cequence energy ltd

HIGHLIGHTS

(000's except per share and per unit amounts)	Three months ended March 31, 2016	2015	% Change
FINANCIAL			
Production revenue [1]	15,772	23,594	(33)
Comprehensive loss	(5,888)	(4,662)	26
Per share – basic and diluted	(0.03)	(0.02)	50
Funds flow from (used in) operations [2][5]	(314)	8,283	(104)
Per share, basic and diluted	(0.00)	0.04	(100)
Capital expenditures, before acquisitions (dispositions)	7,362	22,582	(67)
Capital expenditures, including acquisitions (dispositions)	7,151	19,647	(64)
Net debt and working capital deficiency [3]	(72,941)	(82,667)	(12)
Weighted average shares outstanding – basic and diluted	211,028	211,028	–
OPERATING			
Production volumes			
Natural gas (Mcf/d)	52,253	56,105	(7)
Crude oil (bbls/d)	218	115	90
Natural gas liquids (bbls/d)	235	554	(58)
Condensate (bbls/d)	1,061	1,197	(11)
Total (boe/d)	10,223	11,217	(9)
Sales prices			
Natural gas, including realized hedges ($/Mcf)	2.10	3.33	(37)
Crude oil and condensate, including realized hedges ($/bbl)	46.69	50.13	(7)
Natural gas liquids ($/bbl)	16.68	17.10	(2)
Total ($/boe)	16.95	23.37	(27)
Netback ($/boe)			
Price, including realized hedges	16.95	23.37	(27)
Royalties	(0.61)	(2.00)	(70)
Transportation	(1.17)	(1.88)	(38)
Operating costs	(9.90)	(7.74)	28
Operating netback	5.27	11.75	(55)
General and administrative [5]	(4.03)	(1.97)	105
Interest [4]	(1.69)	(1.60)	6
Cash netback	(0.45)	8.18	(106)

[1] Production revenue is presented gross of royalties and includes realized gains (loss) on commodity contracts.
[2] Funds flow from (used in) operations is calculated as cash flow from operating activities before adjustments for decommissioning liabilities expenditures and net changes in non-cash working capital.
[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 share based payment liability and provisions.
[4] Represents finance costs less amortization on transaction costs and accretion expense on senior notes and provisions.
[5] For the quarter ended March 31, 2016, general and administrative expenses and funds flow used in operations includes $1,730 or $1.86/boe in restructuring charges.

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 unaudited condensed consolidated financial statements (the "consolidated financial statements") and related notes for the three months ended March 31, 2016 as well with the audited consolidated financial statements (the "annual financial statements") and related notes for the years ended December 31, 2015 and 2014.

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 May 10, 2016.

Basis of Presentation

The consolidated financial statements and comparative information have been prepared in accordance with International Accounting Standard ("IAS") 34, "Interim Financial Reporting", as issued by the International Accounting Standards Board ("IASB"). The financial information presented reflects the consolidated financial statements of Cequence.

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 three months ended March 31, 2016 the ratio between the average price of West Texas Intermediate ("WTI") crude oil at Cushing and NYMEX natural gas was approximately 17:1 ("Value Ratio"). The Value Ratio is obtained using the first three months of 2016 WTI average price of $33.41 (US$/Bbl) for crude oil and the first three months 2016 NYMEX average price of $1.98 (US$/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 (used in) 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 share based payment liability and provisions. 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 (used in) 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 (used in) operations. The Company considers funds flow from (used in) 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 (used in) operations may not be comparable to that reported by other companies. Funds flow from (used in) 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.

Description of the Business

Cequence is engaged in the exploration for and the development of oil and natural gas reserves. Cequence's primary focus is the development of its Simonette asset in the Alberta Deep Basin. The Company also has assets in Northeast British Columbia and the Peace River Arch of Alberta. The common shares of Cequence trade on the Toronto Stock Exchange under the symbol CQE.

The current outlook for natural gas prices for the remainder of 2016 is weak and the Company has taken measures to manage its balance sheet and improve its cost structure. Planned capital expenditures, net of dispositions, for 2016 are expected to be $7,000 and will be directed towards long term cost reduction projects. A water injection well to reduce water handling costs incurred when drilling and producing wells is expected to be drilled at Simonette in the third quarter. The project is expected to have an impact on operating costs in the fourth quarter.

The Company has taken steps to reduce its general and administrative costs through a reduction in staff and employee compensation. G&A expenses in the first quarter include $1,730 in severance expense associated with the staff reductions. Further cost reductions are expected in the fourth quarter when the Company's current office lease expires. After taking into account all of the expected changes in G&A, management expects fourth quarter run rate G&A expense to be approximately $6,000 per year representing a 30 percent decrease from 2015.

In first quarter of 2016, the Company completed the addition of a shallow cut refrigeration upgrade at the Company's Simonette natural gas processing facility. The addition of a refrigeration system is expected to provide Cequence with greater long term flexibility and pricing for natural gas and liquids from its Simonette property.

The Company's net debt at March 31, 2016 is $72,941 and is comprised of $60,000 of senior notes, cash of $5,709 and a working capital deficiency of $18,650. The Company's senior notes carry a five year term and are due in October 2018. The senior credit facility remains undrawn at March 31, 2016 providing $60,000 in liquidity based on March 31, 2016 debt balances.

Financial and Operating Results

PRODUCTION

	Three months ended March 31,	
	2016	**2015**
Natural gas (Mcf/d)	**52,253**	56,105
Crude oil (bbls/d)	**218**	115
Natural gas liquids (bbls/d)	**235**	554
Condensate (bbls/d)	**1,061**	1,197
Total (boe/d)	**10,223**	11,217
Total production (boe)	**930,273**	1,009,530

Production for the three months ended March 31, 2016 averaged 10,223 boe/d compared to production of 11,217 boe/d in 2015. The Company is not producing at its full productive capability as uneconomic natural gas production has been curtailed for pricing considerations. The Company estimates its current productive capacity at 12,000 boe/d. Based on the forward strip for natural gas, Cequence expects that production will remain shut in through the remainder of the year. Annual production is expected to average 8,500 boe/d.

