Q1 2018

Condensed Consolidated Financial Statements

CHINOOK energy inc

Chinook Energy Inc. | 1000, 517 – 10th Avenue S.W. Calgary, Alberta T2R 0A8 TSX:CKE

Condensed Consolidated Statements of Financial Position

(unaudited)

		March 31		December 31
(in thousands of Canadian dollars)		2018		2017
Assets				
Current				
Cash	$	-	$	4,341
Accounts receivable		4,105		3,490
Prepaids & deposits		1,307		1,373
Fair value of commodity price contract (note 5)		151		-
		5,563		9,204
Development & production assets (note 6)		108,356		110,078
Exploration & evaluation assets (note 7)		13,308		11,289
	$	127,227	$	130,571
Liabilities & Shareholders' Equity				
Current				
Accounts payable & accrued liabilities	$	5,972	$	9,915
Debt (note 9)		3,401		-
Deferred customer obligation		775		775
Provisions (note 8)		1,382		1,655
		11,530		12,345
Deferred customer obligation		1,233		1,427
Provisions (note 8)		31,622		31,627
Flow-through common shares premium (note 7)		-		323
Shareholders' Equity				
Share capital		786,492		786,492
Contributed surplus		19,926		19,835
Deficit		(723,576)		(721,478)
		82,842		84,849
	$	127,227	$	130,571

See accompanying notes to the condensed consolidated financial statements.

Condensed Consolidated Statements of Operations and Comprehensive Income (Loss)

(unaudited)

(in thousands of Canadian dollars, except per share amounts)	Three months ended March 31 **2018**	2017
Petroleum & natural gas revenues (note 11)	**$ 5,858**	$ 6,775
Royalty (expense) recovery	**(43)**	63
Petroleum & natural gas revenues, net of royalties	**5,815**	6,838
Processing & gathering revenues (note 11)	**288**	260
Take or pay contract revenue (note 11)	**1,003**	536
Petroleum, natural gas & other revenues, net of royalties	**7,106**	7,634
Realized (loss) gain on commodity price contract	**(295)**	436
Unrealized gain on commodity price contracts	**151**	1,287
(Loss) gain on commodity price contracts	**(144)**	1,723
Total revenues, net of royalties and commodity price contracts	**6,962**	9,357
Production & operating	**4,011**	3,824
General & administrative	**1,171**	1,612
Take or pay contract expense	**1,155**	629
Severance costs	**721**	373
Exploration & evaluation (note 7)	**72**	92
Gain on dispositions of properties	**-**	(10,926)
Depletion, depreciation & amortization (notes 6 & 7)	**2,220**	2,933
Share-based compensation (note 10)	**91**	251
Amortization of flow-through common shares premium (note 7)	**(323)**	-
Deferred customer obligation amortization	**(194)**	-
Other (income) losses	**(26)**	62
Total expenses, net of gains on dispositions of properties, excluding finance expenses	**8,898**	(1,150)
(Loss) income before finance expenses	**(1,936)**	10,507
Interest & financing income	**(12)**	(84)
Accretion of provisions (notes 8)	**174**	169
Finance expenses	**162**	85
Net & comprehensive (loss) income	**$ (2,098)**	$ 10,422
Net (loss) income per share, basic and diluted (note 12)	**$ (0.01)**	$ 0.05

See accompanying notes to the condensed consolidated financial statements.

Condensed Consolidated Statements of Changes in Shareholders' Equity

(unaudited)

(in thousands of Canadian dollars, except common shares)	Common Shares (thousands)		Share Capital		Contributed Surplus		Deficit		Shareholders' Equity
Balance as at December 31, 2017	**223,565**	**$**	**786,492**	**$**	**19,835**	**$**	**(721,478)**	**$**	**84,849**
Share-based compensation (note 10)	-		-		91		-		91
Net loss	-		-		-		(2,098)		(2,098)
Balance as at March 31, 2018	**223,565**	**$**	**786,492**	**$**	**19,926**	**$**	**(723,576)**	**$**	**82,842**
Balance as at December 31, 2016	**216,443**	**$**	**784,105**	**$**	**19,759**	**$**	**(704,564)**	**$**	**99,300**
Share-based compensation (note 10)	-		-		251		-		251
Net income	-		-		-		10,422		10,422
Balance as at March 31, 2017	**216,443**	**$**	**784,105**	**$**	**20,010**	**$**	**(694,142)**	**$**	**109,973**

See accompanying notes to the condensed consolidated financial statements.

