
Amortization of transaction costs	**76**	–	**76**	–
Accretion expense on senior notes	**58**	–	**58**	–
Accretion expense on provisions	**215**	202	**830**	725
Total finance costs	**2,038**	606	**4,403**	2,725
Per unit of production ($/boe)	**2.13**	0.74	**1.18**	0.83
Interest per unit of production ($/boe)	**1.77**	0.49	**0.93**	0.61

Finance costs for the three months ended December 31, 2013 were $2,038 compared to $606 for the comparative period in 2012. Finance costs for the twelve months ended December 31, 2013 were $4,403 compared to $2,725 for the comparative period in 2012. The increase is directly attributable to increased interest expense on the senior notes which were issued by the Company on October 3, 2013.

OTHER EXPENSE (INCOME)

	Three months ended December 31,		Twelve months ended December 31,	
$(000s)	**2013**	2012	**2013**	2012
Gain on sale of property and equipment	**–**	–	**(1,092)**	(20,390)
Termination fee net of transaction costs	**–**	(39)	**–**	(3,347)
Transaction costs	**–**	–	**353**	–
Other	**(43)**	(20)	**(118)**	(57)
Total other expense (income)	**(43)**	(59)	**(857)**	(23,794)

During the twelve months ended December 31, 2013, the Company completed the sales of certain oil and gas properties for total cash consideration of $2,878 (2012 – $20,662), subject to final adjustments. The sales resulted in a gain recognized in comprehensive loss of $1,092 (2012 – $20,390).

In June 2012, Cequence and Open Range Energy Corp. ("Open Range") entered into an arrangement agreement whereby Cequence agreed to acquire all of the outstanding common shares of Open Range. In July 2012, Open Range accepted a superior proposal from another publicly traded Canadian oil and gas company and in accordance with the terms of the arrangement agreement, Open Range paid to Cequence a termination fee of $4,600. Transaction costs of $1,253 were incurred by the Company with respect to this arrangement agreement during 2012. The net amount of $3,347 has been included in other expense (income) for the twelve months ended December 31, 2012.

On April 15, 2013, the Company acquired oil and gas properties located in the Simonette area of Alberta and recorded transaction costs of $353 related to this acquisition.

DEPLETION, DEPRECIATION AND IMPAIRMENT

	Three months ended December 31,		Twelve months ended December 31,	
$(000s)	**2013**	2012	**2013**	2012
Depletion and depreciation expense	**10,907**	9,345	**40,932**	39,564
Impairment	**–**	1,113	**2,164**	26,894
Total depletion, depreciation and impairment	**10,907**	10,458	**43,096**	66,458
Per unit of production ($/boe)	**11.41**	12.70	**11.59**	20.20
Per unit of production, excluding impairment ($/boe)	**11.41**	11.35	**11.01**	12.02

Depletion and depreciation expense for the three and twelve months ended December 31, 2013, was $10,907 ($11.41 per boe) and $40,932 ($11.01 per boe), respectively. Depletion and depreciation rates are similar to the comparable period in 2012 as there have not been significant changes to Cequence's resource base during this time.

Impairment expense for the twelve months ended December 31, 2013 was $2,164 compared to $26,894 for the comparable period in 2012. During the three months ended June 30, 2013 the Company recorded an impairment of $2,164 reflecting the difference between the carrying value and fair value of the Fir assets included as consideration transferred in the Simonette property acquisition. Substantially all of the Company's capital expenditures in the past two years have been on the Deep Basin cash generating unit ("CGU"). The 2012 impairment of the Northeast British Columbia and Peace River Arch CGU's resulted largely from declining natural gas prices and minimal capital expenditures in these areas. The following represents impairment recognized per CGU in the three and twelve months ended December 31, 2013 and 2012:

	Three months ended December 31,		Twelve months ended December 31,	
$(000s)	**2013**	2012	**2013**	2012
Northeast British Columbia	**–**	–	**–**	14,931
Peace River Arch	**–**	1,113	**–**	11,963
Deep Basin disposition	**–**	–	**2,164**	–
Total	**–**	1,113	**2,164**	26,894

PROVISIONS

Decommissioning liabilities

Total decommissioning liabilities at December 31, 2013 were $26,643 compared to $32,564 at December 31, 2012. The following table summarizes the changes in decommissioning liabilities for the respective periods:

(000's)	**December 31, 2013**	December 31, 2012
Balance, beginning of year	**32,564**	28,135
Property acquisitions	**285**	417
Property dispositions	**(1,729)**	(533)
Accretion expense	**819**	730
Liabilities incurred	**1,120**	1,775
Abandonment costs incurred	**(619)**	(904)
Revisions in estimated cash flows	**(973)**	2,078
Revisions due to change in discount rates	**(4,824)**	866
Balance, end of year	**26,643**	32,564

The Company's decommissioning liabilities result from its ownership in oil and natural gas assets including well sites, facilities and gathering systems. The total estimated, undiscounted cash flows, inflated at 2 percent, required to settle the obligations are $55,632 (2012 - $47,549). These cash flows have been discounted using a risk-free interest rate of 3.20 percent (2012 – 2.37 percent) based on Government of Canada long-tern benchmark bonds. The Company expects these obligations to be settled in approximately 1 to 50 years (2012 – 1 to 50 years).

Onerous Contracts

As at December 31, 2013, the Company recognized a provision related to an onerous lease contract of $502 (December 31, 2012 – $812). The provision for onerous lease contract represents the present value of the future lease obligations that the Company is presently obligated to make under a non-cancellable onerous operating lease contract, less revenue expected to be earned on the lease, including estimated future sub-lease revenue.

SHARE BASED PAYMENTS

The Company recognizes share based payment expense for stock options and restricted rights.

Stock Options

For the twelve months ended December 31, 2013, Cequence recorded $3,633 (2012 – $5,717) in share based payment expense related to stock options with a corresponding increase to contributed surplus.

	December 31, 2013		December 31, 2012	
	Number of Options (000's)	**Weighted Average Exercise Price $**	Number of Options (000's)	Weighted Average Exercise Price $
Outstanding, beginning of year	**17,289**	**2.19**	13,094	2.54
Granted	**1,780**	**1.70**	5,118	1.30
Forfeited	**(444)**	**1.92**	(923)	2.20
Exercised	**(8)**	**1.35**	–	–
Outstanding, end of year	**18,617**	**2.15**	17,289	2.19

Restricted Share Units

For the twelve months ended December 31, 2013, Cequence recorded $111 (2012 – nil) in share based payment expense related to restricted share units ("RSU") with a corresponding increase to share based payment liability. RSUs are granted to directors, officers and employees of the Company and vest annually in equal amounts over a three year period.

	Number (000s)
Outstanding, beginning of year	–
Granted	**561**
Outstanding, end of year	**561**

COMMON SHARES OUTSTANDING

Cequence has an unlimited number of common voting shares and common non-voting shares with no par value.

Issued common voting shares (000s)	**Number**	**Stated Value**
Balance, December 31, 2011	161,856	$ 559,371
Common shares	21,269	25,523
Flow-through common shares	17,485	24,429
Share issue costs, net of taxes of $874	–	(2,620)
Balance, December 31, 2012	200,610	$ 606,703
Common shares issued on property acquisition	**10,300**	**17,510**
Common shares issued on exercise of stock options	**8**	**15**
Share issue costs, net of taxes of ($35)	–	**104**
Balance, December 31, 2013	**210,918**	**$ 624,332**

On June 20, 2012, the Company completed the sale of 11,684 common voting shares at a price of $1.20 per share for gross proceeds of $14,020. On July 12, 2012, the Company further completed the sale of 1,252 common voting shares at a price of $1.20 per share for gross proceeds of $1,503 related to the exercise of an over-allotment option on the above issuance.

On June 20, 2012, the Company completed the sale of 4,850 common voting shares on a CEE "flow-through" basis at $1.45 per share for gross proceeds of $7,033 as well as 3,800 common voting shares on a CDE "flow-through" basis at $1.32 per share for gross proceeds of $5,016, resulting in a total issuance of 8,650 common voting shares for total gross proceeds of $12,049. The above transaction resulted in an increase to share capital of $10,380 and the recognition of an obligation related to flow-through shares of $1,669 included with other liabilities at December 31, 2012. In accordance with the terms of the related agreements and pursuant to certain provisions of the Income Tax Act (Canada), the Company is required to renounce, for income tax purposes, exploration expenditures of $7,033 and development expenditures of $5,016 to the holders of the flow-through common shares effective December 31, 2012. As at December 31, 2012, the Company has incurred all qualifying CEE and CDE expenditures.

On June 22, 2012, the Company completed the sale, on a private placement basis, of 8,333 common voting shares at a price of $1.20 per share for gross proceeds of $10,000.

On December 5, 2012, the Company completed the public sale of 8,560 common voting shares on a CEE "flow-through" basis at $1.87 per share for gross proceeds of $16,007. On December 21, 2012, the Company completed a private placement sale of 275 common voting shares to certain officers and directors on a CEE "flow-through" basis at $1.87 per share for gross proceeds of $514. The private placement transaction has been recorded at the exchange amount, which is the amount of consideration established and agreed to by the related parties, and is equal to fair value. The above transactions resulted in an increase to share capital of $14,048 and the recognition of an obligation related to flow-through shares of $2,473 included with other liabilities at December 31, 2012. In accordance with the terms of the related agreements and pursuant to certain provisions of the Income Tax Act (Canada), the Company is required to renounce, for income tax purposes, exploration expenditures of $16,521 to the holders of the flow-through common shares effective December 31, 2012. As at December 31, 2013, the Company has incurred all qualifying CEE expenditures.

On April 15, 2013, the Company issued an aggregate of 10,300,000 Cequence common shares as partial consideration for the acquisition of oil and gas properties located in the Simonette area of Alberta. The common shares were distributed directly to the shareholders of a publicly listed Canadian company.

Issued warrants (000's)	Number	Stated Value
Balance, December 31, 2011	2,250	$ –
Cancelled	(2,250)	–
Balance, December 31, 2012	**–**	$ –
Granted on issuance of senior notes, net of tax of $183 (2012 –nil)	**3,000**	**1,399**
Share issue costs, net of taxes of $13 (2012 – nil)	**–**	**(39)**
Balance, December 31, 2013	**3,000**	**$ 1,300**

On March 8, 2012, the Company's 2012 Warrants related to a previous private placement of common shares were cancelled at no cost to Cequence and no redress to the shareholder.

On October 3, 2013, Cequence granted to the lender of the senior notes 3.0 million warrants at an exercise price of $2.03 to purchase common shares. The warrants will expire on October 3, 2020 and were issued with an exercise price of $2.03 which was based at a 30 percent premium to the 30 trading day volume weighted average trading price of the Cequence common shares on the TSX ending on the day immediately preceding the closing date.

As of the date of this MD&A, Cequence had the following securities outstanding: 210,918 common voting shares, 3,000,000 warrants to purchase common shares, 18,637 stock options and 589 RSUs.

CAPITAL EXPENDITURES

	Three months ended December 31,		Twelve months ended December 31,	
$(000s)	**2013**	2012	**2013**	2012
Property acquisitions [1]	**(6)**	644	**203**	7,404
Property dispositions [1]	**(41)**	–	**(2,878)**	(20,662)
Land	**9,281**	335	**11,614**	1,201
Geological & geophysical and capitalized overhead	**315**	418	**1,997**	4,046
Drilling, completions and workovers	**34,681**	19,827	**77,101**	60,926
Equipment and facilities	**7,283**	3,406	**27,105**	25,360
Office furniture & equipment	**18**	11	**92**	125
Total capital expenditures	**51,531**	24,641	**115,234**	78,400

(1) Represent the cash proceeds from the sale of assets and cash paid for the acquisition of assets, as applicable.

Net capital expenditures for the twelve months ended December 31, 2013 increased to $115,234 from $78,400 in 2012. The increase is mainly due the impact of $20,662 of property dispositions and $7,404 of acquisitions in 2012 compared to 2013 and Cequence's increased capital program during the fourth quarter of 2013.

For the twelve months ended December 31, 2013, drilling, completion and workover expenditures totalled $77,101 which included the drilling of 15.0 gross (11.8 net) horizontal wells. For the twelve months ended December 31, 2012, drilling, completion and workover expenditures totalled $60,926 which included the drilling of 7.0 gross (5.8 net) horizontal wells as well as the completion of 8.0 gross (5.7 net) horizontal wells.

Equipment and facility expenditures in the twelve months ended December 31, 2013 of $27,105 were mainly directed towards a facility expansion for the Simonette compression and dehydration facility, along with additional pipelines. For the twelve months ended December 31, 2012 equipment and facility expenditures of $25,360 were directed towards completion of the meter station and tie in to the Alliance pipeline related to the Aux Sable arrangement discussed above as well as to compression and gathering facilities in the Deep Basin.

On January 13, 2012, the Company closed the acquisition of properties, composed primarily of undeveloped land, located in the Deep Basin for total cash consideration of $6,760, subject to adjustments.

During the twelve months ended December 31, 2013, the Company completed the sales of certain oil and gas properties for total cash consideration of $2,878 (2012 – $20,662), subject to final adjustments. The sales resulted in a gain recognized in comprehensive loss of $1,092 (2012 – $20,390).

The Company's total capital expenditures for the twelve months ended December 31, 2013 were $115,234 compared to previously issued guidance of $110,000. Capital expenditures were funded from cash flow, proceeds from the senior notes and borrowing from the Company's senior credit facility. Upon the closing of the senior notes offering Cequence increased its capital expenditure budget in 2013 to $110,000 from $97,000. Actual capital expenditures for 2013 of $115,234 were higher than budget due to higher than expected land expenditures in the fourth quarter as the Company spent $8,900 to increase its land position at its Ansell property.

Cequence has budgeted net capital expenditures of $120,000 for the year ended December 31, 2014 and is expected to be focused on the development of the Company's Simonette and Ansell assets. Capital expenditures for 2014 are expected to be funded from cash flow, proceeds from the senior notes and borrowing from the Company's senior credit facility. The Company continually monitors fluctuations in natural gas prices and may adjust budgeted discretionary capital spending based on the Company's hedge position and short to medium term natural gas prices.

PROPERTY ACQUISITION

On April 15, 2013, the Company acquired oil and gas properties located in the Simonette area of Alberta. As consideration for the assets, Cequence transferred its interest in its non-operated oil and gas properties located in the Fir area, and issued an aggregate of 10,300,000 Cequence common shares to the Corporation. The Company recorded $353 of transaction costs related to this acquisition. Cequence believes that this expansion and consolidation of its contiguous Montney land position at Simonette has significant present and future economic and strategic value.

Cequence assessed the property acquisition and determined that it constitutes a business combination under IFRS. In a business combination, acquired assets and liabilities are recognized by the acquirer at their fair value at the time of purchase. Any difference between the determined fair value of the assets and liabilities and the purchase price is recognized as either a bargain purchase gain or goodwill in the period of acquisition.