REVENUE AND PRICING

	Three months ended March 31,	
$(000's)	**2016**	**2015**
Revenue		
Natural gas	**7,724**	14,168
Realized gain (loss) on natural gas hedges	**2,258**	2,653
Total natural gas	**9,982**	16,821
Crude oil and condensate	**4,725**	5,920
Realized gain on crude oil hedges	**707**	–
Total crude oil and condensate	**5,432**	5,920
Natural gas liquids	**358**	853
Total production revenue, gross of royalties	**15,772**	23,594
Average prices		
Natural gas ($/Mcf)	**1.62**	2.81
Realized natural gas hedge ($/Mcf)	**0.48**	0.52
Natural gas including hedge ($/Mcf)	**2.10**	3.33
Crude oil and condensate ($/bbl)	**40.61**	50.13
Realized crude oil hedge ($/bbl)	**6.08**	–
Crude oil and condensate including hedge ($/bbl)	**46.69**	50.13
Natural gas liquids ($/bbl)	**16.68**	17.10
Average sales price before hedge ($/boe)	**13.77**	20.74
Average sales price including hedge ($/boe)	**16.95**	23.37
Benchmark pricing		
AECO-C spot (CDN$/Mcf)	**1.83**	2.75
WTI crude oil (US$/bbl)	**33.41**	48.49
Edmonton par price (CDN$/bbl)	**41.39**	52.75
US$/CDN$ exchange rate	**0.73**	0.81

Total production revenue, gross of royalties, was $15,772 in the first quarter of 2016 compared to $23,594 in 2015. The decrease in revenue is attributable to the 27 percent decrease in realized sales prices and 9 percent decrease in production.

Natural gas prices remained low throughout the first quarter of 2016 as North American production has been sustained at record high levels while seasonal demand has been lower than expected due to a warm North American winter. Canadian benchmark natural gas prices averaged $1.83 per mcf for the three months ended March 31, 2016, respectively, down 33 percent from the same time period in 2015. Realized natural gas prices before hedging for the three months ended March 31, 2016 were $1.62 per mcf compared to $2.81 per mcf in the comparable period of 2015.

The Company's average natural gas price realization in the first quarter of 2016 was an 11 percent discount to AECO compared to a premium of two percent in 2015. The Company's marketing contracts at Simonette expired in the fourth quarter of 2015 and Cequence has negotiated short term sales contracts for 2016 at fixed differentials to AECO. In the first quarter, the Company realized an average price discount to AECO of $0.54 prior to adjustments for heat content. For the second and third quarters of 2016, Cequence has contracts on Alliance that average 32,800 GJ/d at an average discount to AECO of $0.52. In April 2016, the Company completed a sales connection to Transcanada NGTL pipeline providing egress options from the Simonette property on both the Alliance and NGTL pipeline systems. The Company expects to improve its natural gas pricing relative to AECO with its recent connection to NGTL and the increased availability and cost of marketing contracts on Alliance observed so far in 2016.

Crude oil and condensate prices have also declined significantly in 2015 and 2016 as Edmonton par prices declined 22 percent. Crude oil and condensate prices for the first quarter of 2016 were $40.61 per barrel down 19 percent from the same time period in 2015. Natural gas liquids prices for the three months ended March 31, 2016 were $16.68 per barrel down two percent from the same time period in 2015.

COMMODITY PRICE MANAGEMENT

	Three months ended March 31,	
$(000's)	**2016**	2015
Realized gain on commodity contracts	**2,966**	2,653
Unrealized gain (loss) on commodity contracts	**3,190**	(1,634)
Total	**6,156**	1,019

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 against an unpredictable commodity price environment. In the first quarter of 2016 the realized and unrealized hedging gains are a result of the weakness in both current and future strip crude oil and natural gas prices. Cequence has hedged approximately 50 percent of expected 2016 base natural gas production (net of royalties) at an average price of $2.65/GJ or $2.84/mcf.

The fair value of the commodity contracts outstanding at March 31, 2016 was a current asset of $6,834 (December 31, 2015 – current asset of $3,644). Cequence has the following natural gas and crude oil hedges as at the date of this MD&A:

Term	Product	Type	Average Volume (GJ/d)	Average Price ($/GJ)	Average Price ($/mcf)[(1)]	Basis
April 1, 2016 to September 30, 2016	Gas	Swap	20,000	$2.64	$2.83	AECO
October 1, 2016 to December 31, 2016	Gas	Swap	20,000	$2.65	$2.84	AECO
January 1, 2017 to March 31, 2017	Gas	Swap	7,500	$2.49	$2.66	AECO
April 1, 2017 to December 31, 2017	Gas	Swap	2,500	$2.54	$2.72	AECO

(1) The conversion from GJ to Mcf is based on estimated average natural gas heat content of 37.8 MJ/m^3

Term	Product	Type	Average Volume (bbl/d)	Average Price ($/bbl)	Basis
April 1, 2016 to December 31, 2016	Oil	Swap	400	$65.35	WTI

OPERATING NETBACK

($/boe)	Three months ended March 31, 2016	2015
Production revenue [1]	16.95	23.37
Royalty expense	(0.61)	(2.00)
Transportation expense	(1.17)	(1.88)
Operating costs	(9.90)	(7.74)
Operating netback, $/boe	5.27	11.75
Operating netback, excluding realized hedges , $/boe	2.09	9.12

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

Cequence's netback for the three months ended March 31, 2016 decreased 55 percent to $5.27 per boe from $11.75 per boe in 2015. The decrease in 2016 operating netbacks is mainly due to lower production revenue and increased operating costs that were only partially offset by lower royalty and transportation expenses.

ROYALTY EXPENSE

$(000's)	Three months ended March 31, 2016	2015
Crown	106	943
Freehold / Overriding	459	1,080
Total royalties	565	2,023
Royalties as a percentage of revenue, before hedging	4%	10%
Per unit of production	0.61	2.00

Royalty expense for the three months ended March 31, 2016 was $565 or 4 percent of revenue compared to $2,023 or 10 percent of revenue in 2015.

The average crown royalty rate decreased partly due to lower commodity prices in 2016. Crown royalties operate on a sliding scale and royalty rates decrease when commodity prices decrease. In addition, credits for gas cost allowance remained at a similar amount to prior year despite lower crown royalties. As a result, royalties as a percentage of revenue are lower than the Company's expected royalty rate of approximately six percent of production revenue.

