# HIGHLIGHTS

| | Three months ended June 30, | | | Six months ended June 30, | | |
|---|---|---|---|---|---|---|
| (000's except per share and per unit amounts) | **2013** | 2012 | % Change | **2013** | 2012 | % Change |
| **Financial** ($) | | | | | | |
| Production revenue [1] | **29,803** | 16,032 | **86** | **51,808** | 35,896 | **44** |
| Comprehensive income (loss) | **4,170** | (6,579) | **163** | **(1,269)** | (14,515) | **(91)** |
| Per share, basic and diluted | **0.02** | (0.04) | **150** | **(0.01)** | (0.09) | **(89)** |
| Funds flow from operations [2] | **14,831** | 4,563 | **225** | **25,484** | 11,318 | **125** |
| Per share, basic and diluted | **0.07** | 0.03 | **133** | **0.12** | 0.07 | **71** |
| **Production volumes** | | | | | | |
| Natural gas (Mcf/d) | **58,153** | 45,042 | **29** | **52,262** | 47,483 | **10** |
| Crude oil (bbls/d) | **874** | 618 | **41** | **742** | 651 | **14** |
| Natural gas liquids (bbls/d) | **639** | 535 | **19** | **568** | 497 | **14** |
| Total (boe/d) | **11,205** | 8,660 | **29** | **10,020** | 9,062 | **11** |
| **Sales prices** | | | | | | |
| Natural gas, including realized hedges ($/Mcf) | **3.85** | 2.11 | **82** | **3.70** | 2.28 | **62** |
| Crude oil ($/bbl) | **90.56** | 79.92 | **13** | **91.11** | 85.00 | **7** |
| Natural gas liquids ($/bbl) | **38.23** | 59.54 | **(36)** | **44.57** | 67.43 | **(34)** |
| Total ($/boe) | **29.23** | 20.34 | **44** | **28.57** | 21.77 | **31** |
| **Operating Netback** ($/boe) | | | | | | |
| Price | **29.23** | 20.34 | **44** | **28.57** | 21.77 | **31** |
| Royalties | **(2.40)** | (0.15) | **1,500** | **(2.50)** | (1.39) | **80** |
| Transportation | **(1.56)** | (2.11) | **(26)** | **(1.57)** | (2.09) | **(25)** |
| Operating costs | **(7.71)** | (8.32) | **(7)** | **(7.51)** | (8.13) | **(8)** |
| Operating netback | **17.56** | 9.76 | **80** | **16.99** | 10.16 | **67** |
| **Capital Expenditures** ($) | | | | | | |
| Capital expenditures | **4,723** | 9,909 | **(52)** | **48,382** | 50,843 | **(5)** |
| Net acquisitions (dispositions) [4] | **(2,641)** | (2,980) | **(11)** | **(2,623)** | (13,922) | **(81)** |
| Total capital expenditures | **2,082** | 6,929 | **(70)** | **45,759** | 36,921 | **24** |
| Net debt and working capital (deficiency) [3] | **(66,001)** | (43,855) | **50** | **(66,001)** | (43,855) | **50** |
| Weighted average shares outstanding | | | | | | |
| Basic | **209,213** | 164,823 | **27** | **204,935** | 163,339 | **25** |
| Diluted | **209,767** | 164,823 | **27** | **204,935** | 163,339 | **25** |
| Undeveloped land (net acres) | **203,387** | 223,200 | **(9)** | **203,387** | 223,200 | **(9)** |

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

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

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

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

# 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 and six months ended June 30, 2013 as well as with the audited consolidated financial statements (the "annual financial statements") and related notes for the years ended December 31, 2012 and 2011.

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 August 8, 2013.

## Basis of Presentation

The consolidated financial statements and comparative information have been prepared in accordance with IAS 34, "Interim Financial Reporting" ("IAS 34"), 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 the first six months of 2013, the ratio between the average price of West Texas Intermediate ("WTI") crude oil at Cushing and NYMEX natural gas was approximately 25:1 ("Value Ratio"). The Value Ratio is obtained using the first six months 2013 WTI average price of $94.22 (US$/Bbl) for crude oil and the first six months 2013 NYMEX average price of $3.75 (US$/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 netback, net debt and working capital (deficiency) and funds flow from operations.

Netback is not defined by IFRS in Canada and is referred to as a non-GAAP measure. Netback equals total revenue less royalties, operating costs and transportation costs. Management utilizes this measure 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 and demand credit facilities and excluding other liabilities. Cequence uses net debt and working capital deficiency as it provides an estimate of the Company's assets and obligations expected to be settled in cash.

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

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

## Selected Financial Information

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

| | **Three months ended June 30,** | | **Six months ended June 30,** | |
|---|---|---|---|---|
| $(000's) | **2013** | 2012 | **2013** | 2012 |
| Cash flow from operating activities | **4,162** | 2,135 | **19,273** | 10,578 |
| Decommissioning liabilities expenditures | **315** | 194 | **389** | 724 |
| Net change in non-cash working capital | **10,354** | 2,234 | **5,822** | 16 |
| Funds flow from operations | **14,831** | 4,563 | **25,484** | 11,318 |
| Per share, basic and diluted ($) | **0.07** | 0.03 | **0.12** | 0.07 |
| Production revenue | **29,803** | 16,032 | **51,808** | 35,896 |
| Comprehensive income (loss) | **4,170** | (6,579) | **(1,269)** | (14,515) |
| Per share, basic and diluted ($) | **0.02** | (0.04) | **(0.01)** | (0.09) |
| Total assets | **548,210** | 500,865 | **548,210** | 500,865 |
| Demand credit facilities | **57,170** | 40,236 | **57,170** | 40,236 |

Cequence recorded a comprehensive income of $4,170 for the three months ended June 30, 2013 compared to a loss of $6,579 in 2012. The increase in income is mainly due to increased production revenue due to higher production volumes and commodity prices in 2013 compared to prior year.

The decrease in the Company's comprehensive loss for the six months ended June 30, 2013, was mainly attributable to higher operating netbacks due to increased production volumes and commodity prices. In addition, the Company's 2012 net loss was negatively impacted by lower natural gas prices and impairments recognized on the Company's property and equipment, offset by gains realized on the sale of certain undeveloped land.

Funds flow from operations was $14,831 and $25,484 for the three and six months ended June 30, 2013, respectively, compared to $4,563 and $11,318 in 2012. The increase in funds flow from operations was achieved through higher operating netbacks due to increase production volumes and commodity prices from the comparative period.

## Results of Operations

### Production

Average production volumes, revenue and prices for the three and six months ended June 30, 2013 and 2012 are outlined below:

| | Three months ended June 30, | | Six months ended June 30, | |
|---|---|---|---|---|
| | **2013** | 2012 | **2013** | 2012 |
| Natural gas (Mcf/d) | **58,153** | 45,042 | **52,262** | 47,483 |
| Crude oil (bbls/d) | **874** | 618 | **742** | 651 |
| Natural gas liquids (bbls/d) | **639** | 535 | **568** | 497 |
| Total (boe/d) | **11,205** | 8,660 | **10,020** | 9,062 |
| Total production (boe) | **1,019,660** | 788,039 | **1,813,618** | 1,649,229 |

Production for the three months and six months ended June 30, 2013 averaged 11,205 boe/d and 10,020 boe/d, respectively, compared to production of 8,660 boe/d and 9,062 boe/d in 2012. Higher average production resulted from production additions commencing April 2013 from the winter drilling program. Cequence's average production is forecast to average between 10,000 and 10,500 boe/d for the year ended December 31, 2013.

### Revenue

| | Three months ended June 30, | | Six months ended June 30, | |
|---|---|---|---|---|
| $(000's) | **2013** | 2012 | **2013** | 2012 |
| **Revenue** | | | | |
| Natural gas | **20,815** | 8,564 | **35,335** | 19,651 |
| Realized gain (loss) on natural gas hedges | **(438)** | 76 | **(343)** | 76 |
| Total natural gas | **20,377** | 8,640 | **34,992** | 19,727 |
| Crude oil | **7,205** | 4,492 | **12,237** | 10,071 |
| Natural gas liquids | **2,221** | 2,900 | **4,579** | 6,098 |
| Total production revenue, gross of royalties | **29,803** | 16,032 | **51,808** | 35,896 |
| **Average prices** | | | | |
| Natural gas ($/Mcf) | **3.93** | 2.09 | **3.74** | 2.27 |
| Realized natural gas hedge ($/Mcf) | **(0.08)** | 0.02 | **(0.04)** | 0.01 |
| Natural gas including hedge ($/Mcf) | **3.85** | 2.11 | **3.70** | 2.28 |
| Crude oil ($/bbl) | **90.56** | 79.92 | **91.11** | 85.00 |
| Natural gas liquids ($/bbl) | **38.23** | 59.54 | **44.57** | 67.43 |
| Average sales price before hedge ($/boe) | **29.66** | 20.25 | **28.76** | 21.72 |
| Average sales price including hedge ($/boe) | **29.23** | 20.34 | **28.57** | 21.77 |
| **Benchmark pricing** | | | | |
| AECO-C spot (CDN$/Mcf) | **3.55** | 1.91 | **3.38** | 2.02 |
| WTI crude oil (US$/bbl) | **94.14** | 93.30 | **94.22** | 98.15 |
| Edmonton par price (CDN$/bbl) | **92.95** | 84.97 | **90.75** | 88.92 |
| US$/CDN$ exchange rate | **0.98** | 0.99 | **0.98** | 0.99 |

Total production revenue, gross of royalties, was $29,803 in the second quarter of 2013 compared to $16,032 in 2012. The increase in revenue is attributable to the 46 percent increase in realized sales prices and 29 percent increase in production. For the six months ended June 30, 2013, production revenue, gross of royalties, increased 44 percent to $51,808 from $35,896 in the comparable period of 2012. The increase is a result of a 32 percent increase in realized sales prices and an 11 percent increase in production volumes.