Condensed Consolidated Statements of Cash Flows

(unaudited)

	Three months ended March 31	
(in thousands of Canadian dollars)	**2018**	2017
Operating Activities		
Net (loss) income	**$ (2,098)**	$ 10,422
Add (deduct):		
Depletion, depreciation & amortization (notes 6 & 7)	**2,220**	2,933
Gain on dispositions of properties	**-**	(10,926)
Unrealized gain on commodity price contracts	**(151)**	(1,287)
Share-based compensation (note 10)	**91**	251
Accretion of provisions (notes 8)	**174**	169
Amortization of flow-through common shares premium (note 7)	**(323)**	-
Deferred customer obligation amortization	**(194)**	-
Foreign currency (gain) loss on cash	**(41)**	9
Provision expenditures (notes 8a & 8b)	**(472)**	(93)
Change in operating non-cash working capital (note 12)	**(928)**	(2,923)
Cash outflow from operating activities	**(1,722)**	(1,445)
Financing Activities		
Debt borrowings (note 9)	**3,401**	-
Change in financing non-cash working capital (note 12)	**(20)**	-
Cash inflow from financing activities	**3,381**	-
Investing Activities		
Proceeds on property dispositions	**-**	17,838
Development & exploration expenditures (notes 6 & 7)	**(2,497)**	(8,823)
Change in investing non-cash working capital (note 12)	**(3,544)**	(760)
Cash (outflow) inflow from investing activities	**(6,041)**	8,255
Change in cash, during the period	**(4,382)**	6,810
Cash, beginning of period	**4,341**	14,821
Cash, foreign currency gain (loss)	**41**	(9)
Cash, end of period	**$ -**	$ 21,622

See accompanying notes to the condensed consolidated financial statements.

Notes to the Condensed Consolidated Financial Statements

(unaudited)

For the three months ended March 31, 2018 and 2017

Tabular amounts in thousands of Canadian dollars, except as noted

1. Reporting Entity

Chinook Energy Inc. is a Calgary-based petroleum and natural gas production company focused on development and exploration opportunities in western Canada.

These unaudited condensed consolidated financial statements for the three months ended March 31, 2018 and 2017 (these “Financial Statements”) include the accounts of Chinook Energy Inc. and two directly held wholly-owned subsidiaries (collectively, including all subsidiaries, “Chinook” or the “Company”): 1542991 Alberta Ltd. and Storm Ventures International (BVI) Limited).

All intercompany balances and transactions have been eliminated.

2. Basis of Presentation

These Financial Statements have been prepared following the same accounting policies as summarized in note 3 in the audited consolidated financial statements of Chinook for the years ended December 31, 2017 and 2016 (the “Audited Financial Statements”), except the policies for Financial Instruments and Revenue Recognition. These policies were respectively replaced upon the January 1, 2018, adoptions of IFRS 9 “Financial Instruments” and IFRS 15 “Revenue from Contracts with Customers” as detailed in note 3 to these Financial Statements. The reader is advised that these Financial Statements do not include all of the required disclosures for annual consolidated financial statements and therefore should be read in conjunction with the Audited Financial Statements and the notes thereto.

These Financial Statements have been prepared by management in accordance with International Accounting Standard 34 ‘Interim Financial Reporting’ using accounting principles consistent with International Financial Reporting Standards issued by the International Accounting Standards Board.

Certain balances in the comparative period have been reclassified to conform to the current period’s presentation.

These Financial Statements were approved and authorized for issuance by Chinook’s Board of Directors on May 10, 2018.

3. Adopted New Accounting Standards

The IFRS 9 and IFRS 15 accounting standards were adopted on January 1, 2018 using the retrospective and cumulative effect methods, respectively. The adoption of these standards did not have a material impact on these Financial Statements.

Financial Instruments

IFRS 9 contains three principal classification categories for financial assets: measured at amortized cost, fair value through other comprehensive income or fair value through profit or loss (“FVTPL”). The classification of financial assets under IFRS 9 is generally based on the business model in which a financial asset is managed and its contractual cash flow characteristics.

