

Condensed Consolidated Financial Statements of

CEQUENCE ENERGY LTD.

June 30, 2012

CEQUENCE ENERGY LTD.

Condensed Consolidated Balance Sheets (Unaudited) (Expressed in thousands of Canadian dollars)

	June 30, 2012 \$	December 31, 2011 \$
ASSETS		
CURRENT		
Cash	311	380
Accounts receivable (Note 5)	17,619	21,032
Deposits and prepaid expenses (Note 15)	3,961	3,231
Commodity contracts (Note 16)	69	-
	<u>21,960</u>	<u>24,643</u>
Exploration and evaluation assets (Note 3)	13,517	6,221
Property and equipment (Note 3)	419,283	409,729
Deposits and prepaid expenses (Note 15)	2,332	2,456
Deferred income taxes	43,773	48,316
	<u>500,865</u>	<u>491,365</u>
LIABILITIES		
CURRENT		
Demand credit facilities (Note 4)	40,236	11,618
Accounts payable and accrued liabilities (Note 6)	25,510	64,467
Other liabilities (Note 7)	1,985	5,289
	<u>67,731</u>	<u>81,374</u>
Commodity contracts (Note 16)	188	-
Provisions (Note 11)	30,646	28,942
	<u>98,565</u>	<u>110,316</u>
CONTINGENCIES AND COMMITMENTS (Note 15)		
SUBSEQUENT EVENTS (Note 18)		
SHAREHOLDERS' EQUITY		
Share capital (Note 12)	592,061	559,371
Contributed surplus	19,915	16,839
Deficit	(209,676)	(195,161)
	<u>402,300</u>	<u>381,049</u>
	<u>500,865</u>	<u>491,365</u>

APPROVED BY THE BOARD

"Donald Archibald"

Donald Archibald, Director

"Brian Felesky"

Brian Felesky, Director

The accompanying notes are an integral part of these condensed consolidated financial statements.

CEQUENCE ENERGY LTD.

Condensed Consolidated Statements of Comprehensive Loss

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

	Three months ended		Six months ended	
	June 30,		June 30,	
	2012	2011	2012	2011
	\$	\$	\$	\$
REVENUE				
Production revenue (Note 8)	15,838	23,657	33,526	44,341
Gain (loss) on derivative financial instruments (Note 16)	(43)	61	(43)	316
	15,795	23,718	33,483	44,657
EXPENSES				
Depletion, depreciation and impairment (Note 3)	14,050	10,520	42,698	19,657
General and administrative	2,016	1,965	3,790	3,758
Finance costs (Note 10)	883	804	1,440	1,911
Operating costs	6,554	7,439	13,416	14,180
Stock-based compensation (Note 13)	1,450	2,130	3,076	3,481
Transportation	1,661	1,883	3,452	3,712
Other expense (income) (Note 9)	(2,551)	(1,837)	(20,028)	(3,982)
	24,063	22,904	47,844	42,717
INCOME (LOSS) BEFORE INCOME TAXES	(8,268)	814	(14,361)	1,940
INCOME TAXES	(1,689)	1,515	154	4,616
NET LOSS AND COMPREHENSIVE LOSS	(6,579)	(701)	(14,515)	(2,676)
Loss per share, basic and diluted (Note 14)	\$ (0.04)	\$ (0.00)	\$ (0.09)	\$ (0.02)

The accompanying notes are an integral part of these condensed consolidated financial statements.

CEQUENCE ENERGY LTD.

Condensed Consolidated Statements of Changes in Equity (Unaudited) (Expressed in thousands of Canadian dollars)

	Six months ended June 30,	
	2012	2011
	\$	\$
SHARE CAPITAL		
Common Shares		
Balance, beginning of period	559,371	452,526
Deemed proceeds from shares issued in public offerings	24,400	44,168
Proceeds from shares issued in private placements	10,000	-
Shares issued on exercise of stock options	-	1,794
Share issue costs, net of tax of \$569 (2011 - \$729)	(1,710)	(2,113)
Balance, end of period	592,061	496,375
CONTRIBUTED SURPLUS		
Balance, beginning of period	16,839	10,681
Stock-based compensation expense (Note 13)	3,076	3,481
Exercise of stock options	-	(600)
Balance, end of period	19,915	13,562
DEFICIT		
Balance, beginning of period	(195,161)	(175,003)
Comprehensive loss	(14,515)	(2,676)
Balance, end of period	(209,676)	(177,679)
TOTAL EQUITY	402,300	332,258

The accompanying notes are an integral part of these condensed consolidated financial statements.

