Q1 2016

# Management's Discussion and Analysis

CHINOOK energy inc

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

The following Management's Discussion and Analysis ("MD&A") reports on the financial condition and the results of operations of Chinook Energy Inc. ("our", "we" or "us") for the three months ended March 31, 2016 and 2015 and should be read in conjunction with our unaudited condensed consolidated financial statements and accompanying notes as at and for the three months ended March 31, 2016 and 2015 (the "Interim Financial Statements") and our audited consolidated financial statements and accompanying notes as at and for the years ended December 31, 2015 and 2014 (the "Annual Financial Statements"). This MD&A is based on information available as at May 10, 2016.

The term "first quarter" or similar terms are used throughout this document and refer to the three months ended March 31, 2016. The term "same quarter of 2015" or similar terms are used throughout this document and refer to the three months ended March 31, 2015. The term "reported periods" or similar terms are used throughout this document and refer to both the three months ended March 31, 2016 and 2015, in this respective order.

This MD&A contains measures which are not prescribed by IFRS ("non-GAAP") and, therefore, may not be comparable with the calculations of similar measures presented by other companies. Statements throughout this MD&A that are not historical facts may be considered "forward-looking statements". Readers should read the advisories under the headings "Non-GAAP Measures" and "Forward-Looking Statements" included at the end of this MD&A.

## Additional Information

Additional information on our company, including our Annual Information Form for the year ended December 31, 2015 ("AIF"), can be found on SEDAR at www.sedar.com or at www.chinookenergyinc.com.

## Basis of Presentation

The Interim Financial Statements have been prepared in accordance with International Accounting Standard 34 'Interim Financial Reporting' using accounting principles consistent with International Financial Reporting Standards ("IFRS") issued by the International Accounting Standards Board. They include the accounts of our direct subsidiaries, all of which are wholly owned. All amounts are in Canadian dollars, unless otherwise stated and all tabular amounts are in thousands of Canadian dollars, except per unit amounts or as otherwise noted.

## Introduction to Chinook

We are a Calgary-based public petroleum and natural gas production company focused on development and exploration opportunities in western Canada. Our operations combine multi-zone conventional production and resource plays in our Western Canadian Sedimentary Basin producing properties and undeveloped land predominantly located in northwestern Alberta and northeastern British Columbia ("BC"). We are currently focused on the development of Montney liquids rich natural gas on our Birley/Umbach, BC properties, and are well positioned to return focus to our Montney and Dunvegan light crude oil in Grande Prairie, Alberta. With improved commodity prices, these assets provide the opportunity for substantial growth and long-term profitable development.

We are incorporated under the laws of the Province of Alberta, Canada. Our common shares are listed and posted for trading on the Toronto Stock Exchange under the symbol "CKE". Our head office and principal address is Suite 1000, 517 – 10th Avenue S.W., Calgary, Alberta, Canada T2R 0A8.

# Financial and Operating Highlights

| Three months ended March 31 | | 2016 | | 2015 |
|---|---|---|---|---|
| **Production** (1) | | | | |
| Crude oil (bbl/d) | | **817** | | 1,485 |
| Natural gas liquids (boe/d) | | **733** | | 682 |
| Natural gas (mcf/d) | | **25,215** | | 33,007 |
| Average daily production (boe/d) | | **5,753** | | 7,668 |
| **Sales Prices** | | | | |
| Average oil price ($/bbl) | **$** | **35.41** | $ | 49.03 |
| Average natural gas liquids price ($/boe) | **$** | **27.65** | $ | 36.47 |
| Average natural gas price ($/mcf) | **$** | **1.43** | $ | 2.65 |
| **Netback** (2) | | | | |
| Average commodity pricing ($/boe) | **$** | **14.82** | $ | 24.15 |
| Royalties ($/boe) | **$** | **(0.99)** | $ | (2.07) |
| Net production expenses ($/boe) (2) | **$** | **(15.12)** | $ | (17.04) |
| G&A expense ($/boe) | **$** | **(3.61)** | $ | (4.00) |
| Netback ($/boe) (2) | **$** | **(4.90)** | $ | 1.04 |
| **Wells Drilled (net)** | | | | |
| Total natural gas wells drilled (net) | | **-** | | 2.75 |
| **FINANCIAL** ($ thousands, except per share amounts) | | | | |
| Petroleum & natural gas revenues, net of royalties | **$** | **7,244** | $ | 15,240 |
| (Outflow) funds from operations (2) | **$** | **(2,890)** | $ | 1,220 |
| Per share - basic & diluted ($/share) | **$** | **(0.01)** | $ | 0.01 |
| Net (loss) income | **$** | **(12,775)** | $ | 8,189 |
| Per share - basic and diluted ($/share) | **$** | **(0.06)** | $ | 0.04 |
| Capital expenditures | **$** | **3,026** | $ | 22,093 |
| Net surplus (2) | **$** | **(20,180)** | $ | (48,596) |
| Total assets | **$** | **299,623** | $ | 431,085 |
| **Common Shares** (thousands) | | | | |
| Weighted average during period | | | | |
| - basic | | **215,349** | | 215,083 |
| - diluted | | **215,349** | | 215,112 |
| Outstanding at period end | | **215,350** | | 215,083 |

(1) Throughout this MD&A our production is presented in either barrels of oil ("bbl"), thousands of cubic feet ("mcf") or barrels of oil equivalent ("boe"); production per day is presented as bbl/d, mcf/d, and boe/d, respectively; commodity prices or revenues and expense per sales are presented as $/bbl, $/mcf, and $/boe, respectively. Production volumes and sales volumes are equal and are used interchangeably throughout this MD&A.

(2) Non-GAAP measures which may not be comparable to similar non-GAAP measures used by other entities. Refer to the section entitled "Non-GAAP Measures" contained within this MD&A.

