# 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"

Todd Brown
Chief Executive Officer

"signed"

Dave Gillis
Executive Vice President, Finance
and Chief Financial Officer

March 13, 2017

# INDEPENDENT AUDITOR'S REPORT

## TO THE SHAREHOLDERS OF CEQUENCE ENERGY LTD.

We have audited the accompanying consolidated financial statements of Cequence Energy Ltd., which comprise the consolidated balance sheets as at December 31, 2016 and 2015, 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 CONSOLIDATED FINANCIAL STATEMENTS

Management is responsible for the preparation and fair presentation of these 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 audits 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, 2016 and December 31, 2015, and their financial performance and their cash flows for the years then ended in accordance with International Financial Reporting Standards.

/s/ Deloitte LLP

Chartered Professional Accountants
March 13, 2017
Calgary, Alberta

# CONSOLIDATED BALANCE SHEETS

(Expressed in thousands of Canadian dollars)

| | December 31, 2016 | December 31, 2015 |
|---|---|---|
| | $ | $ |
| **ASSETS** | | |
| CURRENT | | |
| Cash | **17,778** | 13,246 |
| Accounts receivable (Note 7) | **14,145** | 22,321 |
| Deposits and prepaid expenses | **877** | 1,669 |
| Commodity contracts (Note 19) | **–** | 3,644 |
| | **32,800** | 40,880 |
| Property and equipment (Note 4) | **356,058** | 368,679 |
| | **388,858** | 409,559 |
| **LIABILITIES** | | |
| CURRENT | | |
| Accounts payable and accrued liabilities (Note 8) | **36,124** | 41,688 |
| Share based payment liability (Note 16) | **341** | 169 |
| Provisions (Note 13) | **366** | 826 |
| Commodity contracts (Note 19) | **4,491** | – |
| | **41,322** | 42,683 |
| Commodity contracts (Note 19) | **159** | – |
| Senior notes (Note 6) | **58,557** | 57,849 |
| Provisions (Note 13) | **37,795** | 39,882 |
| | **137,833** | 140,414 |
| COMMITMENTS (Note 18) | | |
| **SHAREHOLDERS' EQUITY** | | |
| Share capital (Note 15) | **633,848** | 624,619 |
| Warrants (Note 15) | **1,300** | 1,300 |
| Contributed surplus | **30,085** | 29,377 |
| Deficit | **(414,208)** | (386,151) |
| | **251,025** | 269,145 |
| | **388,858** | 409,559 |

**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, 2016 | 2015 |
|---|---|---|
| | $ | $ |
| **REVENUE** | | |
| Production revenue (Note 9) | **50,726** | 68,596 |
| Gain (loss) on derivative financial instruments (Note 19) | **(1,489)** | 4,854 |
| | **49,237** | 73,450 |
| **EXPENSES** | | |
| Depletion and depreciation (Note 4) | **31,662** | 39,191 |
| Impairment (Note 4) | **–** | 230,400 |
| General and administrative (Note 12) | **8,951** | 7,959 |
| Finance costs (Note 11) | **7,743** | 8,276 |
| Operating costs | **27,436** | 31,746 |
| Share based payment (Note 16) | **1,082** | 1,207 |
| Transportation | **4,018** | 6,323 |
| Other income (Note 10) | **(3,558)** | (6,128) |
| | **77,294** | 318,974 |
| LOSS BEFORE INCOME TAXES | **(28,057)** | (245,524) |
| INCOME TAXES (Note 14) | **–** | 4,548 |
| **NET LOSS AND COMPREHENSIVE LOSS** | **(28,057)** | (250,072) |
| Loss per share (Note 17) | | |
| Basic and diluted | **($0.13)** | ($1.19) |

# CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

(Expressed in thousands of Canadian dollars)

| | Year ended December 31, | |
|---|---|---|
| | **2016** | 2015 |
| | **$** | $ |
| **SHARE CAPITAL** | | |
| **Common Shares** (Note 15) | | |
| Balance, beginning of year | **624,619** | 624,619 |
| Proceeds on issuance of flow-through shares | **10,005** | – |
| Share issue costs | **(776)** | – |
| Balance, end of year | **633,848** | 624,619 |
| **Warrants** (Note 15) | | |
| Balance, beginning of year | **1,300** | 1,300 |
| Balance, end of year | **1,300** | 1,300 |
| **CONTRIBUTED SURPLUS** | | |
| Balance, beginning of year | **29,337** | 28,270 |
| Share based payment expense (Note 16) | **708** | 1,107 |
| Balance, end of year | **30,085** | 29,377 |
| **DEFICIT** | | |
| Balance, beginning of year | **(386,151)** | (136,079) |
| Comprehensive loss | **(28,057)** | (250,072) |
| Balance, end of year | **(414,208)** | (386,151) |
| **TOTAL EQUITY** | **251,025** | 269,145 |