A summary of the acquired property is as follows:

Estimated fair value of acquisition:	
Property and equipment	23,336
Decommissioning liabilities	(239)
Deferred income tax liability	(3)
	23,094

Consideration:	
Common shares issued	17,510
Property and equipment transferred	6,004
Decommissioning liabilities transferred	(420)
	23,094

INCOME TAXES

At December 31, 2013, a deferred income tax asset of $36,094 (December 31, 2012 – $44,266) has been recognized as the Company believes, based on estimated cash flows, its realization is probable. At December 31, 2013, Cequence has the following tax pools:

Classification	Amount $(000s)
Canadian exploration expense	208,544
Non-capital losses	138,001
Undepreciated capital cost	118,834
Canadian oil and gas property expense	85,223
Canadian development expense	80,334
Scientific research and experimental development tax credit	22,704
Share issue costs	5,616
Investment tax credits	3,981
	663,237

The Company's non-capital losses expire in 2026 and thereafter.

In accordance with the terms of the related agreements and pursuant to certain provisions of the Income Tax Act (Canada), the Company renounced, for income tax purposes, development expenditures of $5,016 and exploration expenditures of $23,555 to the holders of flow-through common shares effective December 31, 2012. Deferred tax of approximately $7,143 associated with renouncing the expenditures was recorded on the date of renunciation in the first quarter of 2013, the related obligation on flow-through shares of $4,142 was drawn down and the difference was recognized as deferred income tax expense. As at December 31, 2013, the Company has estimated that it has incurred all of the qualifying expenditures.

Based on the Company's expected cash flow and available tax pools, Cequence does not expect to be taxable for the next three years.

Liquidity and Capital Resources

Cequence's objectives are to maintain a flexible capital structure in order to meet its financial obligations and to execute its business plan throughout the commodity cycle. The Company's capital comprises shareholders' equity, demand credit facilities, senior notes and working capital. Cequence manages the capital structure and makes adjustments in light of economic conditions and the risk characteristics of the underlying assets.

In October 2013, Cequence closed an investment with CPPIB Credit Investments Inc., ("CII"), a wholly-owned subsidiary of Canada Pension Plan Investment Board ("CPPIB"), for an initial investment by CII of $60 million in unsecured five year senior notes with a further $60 million of notes available at a future date, subject to the approval of both CII and Cequence on terms to be confirmed at the time of issuance. In addition, Cequence granted CII 3.0 million warrants to purchase common shares. The investment has allowed Cequence to accelerate the development of its assets.

The initial investment of $60 million of senior notes were issued at par and carry a 9% coupon rate per annum. A standby charge of 0.7% is applied to the further $60 million of notes available at a future date. The senior notes, which have make whole and other change of control provisions, have been issued pursuant to a trust indenture with a Canadian trust company (the "Indenture"), which is available under the Company's profile on SEDAR at www.sedar.com. The Indenture contains certain covenants regarding the incurrence of additional debt, the creation of liens in connection with indebtedness, dividends and other distributions, asset sales and other matters, and customary events of default.

The proceeds from the senior notes issuance were initially used for the repayment of indebtedness on the senior credit facility. The financial flexibility afforded by the senior notes allowed Cequence to accelerate the development of the Company's Simonette project beginning in the fourth quarter of 2013 which included the drilling of an additional 3.0 (2.5 net) wells prior to year end.

The Company monitors net debt to funds flow as one measure of the Company's ability to manage its debt levels under current operating conditions and meet current obligations as they come due. Management targets a debt to cash flow ratio of less than two times. As at December 31, 2013, the Company's net debt to annualized funds flow ratio was calculated as 1.9:1 (December 31, 2012 – 1.1:1) based on annualized fourth quarter results. In a typical year due to seasonality, capital expenditures increase in the winter months and are lower in the spring and early summer. As a result, the Company's accounts payable and accrued liabilities often peak at the end of the first quarter. The Company's budgeted capital expenditures for 2013 and 2014 result in peak first quarter debt to cash flow of approximately 2.5 times.

As disclosed in the annual financial statements, Cequence has periodically issued common shares and flow through common shares to fund a capital program that has been greater than the Company's cash flow. For the

twelve months ended December 31, 2013, Cequence used funds flow from operations of $51,312, bank debt and proceeds from the issuance of the senior notes to finance its capital expenditures of $115,234.

The Company's credit facility with a syndicate of Canadian chartered banks has been redetermined and is now $120 million after giving effect to the issuance of the senior notes. Credit facility A is a $110,000 (December 31, 2012 – $90,000) extendible revolving term credit facility by way of prime loans, U.S. Base Rate Loans, Banker's Acceptances and Libor Loans. Credit facility B is a $10,000 (December 31, 2012 – $10,000) operating facility by way of prime loans, U.S. Base Rate Loans, Banker's Acceptances and letters of credit. Prime loans and U.S. Base Rate Loans on these facilities bear interest at the bank prime rate or U.S. Base Rate, respectively, plus 1.0 percent to 2.5 percent on a sliding scale, depending on the Company's debt to adjusted EBITDA ratio (ranging from being less than or equal to 1.0:1.0 to greater than 2.5:1.0). Banker's Acceptances, Libor Loans and letters of credit on these facilities bear interest at the Banker's Acceptance rate, Libor rate or letter of credit rate, as applicable, plus 2.0 percent to 3.5 percent based on the same sliding scale as above. The credit facilities may be extended and revolve beyond the initial one-year period, if requested by the Company and accepted by the lenders. If the credit facilities do not continue to revolve, the facilities will convert to a 366-day non-revolving term loan facility.

Both credit facilities, and the amount available for draws under the facilities, are subject to periodic review by the bank and are secured by a general assignment of book debts and a $250,000 demand debenture with a first floating charge over all assets of the Company. As at December 31, 2013, the Company has drawn $22,763 under the extendible revolving term credit facility and $nil under the operating facility (December 31, 2012 – $23,191 and $nil for the revolving and operating facilities, respectively). The Company has covenants that require Consolidated Debt and Senior Debt to twelve month trailing earnings before interest, taxes and depletion and depreciation to be less that 4:0 to 1:0 and 3:0 to 1:0, respectively. Consolidated Debt is defined as the sum of the Company's period end balance of the credit facility and senior notes. Senior Debt is defined as the sum of Consolidated Debt less the period end balance of the senior notes. The Company was in compliance with the lender's covenants at December 31, 2013. The effective annualized interest rate, including standby fees and commitment fees, for the twelve months ended December 31, 2013 was 5.43 percent (2012 – 4.41 percent). The next scheduled credit facility review is to take place on May 2014.

The oil and gas business can involve significant capital expenditures as assets are explored for and developed. In order to fund capital expenditures Cequence may adjust the capital structure through the issue of new common shares, new debt or replace existing debt, adjust capital expenditures and acquire or dispose of assets. Historically, a significant portion of the Company's capital expenditures have been discretionary and can be adjusted in response to fluctuation in commodity prices in order to manage the Company's debt levels. The Company has also hedged natural gas production to protect future cash flow.

Net Debt and Working Capital (Deficiency)

Net debt and working capital (deficiency) is calculated as cash and net working capital less commodity contract assets and liabilities, demand credit facilities, principal value of senior notes and excluding other liabilities, as follows:

$(000s)	**As at December 31, 2013**	As at December 31, 2012
Demand credit facilities	**(22,763)**	(23,191)
Senior notes – principal	**(60,000)**	–
Accounts payable and accrued liabilities	**(51,692)**	(42,190)
Accounts receivable	**19,834**	16,084
Deposits and prepaid expenses – current	**3,188**	3,428
Net debt and working capital (deficiency)	**(111,433)**	(45,869)

Contractual Obligations

	2014	2015	2016	2017	2018+	Total
Office leases	1,129	1,016	829	622	–	3,596
Pipeline transportation	1,730	1,583	–	–	–	3,313
Total	2,859	2,599	829	622	–	6,909

The pipeline transportation contract expires on November 30, 2015.

In 2011, the Company entered into a drilling service agreement whereby the Company made a deposit of $3,500 to obtain a right of first refusal on the use of two drilling rigs over the five years following the date that use of the rigs commences. The deposit is to be applied as the Company incurs costs related to the use of the drilling rigs and $1,751 has been drawn down at December 31, 2013. Cequence expects to reduce the deposit by $702 in the year ended December 31, 2014, which amount is included with deposits and prepaid expenses at December 31, 2013. The portion of the outstanding deposit expected to be drawn down in the period subsequent to December 31, 2014 of $1,047 is carried as a non-current asset at December 31, 2013.

Disclosure Controls and Internal Controls Over Financial Reporting

The President and Chief Executive Officer and the Vice President, Finance and Chief Financial Officer are responsible for designing internal controls over financial reporting or causing them to be designed under their 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. The Company's President and Chief Executive Officer and Vice President, Finance and Chief Financial Officer have designed, or caused to be designed under their supervision, disclosure controls and procedures to provide reasonable assurance that information required to be disclosed by the Company in its annual filings, interim filings or other reports filed or submitted by it under securities legislation is recorded, processed, summarized and reported within the time periods specified in the securities legislation and include controls and procedures designed to ensure that information required to be disclosed by an issuer in its annual filings, interim filings or other reports filed or submitted under securities legislation is accumulated and communicated to the Company's management, including its President and Chief Executive Officer and Vice President, Finance and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

The Committee of Sponsoring Organizations ("COSO") framework provides the basis for management's design of internal controls over financial reporting. Management and the Board work to mitigate the risk of a material misstatement in financial reporting; however, a 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 and it should not be expected that the disclosure and internal control procedures will prevent all errors or fraud.

As at December 31, 2013, the President and Chief Executive Officer and the Vice President, Finance and Chief Financial Officer have concluded, based on their evaluation of the design and operating effectiveness of the Company's disclosure controls and internal controls over financial reporting ("ICFR") that disclosure controls and ICFR are effective.

Quarterly Information

FINANCIAL

($ thousands except per share data)	2013 Q4	2013 Q3	2013 Q2	2013 Q1	2012 Q4	2012 Q3	2012 Q2	2012 Q1
Production revenue [1]	**28,483**	**25,325**	**29,803**	**22,005**	21,939	17,814	16,032	19,864
Royalties expense	**1,769**	**2,305**	**2,452**	**2,089**	1,546	992	118	2,176
Transportation expense	**1,550**	**1,558**	**1,590**	**1,259**	1,449	1,801	1,661	1,791
Operating costs	**7,007**	**7,852**	**7,867**	**5,746**	5,397	5,627	6,554	6,862
Comprehensive income (loss)	**(827)**	**(517)**	**4,170**	**(5,439)**	666	(3,824)	(6,579)	(7,936)
Per share – basic & diluted	**(0.00)**	**(0.00)**	**0.02**	**(0.03)**	(0.00)	(0.02)	(0.04)	(0.05)
Funds flow from operations [2]	**14,855**	**10,973**	**14,831**	**10,652**	11,603	10,803	4,563	6,755
Per share – basic & diluted	**0.07**	**0.05**	**0.07**	**0.05**	0.06	0.06	0.03	0.04
Capital expenditures, net	**51,578**	**17,949**	**4,723**	**43,659**	23,997	16,818	9,909	40,934
Net acquisitions (dispositions) [3]	**(47)**	**(5)**	**(2,641)**	**18**	644	20	(2,980)	(10,942)
Total capital expenditures	**51,531**	**17,944**	**2,082**	**43,677**	24,641	16,838	6,929	29,992

(1) Production revenue is presented gross of royalties and includes realized gain (loss) on commodity contracts.

(2) Funds flow from operations is calculated as cash flow from operating activities before adjustments for decommissioning liabilities expenditures, proceeds from the sale of commodity contracts and net changes in non-cash working capital.

(3) Represents the cash proceeds from the sale of assets and cash paid for the acquisition of assets, as applicable.

OPERATIONAL

	2013 Q4	2013 Q3	2013 Q2	2013 Q1	2012 Q4	2012 Q3	2012 Q2	2012 Q1
Production volumes								
Natural gas (Mcf/d)	**53,433**	**52,848**	**58,153**	**46,306**	47,125	46,641	45,042	49,924
Oil (bbls/d)	**838**	**844**	**874**	**608**	583	606	618	684
NGLs (bbls/d)	**651**	**640**	**639**	**496**	515	516	535	459
Total (boe/d)	**10,394**	**10,292**	**11,205**	**8,822**	8,951	8,895	8,660	9,464
Average selling price								
Natural gas ($/Mcf)	**3.82**	**3.08**	**3.85**	**3.51**	3.49	2.61	2.11	2.44
Oil ($/bbl)	**87.37**	**97.42**	**90.56**	**91.90**	86.78	83.38	79.92	89.58
NGLs ($/bbl)	**49.54**	**47.26**	**38.23**	**52.84**	45.83	41.89	59.54	76.63
Total ($/boe)	**29.79**	**26.75**	**29.23**	**27.72**	26.64	21.77	20.34	23.07
Operating netback ($/boe)								
Price	**29.79**	**26.75**	**29.23**	**27.72**	26.64	21.77	20.34	23.07
Royalties	**(1.85)**	**(2.44)**	**(2.40)**	**(2.63)**	(1.88)	(1.13)	(0.15)	(2.53)
Transportation	**(1.62)**	**(1.65)**	**(1.56)**	**(1.59)**	(1.76)	(2.20)	(2.11)	(2.08)
Operating costs	**(7.33)**	**(8.29)**	**(7.71)**	**(7.24)**	(6.55)	(6.88)	(8.32)	(7.97)
Operating netback	**18.99**	**14.37**	**17.56**	**16.26**	16.45	11.56	9.76	10.49

Funds flow from operations is impacted from quarter to quarter primarily due to changes in productions volumes, realized average selling prices, royalties, operating expenses, transportation costs and G&A expense. The Company's production volumes are 86 percent natural gas and fluctuations in natural gas prices have the greatest impact on the Company's revenue and funds flow from operations.

The Company's quarterly net comprehensive income (loss) is affected by fluctuations in non-cash charges, in particular, depletion, depreciation and impairment expense, accretion of decommissioning obligations, gains/losses on derivative financial instruments, share based payments and other expense (income). During the twelve months ended December 31, 2012, the Company recorded impairment expense of $26,894 compared to $18,332 in the comparable period in 2011. The impairments were incurred on the Company's Northeast British Columbia and Peace River Arch CGUs. Impairments recognized are mainly the result of declining benchmark natural gas prices and minimal capital expenditures being incurred in the Northeast British Columbia and Peace River Arch CGUs as substantially all of the Company's capital expenditures over the past two years have been allocated to the Deep Basin CGU. These impairments cause significant reductions and increased volatility in the Company's net comprehensive income (loss).

Please refer to the results of operations and other sections of this MD&A and the Company's previously issued MD&A for detailed discussions on variances between reporting periods and changes in prior periods.

