Q2 2017

Condensed Consolidated Financial Statements

CHINOOK energy inc

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

Condensed Consolidated Statements of Financial Position

(unaudited)

(in thousands of Canadian dollars)	**June 30 2017**	December 31 2016
Assets		
Current		
Cash	**$ 19,977**	$ 14,821
Accounts receivable	**3,286**	6,658
Restricted cash (note 9)	**-**	1,308
Prepaids & deposits	**1,940**	3,569
Fair value of commodity price contracts (note 4)	**1,433**	-
Assets held for sale (note 7)	**-**	7,148
	26,636	33,504
Development & production assets (note 5)	**105,743**	92,959
Exploration & evaluation assets (note 6)	**12,512**	13,512
	$ 144,891	$ 139,975
Liabilities & Equity		
Current		
Accounts payable, accrued liabilities & other	**$ 6,909**	$ 11,218
Fair value of commodity price contract (note 4)	**-**	154
Decommissioning obligations (note 8)	**1,170**	1,300
Liabilities held for sale (note 7)	**-**	236
	8,079	12,908
Decommissioning obligations (note 8)	**28,834**	27,767
Shareholders' Equity		
Share capital	**784,935**	784,105
Contributed surplus	**19,438**	19,759
Deficit	**(696,395)**	(704,564)
	107,978	99,300
	$ 144,891	$ 139,975

See accompanying notes to the condensed consolidated financial statements.

Condensed Consolidated Statements of Operations and Comprehensive Income (Loss)

(unaudited)

	Three months ended June 30		Six months ended June 30	
(in thousands of Canadian dollars, except per share amounts)	**2017**	2016	**2017**	2016
Petroleum & natural gas revenues	**$ 6,694**	$ 7,758	**$ 13,469**	$ 15,519
Royalties	**(111)**	(208)	**(48)**	(725)
Petroleum & natural gas revenues, net of royalties	**6,583**	7,550	**13,421**	14,794
Processing & gathering revenues	**208**	597	**468**	1,457
Petroleum, natural gas & other revenues, net of royalties	**6,791**	8,147	**13,889**	16,251
Realized gain on commodity price contracts	**333**	68	**769**	68
Unrealized gain (loss) on commodity price contracts	**300**	(3,576)	**1,587**	(3,576)
Gain (loss) on commodity price contracts	**633**	(3,508)	**2,356**	(3,508)
Total revenues, net of royalties and commodity price contracts	**7,424**	4,639	**16,245**	12,743
Production & operating	**4,122**	7,534	**7,946**	16,312
General & administrative	**1,535**	2,067	**3,147**	3,957
Transaction & severance costs	**135**	1,620	**508**	1,620
Exploration & evaluation	**103**	321	**195**	817
Depletion, depreciation & amortization	**3,074**	6,642	**6,007**	13,788
Gain on dispositions of properties	**-**	(6,714)	**(10,926)**	(5,859)
Share-based compensation	**258**	672	**509**	1,352
Bad debt expense	**-**	379	**-**	458
Other losses	**321**	212	**476**	602
Total expenses, net of gains on dispositions of properties, excluding finance expenses	**9,548**	12,733	**7,862**	33,047
(Loss) income before finance expenses	**(2,124)**	(8,094)	**8,383**	(20,304)
Interest & financing (income) charges	**(40)**	99	**(124)**	112
Accretion of decommissioning obligations	**169**	578	**338**	1,130
Finance expenses	**129**	677	**214**	1,242
(Loss) income before deferred income tax	**(2,253)**	(8,771)	**8,169**	(21,546)
Deferred income tax	**-**	7,100	**-**	7,100
Net (loss) income including non-controlling interest	**(2,253)**	(15,871)	**8,169**	(28,646)
Net loss attributable to non-controlling interest	**-**	3,351	**-**	3,351
Net & comprehensive (loss) income	**$ (2,253)**	$ (12,520)	**$ 8,169**	$ (25,295)
Net (loss) income per share, basic and diluted (note 11)	**$ (0.01)**	$ (0.06)	**$ 0.04**	$ (0.12)

See accompanying notes to the condensed consolidated financial statements.