## Petroleum and Natural Gas Production Volumes

| Three months ended March 31 | 2016 | 2015 |
|---|---|---|
| Crude oil (bbl/d) | **817** | 1,485 |
| Natural gas liquids (boe/d) | **733** | 682 |
| Natural gas (mcf/d) | **25,215** | 33,007 |
| Total (boe/d) | **5,753** | 7,668 |

### Total Production Volumes

During mid-February 2016, we brought on-stream an additional three (2.75 net) wells at our Birley/Umbach area on the commissioning of our facility expansion. Currently we have production from five wells (4.25 net) in this area and have the capacity to add the volumes from a sixth well (0.75 net). Our production volumes during the month of March did not achieve the capacity of our 29 mmcf/d compression facility because of temporary capacity constraints. Despite these constraints, March's net sales volumes from our Birley/Umbach area increased to 2,600 boe/d (13,000 mcf/d natural gas and 450 boe/d liquids). This increase combined with other well reactivations resulted in the first quarter volumes being 1,825 boe/d higher than the fourth quarter of 2015.

Despite increased volumes at our Birley/Umbach area and other well reactivations, production volumes for the first quarter decreased by 1,915 boe/d compared to the same quarter of 2015. We responded to continued depressed Station 2 pricing by temporarily shutting in production volumes which were not tied to firm processing or transportation commitments with approximately 1,100 boe/d of production shut-in by the end of the first quarter. Prior to the first quarter, we had also shut-in another 1,500 boe/d of production in response to lower commodity prices.

Also contributing to the decrease in the first quarter's production volumes, compared to the same quarter of 2015, was last year's disposition of the predominantly crude oil Rainbow property in northeastern Alberta with associated production of 183 boe/d. At the end of the first quarter, we also sold portions of our crude oil Enchant property in southcentral Alberta with associated production of 55 boe/d at the time of its sale.

To date, our production volumes have not been affected by the wildfires in northeastern Alberta in the Fort McMurray area.

#### *Natural Gas and Natural Gas Liquids Production ("NGL") Volumes*

Natural gas production for the first quarter decreased compared to the same quarter of 2015. This decrease resulted from last year's shut-ins of relatively high operating cost properties in addition to recent voluntary shut-ins in reaction to low natural gas pricing. These recent shut-ins included our Martin Creek and Black Conroy areas in northeastern BC. Also contributing to this decrease were natural production declines. Partially offsetting this first quarter decrease was higher natural gas production and its associated liquids from our recent Birley/Umbach area development program.

#### *Crude Oil Production Volumes*

Our crude oil production volumes for the first quarter decreased by 668 bbl/d compared to the same quarter of 2015. This decrease was a consequence of the production associated with the voluntary shut-in of properties in response to lower natural gas pricing, pipeline service restrictions in the Grande Prairie area and natural production declines. We also had crude oil production associated with the disposed Rainbow and Enchant properties.

## Petroleum and Natural Gas Revenues and Realized Pricing

| Three months ended March 31 | 2016 | 2015 |
|---|---|---|
| ($ thousands, except per unit amounts) | | |
| Oil sales | **$ 2,633** | $ 6,553 |
| $/bbl | **35.41** | 49.03 |
| Natural gas liquids sales | **$ 1,846** | $ 2,238 |
| $/boe | **27.65** | 36.47 |
| Natural gas sales | **$ 3,282** | $ 7,877 |
| $/mcf | **1.43** | 2.65 |
| Petroleum & natural gas revenue | **$ 7,761** | $ 16,668 |
| $/boe | **14.82** | 24.15 |

Our petroleum and natural gas revenues during the first quarter of $7.8 million significantly decreased compared to the same quarter of 2015. This decrease was caused by both lower realized commodity pricing and sales volumes. The decrease in our realized commodity pricing was due to lower benchmarks whose decline accelerated starting in the fourth quarter of 2014. These decreased benchmark prices resulted in realized pricing that lowered by 27% for oil, 46% for natural gas and 24% for the associated liquids. Our ratio of petroleum relative to total sales volumes of 27% remained relatively unchanged during the reported periods. This resulted from the focus on our Birley/Umbach property, which has liquid rich natural gas. However, overall there was a decrease in the comparatively higher priced crude oil sales volumes. This decrease contributed to a lower realized weighted average commodity price.

## Benchmark Prices

| **Three months ended March 31** | **2016** | 2015 |
|---|---|---|
| Crude oil | | |
| Canadian light sweet (1) ($/bbl) | **$ 41.22** | $ 53.22 |
| Natural gas liquids | | |
| WTI (2) ($US/bbl) | **$ 33.45** | $ 48.63 |
| Natural gas | | |
| AECO gas (3) ($/mcf) | **$ 1.83** | $ 2.79 |

(1) Central market point for Canadian crude oil
(1) West Texas Intermediate – Central market point for US crude oil
(2) Central market point for Canadian natural gas

### Crude Oil Pricing

Our conventional crude oil production is sold at prices based on the Canadian light sweet benchmark postings adjusted for quality. This benchmark price decreased during the first quarter, as did our average realized crude oil prices, compared to the same quarter of 2015.

### NGL Pricing

Our NGL price is a blend of prices received for a range of liquids from ethane through to condensates that are produced in association with natural gas. There are various benchmarks for natural gas liquids, depending on the type sold; however, we benchmark our liquids in reference to Canadian light sweet or WTI. During the first quarter, and consistent with the decrease in the Canadian light sweet oil benchmark, our realized NGL price of $27.65/boe decreased compared to $36.47/boe for the same quarter of 2015. The ratio of our NGL price relative to Canadian light sweet oil was approximately 68% for the reported periods. This ratio remained unchanged despite a larger percentage decrease in butane pricing relative to Canadian light sweet oil because of an increase in the proportion of more liquid-rich condensates relative to our total NGL sales volumes. This proportion increase, in addition to higher overall NGL sales volumes, resulted from the recent development of our Birley/Umbach area.

### Natural Gas Pricing

Our realized natural gas price of $1.43/mcf for the first quarter decreased from $2.65/mcf for the same quarter of 2015. This decrease was due to both an increase in the ratio of our production from BC in addition to lower benchmark pricing. This downward price pressure included Station 2 pricing during March averaging $0.94/mcf with that price continuing through April.

