

Q2
2015

Condensed Consolidated Financial Statements



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

Condensed Consolidated Statements of Financial Position

(unaudited)

	June 30	December 31
(in thousands of Canadian dollars)	2015	2014
Assets		
Current		
Cash	\$ 50,732	\$ 46,018
Accounts receivable	13,719	24,952
Prepays & deposits	3,456	2,207
Derivative contracts (note 3)	797	1,481
Assets held for sale (note 6)	-	23,066
	68,704	97,724
Development & production assets (note 4)	318,385	309,217
Exploration & evaluation assets (note 5)	27,191	27,377
	\$ 414,280	\$ 434,318
Liabilities and Shareholders' Equity		
Current		
Accounts payable, accrued liabilities & other (note 8)	\$ 21,202	\$ 44,389
Liabilities held for sale (note 6)	-	752
	21,202	45,141
Provisions (note 9)	107,212	106,726
Shareholders' Equity		
Share capital	782,440	782,071
Contributed surplus	17,860	17,180
Deficit	(514,434)	(516,800)
	285,866	282,451
	\$ 414,280	\$ 434,318

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 June 30		Six months ended June 30	
	2015	2014	2015	2014
Petroleum & natural gas revenues	\$ 15,367	\$ 38,696	\$ 32,035	\$ 79,010
Royalties	(433)	(6,101)	(1,861)	(10,386)
Petroleum & natural gas revenues, net of royalties	14,934	32,595	30,174	68,624
Processing & gathering revenues	786	1,466	1,856	2,784
Petroleum, natural gas & other revenues, net of royalties	15,720	34,061	32,030	71,408
Realized gain (loss) on derivative contracts	441	(1,697)	741	(2,871)
Unrealized (loss) gain on derivative contracts	(398)	1,686	(684)	(2,075)
Gain (loss) on derivatives	43	(11)	57	(4,946)
	15,763	34,050	32,087	66,462
Production & operating	11,026	13,750	23,856	27,131
General & administrative	2,053	3,087	4,814	7,708
Exploration & evaluation expenditures	424	116	917	585
Depletion, depreciation & amortization (notes 4 & 5)	8,982	12,346	19,490	24,633
Gains on disposition of properties (note 7)	(2,390)	(166)	(21,793)	(166)
Share-based compensation (note 11)	623	109	1,049	303
Bad debt expense	57	46	554	66
Foreign exchange loss (gains) & other	172	(139)	(290)	(301)
Deferred lease obligation amortization	-	(264)	-	(528)
	20,947	28,885	28,597	59,431
(Loss) income from continuing operations before finance expenses	(5,184)	5,165	3,490	7,031
Interest and financing charges (income)	16	881	(115)	1,591
Amortization of deferred financing cost	-	75	-	149
Accretion of decommissioning obligations (note 9)	622	678	1,239	1,350
Finance expenses	638	1,634	1,124	3,090
Net (loss) income from continuing operations	(5,822)	3,531	2,366	3,941
Discontinued operations				
Net income from discontinued operations, net of income taxes	-	860	-	6,535
Net (loss) income	(5,822)	4,391	2,366	10,476
Foreign currency translation (loss) gain from discontinued operations	-	(4,560)	-	182
Comprehensive (loss) income	\$ (5,822)	\$ (169)	\$ 2,366	\$ 10,658
Net (loss) income per share, basic & diluted (note 12):				
Continuing operations	\$ (0.03)	\$ 0.02	\$ 0.01	\$ 0.02
Discontinued operations	\$ -	\$ -	\$ -	\$ 0.03
Net (loss) income per share	\$ (0.03)	\$ 0.02	\$ 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	Accumulated Other Comprehensive Income	Shareholders' Equity
Balance as at December 31, 2014	215,082	\$ 782,071	\$ 17,180	\$ (516,800)	\$ -	\$ 282,451
Share options exercised (note 11a)	2	-	-	-	-	-
Release of restricted and performance share units (note 11b)	152	369	(369)	-	-	-
Share-based compensation (note 11)	-	-	1,049	-	-	1,049
Net income	-	-	-	2,366	-	2,366
Balance as at June 30, 2015	215,236	\$ 782,440	\$ 17,860	\$ (514,434)	\$ -	\$ 285,866
Balance as at December 31, 2013	214,188	\$ 778,070	\$ 20,846	\$ (478,400)	\$ 6,241	\$ 326,757
Share options exercised	486	2,549	(2,324)	-	-	225
Share-based compensation (note 11)	-	-	303	-	-	303
Foreign currency translation gain on discontinued operations	-	-	-	-	182	182
Net income	-	-	-	10,476	-	10,476
Balance as at June 30, 2014	214,674	\$ 780,619	\$ 18,825	\$ (467,924)	\$ 6,423	\$ 337,943