In 2016, the Alberta government announced a Modernized Royalty Framework ("MRF") that will come into effect on January 1, 2017. The royalty structure for wells drilled prior to January 1, 2017 will not change for a 10 year period from the royalty program's implementation date. The MRF will utilize a revenue minus cost framework with different royalty rates pre and post payout based on commodity prices and with a reduction in royalty rates for mature wells. The government has announced the internal rates of return under the MRF are expected to be neutral to the current royalty framework. Ninety percent of the Company's production is in Alberta and will be subject to the MRF. The economics of drilling wells at its Simonette property and, within expected price ranges, are estimated to improve modestly under the MRF. Cequence will continue to monitor the impact of the MRF on its operations in Alberta.

OPERATING COSTS

$(000's)	Three months ended March 31, 2016	2015
Operating costs	9,212	7,811
Per unit of production ($/boe)	9.90	7.74

Operating costs for the three months ended March 31, 2016 were $9.90 per boe compared to $7.74 per boe in 2015. Operating costs have increased due to increased water handling and storage costs and the addition midstream fees in the Simonette field following the Kanata transaction in June 2015. The Company has used less produced water for completion operations as it has slowed down its drilling and completions activity as commodity prices have declined. As a result, the costs to store and dispose of water in the field has increased by $0.69 per boe compared to the prior year. The midstream transaction completed in June 2015 increased capital fees and reduced 3rd party processing recoveries amounting to an increase of $0.99 per boe from the first quarter of 2015.

TRANSPORTATION EXPENSE

$(000's)	Three months ended March 31, 2016	2015
Transportation	1,092	1,903
Per unit of production ($/boe)	1.17	1.88

Transportation expenses decreased in 2016 compared to the prior year as the Company's firm gas transportation commitment on Alliance terminated in the fourth quarter of 2015. In addition the Company observed an increase in trucking expenses in the first quarter of 2015 due to wet weather in the field.

GENERAL AND ADMINISTRATIVE EXPENSES

$(000's)	Three months ended March 31, 2016	2015
G&A expenses	2,114	2,326
Restructuring charges	1,730	–
Total G&A expenses	3,844	2,326
Administrative and capital recovery	(95)	(339)
Total G&A expenses	3,749	1,987
Per unit of production, prior to restructuring charges ($/boe)	2.17	1.97
Per unit of production ($/boe)	4.03	1.97

The Company has undertaken a number of measures to reduce G&A expenses in the current commodity price environment. Compared to the first quarter of 2015, gross G&A expenses prior to restructuring charges decreased 9 percent from prior year to $2,114.

The Company incurred $1,730 in the first quarter of 2016 relating to severance payments associated with a downsizing of the Company's personnel. The Company expects approximately $200 of additional charges in 2016. Further G&A cost reductions are expected in the fourth quarter as its Company's current office lease expires in September. Following all of the expected cost savings management expects that annual G&A expenses will be approximately $6,000.

FINANCE COSTS

	Three months ended March 31,	
	2016	2015
Interest and stand by fees expense on credit facilities	122	177
Interest and stand by fees expense on senior notes	1,448	1,435
Amortization of transaction costs	95	86
Accretion expense on senior notes	74	66
Accretion expense on provisions	209	207
Total finance costs	1,948	1,971
Per unit of production ($/boe)	2.09	1.95
Interest per unit of production ($/boe)	1.69	1.60

Finance costs for the three months ended March 31, 2016 were $1,948 and comparable to $1,971 in 2015. Cequence incurred lower interest expense on its credit facility which was undrawn during the first quarter of 2016 and 2015.

OTHER INCOME

	Three months ended March 31,	
$(000's)	2016	2015
Interest income	(27)	(71)
Other	(74)	(35)
Total other income	(101)	(106)

DEPLETION AND DEPRECIATION

	Three months ended March 31,	
$(000's)	2016	2015
Depletion and depreciation expense	8,097	11,959
Per unit of production ($/boe)	8.70	11.85

Depletion and depreciation expense for the three months ended March 31, 2016, was $8,097 or $8.70 per boe. Depletion and depreciation rates decreased from prior year due to reduced book values from impairment charges in 2015.

SHARE BASED PAYMENTS

The Company uses both stock options and restricted stock units ("RSU") as long term compensation incentives for its employees, directors and service providers. The Company recognizes share based payment expense for stock options and RSUs. For the three months ended March 31, 2016, Cequence recorded $246 (2015 – $304) in share based payment expense related to stock options with a corresponding increase to contributed surplus. For the three months ended March 31, 2016, Cequence recognized $43 (2015 – $74) in share based payment expense related to RSUs with a corresponding increase to share based payment liability. During the three months ended March 31, 2016, the Company granted nil stock options and RSUs.

CAPITAL EXPENDITURES

$(000's)	Three months ended March 31, 2016	2015
Land	188	280
Geological & geophysical and capitalized overhead	291	382
Drilling, completions and workovers	2,217	11,102
Equipment, facilities and tie-ins	4,665	10,786
Office furniture & equipment	1	32
Capital expenditures	7,362	22,582
Property acquisitions [1]	–	13
Property dispositions [1]	(211)	(2,948)
Total capital expenditures	7,151	19,647

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

For the three months ended March 31, 2016, capital expenditures, excluding acquisitions and dispositions, decreased to $7,362 from $22,582 in 2015. Equipment, facility and tie-in expenditures of $4,665 were directed towards the completion of the facility expansion and gas plant construction at Simonette and to the remaining tie-ins from the winter drilling program. The gas plant was operational early in the first quarter and the expansion was completed on time and approximately 14 percent under budget.

The Company has suspended its drilling program until commodity prices improve. Net capital expenditures for 2016 are budgeted at $7,000 and include a water disposal well and facilities at Simonette. Dispositions for the remainder of the year are estimated at $7,000 and include the sale of pipeline and facilities at Simonette.

INCOME TAXES

As at March 31, 2016, the Company has tax pools and available losses of $624,578 (December 31, 2015 – $616,084). Due to the uncertainty of future realization, a deferred tax asset has not been recognized.

At March 31, 2016, Cequence has the following tax pools:

Classification	Amount $(000's)	Annual Deductibility
Canadian exploration expense	166,734	100%
Non-capital losses	261,982	100%
Undepreciated capital cost	67,924	Primarily 25%, declining balance
Canadian oil and gas property expense	11,236	10%, declining balance
Canadian development expense	88,307	30%, declining balance
Other	28,395	Various
	624,578	

The Company's non-capital losses expire in 2025 and thereafter. Based on the Company's expected cash flow and available tax pools, Cequence does not expect to be taxable for the next three years.