AECO pricing has been significantly affected due to a decrease in intra-Alberta demand resulting from the May wildfires in Fort McMurray, Alberta.

## Royalties

| **Three months ended March 31** | **2016** | 2015 |
|---|---|---|
| ($ thousands, except where noted) | | |
| Royalties | **$ 517** | $ 1,428 |
| Per sales ($/boe) | **$ 0.99** | $ 2.07 |
| Percent of revenues (%) | **7** | 9 |

For the first quarter, our royalties decreased on an overall basis, per boe and as a percentage of revenue, compared to the same quarter of 2015. The overall decrease in royalties resulted from both lower commodity pricing and sales volumes. The lower commodity pricing caused a decrease in royalty rates where such rates are based on a sliding pricing scale. Our focus on the development of our

Montney play in the Birley/Umbach area increased the proportion of our production from BC which has relatively lower associated royalty rates in comparison to our overall rates. Finally, we increased our estimate of gas cost allowance in proportion to lower rates, through a review of last year's actual recoveries.

## Production and Operating Expense

| **Three months ended March 31** | | **2016** | | 2015 |
|---|---|---|---|---|
| ($ thousands, except where noted) | | | | |
| Production & operating | **$** | **8,778** | $ | 12,830 |
| Less: | | | | |
| Processing & gathering revenues | | **(860)** | | (1,070) |
| Net production & operating expense [1] | **$** | **7,918** | $ | 11,760 |
| Per sales net production & operating expenses ($/boe) [1] | **$** | **15.12** | $ | 17.04 |
| Per sales production & operating expenses ($/boe) | **$** | **16.77** | $ | 18.59 |

(1) Non-GAAP measure which may not be comparable to similar non-GAAP measures used by other entities. Refer to the section entitled "Non-GAAP Measures" contained within this MD&A.

The first quarter's production and operating expenses of $8.8 million decreased compared to the same quarter of 2015. This decrease partially resulted from the disposition of properties during 2015, most notably Rainbow and to a lesser extent Karr. Also contributing to this decrease was last year's voluntary shut-in of relatively higher operating cost/lower netback wells. These wells are mostly located on our Hoffard, Pouce Coupe, Gold Creek, Boundary Lake North and Rigel properties. Further decreases in these costs were due to the associated production from the voluntary temporary shut-in of natural gas production in response to decreased commodity prices in BC. We also realized cost saving initiatives implemented in 2015 principally through optimization of field staff and lower costs for hauling, chemicals, repairs and maintenance without compromising our commitment to health and safety. During the comparative quarter we also incurred one-time field staff cost increases.

On a per boe basis, for the same reasons as just discussed, operating costs in the first quarter decreased compared to the same quarter of 2015. The Rainbow and Karr property dispositions had higher average operating costs per boe. Through these dispositions, we lowered our per boe average operating costs. In addition, we increased our volumes at Birley/Umbach and although this added to our total operating costs, the synergies achieved through these incremental volumes had the effect of decreasing our operating costs in this area from $20/boe in December to an estimated $11/boe in March.

The first quarter processing and gathering revenue decreased compared to the same quarter of 2015. This decrease was the result of lower third party volumes that flowed through our processing facilities and distribution lines. These lower revenues correspond to areas where we had shut-in volumes during 2015 in response to decreased commodity pricing. The associated processing and distribution costs as reported through operating costs correspondingly also decreased.

## General & Administrative ("G&A") Expense

| **Three months ended March 31** | | **2016** | | 2015 |
|---|---|---|---|---|
| ($ thousands, except per unit amounts) | | | | |
| G&A expense | **$** | **1,890** | $ | 2,761 |
| Per sales ($/boe) | **$** | **3.61** | $ | 4.00 |

We have continued to focus on improving our G&A cost structure and as a result of cost cutting initiatives, we have reduced our G&A expense, on an overall basis, during the first quarter compared to the same quarter of 2015. We continue to assess our G&A expenses and make reductions where necessary. Our first quarter's decreases in G&A, compared to the same quarter of 2015, resulted from both lower staffing costs caused by reductions in headcount, reduced officers' and directors' compensation, the absence of one time severance costs, reduced employee benefits and less reliance on consultants. Further decreases resulted from renegotiated telecommunications and insurance costs. Beginning mid-way through the second quarter of 2015, we implemented a planned temporary reduction in our work week which saved us $0.5 million. We have announced to our staff a similar arrangement for 2016 that will mainly affect the second and third quarters of 2016.

On a boe basis, we achieved a decrease during the first quarter despite lower production volumes compared to the same quarter of 2015. We continue to evaluate our existing G&A cost structure and will implement future cost savings initiatives.

## Netback

The following table outlines the calculation of our netback[1]:

| Three months ended March 31 | 2016 | 2015 |
|---|---|---|
| Per sales ($/boe) | | |
| Realized sales price | $ 14.82 | $ 24.15 |
| Less: | | |
| Royalties | (0.99) | (2.07) |
| Net production expense [1] | (15.12) | (17.04) |
| G&A expense | (3.61) | (4.00) |
| Netback [1] | $ (4.90) | $ 1.04 |

(1) Non-GAAP measure which may not be comparable to similar non-GAAP measures used by other entities. Refer to the section entitled "Non-GAAP Measures" contained within this MD&A.

The netback for the first quarter significantly decreased compared to the same quarter of 2015. This decrease was caused by lower commodity benchmark prices. As a result, our first quarter realized prices were only 61% of the natural gas and associated liquid or crude oil prices that we reported during the same quarter of 2015.

For the first quarter, the decrease in the proportion of crude oil sales relative to our total volumes was caused by higher natural gas production, with an increase in associated liquids, which resulted from our recent development program at our Birley/Umbach area. Generally, crude oil sales have had a higher netback than on an equivalent volume of natural gas as determined from its heating value. This change in the proportion of crude oil sales partly caused a decrease to our realized prices, which then resulted in an unfavorable netback. However, the lower commodity pricing was partially offset by a combined $3.39/boe decrease in expenses.