CEQUENCE ENERGY LTD.

Condensed Consolidated Statements of Cash Flows (Unaudited) (Expressed in thousands of Canadian dollars)

	Three months ended		Six months ended	
	June 30,		June 30,	
	2012	2011	2012	2011
	\$	\$	\$	\$
CASH FLOWS RELATED TO THE FOLLOWING ACTIVITIES:				
OPERATING				
Net loss	(6,579)	(701)	(14,515)	(2,676)
Adjustments for non-cash items:				
Depletion, depreciation and impairment	14,050	10,520	42,698	19,657
Finance costs related to provisions (Note 10)	185	250	336	508
Stock-based compensation (Note 13)	1,450	2,130	3,076	3,481
Amortization of transaction costs on financial instruments (Note 10)	-	153	-	320
Unrealized loss (gain) on derivative financial instruments	119	10	119	(140)
Costs related to onerous contracts (Note 11)	(80)	-	(160)	-
Gain on sale of assets (Note 9)	(2,893)	(1,835)	(20,390)	(3,951)
Deferred income tax (recovery)	(1,689)	1,515	154	4,623
	4,563	12,042	11,318	21,822
Decommissioning liabilities expenditures (Note 11)	(194)	(88)	(724)	(115)
Net change in non-cash working capital (Note 17)	(2,234)	(4,380)	(16)	(2,293)
	2,135	7,574	10,578	19,414
INVESTING				
Property and equipment and exploration and evaluation assets expenditures	(9,909)	(16,470)	(50,843)	(62,044)
Acquisitions	-	(21,700)	(6,740)	(21,700)
Proceeds from sale of assets	2,980	7,566	20,662	29,210
Net change in non-cash working capital (Note 17)	(16,567)	(24,189)	(36,574)	(2,144)
	(23,496)	(54,793)	(73,495)	(56,678)
FINANCING				
Proceeds from demand credit facilities (Note 4)	-	46,305	41,521	46,305
Repayment of demand credit facilities (Note 4)	(12,903)	-	(12,903)	(52,518)
Transaction costs on financial instruments (Note 4)	-	-	-	(57)
Issue of common shares (Note 12)	36,069	1,194	36,069	46,727
Share issue costs (Note 12)	(2,279)	(333)	(2,279)	(2,842)
Net change in non-cash working capital (Note 17)	440	-	440	-
	21,327	47,166	62,848	37,615
NET INCREASE (DECREASE) IN CASH	(34)	(53)	(69)	351
CASH, BEGINNING OF PERIOD	345	1,725	380	1,321
CASH, END OF PERIOD	311	1,672	311	1,672
SUPPLEMENTARY INFORMATION				
Income taxes paid	-	-	-	-
Interest paid	755	310	1,217	989

The accompanying notes are an integral part of these condensed consolidated financial statements.

CEQUENCE ENERGY LTD.

Notes to the Condensed Consolidated Financial Statements

Three and six month periods ended June 30, 2012 with 2011 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 (“TSX”). 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, 2011.

The consolidated financial statements were authorized for issue by the Company’s Board of Directors on August 14, 2012.

Basis of presentation

The consolidated financial statements have been prepared using the same accounting policies and methods as those used in the consolidated financial statements for the year ended December 31, 2011. 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.

CEQUENCE ENERGY LTD.