ACCOUNTING POLICIES ADOPTED

On January 1, 2013, Cequence adopted the following standards and amendments, as issued by the IASB:

- IFRS 10, "Consolidated Financial Statements", which is the result of the IASB's project to replace Standing Interpretations Committee 12, "Consolidation – Special Purpose Entities" and the consolidation requirements of IAS 27, "Consolidated and Separate Financial Statements". The new standard eliminates the current risk and rewards approach and establishes control as the single basis for determining the consolidation of an entity. The adoption of this standard did not have a material impact on the Company's consolidated financial statements.
- IFRS 11, "Joint Arrangements", which is the result of the IASB's project to replace IAS 31, "Interest in Joint Ventures". The new standard redefines joint operations and joint ventures and requires joint operations to be proportionately consolidated and joint ventures to be equity accounted. Under IAS 31, joint ventures could be proportionately accounted. The adoption of this standard did not have a material impact on the Company's consolidated financial statements.
- IFRS 12, "Disclosure of Interests in Other Entities", which outlines the required disclosures for interests in subsidiaries and joint arrangements. The new disclosures require information that will assist financial statement users to evaluate the nature, risks and financial effects associated with an entity's interests in subsidiaries and joint arrangements. The adoption of this standard did not have a material impact on the Company's consolidated financial statements.
- IFRS 13, "Fair Value Measurement", which provides a common definition of fair value, establishes a framework for measuring fair value under IFRS and enhances the disclosures required for fair value measurements. The standard applies where fair value measurements are required and does not require new fair value measurements. The adoption of this standard required the Company to provide additional disclosures in the notes to the consolidated financial statements.

The Company has reviewed new and revised accounting pronouncements that have been issued but are not yet effective.

As of January 1, 2014, the Company will be required to adopt amendments to IAS 36, "Impairment of Assets". The amendments reduce the circumstances in which the recoverable amount of CGUs is required to be disclosed and clarifies the disclosures required when an impairment loss has been recognized or reversed in the period.

As of January 1, 2014, the Company will be required to adopt IFRS Interpretations Committee ("IFRIC") 21 "Levies". IFRIC 21 clarifies that an entity recognizes a liability for a levy when the activity that triggers payment, as identified in the relevant legislation, occurs.

Application of Critical Accounting Estimates

The significant accounting policies used by Cequence are disclosed in note 2 to the Financial Statements. Certain accounting policies require that management make appropriate decisions with respect to the formulation of estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. Management reviews its estimates on a regular basis. The emergence of new information and changed circumstances may result in actual results or changes to estimate amounts that differ materially from current estimates. The following discussion identifies the critical accounting policies and practices of the Company and helps to assess the likelihood of materially different results being reported.

Reserves

Oil and gas reserves are estimates made using all available geological and reservoir data, as well as historical production data. All of the Company's reserves were evaluated and reported on by an independent qualified reserves evaluator. However, revisions can occur as a result of various factors including: actual reservoir performance, change in price and cost forecasts or a change in the Company's plans. Reserve changes will impact the financial results as reserves are used in the calculation of depletion and are used to assess whether asset impairment occurs.

Depletion

The net carrying value of development and production assets plus future development costs on proved plus probable reserves is depleted using the unit of production method based on proved and probable reserves, gross of royalties, as determined by independent engineers, on an area by area basis. An increase in estimated proved plus probable reserves would result in a reduction in depletion expense. A decrease in estimated future development costs would also result in a reduction in depletion expense.

Exploration and Evaluation Assets

Exploration and evaluation costs, including the costs of acquiring licenses and directly attributable costs, are initially capitalized as exploration and evaluation assets to the extent that they do not relate to a field with proven reserves attributed. The costs are accumulated in cost centers by field or exploration area pending determination of technical feasibility and commercial viability.

Exploration and evaluation assets are assessed for impairment if sufficient data exists to determine technical feasibility and commercial viability, or if facts and circumstances suggest that the carrying amount exceeds the recoverable amount.

The technical feasibility and commercial viability of extracting a mineral resource is considered to be determinable when proven reserves are determined to exist and are capable of economic production. A review of each exploration field is carried out, at least annually, to ascertain whether proven reserves have been discovered that are capable of economic production. Upon determination of proven reserves, exploration and evaluation assets attributable to those reserves are first tested for impairment and then reclassified from exploration and evaluation assets to development and production assets included in property and equipment.

Development and Production Costs

Items of property and equipment, which include oil and gas development and production assets, are measured at cost less accumulated depletion and depreciation and accumulated impairment losses.

Development and production assets are grouped into CGUs for impairment testing. CGUs are defined as the smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets. The Company evaluates the geography, geology, production profile and infrastructure of its assets in determining its CGUs. Based on this assessment, Cequence's CGUs are generally

composed of significant development areas. The Company reviews the composition of its CGUs at each reporting date to assess whether any changes are required in light of new facts and circumstances.

When significant parts of an item of property and equipment, including oil and natural gas interests, have different useful lives, they are accounted for as separate items (major components).

Gains and losses on disposal of an item of property and equipment, including oil and natural gas interests, are determined by comparing the proceeds from disposal with the carrying amount of the related property and equipment and are recognized net within other expense (income).

Impairment

The carrying amounts of all assets, other than financial assets and deferred tax assets, are reviewed at each reporting date to determine whether there is indication of an impairment loss. If any such indication exists, the asset's recoverable amount is estimated.

For any asset that does not generate largely independent cash flows, the recoverable amount is determined for the CGU to which the asset belongs. If the carrying amount of an asset (or CGU) exceeds its recoverable amount, the asset (or CGU) is written down.

The recoverability of the carrying amount of an exploration and evaluation asset is dependent on successful development and commercial exploitation, or alternatively, sale of the respective area of interest. Where a potential impairment is indicated, an assessment is performed for each field or area to which the exploration and evaluation expenditure is attributed. To the extent that capitalized expenditures are not expected to be recovered, the excess of the carrying amount over the recoverable amount is recognized immediately.

The recoverable amount of a development and production asset (or CGU) or other intangible asset (or CGU) is determined as the higher of its value in use and fair value less cost to sell. Value in use is determined by estimating future cash flows after taking into account the risks specific to the asset (or group of assets within a CGU) and discounting them to their present value using a pre-tax discount rate that reflects the current market assessment of the time value of money. In determining fair value less cost to sell, an appropriate valuation model is used. These calculations are corroborated by external valuation metrics or other available fair value indicators wherever possible.

Where the carrying amount of a development and production asset (or CGU) or other intangibles asset exceeds its recoverable amount, the excess is recognized immediately in comprehensive income (loss).

Where an impairment loss subsequently reverses, the carrying amount of the asset (or CGU) is increased to the revised estimate of its recoverable amount, but only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or depletion, if no impairment loss had been recognized.

Decommissioning Liabilities

The Company records a liability for the fair value of legal obligations associated with the retirement of petroleum and natural gas assets. The liability is equal to the discounted fair value of the obligation in the period in which the asset is recorded with an equal offset to the carrying amount of the asset. The liability then accretes to its fair value with the passage of time and the accretion is recognized as finance costs in the financial statements. The total amount of the decommissioning liability is an estimate based on the Company's net ownership interest in all wells and facilities, the estimated costs to abandon and reclaim the wells and facilities and the estimated timing of the costs to be incurred in future periods. The total amount of the estimated cash flows required to settle the decommissioning liabilities, the timing of those cash flows and the discount rate used to calculate the present value of those cash flows are all estimates subject to measurement uncertainty. Any change in these estimates would impact the decommissioning liabilities and the accretion expense.

Share Based Payments

The Company has a stock option plan and issues stock options to directors, officers, employees and other service providers. Compensation costs attributable to stock options granted are measured at fair value at the date of grant and are expensed over the vesting period, using a graded vesting schedule, with a corresponding increase in contributed surplus. When stock options are exercised, the cash proceeds together with the amount previously recorded as contributed surplus are recorded as share capital. The Company incorporates an estimated forfeiture rate for stock options that will not vest, and subsequently adjusts for actual forfeitures as they occur.

The Company has a RSU plan and issues RSUs to directors, officers, employees and other service providers. Cequence has the option to settle the RSUs with cash or with Cequence common shares, however, management's intent is to settle the RSUs in cash and the amount settled is expected to be deductible for income tax purposes. The RSUs are accounted for in accordance with the requirements for cash-settled share-based payment transactions with the value of one RSU being notionally equivalent to one Cequence common share. Compensation costs attributable to RSU granted are measured at fair value at the date of grant and subsequently remeasured each period end date and are expensed over the vesting period, using a graded vesting schedule, with a corresponding adjustment to share based payment liability. The Company incorporates an estimated forfeiture rate for RSUs that will not vest, and subsequently adjusts for actual forfeitures as they occur.

Senior Notes

The Corporation uses estimates to allocate the proceeds from senior notes issuances between debt and the equity components, as appropriate.

Income Taxes

The determination of income and other tax assets and liabilities requires interpretation of complex laws and regulations. All tax filings are subject to audit and potential reassessment after the lapse of considerable time. Accordingly, the actual income tax asset may differ significantly from that estimated and recorded by management.

The recognition of a deferred income tax asset is also based on estimates of whether it is probable that the Company is able to realize these assets. This estimate, in turn, is based on estimates of proved and probable reserves, future oil and natural gas prices, royalty rates and costs. Changes in these estimates could materially impact comprehensive income (loss) and the deferred income tax asset recognized.

Acquisitions

The allocation of the purchase price of business combinations to the net assets acquired at the respective acquisition dates are based on estimates of numerous factors affecting valuation including discount rates, proved and probable reserves, future petroleum and natural gas prices and other factors.

Commodity Contracts

The fair value of commodity contracts and the resultant unrealized gains (loss) on commodity contracts is based on estimates of future natural gas and crude oil prices.

Other Estimates

The accrual method of accounting requires management to incorporate certain estimates including estimates of revenues, royalties, capital, drilling credits and operating costs as at a specific reporting date, but for which actual revenues and costs have not yet been received. In addition, estimates are made on capital projects which are in progress or recently completed where actual costs have not been received by the reporting date. The Company obtains the estimates from the individuals with the most knowledge of the activity and from all project

documentation received. The estimates are reviewed for reasonableness and compared to past performance to assess the reliability of the estimates. Past estimates are compared to actual results in order to make informed decisions on future estimates.

Financial Instruments and Risk Management

The Company's financial instruments, including derivative financial instruments, recognized in the consolidated balance sheet consist of accounts receivable, commodity contracts, demand credit facilities, senior notes and accounts payable and accrued liabilities.

The Company's accounts receivable, demand credit facilities and accounts payable and accrued liabilities approximate their carrying values due to their short terms to maturity and the floating interest rate on the Company's debt. The senior notes bear interest at rates available to Cequence and accordingly the fair value approximates the carrying value excluding deferred financing costs.

The Company is engaged in the exploration, development, production and acquisition of crude oil and natural gas. This business is inherently risky and there is no assurance that hydrocarbon reserves will be discovered and economically produced. Financial risks associated with the petroleum industry include fluctuations in commodity prices, interest rates and currency exchange rates along with the credit risk of the Company's industry partners. Operational risks include reservoir performance uncertainties, the reliance on operators of the Company's non-operated properties, competition, environmental and safety issues, and a complex and changing regulatory environment.

The primary risks and how the Company mitigates them are as follows:

COMMODITY PRICE AND EXCHANGE RATE VOLATILITY

Revenues and consequently cash flows fluctuate with commodity prices and the U.S. / Canadian dollar exchange rate. Commodity prices are determined on a global basis and circumstances that occur in various parts of the world are outside of the control of the Company. The Company protects itself from fluctuations in prices by maintaining an appropriate hedging strategy, diversifying its asset mix and strengthening its balance sheet in order to take advantage of low price environments by making strategic acquisitions. Cequence enters into commodity price contracts to actively manage the risks associated with price volatility and thereby protect the Company's cash flows used to fund its capital program. Comprehensive loss for the year ended December 31, 2013 includes $1,103 of realized gains (2012 – $161 loss) and $3,713 (2012 – $757 gain) of unrealized loss on these transactions.

Cequence is also exposed to fluctuations in the exchange rate between the Canadian and U.S. dollar. Most commodity prices are based on U.S. dollar benchmarks that results in the Company's realized prices being influenced mainly by the U.S. / Canadian currency exchange rates. As at December 31, 2013, the Company has a pipeline commitment in U.S. dollars and sells certain quantities of natural gas in the U.S. dollar. There are no other forward contracts, foreign exchange contracts or other significant items denominated in foreign currencies.

INTEREST RATE RISK

The Company is exposed to interest rate risk to the extent that changes in market interest rates impact its borrowings under the floating rate credit facilities. The floating rate debt is subject to interest rate cash flow risk, as the required cash flows to service the debt will fluctuate as a result of changes in market rates. The Company has no interest rate swaps or financial contracts in place as at or during the year ended December 31, 2013.

As at December 31, 2013 a 1 percent change in interest rates on the Company's outstanding debt, with all other variables constant, would result in a change in comprehensive loss of $228 ($171 after tax) (2012 – $232 ($174 after tax)).

CREDIT RISK

Credit risk is the risk of financial loss to the Company if a counterparty to a financial instrument fails to meet its contractual obligations. The company is exposed to credit risk with respect to its accounts receivable and cash.

The majority of the Company's accounts receivable are due from joint venture partners in the oil and gas industry and from marketers of the Company's petroleum and natural gas production. The Company mitigates its credit risk by entering into contracts with established counterparties that have strong credit ratings and reviewing its exposure to individual counterparties on a regular basis. At December 31, 2013, the Company has an allowance for doubtful accounts of $581 (2012 – $515).

LIQUIDITY RISK

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they are due. The nature of the oil and gas industry is capital intensive and the Company maintains and monitors a certain level of cash flow to finance operating and capital expenditures. The Company believes it has sufficient credit facilities to satisfy its financial obligations as they come due.

The Company's ongoing liquidity is impacted by various external events and conditions, including commodity price fluctuations and the global economic environment.

The expected timing of cash flows relating to financial liabilities as at December 31, 2013 is as follows:

	< 1 Year	1 – 2 Years	2 – 5 Years	Thereafter
Demand credit facilities	**–**	22,763	–	–
Senior notes – principal	**–**	–	60,000	–
Accounts payable and accrued liabilities	**51,692**	–	–	–
	51,692	22,763	60,000	–

ACCESS TO CAPITAL RISK

The Company anticipates making substantial capital expenditures for the acquisition, exploration, development and production of oil and natural gas reserves in the future. As the Company's revenues may decline as a result of decreased commodity pricing, it may be required to reduce capital expenditures. There can be no assurance that debt or equity financing, or cash generated by operations will be available or sufficient to meet these requirements or for other corporate purposes or, if debt or equity financing is available, that it will be on terms acceptable to the Company. The inability of the Company to access sufficient capital for its operations could have a material adverse effect on the Company's business, financial condition, results of operations and prospects.

ENVIRONMENTAL CONCERNS

The oil and natural gas industry is subject to environmental regulation pursuant to local, provincial and federal legislation. A breach of such legislation may result in the imposition of fines or issuance of clean up orders in respect of Cequence or its working interests. Such legislation may be changed to impose higher standards and potentially more costly obligations on Cequence. Furthermore, management believes the federal political parties appear to favor new programs for environmental laws and regulation, particularly in relation to the reduction of emissions, and there is no assurance that any such programs, laws or regulations, if proposed and enacted, will not contain emission reduction targets which Cequence cannot meet, and financial penalties or charges could be incurred as a result of the failure to meet such targets. In particular there is uncertainty regarding the Federal Government's future regulation of air emissions.

