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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)

(in thousands of Canadian dollars)	March 31 2014	December 31 2013
Assets		
Current		
Cash	**$ 16,253**	$ 25,979
Accounts receivable (note 4)	**66,113**	36,200
Inventory	**535**	634
Prepaids & deposits	**4,368**	3,263
	87,269	66,076
Development & production assets (note 6)	**500,739**	476,806
Exploration & evaluation assets (note 6)	**16,411**	12,459
	$ 604,419	$ 555,341
Liabilities and Shareholders' Equity		
Current		
Accounts payable, accrued liabilities & other (note 7)	**$ 79,843**	$ 48,332
Derivative contracts (note 5)	**4,879**	1,572
Taxes payable	**5,791**	3,696
	90,513	53,600
Long-term debt (note 8)	**76,025**	75,897
Decommissioning obligation (note 9)	**91,269**	90,369
Deferred income taxes	**8,834**	8,718
Shareholders' Equity		
Share capital	**778,070**	778,070
Contributed surplus	**21,040**	20,846
Deficit	**(472,315)**	(478,400)
Accumulated other comprehensive income	**10,983**	6,241
	337,778	326,757
	$ 604,419	$ 555,341

See accompanying notes to the condensed consolidated financial statements.

Condensed Consolidated Statements of Operations and Comprehensive Income

(unaudited)

Three months ended March 31	2014	2013
(in thousands of Canadian dollars, except per share amounts)		
Revenues		
Petroleum & natural gas revenues	**$ 59,459**	$ 41,155
Royalties	**(4,914)**	(3,415)
Petroleum & natural gas revenues, net of royalties	**54,545**	37,740
Processing & gathering revenues	**1,318**	3,399
Petroleum, natural gas & other revenues, net of royalties	**55,863**	41,139
Expenses		
Production & operating	**18,456**	18,279
General & administrative	**5,165**	2,722
Exploration & evaluation (note 6)	**874**	4,499
Derivative contracts losses (note 5)	**4,499**	604
Net financing (note 10)	**1,766**	1,813
Depletion, depreciation & amortization (note 6)	**17,589**	17,969
Gains on disposition of properties (note 6)	**-**	(6,259)
Foreign exchange & other gains	**(276)**	(2,948)
	48,073	36,679
Income before income taxes	**7,790**	4,460
Income taxes		
Current income tax expense	**1,931**	630
Deferred income tax recovery	**(226)**	(670)
	1,705	(40)
Net income	**6,085**	4,500
Foreign currency translation gain on foreign operations	**4,742**	2,144
Comprehensive income	**$ 10,827**	$ 6,644
Net income per share, basic & diluted (note 11)	**$ 0.03**	$ 0.02

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 (Loss)	Shareholders' Equity
Balance as at December 31, 2012	**214,188**	**$ 778,070**	**$ 19,517**	**$ (451,700)**	**$ (2,285)**	**$ 343,602**
Share-based compensation	-	-	435	-	-	435
Other comprehensive income	-	-	-	-	2,144	2,144
Net income	-	-	-	4,500	-	4,500
Balance as at March 31, 2013	**214,188**	**$ 778,070**	**$ 19,952**	**$ (447,200)**	**$ (141)**	**$ 350,681**
Balance as at December 31, 2013	**214,188**	**$ 778,070**	**$ 20,846**	**$ (478,400)**	**$ 6,241**	**$ 326,757**
Share-based compensation	-	-	194	-	-	194
Other comprehensive income	-	-	-	-	4,742	4,742
Net income	-	-	-	6,085	-	6,085
Balance as at March 31, 2014	**214,188**	**$ 778,070**	**$ 21,040**	**$ (472,315)**	**$ 10,983**	**$ 337,778**

See accompanying notes to the condensed consolidated financial statements.

