



**Condensed Interim Consolidated Financial Statements  
Three and Six Months Ended June 30, 2016 and 2015**

**NOTICE OF NO AUDITOR REVIEW**

**Pursuant to National Instrument 51-102, Part 4, subsection 4.3(3)(a), the accompanying unaudited condensed interim consolidated financial statements have been prepared by management. The Company's independent auditors have not performed a review of these financial statements in accordance with standards established by the Chartered Professional Accountants Canada for a review of interim financial statements by an entity's auditor.**

## Three and Six Months Ended June 30, 2016

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## Condensed Interim Consolidated Balance Sheets

(unaudited - amounts in US dollars)

	Notes	June 30, 2016	December 31, 2015
<b>Assets</b>			
<b>Current assets</b>			
Cash	4(b)	\$ 552,143	\$ 1,434,645
Restricted cash	4(b)	3,951,342	3,585,011
Accounts receivable	4(b)	14,042,957	17,424,561
Fair value of commodity contracts	4(d)	-	4,628,710
Decommissioning contracts receivable	9	40,130,369	28,519,553
Prepaid expenses	10	3,044,852	3,654,129
<b>Total current assets</b>		<b>61,721,663</b>	<b>59,246,609</b>
Fair value of commodity contracts	4(d)	-	3,544,455
Decommissioning contracts receivable	9	10,752,175	15,688,958
Exploration and evaluation assets	5	242,172	242,172
Property and equipment	6	83,791,665	83,880,422
Note receivable	7	4,299,534	4,234,712
Asset retirement deposits	9	1,507,458	1,873,789
Deferred income taxes		8,277,000	5,921,000
<b>Total assets</b>		<b>\$ 170,591,667</b>	<b>\$ 174,632,117</b>
<b>Liabilities and shareholders' equity (deficiency)</b>			
<b>Current liabilities</b>			
Accounts payable and accrued liabilities	4(c)	\$ 12,288,653	\$16,622,618
Deferred revenues	9	5,618,554	3,977,019
Loans payable	8	13,266,930	17,204,707
Due to related parties	16	8,253,057	8,219,405
Asset retirement obligations	9	44,257,748	30,768,877
<b>Total current liabilities</b>		<b>83,684,942</b>	<b>76,792,626</b>
<b>Long-term liabilities</b>			
Deferred revenues	9	3,823,368	4,587,358
Loans payable	8	55,158,139	54,431,031
Accrued interest payable	8	6,789,025	5,608,506
Due to related parties	16	3,601,640	3,601,640
Asset retirement obligations	9	20,157,732	27,858,624
<b>Total liabilities</b>		<b>173,214,846</b>	<b>172,879,786</b>
<b>Shareholders' equity (deficiency)</b>			
Share capital	11	122,112,182	122,112,182
Reserve from common control		(77,545,026)	(77,545,026)
Contributed surplus	11	3,952,477	3,873,880
Deficit		(51,142,812)	(46,688,705)
<b>Total shareholders' equity (deficiency)</b>		<b>(2,623,179)</b>	<b>1,752,331</b>
<b>Total liabilities and shareholders' equity (deficiency)</b>		<b>\$ 170,591,667</b>	<b>\$ 174,632,117</b>

Going concern (note 2(b))

Commitments and contingencies (note 15)

Subsequent events (note 18)

*The accompanying notes are an integral part of these condensed interim consolidated financial statements.*

## Condensed Interim Consolidated Statements of Loss and Comprehensive Loss

(unaudited - amounts in US dollars)

