

Q3
2016

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)	2016	2015
Assets		
Current		
Cash	\$ 23,213	\$ 37,947
Restricted cash (note 9)	1,298	-
Accounts receivable	8,993	11,173
Prepays & deposits	4,056	2,101
Derivative contracts (note 4)	153	-
Assets held for sale (note 8)	55,671	-
	93,384	51,221
Development & production assets (note 5)	158,734	246,036
Exploration & evaluation assets (note 6)	22,556	24,307
	\$ 274,674	\$ 321,564
Liabilities & Equity		
Current		
Accounts payable, accrued liabilities & other	\$ 13,113	\$ 21,607
Derivative contracts (note 4)	348	-
Current portion of long-term debt (note 9)	17,230	-
Provisions (note 7)	300	2,700
Liabilities held for sale (note 8)	42,135	-
	73,126	24,307
Derivative contracts (note 4)	1,734	-
Provisions (note 7)	70,500	96,042
	145,360	120,349
Equity		
Share capital	784,105	782,705
Contributed surplus	19,201	18,916
Deficit	(687,024)	(600,406)
Shareholders' Equity	116,282	201,215
Non-controlling interest	13,032	-
	129,314	201,215
	\$ 274,674	\$ 321,564

Subsequent event (note 12)

See accompanying notes to the condensed consolidated financial statements.

Condensed Consolidated Statements of Operations and Comprehensive Loss

(unaudited)

(in thousands of Canadian dollars, except per share amounts)	Three months ended September 30		Nine months ended September 30	
	2016	2015	2016	2015
Petroleum & natural gas revenues	\$ 11,976	\$ 11,036	\$ 27,495	\$ 43,071
Royalties	(458)	(509)	(1,183)	(2,370)
Petroleum & natural gas revenues, net of royalties	11,518	10,527	26,312	40,701
Processing & gathering revenues	553	610	2,010	2,466
Petroleum, natural gas & other revenues, net of royalties	12,071	11,137	28,322	43,167
Realized gain on derivative contracts (note 4)	1,093	391	1,161	1,132
Unrealized gain (loss) on derivative contracts (note 4)	1,647	(406)	(1,929)	(1,090)
Gain (loss) on derivative contracts	2,740	(15)	(768)	42
	14,811	11,122	27,554	43,209
Production & operating	8,050	6,243	24,362	30,099
General & administrative	2,794	1,981	6,751	6,795
Transaction costs (note 3)	120	-	1,740	-
Exploration & evaluation	151	-	968	917
Depletion, depreciation & amortization (notes 5 & 6)	7,672	7,458	21,460	26,948
Impairment of development & production assets (note 5)	48,000	75,000	48,000	75,000
Loss on assets held for sale (note 8)	4,000	-	4,000	-
(Gain) loss on dispositions of properties (note 5)	(161)	6	(6,020)	(21,787)
Share-based compensation	333	722	1,685	1,771
Bad debt expense	-	-	458	554
Foreign exchange losses (gains) & other	34	(251)	636	(541)
	70,993	91,159	104,040	119,756
Loss before finance expenses	(56,182)	(80,037)	(76,486)	(76,547)
Interest & financing charges (income)	381	6	493	(109)
Accretion of decommissioning obligations (note 7)	688	626	1,818	1,865
Finance expenses	1,069	632	2,311	1,756
Loss before deferred income tax recovery	(57,251)	(80,669)	(78,797)	(78,303)
Deferred income tax recovery (note 5)	(7,100)	-	-	-
Net loss including non-controlling interest	(50,151)	(80,669)	(78,797)	(78,303)
Net loss attributable to non-controlling interest (note 3)	14,246	-	17,597	-
Net & comprehensive loss	\$ (35,905)	\$ (80,669)	\$ (61,200)	\$ (78,303)
Net loss per share, basic & diluted (note 11)	\$ (0.17)	\$ (0.37)	\$ (0.28)	\$ (0.36)

See accompanying notes to the condensed consolidated financial statements.