REGULATORY RISK

There can be no assurance that government royalties, income tax laws, environmental laws and regulatory requirements relating to the oil and gas industry will not be changed in a manner which adversely affects the Company or its shareholders. Although the Company has no control over these regulatory risks, it continuously monitors changes in these areas by participating in industry organizations and conferences, exchanging information with third party experts and employing qualified individuals to assess the impact of such changes on the Company's financial and operating results.

EXPLORATION, DEVELOPMENT AND PRODUCTION RISKS

The long term commercial success of the Company depends on its ability to find, acquire, develop and commercially produce oil and natural gas reserves. Without the addition of new reserves, the Company's reserves will decline over time as existing reserves are exploited. A future increase in the Company's reserves will depend not only on its ability to explore and develop any properties but also on its ability to select and acquire suitable producing properties or prospects.

Future oil and natural gas exploration may involve unprofitable efforts, not only from dry wells, but from wells that are productive but do not produce sufficient net revenues to return a profit after drilling, operating and other costs. In addition, drilling hazards or environmental damage could greatly increase the cost of operations, and various field operating conditions may adversely affect the production from successful wells. These conditions include delays in obtaining governmental approvals or consents, shut-ins of connected wells resulting from extreme weather conditions, insufficient storage or transportation capacity or other geological or mechanical conditions.

While diligent well supervision and effective maintenance operations can contribute to maximizing production rates over time, production delays and declines from normal field operating conditions cannot be eliminated and can be expected to adversely affect revenue and cash flow levels to varying degrees. To the extent the Company is not the operator of its oil and gas properties, the Company is dependent on such operators for the timing of activities related to such properties and will be largely unable to direct or control the activities of the operators.

Oil and natural gas exploration, development and production operations are subject to all the risks and hazards typically associated with such operations, including hazards such as fire, explosion, blowouts, cratering, sour gas releases and spills, each of which could result in substantial damage to oil and natural gas wells, pipelines, production facilities, other property and the environment or in personal injury. The Company employs prudent risk management practices and maintains suitable liability insurance but may become liable for damages arising from such events against which it cannot insure, elects not to insure or because of high premium costs or other reasons. Costs incurred to repair such damage or pay such liabilities will reduce the cash flow of the Company.

Outlook Information

On October 3, 2013 Cequence provided the following guidance:

	2013 Actuals	2014 Guidance
Average production, BOE/d [1]	10,183	13,500 – 14,000
Average production per share [2]	49	65
Exit production, BOE/d	12,000	15,000
Funds flow from operations ($) [3]	$51 million	$85 million
Funds flow from operations per share	$0.25	$0.39
Capital expenditures ($)	$115 million	$120 million
Wells drilled	15(12)	16(14)
Operating costs ($ per boe)	$7.66	$6.85
Royalties (% revenue)	8	8
Crude – WTI (US$/bbl)	$98.01	$95.75
Natural gas – AECO (CDN$/GJ)	$3.01	$3.50
December 31, net debt and working capital deficiency ($) [4]	$111 million	$145 million
Basic shares outstanding	208 million	211 million

(1) Average production estimates on a per BOE basis are comprised of 85% natural gas and 15% oil and natural gas liquids.

(2) Calculated as average production per million shares.

(3) Funds flow from operations is calculated as cash flow from operating activities before adjustments for decommissioning liabilities expenditures and net changes in non-cash working capital.

(4) Net debt and working capital (deficiency) is calculated as cash and net working capital less commodity contract assets and liabilities, demand credit facilities and the aggregate principal amount of the senior notes and excluding other liabilities.

Capital expenditures for 2014 are expected to be funded from funds flow from operations, available bank lines and proceeds from the 2013 issuance of senior notes. The Company closely monitors fluctuations in natural gas prices and will adjust the 2014 budget if facts and circumstances require.

Forward-Looking Statements

Certain statements contained within this MD&A constitute forward-looking statements. These statements relate to future events or the Company's 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", "project", "predict", "potential", "targeting", "intend", "could", "might", "should", "believe", and similar expressions. Forward-looking statements in this MD&A include, but are not limited to, statements with respect to: the potential impact of implementation of the Alberta Royalty Framework on Cequence's condition and projected 2014 capital investments; projections with respect to growth of natural gas production; the projected impact of land access and regulatory issues; projections relating to the volatility of crude oil and natural gas prices in 2014 and beyond and reasons therefore; the Company's projected capital investment levels for 2014 and the source of funding therefore; the effect of the Company's risk management program, including the impact of derivative financial instruments; the Company's defence of lawsuits; the impact of the climate change initiatives on operating costs; the impact of Western Canada pipeline constraints. Readers are cautioned not to place undue reliance on forward-looking statements, as there can be no assurance that the plans, intentions or expectations upon which they are based will occur.

By their nature, forward-looking statements involve numerous assumptions, known and unknown risks and uncertainties, both general and specific, that contribute to the possibility that the predictions, forecasts, projections and other forward-looking statements will not occur, which may cause the Company's actual performance and financial results in future periods to differ materially from any estimates or projections of future performance or results expressed or implied by such forward-looking statements. These assumptions, risks and uncertainties include, among other things: volatility of and assumptions regarding oil and natural gas prices; assumptions based upon Cequence's current guidance; fluctuations in currency and interest rates; product supply and demand; market competition; risks inherent in the Company's marketing operations, including credit risks; imprecision of reserves estimates and estimates of recoverable quantities of oil, natural gas and liquids from resource plays and other sources not currently classified as proved; the Company's ability to replace and expand oil and gas reserves; the Company's ability to generate sufficient cash flow from operations to meet its current and future obligations; the Company's ability to access external sources of debt and equity capital; the timing and cost of well and pipeline constructions; the Company's ability to secure adequate product transportation; changes in royalty, tax, environmental and other laws or regulations or the interpretations of such laws or regulations; risks associated with existing and potential future lawsuits and regulatory actions made against the Company; and other risks and uncertainties described from time to time in the reports and filings made with securities regulatory authorities by Cequence. Statements relating to "reserves" are deemed to be forward-looking statements, as they involve the implied assessment, based on certain estimates and assumptions that the resources and reserves described can be profitably produced in the future.

The forward-looking statements contained herein concerning production, sales prices, operating expenses and capital spending are based on Cequence's 2014 capital program. The material assumptions supporting the 2014 capital program are provided in the table above under the heading "Outlook Information".

Financial outlook information contained in this MD&A about prospective results of operations, financial position or cash flows is based on assumptions about future events, including economic conditions and proposed courses of action, based on management's assessment of the relevant information currently available. The purpose of such financial outlook is to enrich this MD&A. Readers are cautioned that such financial outlook information contained in this MD&A should not be used for purposes other than for which it is disclosed herein.

Although Cequence believes that the expectations represented by such forward-looking statements are reasonable, there can be no assurance that such expectations will prove to be correct. Readers are cautioned that the foregoing list of important factors is not exhaustive. Furthermore, the forward-looking statements contained in this MD&A are made as of the date of this MD&A and, except as required by law, Cequence does not undertake any obligation to update publicly or to revise any of the included forward-looking statements, whether as a result of new information, future events or otherwise. The forward-looking statements contained in this MD&A are expressly qualified by this cautionary statement.

Management's Responsibility for Financial Information

The accompanying financial statements and all information in the MD&A have been prepared by management and approved by the Board of Directors of Cequence Energy. The financial statements have been prepared in accordance with International Financial Reporting Standards and, where appropriate, reflect management's best estimates and judgments. Management is responsible for the accuracy, integrity and objectivity of the financial statements within reasonable limits of materiality and for the consistency of financial data included in the text of the MD&A with that in the financial statements.

To assist management in the discharge of these responsibilities, the Company maintains a system of internal controls designed to provide reasonable assurance that accounting records are reliable, transactions are properly authorized and assets are safeguarded from loss or unauthorized use. The Audit Committee is appointed by the Board of Directors, with all of its members being independent directors. The Audit Committee meets with management, as well as with the external auditors, to satisfy itself that management is properly discharging its financial reporting responsibilities and to review the financial statements and the auditor's report. The Audit Committee reports its findings to the Board of Directors for consideration in approving the financial statements for presentation to the shareholders. The external auditors have direct access to the Audit Committee of the Board of Directors.

The financial statements have been audited independently by Deloitte LLP on behalf of the Company in accordance with generally accepted auditing standards. Their report outlines the nature of their audits and expresses their opinion on the financial statements.

"signed"
Paul Wanklyn
President and Chief Executive Officer
March 6, 2014

"signed"
Dave Gillis
Chief Financial Officer

Independent Auditor's Report

TO THE SHAREHOLDERS OF CEQUENCE ENERGY LTD.

We have audited the accompanying financial statements of Cequence Energy Ltd., which comprise the consolidated balance sheets as at December 31, 2013 and 2012, and the consolidated statements of comprehensive loss, consolidated statements of changes in equity and consolidated statements of cash flows for the years then ended, and a summary of significant accounting policies and other explanatory information.

MANAGEMENT'S RESPONSIBILITY FOR THE FINANCIAL STATEMENTS

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

AUDITOR'S RESPONSIBILITY

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audit is sufficient and appropriate to provide a basis for our audit opinion.

OPINION

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Cequence Energy Ltd. as at December 31, 2013 and 2012, and its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards.

Deloitte LLP

Chartered Accountants
Calgary, Alberta

March 6, 2014

Consolidated Balance Sheets

(Expressed in thousands of Canadian dollars)

	December 31, 2013	December 31, 2012
	$	$
ASSETS		
CURRENT		
Accounts receivable (Note 7)	**19,834**	16,084
Deposits and prepaid expenses (Note 19)	**3,188**	3,428
Commodity contracts (Note 20)	**–**	694
	23,022	20,206
Exploration and evaluation assets (Note 4)	**–**	13,829
Property and equipment (Note 4)	**537,511**	439,059
Deposits and prepaid expenses (Note 19)	**1,047**	1,901
Commodity contracts (Note 20)	**–**	63
Deferred income taxes (Note 15)	**36,094**	44,266
	597,674	519,324
LIABILITIES		
CURRENT		
Demand credit facilities (Note 5)	**22,763**	23,191
Accounts payable and accrued liabilities (Note 8)	**51,692**	42,190
Share based payment liability (Note 17)	**111**	–
Commodity contracts (Note 20)	**2,880**	–
Other liabilities (Note 9)	**317**	4,459
	77,763	69,840
Senior notes (Note 6)	**56,637**	–
Commodity contracts (Note 20)	**76**	–
Provisions (Note 14)	**26,828**	33,059
	161,304	102,899
CONTINGENCIES AND COMMITMENTS (Note 19)		
SHAREHOLDERS' EQUITY		
Share capital (Note 16)	**624,332**	606,703
Warrants (Note 16)	**1,300**	–
Contributed surplus	**26,185**	22,556
Deficit	**(215,447)**	(212,834)
	436,370	416,425
	597,674	519,324

APPROVED BY THE BOARD

[signed] "Donald Archibald" Donald Archibald, Director

[signed] "Brian Felesky" Brian Felesky, Director

Consolidated Statements of Comprehensive Loss

(Expressed in thousands of Canadian dollars except per share amounts)

	Year ended December 31, 2013	2012
	$	$
REVENUE		
Production revenue (Note 10)	**95,899**	71,049
Gain (loss) on derivative financial instruments (Note 20)	**(2,610)**	596
	93,289	71,645
EXPENSES		
Depletion, depreciation and impairment (Note 4)	**43,096**	66,458
General and administrative (Note 13)	**7,266**	7,105
Finance costs (Note 12)	**4,403**	2,725
Operating costs	**28,472**	24,440
Share based payment (Note 17)	**3,744**	5,717
Transportation	**5,957**	6,702
Other expense (income) (Note 11)	**(857)**	(23,794)
	92,081	89,353
INCOME (LOSS) BEFORE INCOME TAXES	**1,208**	(17,708)
INCOME TAXES (Note 15)	**3,821**	(35)
NET LOSS AND COMPREHENSIVE LOSS	**(2,613)**	(17,673)
Loss per share, basic and diluted (Note 18)	**$ (0.01)**	$ (0.10)

Consolidated Statements of Changes in Equity

(Expressed in thousands of Canadian dollars)

	Year ended December 31, 2013	2012
	$	$
SHARE CAPITAL		
COMMON SHARES (Note 16)		
Balance, beginning of year	**606,703**	559,371
Shares issued on property acquisition (Note 4)	**17,510**	–
Proceeds from shares issued in public offerings	**–**	39,514
Proceeds from shares issued in private placements	**–**	10,438
Shares issued on exercise of stock options	**15**	–
Share issue costs, net of tax of ($35) (2012 – $874)	**104**	(2,620)
Balance, end of year	**624,332**	606,703
WARRANTS (Note 16)		
Balance, beginning of year	**–**	–
Warrants granted on issuance of senior notes, net of tax of $183 (2012 – nil)	**1,339**	–
Share issue costs, net of tax of $13 (2012 – nil)	**(39)**	–
Balance, end of year	**1,300**	–
CONTRIBUTED SURPLUS		
Balance, beginning of year	**22,556**	16,839
Share based payment expense (Note 17)	**3,634**	5,717
Exercise of stock options	**(5)**	–
Balance, end of year	**26,185**	22,556
DEFICIT		
Balance, beginning of year	**(212,834)**	(195,161)
Comprehensive loss	**(2,613)**	(17,673)
Balance, end of year	**(215,447)**	(212,834)
TOTAL EQUITY	**436,370**	416,425

Consolidated Statements of Cash Flows

(Expressed in thousands of Canadian dollars)

	Year ended December 31, 2013	2012
	$	$
CASH FLOWS RELATED TO THE FOLLOWING ACTIVITIES:		
OPERATING		
Net loss	**(2,613)**	(17,673)
Adjustments for non-cash items:		
Depletion, depreciation and impairment	**43,096**	66,458
Finance costs related to provisions (Note 12)	**830**	725
Share based payment (Note 17)	**3,744**	5,717
Amortization of transaction costs on senior notes (Note 6)	**76**	–
Accretion on senior notes (Note 6)	**58**	–
Unrealized loss (gain) on derivative financial instruments (Note 20)	**3,713**	(757)
Costs related to onerous contracts (Note 14)	**(321)**	(321)
Gain on sale of assets (Note 4)	**(1,092)**	(20,390)
Deferred income tax expense (recovery) (Note 15)	**3,821**	(35)
Decommissioning liabilities expenditures (Note 14)	**(619)**	(904)
Net change in non-cash working capital (Note 21)	**(6,870)**	4,950
	43,823	37,770
INVESTING		
Property and equipment and exploration and evaluation assets expenditures (Note 4)	**(117,909)**	(91,658)
Property acquisitions	**(203)**	(7,404)
Proceeds from sale of assets (Note 4)	**2,878**	20,662
Net change in non-cash working capital (Note 21)	**13,304**	(22,186)
	(101,930)	(100,586)
FINANCING		
Proceeds from demand credit facilities (Note 5)	**55,572**	41,521
Repayment of demand credit facilities (Note 5)	**(56,000)**	(29,948)
Issue of senior notes, net of transaction costs (Note 6)	**57,974**	–
Issue of common shares (Note 16)	**10**	54,092
Share issue costs (Note 16)	**139**	(3,494)
Net change in non-cash working capital (Note 21)	**412**	265
	58,107	62,436
NET DECREASE IN CASH	**–**	(380)
CASH, BEGINNING OF YEAR	**–**	380
CASH, END OF YEAR	**–**	–
SUPPLEMENTARY INFORMATION		
Income taxes paid	**–**	–
Interest paid	**2,784**	2,061

1. Nature and Description of the Company

Cequence Energy Ltd. (the "Company" or "Cequence") is incorporated under the laws of Alberta with common shares that are widely held and listed on the Toronto Stock Exchange. Cequence is engaged in the acquisition, exploration and production of petroleum and natural gas reserves in Western Canada. The registered office of the Company is located at Suite 3100, 525 - 8th Ave. SW, Calgary, Alberta, T2P 1G1.