Condensed Consolidated Statements of Cash Flows

(unaudited)

Three months ended March 31		2014		2013
(in thousands of Canadian dollars)				
Operating Activities				
Net income	**$**	**6,085**	$	4,500
Add (deduct):				
Accretion (note 9)		**707**		704
Amortization of deferred financing costs (note 8)		**213**		61
Depletion, depreciation & amortization (note 6)		**17,589**		17,969
Exploration & evaluation expense (note 6)		**874**		4,499
Unrealized losses on derivative contracts (note 5)		**3,307**		593
Gains on disposition of properties (note 6)		**-**		(6,259)
Non-cash general and administrative (recoveries) expenses		**(50)**		171
Deferred income tax recovery		**(226)**		(670)
Deferred disposition proceeds on joint arrangement (note 6)		**-**		(3,051)
Foreign exchange		**(50)**		(50)
Decommissioning expenditures (note 9)		**(605)**		(828)
Change in operating non-cash working capital (note 11)		**(19,243)**		(13,747)
Cash flow from operating activities		**8,601**		3,892
Financing Activities				
Deferred financing charges		**-**		(2,347)
Cash outflow from financing activities		**-**		(2,347)
Investing Activities				
Capital expenditures (note 6)		**(40,391)**		(25,046)
Exploration & evaluation expenditures (note 6)		**(874)**		(3,109)
Proceeds on property dispositions (note 6)		**-**		13,060
Change in investing non-cash working capital (note 11)		**22,047**		7,555
Cash outflow from investing activities		**(19,218)**		(7,540)
Use of cash, during the period		**(10,617)**		(5,995)
Cash, beginning of period		**25,979**		30,647
Cash, foreign currency translation gain		**891**		84
Cash, end of period	**$**	**16,253**	$	24,736
Supplementary information (note 11)				

See accompanying notes to the condensed consolidated financial statements.

Notes to the Condensed Consolidated Financial Statements

(unaudited)

Three months ended March 31, 2014 and 2013
Tabular amounts in thousands of Canadian dollars, except as noted

1. Reporting Entity

Chinook Energy Inc. was incorporated under the laws of the Province of Alberta, Canada, on August 28, 2003.

These condensed consolidated financial statements include the accounts of Chinook Energy Inc. and its direct and indirect wholly-owned subsidiaries and foreign branches: 1398216 Alberta Limited, Cyries Wyoming Inc., Iteration (Texas) llc, 1542991 Alberta Limited, Storm Ventures International (BVI) Limited and Storm Ventures International (Barbados) Limited and Storm Sahara Limited and their Tunisian branches as included in them (collectively, “Chinook” or the “Company”). On December 31, 2013, Chinook Energy Partnership and Iteration Energy were dissolved. On January 1, 2014, Chinook Energy Inc. was amalgamated with two of its’ wholly owned subsidiaries, Chinook Energy Ltd. and Iteration Energy Inc. to form “Chinook Energy Inc.”. All intercompany balances and transactions have been eliminated.

Chinook’s operations, located in western Canada and onshore and offshore in Tunisia, are focused on the development and production of natural gas, crude oil and natural gas liquids in addition to exploration predominately for crude oil. In addition to the Corporate segment, Chinook has treated each country in which it conducts business as an identifiable reporting segment.

Chinook’s common shares are listed on the Toronto Stock Exchange under the symbol CKE. The head office and principal address of Chinook is Suite 1000, 517 – 10th Avenue S.W., Calgary, Alberta, Canada T2R 0A8.

2. Basis of Presentation

Statement of Compliance

These unaudited condensed consolidated financial statements have been prepared following the same accounting policies as disclosed in Note 3 in the audited consolidated financial statements for the years ended December 31, 2013 and 2012 with the exception of the new accounting policies disclosed in Note 3 below. These unaudited condensed consolidated financial statements for the three months ended March 31, 2014 and 2013 should be read in conjunction with the consolidated financial statements for the years ended December 31, 2013 and 2012 and the notes thereto. These unaudited condensed consolidated financial statements for the three months ended March 31, 2014 and 2013 do not include all of the required disclosures for annual consolidated financial statements.

These condensed consolidated financial statements have been prepared by management in accordance with International Accounting Standard (“IAS”) 34 ‘Interim Financial Reporting’ using accounting principles consistent with International Financial Reporting Standards (“IFRS”) issued by the International Accounting Standards Board.

These condensed consolidated financial statements were approved and authorized for issuance by the Board of Directors on May 13, 2014.