## Pricing

Cequence's production is approximately 87 percent natural gas and consequently, fluctuations in natural gas prices have a significant impact on the Company's revenue and funds flow. Canadian benchmark natural gas prices averaged $3.38 per mcf during the six months ended June 30, 2013, an increase of 67 per cent from $2.02 per mcf in 2012.

Realized natural gas prices for the three months ended June 30, 2013 were $3.93 per mcf, up 88 percent from the comparable period in 2012. Realized natural gas prices for the six months ended June 30, 2013 were $3.74 per Mcf, up 65 percent from the comparable period in 2012. Realized natural gas prices for the six months ended June 30, 2013 are above benchmark prices as much of the Company's natural gas sells at a premium to AECO due to the heat content of the gas.

Oil prices for the second quarter of 2013 were $90.56 per barrel, up 13 percent from the same time period in 2012. Oil prices for the six months ended June 30, 2013 were $91.11 per barrel, up 7 percent from the comparable period in 2012.

Natural gas liquids prices for the three months ended June 30, 2013 were $38.23 per barrel, down 36 percent from the same time period in 2012. Natural gas liquids prices for the six months ended June 30, 2013 were $44.57 per barrel, down 34 percent from 2012. The decline in average realized natural gas liquids prices is due to an increase in ethane and propane production as a percentage of the natural gas liquid mix from prior year. Ethane and propane have the lowest realized price and value of all natural gas liquids.

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

## Commodity Price Management

| | Three months ended June 30, | | Six months ended June 30, | |
|---|---|---|---|---|
| $(000's) | **2013** | 2012 | **2013** | 2012 |
| Realized gain (loss) on commodity contracts | **(438)** | 76 | **(343)** | 76 |
| Unrealized gain (loss) on commodity contracts | **3,810** | (119) | **482** | (119) |
| Total | **3,372** | (43) | **139** | (43) |

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. The Company has the following outstanding positions for commodity derivative financial instruments:

| Term | Product | Type | Volume | Price | Basis |
|---|---|---|---|---|---|
| January 1, 2013 to December 31, 2013 | Gas | Swap | 2,000 gj/day | $2.84 | AECO |
| January 1, 2013 to December 31, 2013 | Gas | Swap | 2,500 gj/day | $3.09 | AECO |
| January 1, 2013 to December 31, 2013 | Gas | Swap | 2,500 gj/day | $3.00 | AECO |
| January 1, 2013 to December 31, 2013 | Gas | Swap | 5,000 gj/day | $3.10 | AECO |
| January 1, 2013 to December 31, 2013 | Gas | Swap | 2,500 gj/day | $3.24 | AECO |
| January 1, 2013 to December 31, 2013 | Gas | Swap | 2,500 gj/day | $3.40 | AECO |
| March 1, 2013 to December 31, 2013 | Gas | Swap | 2,500 gj/day | $3.03 | AECO |
| March 1, 2013 to December 31, 2013 | Gas | Swap | 2,500 gj/day | $3.17 | AECO |
| May 1, 2013 to October 31, 2013 | Gas | Swap | 2,500 gj/day | $3.49 | AECO |
| January 1, 2014 to September 30, 2014 | Gas | Swap | 2,500 gj/day | $3.51 | AECO |
| January 1, 2014 to December 31, 2014 | Gas | Swap | 2,500 gj/day | $3.42 | AECO |
| January 1, 2014 to December 31, 2014 | Gas | Swap | 2,500 gj/day | $3.53 | AECO |
| January 1, 2014 to December 31, 2014 | Gas | Swap | 2,500 gj/day | $3.70 | AECO |
| January 1, 2014 to December 31, 2014 | Gas | Swap | 2,500 gj/day | $3.47 | AECO |
| January 1, 2013 to December 31, 2013 | Oil | Sold Call | 200 bbls/day | $110.00 USD | WTI |

For the remainder of 2013, Cequence has hedged approximately 50 percent (23,667 GJ/d) of its forecasted natural gas production volumes net of royalties at an average AECO price of $3.14 per GJ or approximately $3.64 per mcf. Cequence has hedged approximately 11,875 GJ/d of estimated 2014 natural gas production volumes at an average price of $3.53 per GJ or approximately $4.09 per mcf.

The fair value of the commodity contracts outstanding at June 30, 2013 was a current asset of $889 and a non-current asset of $351 (December 31, 2012 - current asset of $694 and a non-current asset of $63).

## Royalty Expense

| | Three months ended June 30, | | Six months ended June 30, | |
|---|---|---|---|---|
| $(000's) | **2013** | 2012 | **2013** | 2012 |
| Crown | **1,389** | (337) | **2,726** | 1,513 |
| Freehold / Overriding | **1,063** | 455 | **1,815** | 781 |
| | **2,452** | 118 | **4,541** | 2,294 |
| **As a % of Revenue, Before Hedging Activity** | | | | |
| Crown | **5** | (2) | **5** | 4 |
| Freehold / Overriding | **3** | 3 | **4** | 2 |
| | **8** | 1 | **9** | 6 |
| **Per Unit of Production** ($/boe) | | | | |
| Crown | **1.36** | (0.43) | **1.50** | 0.92 |
| Freehold / Overriding | **1.04** | 0.58 | **1.00** | 0.47 |
| | **2.40** | 0.15 | **2.50** | 1.39 |

Royalty expense for the three months ended June 30, 2013 was $2,451 or 8 percent of revenue compared to $118 or 1 percent of revenue in 2012. Royalty expense for the six months ended June 30, 2013 was $4,541 or 9 percent of revenue compared to $2,294 or 6 percent of revenue in 2012. In 2012, crown royalties were lower due to decreased

natural gas prices and an adjustment for gas cost allowance recognized. Crown royalties as a percentage of revenue remain low in 2013 due to low natural gas prices and royalty rates of 5 percent on initial production from new horizontal wells. Royalties as percentage of revenue are within the Company's guidance of approximately 9 percent for the year ended December 31, 2013.

## Transportation Expense

| | Three months ended June 30, | | Six months ended June 30, | |
|---|---|---|---|---|
| $(000's) | **2013** | 2012 | **2013** | 2012 |
| Transportation ($) | **1,590** | 1,661 | **2,849** | 3,452 |
| Per unit of production ($/boe) | **1.56** | 2.11 | **1.57** | 2.09 |

Transportation expense for the three months ended June 30, 2013 was $1.56 per boe, a decrease of 26 percent from the comparative period in 2012. For the six months ended 2013, transportation expense decreased to $1.57 per boe from $2.09 per boe in the comparative period in 2012. The decrease is due to lower transportation rates on marketing contracts which were renewed in late 2012. Cequence expects transportation expense to average approximately $1.50 to $1.75 per boe for the year ended December 31, 2013.

## Operating Costs

| | Three months ended June 30, | | Six months ended June 30, | |
|---|---|---|---|---|
| $(000's) | **2013** | 2012 | **2013** | 2012 |
| Operating costs ($) | **7,867** | 6,554 | **13,613** | 13,416 |
| Per unit of production ($/boe) | **7.71** | 8.32 | **7.51** | 8.13 |

For the three months ended June 30, 2013, operating costs decreased to $7.71 per boe from $8.32 per boe in the comparative period in 2012. Operating costs for the six months ended June 30, 2013 were $13,613 or $7.51 per boe compared to $13,416 or $8.13 per boe for the same period in 2012. The decrease in operating costs per boe in both the three and six month periods is due to production additions in the Simonette area that carry lower operating costs than the Company's other areas. In addition, operating costs for the three months ended June 30, 2013, are higher than the Company's previously issued guidance of $6.75 per boe. The difference is mainly due to additional costs associated with wet break-up conditions and plant turnaround costs. The Company's operating costs per boe are expected to be approximately $6.75 per boe for the year ended December 31, 2013.

The third quarter of 2012 was the first full quarter with significant production volumes being sold under the Aux Sable Arrangement. Cequence realized slightly higher NGL volumes at Simonette and higher operating netbacks, through a reduction of processing fees of approximately $0.50 per mcf on volumes sold under this arrangement when compared to the previous processing arrangements.