See accompanying notes to the condensed consolidated financial statements.

Condensed Consolidated Statements of Cash Flows

(unaudited)

(in thousands of Canadian dollars)	Three months ended June 30		Six months ended June 30	
	2015	2014	2015	2014
Operating Activities				
Net (loss) income	\$ (5,822)	\$ 4,391	\$ 2,366	\$ 10,476
Deduct: net income from discontinued operations	-	(860)	-	(6,535)
Net (loss) income from continuing operations	(5,822)	3,531	2,366	3,941
Add (deduct):				
Gains on disposition of properties (note 7)	(2,390)	(166)	(21,793)	(166)
Depletion, depreciation & amortization (notes 4 & 5)	8,982	12,346	19,490	24,633
Accretion of decommissioning obligations (note 9)	622	678	1,239	1,350
Bad debt expense	57	46	554	66
Exploration & evaluation expenditures	424	116	917	585
Share-based compensation (note 11)	623	109	1,049	303
Unrealized loss (gain) on derivative contracts	398	(1,686)	684	2,075
Foreign exchange loss (gain) & other	101	13	(288)	(14)
Amortization of deferred financing cost	-	75	-	149
Deferred lease obligation amortization	-	(264)	-	(528)
Funds from operations	2,995	14,798	4,218	32,394
Decommissioning obligation expenditures & other (note 9)	(587)	(571)	(1,040)	(1,161)
Change in operating non-cash working capital (note 12)	1,375	(4,960)	1,246	(9,777)
Cash flow from operating activities:				
Continuing operations	3,783	9,267	4,424	21,456
Discontinued operations	-	22,800	-	19,212
Cash flow from operating activities	3,783	32,067	4,424	40,668
Financing Activities				
Net consideration on share issuance	-	225	-	225
Long-term debt borrowing	-	19,315	-	19,315
Deferred financing charges	-	(136)	-	(136)
Change in financing non-cash working capital (note 12)	-	(285)	-	(285)
Cash flow from continuing operations financing activities:	-	19,119	-	19,119
Investing Activities				
Proceeds on property dispositions (note 6)	1,200	33	42,935	33
Capital expenditures (notes 4 & 5)	(4,921)	(18,998)	(27,014)	(42,611)
Exploration & evaluation expenditures	(424)	(116)	(917)	(585)
Change in investing non-cash working capital (note 12)	(8,909)	(15,373)	(14,744)	651
Cash flow from investing activities:				
Continuing operations	(13,054)	(34,454)	260	(42,513)
Discontinued operations	(142)	(16,027)	(353)	(27,186)
Cash flow from investing activities	(13,196)	(50,481)	(93)	(69,699)
Change in cash, during the period				
Continuing operations	(9,271)	(6,068)	4,684	(1,938)
Discontinued operations	(142)	6,773	(353)	(7,974)
Cash, beginning of period	60,274	16,253	46,018	25,979
Cash, foreign currency translation (loss) gain	(129)	(523)	383	368
Cash, end of period	\$ 50,732	\$ 16,435	\$ 50,732	\$ 16,435

Other supplementary information (note 12).

See accompanying notes to the condensed consolidated financial statements.

