

Q3
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)

	September 30	December 31
(in thousands of Canadian dollars)	2015	2014
Assets		
Current		
Cash	\$ 46,231	\$ 46,018
Accounts receivable	12,568	24,952
Prepays & deposits	2,826	2,207
Derivative contracts (note 3)	391	1,481
Assets held for sale (note 6)	-	23,066
	62,016	97,724
Development & production assets (note 4)	246,371	309,217
Exploration & evaluation assets (note 5)	24,649	27,377
	\$ 333,036	\$ 434,318
Liabilities and Shareholders' Equity		
Current		
Accounts payable, accrued liabilities & other (note 8)	\$ 20,444	\$ 44,389
Liabilities held for sale (note 6)	-	752
	20,444	45,141
Provisions (note 9)	106,673	106,726
Shareholders' Equity		
Share capital	782,670	782,071
Contributed surplus	18,352	17,180
Deficit	(595,103)	(516,800)
	205,919	282,451
	\$ 333,036	\$ 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		Nine months ended	
	September 30		September 30	
	2015	2014	2015	2014
Petroleum & natural gas revenues	\$ 11,036	\$ 30,633	\$ 43,071	\$ 109,643
Royalties	(509)	(4,661)	(2,370)	(15,046)
Petroleum & natural gas revenues, net of royalties	10,527	25,972	40,701	94,597
Processing & gathering revenues	610	1,676	2,466	4,460
Petroleum, natural gas & other revenues, net of royalties	11,137	27,648	43,167	99,057
Realized gain (loss) on derivative contracts	391	(731)	1,132	(3,601)
Unrealized (loss) gain on derivative contracts	(406)	2,440	(1,090)	363
(Loss) gain on derivatives	(15)	1,709	42	(3,238)
	11,122	29,357	43,209	95,819
Production & operating	6,243	13,451	30,099	40,582
General & administrative	1,981	2,916	6,795	10,624
Exploration & evaluation expenditures	-	478	917	1,063
Depletion, depreciation & amortization (notes 4 & 5)	7,458	11,503	26,948	36,136
Impairment of development & production assets (note 4)	75,000	-	75,000	-
Losses (gains) on disposition of properties (note 7)	6	(2,754)	(21,787)	(2,920)
Share-based compensation (note 11)	722	258	1,771	561
Bad debt expense	-	100	554	165
Foreign exchange gains & other	(251)	(2,079)	(541)	(2,380)
Deferred lease obligation amortization	-	-	-	(528)
	91,159	23,873	119,756	83,303
(Loss) income from continuing operations before finance expenses	(80,037)	5,484	(76,547)	12,516
Interest and financing charges (income)	6	912	(109)	2,503
Amortization of deferred financing cost	-	195	-	343
Accretion of decommissioning obligations (note 9)	626	681	1,865	2,031
Finance expenses	632	1,788	1,756	4,877
Net (loss) income from continuing operations	(80,669)	3,696	(78,303)	7,639
Discontinued operations				
Net income from discontinued operations, net of income taxes	-	7,776	-	14,309
Net (loss) income	(80,669)	11,472	(78,303)	21,948
Foreign currency translation gain from discontinued operations	-	3,123	-	3,305
Transfer of accumulated comprehensive income on disposition of foreign operations	-	(9,546)	-	(9,546)
Other comprehensive loss	-	(6,423)	-	(6,241)
Comprehensive (loss) income	\$ (80,669)	\$ 5,049	\$ (78,303)	\$ 15,707
Net (loss) income per share, basic & diluted (note 12):				
Continuing operations	\$ (0.37)	\$ 0.02	\$ (0.36)	\$ 0.04
Discontinued operations	\$ -	\$ 0.03	\$ -	\$ 0.06
Net (loss) income per share	\$ (0.37)	\$ 0.05	\$ (0.36)	\$ 0.10

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	215,083	\$ 782,071	\$ 17,180	\$ (516,800)	\$ -	\$ 282,451
Share options exercised (note 11a)	2	-	-	-	-	-
Settlement of restricted and performance share awards	249	599	(599)	-	-	-
Cancelled common shares	(6)	-	-	-	-	-
Share-based compensation (note 11)	-	-	1,771	-	-	1,771
Net loss	-	-	-	(78,303)	-	(78,303)
Balance as at September 30, 2015	215,328	\$ 782,670	\$ 18,352	\$ (595,103)	\$ -	\$ 205,919