## Operating Netback

| | Three months ended June 30, | | Six months ended June 30, | |
|---|---|---|---|---|
| $(000's) | **2013** | 2012 | **2013** | 2012 |
| Production revenue [1] | **29.23** | 20.34 | **28.57** | 21.77 |
| Royalty expense | **(2.40)** | (0.15) | **(2.50)** | (1.39) |
| Transportation expense | **(1.56)** | (2.11) | **(1.57)** | (2.09) |
| Operating costs | **(7.71)** | (8.32) | **(7.51)** | (8.13) |
| Operating netback, $/boe | **17.56** | 9.76 | **16.99** | 10.16 |
| Operating netback, excluding realized hedges, $/boe | **17.98** | 9.67 | **17.17** | 10.11 |

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

Cequence's netback for the three months ended June 30, 2013 increased 80 percent to $17.56 per boe from $9.76 per boe in 2012. For the six months ended June 30, 2013, the netback increased to $16.99 per boe from $10.16 per boe in the comparative period in 2012.The increase in 2013 operating netbacks is mainly due to a increase production revenue due to higher production volumes and commodity prices in 2013 compared to 2012.

## General and Administrative Expenses

| | Three months ended June 30, | | Six months ended June 30, | |
|---|---|---|---|---|
| $(000's) | **2013** | 2012 | **2013** | 2012 |
| G&A expenses ($) | **2,182** | 2,016 | **3,782** | 3,790 |
| Per unit of production ($/boe) | **2.14** | 2.56 | **2.09** | 2.30 |

Total general and administrative ("G&A") costs for the three and six months ended June 30, 2013 were consistent with the prior year as the size and nature of the business have not changed significantly. G&A per boe has decreased in the three and six month periods primarily as a result of increased production volumes. The Company's G&A expenses per boe for the year ended December 31, 2013 is expected to average approximately $2.00 to $2.25 per boe.

## Finance Costs

| | Three months ended June 30, | | Six months ended June 30, | |
|---|---|---|---|---|
| $(000's) | **2013** | 2012 | **2013** | 2012 |
| Interest expense | **711** | 698 | **1,094** | 1,104 |
| Accretion expense on provisions | **200** | 185 | **399** | 336 |
| Total finance costs | **911** | 883 | **1,493** | 1,440 |
| Per unit of production ($/boe) | **0.89** | 1.12 | **0.82** | 0.87 |
| Interest per unit of production, ($/boe) | **0.70** | 0.89 | **0.60** | 0.67 |

Finance costs for the three months ended June 30, 2013 were $911 compared to $883 for the comparative period in 2012. Finance costs for the six months ended June 30, 2013 were $1,493 compared to $1,440 for the comparative period in 2012.

## Other Expense (Income)

| | Three months ended June 30, | | Six months ended June 30, | |
|---|---|---|---|---|
| $(000's) | **2013** | 2012 | **2013** | 2012 |
| Gain on sale of property and equipment | **(1,092)** | (2,893) | **(1,092)** | (20,390) |
| Transaction costs | **120** | – | **345** | – |
| Other | **(29)** | 342 | **(59)** | 362 |
| Total other expense (income) | **(1,001)** | (2,551) | **(806)** | (20,028) |

On April 15, 2013, the Company acquired oil and gas properties located in the Simonette area of Alberta and recorded transactions costs of $345 related to this acquisition.

During the six months ended June 30, 2013, the Company completed the sales of certain oil and gas properties for total cash consideration of $2,820 (2012 - $20,662), subject to final adjustments. The sales resulted in a gain recognized in comprehensive loss of $1,092 (2012 - $20,390).

## Depletion, Depreciation and Impairment

| | Three months ended June 30, | | Six months ended June 30, | |
|---|---|---|---|---|
| $(000's) | **2013** | 2012 | **2013** | 2012 |
| Depletion and depreciation expense | **11,028** | 9,634 | **19,958** | 20,201 |
| Impairment | **2,164** | 4,416 | **2,164** | 22,497 |
| Total depletion, depreciation and impairment | **13,192** | 14,050 | **22,122** | 42,698 |
| Per unit of production ($/boe) | **12.94** | 17.83 | **12.20** | 25.89 |
| Per unit of production, excluding impairment ($/boe) | **10.82** | 12.23 | **11.00** | 12.25 |

Depletion and depreciation expense for the three and six month periods ended June 30, 2013 was $11,028 ($10.82 per boe) and $19,958 ($11.00 per boe), respectively. Depletion and depreciation rates are similar to the comparable period in 2012 as there have not been significant changes to Cequence's resource base during this time.

Impairment expense for the six months ended June 30, 2013 was $2,164 compared to $22,497 for the comparable period in 2012. During the three months ended June 30, 2013 the Company recorded an impairment of $2,164 reflecting the difference between the carrying value and fair value of the Fir assets included as consideration transferred in the Simonette property acquisition. Substantially all of the Company's capital expenditures in the past two years have been on the Deep Basin cash generating unit ("CGU"). The 2012 impairment of the Northeast British Columbia and Peace River Arch CGU's resulted largely from declining natural gas prices. The following represents impairment recognized per CGU in the three and six months ended June 30, 2013 and 2012:

| | Three months ended June 30, | | Six months ended June 30, | |
|---|---|---|---|---|
| $(000's) | **2013** | 2012 | **2013** | 2012 |
| Northeast British Columbia | – | 737 | – | 13,931 |
| Peace River Arch | – | 3,679 | – | 8,566 |
| Deep Basin disposition | **2,164** | – | **2,164** | – |
| Total | **2,164** | 4,416 | **2,164** | 22,497 |

## Provisions

### Decommissioning liabilities

Total decommissioning liabilities at June 30, 2013 were $27,457 compared to $32,564 at December 31, 2012. The following table summarizes the changes in decommissioning liabilities for the respective periods:

| (000's) | June 30, 2013 | December 31, 2012 |
|---|---|---|
| Balance, beginning of period | **32,564** | 28,135 |
| Property acquisitions | **239** | 417 |
| Property dispositions | **(1,728)** | (533) |
| Accretion expense | **399** | 730 |
| Liabilities incurred | **505** | 1,775 |
| Abandonment costs incurred | **(389)** | (904) |
| Revisions in estimated cash flows | **(593)** | 2,078 |
| Revisions due to change in discount rates | **(3,540)** | 866 |
| Balance, end of period | **27,457** | 32,564 |

### Onerous contracts

As at June 30, 2013, the Company recognized a provision related to an onerous lease contract of $652 (December 31, 2012 - $812). The provision for onerous lease contract represents the present value of the future lease obligations that the Company is presently obligated to make under a non-cancellable onerous operating lease contract, less revenue expected to be earned on the lease, including estimated future sub-lease revenue.

## Share Based Payments

The Company recognizes share based payment expense for stock options. For the six months ended June 30, 2013, Cequence recorded $2,239 (2012 – $3,076) in share based payment expense related to stock options with a corresponding increase to contributed surplus.

| | June 30, 2013 | | December 31, 2012 | |
|---|---|---|---|---|
| | Number of Options (000's) | Weighted Average Exercise Price $ | Number of Options (000's) | Weighted Average Exercise Price $ |
| Outstanding, beginning of period | **17,289** | **2.19** | 13,094 | 2.54 |
| Granted | **125** | **1.35** | 5,118 | 1.30 |
| Forfeited | **(200)** | **1.92** | (923) | 2.20 |
| Outstanding, end of period | **17,214** | **2.18** | 17,289 | 2.19 |

## Common Shares Outstanding

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

| Issued common voting shares (000's) | Number | Stated Value |
|---|---|---|
| Balance, December 31, 2011 | 161,856 | $ 559,371 |
| Common shares | 21,269 | 25,523 |
| Flow-through common shares | 17,485 | 24,429 |
| Share issue costs, net of taxes of $874 | – | (2,620) |
| Balance, December 31, 2012 | 200,610 | $ 606,703 |
| Common shares issued on property acquisition | **10,300** | **17,510** |
| Share issue costs, net of taxes of ($22) | – | **64** |
| Balance, June 30, 2013 | **210,910** | **$ 624,277** |

On April 15, 2013, the Company issued an aggregate of 10,300,000 Cequence common shares as partial consideration for the acquisition of oil and gas properties located in the Simonette area of Alberta.

As of the date of this MD&A, Cequence had the following securities outstanding: 210,917,883 common voting shares and 17,206,667 stock options.

## Capital Expenditures

| | Three months ended June 30, | | Six months ended June 30, | |
|---|---|---|---|---|
| $(000's) | **2013** | 2012 | **2013** | 2012 |
| Property acquisitions [1] | **179** | – | **197** | 6,740 |
| Property dispositions [1] | **(2,820)** | (2,980) | **(2,820)** | (20,662) |
| Land | **1,452** | 290 | **2,103** | 553 |
| Geological & geophysical and capitalized overhead | **459** | 393 | **914** | 2,617 |
| Drilling, completions and workovers | **173** | 3,772 | **30,715** | 29,474 |
| Equipment and facilities | **2,626** | 5,362 | **14,582** | 18,095 |
| Office furniture & equipment | **13** | 92 | **68** | 104 |
| Total capital expenditures | **2,082** | 6,929 | **45,759** | 36,921 |

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

Net capital expenditures for the six months ended June 30, 2013 increased to $45,759 from $36,921 in 2012. The increase is mainly due the impact of $20,662 of property dispositions and $6,740 of acquisitions in 2012 compared to 2013.

For the six months ended June 30, 2013, drilling, completion and workover expenditures totalled $30,715 which included the completion of 6.0 gross (4.8 net) horizontal wells. Two of the wells drilled in the first quarter were farm in wells whereby Cequence incurred 100 percent of the capital costs to earn a 65 percent working interest in the wells and a 65 percent working interest in 3 sections of prospective land.