## Exploration and Evaluation Expense

| Three months ended March 31 | 2016 | 2015 |
|---|---|---|
| ($ thousands) | | |
| Exploration & evaluation expenditures | $ 496 | $ 493 |

Exploration and evaluation expense reported during the first and the comparative quarter were due to salaries, pre-licensing evaluation and exploratory lease rental costs.

## Depletion, Depreciation and Amortization ("DD&A") Expense

| Three months ended March 31 | 2016 | 2015 |
|---|---|---|
| ($ thousands, except per unit amounts) | | |
| Depletion, depreciation & amortization | $ 7,146 | $ 10,507 |
| Depletion per sales ($/boe) | $ 11.84 | $ 15.22 |

DD&A expense decreased on an overall basis during the first quarter compared to the same quarter of 2015. On an overall basis, this decrease resulted from both a lower depletion rate and production volumes. The decrease in our depletion rate was due to the impact of lowering the 2016 carrying value of our development and production assets ("D&P Assets") to their recoverable value through recognizing last year's impairment charge of $75.0 million.

## Losses (Gains) on Disposition of Properties

| Three months ended March 31 | 2016 | 2015 |
|---|---|---|
| ($ thousands) | | |
| Losses (gains) on disposition of properties | $ 855 | $ (19,403) |

During the first quarter, we completed the sale of certain petroleum and natural gas properties located in the Enchant area of southcentral Alberta for proceeds of $0.3 million. The comparative quarter's gain was from the sale of the Karr properties in northwestern Alberta as well as one additional insignificant disposition. Aggregate proceeds associated with the comparative quarter's gain were $41.7 million.

## Share-Based Compensation

| Three months ended March 31 | 2016 | 2015 |
|---|---|---|
| ($ thousands) | | |
| Share-based compensation | $ 680 | $ 426 |

Late in the second quarter of 2015, we granted additional restricted and performance awards. This higher number of granted awards resulted in an increase in the first quarter's reported amortization of the fair value assigned to these awards compared to the same quarter of 2015. We also amortized the fair value of share options granted throughout 2015. Combined, last year's restricted and performance awards and option grants increased the first quarter's share-based compensation compared to the same quarter of 2015.

## Bad Debt Expense

| Three months ended March 31 | 2016 | 2015 |
|---|---|---|
| ($ thousands) | | |
| Bad debt expense | $ 79 | $ 497 |

In an effort to manage our credit risk we continuously monitor and assess the collectability of our purchaser and joint arrangement partners' receivables in addition to our other receivable positions. For the reporting periods, we identified joint arrangement partners that had either filed for creditor protection or have since become insolvent. As a result, for the first quarters of 2016 and 2015 we provided for $0.1 million and $0.5 million, respectively, of receivables that were deemed uncollectible.

## Foreign Exchange Losses (Gains) & Other

| Three months ended March 31 | 2016 | 2015 |
|---|---|---|
| ($ thousands) | | |
| Foreign exchange losses (gains) & other | $ 390 | $ (460) |

During the first quarter we incurred a fee for a take or pay processing agreement where we did not deliver liquids because the current economic conditions have caused us to delay our Montney development plans. We have partially mitigated our continued exposure to this agreement's costs at least through to the second quarter but with the potential for this cost mitigation to continue for a longer term. The first quarter also includes a $0.1 million foreign exchange loss due to the effect on our US dollar cash position resulting from the strengthening of the Canadian dollar relative to the US dollar. This compares to the $0.5 million foreign exchange gain we reported during the comparative quarter.

## Financing Expenses

| Three months ended March 31 | 2016 | 2015 |
|---|---|---|
| ($ thousands) | | |
| Interest & financing charges (income) | $ 13 | $ (131) |
| Accretion of decommissioning obligation | 552 | 617 |
| Total | $ 565 | $ 486 |

Interest & financing charges increased $0.1 million during the first quarter compared to the same quarter of 2015. This increase was caused by $0.2 million less interest income resulting from a decreased cash position. Despite an increase in our net surplus position, during 2015 we used cash to finance a decrease in non-cash working capital. Our cash position further decreased during the first quarter as it was used to finance an outflow from operations, a decrease in non-cash working capital in addition to development, exploration, and decommissioning expenditures. This decrease in interest income was partially offset by lower standby fees. Our credit facility, which was undrawn in both reported quarters, has decreased from $125 million in the comparative quarter to its current availability of $50 million. This decrease in availability was due to significantly reduced forward commodity pricing and non-core asset dispositions.

The first quarter accretion charges decreased compared to the same quarter of 2015. This decrease resulted from applying a lower discount rate when accounting for the passage of time related to the decommissioning obligation. We updated for a lower risk-free discount rate as first applied to the December 31, 2015 carrying value of this obligation.

# Net and Comprehensive Loss

| Three months ended March 31 | 2016 | 2015 |
|---|---|---|
| ($ thousands, except where noted) | | |
| Weighted average shares outstanding - basic (thousands) | 215,349 | 215,083 |
| Dilutive impact of share options, restricted and performance awards (thousands) | - | 29 |
| Weighted average shares outstanding - diluted (thousands) | 215,349 | 215,112 |
| **Net (loss) income and comprehensive (loss) income** | $ (12,775) | $ 8,189 |
| Per share - basic & diluted ($/share) | $ (0.06) | $ 0.04 |

We are reporting a net loss from operations for the first quarter compared to net income in the same quarter of 2015. Contributing to the first quarter's net loss was a decrease of approximately one-half of the petroleum and natural gas revenues when compared to the same quarter of 2015. This decrease was due to the effect of significantly lower realized commodity prices and to a lesser extent sales volumes. During the comparative quarter, we also reported a non-cash gain of $19.4 million which contributed to that period's net income.

# Capital Resources, Capital Expenditures and Liquidity

Commodity pricing has continued to decrease since mid-2014 and the result of this continued price erosion is that we are reporting a first quarter funds outflow from operations. We continue to monitor the funds outflow from certain operations in an effort to mitigate further erosion. Despite the current price environment some of our properties are cash flow positive; however, many are not. These outflows from operations need to be considered in relation to firm capacity pipeline commitments in addition to the incremental costs of the suspension and the carrying cost of such operations. Where such costs actually preserve future value relative to continued production in this low commodity price environment, we will shut-in those properties. We will also continue with our disposition program of non-core properties. Combined, this should assist in mitigating the extent of fund outflows from these properties given the current commodity pricing environment.