Condensed Consolidated Statements of Changes in Equity

(unaudited)

(in thousands of Canadian dollars, except common shares)	Common Shares (thousands)	Share Capital	Contributed Surplus	Deficit	Non-controlling interest (note 3)	Equity
Balance as at December 31, 2015	215,349	\$ 782,705	\$ 18,916	\$ (600,406)	\$ -	\$ 201,215
Non-controlling interest on acquisition (note 3)	-	-	-	-	1,563	1,563
Non-controlling interest in Subject Assets (note 3)	-	-	-	-	29,066	29,066
Equity loss (note 3)	-	-	-	(25,418)	-	(25,418)
Net loss attributable to non-controlling interest (note 3)	-	-	-	-	(17,597)	(17,597)
Settlement of restricted and performance share awards (note 10)	1,094	1,400	(1,400)	-	-	-
Share-based compensation	-	-	1,685	-	-	1,685
Net loss	-	-	-	(61,200)	-	(61,200)
Balance as at September 30, 2016	216,443	\$ 784,105	\$ 19,201	\$ (687,024)	\$ 13,032	\$ 129,314
Balance as at December 31, 2014	215,083	\$ 782,071	\$ 17,180	\$ (516,800)	\$ -	\$ 282,451
Share options exercised	2	-	-	-	-	-
Settlement of restricted and performance share awards	249	599	(599)	-	-	-
Cancelled common shares	(6)	-	-	-	-	-
Share-based compensation	-	-	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

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	
	2016	2015	2016	2015
Operating Activities				
Net loss	\$ (35,905)	\$ (80,669)	\$ (61,200)	\$ (78,303)
Add (deduct):				
Depletion, depreciation & amortization (notes 5 & 6)	7,672	7,458	21,460	26,948
(Gain) loss on dispositions of properties (note 5)	(161)	6	(6,020)	(21,787)
Deferred income tax recovery (note 5)	(7,100)	-	-	-
Impairment of development & production assets (note 5)	48,000	75,000	48,000	75,000
Loss on assets held for sale (note 8)	4,000	-	4,000	-
Share-based compensation	333	722	1,685	1,771
Accretion of decommissioning obligations (note 7)	688	626	1,818	1,865
Bad debt expense	-	-	458	554
Foreign exchange (gain) loss	(11)	(250)	42	(538)
Unrealized (gain) loss on derivative contract	(1,647)	406	1,929	1,090
Net loss attributable to non-controlling interest (note 3)	(14,246)	-	(17,597)	-
Decommissioning obligation expenditures & other	(124)	(861)	(3,800)	(1,901)
Change in operating non-cash working capital (note 11)	(3,337)	(1,696)	1,422	(450)
Cash flow from operating activities	(1,838)	742	(7,803)	4,249
Financing Activities				
Debt repayments, net	(970)	-	(563)	-
Cash flow from financing activities	(970)	-	(563)	-
Investing Activities				
Proceeds on property dispositions (note 5)	162	-	8,074	42,935
Development & exploration expenditures (notes 5 & 6)	(661)	(7,313)	(5,034)	(34,327)
Business combination price adjustments (note 5)	-	(898)	-	(898)
Investment in restricted cash (note 9)	(106)	-	(1,298)	-
Cash acquired on business acquisition (note 3)	-	-	867	-
Change in investing non-cash working capital (note 11)	(646)	2,589	(8,869)	(12,155)
Cash flow from investing activities:				
Continuing operations	(1,251)	(5,622)	(6,260)	(4,445)
Discontinued operations	-	(29)	-	(382)
Cash flow from investing activities	(1,251)	(5,651)	(6,260)	(4,827)
Change in cash, during the period				
Continuing operations	(4,059)	(4,880)	(14,626)	(196)
Discontinued operations	-	(29)	-	(382)
Cash, beginning of period	27,254	50,732	37,947	46,018
Cash, foreign currency translation gain (loss)	18	408	(108)	791
Cash, end of period	\$ 23,213	\$ 46,231	\$ 23,213	\$ 46,231

Other supplementary information (note 11)

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, 2016 and 2015

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, 2016 and 2015 (these "Financial Statements") include the accounts of Chinook Energy Inc. ("CEI") and two directly held wholly-owned subsidiaries: 1542991 Alberta Ltd. ("WOGH GP") and Storm Ventures International (BVI) Limited.