Equipment and facility expenditures in the six months ended June 30, 2013 of $14,582 were mainly directed towards a facility expansion for the Simonette compression and dehydration facility, along with additional pipelines.

On January 13, 2012, the Company closed the acquisition of properties, composed primarily of undeveloped land, located in the Deep Basin for total cash consideration of $6,800, subject to adjustments.

During the six months ended June 30, 2013, the Company completed the sales of certain oil and gas properties for total cash consideration of $2,820 (2012 - $20,662), subject to final adjustments. The sales resulted in a gain recognized in comprehensive loss of $1,092 (2012 - $20,390).

Cequence has budgeted net capital expenditures of $97,000 for the year ended December 31, 2013 and is expected to be focused on the development of the Company's Simonette assets. Capital expenditures will be funded out of cash flow, proceeds equity financing, existing credit lines and potential asset sales. The Company continually monitors fluctuations in natural gas prices and will adjust budgeted discretionary capital spending based on the Company's hedge position and short to medium term natural gas prices.

## Property Acquisition

On April 15, 2013, the Company acquired oil and gas properties located in the Simonette area of Alberta. As consideration for the assets, Cequence transferred its interest in its non-operated oil and gas properties located in the Fir area, and issued an aggregate of 10,300,000 Cequence common shares to the Corporation. The Company recorded $345 of transactions costs related to this acquisition. Cequence believes that this expansion and consolidation of its contiguous Montney land position at Simonette has significant present and future economic and strategic value.

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

A summary of the acquired property is as follows:

| | |
|---|---|
| **Estimated fair value of acquisition:** | |
| Property and equipment | 23,336 |
| Decommissioning liabilities | (239) |
| Deferred income tax liability | (3) |
| | 23,094 |
| **Consideration:** | |
| Common shares issued | 17,510 |
| Property and equipment transferred | 6,004 |
| Decommissioning liabilities transferred | (420) |
| | 23,094 |

## Income Taxes

At June 30, 2013, a deferred income tax asset of $36,371 (December 31, 2012 - $44,266) has been recognized as the Company believes, based on estimated cash flows, its realization is probable. At June 30, 2013, Cequence has the following tax pools:

| Classification | Amount $(000's) |
|---|---|
| Canadian exploration expense | 201,872 |
| Non-capital losses | 116,374 |
| Undepreciated capital cost | 121,108 |
| Canadian oil and gas property expense | 81,202 |
| Canadian development expense | 64,534 |
| Scientific research and experimental development tax credit | 22,704 |
| Share issue costs | 7,547 |
| Investment tax credits | 3,981 |
| | 619,322 |

The Company's non-capital losses expire in 2019 and thereafter.

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

recognized as deferred income tax expense. As at June 30, 2013, the Company has estimated that it has incurred all of the qualifying expenditures.

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

## Liquidity and Capital Resources

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

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

The Company monitors net debt to funds flow as one measure of the Company's ability to manage its debt levels under current operating conditions and meet current obligations as they come due. Management targets a debt to cash flow ratio of less than two times. As at June 30, 2013, the Company's net debt to annualized funds flow ratio was calculated as 1:1 (December 31, 2012 – 1:1) based on annualized second quarter results. In a typical year due to seasonality, capital expenditures increase in the winter months and are lower in the spring and early summer. As a result, the Company's accounts payable and accrued liabilities often peak at the end of the first quarter.

Cequence expects to finance its budgeted 2013 capital expenditures through cash flow, bank debt and proceeds from the December 2012 flow through share offering. Budgeted capital expenditures for 2013 are $97,000 resulting in estimated net debt of approximately $88,000 at December 31, 2013. Using forecasted 2013 cash flow of $55,000 this represents a debt to cash flow ratio of 1.6.

As disclosed in the annual financial statements, Cequence has periodically issued common shares and flow through common shares to fund a capital program that has been greater than the Company's cash flow. For the six months ended June 30, 2013, Cequence used funds flow of $25,484 and bank debt to finance its capital expenditures of $45,759.

The Company has credit facilities of $125,000 with a syndicate of Canadian chartered banks. Credit facility A is a $115,000 (December 31, 2012 - $90,000) extendible revolving term credit facility by way of prime loans, U.S. Base Rate Loans, Banker's Acceptances and Libor Loans. Credit facility B is a $10,000 (December 31, 2012 - $10,000) operating facility by way of prime loans, U.S. Base Rate Loans, Banker's Acceptances and letters of credit. Prime loans and U.S. Base Rate Loans on these facilities bear interest at the bank prime rate or U.S. Base Rate, respectively, plus 1.0 percent to 2.5 percent on a sliding scale, depending on the Company's debt to adjusted EBITDA ratio (ranging from being less than or equal to 1.0:1.0 to greater than 2.5:1.0). Banker's Acceptances, Libor Loans and letters of credit on these facilities bear interest at the Banker's Acceptance rate, Libor rate or letter of credit rate, as applicable, plus 2.0 percent to 3.5 percent based on the same sliding scale as above. The credit facilities may be extended and revolve beyond the initial one-year period, if requested by the Company and accepted by the lenders. If the credit facilities do not continue to revolve, the facilities will convert to a 366-day non-revolving term loan facility.

Both credit facilities, and the amount available for draws under the facilities, are subject to periodic review by the bank and are secured by a general assignment of book debts and a $250,000 demand debenture with a first floating charge over all assets of the Company. As at June 30, 2013, the Company has drawn $57,170 under the extendible revolving term credit facility and $nil under the operating facility (December 31, 2012 – $23,191 and $nil for the revolving and operating facilities, respectively) and is in compliance with all covenants. The effective annualized interest rate, including standby fees and commitment fees, for the six months ended June 30, 2013 was 3.6 percent (2012 – 2.8 percent). The next scheduled credit facility review is to take place on November 2013.

## Net Debt and Working Capital (Deficiency)

Net debt and working capital (deficiency) is calculated as cash and net working capital less commodity contract asset and demand credit facilities and excluding other liabilities, as follows:

| $(000's) | **As at June 30, 2013** | As at December 31, 2012 |
|---|---|---|
| Demand credit facilities | **(57,170)** | (23,191) |
| Accounts payable and accrued liabilities | **(27,962)** | (42,190) |
| Accounts receivable | **15,438** | 16,084 |
| Deposits and prepaid expenses – current | **3,693** | 3,428 |
| Net debt and working capital (deficiency) | **(66,001)** | (45,869) |

## Contractual Obligations

| | **2013** | 2014 | 2015 | 2016 | 2017+ | Total |
|---|---|---|---|---|---|---|
| Office leases | **566** | 922 | 187 | – | – | 1,657 |
| Drilling services | **1,071** | – | – | – | – | 1,071 |
| Pipeline transportation | **868** | 1,722 | 1,576 | – | – | 4,166 |
| Total | **2,505** | 2,644 | 1,763 | – | – | 6,912 |

The pipeline transportation contract expires on November 30, 2015.

In 2011, the Company entered into a drilling service agreement whereby the Company has committed to use a drilling rig for 360 days over the two years following commencement of use of the drilling rig at current market rates. The commitment is drawn down when the rig is in use, whether by Cequence or third parties. Cequence expects to meet the commitment in the required time.

In 2011, the Company entered into a drilling service agreement whereby the Company made a deposit of $3,500 to obtain a right of first refusal on the use of two drilling rigs over the five years following the date that use of the rigs commences. The deposit is to be applied as the Company incurs costs related to the use of the drilling rigs and $1,251 has been drawn down at June 30, 2013. Cequence expects to reduce the deposit by $794 in the twelve months ended June 30, 2014, which amount is included with deposits and prepaid expenses at June 30, 2013. The portion of the outstanding deposit expected to be drawn down in the period subsequent to June 30, 2014 of $1,455 is carried as a non-current asset at June 30, 2013.

## Disclosure Controls and Internal Controls over Financial Reporting

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

The Committee of Sponsoring Organizations ("COSO") framework provides the basis for management's design of internal controls over financial reporting. Management and the Board work to mitigate the risk of a material misstatement in financial reporting; however, a control system, no matter how well conceived or operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met and it should not be expected that the disclosure and internal control procedures will prevent all errors or fraud.

As at June 30, 2013, the President and Chief Executive Officer and the Vice President, Finance and Chief Financial Officer have concluded, based on their evaluation of the design and operating effectiveness of the Company's disclosure controls and internal controls over financial reporting ("ICFR") that disclosure controls and ICFR are effective.