These consolidated financial statements ("consolidated financial statements") include all assets, liabilities, revenues and expenses of Cequence and its wholly-owned subsidiary, 1175043 Alberta Ltd.

2. Significant Accounting Policies

STATEMENT OF COMPLIANCE AND AUTHORIZATION

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS"), as issued by the International Accounting Standards Board ("IASB").

The consolidated financial statements were authorized for issue by the Company's Board of Directors on March 6, 2014.

BASIS OF PRESENTATION

The consolidated financial statements have been prepared using historical costs, except for financial instruments carried at fair value, on a going concern basis and have been presented in Canadian dollars, which is also the Company's functional currency. The accounting policies set out below have been applied consistently in all material respects.

BASIS OF CONSOLIDATION

The consolidated financial statements include the accounts of the Company and its consolidated subsidiaries, which are the entities over which the Company has control. Control exists when the Company has the power to govern the financial and operating policies of an entity so as to obtain benefit from its activities. All intercompany transactions and balances are eliminated on consolidation.

BUSINESS COMBINATIONS

The acquisition method of accounting is used to account for acquisitions of subsidiaries and assets that meet the definition of a business under IFRS. The cost of an acquisition is measured as the fair value of the assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange. Acquisition-related costs are recognized in comprehensive income (loss) as incurred. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date. The excess of the cost of acquisition over the fair value of the

identifiable assets and liabilities acquired and contingent liabilities for which a provision is provided is recorded as goodwill. If the cost of acquisition is less than the fair value of the net assets of the subsidiary acquired, the difference is recognized as a bargain purchase gain in comprehensive income (loss). Results of subsidiaries are included in the consolidated statement of comprehensive income (loss) from the closing date of acquisition.

FINANCIAL INSTRUMENTS

A financial instrument is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity. Financial assets and financial liabilities are recognized on the consolidated balance sheet at the time the Company becomes a party to the contractual provisions. Upon initial recognition, financial instruments are measured at fair value. Measurement in subsequent periods is dependent on the classification of the financial instrument.

The Company has made the following classifications:

- Cash is classified as a financial asset recorded at fair value through profit or loss and is carried at fair value. Gains and losses from revaluation are recognized in comprehensive income (loss).
- Accounts receivable are classified as loans and receivables and are initially measured at fair value plus directly attributable transaction costs. Subsequently, they are recorded at amortized cost using the effective interest method.
- Deposits if refundable in cash are classified as a financial asset recorded at fair value through profit or loss and are carried at fair value. Gains and losses from revaluation are recognized in comprehensive income (loss).
- Demand credit facilities, senior notes, accounts payable and accrued liabilities are classified as other liabilities and are initially measured at fair value less directly attributable transaction costs. Subsequently, they are recorded at amortized cost using the effective interest method.
- Derivative instruments, including embedded derivative instruments, that do not qualify as hedges, or are not designated as hedges for accounting purposes, including commodity contracts, are classified as fair value through profit or loss and are recorded and carried at fair value with changes in fair value recognized in comprehensive income (loss). Derivative instruments are used by the Company to manage economic exposure to market risks relating to commodity prices. Cequence's policy is to not utilize derivative financial instruments for speculative purposes.

Transaction costs related to financial instruments classified as fair value through profit or loss are expensed as incurred. All other transaction costs related to financial instruments are recorded as part of the instrument and are amortized using the effective interest method.

The Company's senior notes are classified as debt with a portion of proceeds allocated to equity representing the residual value allocated to the warrants issued to the lender. The debt component associated with the senior notes accretes over time to the amount owing on maturity and such increases in the debt component are reflected as non-cash interest expense in comprehensive income (loss). The issue costs are amortized to comprehensive income (loss) using the effective interest rate method. The senior notes are carried net of transaction costs on the statement of financial position.

Contracts that are entered into for the purpose of the receipt or delivery of a non-financial item in accordance with the Company's expected purchase, sale or usage requirements (such as physical delivery commodity contracts) do not qualify as financial instruments and thus, are accounted for in accordance with other applicable standards and are not recorded as assets or liabilities.

Embedded derivatives are separated from the host contract and accounted for separately if the economic characteristics and risks of the host contract and the embedded derivative are not closely related, a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative, and the combined instrument is not measured at fair value through profit or loss. Changes in the fair value of separable embedded derivatives are recognized immediately in comprehensive income (loss).

IFRS establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The three levels of the fair value hierarchy are described below:

Level 1: Values based on quoted prices in active markets that are accessible at the measurement date for identical assets or liabilities.

Level 2: Values based on quoted prices in markets that are not active or model inputs that are observable either directly or indirectly for substantially the full term of the asset or liability.

Level 3: Values based on prices or valuation techniques that require inputs that are both unobservable and significant to the overall fair value measurement.

When the inputs used to measure fair value fall within different levels of the hierarchy, the level within which the fair value measurement is categorized is based on the lowest level input that is significant to the fair value measure in its entirety.

Impairment of Financial Assets

Financial assets, other than those classified as fair value through profit or loss, are assessed for indicators of impairment at the end of each reporting period. Financial assets are considered to be impaired when there is objective evidence that, as a result of one or more events that occurred after the initial recognition of the financial asset, the estimated future cash flows of the investment have been negatively affected.

For financial assets carried at amortized cost, the amount of the impairment loss recognized in comprehensive income (loss) is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the financial asset's original effective interest rate.

The carrying amount of the financial asset is reduced by the impairment loss directly for all financial assets with the exception of trade receivables, where the carrying amount is reduced through the use of an allowance account. When a trade receivable is considered uncollectible, it is written off against the allowance account. Subsequent recoveries of amounts previously written off are recognized in comprehensive income (loss). Changes in the carrying amount of the allowance accounts are recognized in comprehensive income (loss).

PROPERTY AND EQUIPMENT AND EXPLORATION AND EVALUATION ASSETS

Recognition and Measurement

Exploration and Evaluation Expenditures

Pre-license costs, geological and geophysical costs are recognized in comprehensive income (loss) as incurred.

Exploration and evaluation ("E&E") costs, including the costs of acquiring licenses, drilling exploratory wells and other directly attributable costs, are initially capitalized as E&E assets to the extent that they do not relate to a field with proven reserves attributed. The costs are accumulated in cost centers by field or exploration area pending determination of technical feasibility and commercial viability.

The Company enters into E&E farm-in arrangements to fund a portion of the partner's (farmor's) exploration and/or future development expenditures ("carried interests"), these expenditures are reflected in the consolidated financial statements when the exploration and development work progresses. For E&E farm-out arrangements where the farmee correspondingly undertakes to fund carried interests as part of the consideration no gain or loss is recognized by the Company.

E&E assets are assessed for impairment if sufficient data exists to determine technical feasibility and commercial viability, or if facts and circumstances suggest that the carrying amount exceeds the recoverable amount.

The technical feasibility and commercial viability of extracting a mineral resource is considered to be determinable when proven reserves are determined to exist and are capable of economic production. A review of each exploration field is carried out, at least annually, to ascertain whether proven reserves have been discovered that are capable of economic production. Upon determination of proven reserves, E&E assets attributable to those reserves are first tested for impairment and then reclassified from E&E assets to development and production assets included in property and equipment.

Recognition and Measurement

Development and Production Costs

Items of property and equipment, which include oil and gas development and production assets, are measured at cost less accumulated depletion and depreciation and accumulated impairment losses, net of any reversals.

Development and production assets are grouped into Cash Generating Units ("CGUs") for impairment testing. CGUs are defined as the smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets. The Company evaluates the geography, geology, production profile and infrastructure of its assets in determining its CGUs. Based on this assessment, Cequence's CGUs are generally composed of significant development areas. The Company reviews the composition of its CGUs at each reporting date to assess whether any changes are required in light of new facts and circumstances.

When significant parts of an item of property and equipment, including oil and natural gas interests, have different useful lives, they are accounted for as separate items (major components).

Gains and losses on disposal of an item of property and equipment, including oil and natural gas interests, are determined by comparing the proceeds from disposal with the carrying amount of the related property and equipment and are recognized net within "other expense (income)".

Subsequent Costs

Costs incurred subsequent to the determination of technical feasibility and commercial viability and the costs of replacing parts of property and equipment are recognized as oil and natural gas interests only when they increase the future economic benefits embodied in the specific asset to which they relate. All other expenditures are recognized in comprehensive income (loss) as incurred. Such capitalized oil and natural gas interests generally represent costs incurred in developing proved and/or probable reserves and bringing in or enhancing production from such reserves, and are accumulated on a field or area basis. The carrying amount of any replaced or sold component is derecognized. The costs of the day-to-day servicing of property and equipment are recognized as operating costs as incurred.

Depletion and Depreciation

The net carrying value of development and production assets plus future development costs on proved plus probable reserves is depleted using the unit of production method based on proved and probable reserves, gross of royalties, as determined by independent engineers, on an area by area basis. For the purpose of this calculation, production and reserves of petroleum and natural gas are converted to a common unit of measurement on the basis of their relative energy content, where six thousand cubic feet of natural gas equates to one barrel of oil. Costs are only depleted once production in a given area begins.

Cequence depletes separately, where applicable, any significant components within development and production assets, such as fields, processing facilities and pipelines, which are significant in relation to the total cost of a development and production asset and have a different useful life than such assets.

Other property and equipment and other intangible assets are amortized over 3 to 5 years on a straight line basis.

Impairment

The carrying amounts of all assets, other than financial assets and deferred tax assets, are reviewed at each reporting date to determine whether there is indication of an impairment loss. If any such indication exists, the asset's recoverable amount is estimated.

For any asset that does not generate largely independent cash flows, the recoverable amount is determined for the CGU to which the asset belongs. If the carrying amount of an asset (or CGU) exceeds its recoverable amount, the asset (or CGU) is written down.

The recoverability of the carrying amount of an E&E asset is dependent on successful development and commercial exploitation, or alternatively, sale of the respective area of interest. Where a potential impairment is indicated, an assessment is performed for each field or area to which the E&E expenditure is attributed. To the extent that capitalized expenditures are not expected to be recovered, the excess of the carrying amount over the recoverable amount is recognized immediately in comprehensive income (loss).

The recoverable amount of a development and production asset (or CGU) or other intangible asset (or CGU) is determined as the higher of its value in use and fair value less cost to sell. Value in use is determined by estimating future cash flows after taking into account the risks specific to the asset (or group of assets within a CGU) and discounting them to their present value using a pre-tax discount rate that reflects the current market assessment of the time value of money. In determining fair value less cost to sell, an appropriate valuation model is used. These calculations are corroborated by external valuation metrics or other available fair value indicators wherever possible.

Where the carrying amount of a development and production asset (or CGU) or other intangibles asset (or CGU) exceeds its recoverable amount, the excess is recognized immediately in comprehensive income (loss).

Where an impairment loss subsequently reverses, the carrying amount of the asset (or CGU) is increased to the revised estimate of its recoverable amount, but only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or depletion, if no impairment loss had been recognized.

PROVISIONS

Provisions are recognized when the Company has a present obligation as a result of a past event that can be estimated with reasonable certainty and are measured at the amount that the Company would rationally pay to be relieved of the present obligation. To the extent that provisions are estimated using a present value technique, such amounts are determined by discounting the expected future cash flows at a risk-free pre-tax rate and adjusting the liability for the risks specific to the liability.

Decommissioning Liabilities

The Company records the present value of the estimated cost of legal and constructive obligations to restore operating locations in the period in which the obligation arises. The nature of restoration activities includes the removal of facilities, abandonment of wells and restoration of affected areas. Provision is made for the estimated cost of restoration and capitalized in the relevant asset category.

Decommissioning liabilities are measured at the present value of management's best estimate of the expenditure required to settle the present obligation at the balance sheet date. Subsequent to the initial measurement, the obligations are adjusted at the end of each period to reflect the passage of time and changes in the estimated future cash flows underlying the obligation as well as changes to the discount rate. The increase in the provision due to the passage of time is recognized as finance cost whereas increases or decreases due to changes in the estimated future cash flows or changes in the discount rate are capitalized. Actual costs incurred upon settlement of the decommissioning liabilities are charged against the decommissioning liabilities.

Onerous Contracts

Present obligations arising under onerous contracts are recognized and measured as provisions. An onerous contract is considered to exist where the Company has a contract under which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received from the contract.

JOINTLY CONTROLLED ASSETS

A significant portion of the Company's oil and natural gas activities involve jointly controlled assets and any related liabilities incurred. The consolidated financial statements include the Company's share of these jointly controlled assets and liabilities and a proportionate share of the relevant revenues and related costs, classified according to their nature.

SHARE BASED PAYMENTS

The Company has a stock option plan and issues stock options to directors, officers, employees and other service providers. Compensation costs attributable to stock options granted are measured at fair value at the date of grant and are expensed over the vesting period, using a graded vesting schedule, with a corresponding increase in contributed surplus. When stock options are exercised, the cash proceeds together with the amount previously recorded as contributed surplus are recorded as share capital. The Company incorporates an estimated forfeiture rate for stock options that will not vest, and subsequently adjusts for actual forfeitures as they occur.

The Company issues Restricted Share Units ("RSU") under the RSU Plan to directors, officers and other service providers. RSUs are accounted as cash-settled share based payments and are originally measured at the grant date fair value and subsequently remeasured each period end until the vesting date when the RSUs are settled in cash. Share based payment expense on the RSUs is charged to net earnings or loss in the period they vest with a corresponding adjustment to share based payment liability. The Company incorporates an estimated forfeiture rate for RSUs that will not vest, and subsequently adjusts for actual forfeitures as they occur.

REVENUE

Revenue from the sale of petroleum and natural gas is recognized when the risks and rewards of ownership of the product are transferred to the customer, based on volumes delivered to customers at contractual delivery points and rates. The costs associated with the delivery, including operating and maintenance costs, transportation and production-based royalty expenses are recognized in the same period in which the related revenue is earned and recorded. Revenue is measured net of related royalties.

Revenue from interest income is recognized as it accrues, using the effective interest method.