Balance as at December 31, 2013	214,188	\$ 778,070	\$ 20,846	\$ (478,400)	\$ 6,241	\$ 326,757
Share options exercised	891	3,992	(3,864)	-	-	128
Share options surrendered	-	-	(922)	-	-	(922)
Share-based compensation (note 11)	-	-	561	-	-	561
Transaction costs on discontinued operations	-	-	193	-	-	193
Foreign currency translation gain on discontinued operations	-	-	-	-	3,305	3,305
Transfer of accumulated other comprehensive income on disposition of foreign operations	-	-	-	-	(9,546)	(9,546)
Net income	-	-	-	21,948	-	21,948
Balance as at September 30, 2014	215,079	\$ 782,062	\$ 16,814	\$ (456,452)	\$ -	\$ 342,424

See accompanying notes to the condensed consolidated financial statements.

Condensed Consolidated Statements of Cash Flows

(unaudited)

(in thousands of Canadian dollars)	Three months ended September 30		Nine months ended September 30	
	2015	2014	2015	2014
Operating Activities				
Net (loss) income	\$ (80,669)	\$ 11,472	\$ (78,303)	\$ 21,948
Deduct: net income from discontinued operations	-	(7,776)	-	(14,309)
Net (loss) income from continuing operations	(80,669)	3,696	(78,303)	7,639
Add (deduct):				
Depletion, depreciation & amortization (notes 4 & 5)	7,458	11,503	26,948	36,136
Losses (gains) on disposition of properties (note 7)	6	(2,754)	(21,787)	(2,920)
Impairment of development & production assets (note 4)	75,000	-	75,000	-
Accretion of decommissioning obligations (note 9)	626	681	1,865	2,031
Share-based compensation (note 11)	722	258	1,771	561
Unrealized loss (gain) on derivative contracts	406	(2,440)	1,090	(363)
Exploration & evaluation expense	-	478	917	1,063
Bad debt expense	-	100	554	165
Foreign exchange gain	(250)	(2,024)	(538)	(2,038)
Amortization of deferred financing cost	-	195	-	343
Deferred lease obligation amortization	-	-	-	(528)
Funds from operations	3,299	9,693	7,517	42,089
Decommissioning obligation expenditures & other (note 9)	(861)	(599)	(1,901)	(1,760)
Change in operating non-cash working capital (note 12)	(1,696)	7,503	(450)	(2,274)
Cash flow from operating activities:				
Continuing operations	742	16,597	5,166	38,055
Discontinued operations	-	(12,363)	-	6,847
Cash flow from operating activities	742	4,234	5,166	44,902
Financing Activities				
Net consideration on share issuance	-	-	-	128
Long-term debt repayments	-	(97,815)	-	(78,500)
Deferred financing charges	-	-	-	(135)
Change in financing non-cash working capital (note 12)	-	189	-	-
Cash flow from continuing financing activities	-	(97,626)	-	(78,507)
Investing Activities				
Proceeds on property dispositions (note 6)	-	5,414	42,935	5,446
Capital expenditures (notes 4 & 5)	(7,313)	(14,301)	(34,327)	(56,913)
Business combination and other price adjustments (note 4)	(898)	-	(898)	-
Exploration & evaluation expense	-	(478)	(917)	(1,063)
Change in investing non-cash working capital (note 12)	2,589	8,709	(12,155)	9,360
Cash flow from investing activities:				
Continuing operations	(5,622)	(656)	(5,362)	(43,170)
Consideration on sale of discontinued operations	-	140,480	-	140,480
Discontinued operations	(29)	(17,467)	(382)	(44,652)
Cash flow from investing activities	(5,651)	122,357	(5,744)	52,658
Change in cash, during the period				
Continuing operations	(4,880)	58,795	(196)	56,858
Discontinued operations	(29)	(29,830)	(382)	(37,805)
Cash, beginning of period	50,732	16,435	46,018	25,979
Cash, foreign currency translation gain	408	2,050	791	2,418
Cash, end of period	\$ 46,231	\$ 47,450	\$ 46,231	\$ 47,450

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 nine months ended September 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 nine months ended September 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 Financial Statements for the three and nine months ended September 30, 2014 also include the accounts of 1398216 Alberta Ltd., Cyries Wyoming, Inc. and Iteration Energy (Texas), LLC, as well as the accounts of Storm Ventures International (Barbados) Limited ("SVI Barbados") and its wholly-owned subsidiary Storm Sahara Limited ("SSL") (combined the "Discontinued Operations") up to August 19, 2014. 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 November 9, 2015.