Notes to the Condensed Consolidated Financial Statements

Three and six month periods ended June 30, 2012 with 2011 comparatives

(All figures expressed in thousands except per share amounts unless otherwise noted)

3. PROPERTY AND EQUIPMENT AND EXPLORATION AND EVALUATION ASSETS

	Property and equipment	Exploration and evaluation assets	Total
Cost:			
Balance at December 31, 2010	420,368	-	420,368
Additions	152,569	6,221	158,790
Acquisitions	25,540	-	25,540
Disposals	(57,273)	-	(57,273)
Balance at December 31, 2011	541,204	6,221	547,425
Additions	53,056	138	53,194
Acquisitions	-	7,158	7,158
Disposals	(1,440)	-	(1,440)
Balance at June 30, 2012	592,820	13,517	606,337
Depletion, depreciation and impairment:			
Balance at December 31, 2010	(78,567)	-	(78,567)
Depletion and depreciation	(41,228)	-	(41,228)
Impairment loss	(18,332)	-	(18,332)
Disposals	6,652	-	6,652
Balance at December 31, 2011	(131,475)	-	(131,475)
Depletion and depreciation	(20,201)	-	(20,201)
Impairment loss	(22,497)	-	(22,497)
Disposals	636	-	636
Balance at June 30, 2012	(173,537)	-	(173,537)
Carrying amounts:			
At December 31, 2011	409,729	6,221	415,950
At June 30, 2012	419,283	13,517	432,800

Costs subject to depletion include \$408,947 of estimated future capital costs (December 31, 2011 – \$426,485).

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).

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

Impairment

The Company reviewed each CGU comprising its property and equipment at June 30, 2012 for indicators of impairment and determined that indicators were present related to decreases to future natural gas prices used to estimate the value in use and fair value less cost to sell of each of the Company's CGUs.

CEQUENCE ENERGY LTD.

Notes to the Condensed Consolidated Financial Statements

Three and six month periods ended June 30, 2012 with 2011 comparatives

(All figures expressed in thousands except per share amounts unless otherwise noted)

3. PROPERTY AND EQUIPMENT AND EXPLORATION AND EVALUATION ASSETS (Continued)

Impairment (continued)

As a result, impairment tests were carried out at June 30, 2012. The recoverable amounts of each of the Company's CGUs at June 30, 2012 were estimated as their fair value less cost to sell, based on the net present value of discounted future cash flows from oil and gas reserves, as estimated by the Company's independent reserves evaluator, and adjusted for changes to forward prices since the Company's reserves were evaluated at December 31, 2011. Consideration was also given to acquisition metrics of recent transactions completed on similar assets to those contained within the relevant CGU.

The benchmark escalated prices on which the June 30, 2012 impairment tests are based are as follows:

	Natural Gas	Condensate	Crude Oil
	AECO Spot (\$/mmbtu)	Edmonton Pentanes Plus (\$/bbl)	Edmonton Par (\$/bbl)
2012	2.87	89.76	79.08
2013	3.44	95.41	86.73
2014	3.90	99.76	95.92
2015	4.36	105.06	101.02
2016	4.82	105.06	101.02
2017	5.28	105.06	101.02
2018	5.68	106.49	102.40
2019	5.80	108.65	104.47
2020	5.19	110.84	106.58
2021	6.03	113.08	108.73

Prices increase at a rate of approximately 2.0 percent per year for natural gas, condensate and crude oil after 2021. Adjustments were made to the benchmark prices, for purposes of the impairment tests, to reflect varied delivery points and quality differentials in the products delivered.

Results of the Company's impairment tests for the three and six months ended June 30, 2012 and 2011 are as follows:

	Three months ended June 30,		Six months ended June 30,	
	2012	2011	2012	2011
Northeast British Columbia	\$ 737	\$ -	\$ 13,931	\$ -
Peace River Arch	3,679	-	8,566	-
Deep Basin	-	-	-	-
Total	\$ 4,416	\$ -	\$ 22,497	\$ -

Sale of Assets

During the six months ended June 30, 2012, the Company completed the sale of certain undeveloped land and gas-weighted properties located in Northwest Alberta for total cash consideration of \$20,662, subject to final adjustments. The sales resulted in a gain recognized in comprehensive income (loss) of \$20,390.

CEQUENCE ENERGY LTD.