Condensed Consolidated Statements of Changes in Shareholders' Equity

(unaudited)

(in thousands of Canadian dollars, except common shares)	Common Shares (thousands)	Share Capital	Contributed Surplus	Deficit	Non-controlling interest	Shareholders' Equity
Balance as at December 31, 2016	**216,443**	**$ 784,105**	**$ 19,759**	**$ (704,564)**	**$ -**	**$ 99,300**
Settlement of restricted and performance share awards	672	830	(830)	-	-	-
Share-based compensation	-	-	509	-	-	509
Net income	-	-	-	8,169	-	8,169
Balance as at June 30, 2017	**217,115**	**$ 784,935**	**$ 19,438**	**$ (696,395)**	**$ -**	**$ 107,978**
Balance as at December 31, 2015	**215,349**	**$ 782,705**	**$ 18,916**	**$ (600,406)**	**$ -**	**$ 201,215**
Non-controlling interest in Craft Oil Inc. acquisition	-	-	-	-	37,134	37,134
Equity loss	-	-	-	(3,533)		(3,533)
Net loss attributable to non-controlling interest	-	-	-	-	(3,351)	(3,351)
Settlement of restricted share awards	1	3	(3)	-	-	-
Share-based compensation	-	-	1,352	-	-	1,352
Net loss	-	-	-	(25,295)	-	(25,295)
Balance as at June 30, 2016	**215,350**	**$ 782,708**	**$ 20,265**	**$ (629,234)**	**$ 33,783**	**$ 207,522**

See accompanying notes to the condensed consolidated financial statements.

Condensed Consolidated Statements of Cash Flows

(unaudited)

	Three months ended June 30		Six months ended June 30	
(in thousands of Canadian dollars)	**2017**	2016	**2017**	2016
Operating Activities				
Net (loss) income	**$ (2,253)**	$ (12,520)	**$ 8,169**	$ (25,295)
Add (deduct):				
Depletion, depreciation & amortization	**3,074**	6,642	**6,007**	13,788
Gain on dispositions of properties	**-**	(6,714)	**(10,926)**	(5,859)
Unrealized (gain) loss on commodity price contracts	**(300)**	3,576	**(1,587)**	3,576
Share-based compensation	**258**	672	**509**	1,352
Accretion of decommissioning obligations	**169**	578	**338**	1,130
Foreign exchange losses (gains)	**9**	(24)	**18**	53
Bad debt expense	**-**	379	**-**	458
Deferred income taxes	**-**	7,100	**-**	7,100
Net loss attributable to non-controlling interest	**-**	(3,351)	**-**	(3,351)
Decommissioning obligation expenditures	**(41)**	(511)	**(134)**	(3,676)
Change in operating non-cash working capital (note 11)	**5,364**	2,543	**2,441**	4,759
Cash flow (outflow) from operating activities	**6,280**	(1,630)	**4,835**	(5,965)
Financing Activities				
Long-term debt borrowing	**-**	407	**-**	407
Cash flow from financing activities	-	407	-	407
Investing Activities				
Proceeds on property dispositions	**-**	7,613	**17,838**	7,912
Development & exploration expenditures	**(8,235)**	(1,347)	**(17,058)**	(4,373)
Restricted cash release (investment)	**1,308**	(1,192)	**1,308**	(1,192)
Cash acquired on business acquisition	**-**	867	**-**	867
Change in investing non-cash working capital (note 11)	**(948)**	(1,856)	**(1,708)**	(8,223)
Cash (outflow) flow from investing activities	**(7,875)**	4,085	**380**	(5,009)
Change in cash, during the period	**(1,595)**	2,862	**5,215**	(10,567)
Cash, beginning of period	**21,622**	24,385	**14,821**	37,947
Cash, foreign currency (loss) gain	**(50)**	7	**(59)**	(127)
Cash, end of period	**$ 19,977**	$ 27,254	**$ 19,977**	$ 27,254

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 six months ended June 30, 2017 and 2016

Tabular amounts in thousands of Canadian dollars, except as noted

1. Reporting Entity

Chinook Energy Inc. is a Calgary-based petroleum and natural gas production company focused on development and exploration opportunities in western Canada.

These unaudited condensed consolidated financial statements for the three and six months ended June 30, 2017 and 2016 (these "Financial Statements") include the accounts of Chinook Energy Inc. ("CEI") and two directly held wholly-owned subsidiaries: 1542991 Alberta Ltd. and Storm Ventures International (BVI) Limited. From June 10, 2016 the condensed consolidated statements of operations and comprehensive income (loss) and condensed consolidated statements of cash flow also include the accounts of Craft Oil Inc. (collectively, including all three subsidiaries, "Chinook" or the "Company").