PROVISIONS – DECOMMISSIONING LIABILITIES

Decommissioning liabilities represent the estimated future cost of abandoning and reclaiming the company's oil and natural gas wells and related facilities. Total decommissioning liabilities at March 31, 2016 were $41,709 compared to $40,708 at December 31, 2015. Decommissioning obligations are adjusted periodically for revisions to the future liability costs and the estimated timing of costs to be incurred in future years. The Company estimates that it will incur $521 of decommissioning obligations in 2016. The following table summarizes the changes in decommissioning liabilities for the respective periods:

	March 31, 2016	December 31, 2015
Balance, beginning of period	40,708	37,263
Property dispositions	–	(3,283)
Accretion expense	209	853
Liabilities incurred	–	1,819
Abandonment costs incurred	(1,024)	(720)
Revisions in estimated cash flows	375	3,195
Revisions due to change in discount rates	1,441	1,581
Balance, end of period	41,709	40,708

The total estimated, undiscounted cash flows, inflated at 2 percent, required to settle the obligations are $67,994 (December 31, 2015 – $69,020). These cash flows have been discounted using a risk-free interest rate of 2 percent (December 31, 2015 – 2.16 percent) based on Government of Canada long-term benchmark bonds. The Company expects these obligations to be settled in approximately 1 to 50 years (December 31, 2015 – 1 to 50 years).

LIQUIDITY AND CAPITAL RESOURCES

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.

$(000's)	As at March 31, 2016	As at December 31, 2015
Cash	5,709	13,246
Demand credit facilities	-	–
Senior notes – principal	(60,000)	(60,000)
Accounts payable and accrued liabilities	(36,287)	(41,688)
Accounts receivable	16,063	22,321
Deposits and prepaid expenses – current	1,574	1,669
Net debt and working capital (deficiency)	(72,941)	(64,452)
Funds from operations trailing twelve months	16,981	25,578
Net debt to funds from operations	4.3:1	2.5:1
EBITDA trailing twelve months	23,726	32,365
Debt to EBITDA [(1)]	2.7:1	2.0:1

[(1)] For purposes of the Debt to EBITDA calculation in the senior credit agreement, Debt at March 31, 2016 is calculated as the principal amount of the senior notes, amounts drawn on the senior bank facility and outstanding letters of credit.

Cequence's objective is to maintain a flexible capital structure in order to meet its financial obligations and to execute its business plan throughout the commodity cycle. The oil and gas business involves a number of factors, including the timing of capital expenditures and volatile commodity prices that may cause the Company's debt to funds flow ratio to fluctuate on a quarterly basis. At March 31, 2016 the Company's debt to funds flow is higher than the Company's long term stated target of 2:1 due to the prolonged period of low commodity prices. AECO prices are forecasted to be weak throughout 2016 and Cequence expects its debt to funds flow ratio to continue to exceed 2:1 if commodity prices remain at current levels.

To manage its leverage, the Company has reduced capital expenditures to limit borrowing on its senior credit facility. The Company currently expects 2016 net capital expenditures of approximately $7,000. A significant increase in capital expenditures is not planned until commodity prices improve. Historically, the Company has managed its debt levels through its hedging program, issuing common shares, adjusting capital expenditures, and executing asset dispositions.

At March 31, 2016, the Company has net debt of $72,941 comprised of $60,000 of senior notes (maturing in October 2018) and a $12,941 working capital deficiency. The Company has a senior credit facility of $60,000 that is undrawn at March 31, 2016.

SENIOR CREDIT FACILITY

At March 31, 2016, Cequence had a $60,000 (December 31, 2015 – $60,000) extendible revolving term credit facility available from a syndicate of Canadian chartered banks. The credit facility is secured by a first floating charge debenture, general assignment of book debts and Cequence's oil and natural gas properties and equipment. 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. The senior credit facility is reviewed on a semi-annual basis with the current review scheduled to be completed by the end of May 2016. Cequence expects the current review to result in a reduction in the credit facility but anticipates sufficient liquidity to be maintained to execute the 2016 capital program.

As at March 31, 2016, the Company is not drawn under the credit facility (December 31, 2015 – $nil). The company has letters of credit outstanding of $3,207 (December 31, 2015 – $3,207). 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 than 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 March 31, 2016 with ratios of 2.7 and 0 times, respectively (December 31, 2015 – 1.95 and 0 times, respectively). If current commodity prices persist, Cequence may exceed these ratios in 2016 as future cash flows are negatively impacted by low crude oil and natural gas prices. Based on the small amount of expected borrowing relative to the size of the approved facility, the Company currently expects to obtain covenant relief which may result in higher lending fees. Other possible remedies include the sale of assets, further adjustments to the capital program, monetization of commodity contracts or the issuance of equity.

SENIOR NOTES

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 senior notes diversify the Company's capital structure by providing longer term debt that is not reserve-based or subject to periodic redetermination. 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 contain incurrence covenants that use a Debt to Cashflow test of 2.5 times to limit 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. At March 31, 2016, the Company's Debt to Cashflow ratio was 3.5 times (December 31, 2015 – 2.4 times). If current commodity prices persist, the Company expects that its Debt to Cashflow ratio will remain in excess of 2.5 times in 2016. However, the Company does not currently anticipate initiating an action that would be restricted by the incurrence covenants.

CONTRACTUAL OBLIGATIONS

Cequence has assumed various contractual obligations and commitments in the normal course of operations and financing activities.

	2016	2017	2018	2019	2020+	Total
Office leases	**441**	17	–	–	–	458
Pipeline transportation	**–**	–	1,954	2,593	16,199	20,746
Gas processing	**2,859**	3,794	3,794	3,794	39,220	53,461
Total	**3,300**	3,811	5,748	6,387	55,419	74,665

On June 17, 2015, in conjunction with the Simonette disposition Cequence entered into a 15 year take or pay agreement with the operator of the Simonette facility. The minimum volume commitment under the take or pay is 42 mmcf/d. In addition, the Company has firm transportation on a major pipeline system for 35 mmcf/d commencing April 1, 2018 to March 30, 2026.