Basis of Measurement

These condensed consolidated financial statements have been prepared on the historical cost basis with the exception of cash and derivative contracts which are measured at fair value.

Functional and Presentation Currency

These condensed consolidated financial statements and the notes thereto are presented in thousands of Canadian dollars, unless otherwise noted. The Company’s Canadian and Corporate segments’ functional currency is also the Canadian dollar. The Tunisian segment’s functional currency is the United States dollar. References to “US$” are to United States dollars.

3. New Accounting Amendments and Interpretation

Current Year Accounting Changes

The Company adopted the following new amendments and interpretation:

- Amendments to IAS 32, *Financial Instruments: Presentation*, and
- IFRS Interpretation Committee (“IFRIC”) 21, *Levies*.

The adoption of these amendments and interpretation had no material impact on the financial results recorded in the condensed consolidated financial statements as at March 31, 2014 and December 31, 2013.

4. Accounts Receivable

Chinook's accounts receivable were comprised of:

	March 31 2014	December 31 2013
Trade accounts receivable & accrued receivables	**$ 56,634**	$ 27,728
Other receivables	**3,576**	3,048
Cash call receivables	**7,588**	7,174
Allowance for doubtful accounts	**(1,685)**	(1,750)
	$ 66,113	$ 36,200

Chinook's accounts receivable balance was aged as follows:

	March 31 2014	December 31 2013
Not past due	**$ 62,051**	$ 31,103
Past due by more than 90 days, net of allowance	**4,062**	5,097
	$ 66,113	$ 36,200

5. Derivative Contracts

Chinook's realized and unrealized losses from commodity price risk management contracts for the three months ended March 31, 2014 and 2013 were as follows:

Three months ended March 31	2014	2013
Realized loss on derivative contracts	**$ 1,192**	$ 11
Unrealized loss on derivative contracts	**3,307**	593
	$ 4,499	$ 604

Chinook uses commodity price risk management contracts to reduce its exposure to fluctuations in commodity prices. The following price risk management contracts were in place as at March 31, 2014:

Indexed Price	Notional Volumes	Company's Received Price	Remaining Contractual Term
AECO	5,000 GJ/d	$3.25/GJ to $3.50/GJ	April 1, 2014 to December 31, 2014
AECO	5,000 GJ/d	$3.68/GJ	April 1, 2014 to December 31, 2014
AECO	5,000 GJ/d	$3.5025/GJ	April 1, 2014 to October 31, 2014
WTI	500 bbl/d	$101.30/bbl	April 1, 2014 to December 31, 2014
Brent	500 bbl/d	$98.00 US/bbl to $108.00 US/bbl	April 1, 2014 to December 31, 2014

The commodity price contracts were assessed as level 2 on the fair value hierarchy and were reported at March 31, 2014 at their fair value liability of $4.9 million as included in current derivative liabilities on the condensed consolidated statements of financial position (December 31, 2013 – $1.6 million). This estimate was partially determined through the difference in the referenced benchmark forward price as compared to each contract's strike price multiplied by the notional volumes during the remaining contractual term.

6. Development & Production and Exploration & Evaluation Assets

The following table reconciles Chinook's D&P Assets and E&E Assets:

	Development & Production Assets	Exploration & Evaluation Assets	Total
Cost of Assets			
Balance as at December 31, 2013	**$ 898,235**	**$ 52,915**	**$ 951,150**
Capital expenditures	35,986	4,405	40,391
Change in decommissioning assets	539	46	585
Foreign exchange adjustment	8,136	8	8,144
Balance as at March 31, 2014	**$ 942,896**	**$ 57,374**	**$ 1,000,270**
Accumulated Depletion, Depreciation & Amortization			
Balance as at December 31, 2013	**$ (421,429)**	**$ (40,456)**	**$ (461,885)**
Depletion, depreciation & amortization	(17,082)	(507)	(17,589)
Inventoried depletion	(91)	-	(91)
Foreign exchange adjustment	(3,555)	-	(3,555)
Balance as at March 31, 2014	**$ (442,157)**	**$ (40,963)**	**$ (483,120)**
Net Book Values			
Balance as at December 31, 2013	$ 476,806	$ 12,459	$ 489,265
Balance as at March 31, 2014	**$ 500,739**	**$ 16,411**	**$ 517,150**

Chinook incurred $40.4 million in capital expenditures during the three months ended March 31, 2014 ($25.0 million for the three months ended March 31, 2013). The Company capitalized $1.1 million and $1.3 million of direct G&A costs as related to its exploration and development activity during the three months ended March 31, 2014 and 2013, respectively.