# CONSOLIDATED STATEMENTS OF CASH FLOWS

(Expressed in thousands of Canadian dollars)

| | Year ended December 31, 2016 | 2015 |
|---|---|---|
| | **$** | $ |
| **CASH FLOWS RELATED TO THE FOLLOWING ACTIVITIES:** | | |
| **OPERATING** | | |
| Net loss | **(28,057)** | (250,072) |
| Adjustments for non-cash items: | | |
| Depletion and depreciation expense | **31,622** | 39,191 |
| Impairment expense | **–** | 230,400 |
| Finance costs related to provisions (Note 11) | **803** | 853 |
| Share based payment expense (Note 16) | **1,082** | 1,207 |
| Amortization of transaction costs on senior notes (Note 11) | **399** | 360 |
| Accretion on senior notes (Note 11) | **309** | 277 |
| Unrealized loss on derivative financial instruments (Note 19) | **8,294** | 4,541 |
| Costs related to onerous contracts | **–** | (190) |
| Gain on sale of property and equipment (Note 10) | **(3,202)** | (5,537) |
| Deferred income tax expense (Note 14) | **–** | 4,548 |
| Decommissioning liabilities expenditures (Note 13) | **(1,852)** | (720) |
| Net change in non-cash working capital (Note 20) | **2,243** | 7,026 |
| | **11,641** | 31,884 |
| **INVESTING** | | |
| Property and equipment expenditures (Note 4) | **(22,590)** | (62,261) |
| Property acquisitions (Note 4) | **60** | (1,062) |
| Proceeds from sale of property and equipment (Note 4) | **5,234** | 44,763 |
| Net change in non-cash working capital (Note 20) | **1,268** | (27,522) |
| | **(16,028)** | (46,082) |
| **FINANCING** | | |
| Proceeds from demand credit facilities (Note 5) | **6,200** | – |
| Repayment of demand credit facilities (Note 5) | **(6,200)** | – |
| Cash settlement of share based payments (Note 16) | **(203)** | (107) |
| Issue of common shares (Note 15) | **10,005** | – |
| Share issue costs (Note 15) | **(776)** | – |
| Net change in non-cash working capital (Note 20) | **(107)** | (128) |
| | **8,919** | (235) |
| **NET INCREASE (DECREASE) IN CASH** | **4,532** | (14,433) |
| **CASH, BEGINNING OF YEAR** | **13,246** | 27,679 |
| **CASH, END OF YEAR** | **17,778** | 13,246 |
| **SUPPLEMENTARY INFORMATION** | | |
| Income taxes paid | **–** | – |
| Interest paid | **6,342** | 6,606 |

## 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 1400, 215 – 9th Avenue. SW, Calgary, Alberta, T2P 1K3.

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 13, 2017.

### 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 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 loss. Results of subsidiaries are included in the consolidated statement of comprehensive 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 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 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 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 loss. The issue costs are amortized to comprehensive 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 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 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 loss. Changes in the carrying amount of the allowance accounts are recognized in comprehensive 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 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.

### *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)".

### *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 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 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.

### *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 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.

## 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 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, RSUs 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 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 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

Note 13: Provisions

Note 16: Share based payment plans

Note 18: Commitments

Note 19: 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.

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

In April 2016, the IASB issued its final amendments to IFRS 15 "Revenue from Contracts with Customers", which replaces IAS 18 "Revenue", IAS 11 "Construction Contracts", and related interpretations. IFRS 15 provides a single, principles-based five-step model to be applied to all contracts with customers. The standard requires an entity to recognize revenue to reflect the transfer of goods and services for the amount it expects to receive, when control is transferred to the purchaser. Disclosure requirements have also been expanded. The standard is required to be adopted either retrospectively or using a modified retrospective approach for annual periods beginning on or after January 1, 2018, with earlier adoption permitted. IFRS 15 will be applied by Cequence on 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 consolidated 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.