At March 31, 2016, we had a net working capital surplus of $20.2 million and had access to an undrawn $50 million credit facility, which can be used to fund the remainder our $10.1 million 2016 capital program.

In the first quarter, we financed our outflows from operations, investment in capital, decommissioning, exploration and evaluation expenditures and non-cash working capital from cash on hand and the proceeds from a property disposition. Although in the short-term we can finance funds outflows from operations with our cash position, we will continue to look for ways to preserve our funds in this low pricing environment.

## (Outflow) Funds from Operations

| Three months ended March 31 | 2016 | 2015 |
|---|---|---|
| ($ thousands, except where noted) | | |
| Cash flow from operating activities | $ (4,335) | $ 146 |
| Add back (deduct): | | |
| Change in operating non-cash working capital | (2,216) | 128 |
| Decommissioning obligation expenditures & other | 3,165 | 453 |
| Exploration & evaluation expenses | 496 | 493 |
| (Outflow) funds from operations [(1)] | $ (2,890) | $ 1,220 |
| Per share - basic & diluted | $ (0.01) | $ 0.01 |

(1) Non-GAAP measure which may not be comparable to similar non-GAAP measures used by other entities. Refer to the section entitled "Non-GAAP Measures" contained within this MD&A.

During the first quarter, we are reporting an outflow from operations of $2.9 million, a decrease compared to funds from operations of $1.2 million in the same quarter of 2015. Contributing to this outflow was approximately one-half of the petroleum and natural gas revenues when compared to the same quarter of 2015. This decrease was due to the effect of significantly lower realized commodity prices and to a lesser extent sales volumes.

## Credit Facility

| | March 31 2016 | December 31 2015 |
|---|---|---|
| ($ thousands) | | |
| Long-term debt | $ - | $ - |
| Add: | | |
| Accounts payable, accrued liabilities & other | 16,574 | 21,607 |
| Less: | | |
| Cash | (24,385) | (37,947) |
| Accounts receivable | (10,110) | (11,173) |
| Prepaids & deposits | (2,259) | (2,101) |
| Net surplus (1) | $ (20,180) | $ (29,614) |

(1) Non-GAAP measure which may not be comparable to similar non-GAAP measures used by other entities. Refer to the section entitled "Non-GAAP Measures" contained within this MD&A.

We remain undrawn on our credit facility at March 31, 2016.

We had a net surplus of $20.2 million at March 31, 2016, compared to $29.6 million at December 31, 2015. This decrease of $9.4 million was due to an outflow from operations of $2.9 million, which excludes a $0.1 million foreign exchange loss on a US dollar cash position, and $6.4 million of capital, decommissioning, exploration and evaluation expenditures, net of disposition proceeds.

At March 31, 2016 and December 31, 2015, our reserve-based 364 day revolving credit facility (the "Revolving Term Credit Facility"), which we hold with a syndicate of Canadian banks, had a borrowing base of $50.0 million. 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. In the event that the revolving period is not extended at the next redetermination date, all amounts then outstanding under the facility must be repaid before June 23, 2017. Changes in the availability in the Revolving Term Credit Facility are possible, from one renewal period to the next, with draws in excess of availability becoming payable within 60 days. The Revolving Term Credit Facility is collateralized by floating charges and security interests over all present and future properties and other assets. At March 31, 2016 and December 31, 2015, we were undrawn on the Revolving Term Credit Facility. At March 31, 2016, we had an outstanding letter of credit of $0.3 million which reduced the available credit to $49.7 million.

During the second quarter, we anticipate that we will be renewing the Revolving Term Credit Facility. We anticipate a reduction in the amount of the facility upon renewal as forward commodity prices and our proved developed reserves have decreased since we last renewed this facility's availability.

## Capital Expenditures

Capital expenditures were as follows:

| Three months ended March 31 | 2016 | 2015 |
|---|---|---|
| ($ thousands) | | |
| Land & lease | $ 29 | $ 112 |
| Drilling & completions | - | 11,671 |
| Facilities & equipment | 2,678 | 10,005 |
| Field expenditures | 2,707 | 21,788 |
| Capitalized G&A | 319 | 299 |
| Furniture & equipment | - | 6 |
| Total | $ 3,026 | $ 22,093 |
| Proceeds from dispositions | $ 299 | $ 41,734 |

During the first quarter of 2016, we acquired sand separators for three (2.75 net) previously drilled wells and incurred the remaining costs of the first phase expansion of the compression facility in our Birley/Umbach area, as commissioned for operations during the first quarter of 2016. This first expansion has increased our facility's capacity by 25 mmcf/d and eliminated the need for a rental compressor. The net result increased our throughput capacity at this facility to 29 mmcf/d. Expanding our Birley/Umbach facility has allowed us to commence production, during the first quarter of 2016, from an additional three (2.75 net) wells in our Birley/Umbach area, bringing the total wells on production in this area to five wells (4.25 net).

## Rationalization of Properties

We may from time to time, dispose of properties so that we can focus on the development of Montney liquids rich natural gas on our Birley/Umbach BC properties and in the near future our Montney and Dunvegan light crude oil in Grande Prairie, Alberta. As a result, during the first quarter we completed the sale of petroleum and natural gas properties located in the Enchant area of southcentral Alberta, for net proceeds of $0.3 million.

## Provisions

Our provisions balance primarily relates to the future abandonment and reclamation of our properties. At March 31, 2016, we had provisions of $93.9 million, which was a decrease from $98.7 million at December 31, 2015. This decrease resulted from the sale of approximately $2.2 million of decommissioning obligations related to our Enchant area disposition in southcentral Alberta as well as decommissioning obligation expenditures of $3.0 million. There was also $0.6 million of accretion charges recognized in the first quarter.