Exploration Wells

For the three months ended March 31, 2014 and 2013, respectively, $0.9 million and $3.1 million of pre-licensing evaluation, exploratory lease rental and geological and geophysical costs were incurred.

In addition to the above, in Canada during the three months ended March 31, 2013, management completed its evaluation and determined that an exploration well drilled during 2012, at a cost of $1.4 million, was unsuccessful for petroleum or natural gas reserves.

In total, these charges resulted in an exploration and evaluation expense of $0.9 million and $4.5 million, respectively, for the three months ended March 31, 2014 and 2013. Excluding charges reported as capital expenditures in prior years, cash exploration and evaluation costs of $0.9 million and $3.1 million were included as investing activities on the condensed consolidated statements of cash flows for the three months ended March 31, 2014 and 2013, respectively.

Property Dispositions

During the three months ended March 31, 2013, the Company completed the sale of several petroleum and natural gas properties for aggregate net proceeds of $13.1 million, resulting in a gain of $6.3 million. Chinook did not have any property dispositions during the three months ended March 31, 2014.

Joint Arrangement

During the three months ended March 31, 2013, a third party terminated its optional right to complete its earning and acquisition of an interest in the Company's Cosmos Concession. Pursuant to this termination, Chinook reported the US$3.0 million it had received for this optional right as realized through the line item foreign exchange & other gains on the condensed consolidated statements of operations and comprehensive income during the three months ended March 31, 2013.

7. Accounts Payable, Accrued Liabilities and Other

	March 31 2014	December 31 2013
Trade accounts payable	**$ 31,309**	$ 13,086
Accrued liabilities	**43,877**	29,177
Joint operations accounts payable	**4,375**	5,350
Other payables	**282**	719
	$ 79,843	$ 48,332

8. Long-Term Debt

	March 31 2014	December 31 2013
Canadian revolving term credit facility	**$ 78,500**	$ 78,500
Unamortized deferred financing costs	**(2,475)**	(2,603)
	$ 76,025	$ 75,897

Canadian Revolving Term Credit Facility

At March 31, 2014 and December 31, 2013, Chinook's Canadian reserve-based 364 day revolving credit facility (the "Canadian Revolving Term Credit Facility"), which it holds with a syndicate of Canadian banks, had a maximum availability of $115.0 million. In June 2013, Chinook extended the current revolving period to June 26, 2014 at which time this facility's revolving period and availability will be redetermined. In the event that the revolving period is not extended by the banking syndicate on or prior to this date, all amounts then outstanding under the Canadian Revolving Term Credit Facility must be repaid before June 26, 2015. The Canadian Revolving Term Credit Facility is subject to a semi-annual review and redetermination. Changes in the availability of the Canadian Revolving Term Credit Facility are possible, from one renewal period to the next, with draws in excess of availability becoming payable within 60 days. At both March 31, 2014 and December 31, 2013, Chinook had drawings of $78.5 million and outstanding letters of credit of $0.4 million against the Canadian Revolving Term Credit Facility, resulting in available credit on this facility of $36.1 million.

The Canadian Revolving Term Credit Facility is collateralized by floating charges and security interests over all present and future Canadian properties and other Canadian assets of Chinook. Interest payable on amounts drawn on this facility vary based on the applicable pricing rate as combined with either the Canadian prime, U.S. Base rate, U.S. LIBOR or Bankers' Acceptances depending on the borrowing option selected by Chinook. The effective interest rate on draws against the Canadian Revolving Term Credit Facility for the three months ended March 31, 2014, was 3.9% (three months ended March 31, 2013 – 5.2%). The Canadian Revolving Term Credit Facility contains a covenant whereby the ratio of Chinook's drawings against this facility to the earnings attributable to its Canadian operations before interest, taxes, depreciation/depletion and amortization cannot be greater than 4:1 as determined on a rolling four quarter basis for the most current fiscal quarter. At March 31, 2014, Chinook was in compliance with this covenant.