Since June 10, 2016, these Financial Statements also include the accounts of Tournament Exploration Ltd., which subsequently changed its name to Craft Oil Ltd. ("Craft") a privately owned Calgary-based petroleum and natural gas production company (collectively, including all three subsidiaries, "Chinook"). On June 10, 2016 (the "Closing Date"), CEI completed the acquisition of 70% of Craft's issued and outstanding common shares pursuant to an asset purchase and sale agreement (the "PSA") dated and effective May 1, 2016 (see note 3, "Business Acquisition"). As a result, Craft became a partially-owned but controlled subsidiary of CEI. In consideration, CEI transferred most of its non-Montney producing and undeveloped properties in Alberta, Canada, and the associated decommissioning obligations in addition to \$0.9 million of cash to Craft (the "Subject Assets"). As at June 30, 2016, Chinook recorded a provisional amount for the estimated fair value of the oil and gas properties included in the acquisition of Craft. On October 31, 2016, Craft disposed of certain oil and gas properties, the majority of which were owned by Craft on the date it was acquired by Chinook. Chinook amended the preliminary Craft business combination from that initially reported in its condensed financial statements for the three and six months ended June 30, 2016 to reflect the selling price in the October 31, 2016 disposition. Since CEI maintained control over the Subject Assets, the measure of its consideration for Craft's common shares on the Closing Date was calculated at \$29.1 million based on the 30% non-controlling interest in the carrying values of the Subject Assets. Exclusive of the Subject Assets consideration, the fair value evaluated for Craft's net assets on the Closing Date was used to determine a \$1.6 million non-controlling interest in Craft's common shares. These measures are initially reported as non-controlling interest on the consolidated statements of financial position. The non-controlling interest portion in Craft's financial results since June 10, 2016 as included in these Financial Statements, is reported through the same account on the condensed consolidated statements of operations and comprehensive income (loss).

On August 2, 2016, CEI initiated a review of strategic alternatives, which may include, among other things, a review of acquisition opportunities, a merger, sale, joint venture or other opportunities.

All intercompany balances and transactions have been eliminated.

2. Basis of Presentation

These Financial Statements have been prepared following the same accounting policies as summarized in note 3 in the audited consolidated financial statements of Chinook for the years ended December 31, 2015 and 2014 (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, 2016.

Management Judgments and Estimation Uncertainty

The preparation of these Financial Statements requires management judgments and estimation uncertainty that affect the reported amounts at the date of these Financial Statements of assets, liabilities, shareholders' equity, revenues and expenses in addition to the disclosure of contingencies. Actual results could differ from those estimated. Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the year in which the estimates are revised and in any future years affected.

Judgments that management has made through applying accounting policies that have the most significant effect on the Financial Statements are discussed below:

Cash Generating Units

Cash Generating Units ("CGUs") are defined as the lowest grouping of integrated assets that generate identifiable cash inflows that are largely independent of the cash inflows of other assets or groups of assets. The classification of assets into CGUs requires significant judgment and interpretations with respect to the integration between assets, the existence of active markets, external users, shared infrastructures and the way in which management monitors Chinook's operations.

Impairment indicators

Judgments are required to assess when impairment indicators exist and impairment testing is required. When assessing the recoverability of petroleum and natural gas properties, each CGU's carrying value is compared to its recoverable amount, defined as the greater of its fair value less cost to sell and value in use. In determining the recoverable amount of assets, in the absence of quoted market prices, impairment tests are based on reserve estimates, market value of undeveloped lands and other relevant assumptions.

Key estimates that management has made that affect the measurement of balances and transactions in the Financial Statements:

Reserve estimates

Petroleum and natural gas reserves are used in the calculation of depletion, impairment and impairment reversals. Reserve estimates and their resulting cash flows are based on engineering data, probability assessments of reserve recoveries, future prices and costs, future production rates, discount rates and the timing and extent of future capital expenditures, all of which are subject to many uncertainties and interpretation. Management expects that over time Chinook's reserve estimates will be revised, either upward or downward, based on updated information such as the results of future drilling, production costs, testing and production levels and changes to forward petroleum and natural gas prices.

Decommissioning obligation

Decommissioning obligations are recognized for the future decommissioning and restoration of property, plant and equipment. These obligations are based on current legal and constructive requirements, technology, price levels and expected plans for remediation. Actual costs and cash outflows can differ from estimates because of changes in laws and regulations, public expectations, market conditions, discovery and analysis of site conditions and changes in technology. The expected timing of future decommissioning and restoration may change due to certain factors, including reserve life. Changes to assumptions related to future expected costs, discount rates and timing may have a material impact on the amounts presented.

Deferred taxes

Tax interpretations, regulations and legislation in the various jurisdictions in which Chinook operates are subject to change. The deferred tax asset and/or liability is based on estimates as to the timing of the reversal of temporary differences, substantively enacted tax rates and the likelihood of assets being realized from future taxable earnings.