OUTSTANDING SHARE DATA

Details of share capital and share awards outstanding are as follows:

	March 31, 2016	December 31, 2015
Common shares	**211,028**	211,028
Stock options	**10,940**	11,395
Restricted share units	**1,457**	1,707
Warrants	**3,000**	3,000

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

As of the date of this MD&A, Cequence had the following securities outstanding: 211,027,883 common voting shares, 3,000,000 warrants to purchase common shares, 10,940,001 stock options and 1,457,325 RSUs.

SELECTED FINANCIAL INFORMATION

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

	Three months ended March 31,		
$(000's)	2016	2015	2014
Cash flow from operating activities	**4,893**	8,129	28,805
Decommissioning liabilities expenditures	**1,024**	305	208
Net change in non-cash working capital	**(6,231)**	(151)	(5,931)
Funds flow from (used in) operations	**(314)**	8,283	23,082
Per share, basic and diluted ($)	**0.00**	0.04	0.11
Production revenue	**15,772**	23,594	41,095
Comprehensive income (loss)	**(5,888)**	(4,662)	512
Per share – basic and diluted ($)	**(0.03)**	(0.02)	0.00
Total assets	**399,729**	667,143	641,577
Demand credit facilities	**–**	–	26,747
Senior notes – principal	**60,000**	60,000	60,000

Funds flow from (used in) operations was ($314) for the three months ended March 31, 2016 compared to $8,283 in 2015. The decrease in funds flow is a result of lower commodity prices and production volumes from the comparable period as well as restructuring charges of $1,730 in the quarter.

Cequence recorded a comprehensive loss of $5,888 for the three months ended March 31, 2016 compared to loss of $4,662 in 2015.

Quarterly Information

FINANCIAL

($ thousands except per share data)	2016 Q1	2015 Q4	2015 Q3	2015 Q2	2015 Q1	2014 Q4	2014 Q3	2014 Q2
Production revenue [1]	**15,772**	16,112	19,383	21,802	23,594	25,566	29,013	41,219
Royalties expense	**565**	(507)	368	1,016	2,023	1,119	3,882	4,706
Transportation expense	**1,092**	1,339	1,323	1,757	1,903	1,324	1,284	1,700
Operating costs	**9,212**	7,031	8,951	7,954	7,811	5,961	6,826	9,911
Comprehensive income (loss)	**(5,888)**	(146,585)	(99,070)	246	(4,662)	(4,422)	74,402	8,876
Per share – basic & diluted	**(0.03)**	(0.69)	(0.47)	0.00	(0.02)	(0.02)	0.35	0.04
Funds flow from (used in) operations [2]	**(314)**	4,874	5,139	7,283	8,283	13,745	13,588	20,235
Per share – basic	**(0.00)**	0.02	0.02	0.03	0.04	0.07	0.06	0.10
Per share – diluted	**(0.00)**	0.02	0.02	0.03	0.04	0.06	0.06	0.09
Capital expenditures, net	**7,362**	15,175	4,656	19,848	22,582	56,472	49,239	15,957
Net acquisitions (dispositions) [3]	**(211)**	1,176	1,136	(43,078)	(2,935)	(2,381)	(142,034)	(3,138)
Total capital expenditures	**7,151**	16,351	5,792	(23,230)	19,647	54,091	(92,795)	12,819

(1) Production revenue is presented gross of royalties and includes realized gain (loss) on commodity contracts.
(2) Funds flow from (used in) 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

	2016 Q1	2015 Q4	2015 Q3	2015 Q2	2015 Q1	2014 Q4	2014 Q3	2014 Q2
Production volumes								
Natural gas (Mcf/d)	**52,253**	41,794	43,987	48,665	56,105	49,265	49,515	64,810
Oil (bbls/d)	**218**	225	199	100	115	97	118	100
NGLs (bbls/d)	**235**	300	485	562	554	541	523	753
Condensate (bbls/d)	**1,061**	723	807	953	1,197	872	801	1,080
Total (boe/d)	**10,223**	8,213	8,822	9,726	11,217	9,720	9,694	12,735
Average selling price								
Natural gas ($/Mcf)	**2.10**	2.89	3.46	3.35	3.33	3.92	4.19	4.60
Oil ($/bbl)	**71.22**	49.72	47.01	61.06	44.03	73.15	90.77	97.59
NGLs ($/bbl)	**16.68**	16.45	16.80	17.49	17.10	29.67	38.34	42.28
Condensate ($/bbl)	**41.67**	53.12	50.83	63.41	50.72	70.59	96.02	104.76
Total ($/boe)	**16.95**	21.32	23.88	24.63	23.37	28.59	32.53	35.57
Operating netback, including realized hedges ($/boe)								
Price	**16.95**	21.32	23.88	24.63	23.37	28.59	32.53	35.57
Royalties	**(0.61)**	0.67	(0.45)	(1.15)	(2.00)	(1.25)	(4.35)	(4.06)
Transportation	**(1.17)**	(1.77)	(1.63)	(1.99)	(1.88)	(1.48)	(1.44)	(1.47)
Operating costs	**(9.90)**	(9.30)	(11.03)	(8.99)	(7.74)	(6.67)	(7.65)	(8.55)
Operating netback	**5.27**	10.92	10.77	12.50	11.75	19.19	19.09	21.49

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 85 percent natural gas and fluctuations in natural gas prices have the greatest impact on the Company's revenue and funds flow from operations.

The decrease in production revenue and funds flow in the second half of 2014 and 2015 can be attributed to declining commodity prices. Canadian AECO natural gas prices averaged $2.71 per mcf in 2015, a decrease of 40% from $4.50 per mcf in 2014. In the first quarter of 2016, AECO natural gas prices averaged $1.83/mcf.

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 2015, the Company recorded impairment expense of $230,400, including $144,000 in the fourth quarter, compared to $18,482 in the comparable period of 2014. Impairments recognized were mainly the result of declining benchmark natural gas prices. 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.

Disclosure Controls and Internal Controls over Financial Reporting

The Chief Executive Officer 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 Chief Executive Officer 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 March 31, 2016, Chief Executive Officer and Chief Financial Officer have concluded, based on their evaluation of the design and operating effectiveness of the Company's disclosure controls and procedures and internal controls over financial reporting ("ICFR") that disclosure controls and procedures and ICFR are effective.