## Quarterly Information

### Financial

| ($ thousands except per share data) | **2013 Q2** | 2013 Q1 | 2012 Q4 | 2012 Q3 | 2012 Q2 | 2012 Q1 | 2011 Q4 | 2011 Q3 |
|---|---|---|---|---|---|---|---|---|
| Production revenue [(1)] | **29,803** | 22,005 | 21,939 | 17,814 | 16,032 | 19,864 | 23,527 | 27,144 |
| Royalties expense | **2,452** | 2,089 | 1,546 | 992 | 118 | 2,176 | 3,063 | 3,872 |
| Transportation expense | **1,590** | 1,259 | 1,449 | 1,801 | 1,661 | 1,791 | 1,580 | 1,861 |
| Operating costs | **7,867** | 5,746 | 5,397 | 5,627 | 6,554 | 6,862 | 7,022 | 8,471 |
| Comprehensive income (loss) | **4,170** | (5,439) | 666 | (3,824) | (6,579) | (7,936) | (15,598) | (1,884) |
| Per share – basic & diluted | **0.02** | (0.03) | (0.00) | (0.02) | (0.04) | (0.05) | (0.10) | (0.01) |
| Funds flow from operations [(2)] | **14,831** | 10,652 | 11,603 | 10,803 | 4,563 | 6,755 | 10,002 | 10,438 |
| Per share – basic & diluted | **0.07** | 0.05 | 0.06 | 0.06 | 0.03 | 0.04 | 0.06 | 0.07 |
| Capital expenditures, net | **4,723** | 43,659 | 23,997 | 16,818 | 9,909 | 40,934 | 56,335 | 31,222 |
| Net acquisitions (dispositions) [(3)] | **(2,641)** | 18 | 644 | 20 | (2,980) | (10,942) | – | (15,513) |
| Total capital expenditures | **2,082** | 43,677 | 24,641 | 16,838 | 6,929 | 29,992 | 56,335 | 15,709 |

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

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

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

## Operational

| | **2013 Q2** | 2013 Q1 | 2012 Q4 | 2012 Q3 | 2012 Q2 | 2012 Q1 | 2011 Q4 | 2011 Q3 |
|---|---|---|---|---|---|---|---|---|
| **Production volumes** | | | | | | | | |
| Natural gas (Mcf/d) | **58,153** | 46,306 | 47,125 | 46,641 | 45,042 | 49,924 | 47,203 | 52,694 |
| Oil (bbls/d) | **874** | 608 | 583 | 606 | 618 | 684 | 503 | 514 |
| NGLs (bbls/d) | **639** | 496 | 515 | 516 | 535 | 459 | 509 | 536 |
| Total (boe/d) | **11,205** | 8,822 | 8,951 | 8,895 | 8,660 | 9,464 | 8,879 | 9,833 |
| **Average selling price** | | | | | | | | |
| Natural gas ($/Mcf) | **3.85** | 3.51 | 3.49 | 2.61 | 2.11 | 2.44 | 3.59 | 4.04 |
| Oil ($/bbl) | **90.56** | 91.90 | 86.78 | 83.38 | 79.92 | 89.58 | 97.15 | 87.65 |
| NGLs ($/bbl) | **38.23** | 52.84 | 45.83 | 41.89 | 59.54 | 76.63 | 73.19 | 69.34 |
| Total ($/boe) | **29.23** | 27.72 | 26.64 | 21.77 | 20.34 | 23.07 | 28.80 | 30.00 |
| **Operating Netback** ($/boe) | | | | | | | | |
| Price | **29.23** | 27.72 | 26.64 | 21.77 | 20.34 | 23.07 | 28.80 | 30.00 |
| Royalties | **(2.40)** | (2.63) | (1.88) | (1.13) | (0.15) | (2.53) | (3.75) | (4.28) |
| Transportation | **(1.56)** | (1.59) | (1.76) | (2.20) | (2.11) | (2.08) | (1.93) | (2.06) |
| Operating costs | **(7.71)** | (7.24) | (6.55) | (6.88) | (8.32) | (7.97) | (8.60) | (9.36) |
| Operating netback | **17.56** | 16.26 | 16.45 | 11.56 | 9.76 | 10.49 | 14.52 | 14.30 |

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

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

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

## Accounting policies adopted

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

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

## Outlook Information

On May 13, 2013 Cequence provided the following guidance for the year ended December 31, 2013.

| | 2013 |
|---|---|
| Average production, BOE/d [(1)] | 10,000-10,500 |
| Exit rate production, BOE/d | 11,500 |
| Capital expenditures ($) | 97 million |
| Operating costs ($ per boe) | 6.75 |
| Royalties (% revenue) | 9 |
| Crude – WTI (US$/bbl) | 95.00 |
| Natural gas – AECO (Cdn$/GJ) | 3.35 |
| Funds flow from operations ($) [(2)] | 55 million |
| December 31, 2013 net debt and working capital deficiency ($) [(3)] | 88 million |
| December 31, 2013 net debt to Q4 2013 annualized cash flow | 1.3 |
| Basic shares outstanding [(4)] | 210.9 million |

(1) Comprised of 53.1 mmcf/d of natural gas and 1,350 boe/d of 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 and demand credit facilities and excluding other liabilities.

(4) Includes the 10.3 million shares issued April 15, 2013 on the acquisitions of the Montney assets.

Capital expenditures for 2013 are expected to be funded from funds flow from operations, available bank lines and proceeds from 2012 equity raises. The Company closely monitors fluctuations in natural gas prices and will adjust the 2013 budget if facts and circumstances require.

## Forward-looking Statements

Certain statements contained within this MD&A constitute forward-looking statements. These statements relate to future events or the Company's future performance. All statements other than statements of historical fact may be forward-looking statements. Forward-looking statements are often, but not always, identified by the use of words such as "seek", "anticipate", "budget", "plan", "continue", "estimate", "expect", "forecast", "may", "will", "project", "predict", "potential", "targeting", "intend", "could", "might", "should", "believe", and similar expressions. Forward-looking statements in this MD&A include, but are not limited to, statements with respect to: the potential impact of implementation of the Alberta Royalty Framework on Cequence's condition and projected 2013 capital investments; projections with respect to growth of natural gas production; the projected impact of land access and regulatory issues; projections relating to the volatility of crude oil and natural gas prices in 2013 and beyond and reasons therefore; the Company's projected capital investment levels for 2013 and the source of funding therefore; the effect of the Company's risk management program, including the impact of derivative financial instruments; the Company's defence of lawsuits; the impact of the climate change initiatives on operating costs; the impact of Western Canada pipeline constraints. Readers are cautioned not to place undue reliance on forward-looking statements, as there can be no assurance that the plans, intentions or expectations upon which they are based will occur.

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

The forward looking statements contained herein concerning production, sales prices, operating expenses and capital spending are based on Cequence's 2013 capital program. The material assumptions supporting the 2013 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.

# Consolidated Balance Sheets

(Unaudited) (Expressed in thousands of Canadian dollars)

| | **June 30, 2013** | December 31, 2012 |
|---|---|---|
| | **$** | $ |
| **ASSETS** | | |
| CURRENT | | |
| Accounts receivable (Note 5) | **15,438** | 16,084 |
| Deposits and prepaid expenses (Note 14) | **3,693** | 3,428 |
| Commodity contracts (Note 15) | **889** | 694 |
| | **20,020** | 20,206 |
| Exploration and evaluation assets (Note 3) | **16,607** | 13,829 |
| Property and equipment (Note 3) | **473,406** | 439,059 |
| Deposits and prepaid expenses (Note 14) | **1,455** | 1,901 |
| Commodity contracts (Note 15) | **351** | 63 |
| Deferred income taxes | **36,371** | 44,266 |
| | **548,210** | 519,324 |
| **LIABILITIES** | | |
| CURRENT | | |
| Demand credit facilities (Note 4) | **57,170** | 23,191 |
| Accounts payable and accrued liabilities (Note 6) | **27,962** | 42,190 |
| Other liabilities (Note 7) | **315** | 4,459 |
| | **85,447** | 69,840 |
| Provisions (Note 11) | **27,794** | 33,059 |
| | **113,241** | 102,899 |
| CONTINGENCIES AND COMMITMENTS (Note 14) | | |
| **SHAREHOLDERS' EQUITY** | | |
| Share capital (Note 12) | **624,277** | 606,703 |
| Contributed surplus | **24,795** | 22,556 |
| Deficit | **(214,103)** | (212,834) |
| | **434,969** | 416,425 |
| | **548,210** | 519,324 |

APPROVED BY THE BOARD

"Donald Archibald"
Donald Archibald, Director

"Brian Felesky"
Brian Felesky, Director

# Consolidated Statements of Comprehensive Loss

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

| | **Three months ended June 30,** | | Six months ended June 30, | |
|---|---|---|---|---|
| | **2013** | 2012 | **2013** | 2012 |
| | **$** | $ | **$** | $ |
| **REVENUE** | | | | |
| Production revenue (Note 8) | **27,790** | 15,838 | **47,611** | 33,526 |
| Gain (loss) on derivative financial instruments (Note 15) | **3,372** | (43) | **139** | (43) |
| | **31,162** | 15,795 | **47,750** | 33,483 |
| **EXPENSES** | | | | |
| Depletion, depreciation and impairment (Note 3) | **13,192** | 14,050 | **22,122** | 42,698 |
| General and administrative | **2,182** | 2,016 | **3,782** | 3,790 |
| Finance costs (Note 10) | **911** | 883 | **1,493** | 1,440 |
| Operating costs | **7,867** | 6,554 | **13,613** | 13,416 |
| Share based payment (Note 13) | **1,105** | 1,450 | **2,239** | 3,076 |
| Transportation | **1,590** | 1,661 | **2,849** | 3,452 |
| Other expense (income) (Note 9) | **(1,001)** | (2,551) | **(806)** | (20,028) |
| | **25,846** | 24,063 | **45,292** | 47,844 |
| INCOME (LOSS) BEFORE INCOME TAXES | **5,316** | (8,268) | **2,458** | (14,361) |
| Deferred income tax expense (recovery) | **1,146** | (1,689) | **3,727** | 154 |
| **NET INCOME (LOSS) AND COMPREHENSIVE INCOME (LOSS)** | **4,170** | (6,579) | **(1,269)** | (14,515) |
| Income (loss) per share, basic and diluted (Note 17) | **$ 0.02** | $ (0.04) | **$ (0.01)** | $ (0.09) |