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, 2016 and 2015 (the "Audited Financial Statements"). They do not include all of the required disclosures for annual consolidated financial statements and therefore should be read in conjunction with the Audited Financial Statements and the notes thereto.

These Financial Statements have been prepared by management in accordance with International Accounting Standard 34 'Interim Financial Reporting' using accounting principles consistent with International Financial Reporting Standards issued by the International Accounting Standards Board.

These Financial Statements were approved and authorized for issuance by Chinook's Board of Directors on August 10, 2017.

3. New Accounting Standards and Amendments

In July 2014, the IASB issued IFRS 9 "Financial Instruments" to replace IAS 39, "Financial Instruments Recognition and Measurement". The new standard replaces the current multiple classification and measurement models for financial instruments with a single model that has only two classifications categories: amortized cost and fair value. Due to the fact that all of Chinook's financial instruments are carried at amortized cost or fair value, this standard is not expected to have a significant effect on Chinook's financial statement disclosure. Chinook does not currently apply, nor does it intend to apply, hedge accounting to its financial instrument commodity price contracts on adoption of IFRS 9.

In May 2014 the IASB issued IFRS 15 "Revenue from Contracts with Customers" to replace International Accounting Standard ('IAS") 18, Revenue, IAS 11 "Construction Contracts", and related interpretations. The standard contains a single model that applies to contracts with customers and two approaches to recognizing revenue: at a point in time or over time. The model features a contract-based five-step analysis of transactions to determine whether, how much and when revenue is recognized. New estimates and judgmental thresholds have been introduced, which affect the amount and/or timing of revenue recognized. Chinook is currently in the process of assessing underlying revenue contracts with customers to determine the impact, if any, that the adoption of IFRS 15 will have on its financial statements including enhanced disaggregation of revenue disclosures.

As of January 1, 2018, Chinook will be required to adopt the above two standards.

In January 2016, the IASB issued IFRS 16 "Leases". The standard requires entities to recognize lease assets and lease obligations on the statements of financial position. For lessees, there will be a single lease accounting model for all leases. There will no longer be a classification test between finance and operating leases. The lessee will recognize a Right of Use ("ROU") asset and a lease liability, and the lease will be treated as an asset on a financed basis. There will be an optional exemption from the above for short term leases and leases of low value assets, defined at 12 months or less and an option for portfolio accounting on leases that have similar criteria. From the lessor's perspective, there will still be a dual lease accounting model that follows the criteria set out in IAS 17. As of January 1, 2019, Chinook will be required to adopt this standard. Chinook is currently assessing all major leases including firm commitment contracts, which are expensed as operating leases for reclassification to the statements of financial position.

4. Fair Value of Commodity Price Contracts

As at June 30, 2017, Chinook had the following commodity price contracts:

Financial AECO Natural Gas Contracts					
Remaining Contractual Term	**Notional Volumes (GJ/d)**	**Company's Received Price**	**Indexed Price**		**Fair Value**
July 1, 2017 to December 31, 2017	7,500	$3.205/GJ	AECO	$	1,318
July 1, 2017 to October 31, 2017	4,000	$2.50/GJ	AECO		115
				$	1,433

At June 30, 2017, the natural gas price contracts had a combined fair value asset of $1.4 million as reported through the line item fair value of commodity price contracts in current assets 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. As at December 31, 2016, Chinook had one outstanding commodity price contract with a fair value liability of $0.2 million as reported through the line item fair value of commodity price contract as a current liability on the condensed consolidated statements of financial position.

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

The following table reconciles Chinook's D&P Assets for the six months ended June 30, 2017:

Cost of Assets		**2017**
Balance, beginning of period	**$**	**237,868**
Capital expenditures		**17,058**
Transfer from exploration & evaluation assets (note 6)		**100**
Decommissioning asset additions (note 8)		**733**
Balance, end of period	**$**	**255,759**
Accumulated Depletion & Depreciation		
Balance, beginning of period	**$**	**(144,909)**
Depletion & depreciation		**(5,107)**
Balance, end of period	**$**	**(150,016)**
Net book values		
Balance as at December 31, 2016	**$**	**92,959**
Balance as at June 30, 2017	**$**	**105,743**

Capitalized general and administrative expenses

Chinook capitalized $0.2 million and $0.4 million of direct general and administrative costs related to its development activity during the three and six months ended June 30, 2017, respectively (three and six months ended June 30, 2016 - $0.6 and $0.9 million, respectively).