As at March 31, 2016 and December 31, 2015, the estimated obligation includes assumptions in respect of actual costs to abandon wells and facilities or reclaim the property, the time frame in which such costs will be incurred, as well as annual inflation of 2.0%, in order to calculate the future obligation. At March 31, 2016 and December 31, 2015, a risk-free interest rate of 2.2% was used in order to calculate the present value of the obligation.

## Outstanding Share Data

Authorized:

- Unlimited number of common shares
- Unlimited number of first preferred shares

Details of share capital and share awards outstanding are as follows:

| | **March 31 2016** | December 31 2015 |
|---|---|---|
| Common shares outstanding | **215,350,269** | 215,349,412 |
| Share options | **9,242,035** | 9,465,617 |
| Restricted awards | **1,070,464** | 1,084,226 |
| Performance awards | **999,356** | 1,006,996 |
| Weighted average common shares - basic and diluted | **215,349,441** | 215,196,938 |

As at May 9, 2016, we had 215,350,269 common shares, 8,978,035 share options, 1,070,464 restricted awards and 999,356 performance awards outstanding.

## Off Balance Sheet Arrangements

We did not enter into any off balance sheet arrangements during the first quarter.

# Outlook

Our strategy for the balance of 2016 will remain focused on cost reductions, prudent capital spending and continued rationalization of our non-core assets. We are moving towards a pure Montney play focused company with several Montney projects in various stages of development, of which Birley/Umbach is our top priority.

With commodity prices expected to remain low for the remainder of the year, we are reducing our total 2016 capital program to $10.1 million, focused on maintenance of our ongoing operations and abandonment program.

# Quarterly Information from Operations

Summarized information by quarter for the two years ended March 31, 2016, appears below:

| | **Mar. 31 2016** | Dec. 31 2015 | Sept. 30 2015 | Jun. 30 2015 | Mar. 31 2015 | Dec. 31 2014 | Sep. 30 2014 | Jun. 30 2014 |
|---|---|---|---|---|---|---|---|---|
| **Production Volumes** | | | | | | | | |
| Crude oil (bbl/d) | **817** | 922 | 1,065 | 1,284 | 1,485 | 1,981 | 1,823 | 2,267 |
| Natural gas liquids (boe/d) | **733** | 364 | 395 | 604 | 682 | 778 | 678 | 715 |
| Natural gas (mcf/d) | **25,215** | 15,851 | 20,641 | 25,290 | 33,007 | 34,879 | 29,028 | 29,570 |
| Average daily production (boe/d) | **5,753** | 3,928 | 4,900 | 6,103 | 7,668 | 8,572 | 7,339 | 7,911 |
| **Sales Prices** | | | | | | | | |
| Average oil price ($/bbl) | **$ 35.41** | $ 47.93 | $ 51.34 | $ 62.90 | $ 49.03 | $ 70.84 | $ 93.10 | $ 101.01 |
| Average natural gas liquids price ($/boe) | **$ 27.65** | $ 30.59 | $ 31.68 | $ 41.06 | $ 36.47 | $ 48.05 | $ 64.71 | $ 72.06 |
| Average natural gas price ($/mcf) | **$ 1.43** | $ 2.09 | $ 2.56 | $ 2.50 | $ 2.65 | $ 3.57 | $ 4.11 | $ 4.89 |
| **Netback** [(1)] | | | | | | | | |
| Average commodity pricing ($/boe) | **$ 14.82** | $ 22.51 | $ 24.48 | $ 27.67 | $ 24.15 | $ 35.26 | $ 45.37 | $ 53.75 |
| Royalties ($/boe) | **$ (0.99)** | $ 2.39 | $ (1.13) | $ (0.78) | $ (2.07) | $ (4.74) | $ (6.90) | $ (8.47) |
| Net production expenses ($/boe) [(1)] | **$ (15.12)** | $ (14.17) | $ (12.49) | $ (18.36) | $ (17.04) | $ (18.89) | $ (17.44) | $ (17.06) |
| G&A expense ($/boe) | **$ (3.61)** | $ (8.31) | $ (4.39) | $ (3.70) | $ (4.00) | $ (4.26) | $ (4.32) | $ (4.30) |
| Netback ($/boe) [(1)] | **$ (4.90)** | $ 2.42 | $ 6.47 | $ 4.83 | $ 1.04 | $ 7.37 | $ 16.71 | $ 23.92 |
| **Wells Drilled (net)** | | | | | | | | |
| Oil | **-** | - | - | - | - | 1.62 | 1.26 | - |
| Gas | **-** | - | - | - | 2.75 | 0.83 | 0.75 | - |
| Disposal/injection | **-** | - | - | - | - | - | 0.37 | - |
| Total wells drilled (net) | **-** | - | - | - | 2.75 | 2.45 | 2.38 | - |
| **FINANCIAL** *($ thousands, except per share amounts)* | | | | | | | | |
| Petroleum & natural gas revenues, net of | **$ 7,244** | $ 9,000 | $ 10,527 | $ 14,934 | $ 15,240 | $ 24,065 | $ 25,972 | $ 32,595 |
| (Outflow) funds from operations [(1)] | **$ (2,890)** | $ 1,516 | $ 3,299 | $ 2,995 | $ 1,220 | $ 6,069 | $ 9,693 | $ 14,798 |
| Per share - basic & diluted ($/share) | **$ (0.01)** | $ 0.01 | $ 0.02 | $ 0.01 | $ 0.01 | $ 0.03 | $ 0.05 | $ 0.07 |
| Net (loss) income from continuing operations | **$ (12,775)** | $ (5,303) | $ (80,669) | $ (5,822) | $ 8,189 | $ (58,311) | $ 3,696 | $ 3,531 |
| Per share - basic & diluted ($/share) | **$ (0.06)** | $ (0.02) | $ (0.37) | $ (0.03) | $ 0.04 | $ (0.27) | $ 0.02 | $ 0.02 |
| Net (loss) income [(2)(3)] | **$ (12,775)** | $ (5,303) | $ (80,669) | $ (5,822) | $ 8,189 | $ (60,348) | $ 11,472 | $ 4,391 |
| Per share - basic & diluted ($/share) | **$ (0.06)** | $ (0.02) | $ (0.37) | $ (0.03) | $ 0.04 | $ (0.28) | $ 0.05 | $ 0.02 |
| Capital expenditures | **$ 3,026** | $ 9,998 | $ 7,313 | $ 4,921 | $ 22,093 | $ 23,821 | $ 14,301 | $ 18,998 |
| Net debt (surplus) [(1)(4)] | **$ (20,180)** | $ (29,614) | $ (41,181) | $ (46,705) | $ (48,596) | $ (28,788) | $ (35,870) | $ 80,536 |
| Total assets [(4)] | **$ 299,623** | $ 321,564 | $ 333,036 | $ 414,280 | $ 431,085 | $ 434,318 | $ 472,241 | $ 589,515 |
| **Common Shares** (thousands) | | | | | | | | |
| Weighted average during period - basic | **215,349** | 215,337 | 215,274 | 215,089 | 215,083 | 215,081 | 214,895 | 214,226 |
| Weighted average during period - diluted | **215,349** | 215,337 | 215,274 | 215,089 | 215,112 | 215,081 | 216,773 | 215,814 |
| Outstanding at period end | **215,350** | 215,349 | 215,328 | 215,236 | 215,083 | 215,082 | 215,079 | 214,674 |