Future Accounting Policies

On May 28, 2014, the IASB issued IFRS 15 "Revenue from Contracts with Customers", a new standard that specifies recognition requirements for revenue as well as requiring entities to provide the users of financial statements with more informative and relevant disclosures. The standard replaces IAS 11 "Construction Contracts" and IAS 18 "Revenue" as well as a number of revenue-related interpretations. The Company will adopt the standard for reporting periods beginning January 1, 2018. The Company is currently evaluating the impact of adoption of this standard and the effect on Cequence's consolidated financial statements has not yet been determined.

Since November 2009, the IASB has been in the process of completing a three phase project to replace IAS 39, "Financial Instruments: Recognition and Measurement" with IFRS 9 "Financial Instruments", which includes requirements for hedge accounting, accounting for financial assets and liabilities and impairment of financial instruments. As of February 2014, the mandatory effective date of IFRS 9 has been tentatively set to January 1, 2018. The Company is assessing the effect of this future pronouncement on its financial statements.

In January 2016, the IASB issued IFRS 16 "Leases". For lessees applying IFRS 16, a single recognition and measurements model for leases would apply, with required recognition of assets and liabilities for most leases. The standard will come into effect for annual periods beginning on or after January 1, 2019, with earlier adoption permitted if the entity is also applying IFRS 15 "Revenue from Contracts with Customers". The Company is currently evaluating the impact of adoption of this standard and the effect on Cequence's consolidated financial statements has not yet been determined.

Outlook Information

On May 10, 2016 the Company issued the following guidance:

(000's, except per share and per unit references)	2016 Guidance
Average production, BOE/d [1]	8,500
Funds flow from operations ($) [2] [4]	2,000
Funds flow from operations per share [2]	0.01
Capital expenditures, prior to dispositions ($)	14,000
Capital expenditures, net of dispositions ($)	7,000
Operating and transportation costs ($ per boe)	11.30
G&A costs ($) [4]	8,500
Royalties (% revenue)	6
Crude – WTI (US$/bbl)	43.00
Natural gas – AECO (CDN$/GJ)	1.90
Period end, net debt and working capital deficiency ($) [3]	70,000
Basic shares outstanding	211,000

(1) Average production estimates on a per BOE basis are comprised of 85% natural gas and 15% oil and natural gas liquids.
(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.
(3) 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 share based payment liability and provisions.
(4) Annual G&A costs include $2.0 million in restructuring charges.

Risk Assessment

The acquisition, exploration and development of oil and natural gas properties and the production, transportation and marketing of oil and natural gas involves many risks, which may influence the ultimate success of the Company. While the management of Cequence realizes these risks cannot be eliminated, they are committed to monitoring and mitigating these risks. These risk include, but are not limited to:

- Volatility in market prices and demand for oil, NGLs and natural gas and hedging activities related thereto;
- Variance of the Company's actual capital costs, operating costs and economic returns from those anticipated;
- the ability to find, develop or acquire additional reserves and the availability of the capital or financing necessary to do so on satisfactory terms;
- Risks related to the exploration, development and production of oil and natural gas reserves and resources;

- Negative public perception of oil sands development, oil and natural gas development and transportation, hydraulic fracturing and fossil fuels;
- Actions by governmental authorities, including changes in government regulation, royalties and taxation;
- The availability, cost or shortage of rigs, equipment, raw materials, supplies or qualified personnel;
- Dependence upon compressors, gathering lines, pipelines and other facilities, certain of which the Company does not control;
- The ability to satisfy obligations under the Company's firm commitment transportation arrangements;
- The possibility that the Company's drilling activities may encounter sour gas;
- Execution of the Company's business plan;
- The concentration of the Company's assets in the Simonette area;
- First Nations claims;
- Limited intellectual property protection for operating practices and dependence on employees and contractors;
- Environmental, health and safety requirements;
- Extensive competition in the Company's industry;
- Third party credit risk;
- Dependence upon a limited number of customers;
- Variations in foreign exchange rates and interest rates;
- Litigation; and
- General economic, business and industry conditions.

For additional information regarding the risks that the Company is exposed to, see the disclosure provided under the heading "Risk Factors" in the AIF, which is available on the SEDAR website at www.sedar.com.

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: projections with respect to natural gas production; the projection of future royalty, operating, transportation and G&A expenses; the projected impact of land access and regulatory issues; projections relating to the volatility of crude oil and natural gas prices in 2016 and beyond ; the Company's projected capital investment levels for 2016 and the source of funding therefore; the effect of the Company's risk management program, including the impact of derivative financial instruments; 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 2016 capital program. The material assumptions supporting the 2016 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.

CONDENSED CONSOLIDATED BALANCE SHEETS

(Expressed in thousands of Canadian dollars)

	March 31, 2016	December 31, 2015
	$	$
	(Unaudited)	(Audited)
ASSETS		
CURRENT		
Cash	5,709	13,246
Accounts receivable	16,063	22,321
Deposits and prepaid expenses	1,574	1,669
Commodity contracts (Note 10)	6,834	3,644
	30,180	40,880
Property and equipment (Note 3)	369,549	368,679
	399,729	409,559
LIABILITIES		
CURRENT		
Demand credit facilities (Note 4)	–	–
Accounts payable and accrued liabilities	36,287	41,688
Share based payment liability (Note 8)	212	169
Provisions (Note 7)	521	826
	37,020	42,683
Senior notes (Note 5)	58,018	57,849
Provisions (Note 7)	41,188	39,882
	136,226	140,414
SHAREHOLDERS' EQUITY		
Share capital	624,619	624,619
Warrants	1,300	1,300
Contributed surplus	29,623	29,377
Deficit	(392,039)	(386,151)
	263,503	269,145
	399,729	409,559

APPROVED BY THE BOARD

[signed] "Donald Archibald"
Donald Archibald, Director

[signed] "Brian Felesky"
Brian Felesky, Director

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS

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

	Three months ended March 31, 2016	2015
	$	$
REVENUE		
Production revenue	12,241	18,917
Gain on derivative financial instruments (Note 10)	6,156	1,019
	18,397	19,936
EXPENSES		
Depletion and depreciation (Note 3)	8,097	11,959
General and administrative	3,748	1,987
Finance costs (Note 6)	1,948	1,971
Operating costs	9,212	7,811
Share based payment (Note 8)	289	378
Transportation	1,092	1,903
Other income	(101)	(106)
	24,285	25,903
LOSS BEFORE INCOME TAXES	(5,888)	(5,967)
INCOME TAXES	–	(1,305)
NET LOSS AND COMPREHENSIVE LOSS	(5,888)	(4,662)
Loss per share (Note 9)		
Basic and diluted	($0.03)	($0.02)

CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

(Unaudited)(Expressed in thousands of Canadian dollars)

	Three months ended March 31,	
	2016	2015
	$	$
SHARE CAPITAL		
Common Shares		
Balance, beginning of period	**624,619**	624,619
Balance, end of period	**624,619**	624,619
Warrants		
Balance, beginning of period	**1,300**	1,300
Balance, end of period	**1,300**	1,300
CONTRIBUTED SURPLUS		
Balance, beginning of period	**29,377**	28,270
Share based payment expense (Note 8)	**246**	304
Balance, end of period	**29,623**	28,574
DEFICIT		
Balance, beginning of period	**(386,151)**	(136,079)
Comprehensive loss	**(5,888)**	(4,662)
Balance, end of period	**(392,039)**	(140,741)
TOTAL EQUITY	**263,503**	513,752

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)(Expressed in thousands of Canadian dollars)

	Three months ended March 31,	
	2016	2015
	$	$
CASH FLOWS RELATED TO THE FOLLOWING ACTIVITIES:		
OPERATING		
Net loss	(5,888)	(4,662)
Adjustments for non-cash items:		
Depletion and depreciation expense (Note 3)	8,097	11,959
Finance costs related to provisions (Note 6)	209	207
Share based payment expense (Note 8)	289	378
Amortization of transaction costs on senior notes (Note 6)	95	86
Accretion on senior notes (Note 6)	74	66
Unrealized (gain) loss on derivative financial instruments (Note 10)	(3,190)	1,634
Costs related to onerous contracts	–	(80)
Deferred income tax recovery	–	(1,305)
Decommissioning liabilities expenditures (Note 7)	(1,024)	(305)
Net change in non-cash working capital (Note 11)	6,231	151
	4,893	8,129
INVESTING		
Property and equipment expenditures (Note 3)	(7,362)	(22,582)
Property acquisitions	–	(13)
Proceeds from sale of property and equipment (Note 3)	211	2,948
Net change in non-cash working capital (Note 11)	(5,210)	(14,225)
	(12,361)	(33,872)
FINANCING		
Net change in non-cash working capital (Note 11)	(69)	(118)
	(69)	(118)
NET DECREASE IN CASH	(7,537)	(25,861)
CASH, BEGINNING OF PERIOD	13,246	27,679
CASH, END OF PERIOD	5,709	1,818
SUPPLEMENTARY INFORMATION		
Income taxes paid	–	–
Interest paid	1,638	1,730

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Three months ended March 31, 2016 and 2015
(Unaudited) (All figures expressed in thousands except per share amounts unless otherwise noted)

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 interim condensed 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 Accounting Standard ("IAS") 34, "Interim Financial Reporting", as issued by the International Accounting Standards Board ("IASB"). Accordingly, certain information or footnote disclosure normally included in the annual consolidated financial statements prepared in accordance with International Financial Reporting Standards ("IFRS") have been condensed or omitted.

These consolidated financial statements should be read in conjunction with the Company's consolidated financial statements for the year ended December 31, 2015.

The consolidated financial statements were authorized for issue by the Company's Board of Directors on May 10, 2016.

BASIS OF PRESENTATION

The consolidated financial statements have been prepared using the same accounting policies and methods as those used in the consolidated financial statements for the year ended December 31, 2015. The consolidated financial statements have been presented in Canadian dollars, which is also the Company's functional currency, rounded to the nearest thousand, unless otherwise indicated.

3. Property and Equipment

Cost:	
Balance at December 31, 2014	883,838
Additions	62,261
Decommissioning obligation additions and change in estimates	6,595
Acquisitions	1,062
Disposals	(47,211)
Balance at December 31, 2015	906,545
Additions	**7,362**
Decommissioning obligation additions and change in estimates	**1,816**
Disposals	**(211)**
Balance at March 31, 2016	**915,512**
Depletion, depreciation and impairment:	
Balance at December 31, 2014	(272,978)
Depletion and depreciation	(39,191)
Impairment loss	(230,400)
Disposals	4,703
Balance at December 31, 2015	(537,866)
Depletion and depreciation	**(8,097)**
Balance at March 31, 2016	**(545,963)**
Carrying amounts:	
At December 31, 2015	368,679
At March 31, 2016	**369,549**

Costs subject to depletion include $798,969 of estimated future capital costs (December 31, 2015 – $799,624).

The Company's credit facilities are secured by a demand debenture with a first floating charge over all assets of the Company (see note 4).

4. Demand Credit Facilities

The Company has credit facilities totalling $60,000 (December 31, 2015 – $60,000) with a syndicate of Canadian chartered banks. Credit facility A is a $50,000 (December 31, 2015 – $50,000) 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, 2015 – $10,000) operating facility by way of prime loans, U.S. Base Rate Loans, Banker's Acceptances and letters of credit. As at March 31, 2016, the Company has drawn $nil under the extendible revolving term credit facility and $nil under the operating facility (December 31, 2015 – $nil and $nil for the revolving and operating facilities, respectively). The company has letters of credit outstanding of $3,207 (December 31, 2015 – $3,207). 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 than 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 March 31, 2016 and December 31, 2015. The next scheduled review is to take place in May 2016.

5. Senior Notes

	March 31, 2016	December 31, 2015
Senior notes	56,503	56,503
Add transaction costs	1,515	1,346
Total senior notes	58,018	57,849

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 costs of $57,974. The senior notes have a term of five years, 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.

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 March 31, 2016 and December 31, 2015.