3. Business Acquisition

On the Closing Date, CEI completed the acquisition of 70% of Tournament's (now Craft) issued and outstanding common shares, pursuant to the PSA dated and effective May 1, 2016. In consideration for 70% of the issued and outstanding common shares, CEI transferred the Subject Assets to Craft. The purpose of this business acquisition was to consolidate similar Alberta non-Montney properties with sufficient associated reserves to attract additional financing and have a management team focused on the development of these properties. This business acquisition has been prepared in accordance with the acquisition method as disclosed in note 3 of Chinook's Audited Financial Statements.

Concurrent with CEI's contribution of the Subject Assets to Craft, WOGH Limited Partnership ("WOGH") contributed producing and undeveloped properties in similar areas net of associated decommissioning obligations and cash to acquire 10% of Craft's issued and outstanding common shares pursuant to the PSA. WOGH is a partnership principally owned by Alberta Investment Management Corporation, a related party to Chinook. As the issuance of Craft's common shares to CEI and WOGH was evaluated on the fair value of contributed net assets of each transacting party relative to the total fair value, CEI sequenced this business acquisition to already include WOGH's contribution of net assets. As a result, the fair value of net assets acquired by CEI includes both of those contributed from Craft and WOGH.

Transaction costs incurred on this business acquisition include legal and other professional fees in addition to CEI severance costs. These costs have been expensed on the condensed consolidated statements of operations and comprehensive loss. When combined with the transaction costs on the intended distribution of shares (see note 12) the total transaction costs for the three and nine months ended were \$0.1 million and \$1.7 million, respectively. Transaction costs incurred by Craft prior to June 10, 2016, were estimated at \$0.6 million and are included in Craft's accrued liabilities.

Fair Value of Craft's Net Assets

Since Craft is a private company and the fair value of this company's common shares was not available from transparent market transactions, Chinook evaluated the fair value of Craft's net assets as at the Closing Date. This evaluation included evidence from the agreed upon consideration for those properties and associated decommissioning obligations classified as held for sale at September 30, 2016 (see note 8). As at June 30, 2016, Chinook recorded a provisional amount for the estimated fair value of the oil and gas properties acquired on the acquisition of Craft. On October 31, 2016, Craft disposed of certain oil and gas properties, the majority of which were owned by Craft on the date it was acquired by Chinook. Management amended the preliminary Craft business combination as included in these Financial Statements from that initially reported in Chinook's condensed consolidated financial statements for the three and six months ended June 30, 2016 to reflect the selling price in the October 31, 2016 disposition. Management updated the provisional fair value amounts of Craft's net assets as at the Closing Date as follows:

Development & production assets: this fair value was approximated using an internally prepared reserve evaluation. This evaluation uses future net revenues anticipated to be produced from Craft's proved developed producing reserves, using a discount rate of 15%. This is the same metric obtained on the disposition of properties classified as held for sale.

Exploration & evaluation assets: this fair value was approximated using recent market sales transactions of similar undeveloped lands in the immediate surrounding areas.

Decommissioning obligations: this fair value was determined using the timing and estimated costs associated with the abandonment, restoration and reclamation of proved developed wells and infrastructure and then present valued using a market discount rate.

Debt: was fair valued at the outstanding principal amount.

Other financial instruments: the carrying values of other financial instruments approximate their fair values.

Non-controlling interest: the above fair value measures were used to calculate the Closing Date fair value of the 30% non-controlling interest in Craft reported in the account non-controlling interest as included on the condensed consolidated statements of financial position.

CEI's Consideration

As Chinook maintained control over the Subject Assets transferred to Craft after this acquisition, it continued to measure the Subject Assets at the same carrying amounts immediately prior to and after the acquisition. This resulted in the Subject Assets' carrying value at the Closing Date being used to determine the 30% non-controlling interest. An evaluation of the fair value of the D&P assets' component of the Subject Assets revealed that their fair value less costs to sell was less than their carrying amount. As a result, Chinook adjusted for the non-controlling interest portion of this loss through an adjustment to equity of \$25.4 million.

Business Combination

A summary of the preliminary business combination is as follows:

	June 10, 2016
Estimated fair value of net assets acquired:	
Cash	\$ 867
Accounts receivable	4,187
Prepays & deposits	155
Development and production assets (note 5)	23,600
Exploration and evaluation assets (note 6)	1,300
Accounts payable and accrued liabilities	(3,128)
Bank debt (note 9)	(17,793)
Decommissioning obligation (note 7)	(3,977)
Non-controlling interest	(1,563)
	\$ 3,648
Estimated consideration:	
Non-controlling interest in the carrying value of the Subject Assets	\$ 29,066
Equity loss	(25,418)
	\$ 3,648

Since June 10, 2016, as included in Chinook's three and nine months ended September 30, 2016 consolidated statements of operations and comprehensive loss, approximately \$3.3 million and \$4.0 million of revenue and a net income of \$0.6 million and a net loss of \$2.1 million net loss were recognized from Craft's petroleum and natural gas production. These measures exclude the operating results from the Subject Assets since the Closing Date. Had this business acquisition been effective January 1, 2016, management estimates the approximated consolidated pro forma revenues and net losses at \$33.2 million and \$63.5 million, respectively, for the nine months ended September 30, 2016.