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

The following table reconciles Chinook’s E&E Assets for the six months ended June 30, 2017:

Cost of Assets		**2017**
Balance, beginning and end of period	**$**	**30,947**
Transfer to development & production assets (note 5)		**(100)**
Ending balance	**$**	**30,847**
Accumulated Amortization		
Balance, beginning of period	**$**	**(17,435)**
Amortization		**(900)**
Balance, end of period	**$**	**(18,335)**
Net book values		
Balance as at December 31, 2016	**$**	**13,512**
Balance as at June 30, 2017	**$**	**12,512**

7. Property dispositions

During 2017, Chinook completed the sale of certain of its petroleum and natural gas properties including undeveloped lands located in the Knopcik/Pipestone and East Gold Creek areas of northwestern Alberta for net proceeds of $17.8 million after customary adjustments. At December 31, 2016, these properties were classified as held for sale. This classification included carrying values of $7.1 million for both developed and undeveloped properties less $0.2 million for associated decommissioning obligations. Combined, the net carrying amounts of these sold properties and undeveloped lands was less than the sales proceeds resulting in a gain of $10.9 million during the six months ended June 30, 2017.

8. Decommissioning Obligations

The following table reconciles Chinook’s decommissioning obligations for the six months ended June 30, 2017:

		2017
Balance as at December 31, 2016	**$**	**29,067**
Decommissioning obligation additions (note 5)		**733**
Decommissioning obligation expenditures		**(134)**
Accretion expense		**338**
Balance as at June 30, 2017	**$**	**30,004**

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

		2017
Current portion	**$**	**1,170**
Long-term portion		**28,834**
Decommissioning obligations	**$**	**30,004**

9. Long-Term Debt

During the six months ended June 30, 2017, Chinook’s previous credit facility agreement was terminated and Chinook negotiated and secured an $8.0 million demand credit facility (the “Demand Credit Facility”) with a Canadian chartered bank. At any time, the lender can request repayment of all outstanding drawn amounts resulting in any future borrowings being classified as a current liability. The Demand Credit Facility’s availability is subject to semi-annual reviews with the next review scheduled on or before November 1, 2017. Changes in the availability in the Demand Credit Facility are possible, from one review to the next, with draws in excess of availability becoming immediately payable. Borrowings incur interest at the prime rate plus an applicable margin and are collateralized by floating charges and security interests over all of Chinook’s present and future properties and other assets. As at June 30, 2017, Chinook had not made any draws on the Demand Credit Facility, but has outstanding letters of credit of $0.8 million, as secured by its lender, which reduced the available credit to $7.2 million.

The Demand Credit Facility has a financial covenant requiring that the adjusted working capital be 1:1 at each reporting period. For the purposes of this covenant, adjusted working capital is defined as working capital excluding both current commodity price contracts and debt. In addition, the Demand Credit Facility includes operating and financial restrictions on Chinook that include restrictions on paying dividends or repurchasing or making of other distributions with respect to Chinook's securities.

As at the end of any fiscal quarter, if Chinook has any net debt or Demand Credit Facility draws, within 60 days of the end of any such quarter, the terms of the Demand Credit Facility also require that Chinook must enter into commodity price contracts covering no less than 30% of its forecasted twelve month combined production volumes.

As at June 30, 2017, Chinook was in compliance with the above financial covenant and other requirements.

As at December 31, 2016, Chinook had guaranteed a total of $1.3 million in outstanding letters of credit through depositing an equivalent amount in cash with its lender. During the six months ended June 30, 2017, the lender released its restrictions to this cash pursuant to the $8.0 million increase in the Demand Credit Facility availability.