Financial assets are initially measured at fair value. On initial recognition, Chinook classifies its financial assets as subsequently measured at either amortized cost or FVTPL. Financial assets are not reclassified subsequent to their initial recognition.

A financial asset is measured at amortized cost if it meets both of the following conditions and is not designated as FVTPL:

i) The asset is held with the objective to collect contractual cash flows; and

ii) The contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

All other financial assets are subsequently measured at their fair values with changes in fair value recognized in the condensed consolidated statements of operations and comprehensive income (loss).

Accounts receivable continued to be subsequently measured at amortized cost. There was no change to the Company's classification of accounts payable or debt, which are classified as other financial liabilities and are subsequently measured at amortized cost. Cash and commodity price contracts are subsequently measured at their FVTPL.

Chinook uses the expected credit loss model for calculating impairment and recognizes expected credit losses as a loss allowance for assets measured at amortized cost. Chinook's accounts receivable are typically short-term with payments received within a three to four month period and they do not have a significant financing component. As a result, Chinook recognizes an amount equal to the lifetime expected credit losses based on its historical experience and including forward-looking information. The carrying amount of these assets in the condensed consolidated statements of financial position is net of any loss allowance.

Revenue Recognition

IFRS 15 "Revenue from Contracts with Customers", specifies how and when the Company will recognize revenue as well as requiring more informative, relevant disclosures. The new standard provides a single, principles-based five-step analysis of transactions to determine the nature of an entity's obligation to perform and whether, how much and when revenue is recognized. New estimates and judgmental thresholds have been introduced, which may affect the amount and/or timing of revenue recognized.

Chinook's revenues are from the following major sources:

- Revenue from its production of petroleum liquids and natural gas;
- Fees charged to third parties for product processing and distribution services provided at facilities or pipelines where Chinook has an ownership interest; and
- Revenue from a take or pay contract where production is delivered by a third party.

Revenues from the sale of petroleum liquids, natural gas and a take or pay contract is measured based on the consideration specified in contracts with customers. Chinook recognizes these types of revenues when it transfers control of the product to the buyer and collection is reasonably assured. This is generally at the point in time the purchaser obtains legal title to the product which is when it is physically transferred to an agreed upon delivery point, often a pipeline or other terminal point. Revenues from product processing and distribution services are recognized as these services are provided.

The nature of each of its performance obligations, including roles of third parties and partners, are evaluated to determine if Chinook acts as the principal or as an agent. In making this evaluation, management considers if Chinook obtains control of the product delivered, which is indicated by Chinook having the primary responsibility for the delivery of the product, having the ability to establish prices or having inventory risk. If Chinook acts as the principal in a transaction, revenue is recognized on a gross-basis. If Chinook acts in the capacity of an agent in a transaction, then the revenue only reflects the fee, if any, realized by it from the transaction.

4. New Accounting Standards Not Yet Adopted

In January 2016, the IASB issued IFRS 16 "Leases". The standard requires entities to recognize lease assets and lease obligations on the statements of financial position. For lessees, there will be a single lease accounting model for all leases. There will no longer be a classification test between finance and operating leases. The lessee will recognize a Right of Use ("ROU") asset and a lease liability, and the lease will be treated as an asset on a financed basis. There will be an optional exemption from the above for short term leases and leases of low value assets, defined at 12 months or less and an option for portfolio accounting on leases that have similar criteria. From the lessor's perspective, there will still be a dual lease accounting model that follows the criteria set out in IAS 17. As of January 1, 2019, Chinook will be required to adopt this standard. Chinook is currently assessing all its major leases including firm commitment contracts, which are expensed as operating leases for reclassification to the statements of financial position.

5. Fair Value of Commodity Price Contract

As at March 31, 2018, Chinook had the following commodity price contract:

Indexed Price	Notional Volumes	Company's Received Price	Remaining Contractual Term
Chicago City Gate Monthly	6,000 mmbtu/d	US$2.68/mmbtu	April 1, 2018 to March 31, 2019

At March 31, 2018, this natural gas price contract had a fair value asset of $0.2 million as reported through the line item fair value of commodity price contract in current assets on the condensed consolidated statements of financial position. The fair value of this contract was determined through the difference in the referenced benchmark forward price as compared to the contract's strike price multiplied by the notional volumes during the remaining contractual term.