Net Loss Attributable to Non-controlling Interest

The net loss of Craft since June 10, 2016, resulted in a non-controlling interest loss of \$14.2 million and \$17.6 million for the three and nine months ended September 30, 2016, respectively.

4. Derivative Contracts

Subsequent to the Craft business acquisition on June 10, 2016, and in compliance with Craft's credit agreement (see note 9), Craft entered into the following price risk management contracts:

Financial AECO Natural Gas Contract

Portion of Contractual Term	Average Notional Volumes (GJ/d) ⁽¹⁾	Company's Received Price	Indexed Price
October 1, 2016 to December 31, 2016	11,518	\$2.56/GJ	AECO 7A
January 1, 2017 to December 31, 2017	10,616	\$2.56/GJ	AECO 7A
January 1, 2018 to December 31, 2018	8,305	\$2.56/GJ	AECO 7A
January 1, 2019 to December 31, 2019	6,518	\$2.56/GJ	AECO 7A
January 1, 2020 to June 30, 2020	5,412	\$2.56/GJ	AECO 7A

Financial WTI Crude Oil Contract

Portion of Contractual Term	Average Notional Volumes (bbl/d) ⁽¹⁾	Company's Received Price ⁽²⁾	Indexed Price
October 1, 2016 to December 31, 2016	666	USD \$51.20/bbl	WTI
January 1, 2017 to December 31, 2017	577	USD \$51.20/bbl	WTI
January 1, 2018 to December 31, 2018	462	USD \$51.20/bbl	WTI
January 1, 2019 to December 31, 2019	383	USD \$51.20/bbl	WTI
January 1, 2020 to May 31, 2020	323	USD \$51.20/bbl	WTI

(1) The average notional volumes represent the weighted average volume per day of the contractual monthly notional volumes over the portion of the contractual term under discussion. The notional volumes per day decrease over the term of the contracts. These commodity price risk management contracts are settled monthly.

(2) United States Dollars ("USD").

These commodity price contracts were assessed as level 2 on the fair value hierarchy. At September 30, 2016, the natural gas and crude oil derivative contracts had a combined fair value liability of \$1.9 million as reported through the line item derivative contracts in current assets, current liabilities and long term liabilities on the condensed consolidated statements of financial position. The fair value of each contract was determined through the difference in the referenced benchmark forward price as compared to the contract's strike price multiplied by the notional volumes during the remaining contractual term. Chinook had no derivative contracts outstanding at December 31, 2015.

In late October, 2016, as a result of anticipating lower production volumes associated to the properties held for sale (see note 8), Craft settled 31.5% of the outstanding price risk contracts for a payment of \$1.6 million to its counterparty. As a result, the remaining notional volumes are now 68.5% of those reported in the above tables. Concurrent with the closing of those properties classified as held for sale at September 30, 2016, the third party buyer paid \$1.4 million to Craft for 50% of the net increase in the mark-to-market liability from September 30, 2016 through to the closing of this Agreement but prior to any effect from Craft's settlement.

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

The following table reconciles Chinook's D&P Assets for the nine months ended September 30, 2016:

Cost of Assets	2016
Beginning balance	\$ 719,199
Capital expenditures	4,931
Business acquisition (note 3)	23,600
Assets held for sale (note 8)	(121,103)
Cost of properties sold	(14,042)
Decommissioning asset additions and change in estimates (note 7)	15,212
Ending balance	\$ 627,797
Accumulated Depletion & Depreciation	
Beginning balance	\$ (473,163)
Depletion & depreciation	(18,570)
Impairment	(48,000)
Loss on assets held for sale (note 8)	(4,000)
Reclassified on assets held for sale (note 8)	65,432
Reversed on sale of properties	9,238
Ending balance	\$ (469,063)
Net book values	
Balance as at December 31, 2015	\$ 246,036
Balance as at September 30, 2016	\$ 158,734

Chinook capitalized \$0.2 million and \$0.8 million of direct general and administrative costs related to its development activity during the three and nine months ended September 30, 2016, respectively (three and nine months ended September 30, 2015, \$0.4 million and \$1.0 million, respectively).