## 4. 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 | 22,590 |
| Decommissioning obligation additions and change in estimates | (1,134) |
| Acquisitions | (60) |
| Disposals | (2,847) |
| Balance at December 31, 2016 | **925,094** |
| **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 | (31,622) |
| Disposals | 452 |
| Balance at December 31, 2016 | **(569,036)** |
| **Carrying amounts:** | |
| At December 31, 2015 | 368,679 |
| At December 31, 2016 | **356,058** |

Costs subject to depletion include $921,573 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 5).

### Sale of assets

On June 17, 2015, Cequence sold a 50% interest in its existing Simonette facilities and related infrastructure for total cash consideration of approximately $41,827, including estimated purchase price adjustments. The sale resulted in a gain recognized in comprehensive loss of $5,083.

On August 11, 2016, the Company disposed of certain pipeline and facilities at Simonette for proceeds of $5,074 prior to closing adjustments. The sale resulted in a gain recognized in comprehensive loss of $2,964.

During the year ended December 31, 2016, the Company completed additional sales of certain oil and gas properties for total cash consideration of $160 (2015 - $2,936), subject to final adjustments. The sales resulted in a gain recognized in comprehensive loss of $238 (2015 - $454 gain).

### Impairment

At December 31, 2016, Cequence evaluated its development and production assets for indicators of any potential impairment or related reversal. As a result of this assessment, no indicators were identified and no impairment or related reversal was recorded on Cequence's development and production assets for the year ended December 31, 2016.

The Company reviewed each CGU comprising its property and equipment at December 31, 2015 for indicators of impairment and determined that indicators were present in all CGUs, related to decreases to future commodity prices used to estimate the value in use and fair value less cost to sell of each of the Company's CGUs.

Impairment tests were carried out at December 31, 2015 and the recoverable amounts of each of the Company's CGUs at December 31, 2015 were estimated as their value in use, based on the pre-tax net present value of discounted future cash flows from oil and gas reserves as estimated by the Company's independent reserves evaluator. The Company also included the fair value of undeveloped land based on an internal evaluation. Land values are determined using relevant precedent market transactions, industry conventions by CGU and consideration of the remaining tenure of the land. Consideration was also given to acquisition metrics of recent transactions completed on similar assets to those contained within the relevant CGU.

The benchmark escalated prices on which the December 31, 2015 impairment tests are based are as follows:

| | Natural Gas | Condensate | Crude Oil |
|---|---|---|---|
| | AECO Spot (CDN$/mmbtu) | Edmonton Pentanes Plus (CDN$/bbl) | Edmonton Par (CDN$/bbl) |
| 2016 | 2.76 | 60.79 | 55.86 |
| 2017 | 3.27 | 68.48 | 64.00 |
| 2018 | 3.45 | 73.17 | 68.39 |
| 2019 | 3.63 | 78.91 | 73.75 |
| 2020 | 3.81 | 84.30 | 78.79 |
| 2021 | 3.90 | 88.12 | 82.35 |
| 2022 | 4.10 | 94.41 | 88.24 |
| 2023 | 4.30 | 100.71 | 94.12 |
| 2024 | 4.50 | 103.24 | 96.48 |
| 2025 | 4.60 | 105.30 | 98.41 |
| 2026+ | +2%/yr | +2%/yr | +2%/yr |

(1) Source: GLJ Petroleum Consultants, January 1, 2016.

(2) The forecast benchmark prices listed above are adjusted for quality differentials, heat content and distance to market in performing the Company's impairment tests.

Prices increase at a rate of approximately 2.0 percent per year for natural gas, condensate and crude oil after 2025. Adjustments were made to the benchmark prices, for purposes of the impairment tests, to reflect varied delivery points and quality differentials in the products delivered.

The Company used a pre-tax 15% discount rate for the December 31, 2015 impairment tests based on the approximate industry average peer group weighted average cost of capital as appropriate for each CGU and the current market assessment of the time value of money.

The estimated recoverable amounts used in the December 31, 2015 impairment tests were $13,016 for the Northeast British Columbia CGU, $7,203 for the Peace River Arch CGU and $349,323 for the Deep Basin CGU.