# Consolidated Statements of Changes in Equity

(Unaudited) (Expressed in thousands of Canadian dollars)

| | Six months ended June 30, | |
|---|---|---|
| | **2013** | 2012 |
| | **$** | $ |
| **SHARE CAPITAL** | | |
| Common Shares (Note 12) | | |
| Balance, beginning of period | **606,703** | 559,371 |
| Shares issued on property acquisition (Note 3) | **17,510** | – |
| Proceeds from shares issued in public offerings | – | 24,400 |
| Proceeds from shares issued in private placements | – | 10,000 |
| Share issue costs, net of tax of ($22) (2012 - $569) | **64** | (1,710) |
| Balance, end of period | **624,277** | 592,061 |
| **CONTRIBUTED SURPLUS** | | |
| Balance, beginning of period | **22,556** | 16,839 |
| Share based payment (Note 13) | **2,239** | 3,076 |
| Balance, end of period | **24,795** | 19,915 |
| **DEFICIT** | | |
| Balance, beginning of period | **(212,834)** | (195,161) |
| Comprehensive loss | **(1,269)** | (14,515) |
| Balance, end of period | **(214,103)** | (209,676) |
| **TOTAL EQUITY** | **434,969** | 402,300 |

# Consolidated Statements of Cash Flows

(Unaudited) (Expressed in thousands of Canadian dollars)

| | Three months ended June 30, | | Six months ended June 30, | |
|---|---|---|---|---|
| | **2013** | 2012 | **2013** | 2012 |
| | **$** | $ | **$** | $ |
| **CASH FLOWS RELATED TO THE FOLLOWING ACTIVITIES:** | | | | |
| **OPERATING** | | | | |
| Net Income (loss) | **4,170** | (6,579) | **(1,269)** | (14,515) |
| Adjustments for non-cash items: | | | | |
| Depletion, depreciation and impairment | **13,192** | 14,050 | **22,122** | 42,698 |
| Finance costs related to provisions (Note 10) | **200** | 185 | **399** | 336 |
| Share based payment (Note 13) | **1,105** | 1,450 | **2,239** | 3,076 |
| Unrealized loss (gain) on derivative financial instruments (Note 15) | **(3,810)** | 119 | **(482)** | 119 |
| Costs related to onerous contracts (Note 11) | **(80)** | (80) | **(160)** | (160) |
| Gain on sale of assets (Note 3) | **(1,092)** | (2,893) | **(1,092)** | (20,390) |
| Deferred income tax expense (recovery) | **1,146** | (1,689) | **3,727** | 154 |
| Decommissioning liabilities expenditures (Note 11) | **(315)** | (194) | **(389)** | (724) |
| Net change in non-cash working capital (Note 16) | **(10,354)** | (2,234) | **(5,822)** | (16) |
| | **4,162** | 2,135 | **19,273** | 10,578 |
| **INVESTING** | | | | |
| Property and equipment and exploration and evaluation assets expenditures | **(4,723)** | (9,909) | **(48,382)** | (50,843) |
| Property acquisitions | **(179)** | – | **(197)** | (6,740) |
| Proceeds from sale of assets (Note 3) | **2,820** | 2,980 | **2,820** | 20,662 |
| Net change in non-cash working capital (Note 16) | **(18,015)** | (16,567) | **(7,377)** | (36,574) |
| | **(20,097)** | (23,496) | **(53,136)** | (73,495) |
| **FINANCING** | | | | |
| Proceeds from demand credit facilities (Note 4) | **16,137** | – | **33,979** | 41,521 |
| Repayment of demand credit facilities (Note 4) | **–** | (12,903) | **–** | (12,903) |
| Issue of common shares (Note 12) | **–** | 36,069 | **–** | 36,069 |
| Share issue costs (Note 12) | **–** | (2,279) | **86** | (2,279) |
| Net change in non-cash working capital (Note 16) | **(202)** | 440 | **(202)** | 440 |
| | **15,935** | 21,327 | **33,863** | 62,848 |
| **NET DECREASE IN CASH** | **–** | (34) | **–** | (69) |
| **CASH, BEGINNING OF PERIOD** | **–** | 345 | **–** | 380 |
| **CASH, END OF PERIOD** | **–** | 311 | **–** | 311 |
| **SUPPLEMENTARY INFORMATION** | | | | |
| Income taxes paid | **–** | – | **–** | – |
| Interest paid | **720** | 755 | **1,108** | 1,217 |

# Notes to the Consolidated Financial Statements

Three and six months ended June 30, 2013 with 2012 comparatives
(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 IAS 34, "Interim Financial Reporting" ("IAS 34"), 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"), as issued by the IASB, 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, 2012.

The consolidated financial statements were authorized for issue by the Company's Board of Directors on August 8, 2013.

### Basis of presentation

Except as noted below, 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, 2012. 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.

### Accounting policies adopted

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

- IFRS 10, "Consolidated Financial Statements", which is the result of the IASB's project to replace Standing Interpretations Committee 12, "Consolidation – Special Purpose Entities" and the consolidation requirements of IAS 27, "Consolidated and Separate Financial Statements". The new standard eliminates the current risk and rewards approach and establishes control as the single basis for determining the consolidation of an entity. The adoption of this standard did not have a material impact on the Company's consolidated financial statements.

- IFRS 11, "Joint Arrangements", which is the result of the IASB's project to replace IAS 31, "Interest in Joint Ventures". The new standard redefines joint operations and joint ventures and requires joint operations to be proportionately consolidated and joint ventures to be equity accounted. Under IAS 31, joint ventures could be proportionately accounted. The adoption of this standard did not have a material impact on the Company's consolidated financial statements.
- IFRS 12, "Disclosure of Interests in Other Entities", which outlines the required disclosures for interests in subsidiaries and joint arrangements. The new disclosures require information that will assist financial statement users to evaluate the nature, risks and financial effects associated with an entity's interests in subsidiaries and joint arrangements. The adoption of this standard did not have a material impact on the Company's consolidated financial statements.
- IFRS 13, "Fair Value Measurement", which provides a common definition of fair value, establishes a framework for measuring fair value under IFRS and enhances the disclosures required for fair value measurements. The standard applies where fair value measurements are required and does not require new fair value measurements. The adoption of this standard required the Company to provide additional disclosures in the notes to the consolidated financial statements (see Note 15).

## 3. Property and Equipment and Exploration and Evalutation Assets

| | Property and equipment | E&E assets | Total |
|---|---|---|---|
| **Cost:** | | | |
| Balance at December 31, 2011 | 541,204 | 6,221 | 547,425 |
| Additions | 91,231 | 427 | 91,658 |
| Change in decommissioning obligation estimates | 4,720 | – | 4,720 |
| Acquisitions | 641 | 7,181 | 7,822 |
| Disposals | (1,440) | – | (1,440) |
| Balance at December 31, 2012 | 636,356 | 13,829 | 650,185 |
| Additions | **45,604** | **2,778** | **48,382** |
| Change in decommissioning obligation estimates | **(3,628)** | – | **(3,628)** |
| Acquisitions | **23,533** | – | **23,533** |
| Disposals | **(21,961)** | – | **(21,961)** |
| Balance at June 30, 2013 | **679,904** | **16,607** | **696,511** |
| **Depletion, depreciation and impairment:** | | | |
| Balance at December 31, 2011 | (131,475) | – | (131,475) |
| Depletion and depreciation | (39,564) | – | (39,564) |
| Impairment loss | (26,894) | – | (26,894) |
| Disposals | 636 | – | 636 |
| Balance at December 31, 2012 | (197,297) | – | (197,297) |
| Depletion and depreciation | **(19,958)** | – | **(19,958)** |
| Impairment loss | **(2,164)** | – | **(2,164)** |
| Disposals | **12,921** | – | **12,921** |
| Balance at June 30, 2013 | **(206,498)** | – | **(206,498)** |
| Carrying amounts: | | | |
| At December 31, 2012 | 439,059 | 13,829 | 452,888 |
| At June 30, 2013 | **473,406** | **16,607** | **490,013** |

Costs subject to depletion include $815,315 of estimated future capital costs (December 31, 2012 – $631,687).

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

## Impairment

The Company reviewed each CGU comprising its property and equipment at June 30, 2013 for indicators of impairment and determined that there were none.

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

During the three and six months ended June 30, 2013 and 2012, the Company recorded the following impairments:

| | **Three months ended June 30,** | | **Six months ended June 30,** | |
|---|---|---|---|---|
| | **2013** | 2012 | **2013** | 2012 |
| Northeast British Columbia | – | 737 | – | 13,931 |
| Peace River Arch | – | 3,679 | – | 8,566 |
| Deep Basin disposition | **2,164** | – | **2,164** | – |
| Total | **2,164** | 4,416 | **2,164** | 22,497 |

## Property acquisition

On April 15, 2013, the Company acquired oil and gas properties located in the Simonette area of Alberta. As consideration for the assets, Cequence transferred its interest in its non-operated oil and gas properties located in the Fir area, and issued an aggregate of 10,300,000 Cequence common shares to the Corporation. The Company recorded $345 of transactions costs related to this acquisition (see note 9). Cequence believes that this expansion and consolidation of its contiguous Montney land position at Simonette has significant present and future economic and strategic value.