Notes to the Condensed Consolidated Financial Statements

Three and six month periods ended June 30, 2012 with 2011 comparatives

(All figures expressed in thousands except per share amounts unless otherwise noted)

4. DEMAND CREDIT FACILITIES

On May 10, 2012, the Company renewed its credit facilities with a syndicate of Canadian chartered banks. The renewed facilities are on the same terms and at the same interest rates as the previous facilities and consist of a \$90,000 extendible revolving term credit facility and a \$10,000 operating facility. As at June 30, 2012, the Company has drawn \$40,236 under the extendible revolving term credit facility and \$nil under the operating facility (December 31, 2011 – \$11,618 and \$nil for the revolving and operating facilities, respectively) and is in compliance with all covenants. The next scheduled review is to take place in November, 2012. During the six months ended June 30, 2012 the Company capitalized transaction costs related to its credit facilities of \$nil (June 30, 2011 – \$57).

A reconciliation of the Company's credit facilities to the amount presented on the condensed consolidated balance sheet is as follows:

	<u>June 30, 2012</u>	<u>December 31, 2011</u>
Credit facilities	40,236	11,618
Less: transaction costs capitalized (net of accumulated amortization)	-	-
	<u>40,236</u>	<u>11,618</u>

5. ACCOUNTS RECEIVABLE

	<u>June 30, 2012</u>	<u>December 31, 2011</u>
Trade receivables	11,882	13,015
Less: allowance for doubtful accounts	(535)	(551)
Net trade receivables	11,347	12,464
Accrued revenue	6,163	6,332
Other receivables	109	2,236
Total accounts receivable	<u>17,619</u>	<u>21,032</u>

6. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

	<u>June 30, 2012</u>	<u>December 31, 2011</u>
Accounts payable	2,409	36,267
Accrued liabilities	23,101	28,200
Total accounts payable and accrued liabilities	<u>25,510</u>	<u>64,467</u>

CEQUENCE ENERGY LTD.

Notes to the Condensed Consolidated Financial Statements

Three and six month periods ended June 30, 2012 with 2011 comparatives

(All figures expressed in thousands except per share amounts unless otherwise noted)

7. OTHER LIABILITIES

	June 30, 2012	December 31, 2011
Obligations related to onerous contracts – current (Note 11)	316	331
Obligations related to flow-through shares	1,669	4,958
Total other liabilities	<u>1,985</u>	<u>5,289</u>

8. PRODUCTION REVENUE

	Three months ended June 30,		Six months ended June 30,	
	2012	2011	2012	2011
Sales of oil and natural gas	15,956	27,222	35,820	51,149
Less: royalties	(118)	(3,565)	(2,294)	(6,808)
Total production revenue	<u>15,838</u>	<u>23,657</u>	<u>33,526</u>	<u>44,341</u>

9. OTHER EXPENSE (INCOME)

	Three months ended June 30,		Six months ended June 30,	
	2012	2011	2012	2011
Gain on sale of property and equipment	(2,893)	(1,835)	(20,390)	(3,951)
Other	342	(2)	362	(31)
Total other expense (income)	<u>(2,551)</u>	<u>(1,837)</u>	<u>(20,028)</u>	<u>(3,982)</u>

10. FINANCE COSTS

	Three months ended June 30,		Six months ended June 30,	
	2012	2011	2012	2011
Interest expense on demand credit facilities (including stand-by fees and commitment fees of \$121 (2011 - \$112))	698	401	1,104	1,083
Accretion expense on provisions	185	250	336	508
Amortization of transaction costs on financial instruments	-	153	-	320
Total finance costs	<u>883</u>	<u>804</u>	<u>1,440</u>	<u>1,911</u>

CEQUENCE ENERGY LTD.

Notes to the Condensed Consolidated Financial Statements

Three and six month periods ended June 30, 2012 with 2011 comparatives

(All figures expressed in thousands except per share amounts unless otherwise noted)

11. PROVISIONS

Decommissioning liabilities

The following table summarizes the changes in decommissioning liabilities for the six months ended June 30, 2012 and the year ended December 31, 2011:

	June 30, 2012	December 31, 2011
Balance - beginning of period	28,135	26,130
Acquisitions	418	1,539
Property dispositions (Note 3)	(533)	(7,135)
Accretion expense	349	905
Liabilities incurred	870	3,217
Abandonment costs incurred	(724)	(955)
Revisions in estimated cash flows	366	(21)
Revisions due to change in discount rates	1,116	4,455
Balance - end of period	29,997	28,135

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 at June 30, 2012 are \$44,047 (December 31, 2011 - \$42,659). These cash flows have been discounted using a risk-free interest rate of 2.32 percent (December 31, 2011 - 2.50 percent) based on Government of Canada long-term benchmark bonds. The Company expects these obligations to be settled in approximately 2 to 30 years. As at June 30, 2012, no funds have been set aside to settle these liabilities.