The result of the Company's impairment test for the year ended December 31, 2015 is as follows:

| | 2015 |
|---|---|
| Northeast British Columbia | 10,000 |
| Peace River Arch | 7,500 |
| Deep Basin | 212,900 |
| Total | 230,400 |

As at December 31, 2015, a one percent increase in the discount rate applied to the Company's future estimated cash flows would result in an additional impairment of $25,900 whereas a ten percent decrease in forward commodity prices would result in additional impairment of $120,000 recognized in comprehensive loss for the year ended December 31, 2015.

## 5. DEMAND CREDIT FACILITIES

As at December 31, 2016, the Company has an extendible revolving term credit facility ("senior credit facility") of $20,000 (December 31, 2015 - $60,000) with a syndicate of Canadian chartered banks and has drawn $nil (December 31, 2015 - $nil) under the facility. The company has letters of credit outstanding of $3,307 (December 31, 2015 - $3,207). The senior credit facility has a term date of May 31, 2017 and may be extended beyond the initial term, if requested by the Company and accepted by the lenders. If the senior credit facility does not continue to revolve, amounts borrowed under the facility must be repaid on the term date. The credit facility is 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. The senior credit facility is reviewed on a semi-annual basis with the lender holding the right to request an additional review. The Company has a covenant that requires Senior Debt to EBITDA, as defined in the bank agreement, to be less than 3:0 to 1:0. Senior Debt is defined as the sum of Consolidated Debt less the period end balance of the senior notes. Consolidated Debt is defined as the sum of the Company's period end balance of the senior credit facility and senior notes. The Company was in compliance with the lender's covenants at December 31, 2016 and December 31, 2015. The effective annualized interest rate, including standby fees and commitment fees, for the year ended December 31, 2016 was nil percent as the credit facility was undrawn for the majority of the year (2015 – nil percent). The next scheduled review is to take place in May 2017.

In June 2016, the Company's senior credit facility was reduced to $20,000 from $60,000 and the Consolidated Debt to earnings before interest, taxes and depletion and depreciation covenant was removed. In addition, the interest rates and sliding scale on the facility were revised. Prime loans and U.S. Base Rate Loans on the facility now bear interest at the bank prime rate or U.S. Base Rate, respectively, plus 1.0 percent to 3.5 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 3.5:1.0). Banker's Acceptances, Libor Loans and letters of credit on the facility now bear interest at the Banker's Acceptance rate, Libor rate or letter of credit rate, as applicable, plus 2.0 percent to 4.5 percent based on the same sliding scale as above.

## 6. SENIOR NOTES

| | December 31, 2016 | December 31, 2015 |
|---|---|---|
| Senior notes | **56,503** | 56,503 |
| Add transaction costs | **2,054** | 1,346 |
| Total senior notes | **58,557** | 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 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 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 (see note 21). The Company was in compliance with the senior notes covenants at December 31, 2016 and December 31, 2015.

At any time prior to the maturity of October 3, 2018, the Company has the 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 had the option to 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 December 31, 2015 and 2016 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, 2016 | December 31, 2015 |
|---|---|---|
| **Debt component** | | |
| Beginning balance | **57,849** | 57,212 |
| Amortization of transaction costs | **400** | 360 |
| Accretion | **308** | 277 |
| Total debt component | **58,557** | 57,849 |
| **Equity component** | | |
| Warrant issuance, net of allocated transaction costs and deferred tax | **1,300** | 1,300 |
| Total equity component | **1,300** | 1,300 |

## 7. ACCOUNTS RECEIVABLE

| | December 31, 2016 | December 31, 2015 |
|---|---|---|
| Trade receivables | **5,826** | 11,753 |
| Allowance for doubtful accounts | **(647)** | (682) |
| Net trade receivables | **5,179** | 11,071 |
| Accrued receivables | **8,533** | 9,709 |
| Other receivables | **433** | 1,541 |
| Total accounts receivable | **14,145** | 22,321 |

## 8. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

| | December 31, 2016 | December 31, 2015 |
|---|---|---|
| Accounts payable | **12,736** | 12,630 |
| Accrued liabilities | **23,388** | 29,058 |
| Total accounts payable and accrued liabilities | **36,124** | 41,688 |