(1) Non-GAAP measure which may not be comparable to similar non-GAAP measures used by other entities. Refer to the section entitled "Non-GAAP Measures" contained within this MD&A.
(2) Includes $63.5 million and $75.0 million in impairment charges against properties for the three months ended December 31, 2014 and September 30, 2015, respectively.
(3) Quarters prior to and including December 31, 2014 include net income or loss from a discontinued operation.
(4) The three months ended June 30, 2014 includes discontinued operations and their assets or working capital excluding marked-to-market derivative contracts, as applicable.

### Factors That Have Caused Variations over the Quarters

The factors described below only apply to the quarterly information presented above.

Generally, our non-core property disposition program has resulted in a lower trend of natural gas and natural gas liquids production volumes. This trend was offset during the fourth quarter of 2014 when we began to realize continuous production from our drilling program and property acquisitions at Birley/Umbach. Offsetting this lower overall trend of natural gas and natural gas liquid volumes was crude oil production which has generally trended upwards resulting from the reinvestment of our non-core disposition proceeds into core area properties. However, during the first quarter of 2015, production volumes decreased reflecting the impact of significant dispositions in our Gilby and Karr areas and have since fallen in subsequent quarters due to voluntary shut-ins of properties with high operating costs/low netbacks and ongoing pipeline service restrictions and reduced system capacity. Our realized commodity prices and natural gas revenue, net of royalties have mostly trended with the Canadian Light Sweet and AECO benchmarks which generally increased until mid-2014 when they began to decrease with significantly lower benchmark pricing observed since the fourth quarter of 2014. Changes in our petroleum and natural gas revenues, net of royalties and funds from operations have generally trended with benchmark commodity prices and volumes. Our net debt changed to a net surplus in the third quarter of 2014 with the repayment of our entire outstanding debt balance from the proceeds of a discontinued operation. The aforementioned Karr property disposition increased our net surplus during the first quarter of 2015 after which our net surplus began to decrease as our capital expenditures exceeded our funds from operations. Our dispositions of non-core assets combined with funds from operations relative to capital expenditures, have allowed us to avoid having to raise proceeds through the issuance of our common shares or adding or drawing down debt.

Please refer to other sections of this MD&A for detailed discussions on variations during the comparative quarters and to our previously issued interim and annual management's discussion and analysis for changes in prior quarters.

## Risk Factors

Investors should carefully consider the risk factors set out in our Annual Information Form for the year ended December 31, 2015 and consider all other information contained herein and in our other public filings before making an investment decision. The risks set out in our AIF are not an exhaustive list, nor should they be taken as a complete summary or description of all the risks associated with our business and the oil and natural gas business generally. If any of the these risks or other risks occur, our business, prospects, financial condition, results of operations and cash flows could be adversely affected in a material way.

Additional information on risks, assumptions and uncertainties are found under the heading "Forward-Looking Statements".

## Disclosure Controls and Procedures

Our Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO") have designed, or caused to be designed under their supervision, disclosure controls and procedures to provide reasonable assurance that: (i) material information relating to us is made known to our CEO and CFO by others, particularly during the period in which the annual and interim filings are being prepared; and (ii) information required to be disclosed by us in our annual filings, interim filings or other reports filed or submitted by us under securities legislation is recorded, processed, summarized and reported within the time period specified in securities legislation.

## Internal Controls over Financial Reporting

Our CEO and CFO have designed, or caused to be designed under their supervision, internal controls over financial reporting to provide reasonable assurance regarding the reliability of our financial reporting and the preparation of financial statements for external purposes in accordance with IFRS. No material changes in our internal controls over financial reporting were identified during the period beginning on January 1, 2016 and ended on March 31, 2016, that have materially affected, or are reasonably likely to materially affect our internal controls over financial reporting.

We have designed our internal controls over financial reporting based on the framework in *Internal Control – Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

It should be noted that a control system, including our disclosure and internal controls and procedures, no matter how well conceived can provide only reasonable, but not absolute, assurance that the objectives of the control system will be met and it should not be expected that the disclosure and internal controls and procedures will prevent all errors or fraud.

# Non-GAAP Measures

The following non-GAAP measures described below do not have any standardized meanings as prescribed by IFRS and, therefore, may not be comparable with the calculations of similar measures presented by other companies.