Onerous contracts

As at June 30, 2012, the Company recognized a provision related to an onerous lease contract of \$965 (December 31, 2011 - \$1,138). 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 \$990 (December 31, 2011 - \$1,164). These cash flows have been discounted using a risk-free interest rate of 1.04 percent (December 31, 2011 - 0.99 percent) based on Government of Canada three year benchmark bonds.

Cequence expects to reduce the provision by \$316 in the twelve months ended June 30, 2013, which amount is included with other liabilities in the condensed consolidated balance sheet (see note 7). The portion of the provision expected to be realized in the period subsequent to June 30, 2013 of \$649 is carried with provisions as a non-current liability in the condensed consolidated balance sheet as at June 30, 2012. During the six months ended June 30, 2012, the Company recognized a reduction to finance costs of \$13 (June 30, 2011 - \$nil) to account for accretion and changes in estimates and rates related to onerous contracts. The estimates 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, 2012 is 37 months.

CEQUENCE ENERGY LTD.

Notes to the Condensed Consolidated Financial Statements

Three and six month periods ended June 30, 2012 with 2011 comparatives

(All figures expressed in thousands except per share amounts unless otherwise noted)

12. SHARE CAPITAL

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

	Six months ended June 30, 2012		Year ended December 31, 2011	
	Number (000's)	Stated Value \$	Number (000's)	Stated Value \$
Issued common voting shares				
Balance, beginning of period	161,856	559,371	128,750	452,526
Common shares	20,017	24,020	25,358	84,229
Flow-through shares	8,650	10,380	4,898	16,758
Common shares on exercise of stock options	-	-	600	1,794
Common shares on exercise of the 2011 Warrants	-	-	2,250	8,663
	190,523	593,771	161,856	563,970
Share issue costs, net of taxes of \$569 (2011 - \$1,531)	-	(1,710)	-	(4,599)
Balance, end of period	190,523	592,061	161,856	559,371
Warrants, beginning of period	2,250	-	4,500	-
Warrants cancelled	(2,250)	-	-	-
Warrants exercised	-	-	(2,250)	-
Warrants, end of period	-	-	2,250	-

On March 8, 2012, the Company's 2012 Warrants were cancelled at no cost to Cequence and no redress to the shareholder.

On June 20, 2012, the Company completed the sale of 11,684 common voting shares at a price of \$1.20 per share for gross proceeds of \$14,020. On July 12, 2012, the Company further completed the sale of 1,253 common voting shares at a price of \$1.20 per share for gross proceeds of \$1,503 related to the exercise of an over-allotment option on the above issuance.

On June 20, 2012, the Company completed the sale of 4,850 common voting shares on a CEE "flow-through" basis at \$1.45 per share for gross proceeds of \$7,033 as well as 3,800 common voting shares on a CDE "flow-through" basis at \$1.32 per share for gross proceeds of \$5,016, resulting in a total issuance of 8,650 common voting shares for total gross proceeds of \$12,049. The above transaction resulted in an increase to share capital of \$10,380 and the recognition of an obligation related to flow-through shares of \$1,669 included with other liabilities in the condensed consolidated balance sheet at June 30, 2012. In accordance with the terms of the related agreements and pursuant to certain provisions of the Income Tax Act (Canada), the Company is required to renounce, for income tax purposes, exploration expenditures of \$7,033 and development expenditures of \$5,016 to the holders of the flow-through common shares effective December 31, 2012. As at June 30, 2012, the Company has not incurred any of the qualifying expenditures.

CEQUENCE ENERGY LTD.