6. Development and Production Assets ("D&P Assets")

The following table reconciles Chinook's D&P Assets for the three months ended March 31, 2018:

Cost of Assets		
Balance, beginning of period	**$**	**281,904**
Capital expenditures		**73**
Balance, end of period	**$**	**281,977**
Accumulated Depletion & Depreciation		
Balance, beginning of period	**$**	**(171,826)**
Depletion & depreciation		**(1,795)**
Balance, end of period	**$**	**(173,621)**
Net book values		
Balance as at December 31, 2017	**$**	**110,078**
Balance as at March 31, 2018	**$**	**108,356**

7. Exploration & Evaluation Assets ("E&E Assets")

The following table reconciles Chinook's E&E Assets for the three months ended March 31, 2018:

Cost of Assets		
Balance, beginning of period	**$**	**30,529**
Capital expenditures		**2,424**
Decommissioning asset additions (note 8a)		**20**
Balance, end of period	**$**	**32,973**
Accumulated Amortization		
Balance, beginning of period	**$**	**(19,240)**
Amortization		**(425)**
Balance, end of period	**$**	**(19,665)**
Net book values		
Balance as at December 31, 2017	**$**	**11,289**
Balance as at March 31, 2018	**$**	**13,308**

Capitalized general and administrative expenses

Chinook capitalized $0.2 million of direct general and administrative costs related to its exploration activity during the three months ended March 31, 2018.

Flow-Through Common Shares Premium

For the three months ended March 31, 2018, Chinook incurred the required $2.0 million of qualifying Canadian exploration expenditures pursuant to the December 11, 2017 issuance of 6,450,0000 common shares on a flow-through basis. As a result, for the three months ended March 31, 2018, Chinook amortized the associated $0.3 million flow-through common shares premium.

Exploration & Evaluation Expense

During the three months ended March 31, 2018 and 2017, pre-licensing evaluation, exploratory lease rental and geological and geophysical costs of $0.1 million were expensed through the line item "exploration and evaluation" on the condensed consolidated statements of operations and comprehensive loss.

8. Provisions

		March 31 2018		December 31 2017
Decommissioning obligations (a)	$	**31,039**	$	31,125
Onerous contract and indemnifications (b)		**1,965**		2,157
Total provisions	$	**33,004**	$	33,282

As reported on the condensed consolidated statements of financial position, Chinook's provisions' consists of:

		March 31 2018		December 31 2017
Current portion	$	**1,382**	$	1,655
Long term portion		**31,622**		31,627
Total provisions	$	**33,004**	$	33,282

a) Decommissioning obligations

The following table reconciles Chinook's decommissioning obligations for the three months ended March 31, 2018:

Balance, beginning of period	**$**	**31,125**
Decommissioning obligation additions (note 7)		**20**
Expenditures		**(276)**
Accretion expense		**170**
Balance, end of period	**$**	**31,039**

b) Onerous contract and indemnifications

The following table reconciles Chinook's onerous contract and indemnifications' provision for the three months ended March 31, 2018:

Balance, beginning of period	**$**	**2,157**
Expenditures		**(196)**
Accretion expense		**4**
Balance, end of period	**$**	**1,965**

9. Debt

As at March 31, 2018 and December 31, 2017, Chinook had secured a demand credit facility agreement as amended with a Canadian chartered bank with an availability of $18.0 million (the "Demand Credit Facility"). The Demand Credit Facility's next semi-annual review is scheduled for May 31, 2018. Chinook expects its lender to reduce the availability of the Demand Credit Facility given recent decreases in forward natural gas benchmark pricing. While there is no certainty in the amount of the borrowing base redetermination, Chinook expects that its debt borrowings will be less than the anticipated reassessed Demand Credit Facility's availability. As at March 31, 2018, Chinook had debt borrowings of $3.4 million and outstanding letters of credit of $0.8 million, as secured by its lender, which reduced the available Demand Credit Facility credit to $13.8 million (at December 31, 2017 – drawings of $nil, outstanding letters of credit of $0.8 million and available credit of $17.2 million).