- (Outflow) funds from operations is calculated from cash flow from operations adjusted for changes in non-cash working capital related to operations, exploration and evaluation expenses related to operations and decommissioning obligation expenditures related to operations. This term does not have any standardized meaning as prescribed by IFRS and, therefore, may not be comparable with the calculations of similar measures presented by other companies. Management believes that funds from operations is a key measure to assess our ability to finance capital expenditures and when debt is drawn, debt repayments. (Outflow) funds from operations is not intended to represent cash flow from operating activities, net earnings or other measures of financial performance calculated in accordance with IFRS and should not be construed as an alternative to, or more meaningful than, cash flow from operating activities as determined in accordance with IFRS as an indicator of our financial performance.
- Net debt (surplus) is calculated as bank debt adjusted for working capital excluding mark-to-market derivative contracts, current portion of decommissioning obligation and assets and liabilities held for sale. Working capital excluding mark-to-market derivative contracts, current portion of decommissioning obligation and assets and liabilities held for sale is calculated as current assets less current liabilities as they appear on the balance sheets, excluding derivative contracts, assets and liabilities held for sale and the current portion of both debt and decommissioning obligations. Management uses net debt (surplus) to assist us in understanding our liquidity at specific points in time.
- Netback is calculated as a period's sales of petroleum and natural gas, net of royalties less net production and operating expenses and G&A expense, divided by the period's sales volumes. We use this non-GAAP measure to assist us in understanding our profitability relative to current commodity prices and it provides an analytical tool to benchmark changes in operational performance against prior periods.
- Net production and operating expense is calculated as production and operating expense less processing and gathering revenues. Management uses net production and operating expense to determine the current period's cash cost of operating expenses and net production and operating expense per boe is used to measure operating efficiency on a comparative basis.

## Forward-Looking Statements

In the interest of providing our shareholders and readers with information regarding our company, including management's assessment of our future plans and operations, certain statements contained in this MD&A constitute forward-looking statements or information (collectively "forward-looking statements") within the meaning of applicable securities legislation. Forward-looking statements are typically identified by words such as "anticipate", "continue", "estimate", "expect", "forecast", "may", "will", "project", "could", "plan", "intend", "should", "believe", "outlook", "potential", "target" and similar words suggesting future events or future performance. In particular, this MD&A contains, without limitation, forward-looking statements pertaining to: that we will implement future cost savings initiatives, that we will continue with our non-core property disposition program, that we anticipate renewing the Revolving Term Credit Facility and anticipate a reduction in the facility following such renewal, expectations regarding future reductions in operating and G&A costs, future exploration and development activities and the timing thereof and how we intend to manage our company during 2016, that we expect to remain focussed on cost reductions, prudent capital management and continued rationalization of our non-core assets during the balance of 2016, as well as our expectation regarding capital expenditures set out under the heading "Outlook".

With respect to the forward-looking statements contained in this MD&A, we have made assumptions regarding, among other things: that we will continue to conduct our operations in a manner consistent with past operations, future capital expenditure levels, future oil and natural gas prices, future oil and natural gas production levels, future currency, exchange and interest rates, our ability to obtain equipment in a timely manner to carry out exploration and development activities, the ability of the operator of the projects of which we have an interest in to operate in the field in a safe, efficient and effective manner, the impact of increasing competition, field production rates and decline rates, anticipated production volumes, our ability to replace and expand production and reserves through exploration and development activities, certain commodity price and cost assumptions, the results of negotiations and the plans of our partners in certain of our areas; that the budgeted amounts and expenditures set forth herein, which are subject to the discretion of our Board of Directors, will not be amended in the future and the continued availability of adequate cash, debt and cash flow to fund our planned expenditures. Although we believe that the expectations reflected in the forward-looking statements contained in this MD&A, and the assumptions on which such forward-looking statements are made, are reasonable, there can be no assurance that such expectations will prove to be correct. Readers are cautioned not to place undue reliance on forward-looking statements included in this MD&A, as there can be no assurance that the plans, intentions or expectations upon which the forward-looking statements are based will occur. By their nature, forward-looking statements involve numerous assumptions, known and unknown risks and uncertainties that contribute to the possibility that predictions, forecasts, projections and other forward-looking statements will not occur, which may cause our actual performance and financial results in future periods to differ materially from any estimates or projections of future performance or results expressed or implied by such forward-looking statements. These risks and uncertainties include, without limitation, risks associated with oil and gas exploration, development, exploitation, production, marketing and transportation, loss of markets, volatility of commodity prices and currency fluctuations, our Board of Directors may amend the 2016 capital program based on its discretion; environmental risks, competition from other producers, inability to retain drilling rigs and other services, unanticipated increased or unforeseen capital expenditure costs, including drilling, completion and facilities costs, unexpected decline rates in wells, delays in projects and/or operations resulting from surface conditions, wells not performing as expected, delays resulting from or inability to obtain the required regulatory approvals and inability to access sufficient capital from internal and external sources. As a consequence, actual results may differ materially from those anticipated in the forward-looking statements. Readers are cautioned that the forgoing list of factors is not exhaustive. Additional information on these and other factors that could affect our operations and financial results are included in reports on file with Canadian securities regulatory authorities and may be accessed through the SEDAR website (www.sedar.com) and at our website (www.chinookenergyinc.com). Furthermore, the forward-looking statements contained in this MD&A are made as at the date of this MD&A and we do not undertake any obligation to update publicly or to revise any of the forward-looking statements, whether as a result of new information, future events or otherwise, except as may be required by applicable securities laws.

## Barrels of Oil Equivalent

Barrels of oil equivalent (boe) is calculated using the conversion factor of 6 mcf (thousand cubic feet) of natural gas being equivalent to one barrel of oil. Boe's may be misleading, particularly if used in isolation. A boe conversion ratio of 6 mcf:1 bbl (barrel) is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead. Given that the value ratio based on the current price of crude oil as compared to natural gas is significantly different from the energy equivalency of 6:1, utilizing a conversion on a 6:1 basis may be misleading as an indication of value.

## Future Oriented Financial Information

This MD&A may contain Future Oriented Financial Information ("FOFI") within the meaning of applicable securities laws. The FOFI has been prepared by our management to provide an outlook of our activities and results and may not be appropriate for other purposes. The FOFI has been prepared based on a number of assumptions including the assumptions discussed under the heading "Forward-Looking Statements" and assumptions with respect to production rates and commodity prices. The actual results of our operations and the resulting financial results may vary from the amounts set forth herein, and such variation may be material. Our management believes that the FOFI has been prepared on a reasonable basis, reflecting management's best estimates and judgments.