## 9. PRODUCTION REVENUE

| | Year ended December 31, | |
|---|---|---|
| | 2016 | 2015 |
| Sales of oil and natural gas | **52,269** | 71,496 |
| Royalties | **(1,543)** | (2,900) |
| Total production revenue | **50,726** | 68,596 |

## 10. OTHER INCOME

| | Year ended December 31, | |
|---|---|---|
| | 2016 | 2015 |
| Gain on sale of property and equipment (Note 4) | **(3,202)** | (5,537) |
| Interest income | **(115)** | (357) |
| Other | **(241)** | (234) |
| Total other income | **(3,558)** | (6,128) |

## 11. FINANCE COSTS

| | Year ended December 31, 2016 | 2015 |
|---|---|---|
| Interest expense on demand credit facilities | **411** | 966 |
| Interest expense on senior notes | **5,821** | 5,820 |
| Amortization of transaction costs | **400** | 360 |
| Accretion expense on senior notes | **308** | 277 |
| Accretion expense on provisions | **803** | 853 |
| Total finance costs | **7,743** | 8,276 |

## 12. COMPENSATION COSTS AND KEY MANAGEMENT PERSONNEL EXPENSES

Total wages, salaries, benefits, severances, and other personnel costs included in comprehensive loss for the year ended December 31, 2016 were $5,880 (2015 - $4,498).

The aggregate expense of key management personnel, defined as the Company's Chief Executive Officer, Executive Vice President, Finance and Chief Financial Officer and the Company's Board of Directors, was as follows:

| | Year ended December 31, 2016 | 2015 |
|---|---|---|
| Wages, salaries, benefits and other personnel costs(i) | **1,641** | 1,272 |
| Share based payments(ii) | **676** | 292 |
| Total remuneration | **2,317** | 1,564 |

(i) Wages, salaries, benefits and other personnel costs includes $770 of severance to the former Chief Executive Officer.

(ii) 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 16).

## 13. PROVISIONS

### Decommissioning liabilities

The following table summarizes the changes in decommissioning liabilities for the years ended December 31, 2016 and 2015:

| | 2016 | 2015 |
|---|---|---|
| Balance, beginning of year | **40,708** | 37,263 |
| Property dispositions (Note 4) | **(364)** | (3,283) |
| Accretion expense | **803** | 853 |
| Liabilities incurred | **286** | 1,819 |
| Abandonment costs incurred | **(1,852)** | (720) |
| Revisions in estimated cash flows | **(126)** | 3,195 |
| Revisions due to change in discount rates | **(1,294)** | 1,581 |
| Balance, end of year | **38,161** | 40,708 |
| | | |
| Current | **366** | 826 |
| Non-current | **37,795** | 39,882 |
| | **38,161** | 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 $66,240 (December 31, 2015 - $69,020). These cash flows have been discounted using a risk-free interest rate of 2.34 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 December 31, 2016, no funds have been set aside to settle these liabilities.

## 14. INCOME TAXES

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

| | **December 31, 2016** | December 31, 2015 |
|---|---|---|
| Excess of net book value of assets and liabilities over related tax pools | **(89,894)** | (76,256) |
| Non-capital loss carry-forwards | **80,456** | 66,693 |
| Scientific research and development expenses and investment tax credits | **9,056** | 9,056 |
| Other tax assets | **382** | 507 |
| Total net deferred income tax asset | **–** | – |

At December 31, 2016, Cequence has total tax pools of $613,777 (2015 - $616,084) 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. The ongoing period of low commodity prices has created uncertainty regarding the future realization of the Company's deferred tax assets. As a result, a deferred income tax asset of $82,398 has not been recognized (2015 – $77,994). The Scientific Research and Development expenses of approximately $22,704 available for carry-forward do not expire (2015 - $22,704). The non-capital loss carry-forwards expire in 10 to 20 years and the investment tax credit carry-forwards expire in 4 to 8 years.