Notes to the Condensed Consolidated Financial Statements

Three and six month periods ended June 30, 2012 with 2011 comparatives

(All figures expressed in thousands except per share amounts unless otherwise noted)

12. SHARE CAPITAL (Continued)

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

As at June 30, 2012, there were no issued or outstanding non-voting shares (December 31, 2011 – none).

13. STOCK BASED COMPENSATION PLANS

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

During the six months ended June 30, 2012, the Company issued 1,518 stock options at prices ranging from \$1.34 to \$1.95 to employees and directors. The options have a five year life and one third vest annually commencing one year following the grant date. The Company utilized a Black-Scholes option pricing model to price the options. During the six months ended June 30, 2012, 413 options were forfeited.

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

	June 30, 2012	December 31, 2011
	\$	\$
Risk-free interest rate	1.3% - 1.6%	1.3% - 2.8%
Expected life of options	5 years	5 years
Expected volatility	60%	60%
Expected dividend rate	0%	0%
Expected forfeiture rate	15%	15%
Weighted average fair value	\$0.73	\$1.91

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

A summary of the status of the Company's stock option plan and changes during the six months ended June 30, 2012 and the year ended December 31, 2011 is as follows:

	June 30, 2012		December 31, 2011	
	Number of Options (000's)	Weighted Average Exercise Price, \$	Number of Options (000's)	Weighted Average Exercise Price, \$
Outstanding, beginning of period	13,094	2.54	9,713	1.99
Granted	1,518	1.41	4,221	3.69
Forfeited	(413)	2.51	(240)	1.99
Exercised (Note 12)	-	-	(600)	1.99
Outstanding, end of period	14,199	2.42	13,094	2.54

CEQUENCE ENERGY LTD.

Notes to the Condensed Consolidated Financial Statements

Three and six month periods ended June 30, 2012 with 2011 comparatives

(All figures expressed in thousands except per share amounts unless otherwise noted)

13. STOCK BASED COMPENSATION PLANS (Continued)

The following table summarizes information about stock options outstanding at June 30, 2012:

Range of Exercise Price, \$	Options Outstanding		Options Exercisable		
	Weighted Average Exercise Price, \$	Number of Options Outstanding (000's)	Weighted Average Contractual Life Remaining (years)	Number of Options (000's)	Weighted Average Exercise Price, \$
1.34 – 1.99	1.90	10,098	3.0	2,860	1.98
2.96 – 3.94	3.69	4,096	4.0	628	3.73
8.36	8.36	5	5.3	5	8.36
	2.42	14,199	3.3	3,493	2.31

During the six months ended June 30, 2012, \$3,076 (2011 - \$3,481) in compensation expense related to equity-settled stock options has been recognized in comprehensive income (loss).

14. LOSS PER SHARE

Loss per share has been calculated based on the weighted average number of common shares outstanding during the period. The following table reconciles the denominators used for the basic and diluted loss per share calculations. No stock options or warrants have been included in the calculation of diluted shares outstanding for the three or six months ended June 30, 2012 (2011 – none) as their inclusion would be anti-dilutive.

	Three months ended		Six months ended	
	2012	June 30, 2011	2012	June 30, 2011
Basic weighted average shares	164,823	144,314	163,339	137,774
Effect of dilutive stock options and warrants	-	-	-	-
Diluted weighted average shares	164,823	144,314	163,339	137,774

15. CONTINGENCIES AND COMMITMENTS

	2012	2013	2014	2015	2016+	Total
Office leases	\$ 588	1,133	922	187	-	\$ 2,830
Drilling services	689	2,138	-	-	-	2,827
Pipeline transportation	857	1,700	1,700	1,556	-	5,813
Total	\$ 2,134	4,971	2,622	1,743	-	\$ 11,470

The Company has a pipeline transportation contract that expires on November 30, 2015.

During the year ended December 31, 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.

CEQUENCE ENERGY LTD.

Notes to the Condensed Consolidated Financial Statements

Three and six month periods ended June 30, 2012 with 2011 comparatives

(All figures expressed in thousands except per share amounts unless otherwise noted)

15. CONTINGENCIES AND COMMITMENTS (Continued)

During the year ended December 31, 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 drawn down as the Company incurs costs related to the use of the drilling rigs and \$550 has been drawn down at June 30, 2012. Cequence expects to reduce the deposit by \$618 in the twelve months ended June 30, 2013, which amount is included with deposits and prepaid expenses in the condensed consolidated balance sheet as at June 30, 2012. The portion of the outstanding deposit expected to be drawn down in the period subsequent to June 30, 2013 of \$2,332 is carried as a non-current asset in the condensed consolidated balance sheet as at June 30, 2012.

16. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

The Company's financial instruments, including derivative financial instruments and embedded derivative financial instruments, recognized in the condensed consolidated balance sheet 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.

The Company's fair value hierarchy for those assets and liabilities measured at fair value as of June 30, 2012 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, 2012. The fair value of commodity contracts is determined by discounting the difference between the contracted price and published forward price curves as at the balance sheet date, using the remaining contracted petroleum and natural gas volumes, at a credit-adjusted risk-free rate of 6 percent.

The Company has exposure to market risk, credit risk and liquidity risk from its use of financial instruments. 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, 2011 other than as noted below:

During the six months ended June 30, 2012, 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, 2012:

	Product	Type	Volume	Price	Basis
May 1, 2012 to October 31, 2012	Gas	Swap	5,000 gj/day	\$1.82	AECO
June 1, 2012 to October 31, 2012	Gas	Swap	2,500 gj/day	\$2.26	AECO
June 1, 2012 to December 31, 2012	Gas	Swap	2,000 gj/day	\$3.14	AECO
August 1, 2012 to December 31, 2012 ⁽¹⁾	Gas	Swap	2,500 gj/day	\$2.50	AECO
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
				\$110.00	
January 1, 2013 to December 31, 2013	Oil	Sold Call	200 bbls/day	USD	WTI

(1) Swap entered into subsequent to June 30, 2012.

For the six months ended June 30, 2012, realized gains from commodity derivative contracts recognized in comprehensive income (loss) were \$76 compared to a gain of \$176 in the six months ended June 30, 2011.

CEQUENCE ENERGY LTD.

Notes to the Condensed Consolidated Financial Statements

Three and six month periods ended June 30, 2012 with 2011 comparatives

(All figures expressed in thousands except per share amounts unless otherwise noted)

16. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (Continued)

The fair value of the commodity contracts outstanding at June 30, 2012 was a current asset of \$69 and a non-current liability of \$188 (December 31, 2011 - \$nil).

For the six months ended June 30, 2012 the Company recorded an unrealized loss of \$119 from derivative commodity contracts compared to a gain of \$140 for the six months ended June 30, 2011. An estimate of credit risk has been made in the valuation of all derivative commodity contracts.

As at June 30, 2012, an increase in gas price of \$0.50/gj results in a decrease in the fair value of the commodity contracts of \$1,837 (\$1,378 after tax) and a commensurate decrease to comprehensive income (loss).

17. CHANGES IN NON-CASH WORKING CAPITAL

	Three months ended June 30,		Six months ended June 30,	
	2012	2011	2012	2011
Accounts receivable	10,969	(3,461)	3,413	(849)
Deposits and prepaid expenses	(479)	(4,350)	(606)	(4,152)
Accounts payable and accrued liabilities	(28,851)	(20,758)	(38,957)	564
Net change in non-cash working capital	(18,361)	(28,569)	(36,150)	(4,437)
Allocated to:				
Operating activities	(2,234)	(4,380)	(16)	(2,293)
Investing activities	(16,567)	(24,189)	(36,574)	(2,144)
Financing activities	440	-	440	-
	(18,361)	(28,569)	(36,150)	(4,437)

18. SUBSEQUENT EVENTS

During the three months ended June 30, 2012, Cequence made an offer to acquire all of the issued and outstanding shares of Open Range Energy Corp. ("Open Range"), a publicly traded Canadian oil and gas company. Subsequent to June 30, 2012, Open Range accepted a superior proposal from another publicly traded Canadian oil and gas company. In accordance with the terms of the arrangement agreement between Cequence and Open Range, Open Range paid to Cequence a termination fee of \$4,600, prior to related additional transaction costs, which was received by Cequence subsequent to June 30, 2012 and is not reflected in comprehensive income (loss) for the three and six months ended June 30, 2012.