FLOW-THROUGH SHARES

The Company, from time to time, issues flow-through shares to finance a portion of its capital expenditure program. Pursuant to the terms of the flow-through share agreements, the tax deductions associated with the expenditures are renounced to the subscribers. The difference between the value ascribed to flow-through shares issued and the value that would have been received for common shares at the date of issuance of the flow-through shares is initially recognized as a liability on the consolidated balance sheet. When the expenditures are renounced and incurred, the liability is drawn down, a deferred income tax liability is recorded equal to the estimated amount of deferred income tax payable by the Company as a result of the renunciation, and the difference is recognized as income tax expense.

EARNINGS PER SHARE

Basic per share amounts are computed by dividing the net income (loss) by the weighted average number of common shares outstanding during the period. Diluted per share amounts are calculated giving effect to the potential dilution that would occur if stock options, RSUs and warrants were exercised. The dilutive effect of stock options and warrants is calculated with the assumption that proceeds received from the exercise of options, RSUs and warrants for which the exercise price is less than the market price plus the unamortized portion of share based payments are used to repurchase common shares at the average market price for the period.

TAXATION

Income tax expense represents the sum of the tax currently payable and deferred tax.

Current Tax

The tax currently payable is based on taxable income for the year. Taxable income differs from income as reported in the consolidated statement of comprehensive income (loss) because of items of income or expense that are taxable or deductible in other years and items that are never taxable or deductible. The Company's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the end of the reporting period.

Deferred Tax

Deferred tax is recognized on temporary differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable income.

Deferred tax assets are generally recognized for all deductible temporary differences to the extent that it is probable that taxable profits will be available against which such deductible temporary differences can be utilized. Such deferred tax assets and liabilities are not recognized if the temporary difference arises from goodwill or from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither taxable income nor the accounting income.

The carrying amount of deferred tax assets is reviewed at the end of each reporting period and reduced to the extent that it is no longer probable that sufficient taxable income will be available to allow all or part of the asset to be recovered.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply in the period in which the liability is settled or the asset realized, based on tax rates (and tax laws) that have been enacted or substantively enacted by the end of the reporting period. The measurement of deferred tax liabilities and assets reflects the tax consequences that would follow from the manner in which the Company expects, at the end of the reporting period, to recover or settle the carrying amount of its assets and liabilities.

Deferred tax assets and liabilities are offset when there is a legally enforceable right to set off current tax assets against current tax liabilities and when they relate to income taxes levied by the same taxation authority and the Company intends to settle its current tax assets and liabilities on a net basis.

Current and Deferred Tax for the Period

Current and deferred tax are recognized as an expense or income in comprehensive income (loss), except when they relate to items that are recognized outside profit or loss (whether in other comprehensive income or directly in equity), in which case the tax is also recognized outside profit or loss, or where they arise from the initial accounting for a business combination. In the case of a business combination, the tax effect is included in the accounting for the business combination.

SIGNIFICANT ACCOUNTING JUDGMENTS, ESTIMATES AND ASSUMPTIONS

The preparation of the consolidated financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect the reported amount of assets, liabilities, and contingent liabilities at the date of the consolidated financial statements and reported amounts of revenues and expenses during the reporting period. Estimates and judgments are continuously evaluated and are based on management's experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

In particular, information about significant areas of estimation uncertainty considered by management in preparing the consolidated financial statements are described in the following notes:

Note 4: Property and equipment and exploration and evaluation assets

Note 14: Provisions

Note 17: Share based payment plans

Note 19: Contingencies and commitments

Note 20: Financial instruments and risk management

Estimates of recoverable quantities of proved and probable reserves include assumptions regarding commodity prices, exchange rates, discount rates and production and transportation costs for future cash flows. It also requires interpretation of geological and geophysical models in order to make an assessment of the size, shape, depth and quality of reservoirs, and their anticipated recoveries. The economic, geological and technical factors used to estimate reserves may change from period to period. Changes in reported reserves can impact asset carrying values, the provision for decommissioning liabilities and the recognition of deferred tax assets, due to changes in expected future cash flows. Reserve estimates are prepared in accordance with the Canadian Oil and Gas Evaluation Handbook and are reviewed by third party reservoir engineers.

The amounts recorded for depletion and depreciation of property and equipment, the provision for decommissioning liabilities, and the valuation of property and equipment are based on estimates of proved and probable reserves, production rates, future petroleum and natural gas prices, future costs and the remaining lives and period of future benefit of the related assets.

The Company makes judgments in determining its CGUs and evaluates the geography, geology, production profile and infrastructure of its assets in making such determinations, which are based on estimates of reserves. Based on this assessment, Cequence's CGUs are generally composed of significant development areas. The Company reviews the composition of its CGUs at each reporting date to assess whether any changes are required in light of new facts and circumstances.

Costs associated with acquiring oil and natural gas licenses and exploratory drilling are accumulated as E&E assets pending determination of technical feasibility and commercial viability. Establishment of technical feasibility and commercial viability is subject to judgement which management has determined to be based on the allocation of commercial reserves to the exploration area. Upon determination of commercial reserves, E&E assets attributable to those reserves are first tested for impairment and then reclassified from E&E assets to development and production assets included in property and equipment.

Business combinations are accounted for using the acquisition method of accounting. The determination of fair value requires management to make assumptions and estimates about future events. The assumptions and estimates with respect to determining the fair value of E&E assets and development and production costs acquired generally require the most judgement and include estimates of reserves acquired, forecast benchmark commodity prices and discount rates. Changes in any of these assumptions or estimates used in determining the fair value of acquired assets and liabilities could impact the amounts assigned to assets and liabilities in the purchase price allocation.

The amount recorded as decommissioning liabilities is based on current legal and constructive requirements, technology, price levels and expected plans for remediation. Actual costs and cash outflows can differ from estimates because of changes in laws and regulations, public expectations, market conditions, discovery and analysis of site conditions and changes in technology.

The amounts recorded for deferred income tax assets and deferred tax expense (recovery) are based on estimates of the probability of the Company utilizing certain tax pools and assets which, in turn, is dependent on estimates of proved and probable reserves, production rates, future petroleum and natural gas prices, and changes in legislation, tax rates and interpretations by taxation authorities.

The fair value of derivative contracts is estimated, wherever possible, based on quoted market prices, and if not available, on estimates from third-party brokers. Another significant assumption used by the Company in determining the fair value of derivatives is market data or assumptions that market participants would use when pricing the asset or liability, including assumptions about risk. The actual settlement of derivatives could differ materially from the value recorded and could impact future results.

The above judgments, estimates and assumptions relate primarily to unsettled transactions and events as of the date of the consolidated financial statements. Actual results could differ from these estimates and the differences could be material.

3. Future Accounting Pronouncements

The Company has reviewed new and revised accounting pronouncements that have been issued but are not yet effective.

As of January 1, 2014, the Company will be required to adopt amendments to IAS 36, "Impairment of Assets". The amendments reduce the circumstances in which the recoverable amount of CGUs is required to be disclosed and clarifies the disclosures required when an impairment loss has been recognized or reversed in the period.

As of January 1, 2014, the Company will be required to adopt IFRS Interpretations Committee ("IFRIC") 21 "Levies". IFRIC 21 clarifies that an entity recognizes a liability for a levy when the activity that triggers payment, as identified in the relevant legislation, occurs.

The Company is currently evaluating the impact of adoption of these amendments and interpretations and the effect on Cequence's consolidated financial statements has not yet been determined.

On January 1, 2013, Cequence adopted the following standards and amendments, as issued by the IASB:

- IFRS 10, "Consolidated Financial Statements", which is the result of the IASB's project to replace Standing Interpretations Committee 12, "Consolidation – Special Purpose Entities" and the consolidation requirements of IAS 27, "Consolidated and Separate Financial Statements". The new standard eliminates the current risk and rewards approach and establishes control as the single basis for determining the consolidation of an entity. The adoption of this standard did not have a material impact on the Company's consolidated financial statements.
- IFRS 11, "Joint Arrangements", which is the result of the IASB's project to replace IAS 31, "Interest in Joint Ventures". The new standard redefines joint operations and joint ventures and requires joint operations to be proportionately consolidated and joint ventures to be equity accounted. Under IAS 31, joint ventures could be proportionately accounted. The adoption of this standard did not have a material impact on the Company's consolidated financial statements.
- IFRS 12, "Disclosure of Interests in Other Entities", which outlines the required disclosures for interests in subsidiaries and joint arrangements. The new disclosures require information that will assist financial statement users to evaluate the nature, risks and financial effects associated with an entity's interests in subsidiaries and joint arrangements. The adoption of this standard did not have a material impact on the Company's consolidated financial statements.
- IFRS 13, "Fair Value Measurement", which provides a common definition of fair value, establishes a framework for measuring fair value under IFRS and enhances the disclosures required for fair value measurements. The standard applies where fair value measurements are required and does not require new fair value measurements. The adoption of this standard required the Company to provide additional disclosures in the notes to the consolidated financial statements (see Note 20).

4. Property and Equipment and Exploration and Evaluation Assets

	Property and Equipment	E&E Assets	Total
Cost:			
Balance at December 31, 2011	541,204	6,221	547,425
Additions	91,231	427	91,658
Decommissioning obligation additions and change in estimates	4,720	–	4,720
Acquisitions	641	7,181	7,822
Disposals	(1,440)	–	(1,440)
Balance at December 31, 2012	636,356	13,829	650,185
Additions	**103,834**	**14,075**	**117,909**
Transferred to property and equipment	**27,904**	**(27,904)**	**–**
Decommissioning obligation additions and change in estimates	**(4,632)**	**–**	**(4,632)**
Acquisitions	**23,540**	**–**	**23,540**
Disposals	**(22,019)**	**–**	**(22,019)**
Balance at December 31, 2013	**764,983**	**–**	**764,983**
Depletion, depreciation and impairment:			
Balance at December 31, 2011	(131,475)	–	(131,475)
Depletion and depreciation	(39,564)	–	(39,564)
Impairment loss	(26,894)	–	(26,894)
Disposals	636	–	636
Balance at December 31, 2012	(197,297)	–	(197,297)
Depletion and depreciation	**(40,932)**	**–**	**(40,932)**
Impairment loss	**(2,164)**	**–**	**(2,164)**
Disposals	**12,921**	**–**	**12,921**
Balance at December 31, 2013	**(227,472)**	**–**	**(227,472)**
Carrying amounts:			
At December 31, 2012	439,059	13,829	452,888
At December 31, 2013	**537,511**	**–**	**537,511**

Costs subject to depletion include $785,249 of estimated future capital costs (2012 – $631,687).

The Company's credit facilities are secured by a demand debenture with a first floating charge over all assets of the Company (see note 5).

E&E assets consist of the Company's exploration projects which are pending the determination of proven reserves that are capable of economic production. Costs consist primarily of undeveloped land and drilling costs until the drilling of the well is complete and proven reserves which are capable of economic production have been established.

IMPAIRMENT

The Company reviewed each CGU comprising its property and equipment at December 31, 2013 for indicators of impairment and determined that there were none.

During the three months ended June 30, 2013, the Company recorded an impairment of $2,164 on its Fir assets which reflected the difference between the carrying value and fair value of the assets included as consideration transferred in the Simonette property acquisition described below.

Results of the Company's impairment tests for the years ended December 31, 2013 and 2012 are as follows:

	2013	2012
Northeast British Columbia	–	14,931
Peace River Arch	–	11,963
Deep Basin disposition	**2,164**	–
Total	**2,164**	26,894

PROPERTY ACQUISITION

On April 15, 2013, the Company acquired oil and gas properties located in the Simonette area of Alberta. As consideration for the assets, Cequence transferred its interest in its non-operated oil and gas properties located in the Fir area, and issued an aggregate of 10,300,000 Cequence common shares to the Corporation. The Company recorded $353 of transaction costs related to this acquisition (see note 11). Cequence believes that this expansion and consolidation of its contiguous Montney land position at Simonette has significant present and future economic and strategic value.

A property acquisition is accounted for as a business combination when certain criteria are met, such as the acquisition of inputs and processes to convert those inputs into beneficial outputs. Cequence assessed the property acquisition and determined that it constitutes a business combination under IFRS. In a business combination, acquired assets and liabilities are recognized by the acquirer at their fair value at the time of purchase. Any difference between the determined fair value of the assets and liabilities and the purchase price is recognized as either a bargain purchase gain or goodwill in the period of acquisition.

The estimated fair value of the property and equipment acquired was determined using both internal and external estimates. Decommissioning liabilities assumed were determined using the timing and estimated costs associated with the abandonment, restoration and reclamation of the wells and facilities acquired. A summary of the acquired property is as follows:

Estimated fair value of acquisition:	
Property and equipment	23,336
Decommissioning liabilities	(239)
Deferred income tax liability	(3)
	23,094

Consideration:	
Common shares issued	17,510
Property and equipment transferred	6,004
Decommissioning liabilities transferred	(420)
	23,094

If the acquisition had been effective January 1, 2013, the impact on the Company's production revenue and loss before tax would have been immaterial.

SALE OF ASSETS

During the twelve months ended December 31, 2013, the Company completed the sales of certain oil and gas properties for total cash consideration of $2,878 (2012 – $20,662), subject to final adjustments. The sales resulted in a gain recognized in comprehensive loss of $1,092 (2012 – $20,390).

5. Demand Credit Facilities

The Company has credit facilities totalling $120,000 with a syndicate of Canadian chartered banks. Credit facility A is a $110,000 (December 31, 2012 – $90,000) extendible revolving term credit facility by way of prime loans, U.S. Base Rate Loans, Banker's Acceptances and Libor Loans. Credit facility B is a $10,000 (December 31, 2012 – $10,000) operating facility by way of prime loans, U.S. Base Rate Loans, Banker's Acceptances and letters of credit. Prime loans and U.S. Base Rate Loans on these facilities bear interest at the bank prime rate or U.S. Base Rate, respectively, plus 1.0 percent to 2.5 percent on a sliding scale, depending on the Company's debt to adjusted EBITDA ratio (ranging from being less than or equal to 1.0:1.0 to greater than 2.5:1.0). Banker's Acceptances, Libor Loans and letters of credit on these facilities bear interest at the Banker's Acceptance rate, Libor rate or letter of credit rate, as applicable, plus 2.0 percent to 3.5 percent based on the same sliding scale as above. The credit facilities may be extended and revolve beyond the initial one-year period, if requested by the Company and accepted by the lenders. If the credit facilities do not continue to revolve, the facilities will convert to a 366-day non-revolving term loan facility.

Both credit facilities, and the amount available for draws under the facilities, are subject to periodic review by the bank and are secured by a general assignment of book debts and a $250,000 demand debenture with a first floating charge over all assets of the Company. The Company is permitted to hedge up to 67 percent of its production under the lending agreement. As at December 31, 2013, the Company has drawn $22,763 under the extendible revolving term credit facility and $nil under the operating facility (December 31, 2012 – $23,191 and $nil for the revolving and operating facilities, respectively). The Company has covenants that require Consolidated Debt and Senior Debt to twelve month trailing earnings before interest, taxes and depletion and depreciation to be less that 4:0 to 1:0 and 3:0 to 1:0, respectively. Consolidated Debt is defined as the sum of the Company's period end balance of the credit facility and senior notes. Senior Debt is defined as the sum of Consolidated Debt less the period end balance of the senior notes. The Company was in compliance with the lender's covenants at December 31, 2013. The effective annualized interest rate, including standby fees and commitment fees, for the year ended December 31, 2013 was 5.43 percent (2012 – 4.41 percent). The next scheduled review is to take place in May 2014.