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

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

| Estimated fair value of acquisition: | |
| --- | --- |
| Property and equipment | 23,336 |
| Decommissioning liabilities | (239) |
| Deferred income tax liability | (3) |
| | 23,094 |
| **Consideration:** | |
| Common shares issued | 17,510 |
| Property and equipment transferred | 6,004 |
| Decommissioning liabilities transferred | (420) |
| | 23,094 |

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

### Sale of Assets

During the six months ended June 30, 2013, the Company completed the sales of certain oil and gas properties for total cash consideration of $2,820 (2012 - $20,662), subject to final adjustments. The sales resulted in a gain recognized in comprehensive loss of $1,092 (2012 - $20,390).

## 4. Demand Credit Facilities

The Company has credit facilities totalling $125,000 with a syndicate of Canadian chartered banks. Credit facility A is a $115,000 (December 31, 2012 - $90,000) extendible revolving term credit facility by way of prime loans, U.S. Base Rate Loans, Banker's Acceptances and Libor Loans. Credit facility B is a $10,000 (December 31, 2012 - $10,000) operating facility by way of prime loans, U.S. Base Rate Loans, Banker's Acceptances and letters of credit. Prime loans and U.S. Base Rate Loans on these facilities bear interest at the bank prime rate or U.S. Base Rate, respectively, plus 1.0 percent to 2.5 percent on a sliding scale, depending on the Company's debt to adjusted EBITDA ratio (ranging from being less than or equal to 1.0:1.0 to greater than 2.5:1.0). Banker's Acceptances, Libor Loans and letters of credit on these facilities bear interest at the Banker's Acceptance rate, Libor rate or letter of credit rate, as applicable, plus 2.0 percent to 3.5 percent based on the same sliding scale as above. The credit facilities may be extended and revolve beyond the initial one-year period, if requested by the Company and accepted by the lenders. If the credit facilities do not continue to revolve, the facilities will convert to a 366-day non-revolving term loan facility.

Both credit facilities, and the amount available for draws under the facilities, are subject to periodic review by the bank and are secured by a general assignment of book debts and a $250,000 demand debenture with a first floating charge over all assets of the Company. The Company is permitted to hedge up to 67 percent of its production under the lending agreement. As at June 30, 2013, the Company has drawn $57,170 under the extendible revolving term credit facility and $nil under the operating facility (December 31, 2012 – $23,191

and $nil for the revolving and operating facilities, respectively) and is in compliance with all covenants. The effective annualized interest rate, including standby fees and commitment fees, for the six months ended June 30, 2013 was 3.6 percent (2012 – 2.8 percent). The next scheduled review is to take place on November 2013.

## 5. Accounts Receivable

| | June 30, 2013 | December 31, 2012 |
|---|---|---|
| Trade receivables | **6,172** | 7,852 |
| Allowance for doubtful accounts | **(399)** | (515) |
| Net trade receivables | **5,773** | 7,337 |
| Accrued revenue | **9,374** | 7,627 |
| Other receivables | **291** | 1,120 |
| Total accounts receivable | **15,438** | 16,084 |

## 6. Accounts Payable and Accrued Liabilities

| | June 30, 2013 | December 31, 2012 |
|---|---|---|
| Accounts payable | **5,974** | 17,657 |
| Accrued liabilities | **21,988** | 24,533 |
| Total accounts payable and accrued liabilities | **27,962** | 42,190 |

## 7. Other Liabilities

| | June 30, 2013 | December 31, 2012 |
|---|---|---|
| Obligations related to onerous contracts – current (Note 11) | **315** | 317 |
| Obligations related to flow-through shares | – | 4,142 |
| Total other liabilities | **315** | 4,459 |

## 8. Production Revenue

| | Three months ended June 30, | | Six months ended June 30, | |
|---|---|---|---|---|
| | **2013** | 2012 | **2013** | 2012 |
| Sales of oil and natural gas | **30,242** | 15,956 | **52,152** | 35,820 |
| Less: royalties | **(2,452)** | (118) | **(4,541)** | (2,294) |
| Total production revenue | **27,790** | 15,838 | **47,611** | 33,526 |

## 9. Other Expense (Income)

| | Three months ended June 30, | | Six months ended June 30, | |
|---|---|---|---|---|
| | **2013** | 2012 | **2013** | 2012 |
| Gain on sale of property and equipment | **(1,092)** | (2,893) | **(1,092)** | (20,390) |
| Transaction costs | **120** | – | **345** | – |
| Other | **(29)** | 342 | **(59)** | 362 |
| Total other expense (income) | **(1,001)** | (2,551) | **(806)** | (20,028) |

## 10. Finance Costs

| | Three months ended June 30, | | Six months ended June 30, | |
|---|---|---|---|---|
| | **2013** | 2012 | **2013** | 2012 |
| Interest expense on demand credit facilities (including stand-by fees and commitment fees of $296 (2012 - $121)) | **711** | 698 | **1,094** | 1,104 |
| Accretion expense on provisions | **200** | 185 | **399** | 336 |
| Total finance costs | **911** | 883 | **1,493** | 1,440 |

## 11. Provisions

### Decommissioning liabilities

The following table summarizes the changes in decommissioning liabilities for the six months ended June 30, 2013 and the year ended December 31, 2012:

| | **2013** | 2012 |
|---|---|---|
| Balance, beginning of period | **32,564** | 28,135 |
| Property acquisitions (Note 3) | **239** | 417 |
| Property dispositions (Note 3) | **(1,728)** | (533) |
| Accretion expense | **399** | 730 |
| Liabilities incurred | **505** | 1,775 |
| Abandonment costs incurred | **(389)** | (904) |
| Revisions in estimated cash flows | **(593)** | 2,078 |
| Revisions due to change in discount rates | **(3,540)** | 866 |
| Balance, end of period | **27,457** | 32,564 |

The Company's decommissioning liabilities result from its ownership in oil and natural gas assets including well sites, facilities and gathering systems. The total estimated, undiscounted cash flows, inflated at 2 percent, required to settle the obligations are $51,473 (December 31, 2012 - $47,549). These cash flows have been discounted using a risk-free interest rate of 2.96 percent (December 31, 2012 - 2.37 percent) based on Government of Canada long-term benchmark bonds. The Company expects these obligations to be settled in approximately 1 to 50 years (December 31, 2012 – 1 to 50 years). As at June 30, 2013, no funds have been set aside to settle these liabilities (December 31, 2012 – nil).

### Onerous contracts

As at June 30, 2013, the Company recognized a provision related to an onerous lease contract of $652 (December 31, 2012 - $812). The provision for onerous lease contract represents the present value of the future lease obligations that the Company is presently obligated to make under a non-cancellable onerous operating lease contract, less revenue expected to be earned on the lease, including estimated future sub-lease revenue. The total estimated, undiscounted cash flows, required to settle the obligations are $669 (December 31, 2012 - $830). These cash flows have been discounted using a risk-free interest rate of 1.23 percent (December 31, 2012 – 1.20 percent) based on Government of Canada three year benchmark bonds.

Cequence expects to reduce the provision by $315 in the twelve months ended June 30, 2014, which amount is included with other liabilities in the consolidated balance sheet (see note 7). The portion of the provision expected to be realized in the period subsequent to June 30, 2014 of $337 is carried with provisions as a non-current liability in the consolidated balance sheet as at June 30, 2013. The estimate may vary as a result of changes in the utilization of the lease premises and the sub-lease arrangements, where applicable. The unexpired term of the leases at June 30, 2013 is 25 months.

## 12. Share Capital

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

| | **Three months ended June 30, 2013** | | Year ended December 31, 2012 | |
|---|---|---|---|---|
| **Issued common voting shares** | **Number** | **Stated Value** | Number | Stated Value |
| | **(000's)** | **$** | (000's) | $ |
| Balance, beginning of period | **200,610** | **606,703** | 161,856 | 559,371 |
| Common shares | – | – | 21,269 | 25,523 |
| Common shares issued on property acquisition (Note 3) | **10,300** | **17,510** | – | – |
| Flow-through common shares | – | – | 17,485 | 24,429 |
| | **210,910** | **624,213** | 200,610 | 609,323 |
| Share issue costs, net of taxes of ($22) (2012 - $874) | – | **64** | – | (2,620) |
| Balance, end of period | **210,910** | **624,277** | 200,610 | 606,703 |

## 13. 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.

A summary of the status of the Company's stock option plan and changes during the six months ended June 30, 2013 and year ended December 31, 2012 is as follows:

| | **June 30, 2013** | | December 31, 2012 | |
|---|---|---|---|---|
| | **Number of Options** | **Weighted Average Exercise Price** | Number of Options | Weighted Average Exercise Price |
| | **(000's)** | **$** | (000's) | $ |
| Outstanding, beginning of period | **17,289** | **2.19** | 13,094 | 2.54 |
| Granted | **125** | **1.35** | 5,118 | 1.30 |
| Forfeited | **(200)** | **1.92** | (923) | 2.20 |
| Outstanding, end of period | **17,214** | **2.18** | 17,289 | 2.19 |

The following table summarizes information about stock options outstanding at June 30, 2013:

| | | Options Outstanding | | Options Exercisable | |
|---|---|---|---|---|---|
| Range of Exercise Price | Weighted Average Exercise Price | Number of Options Outstanding | Weighted Average Contractual Life Remaining | Number of Options | Weighted Average Exercise Price |
| $ | $ | (000's) | (years) | (000's) | $ |
| 1.24 – 1.99 | 1.72 | 13,168 | 2.9 | 5,895 | 1.94 |
| 2.96 – 3.94 | 3.69 | 4,046 | 3.0 | 1,971 | 3.71 |
| | 2.18 | 17,214 | 2.9 | 7,866 | 2.38 |

During the six months ended June 30, 2013, $2,239 (2012 - $3,076) in share based payment expense related to equity-settled stock options has been recognized in comprehensive loss.