All borrowings under the Demand Credit Facility have been classified as a current liability, as the lender can request repayment at any time of all outstanding drawn amounts. Changes in the availability in the Demand Credit Facility are possible, from one semi-annual review to the next, with draws in excess of availability becoming immediately payable. Borrowings incur interest at the prime rate plus an applicable margin and are collateralized by floating charges and security interests over all of Chinook's present and future properties and other assets.

The Demand Credit Facility has a financial covenant requiring that the adjusted working capital be 1:1 at each reporting period. For the purposes of this covenant, adjusted working capital is defined as working capital excluding both the current portion of commodity price contracts and debt but including the undrawn portion of the Demand Credit Facility. In addition, the Demand Credit Facility includes operating and financial restrictions on Chinook that include restrictions on paying dividends or making other distributions in respect of Chinook's securities.

As at the end of any month, if the greater of Chinook's adjusted working capital deficits or Demand Credit Facility draws are either up to $9.0 million or in excess of $9.0 million, within 60 days of the end of any such month, the terms of the Demand Credit Facility require that Chinook enter into commodity price contracts covering no less than 30% or 50%, respectively, of its forecasted twelve month combined production volumes. For purposes of this compliance requirement, adjusted working capital deficit is current assets less current liabilities, excluding current commodity price contracts.

As at March 31, 2018, Chinook was in compliance with the foregoing financial covenant and other requirements under the Demand Credit Facility except the mandatory commodity price contracts requirement. This requirement will be addressed in conjunction with the May 31, 2018 semi-annual review.

10. Long-term Incentive Plans

Chinook grants share options, restricted awards and performance awards (collectively, "Share-Based Awards") under its long-term incentive plans to employees, officers, directors, consultants and other service providers. The maximum number of common shares issuable from treasury pursuant to all Share-Based Awards may not exceed 10% of Chinook's issued and outstanding common shares.

For the three months ended March 31, 2018, share-based compensation expense related to long-term incentive plans was $0.1 million (three months ended March 31, 2017 - $0.3 million).

Share Option Plan

Outstanding options granted pursuant to Chinook's share option plan vest evenly over a period of three years and expire five years after the grant date. The following table reconciles Chinook's outstanding options for the three months ended March 31, 2018:

	Number of Options (thousands)		Weighted Average Exercise Price ($/option)
Balance, beginning of period	**10,277**	**$**	**0.71**
Granted	6,285		0.20
Forfeited or cancelled	(1,372)		(0.35)
Balance, end of period	**15,190**	**$**	**0.53**
Exercisable	**4,182**	**$**	**1.16**

The table below summarizes the outstanding share options, their respective weighted average exercise prices and remaining life in addition to the number of exercisable options, their respective weighted average prices and remaining life at March 31, 2018:

	Outstanding Options				Outstanding Exercisable Options			
Range of Exercise Prices ($/option)	**Options Outstanding (thousands)**		**Weighted Average Exercise Prices ($/option)**	**Weighted Average Remaining Life (years)**	**Options Outstanding (thousands)**		**Weighted Average Exercise Prices ($/option)**	**Weighted Average Remaining Life (years)**
$0.20 - $0.37	5,933	$	0.20	4.8	-	$	-	-
$0.38 - $0.54	6,143	$	0.42	3.7	1,150	$	0.54	2.7
$0.55 - $2.46	3,114	$	1.39	1.4	3,032	$	1.40	1.4
	15,190	**$**	**0.53**	**3.7**	**4,182**	**$**	**1.16**	**1.7**

In addition to a forfeiture rate of approximately 13%, which was used in the calculation of share-based compensation, the following factors were used in the Black-Scholes pricing model for the determination of the fair value of options granted during the three months ended March 31, 2018:

Expected average life (years) (1)	**3 to 5**
Weighted average risk-free interest rate (%)	**2.0**
Weighted average volatility factor (%) (2)	**59**
Share option exercise price ($/option)	**0.20**

(1) The expected average life of the share option is based on time to vest plus a historical calculation.

(2) The volatility factor is based on historical price volatility of Chinook's common shares over the expected life of the option.