Income tax expense differs from that which would be expected from applying the effective Canadian federal and provincial tax rates of 27 percent (2015 – 26 percent) to loss before income taxes as follows:

| | Year ended December 31, | |
|---|---|---|
| | **2016** | 2015 |
| Expected income tax recovery | **(7,575)** | (63,836) |
| Effect of share based payments | **292** | 314 |
| Change in previously estimated tax pools | **565** | (188) |
| Change in effective tax rate applied | **–** | (2,559) |
| Change in unrecorded deferred income tax asset | **6,699** | 70,537 |
| Other | **19** | 280 |
| Deferred income tax expense | **–** | 4,548 |
| Current income tax | **–** | – |
| Income tax expense | **–** | 4,548 |

Movements in deferred income tax balances are as follows:

| | Balance December 31, 2015 | Recognized in comprehensive loss | Recognized in liabilities | Recognized in equity | **Balance December 31, 2016** |
|---|---|---|---|---|---|
| Property and equipment and provisions | (75,040) | **(15,919)** | **–** | **–** | **(90,959)** |
| Unrealized (gain) loss on financial instruments | (984) | **2,239** | **–** | **–** | **1,255** |
| Senior notes | (233) | **43** | **–** | **–** | **(190)** |
| Non-capital losses | 66,693 | **13,763** | **–** | **–** | **80,456** |
| SRED expenses and investment tax credits | 9,056 | **–** | **–** | **–** | **9,056** |
| Other | 508 | **(126)** | **–** | **–** | **382** |
| Total | – | **–** | **–** | **–** | **–** |

| | Balance December 31, 2014 | Recognized in comprehensive loss | Recognized in liabilities | Recognized in equity | Balance December 31, 2015 |
|---|---|---|---|---|---|
| Property and equipment and provisions | (46,232) | (28,808) | - | - | (75,040) |
| Unrealized (gain) loss on financial instruments | (2,046) | 1,062 | - | - | (984) |
| Senior notes | (249) | 16 | - | - | (233) |
| Non-capital losses | 43,791 | 22,902 | - | - | 66,693 |
| SRED expenses and investment tax credits | 8,602 | 454 | - | - | 9,056 |
| Other | 682 | (174) | - | - | 508 |
| Total | 4,548 | (4,548) | - | - | – |

## 15. 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, 2016** | | Year ended December 31, 2015 | |
|---|---|---|---|---|
| **Issued common voting shares** | **Number** | **Stated Value** | Number | Stated Value |
| | **(000's)** | **$** | (000's) | $ |
| Balance, beginning of year | **211,028** | **624,619** | 211,028 | 624,619 |
| Flow-through common shares | **34,500** | **10,005** | – | – |
| | **245,528** | **634,624** | 211,028 | 624,619 |
| Share issue costs | **–** | **(776)** | – | – |
| Balance, end of year | **245,528** | **633,848** | 211,028 | 624,619 |
| **Warrants** | | | | |
| Balance, beginning of year | **3,000** | **1,300** | 3,000 | 1,300 |
| Balance, end of year | **3,000** | **1,300** | 3,000 | 1,300 |

On October 28, 2016, the Company completed the sale, on a private placement basis, of 34,500 common voting shares on a Canadian development expenses ("CDE") "flow-through" basis at $0.29 per share for gross proceeds of $10,005. An obligation related to flow-through shares has not been recorded as the flow-through shares were not issued at a premium to the fair value of the Company's common shares. In accordance with the terms of the agreement and pursuant to certain provisions of the Income Tax Act (Canada), the Company is required to renounce to the holders of the flow-through common shares, for income tax purposes, development expenditures of $8,500 and $1,505 effective December 31, 2016 and 2017, respectively. As at December 31, 2016, the Company has incurred $8,500 of development expenditures that were renounced to the holders of the flow-through common shares effective December 31, 2016.

## 16. 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, 2016, the Company issued 6,295 stock options (2015 - 1,085) at an exercise price of $0.33 (2015 - $0.81) to employees, officers 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:

| | **2016** | 2015 |
|---|---|---|
| Risk-free interest rate | **0.60%** | 1.0% |
| Expected life of options | **5 years** | 5 years |
| Expected volatility | **60%** | 55% |
| Expected dividend rate | **0%** | 0% |
| Expected forfeiture rate | **15%** | 10% |
| Weighted average fair value | **$0.17** | $0.38 |

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 years ended December 31, 2016 and 2015 is as follows:

| | | **2016** | | 2015 |
|---|---|---|---|---|
| | **Number of Options** | **Weighted Average Exercise Price** | Number of Options | Weighted Average Exercise Price |
| | **000's** | **$** | 000's | $ |
| Outstanding, beginning of year | **11,395** | **2.08** | 18,252 | 2.11 |
| Granted | **6,295** | **0.33** | 1,085 | 0.81 |
| Cancelled/forfeited | **(3,900)** | **1.53** | (12) | 1.93 |
| Expired | **(2,787)** | **3.70** | (7,930) | 1.98 |
| Outstanding, end of year | **11,003** | **0.86** | 11,395 | 2.08 |