During the nine months ended September 30, 2016 and 2015 Chinook completed the sale of several petroleum and natural gas properties for proceeds, including adjustments, of \$8.1 million and \$42.0 million, respectively, resulting in gains of \$6.0 million and \$21.8 million.

Impairment of D&P Assets

On contribution of the Subject Assets from CEI to Craft on the Closing Date, management continued to measure these properties at their carrying value. In evaluating the consideration received on October 31, 2016, for those properties classified as held for sale at September 30, 2016, management concluded that this was evidence that there was a decrease in the fair value of the D&P Assets as included in the Subject Assets contributed from CEI to Craft. This evidence warranted conducting an impairment test in the Craft CGU. It did not warrant testing the CEI CGUs where its associated properties have significantly different characteristics such as geographical location and being prospective for Montney reserves. During the Craft CGU impairment testing, management considered its intention to distribute the shares of Craft to Chinook shareholders as announced on October 17, 2016 (see note 12, Subsequent Event). Management concluded the Craft CGU's recoverable amount of approximately \$49 million to be the fair value less costs to sell. As the consideration for the held for sale properties approximated the future net revenues anticipated to be produced from proved developed producing reserves, using a before income tax discount rate of 15 percent and forward commodity price estimates, management applied these same metrics to estimate the fair value less costs to sell of the Craft CGU. This test resulted in an impairment charge of \$48.0 million for the three and nine months ended September 30, 2016.

The September 30, 2016, proved producing reserves of the Craft CGU were estimated internally by management based on a December 31, 2015 independent reserve report and operational events to September 30, 2016. Assumptions that are valid at the time of the reserve estimates 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 the fair value less costs to sell.

The calculation of the Craft CGU's fair value less costs to sell used the following forward commodity prices, as estimated by management, at September 30, 2016:

As at September 30, 2016	Edmonton light (\$/bbl)	AECO Gas (\$/mmbtu)
2016 (3 months)	\$ 50.74	\$ 2.56
2017	\$ 66.40	\$ 3.20
2018	\$ 72.80	\$ 3.55
2019	\$ 80.90	\$ 3.85
2020	\$ 83.20	\$ 3.95
Thereafter	1.94% to 2.07%/yr	1.6% to 3.77%/yr

A five percent decrease in the forward commodity price estimate or a one percent increase in the applied discount rate, as determined for the Craft CGU, would have resulted in an additional impairment charge totaling approximately \$10 million and \$2 million, respectively.

As a result of recognizing this impairment expense, this reduced the carrying value of Craft's D&P Assets causing a deferred income tax recovery of \$7.1 million during the three months ended September 30, 2016. This income tax recovery eliminated the deferred income tax liability that was reported at June 30, 2016.

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

The following table reconciles Chinook’s E&E Assets for the nine months ended September 30, 2016:

	2016
Cost of Assets	
Beginning balance	\$ 68,622
Capital expenditures	103
Business acquisition (note 3)	1,300
Cost of properties sold	(2,976)
Ending balance	\$ 67,049
Accumulated Amortization	
Beginning balance	\$ (44,315)
Amortization	(2,890)
Properties sold	2,712
Ending balance	\$ (44,493)
Net book values	
Balance as at December 31, 2015	\$ 24,307
Balance as at September 30, 2016	\$ 22,556

7. Provisions

The following table reconciles Chinook’s provisions for the nine months ended September 30, 2016:

	2016
Beginning balance	\$ 98,742
Business acquisition (note 3)	3,977
Decommissioning obligation change in estimate	15,212
Property dispositions	(3,014)
Decommissioning obligation expenditures	(3,424)
Accretion expense	1,818
Liabilities held for sale (note 8)	(42,135)
Expenditures related to other provisions	(376)
Total provisions	\$ 70,800

As reported on the condensed consolidated statements of financial position, Chinook’s provision balance consists of:

	September 30 2016	December 31 2015
Short-term portion of provisions	\$ 300	\$ 2,700
Long-term portion of provisions	70,500	96,042
Total provisions	\$ 70,800	\$ 98,742

The business acquisition addition of \$4.0 million was the fair value estimate of Craft’s decommissioning obligations at the date of acquisition. This was immediately followed by a \$15.2 million change in estimate for these same obligations caused by applying risk-free discount rates from the credit adjusted risk-free rates used to measure fair value.