6. Senior Notes

	December 31, 2013	December 31, 2012
Senior notes	**58,477**	–
Less transaction costs	**(1,840)**	–
Total senior notes	**56,637**	–

On October 3, 2013, Cequence issued $60,000 of unsecured five year term notes ("senior notes") at par with a 9% coupon per annum for gross proceeds net of transaction cost of $57,974. The senior notes are unsecured and are subordinate to Cequence's credit facilities. The senior notes were issued pursuant to a trust indenture with a Canadian trust company, which provides for an additional $60,000 of unsecured senior notes at a future date, subject to approval of both the lender and the Company on terms to be confirmed at the time of issuance. A standby charge of 0.7% is applied to the further $60,000 of senior notes available at a future date. The senior notes require quarterly interest payment of 2.25% of the outstanding balance of the senior notes and no principal payments are required prior to maturity on October 3, 2018. In conjunction with the issuance, the Company's credit facility borrowing base was redetermined to $120 million. In addition, Cequence granted to the lender of the senior notes 3.0 million warrants at an exercise price of $2.03 to purchase common shares.

The senior notes are subject to the same financial covenants as the Company credit facilities as well as other non-financial covenants and restrictive covenants, including restrictions over asset sales, restricted payments and the incurrence of additional indebtedness. The Company was in compliance with the senior notes covenants at December 31, 2013.

At any time prior to the maturity of October 3, 2018, the Company has a prepayment option to redeem all or part of the principal amount plus accrued and unpaid interest on the senior notes in accordance with the provisions of the trust indenture. Prior to October 3, 2016 the Company can redeem all or part of the senior notes at 100% of the principal amount plus accrued and unpaid interest plus 75% of the present value of the remaining scheduled payments of interest from the redemption date until the maturity date. The Company can redeem all or part of the senior notes at 105% of the principal amount plus accrued and unpaid interest during the period October 3, 2016 to October 3, 2017 and at 100% of the principal amount plus accrued and unpaid interest during the period October 3, 2017 to October 3, 2018. The prepayment options within the senior notes are considered embedded derivatives. The value of these embedded derivatives at October 3, 2013 and at December 31, 2013 is negligible. Upon specified change of control events or upon certain sales of assets, the Company must offer to repurchase the senior notes.

The senior notes have been classified as debt, net of transaction costs with the residual value related to the warrants allocated to equity. The transaction costs will be amortized over the life of senior notes and the debt portion of the senior notes will be accreted up to the principal value of $60,000 using an effective interest rate of 10.51%.

	December 31, 2013	December 31, 2012
Issuance	**60,000**	–
Less transaction costs	**(2,026)**	–
Net proceeds	**57,974**	–
Debt component		
Issuance, net of allocated transaction costs	**56,503**	–
Amortization of transaction costs	**76**	–
Accretion	**58**	–
Total debt component	**56,637**	–
Equity component		
Warrant issuance, net of allocated transaction costs and deferred tax	**1,300**	–
Total equity component	**1,300**	–

7. Accounts Receivable

	December 31, 2013	December 31, 2012
Trade receivables	**7,140**	7,852
Allowance for doubtful accounts	**(581)**	(515)
Net trade receivables	**6,559**	7,337
Accrued revenue	**12,591**	7,627
Other receivables	**684**	1,120
Total accounts receivable	**19,834**	16,084

8. Accounts Payable and Accrued Liabilities

	December 31, 2013	December 31, 2012
Accounts payable	**21,660**	17,657
Accrued liabilities	**30,032**	24,533
Total accounts payable and accrued liabilities	**51,692**	42,190

9. Other Liabilities

	December 31, 2013	December 31, 2012
Obligations related to onerous contracts – current (Note 14)	**317**	317
Obligations related to flow-through shares (Note 16)	**–**	4,142
Total other liabilities	**317**	4,459

10. Production Revenue

	Year ended December 31, 2013	2012
Sales of oil and natural gas	**104,514**	75,811
Royalties	**(8,615)**	(4,762)
Total production revenue	**95,899**	71,049

11. Other Expense (Income)

	Year ended December 31, 2013	2012
Gain on sale of property and equipment	**(1,092)**	(20,390)
Termination fee net of transaction costs	**–**	(3,347)
Transaction costs	**353**	–
Other	**(118)**	(57)
Total other expense (income)	**(857)**	(23,794)

In June 2012, Cequence and Open Range Energy Corp. ("Open Range") entered into an arrangement agreement whereby Cequence agreed to acquire all of the outstanding common shares of Open Range. In July 2012, Open Range accepted a superior proposal from another publicly traded Canadian oil and gas company and in accordance with the terms of the arrangement agreement, Open Range paid to Cequence a termination fee of $4,600. Transaction costs of $1,253 were incurred by the Company with respect to this arrangement agreement during 2012. The net amount of $3,347 has been included in other income for the year ended December 31, 2012.

12. Finance Costs

	Year ended December 31, 2013	2012
Interest expense on demand credit facilities (including stand-by fees and commitment fees of $652 (2012 – $307))	**2,105**	2,000
Interest expense on senior notes	**1,334**	–
Amortization of transaction costs	**76**	–
Accretion expense on senior notes	**58**	–
Accretion expense on provisions	**830**	725
Total finance costs	**4,403**	2,725

13. Compensation Costs and Key Management Personnel Expenses

Total wages, salaries, benefits and other personnel costs included in comprehensive loss for the year ended December 31, 2013 were $4,261 (2012 – $4,493).

The aggregate expense of key management personnel, defined as the Company's chief executive officer, chief operating officer, chief financial officer and the Company's board of directors, was as follows:

	Year ended December 31, 2013	2012
Wages, salaries, benefits and other personnel costs	**1,121**	1,137
Share based payments (i)	**757**	1,146
Total remuneration	**1,878**	2,283

(i) Represents the total fair value of share based payment awards granted to officers and directors in the year of grant, as determined using a Black-Scholes option pricing model (see note 17).

14. Provisions

DECOMMISSIONING LIABILITIES

The following table summarizes the changes in decommissioning liabilities for the years ended December 31, 2013 and 2012:

	2013	2012
Balance, beginning of year	**32,564**	28,135
Acquisitions	**285**	417
Property dispositions (Note 4)	**(1,729)**	(533)
Accretion expense	**819**	730
Liabilities incurred	**1,120**	1,775
Abandonment costs incurred	**(619)**	(904)
Revisions in estimated cash flows	**(973)**	2,078
Revisions due to change in discount rates	**(4,824)**	866
Balance, end of year	**26,643**	32,564

The Company's decommissioning liabilities result from its ownership in oil and natural gas assets including well sites, facilities and gathering systems. The total estimated, undiscounted cash flows, inflated at 2 percent, required to settle the obligations are $55,632 (2012 – $47,549). These cash flows have been discounted using a risk-free interest rate of 3.20 percent (2012 – 2.37 percent) based on Government of Canada long-term benchmark bonds. The Company expects these obligations to be settled in approximately 1 to 50 years (2012 – 1 to 50 years). As at December 31, 2013, no funds have been set aside to settle these liabilities.

ONEROUS CONTRACTS

As at December 31, 2013, the Company recognized a provision related to an onerous lease contract of $502 (2012 – $812). The provision for onerous lease contract represents the present value of the future lease obligations that the Company is presently obligated to make under a non-cancellable onerous operating lease contract, less revenue expected to be earned on the lease, including estimated future sub-lease revenue. The total estimated, undiscounted cash flows, required to settle the obligations are $509 (2012 – $830). These cash flows have been discounted using a risk-free interest rate of 1.13 percent (2012 – 1.20 percent) based on Government of Canada benchmark bonds.

Cequence expects to reduce the provision by $317 in the year ended December 31, 2014, which amount is included with other liabilities in the consolidated balance sheet (see note 9). The portion of the provision expected to be realized in the period subsequent to December 31, 2014 of $185 is carried with provisions as a non-current liability in the consolidated balance sheet as at December 31, 2013. The estimate may vary as a result of changes in the utilization of the lease premises and the sub-lease arrangements, where applicable. The unexpired term of the leases at December 31, 2013 is 19 months.

15. Income Taxes

The following table sets forth the components of the Company's deferred income tax asset:

	December 31, 2013	December 31, 2012
Deficiency of net book value of assets and liabilities over related tax pools	**(8,412)**	(3,664)
Non-capital loss carry-forwards	**34,500**	36,969
Scientific research and development expenses and investment tax credits	**8,602**	8,602
Other tax assets	**1,404**	2,359
Total net deferred income tax assets	**36,094**	44,266

At December 31, 2013, Cequence has total tax pools of $663,237 (2012 – $608,300) including non-capital loss carry-forwards, investment tax credit carry-forwards and Scientific Research and Experimental Development ("SRED") expenses available to reduce future years' income for tax purposes. Deferred income tax assets have been recognized to the extent that estimated future taxable profits are sufficient to realize the deferred income tax assets in the allowable timeframes. As at December 31, 2013, a deferred income tax asset has not been recognized on $18,600 (2012 – $18,600) of deductible temporary differences in respect of certain successored resource properties; the deductible temporary differences do not expire. The Scientific Research and Development expenses of approximately $22,704 available for carry-forward do not expire (2012 – $22,704). The non-capital loss carry-forwards expire in 12 to 17 years and the investment tax credit carry-forwards expire in 7 to 11 years.

Income tax expense differs from that which would be expected from applying the effective Canadian federal and provincial tax rates of 25.0 percent (2012 – 25.0 percent) to loss before income taxes as follows:

	Year ended December 31,	
	2013	2012
Expected income tax expense (recovery)	**302**	(4,427)
Effect of share based payments	**936**	1,429
Change in previously estimated tax pools	**(370)**	–
Effect of renunciation of flow-through shares (Note 16)	**3,000**	2,960
Other	**(47)**	3
Deferred income tax expense (recovery)	**3,821**	(35)
Current income tax	**–**	–
Income tax expense (recovery)	**3,821**	(35)

Movements in deferred income tax balances are as follows:

	Balance, Dec. 31, 2012	Recognized in comprehensive loss	Recognized in liabilities	Recognized in equity	**Balance Dec. 31, 2013**
Property and equipment and provisions	(3,475)	1,656	(7,143)	–	**(8,962)**
Unrealized (gain) loss on financial instruments	(189)	928	–	–	**739**
Senior notes	–	(6)	–	(183)	**(189)**
Non-capital losses	36,969	(2,469)	–	–	**34,500**
SRED expenses and investment tax credits	8,602	–	–	–	**8,602**
Other	2,359	(933)	–	(22)	**1,404**
Total	44,266	(824)	(7,143)	(205)	**36,094**

	Balance, Dec. 31, 2011	Recognized in comprehensive loss	Recognized in liabilities	Recognized in equity	Balance Dec. 31, 2012
Property and equipment and provisions	13,605	(12,121)	(4,959)	–	(3,475)
Unrealized gain on financial instruments	–	(189)	–	–	(189)
Non-capital losses	23,659	13,310	–	–	36,969
SRED expenses and investment tax credits	8,602	–	–	–	8,602
Other	2,450	(965)	–	874	2,359
Total	48,316	35	(4,959)	874	44,266

16. Share Capital

Cequence has an unlimited number of common voting shares and common non-voting shares with no par value authorized.

	Year ended December 31, 2013		Year ended December 31, 2012	
Issued common voting shares	**Number**	**Stated Value**	Number	Stated Value
	(000s)	**$**	(000s)	$
Balance, beginning of year	**200,610**	**606,703**	161,856	559,371
Common shares	**8**	**15**	21,269	25,523
Common shares issued on property acquisition (Note 4)	**10,300**	**17,510**	–	–
Flow-through common shares	**–**	**–**	17,485	24,429
	210,918	**624,228**	200,610	609,323
Share issue costs, net of taxes of ($35) (2012 – $874)	**–**	**104**	–	(2,620)
Balance, end of year	**210,918**	**624,332**	200,610	606,703
Warrants				
Balance, beginning of year	**–**	**–**	2,250	–
Granted on issuance of senior notes, net of tax of $183 (2012 – nil) (Note 6)	**3,000**	**1,339**	–	–
Transaction costs, net of tax of $13 (2012 – nil)	**–**	**(39)**	–	–
Cancelled	**–**	–	(2,250)	–
Balance, end of year	**3,000**	**1,300**	–	–

On March 8, 2012, the Company's 2012 Warrants related to a previous private placement of common shares were cancelled at no cost to Cequence and no redress to the shareholder.

On June 20, 2012, the Company completed the sale of 11,684 common voting shares at a price of $1.20 per share for gross proceeds of $14,020. On July 12, 2012, the Company further completed the sale of 1,252 common voting shares at a price of $1.20 per share for gross proceeds of $1,503 related to the exercise of an over-allotment option on the above issuance.

On June 20, 2012, the Company completed the sale of 4,850 common voting shares on a CEE "flow-through" basis at $1.45 per share for gross proceeds of $7,033 as well as 3,800 common voting shares on a CDE "flow-through" basis at $1.32 per share for gross proceeds of $5,016, resulting in a total issuance of 8,650 common voting shares for total gross proceeds of $12,049. The above transaction resulted in an increase to share capital of $10,380 and the recognition of an obligation related to flow-through shares of $1,669 included with other liabilities at December 31, 2012. In accordance with the terms of the related agreements and pursuant to certain provisions of the Income Tax Act (Canada), the Company is required to renounce, for income tax purposes, exploration expenditures of $7,033 and development expenditures of $5,016 to the holders of the flow-through common shares effective December 31, 2012. As at December 31, 2012, the Company had incurred all qualifying CEE and CDE expenditures.

On June 22, 2012, the Company completed the sale, on a private placement basis, of 8,333 common voting shares at a price of $1.20 per share for gross proceeds of $10,000.

On December 5, 2012, the Company completed the public sale of 8,560 common voting shares on a CEE "flow-through" basis at $1.87 per share for gross proceeds of $16,007. On December 21, 2012, the Company completed a private placement sale of 275 common voting shares to certain officers and directors on a CEE "flow-through" basis at $1.87 per share for gross proceeds of $514. The private placement transaction has been recorded at the exchange amount, which is the amount of consideration established and agreed to by the related parties, and is equal to fair value. The above transactions resulted in an increase to share capital of $14,048 and the recognition of an obligation related to flow-through shares of $2,473 included with other liabilities at December 31, 2012. In accordance with the terms of the related agreements and pursuant to certain provisions of the Income Tax Act (Canada), the Company is required to renounce, for income tax purposes, exploration expenditures of $16,521 to the holders of the flow-through common shares effective December 31, 2012. As at December 31, 2013, the Company had incurred all qualifying CEE expenditures.

On October 3, 2013, the Company granted to the lender of the senior notes 3.0 million warrants at an exercise price of $2.03 to purchase Cequence common shares (see note 6).

17. Share Based Payment Plans

STOCK OPTIONS

The Company has a stock option plan for directors, officers, employees and consultants of the Company and its subsidiaries. The number of common shares granted with respect to options may not exceed a rolling maximum of 10 percent of the Company's outstanding common shares. Options typically vest over a three year period, expire five years from the date of grant and are settled by issuing shares of the Company.