The weighted average fair value determined for options granted during the three months ended March 31, 2018 was $0.09 per option.

Restricted Award Plan

The following table reconciles Chinook's outstanding restricted awards for the three months ended March 31, 2018:

	Number of Restricted Awards (thousands)
Balance, beginning of period	**200**
Granted	191
Forfeited	(147)
Balance, end of period	**244**

The fair value determined for restricted awards granted during the three months ended March 31, 2018 was $0.20 per award excluding estimated forfeitures. This fair value was based on the market price of Chinook's common shares on the date the restricted awards were granted.

11. Revenues

Chinooks sells its production and take-or-pay contract deliveries pursuant to variable price and volume contracts. Petroleum and natural gas production is sold under various contracts with terms of up to one year. Take or pay is sold pursuant to a contract with a term through to March 2021. Both petroleum & natural gas and take-or-pay revenues are normally collected in the month following revenue recognition. The transaction price for the take-or-pay and production contracts is based upon benchmark pricing for petroleum or natural gas commodities adjusted for quality, location, transportation or other factors. Under these types of contracts, Chinook is required to deliver a variable volume of petroleum liquids or natural gas to the purchaser. The amount of revenue recognized is based on the agreed transaction price, whereby any variability in revenue relates specifically to Chinook's efforts to transfer production, and therefore the resulting revenue is allocated to the production delivered in the period during which the variability occurs. Petroleum and natural gas revenues are recognized when Chinook gives up control of the unit of production at the delivery point agreed to under the terms of the contracts. As a result, none of the variable revenue is considered constrained.

Processing and distribution services are generally sold under multi-year contracts at fixed fees that vary by volume. Revenues from these contracts are typically collected within three months from billing.

Chinook's production revenue was primarily generated in its Birley/Umbach area located in British Columbia. Chinook's customers are petroleum and natural gas marketers and third party producers in the petroleum and natural gas business and are subject to normal credit risks. Concentration of credit risk is mitigated by marketing production to numerous petroleum and natural gas marketers under customary industry sale and payment terms. Chinook routinely assesses the financial strength of its counterparties.

The following table presents Chinook's total revenues disaggregated by source:

	Three months ended March 31			
		2018		2017
Natural gas	**$**	**3,283**	$	4,391
Petroleum liquids		**2,575**		2,384
Petroleum & natural gas revenues		**5,858**		6,775
Processing & gathering revenues		**288**		260
Take or pay contract revenue		**1,003**		536
Total revenues	**$**	**7,149**	$	7,571

Included in accounts receivable at March 31, 2018 is $2.5 million of accrued and billed revenues, an increase from December 31, 2017 of $1.2 million. Accrued sales revenues as at December 31, 2017, was collected during the three months ended March 31, 2018 without significant impact to the current period's reported revenues.

12. Other Supplementary Information

Changes in non-cash working capital

	Three months ended March 31			
		2018		2017
Cash provided by (used for):				
Accounts receivable	**$**	**(615)**	$	(1,142)
Prepaids & deposits		**66**		(872)
Accounts payable, accrued liabilities & other		**(3,943)**		(1,669)
	$	**(4,492)**	$	(3,683)
Cash used for:				
Operating activities	**$**	**(928)**	$	(2,923)
Investing activities		**(3,544)**		(760)
Financing activities		**(20)**		-
	$	**(4,492)**	$	(3,683)

Per share amounts

	Three months ended March 31			
		2018		2017
Weighted average shares outstanding - basic (thousands)		**223,565**		216,443
Dilutive impact of restricted and performance awards (thousands)		**-**		457
Weighted average shares outstanding - diluted (thousands)		**223,565**		216,900
Net (loss) income	**$**	**(2,098)**	$	10,422
Net (loss) income per share - basic & diluted ($/share)	**$**	**(0.01)**	$	0.05

For the three months ended March 31, 2018, because Chinook reported a net loss, the effect of share options and outstanding restricted awards would have been anti-dilutive resulting in them being excluded in the calculation of diluted weighted average shares outstanding. For the three months ended March 31, 2017, Chinook's outstanding restricted and performance awards (the "Awards") were dilutive because the weighted average number of outstanding Awards exceeded the deemed repurchased shares calculated from unamortized share-based compensation.