8. Assets and Liabilities Held for Sale

On September 29, 2016, Craft entered into an agreement (the “Agreement”) to sell certain of its petroleum and natural gas properties and undeveloped lands, including a portion of the Subject Assets, for gross estimated consideration of \$13.5 million, as comprised of \$9.0 million in cash and \$4.5 million in the buyer’s units. The units are comprised of par value 10.5% senior secured notes due in 2021 and 7.38 million purchase warrants. Each purchase warrant allows Craft to acquire one common share in the buyer at a price of \$0.18/share. The purchase warrants expire November 15, 2021. At September 30, 2016, these properties and their associated decommissioning obligations were classified as held for sale as it was highly probable that their net carrying value would be received through a sales transaction rather than through continued use. Management determined the net carrying value of these properties was \$4.0 million higher than the estimated consideration. This resulted in the recognition of an equivalent loss applied against the carrying value of these properties immediately prior to the \$55.7 million reclassification from D&P Assets to assets held for sale on the condensed consolidated statements of financial position. Decommissioning obligations of \$42.1 million were reclassified to liabilities held for sale on the consolidated statements of financial position. This Agreement closed on October 31, 2016.

9. Current Portion of Long-Term Debt

CEI Credit Facility

During the nine months ended September 30, 2016, CEI voluntarily reduced the borrowing base of its undrawn, reserve-based credit facility (the “CEI Credit Facility”), with a Canadian bank, from \$50.0 million to \$nil, as a result of the transfer of the Subject Assets to Craft. There were no outstanding draws at the time of this voluntary reduction in the borrowing base (undrawn with a borrowing base of \$50.0 million - December 31, 2015). Chinook is currently in discussions with its lender to determine the re-evaluated borrowing base. The CEI Credit Facility does not include any financial covenants and is collateralized by floating charges and security interests over all present and future properties and other assets of CEI.

As a result of this voluntary reduction in the borrowing base to \$nil, Chinook was required to secure a total of \$1.3 million in outstanding letters of credit through depositing an equivalent amount in cash with its lender. This cash is not accessible until such time that the letters of credit expire, the beneficiaries agree to release their guarantees or there is a sufficient increase in the borrowing base of the CEI Credit Facility to provide adequate security against these guarantees. As at September 30, 2016, each letter of credit expires within one year.

Craft Credit Facility

On June 10, 2016, as a result of the acquisition of Craft (see note 3 “Business Acquisition”), Chinook acquired \$17.8 million of outstanding debt under a credit agreement (the “Craft Credit Facility”) Craft had with an international lender. Shortly after June 10, 2016, Craft drew another \$0.4 million to finance its operations prior to repaying \$1.0 million during the three months ended September 30, 2016, bringing the total borrowings to \$17.2 million at September 30, 2016. The Craft Credit Facility is collateralized by floating charges and security interests over all present and future properties and other assets of Craft. Borrowings under the Craft Credit Facility will incur interest at a variable per annum rate equal to 8% plus the Canadian Deposit Offered Rate and then 1% on all draws. Borrowings under the Craft Credit Facility are available in two tranches as follows:

Tranche A: This tranche is \$17.2 million. It was fully drawn at September 30, 2016. Repayments reduce the availability of this tranche by an equivalent amount. Drawings on Tranche A are to be repaid according to a quarterly minimum repayment schedule.

Tranche B: The borrowing base of \$81.8 million under Tranche B does not contemplate a reduction resulting from the Agreement, as a result the full amount of Tranche B is not available. All drawings under this tranche require lender approval and may be used for lender approved acquisition and development activities, closing costs, Craft Credit Facility fees, expenses and fees of the lender and other uses as approved by the lender. The availability of Tranche B ceases on June 10, 2018. There were no drawings under this tranche at September 30, 2016.

The lender is entitled to all of Craft's net operating cash flows until all borrowings are repaid. These Craft net operating cash flows, as defined by a term of the Craft Credit Facility, are first used to meet the quarterly minimum repayment schedule. Cash flows in excess of this minimum repayment schedule are then applied to the remaining outstanding debt. The Craft Credit Facility matures on June 10, 2019, at which time all outstanding borrowings are due.

As at September 30, 2016, Craft was not in compliance with a Craft Credit Facility covenant requiring that GAAP compliant financial statements be filed within 60 days of the end of an interim quarter. Craft is nearing the completion of the compilation of their second quarter of 2016 financial statements that will then be immediately filed with their lender. As a result of not filing these financial statements, at September 30, 2016, the full amount of the outstanding drawings was classified as current portion of long-term debt on the condensed consolidated statement of financial position. The Craft Credit Facility covenants also require that the ratio of Craft's working capital, defined as the ratio of Craft's current assets to current liabilities but excluding marked-to-market derivative assets and/or liabilities and the current portion of long-term debt, is no less than 1.0:1.0 at each quarter end. Craft was in compliance with this ratio at September 30, 2016.