10. Long-term Incentive Plans

Chinook grants share options, restricted awards and performance awards (collectively, "Share-Based Awards") under its long-term incentive plans to employees, officers, directors, consultants and other service providers. 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.

a) Share Option Plan

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

	Number of Options (thousands)	Weighted Average Exercise Price ($/option)
Balance as at December 31, 2016	**6,472**	**$ 1.13**
Granted	5,687	0.38
Forfeited or cancelled	(443)	(1.05)
Expired	(713)	(1.22)
Balance as at June 30, 2017	**11,003**	**$ 0.73**
Exercisable	**3,288**	**$ 1.22**

The table below summarizes the outstanding share options, their respective weighted average exercise prices and remaining life in addition to the number of exercisable options, their respective weighted average prices and remaining life at June 30, 2017:

	Outstanding Options			Outstanding Exercisable Options		
Range of Exercise Prices ($/option)	**Options Outstanding (thousands)**	**Weighted Average Exercise Prices ($/option)**	**Weighted Average Remaining Life (years)**	**Options Outstanding (thousands)**	**Weighted Average Exercise Prices ($/option)**	**Weighted Average Remaining Life (years)**
$0.38 - $0.53	5,687	$ 0.38	4.8	-	$ -	-
$0.54 - $1.08	2,179	$ 0.62	3.3	924	$ 0.69	3.0
$1.09 - $2.46	3,137	$ 1.43	2.1	2,364	$ 1.43	2.0
	11,003	**$ 0.73**	**3.7**	**3,288**	**$ 1.22**	**2.3**

The following factors were used in the Black-Scholes pricing model for the determination of the fair value of options granted during the six months ended June 30, 2017:

Six months ended June 30,	2017
Expected average life (years)	3 to 5
Weighted average risk-free interest rate (%)	1.0
Weighted average volatility factor (%)	58.16
Share option exercise price ($/option)	0.38

(1) The expected average life of the share option is based on time to vest plus a historical calculation.

(2) The volatility factor is based on historical price volatility of Chinook's common shares over the expected life of the option.

The weighted average fair value determined for options granted during the six months ended June 30, 2017 was $0.17 per option.

b) Restricted and Performance Award Plan

A summary of restricted and performance awards ("Awards") outstanding are as follows:

	Number of Restricted Awards (thousands)	Number of Performance Awards (thousands)
Balance as at December 31, 2016	**349**	**382**
Granted	225	-
Distributed	(301)	(346)
Forfeited	(35)	(36)
Balance as at June 30, 2017	**238**	**-**

Certain performance awards distributed in the six months ended June 30, 2017 were subject to a performance multiplier.

The fair value determined for restricted awards granted during the six months ended June 30, 2017 was $0.38 per award excluding estimated forfeitures. This fair value was based on the market price of Chinook's common shares on the date the restricted awards were granted.

11. Other Supplementary Information

Changes in non-cash working capital

	Three months ended June 30		Six months ended June 30	
	2017	2016	**2017**	2016
Cash provided by (used for):				
Accounts receivable	**$ 4,514**	$ 3,816	**$ 3,372**	$ 4,800
Prepaids & deposits	**2,501**	3,533	**1,629**	(1,444)
Accounts payable, accrued liabilities & other	**(2,599)**	(6,662)	**(4,268)**	(6,820)
	$ 4,416	$ 687	**$ 733**	$ (3,464)
Cash provided by (used for):				
Operating activities	**$ 5,364**	$ 2,543	**$ 2,441**	$ 4,759
Investing activities	**(948)**	(1,856)	**(1,708)**	(8,223)
	$ 4,416	$ 687	**$ 733**	$ (3,464)

Cash interest and financing fees paid

	Three months ended June 30		Six months ended June 30	
	2017	2016	**2017**	2016
Cash interest & financing fees paid	**$ 23**	$ 158	**$ 31**	$ 260

Per share amounts

	Three months ended June 30		Six months ended June 30	
	2017	2016	**2017**	2016
Weighted average shares outstanding - basic (thousands)	**216,598**	215,350	**216,521**	215,350
Dilutive impact of Awards	**-**	-	**521**	-
Weighted average shares outstanding - diluted (thousands)	**216,598**	215,350	**217,042**	215,350
Net (loss) income	**$ (2,253)**	$ (12,520)	**$ 8,169**	$ (25,295)
Net (loss) income per share - basic & diluted ($/share):	**$ (0.01)**	$ (0.06)	**$ 0.04**	$ (0.12)

For the six months ended June 30, 2017, Chinook's outstanding Awards were dilutive because the weighted average number of outstanding Awards exceeded the deemed repurchased shares calculated from unamortized share-based compensation. For the three months ended June 30, 2017 and the three and six months ended June 30, 2016, because Chinook reported a net loss, the effect of Share-Based Awards would have been anti-dilutive resulting in them being excluded in the calculation of diluted weighted average shares outstanding.