The following table summarizes information about stock options outstanding at December 31, 2016:

| | | | Options Outstanding | | Options Exercisable |
|---|---|---|---|---|---|
| Range of Exercise Price | Weighted Average Exercise Price | Number of Options | Weighted Average Contractual Life Remaining | Number of Options | Weighted Average Exercise Price |
| $ | $ | (000's) | (years) | (000's) | $ |
| 0.29 – 0.99 | 0.38 | 6,370 | 4.43 | 228 | 0.81 |
| 1.00 – 1.99 | 1.41 | 4,033 | 0.89 | 4,026 | 1.41 |
| 2.00 – 2.22 | 2.22 | 600 | 2.64 | 400 | 2.22 |
| | 0.86 | 11,003 | 3.03 | 4,654 | 1.45 |

During the years ended December 31, 2016, $708 (2015 - $1,107) in share based payment expense related to equity-settled stock options has been recognized in comprehensive loss.

### RESTRICTED SHARE UNITS

The Company has a 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.

A summary of the status of the Company's RSU plan and changes for the years ended December 31, 2016 and 2015 is as follows:

| Number of RSUs (000's) | **2016** | 2015 |
|---|---|---|
| Outstanding, beginning of year | **1,707** | 814 |
| Granted | **2,622** | 1,235 |
| Cancelled/forfeited | **(677)** | (17) |
| Exercised | **(642)** | (325) |
| Outstanding, end of year | **3,010** | 1,707 |

During the years ended December 31, 2016, the Company recognized $374 (2015 - $100) in share based payment expense related to the cash-settled RSUs in comprehensive loss.

## 17. LOSS PER SHARE

Loss per share has been calculated based on the weighted average number of common shares outstanding during the year. For the years ended December 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:

| | Year ended December 31, | |
|---|---|---|
| | **2016** | 2015 |
| Basic weighted average shares | **217,061** | 211,028 |
| Effect of dilutive instruments | **–** | – |
| Diluted weighted average shares | **217,061** | 211,028 |

## 18. COMMITMENTS

| | 2017 | 2018 | 2019 | 2020 | 2021+ | Total |
|---|---|---|---|---|---|---|
| Office leases | 367 | 350 | 262 | - | - | 979 |
| Pipeline transportation | 588 | 1,915 | 2,350 | 2,350 | 12,328 | 19,531 |
| Gas processing | 4,154 | 4,154 | 4,154 | 4,166 | 38,780 | 55,408 |
| Total | 5,109 | 6,419 | 6,766 | 6,516 | 51,108 | 75,918 |

Cequence has a take or pay agreement with the operator of the Simonette facility. The volume commitment under the take or pay is 42 mmcf/d until April 30, 2030.

The Company has firm transportation on a major pipeline system for 9 mmcf/d for the period January 1, 2016 to March 31, 2018 and 35 mmcf/d for the period April 1, 2018 to March 30, 2026.

Subsequent to December 31, 2016, the Company has entered into a binding contract to ship 10,850 GJ/d of natural gas to the TransCanada mainline system from the Empress receipt point to the Dawn hub in Ontario subject to regulatory approval with the National Energy Board and financial assurances. The term of the contract begins on April 1, 2018, is 10 years in duration and has early termination rights that can be exercised following the initial five years of service. The toll for this service is $0.77/GJ.

During the year ended December 31, 2016, the Company recognized expense of $1,116 (2015 – $1,428) of expense related to office leases, included with general and administrative expense.

## 19. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

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

The Company's cash, 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 cash measured at level 1 and commodity contracts measured at level 2 under the Company's fair value hierarchy as of December 31, 2016. 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 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 loss.