3. Derivative Contracts

As at September 30, 2015, Chinook had a fair value level 2 derivative contract asset of \$0.4 million (December 31, 2014 - \$1.5 million) as determined from the following price risk management contract:

<u>Indexed Price</u>	<u>Notional Volumes</u>	<u>Chinook's Received Price</u>	<u>Remaining Contractual Term</u>
AECO	5,000 GJ/d	\$3.50/GJ	October 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 nine months ended September 30, 2015:

Cost of Assets	2015
Beginning balance	\$ 694,361
Capital expenditures	32,356
Business combination price adjustments	587
Cost of properties sold/swapped (note 7)	(837)
Transfer from exploration and evaluation assets	3,528
Decommissioning asset additions (note 9)	287
Ending balance	\$ 730,282
Accumulated Depletion and Depreciation	
Beginning balance	\$ (385,144)
Depletion and depreciation	(24,231)
Impairment	(75,000)
Reversed on sale/swap of properties (note 7)	464
Ending balance	\$ (483,911)
Net book values	
Balance as at December 31, 2014	\$ 309,217
Balance as at September 30, 2015	\$ 246,371

Impairment

At September 30, 2015, Chinook determined that there were indications of impairment that warranted conducting an impairment test in each of its cash generating units (“CGUs”). These triggers resulted from changes in recoverable value due to the continued depression of forward Canadian petroleum and natural gas prices when compared to the forward prices at December 2014, when Chinook last impaired each of its CGUs. Management’s testing of the recoverable value of each of Chinook’s CGU’s relative to its carrying values at September 30, 2015, revealed an impairment charge totaling \$75.0 million, with impairment being recorded in each of the CGUs.

Each CGU’s recoverable value was estimated using a value in use calculation based on expected future cash flows anticipated to be produced from proved plus probable reserves, using a discount rate ranging between 10 percent to 15 percent, depending on the category of reserves, and forward commodity price estimates. The September 30, 2015 proved plus probable reserves of each CGU were estimated internally by management based on the December 31, 2014 independent reserve report and operational events to September 30, 2015. Assumptions that are valid at the time of the reserve estimation may change significantly when new information becomes available. Additional changes in forward price estimates, production costs or recovery rates may change the economic status of reserves and may ultimately result in changes in recoverable value.

Chinook used the following forward commodity price estimates at September 30, 2015 in its calculation of each CGU’s recoverable value:

As at September 30, 2015	Canadian Light Sweet Crude (\$/bbl) ^{(1) (2)}	AECO Gas (\$/mmbtu) ^{(1) (3)}
2015 (3 months)	\$ 60.80	\$ 2.90
2016	\$ 67.40	\$ 3.35
2017	\$ 73.40	\$ 3.65
2018	\$ 78.10	\$ 3.85
2019	\$ 80.90	\$ 4.00
Thereafter	2%/yr	2%/yr

(1) Source: McDaniel & Associates Consultants Ltd. price forecast, effective October 1, 2015.

(2) Central market point for Canadian crude oil.

(3) Central market point for Canadian natural gas.

A five percent decrease in the forward commodity price estimate or a one percent increase in the applied discount rate, as determined for each CGU, would have resulted in an additional impairment charge totaling approximately \$19 million and \$4 million, respectively.

Business Combination and Other Price Adjustments

During the three and nine months ended September 30, 2015, Chinook received from the counterparties purchase price adjustments for which it is reporting \$0.6 million related to a 2014 property acquisition and \$0.3 million related to other price adjustments.

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

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

Cost of Assets	2015
Beginning balance	\$ 69,168
Capital expenditures	1,971
Fair value of property swaps (note 7)	1,757
Cost of properties sold/swapped (note 7)	(564)
Transfer to development and production assets	(3,528)
Ending balance	\$ 68,804
Accumulated Amortization	
Beginning balance	\$ (41,791)
Amortization	(2,717)
Reversed on sale/swap of properties (note 7)	353
Ending balance	\$ (44,155)
Net book values	
Balance as at December 31, 2014	\$ 27,377
Balance as at September 30, 2015	\$ 24,649

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 nine months ended September 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 nine months ended September 30, 2015, the combined gains of these swaps and the dispositions of both the assets held for sale (note 6) and other insignificant properties were \$21.8 million (nine months ended September 30, 2014 – gain of \$2.9 million).