Notes to the Condensed Consolidated Financial Statements

(unaudited)

For the three and six months ended June 30, 2015 and 2014

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 and six months ended June 30, 2015 and 2014 (these "Financial Statements") include the accounts of Chinook Energy Inc. and its directly held wholly-owned subsidiaries (collectively, including all subsidiaries, "Chinook" or the "Company"): 1542991 Alberta Ltd. and Storm Ventures International (BVI) Limited ("SVI (BVI)").

The unaudited condensed consolidated financial statement for the three and six months ended June 30, 2014, also include the accounts of Storm Ventures International (Barbados) Limited ("SVI Barbados") and its wholly-owned subsidiary Storm Sahara Limited ("SSL") (combined the "Discontinued Operations") in addition to 1398216 Alberta Ltd., Cyries Wyoming, Inc. and Iteration Energy (Texas), LLC. All intercompany balances and transactions have been eliminated.

On August 19, 2014, the date control ceased, SVI (BVI) completed the sale, effective January 1, 2014, of all of the issued and outstanding shares of its wholly-owned subsidiary, SVI Barbados, in consideration for \$140.5 million, including \$15.8 million in working capital pursuant to a share purchase and sale agreement dated as of June 14, 2014. The Discontinued Operations' financial results are separately presented as such in these Financial Statements.

Cyries Wyoming, Inc. and Iteration Energy (Texas), LLC, were dissolved in December 2014, and on January 1, 2015, 1398216 Alberta Ltd. was amalgamated with Chinook Energy Inc. to form the same.

2. Basis of Presentation

These Financial Statements have been prepared following the same accounting policies as disclosed in note 3 in the audited consolidated financial statements of Chinook for the years ended December 31, 2014 and 2013 (the "Audited Financial Statements"). They 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.

These Financial Statements were approved and authorized for issuance by Chinook's Board of Directors on August 11, 2015.

3. Derivative Contracts

As at June 30, 2015, Chinook had a fair value level 2 derivative contract asset of \$0.8 million (December 31, 2014 - \$1.5 million) as determined from the following price risk management contract:

Indexed Price	Notional Volumes	Chinook's Received Price	Remaining Contractual Term
AECO - 7A	5,000 GJ/d	\$3.50/GJ	July 1, 2015 to December 31, 2015

4. Development and Production Assets (“D&P Assets”)

The following table reconciles Chinook’s D&P Assets for the six months ended June 30, 2015:

Cost of Assets	2015
Beginning balance	\$ 694,361
Capital expenditures	26,950
Cost of properties sold/swapped (note 7)	(837)
Decommissioning asset additions (note 9)	287
Ending balance	\$ 720,761
Accumulated Depletion and Depreciation	
Beginning balance	\$ (385,144)
Depletion and depreciation	(17,695)
Reversed on sale/swap of properties (note 7)	463
Ending balance	\$ (402,376)
Net book values	
Balance as at December 31, 2014	\$ 309,217
Balance as at June 30, 2015	\$ 318,385

Chinook capitalized \$0.6 million of direct general & administrative costs to its development activities during the six months ended June 30, 2015 (six months ended June 30, 2014 - \$0.5 million).

5. Exploration & Evaluation Assets (“E&E Assets”)

The following table reconciles Chinook’s E&E Assets for the six months ended June 30, 2015:

Cost of Assets	2015
Beginning balance	\$ 69,168
Capital expenditures	64
Fair value of property swaps (note 7)	1,756
Cost of properties sold/swapped (note 7)	(564)
Ending balance	\$ 70,424
Accumulated Amortization	
Beginning balance	\$ (41,791)
Amortization	(1,795)
Reversed on sale/swap of properties (note 7)	353
Ending balance	\$ (43,233)
Net book values	
Balance as at December 31, 2014	\$ 27,377
Balance as at June 30, 2015	\$ 27,191

6. Assets Held for Sale

Effective October 1, 2014, Chinook entered into an agreement to sell certain of its petroleum and natural gas properties and undeveloped lands located in the Karr area of northwestern Alberta and other insignificant properties for gross proceeds of \$42.9 million. At December 31, 2014, the Karr properties were classified as assets held for sale as it was highly probable that their carrying value would be received through a sales transaction rather than through continued use. The net carrying value of \$23.1 million for these Karr properties was reclassified from E&E Assets and D&P Assets to assets held for sale and the associated decommissioning obligations of \$0.8 million were reclassified from provisions to liabilities held for sale on the consolidated statements of financial position. This transaction closed on January 6, 2015.