During the year ended December 31, 2016, 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, 2016:

| Term | Product | Type | Volume | Price | Basis |
|---|---|---|---|---|---|
| January 1, 2017 to March 31, 2017 | Gas | Swap | 20,000 gj/day | $2.66 | AECO |
| April 1, 2017 to September 30, 2017 | Gas | Swap | 22,500 gj/day | $2.78 | AECO |
| October 1, 2017 to December 31, 2017 | Gas | Swap | 19,185 gj/day | $2.76 | AECO |
| January 1, 2018 to March 31, 2018 | Gas | Swap | 2,500 gj/day | $2.80 | AECO |
| January 1, 2017 to December 31, 2017 | Oil | Swap | 200 bbl/day | $65.50 | WTI |

For the year ended December 31, 2016, realized gain from commodity derivative contracts recognized in comprehensive loss were $6,805 (2015 - $9,395 gain).

The fair value of the commodity contracts outstanding at December 31, 2016 was a current liability of $4,491 and non-current liability of $159 (December 31, 2015 – current asset $3,644).

For the year ended December 31, 2016, the Company recorded an unrealized loss of $8,294 from derivative commodity contracts (2015 - $4,541 unrealized loss).

As at December 31, 2016, an change in gas price of $0.50/gj and oil price of $1.00/bbl results in a change in the fair value of the commodity contracts of $3,954 ($2,886 after tax) and $73 ($53 after tax) respectively 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, 2016 the Company had no forward, foreign exchange contracts in place, nor any significant working capital items denominated in foreign currencies (2015 – 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, 2016 (2015 - nil).

As at December 31, 2016, 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 $nil ($nil after tax) (2015 - $nil ($nil 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 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 December 31, 2016, the accounts receivable balance was $14,145 of which $664 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 |
|---|---|---|---|---|
| 12,743 | 529 | 209 | 664 | 14,145 |

At December 31, 2016, the Company has an allowance for doubtful accounts of $647 (2015 – $682). As at December 31, 2016, 44.3 percent (2015 – 19.5) 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, | |
|---|---|---|
| | **2016** | 2015 |
| Balance, beginning of year | **682** | 944 |
| Amounts collected | **(115)** | (431) |
| Amounts written off to accounts receivable | **(164)** | 16 |
| Additional provision | **244** | 153 |
| Balance, end of year | **647** | 682 |

As at December 31, 2016, the maximum exposure to credit risk was $31,923 (2015 - $39,211) being the carrying value of the Company's cash, 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 21 for disclosure related to the management of capital.

The expected timing of cash flows relating to financial liabilities as at December 31, 2016 is as follows:

| | <1 Year | 1 – 2 Years | 2 – 5 Years | Thereafter |
|---|---|---|---|---|
| Senior notes – principal | – | 60,000 | – | – |
| Accounts payable and accrued liabilities | 36,124 | – | – | – |
| | 36,124 | 60,000 | – | – |

## 20. CHANGES IN NON-CASH WORKING CAPITAL

| | Year ended December 31, 2016 | 2015 |
|---|---|---|
| Accounts receivable | **8,176** | 2,460 |
| Deposits and prepaid expenses | **792** | 1,110 |
| Accounts payable and accrued liabilities | **(5,564)** | (24,194) |
| Net change in non-cash working capital | **3,404** | (20,624) |
| Allocated to: | | |
| Operating activities | **2,243** | 7,026 |
| Investing activities | **1,268** | (27,522) |
| Financing activities | **(107)** | (128) |
| | **3,404** | (20,624) |

## 21. 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. 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.

At December 31, 2016, Cequence has $60,000 in senior notes due in 2018 and a $20,000 senior credit facility which the Company had drawn $nil. The Company's senior credit facility is based on the lenders' review of the Company's oil and natural gas reserves with the next scheduled review expected to be completed in May 2017. On October 28, 2016, the Company completed the sale, on a private placement basis, of 34,500 common voting shares on a CDE "flow-through" basis at $0.29 per share for gross proceeds of $10,005. Over the next twelve months, the Company believes that it has the ability to manage its cash flow and net capital expenditures within its available credit and will be in compliance with its financial covenants.

The senior credit facility has a covenant that requires Senior Debt to twelve month trailing EBITDA, as defined in the bank agreement, to be less than 3:0 to 1:0. The Company was in compliance with the lender's covenant at December 31, 2016 with a ratio of 0.2 times (December 31, 2015 - 0 times).

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 December 31, 2016 the Company's Debt to Cashflow ratio was in excess of 2.5 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.

The Company continues to review its options to improve its financial leverage including the sale of assets, further adjustments to the capital program, hedging or the issuance of equity.