The terms of the Craft Credit Facility also require that Craft enter into commodity price risk contracts for a minimum notional volume of crude oil and natural gas based on forecasted proved developed producing volumes. Shortly after June 10, 2016, Craft entered crude oil and natural gas derivative contracts to satisfy this requirement, which represented all of the outstanding risk management contracts at September 30, 2016, and as detailed in note 4. Furthermore, as a condition of the Craft Credit Facility, Craft may only enter into derivative contracts with lender approved counterparties.

10. Long-Term Incentive Plans

CEI

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

During the nine months ended September 30, 2016, the settlement of 562,475 restricted awards and 501,824 performance awards resulted in the issuance of 1,093,442 common shares, after adjusting for the performance multiplier, and the transfer for the estimated fair value of these share-based awards of \$1.4 million from contributed surplus to share capital.

Craft

On September 1, 2016, Craft granted 15,050,000 share options and 20,070,000 performance warrants pursuant to Craft's share option plan, which is materially similar to Chinook's option plan. The performance warrants are comprised of five tranches with each tranche comprised of 4,140,000 performance warrants starting at an exercise price of \$0.15/share and increasing by \$0.05/share increments to \$0.35/share. If "in-the-money", once vested, these share options and performance warrants would be settled through the issuance of Craft's share capital. The following factors were used in the Black-Scholes pricing model for the determination of the fair value of share options and performance warrants granted:

September 30	2016	
	Share Options	Performance Warrants
Expected average life (years)	5	5
Risk-free interest rate (%)	0.52	0.52
Estimated forfeiture rate per annum (%)	-	-
Volatility factor (%)	62.00	62.00
Exercise price (\$/award)	0.20	0.15 to 0.35

The share options and performance warrants granted on September 1, 2016 were determined to have a fair value of \$0.05 per share option and between \$0.02 per performance warrant and \$0.04 per performance warrant.

11. Other Supplementary Information

Changes in non-cash working capital

	Three months ended September 30		Nine months ended September 30	
	2016	2015	2016	2015
Cash provided by (used for):				
Accounts receivable	\$ 1,109	\$ 1,151	\$ 5,909	\$ 11,830
Prepays & deposits	(356)	630	(1,800)	(619)
Accounts payable, accrued liabilities & other	(4,736)	(888)	(11,556)	(23,816)
	\$ (3,983)	\$ 893	\$ (7,447)	\$ (12,605)
Cash provided by (used for):				
Operating activities	\$ (3,337)	\$ (1,696)	\$ 1,422	\$ (450)
Investing activities	(646)	2,589	(8,869)	(12,155)
	\$ (3,983)	\$ 893	\$ (7,447)	\$ (12,605)

Cash interest and financing fees paid

	Three months ended September 30		Nine months ended September 30	
	2016	2015	2016	2015
Three months ended September 30				
Cash interest & financing fees paid	\$ 434	\$ 242	\$ 694	\$ 617

Per share amounts

The per share amounts for the three and nine months ended September 30, 2016 and 2015, were calculated as per the following table:

	Three months ended September 30		Nine months ended September 30	
	2016	2015	2016	2015
Weighted average shares outstanding - basic & diluted (thousands)	216,287	215,274	215,666	215,150
Net loss	\$ (35,905)	\$ (80,669)	\$ (61,200)	\$ (78,303)
Net loss per share - basic & diluted (\$/share)	\$ (0.17)	\$ (0.37)	\$ (0.28)	\$ (0.36)

For the three and nine months ended September 30, 2016 and 2015, because Chinook reported net losses, the effect of share options, restricted awards and performance awards, would have been anti-dilutive resulting in them being excluded in the calculation of diluted weighted average shares outstanding.

12. Subsequent Event

On October 17, 2016, Chinook announced that it will undertake to complete a plan of arrangement under the Business Corporation Act (Alberta) to effect the distribution of all the common shares of Craft acquired by Chinook pursuant to the PSA. Pursuant to this arrangement and upon Chinook's shareholders' approval, a new class of class "A" common shares of Chinook will be created and each currently issued and outstanding common share of Chinook will then be exchanged for one new Chinook class "A" common share and a portion of the common shares of Craft received pursuant to the PSA.