7. Non-monetary Property Swaps

During the three and six months ended June 30, 2015, Chinook participated in three swap transactions. Chinook's management determined that the fair value of the properties and lands that the Company received was \$1.8 million. The carrying amount of the swapped properties given up was \$0.6 million.

For the six months ended June 30, 2015, the combined gains of these swaps in addition to the assets held for sale (note 6) and the disposition of other insignificant properties was \$21.8 million (six months ended June 30, 2014 – gain of \$0.2 million).

8. Accounts Payable, Accrued Liabilities & Other

	June 30 2015	December 31 2014
From Continuing Operations:		
Trade accounts payable	\$ 623	\$ 12,228
Accrued liabilities	15,781	25,870
Joint operations accounts payable	1,966	2,790
Other payables	175	619
Accrued transaction and indemnification costs on the sale of discontinued operations	2,657	2,882
	\$ 21,202	\$ 44,389

9. Provisions

The following table reconciles Chinook's provisions for the six months ended June 30, 2015:

	2015
Beginning balance	\$ 106,726
Provisions added during the period (note 5)	287
Decommissioning obligation expenditures & other	(1,040)
Accretion expense	1,239
Ending balance	\$ 107,212

10. Long-Term Debt

On June 22, 2015, Chinook's reserve-based 364 day revolving credit facility (the "Revolving Term Credit Facility"), which it holds with a syndicate of Canadian banks, was amended following the completion of the semi-annual review. The amended Revolving Term Credit Facility has a borrowing base of \$75.0 million, down from \$125.0 million at December 31, 2014, primarily as a result of reduced commodity pricing and non-core asset dispositions. The Revolving Term Credit Facility is subject to re-determination on a semi-annual basis, with a maturity date of June 23, 2016, subject to further extension. The next redetermination of the facility is scheduled for December 22, 2015. The Revolving Term Credit Facility is collateralized by floating charges and security interests over all present and future properties and other assets of Chinook. At June 30, 2015 and December 31, 2014, Chinook was undrawn on the Revolving Term Credit Facility, but had an outstanding letter of credit of \$0.3 million, as secured by its lending syndicate, which reduced the available credit to \$74.7 million and \$124.7 million, respectively.

11. 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. Share-based compensation, included in net income from continuing operations, for the three and six months ended June 30, 2015, was \$0.6 million and \$1.0 million, respectively (three and six months ended June 30, 2014 - \$0.1 million and \$0.3 million, respectively).

a) Share Option Plan

Outstanding options granted pursuant to Chinook’s share option plan evenly vest over a period of three years and expire five years after the grant date. A summary of options outstanding is as follows:

	Number of Options (thousands)	Weighted Average Exercise Price (\$/option)
Balance as at December 31, 2014	10,530	\$ 1.83
Granted	1,894	\$ 1.18
Exercised for common shares	(2)	\$ (1.19)
Forfeited, cancelled or surrendered	(2,113)	\$ (1.80)
Expired	(1,108)	\$ (2.71)
Balance as at June 30, 2015	9,201	\$ 1.60
Exercisable	4,936	\$ 1.77

The following factors were used in the Black-Scholes pricing model for the determination of the fair value of options granted during the six months ended June 30, 2015:

Six months ended June 30	2015	2014
Expected average life (years)	3 to 5	3 to 5
Risk-free interest rate (%)	0.72 - 1.22	1.20 to 1.77
Estimated forfeiture rate per annum (%)	12.8 to 13.1	12.8 to 13.1
Volatility factor (%)	52 to 58	49 to 54
Share option exercise price (\$/option)	1.08 - 1.24	1.62

The weighted average fair value determined for options granted during the three and six months ended June 30, 2015 was \$0.50 per option (three and six months ended June 30, 2014 - \$0.68 per option).

b) Restricted and Performance Award Plan

A summary of restricted and performance awards outstanding are as follows:

	Number of Restricted Awards (thousands)	Number of Performance Awards (thousands)
Balance as at December 31, 2014	207	244
Granted	1,040	940
Exercised	(70)	(55)
Forfeited	(13)	(10)
Balance as at June 30, 2015	1,164	1,119

The factors used to fair value the restricted award and/or performance award grants for the six months ended June 30, 2015 were as follows:

Six months ended June 30	2015		2014	
	Restricted Awards	Performance Awards	Restricted Awards	Performance Awards
Weighted average common share trading price (\$/share)	1.21	1.25	2.43	2.43
Estimated forfeiture rate per annum (%)	12.9 to 13.1	12.9 to 13.1	13.1	13.1
Estimated performance award payout multiplier	N/A	1.0	N/A	1.0

12. Other Supplementary Information

Changes in non-cash working capital

	Three months ended June 30		Six months ended June 30	
	2015	2014	2015	2014
Cash provided by (used for):				
Accounts receivable	\$ 5,568	\$ 569	\$ 10,679	\$ (10,831)
Accounts payable, accrued liabilities & other	(11,465)	(20,763)	(22,928)	2,859
Prepays & deposits	(1,637)	(424)	(1,249)	(1,439)
	\$ (7,534)	\$ (20,618)	\$ (13,498)	\$ (9,411)
Cash provided by (used for):				
Operating activities	\$ 1,375	\$ (4,960)	\$ 1,246	\$ (9,777)
Investing activities	(8,909)	(15,373)	(14,744)	651
Financing activities	-	(285)	-	(285)
	\$ (7,534)	\$ (20,618)	\$ (13,498)	\$ (9,411)

Cash interest and financing fees paid

	2015	2014	2015	2014
Cash interest and financing fees paid	\$ 167	\$ 924	\$ 330	\$ 1,762

Per share amounts

The per share amounts for the three and six months ended June 30, 2015 and 2014, were calculated as per the following table:

	Three months ended June 30		Six months ended June 30	
	2015	2014	2015	2014
Weighted average shares outstanding - basic (thousands)	215,089	214,226	215,087	214,207
Dilutive impact of share options (thousands)	-	1,588	34	709
Weighted average shares outstanding - diluted (thousands)	215,089	215,814	215,121	214,916
Net (loss) income from continuing operations	\$ (5,822)	\$ 3,531	\$ 2,366	\$ 3,941
Per share - basic & diluted (\$/share)	\$ (0.03)	\$ 0.02	\$ 0.01	\$ 0.02
Net income from discontinued operations	\$ -	\$ 860	\$ -	\$ 6,535
Per share - basic & diluted (\$/share)	\$ -	\$ -	\$ -	\$ 0.03
Net (loss) income	\$ (5,822)	\$ 4,391	\$ 2,366	\$ 10,476
Per share - basic & diluted (\$/share)	\$ (0.03)	\$ 0.02	\$ 0.01	\$ 0.05

For the three months ended June 30, 2015, share options were anti-dilutive because of the net loss and were excluded from the loss per share calculation. For the three months ended June 30, 2014 and the six months ended June 30, 2015 and 2014, diluted income per share assumes the exercise of options as if issued at the later of the date of grant or the beginning of the period. This calculation takes into account only the options that are considered to be "in-the-money".

For the three and six months ended June 30, 2015 and 2014, restricted and performance awards were anti-dilutive because the deemed repurchased shares calculated from unamortized share-based compensation exceeded the weighted average number of outstanding awards.