International Credit Facility

On March 15, 2013, Chinook signed a US$75.0 million international amortizing reserve-based credit facility (the "International Credit Facility") for a term of five years with an international bank. Effective January 1, 2014, Chinook's available borrowing base on this facility was reduced from US$46.5 million to US$23.8 million. This reduction was due to an increase in estimated future costs, included in Chinook's December 31, 2013 reserve report for its Tunisian producing properties, over this facility's remaining anticipated term, despite an increase in these reserves' estimated net recoverable value. At March 31, 2014 and December 31, 2013, Chinook had no outstanding drawings against the International Credit Facility. The International Credit Facility's next semi-annual review and redetermination is scheduled for June 2014 where the available amount will be reassessed and any outstanding draws must be paid down to the lower of the new available amount or the current repayment commitment. The term of the International Credit Facility can be reduced from the anticipated final maturity date in March 2018 to a date when the estimated reserve recoveries of the borrowing base assets fall below a prescribed rate.

The International Credit Facility is collateralized by floating charges and security interests over all of Chinook's Tunisian assets, including the shares of Chinook's international subsidiaries. Interest payable on drawings from the International Revolving Credit Facility will vary based on a prescribed margin plus U.S. LIBOR.

Unamortized Deferred Financing Costs

	Canadian Revolving Term Credit Facility	International Credit Facility	Total
Balance as at December 31, 2013	$ 208	$ 2,395	**$ 2,603**
Additions	-	-	**-**
Amortization	(74)	(139)	**(213)**
Foreign exchange adjustment	-	85	**85**
Balance as at March 31, 2014	$ 134	$ 2,341	**$ 2,475**

The unamortized deferred financing costs are currently being amortized through to the anticipated expiry of each facility's agreement.

9. Decommissioning Obligation

The total future decommissioning obligations were estimated by management based on Chinook's net ownership interest in all wells and facilities, estimated costs to reclaim and abandon the wells and facilities and the estimated timing of the costs to be incurred in future periods. At March 31, 2014, and December 31, 2013, Chinook has estimated the net present value of its total decommissioning obligation based on a total future undiscounted liability of $123.6 million. At March 31, 2014, management estimates that these payments are expected to be made over an average of 18.4 years. At March 31, 2014 and December 31, 2013, a risk free rate of up to 3.2% and an inflation rate of 2.0% were used to calculate the present values of the decommissioning obligations.

Balance as at December 31, 2013	**$ 90,369**
Development and exploration activities	**585**
Settlement	**(605)**
Accretion expense	**707**
Foreign exchange adjustment	**213**
Balance as at March 31, 2014	**$ 91,269**

10. Net Financing Expenses

Three months ended March 31	2014	2013
Interest on bank debt and other interest	**$ 777**	$ 1,275
Interest earned	**(130)**	(299)
Finance charges and fees	**199**	72
Amortization of deferred financing costs	**213**	61
Accretion of decommissioning obligation	**707**	704
	$ 1,766	$ 1,813

11. Supplemental Disclosures

Changes in non-cash working capital:

Three months ended March 31		2014		2013
Cash provided by (used for):				
Accounts receivable	$	**(29,723)**	$	(661)
Accounts payable, accrued liabilities & other		**31,358**		(314)
Inventory		**254**		(2,016)
Prepaids & deposits		**(1,082)**		(1,701)
Taxes payable		**1,997**		(1,500)
	$	**2,804**	$	(6,192)
Cash provided by (used for):				
Operating activities	$	**(19,243)**	$	(13,747)
Investing activities		**22,047**		7,555
	$	**2,804**	$	(6,192)

Other supplemental cash flow information:

Three months ended March 31		2014		2013
Cash taxes paid	$	**-**	$	2,128
Cash interest paid	$	**777**	$	1,219

Per Share Amounts:

The per share amounts for the three months ended March 31, 2014 and 2013, were calculated as per the following table:

Three months ended March 31		2014		2013
Weighted average shares outstanding - basic (thousands)		**214,188**		214,188
Dilutive impact of share options (thousands)		**57**		-
Weighted average shares outstanding - diluted (thousands)		**214,245**		214,188
Net income	$	**6,085**	$	4,500
Net income per share - basic & diluted ($/share)	$	**0.03**	$	0.02

For the three months ended March 31, 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 months ended March 31, 2013, this calculation would have also included warrants outstanding at the end of that period. At March 31, 2014, the dilutive effect of Chinook’s “in-the-money” options calculated using the treasury stock method, resulted in an increase to the diluted weighted average shares outstanding of approximately 0.1 million shares. At March 31, 2013, Chinook’s options and warrants were considered to be “out-of-the-money” per the treasury stock method and had no effect on the diluted weighted average shares outstanding.

12. Segmented Information

Chinook's continuing operating and reportable segments are as follows:

- **Canada –** includes four CGUs in the Company's Western Canadian Sedimentary Basin producing properties and undeveloped land predominately located in northwestern Alberta and northeastern British Columbia.
- **Tunisia –** includes two CGUs: an offshore CGU in the Gulf of Hammamet within the Pelagian Basin (Cosmos and Yasmin) and an onshore CGU containing the Bir Ben Tartar and Adam producing properties and undeveloped onshore blocks all located within the Ghadames Basin.
- **Corporate –** includes derivative transactions, general and administrative costs and assets held corporately.

Selected Segment Information

Three months ended March 31				2014				2013
	Canada	Tunisia	Corporate	Consolidated	Canada	Tunisia	Corporate	Consolidated
Capital expenditures	**$ 23,320**	**$ 16,765**	**$ 306**	**$ 40,391**	$ 17,182	$ 7,834	$ 30	$ 25,046

As at				March 31, 2014				December 31, 2013
Development & production and exploration & evaluation assets	**$382,463**	**$ 131,101**	**$ 3,586**	**$ 517,150**	$ 371,295	$ 114,700	$ 3,270	$ 489,265
Total assets	**$432,529**	**$ 165,797**	**$ 6,093**	**$ 604,419**	$ 409,926	$ 127,314	$ 18,101	$ 555,341

Results by Segment

		Canada		Tunisia		Corporate		Consolidated
Three months ended March 31	2014	2013	2014	2013	2014	2013	2014	2013
Revenues								
Petroleum, natural gas & other revenues, net of royalties	**$ 37,347**	$ 28,046	**$ 18,516**	$ 13,093	**$ -**	$ -	**$ 55,863**	$ 41,139
Expenses								
Production & operating	**13,381**	15,020	**5,075**	3,259	**-**	-	**18,456**	18,279
General & administrative	**773**	1,216	**582**	167	**3,810**	1,339	**5,165**	2,722
Exploration & evaluation	**469**	3,098	**405**	1,401	**-**	-	**874**	4,499
Derivative contracts losses	**-**	-	**-**	-	**4,499**	604	**4,499**	604
Net financing	**1,456**	1,778	**310**	36	**-**	-	**1,766**	1,813
Depletion, depreciation & amortization	**12,287**	13,768	**5,302**	4,201	**-**	-	**17,589**	17,969
Gains on disposition of properties	**-**	(6,259)	**-**	-	**-**	-	**-**	(6,259)
Foreign exchange & other (gains) losses	**(393)**	198	**286**	(3,146)	**(169)**	-	**(276)**	(2,948)
	27,973	28,819	**11,960**	5,918	**8,140**	1,943	**48,073**	36,679
Income (loss) before income taxes	**9,374**	(773)	**6,556**	7,175	**(8,140)**	(1,943)	**7,790**	4,460
Income taxes								
Current income tax expense	**-**	-	**1,931**	630	**-**	-	**1,931**	630
Deferred income tax recovery	**-**	-	**(226)**	(670)	**-**	-	**(226)**	(670)
	-	-	**1,705**	(40)	**-**	-	**1,705**	(40)
Net income (loss)	**$ 9,374**	$ (773)	**$ 4,851**	$ 7,215	**$ (8,140)**	$ (1,943)	**$ 6,085**	$ 4,500