During the year ended December 31, 2013, the Company issued 1,780 stock options at prices ranging from $1.35 to $1.76 to employees and directors. The options have a five year life and one third vest annually commencing one year following the grant date.

A summary of the inputs used to value stock options is as follows:

	2013	2012
Risk-free interest rate	**1.5% – 1.9%**	1.3% – 1.6%
Expected life of options	**5 years**	5 years
Expected volatility	**60%**	60%
Expected dividend rate	**0%**	0%
Expected forfeiture rate	**15%**	15%
Weighted average fair value	**$0.89**	$0.65

Expected volatility is determined by reference to the Company's industry peers as, due largely to changes in the size and structure of the Company in recent years, this was determined to be a more meaningful measure than the historical volatility of the Company's shares.

A summary of the status of the Company's stock option plan and changes during the year ended December 31, 2013 and 2012 is as follows:

		2013		2012
	Number of options	**Weighted average exercise price**	Number of options	Weighted average exercise price
	(000s)	**$**	(000s)	$
Outstanding, beginning of year	**17,289**	**2.19**	13,094	2.54
Granted	**1,780**	**1.70**	5,118	1.30
Forfeited	**(444)**	**1.92**	(923)	2.20
Exercised	**(8)**	**1.34**	–	–
Outstanding, end of year	**18,617**	**2.15**	17,289	2.19

The following table summarizes information about stock options outstanding at December 31, 2013:

			Options outstanding		Options exercisable
Range of Exercise Price	Weighted average exercise price	Number of options outstanding	Weighed average contractual life remaining	Number of options	Weighted average exercise price
$	$	(000s)	(years)	(000s)	$
1.24 – 1.99	1.72	14,593	2.7	9,579	1.87
2.96 – 3.94	3.69	4,024	2.5	2,683	3.69
	2.15	18,617	2.7	12,262	2.27

During the year ended December 31, 2013, $3,633 (2012 – $5,717) in share based payment expense related to equity-settled stock options has been recognized in comprehensive loss.

RESTRICTED SHARE UNITS

In 2013, the Company implemented an RSU plan for directors, officers, employees and consultants of the Company and its subsidiaries. An RSU is a conditional grant to receive a Cequence common share, or the cash equivalent, as determined by the Company, upon vesting of the RSUs and in accordance with the terms of the RSU plan and grant agreement. The value of one RSU is notionally equivalent to one Cequence

common share. RSUs vest over a three year period and management plans to settle the RSUs in cash on the respective vesting date.

During the year ended December 31, 2013, the Company issued 561 RSUs and recognized $111 in share based payment expense related to the cash-settled RSUs in comprehensive loss.

18. Loss per Share

Loss per share has been calculated based on the weighted average number of common shares outstanding during the year. No stock options, RSUs or warrants have been included in the calculation of diluted shares outstanding for the year ended December 31, 2013 (2012 – none) as their inclusion would be anti-dilutive. The following table reconciles the denominators used for the basic and diluted loss per share calculations.

	Year ended December 31,	
	2013	2012
Basic weighted average shares	**207,950**	178,209
Effect of dilutive instruments	**–**	–
Diluted weighted average shares	**207,950**	178,209

19. Contingencies and Commitments

	2014	2015	2016	2017	2018+	Total
Office leases	1,129	1,016	829	622	–	3,596
Pipeline transportation	1,730	1,583	–	–	–	3,313
Total	2,859	2,599	829	622	–	6,909

The pipeline transportation contract expires on November 30, 2015.

In 2011, the Company entered into a drilling service agreement whereby the Company made a deposit of $3,500 to obtain a right of first refusal on the use of two drilling rigs over the five years following the date that use of the rigs commences. The deposit is to be applied as the Company incurs costs related to the use of the drilling rigs and $1,751 has been drawn down at December 31, 2013. Cequence expects to reduce the deposit by $702 in the year ended December 31, 2014, which amount is included with deposits and prepaid expenses at December 31, 2013. The portion of the outstanding deposit expected to be drawn down in the period subsequent to December 31, 2014 of $1,047 is carried as a non-current asset at December 31, 2013.

During the year ended December 31, 2013, the Company recognized $1,366 (2012 – $1,451) of expense related to office leases, included with general and administrative expense.

20. Financial Instruments and Risk Management

The Company's financial instruments, including derivative financial instruments, recognized in the consolidated balance sheets consist of accounts receivable, deposits, commodity contracts, demand credit facilities, senior notes and accounts payable and accrued liabilities.

The Company's accounts receivable, deposits, demand credit facilities and accounts payable and accrued liabilities approximate their carrying values due to their short terms to maturity and the floating interest rate on the Company's debt. The senior notes bear interest at rates available to Cequence and accordingly the fair value approximates the carrying value excluding deferred financing costs.

The Company's fair value hierarchy for those assets and liabilities measured at fair value comprises commodity contracts which are measured at level 2 under the Company's fair value hierarchy as of December 31, 2013. The fair value of commodity contracts is determined by discounting the remaining contracted petroleum and natural gas volumes by the difference between the contracted price and published forward price curves as at the balance sheet date.

The nature of these financial instruments and the Company's operations expose the Company to market risk, credit risk and liquidity risk. The Company manages its exposure to these risks by operating in a manner that minimizes these risks. Senior management employs risk management strategies and policies to ensure that any exposure to risk is in compliance with the Company's business objectives and risk tolerance levels. The Board of Directors has overall responsibility for the establishment and oversight of the Company's risk management framework. The Board has established policies in setting risk limits and controls and monitors these risks in relation to market conditions.

MARKET RISK

Market risk is the risk that changes in market prices, such as foreign exchange rates, commodity prices, and interest rates will affect the Company's comprehensive income (loss) to the extent the Company has outstanding financial instruments. The objective of the Company is to mitigate market risk exposures within acceptable limits, while maximizing returns.

Commodity Price Risk

The nature of the Company's operations results in exposure to fluctuations in commodity prices. Management continuously monitors commodity prices and initiates instruments to manage exposure to these risks when it deems appropriate. As a means of managing commodity price volatility, the Company enters into various derivative financial instrument agreements and physical contracts. The fair values of the derivative financial instruments are based on mark-to-market assessments and estimates of fair value and are recorded on the consolidated balance sheet as either an asset or liability with the change in fair value recognized in comprehensive income (loss).

During the year ended December 31, 2013, the Company entered into several commodity derivative financial instrument contracts. The following information presents all outstanding positions for commodity derivative financial instruments at December 31, 2013:

Term	Product	Type	Volume	Price	Basis
January 1, 2014 to September 30, 2014	Gas	Swap	2,500 gj/day	$3.51	AECO
January 1, 2014 to December 31, 2014	Gas	Swap	2,500 gj/day	$3.42	AECO
January 1, 2014 to December 31, 2014	Gas	Swap	2,500 gj/day	$3.53	AECO
January 1, 2014 to December 31, 2014	Gas	Swap	2,500 gj/day	$3.70	AECO
January 1, 2014 to December 31, 2014	Gas	Swap	2,500 gj/day	$3.47	AECO
January 1, 2014 to December 31, 2014	Gas	Swap	2,500 gj/day	$3.40	AECO
January 1, 2014 to December 31, 2014	Gas	Swap	2,500 gj/day	$3.45	AECO
January 1, 2014 to October 31, 2014	Gas	Swap	2,500 gj/day	$3.46	AECO
January 1, 2014 to December 31, 2014	Gas	Swap	2,500 gj/day	$3.15	AECO
January 1, 2014 to December 31, 2014	Gas	Swap	2,500 gj/day	$3.25	AECO
January 1, 2014 to December 31, 2014	Gas	Swap	2,500 gj/day	$3.41	AECO
January 1, 2014 to December 31, 2014	Gas	Swap	2,500 gj/day	$3.47	AECO
November 1, 2014 to March 31, 2015	Gas	Swap	2,500 gj/day	$3.70	AECO
January 1, 2015 to March 31, 2015	Gas	Swap	5,000 gj/day	$3.76	AECO

For the year ended December 31, 2013, realized gain from commodity derivative contracts recognized in comprehensive loss were $1,103 (2012 – $161 loss).

The fair value of the commodity contracts outstanding at December 31, 2013 was a current liability of $2,880 and non-current liability of $76 (2012 – current asset $694 and non-current asset of $63).

For the year ended December 31, 2013 the Company recorded an unrealized loss of $3,713 from derivative commodity contracts (2012 – $757 unrealized gain).

As at December 31, 2013, an increase in gas price of $0.50/gj results in a decrease in the fair value of the commodity contracts of $5,651 ($4,238 after tax) and a commensurate increase to comprehensive loss.

Foreign Exchange Risk

The Company is exposed to foreign currency fluctuations as crude oil and natural gas prices are referenced to U.S. dollar denominated prices. As at December 31, 2013 the Company had no forward, foreign exchange contracts in place, nor any significant working capital items denominated in foreign currencies (2012 – nil).

Interest Rate Risk

The Company is exposed to interest rate risk to the extent that changes in market interest rates impact its borrowings under the floating rate credit facilities. The floating rate debt is subject to interest rate cash flow risk, as the required cash flows to service the debt will fluctuate as a result of changes in market rates. The Company has no interest rate swaps or financial contracts in place as at or during the year ended December 31, 2013 (2012 – nil).

As at December 31, 2013, a 1 percent change in interest rates on the Company's outstanding credit facilities, with all other variables constant, would result in a change in comprehensive loss of $228 ($171 after tax) (2012 – $232 ($174 after tax)).

CREDIT RISK

Credit risk is the risk of financial loss to the Company if a counterparty to a financial instrument fails to meet its contractual obligation. The Company is exposed to credit risk with respect to its accounts receivable and cash.

The majority of the Company's accounts receivable are due from joint venture partners in the oil and gas industry and from marketers of the Company's petroleum and natural gas production. The Company mitigates its credit risk by entering into contracts with established counterparties that have strong credit ratings and reviewing its exposure to individual counterparties on a regular basis.

As at December 31, 2013, the accounts receivable balance was $19,834 of which $1,519 was past due. The Company considers all amounts greater than 90 days past due. These past due accounts are considered to be collectible, except as provided in the allowance for doubtful accounts. When determining whether past due accounts are uncollectible, the Company factors in the past credit history of the counterparties. The following table provides an aging analysis of the Company's accounts receivables:

Current	30-60 days	60-90 days	90+days	Total
16,781	1,191	343	1,519	19,834

At December 31, 2013, the Company has an allowance for doubtful accounts of $581 (2012 – $515). As at December 31, 2013, 54 percent (2012 – 44.0) of the total receivables balance is due from marketers of the Company's oil and natural gas production. A reconciliation of the Company's allowance for doubtful accounts is as follows:

	Year ended December 31,	
	2013	2012
Balance, beginning of year	**515**	551
Amounts collected	**(140)**	(36)
Amounts written off to accounts receivable	**(1)**	–
Additional provision	**207**	–
Balance, end of year	**581**	515

As at December 31, 2013, the maximum exposure to credit risk was $19,834 (2012 – $16,841) being the carrying value of the Company's accounts receivable and commodity contract assets.

LIQUIDITY RISK

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they are due. The nature of the oil and gas industry is capital intensive and the Company maintains and monitors a certain level of cash flow to finance operating and capital expenditures. Refer to note 22 for disclosure related to the management of capital.

The expected timing of cash flows relating to financial liabilities as at December 31, 2013 is as follows:

	< 1 Year	1 – 2 Years	2 – 5 Years	Thereafter
Demand credit facilities – principal	–	22,763	–	–
Senior notes – principal	–	–	60,000	
Accounts payable and accrued liabilities	51,692	–	–	–
	51,692	22,763	60,000	–

21. Changes in Non-Cash Working Capital

	Year ended December 31, 2013	2012
Accounts receivable	**(3,750)**	4,948
Deposits and prepaid expenses	**1,094**	358
Accounts payable and accrued liabilities	**9,502**	(22,277)
Net change in non-cash working capital	**6,846**	(16,971)
Allocated to:		
Operating activities	**(6,870)**	4,950
Investing activities	**13,304**	(22,186)
Financing activities	**412**	265
	6,846	(16,971)

22. Capital Management

Cequence's objectives are to maintain a flexible capital structure in order to meet its financial obligations and to execute on strategic opportunities throughout the business cycle. The Company's capital comprises shareholders' equity, demand credit facilities, senior notes and working capital. In addition, the Company has an additional $60,000 in senior notes available for issue at a future date. Cequence manages the capital structure and makes adjustments in light of economic conditions and the risk characteristics of the underlying assets.

In order to maintain or adjust the capital structure, Cequence may issue new common shares, issue new debt or replace existing debt, adjust capital expenditures and acquire or dispose of assets.

The Company evaluates its capital structure based on net debt to cash flow from operating activities and the current credit available to Cequence compared to its budgeted capital expenditures.

Net debt to cash flow provides a measure of the Company's ability to manage its debt levels under current operating conditions. The ratio is calculated as net debt, defined as credit facilities, the principal value of senior notes and working capital excluding commodity derivative assets or liabilities and other liabilities, divided by cash flow from operations before decommissioning liabilities expenditures and changes in non-cash working capital for the most recent quarter.

At December 31, 2013, Cequence has a net debt and working capital deficiency of $111,433 (2012 – $45,869).

It is the Company's objective to maintain a net debt to annualized cash flow ratio of less than 2:1. As at December 31, 2013, the ratio was calculated as 1.9:1 (2012 – 1.1:1) based on annualized fourth quarter results.

The Company's current borrowing capacity is based on the lenders' semi-annual review of the Company's oil and natural gas reserves. The Company is also subject to various lenders' restrictions and covenants under the terms of the credit facilities and senior notes. Compliance with these restrictions and covenants is monitored on a regular basis and Cequence was in compliance at December 31, 2013.

Corporate Information

Management

Paul Wanklyn
President & CEO

Howard Crone, P.Eng
Executive Vice President & COO

David Gillis, CA
Vice President, Finance & CFO

James R. Jackson, P.Eng, CFA
Vice President, Engineering

David P. Robinson
Vice President, Geology

Christopher C. Soby
Vice President, Land

Stephen R. Stretch
Vice President, Geophysics

Mike Stewart
Vice President, Operations

Erin Thorson, CMA
Controller

Directors

Don Archibald
Chairman

Peter Bannister
Robert C. Cook
Howard Crone
Brian Felesky
James K. Gray (1)
Francesco Mele
Paul Wanklyn
Daryl Gilbert

(1) Director Emeritus

Transfer Agent and Registrar

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E: info@cequence-energy.com
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Auditors

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Calgary, Alberta

Bankers

Canadian Imperial Bank of Commerce
Calgary, Alberta

National Bank of Canada
Calgary, Alberta

Bank of Montreal
Calgary, Alberta

Legal Counsel

Norton Rose Canada LLP
Calgary, Alberta

Evaluation Engineers

GLJ Petroleum Consultants
Calgary, Alberta

Stock Exchange Listing

Toronto Stock Exchange
Symbol: CQE

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