## 14. Contingencies and Commitments

| | 2013 | 2014 | 2015 | 2016 | 2017+ | Total |
|---|---|---|---|---|---|---|
| Office leases | 566 | 922 | 187 | – | – | 1,675 |
| Drilling services | 1,071 | – | – | – | – | 1,071 |
| Pipeline transportation | 868 | 1,722 | 1,576 | – | – | 4,166 |
| Total | 2,505 | 2,644 | 1,763 | – | – | 6,912 |

The pipeline transportation contract expires on November 30, 2015.

In 2011, the Company entered into a drilling service agreement whereby the Company has committed to use a drilling rig for 360 days over the two years following commencement of use of the drilling rig at current market rates. The commitment is drawn down when the rig is in use, whether by Cequence or third parties. Cequence expects to meet the commitment in the required time.

In 2011, the Company entered into a drilling service agreement whereby the Company made a deposit of $3,500 to obtain a right of first refusal on the use of two drilling rigs over the five years following the date that use of the rigs commences. The deposit is to be applied as the Company incurs costs related to the use of the drilling rigs and $1,251 has been drawn down at June 30, 2013. Cequence expects to reduce the deposit by $794 in the twelve months ended June 30, 2014, which amount is included with deposits and prepaid expenses at June 30, 2013. The portion of the outstanding deposit expected to be drawn down in the period subsequent to June 30, 2014 of $1,455 is carried as a non-current asset at June 30, 2013.

## 15. Financial Instruments and Risk Management

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

The Company's accounts receivable, demand credit facilities and accounts payable and accrued liabilities approximate their carrying values due to their short terms to maturity and the floating interest rate on the Company's debt. As at June 30, 2013, the accounts receivable balance was $15,438 of which $2,061 was past due. The past due accounts are considered collectible, except as provided for in the allowance for doubtful accounts. The following tables provides an aging analysis of the Company's accounts receivables:

| Current | 30-60 days | 60-90 days | 90+days | Total |
|---|---|---|---|---|
| 12,556 | 468 | 353 | 2,061 | 15,438 |

The Company's fair value hierarchy for those assets and liabilities measured at fair value as of June 30, 2013 comprises cash, which is considered a level 1 financial instrument and commodity contracts. Cequence's commodity contracts are measured at level 2 under the Company's fair value hierarchy as of June 30, 2013. The fair value of commodity contracts is determined by discounting the remaining contracted petroleum and natural gas volumes by the difference between the contracted price and published forward price curves as at the balance sheet date.

The nature of these financial instruments and the Company's operations expose the Company to market risk, credit risk and liquidity risk. The Company manages its exposure to these risks by operating in a manner that minimizes these risks. Senior management employs risk management strategies and policies to ensure that any exposure to risk is in compliance with the Company's business objectives and risk tolerance levels. The Board of Directors has overall responsibility for the establishment and oversight of the Company's risk management framework. The Board has established policies in setting risk limits and controls and monitors these risks in relation to market conditions. There have not been any changes to the Company's exposure to risks, or the objectives, policies and processes to manage these risks from December 31, 2012.

### Commodity price risk

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

During the six months ended June 30, 2013, the Company entered into several commodity derivative financial instrument contracts. The following information presents all outstanding positions for commodity derivative financial instruments at June 30, 2013:

| Term | Product | Type | Volume | Price | Basis |
|---|---|---|---|---|---|
| January 1, 2013 to December 31, 2013 | Gas | Swap | 2,000 gj/day | $2.84 | AECO |
| January 1, 2013 to December 31, 2013 | Gas | Swap | 2,500 gj/day | $3.09 | AECO |
| January 1, 2013 to December 31, 2013 | Gas | Swap | 2,500 gj/day | $3.00 | AECO |
| January 1, 2013 to December 31, 2013 | Gas | Swap | 5,000 gj/day | $3.10 | AECO |
| January 1, 2013 to December 31, 2013 | Gas | Swap | 2,500 gj/day | $3.24 | AECO |
| January 1, 2013 to December 31, 2013 | Gas | Swap | 2,500 gj/day | $3.40 | AECO |
| March 1, 2013 to December 31, 2013 | Gas | Swap | 2,500 gj/day | $3.03 | AECO |
| March 1, 2013 to December 31, 2013 | Gas | Swap | 2,500 gj/day | $3.17 | AECO |
| May 1, 2013 to October 31, 2013 | Gas | Swap | 2,500 gj/day | $3.49 | AECO |
| January 1, 2014 to September 30, 2014 | Gas | Swap | 2,500 gj/day | $3.51 | AECO |
| January 1, 2014 to December 31, 2014 | Gas | Swap | 2,500 gj/day | $3.42 | AECO |
| January 1, 2014 to December 31, 2014 | Gas | Swap | 2,500 gj/day | $3.53 | AECO |
| January 1, 2014 to December 31, 2014 | Gas | Swap | 2,500 gj/day | $3.70 | AECO |
| January 1, 2013 to December 31, 2013 | Oil | Sold Call | 200 bbls/day | $110.00 USD | WTI |

For the six months ended June 30, 2013, realized loss from commodity derivative contracts recognized in comprehensive loss were $343 (2012 - $76 gain).

The fair value of the commodity contracts outstanding at June 30, 2013 was a current asset of $889 and non-current asset of $351 (December 31, 2012 - current asset of $694 and non-current asset of $63).

For the six months ended June 30, 2013, the Company recorded an unrealized gain of $482 from derivative commodity contracts (2012 - $119 loss).

As at June 30, 2013, an increase in gas price of $0.50/gj results in an decrease in the fair value of the commodity contracts of $3,857 ($2,893 after tax) and a commensurate increase to comprehensive loss.

## 16. Changes in Non-Cash Working Capital

| | Three months ended June 30, | | Six months ended June 30, | |
|---|---|---|---|---|
| | **2013** | 2012 | **2013** | 2012 |
| Accounts receivable | **(601)** | 10,969 | **646** | 3,413 |
| Deposits and prepaid expenses | **241** | (479) | **181** | (606) |
| Accounts payable and accrued liabilities | **(28,211)** | (28,851) | **(14,228)** | (38,957) |
| Net change in non-cash working capital | **(28,571)** | (18,361) | **(13,401)** | (36,150) |
| Allocated to: | | | | |
| Operating activities | **(10,354)** | (2,234) | **(5,822)** | (16) |
| Investing activities | **(18,015)** | (16,567) | **(7,377)** | (36,574) |
| Financing activities | **(202)** | 440 | **(202)** | 440 |
| | **(28,571)** | (18,361) | **(13,401)** | (36,150) |

## 17. Income (Loss) Per Share

Income (loss) per share has been calculated based on the weighted average number of common shares outstanding during the year. For the three and six months ended June 30, 2013, 12,375,667 and 17,214,042 (2012 – 14,199,500) stock options have been excluded in the calculation of diluted shares outstanding 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 June 30,** | | **Six months ended June 30,** | |
|---|---|---|---|---|
| | **2013** | 2012 | **2013** | 2012 |
| Basic weighted average shares | **209,213** | 164,823 | **204,935** | 163,339 |
| Effect of dilutive stock options | **554** | – | **–** | – |
| Diluted weighted average shares | **209,767** | 164,823 | **204,935** | 163,339 |

# Corporate Information

## Management

**Paul Wanklyn**
President & CEO

**Howard Crone, P.Eng**
Executive Vice President & COO

**David Gillis, CA**
Vice President, Finance & CFO

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

**David P. Robinson**
Vice President, Geology

**Christopher C. Soby**
Vice President, Land

**Stephen R. Stretch**
Vice President, Geophysics

**Mike Stewart**
Vice President, Operations

**Erin Thorson, CMA**
Controller

## Directors

**Don Archibald**
Chairman

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

(1) Director Emeritus

## Transfer Agent and Registrar

**Valiant Trust Company**
Calgary, Alberta

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## Auditors

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Calgary, Alberta

## Bankers

**Canadian Imperial Bank of Commerce**
Calgary, Alberta

**National Bank of Canada**
Calgary, Alberta

**Bank of Montreal**
Calgary, Alberta

## Legal Counsel

**Norton Rose Canada LLP**
Calgary, Alberta

## Evaluation Engineers

**GLJ Petroleum Consultants**
Calgary, Alberta

## Stock Exchange Listing

**Toronto Stock Exchange**
Symbol: CQE

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