8. Accounts Payable, Accrued Liabilities & Other

	September 30 2015	December 31 2014
Accounts payable, accrued liabilities & other from continuing operations	\$ 17,686	\$ 41,507
Accrued transaction and indemnification costs on the sale of discontinued operations	2,758	2,882
	\$ 20,444	\$ 44,389

9. Provisions

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

	2015
Beginning balance	\$ 106,726
Provisions added during the period (note 4)	287
Property dispositions	(304)
Decommissioning obligation expenditures & other	(1,901)
Accretion expense	1,865
Ending balance	\$ 106,673

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 to be completed on or before November 30, 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 September 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 nine months ended September 30, 2015, was \$0.7 million and \$1.8 million, respectively (three and nine months ended September 30, 2014 - \$0.3 million and \$0.6 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 or cancelled	(2,113)	\$ (1.80)
Expired	(1,734)	\$ (2.60)
Balance as at September 30, 2015	8,575	\$ 1.54
Exercisable	4,582	\$ 1.70

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

Nine months ended September 30	2015	2014
Expected average life (years)	3 to 5	3 to 5
Risk-free interest rate (%)	0.72 to 1.22	1.15 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 to 1.24	1.35 to 2.46

No options were granted during the three months ended September 30, 2015. The weighted average fair value determined for options granted during the nine months ended September 30, 2015 was \$0.50 per option (three and nine months ended September 30, 2014 - \$0.97 per option and \$0.86 per option, respectively).

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	1,039	940
Exercised	(88)	(108)
Forfeited	(13)	(10)
Balance as at September 30, 2015	1,145	1,066

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

Nine months ended September 30	2015		2014	
	Restricted Awards	Performance Awards	Restricted Awards	Performance Awards
Weighted average common share trading price (\$/share)	1.21	1.25	2.42	2.39
Estimated forfeiture rate per annum (%)	12.9 to 13.1	12.9 to 13.1	13 to 13.1	13 to 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 September 30		Nine months ended September 30	
	2015	2014	2015	2014
Cash provided by (used for):				
Accounts receivable	\$ 1,151	\$ 10,746	\$ 11,830	\$ 11
Accounts payable, accrued liabilities & other	(888)	4,693	(23,816)	7,552
Prepays & deposits	630	962	(619)	(477)
	\$ 893	\$ 16,401	\$ (12,605)	\$ 7,086
Cash provided by (used for):				
Operating activities	\$ (1,696)	\$ 7,503	\$ (450)	\$ (2,274)
Investing activities	2,589	8,709	(12,155)	9,360
Financing activities	-	189	-	-
	\$ 893	\$ 16,401	\$ (12,605)	\$ 7,086

Cash interest and financing fees paid

	Three months ended September 30		Nine months ended September 30	
	2015	2014	2015	2014
Cash interest and financing fees paid	\$ 242	\$ 915	\$ 617	\$ 2,677

Per share amounts

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

	Three months ended September 30		Nine months ended September 30	
	2015	2014	2015	2014
Weighted average shares outstanding - basic (thousands)	215,274	214,895	215,150	214,439
Dilutive impact of share options, restricted awards and performance awards (thousands)	-	1,878	-	1,151
Weighted average shares outstanding - diluted (thousands)	215,274	216,773	215,150	215,590
Net (loss) income from continuing operations	\$ (80,669)	\$ 3,696	\$ (78,303)	\$ 7,639
Per share - basic & diluted (\$/share)	\$ (0.37)	\$ 0.02	\$ (0.36)	\$ 0.04
Net income from discontinued operations	\$ -	\$ 7,776	\$ -	\$ 14,309
Per share - basic & diluted (\$/share)	\$ -	\$ 0.03	\$ -	\$ 0.06
Net (loss) income	\$ (80,669)	\$ 11,472	\$ (78,303)	\$ 21,948
Per share - basic & diluted (\$/share)	\$ (0.37)	\$ 0.05	\$ (0.36)	\$ 0.10

For the three and nine months ended September 30, 2015, share options, restricted awards and performance awards were anti-dilutive because of the net loss and were excluded from the loss per share calculation. For the three and nine months ended September 30, 2014, the calculation of diluted income per share assumes the exercise of options and the settlement of restricted awards and performance awards 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" and further adjusts the number of diluted shares for the amount in excess of the number of shares deemed repurchased using the unamortized share-based compensation.