6. Finance Costs

	Three months ended March 31,	
	2016	2015
Interest expense on demand credit facilities	122	177
Interest expense on senior notes	1,448	1,435
Amortization of transaction costs	95	86
Accretion expense on senior notes	74	66
Accretion expense on provisions	209	207
Total finance costs	1,948	1,971

7. Provisions

DECOMMISSIONING LIABILITIES

The following table summarizes the changes in decommissioning liabilities for the three months ended March 31, 2016 and year ended December 31, 2015:

	2016	2015
Balance, beginning of period	40,708	37,263
Property dispositions	–	(3,283)
Accretion expense	209	853
Liabilities incurred	–	1,819
Abandonment costs incurred	(1,024)	(720)
Revisions in estimated cash flows	375	3,195
Revisions due to change in discount rates	1,441	1,581
Balance, end of period	41,709	40,708
Current	521	826
Non-current	41,188	39,882
	41,709	40,708

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 $67,994 (December 31, 2015 – $69,020). These cash flows have been discounted using a risk-free interest rate of 2.00 percent (December 31, 2015 – 2.16 percent) based on Government of Canada long-term benchmark bonds. The Company expects these obligations to be settled in approximately 1 to 50 years (December 31, 2015 – 1 to 50 years). As at March 31, 2016, no funds have been set aside to settle these liabilities.

8. Share Based Payment Plans

The Company has a stock option and RSU plan for directors, officers, employees and consultants of the Company and its subsidiaries. During the three months ended March 31, 2016, Cequence recognized share based payment expense on equity-settled stock options of $246 (2015 – $304) and RSUs of $43 (2015 – $74).

A summary of the status of the Company's stock option and RSU plans during the three months ended March 31, 2016 and year ended December 31, 2015 is as follows:

Number of Options (000's)	2016	2015
Outstanding, beginning of period	11,395	18,252
Granted	–	1,085
Forfeited	(445)	(12)
Expired	(10)	(7,930)
Outstanding, end of period	10,940	11,395

Number of RSUs (000's)	2016	2015
Outstanding, beginning of period	1,707	814
Granted	–	1,235
Forfeited	(250)	(17)
Exercised	–	(325)
Outstanding, end of period	1,457	1,707

9. Loss Per Share

Loss per share has been calculated based on the weighted average number of common shares outstanding during the period. For the three months ended March 31, 2016 and 2015, the Company has excluded all dilutive instruments as their inclusion would be anti-dilutive. The following table reconciles the denominators used for the basic and diluted loss per share calculations:

	Three months ended March 31,	
	2016	2015
Basic weighted average shares	211,028	211,028
Effect of dilutive instruments	–	–
Diluted weighted average shares	211,028	211,028

10. Risk Management

There have been no changes to the Company's exposure to risks, or the objectives, policies and processes to manage these risks from December 31, 2015.

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).

The following information presents all outstanding positions for commodity derivative financial instruments at March 31, 2016:

Term	Product	Type	Volume	Price	Basis
April 1, 2016 to September 30, 2016	Gas	Swap	20,000 gj/day	$2.64	AECO
October 1, 2016 to December 31, 2016	Gas	Swap	18,342 gj/day	$2.67	AECO
January 1, 2017 to March 31, 2017	Gas	Swap	2,500 gj/day	$2.49	AECO
April 1, 2016 to December 31, 2016	Oil	Swap	400 bbl/day	$65.35	WTI

For the three months ended March 31, 2016, realized gain from commodity derivative contracts recognized in comprehensive loss were $2,966 (2015 – $2,653 gain).

The fair value of the commodity contracts outstanding at March 31, 2016 was a current asset of $6,834 (December 31, 2015 – current asset $3,644).

For the three months ended March 31, 2016, the Company recorded an unrealized gain of $3,190 from derivative commodity contracts (2015 – $1,634 unrealized loss).

As at March 31, 2016, an increase in gas price of $0.50/gj and oil price of $1.00/bbl results in a decrease in the fair value of the commodity contracts of $2,899 ($2,116 after tax) and $110 ($80 after tax) respectively and a commensurate increase to comprehensive loss.

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 cash, accounts receivable and commodity contract assets.

The Company's cash held with a large established financial institution. 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 March 31, 2016, the accounts receivable balance was $16,063 of which $1,479 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
12,047	1,357	1,180	1,479	16,063

At March 31, 2016, the Company has an allowance for doubtful accounts of $710 (December 31, 2015 – $682).

11. Changes In Non-Cash Working Capital

	Three months ended March 31, 2016	2015
Accounts receivable	6,258	(951)
Deposits and prepaid expenses	95	(136)
Accounts payable and accrued liabilities	(5,401)	(13,105)
Net change in non-cash working capital	952	(14,192)
Allocated to:		
Operating activities	6,231	151
Investing activities	(5,210)	(14,225)
Financing activities	(69)	(118)
	952	(14,192)

12. Capital Management

There have been no changes to the Company's objectives, policies and processes to manage capital from December 31, 2015.

At March 31, 2016, Cequence has $60,000 in senior notes due in 2018 and a $60,000 senior credit facility which is undrawn. The Company's senior credit facility is based on the lenders' semi-annual review of the Company's oil and natural gas reserves with the next review expected to be completed in May 2016.

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 than 4:0 to 1:0 and 3:0 to 1:0, respectively. The Company was in compliance with the lender's covenants at March 31, 2016 with ratios of 2.66 and 0.1 times (December 31, 2015 – 1.95 and 0 times), respectively. If low commodity prices persist, Cequence may exceed these ratios in 2016 as future cash flows are negatively impacted by low crude oil and natural gas prices. At March 31, 2016 the Company had not borrowed under the facility and based on the expected borrowing amount relative to the size of the approved facility, the Company currently expects to obtain covenant relief at its upcoming bank review which may result in higher lending fees.

The senior notes contain incurrence covenants that use a Debt to Cashflow test that is in excess of 2.5 times for the preceding four quarters to limit 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. At March 31, 2016 the Company's Debt to Cashflow ratio was 3.5 times. If low commodity prices persist, the Company expects the Debt to Cashflow ratio to remain in excess of 2.5 times. The Company does not currently anticipate initiating an action that would be restricted by the incurrence covenants. Further, the Company can default under the senior notes if the Company defaults any other indebtedness with an outstanding principal greater than $10,000, unless the default has been waived or remedied.

The Company believes that it has the ability to manage its cash flow and net capital expenditures in 2016 to avoid potential default. These options include the ability to initiate the sale of assets, further adjustments to the capital program, monetization of commodity contracts or the issuance of equity.

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Vice President, Engineering

David P. Robinson
Vice President, Geology

Christopher C. Soby
Vice President, Land

Erin Thorson, CMA
Controller

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