	Notes	Three Months Ended June 30,		Six Months Ended June 30,	
		2016	2015	2016	2015
<b>Revenue</b>					
Petroleum and natural gas		\$ 3,053,592	\$ 6,650,150	\$ 5,787,156	\$ 12,560,303
Production handling		252,296	45,755	278,676	87,811
Well services		1,846,072	3,640,590	3,223,251	7,311,817
Decommissioning contracts		3,056,523	2,677,236	4,685,915	5,863,625
Revenue before the following:		8,208,483	13,013,731	13,974,999	25,823,556
Realized gain on commodity contracts	4(d)	1,157,923	1,751,890	8,956,369	4,113,450
Unrealized loss on commodity contracts	4(d)	(1,157,923)	(4,139,789)	(8,173,165)	(4,837,654)
<b>Total revenue</b>		<b>\$ 8,208,483</b>	<b>\$ 10,625,832</b>	<b>\$ 14,758,202</b>	<b>\$ 25,099,352</b>
<b>Expenses</b>					
Lease operating		4,001,532	5,384,030	7,431,391	11,595,654
Cost of well services		1,186,575	2,295,030	2,251,123	5,241,869
Depreciation and depletion	6	865,846	1,958,081	1,910,256	3,725,768
Repairs and maintenance		136,973	352,813	190,268	528,029
General and administrative		2,196,721	3,263,560	4,594,015	6,318,501
Bad debt	4(b)	10,942	-	63,817	17,174
Stock-based compensation	11	51,966	934,966	78,597	1,121,029
Asset retirement expense		-	555,641	-	-
<b>Total expenses</b>		<b>8,450,556</b>	<b>14,744,121</b>	<b>16,519,468</b>	<b>28,548,024</b>
<b>Operating loss</b>		<b>(242,073)</b>	<b>(4,118,289)</b>	<b>(1,761,266)</b>	<b>(3,448,672)</b>
Gain on asset retirement obligations	9	1,807,484	2,308,657	1,746,401	3,359,099
Unrealized gain on financing warrants	8	-	-	-	1,000
Finance expense	12	(3,267,741)	(3,114,069)	(6,795,243)	(6,148,382)
<b>Loss before income taxes</b>		<b>(1,702,330)</b>	<b>(4,923,701)</b>	<b>(6,810,107)</b>	<b>(6,236,955)</b>
Deferred income tax recovery		(577,599)	(1,396,000)	(2,356,000)	(1,791,000)
<b>Loss and comprehensive loss</b>		<b>\$ (1,124,731)</b>	<b>\$ (3,527,701)</b>	<b>\$ (4,454,107)</b>	<b>\$ (4,445,955)</b>
<b>Loss per share</b>					
	13				
Basic		(\$0.00)	(\$0.01)	(\$0.01)	(\$0.01)
Diluted		(\$0.00)	(\$0.01)	(\$0.01)	(\$0.01)

Segment information (note 17)

The accompanying notes are an integral part of these condensed interim consolidated financial statements.

## Condensed Interim Consolidated Statements of Changes in Shareholders' Equity (Deficiency)

(unaudited –amounts in US dollars)

	Notes	Number of Common Shares <sup>(1)</sup>	Common Share Capital Stated Value	Number of Proportionate Voting Shares	Proportionate Voting Shares Stated Value	Reserve From Common Control	Contributed Surplus	Deficit	Total Shareholders' Equity (Deficiency)
Balance, December 31, 2014		259,028,502	\$ 92,949,630	65,071	\$ 29,162,552	\$ (77,545,026)	\$ 2,816,379	\$ (27,503,431)	\$ 19,880,104
Stock-based compensation		-	-	-	-	-	1,121,029	-	1,121,029
Loss for the period		-	-	-	-	-	-	(4,445,955)	(4,445,955)
Balance, June 30, 2015.		259,028,502	\$ 92,949,630	65,071	\$ 29,162,552	\$ (77,545,026)	\$ 3,937,408	\$ (31,949,386)	\$ 16,555,178
Stock-based compensation	11	-	-	-	-	-	(63,528)	-	(63,528)
Proportionate voting shares converted to common shares		4,082,000	1,829,410	(4,082)	(1,829,410)	-	-	-	-
Loss for the period		-	-	-	-	-	-	(14,739,319)	(14,739,319)
Balance, December 31, 2015		263,110,502	\$ 94,779,040	60,989	\$ 27,333,142	\$ (77,545,026)	\$ 3,873,880	\$ (46,688,705)	\$ 1,752,331
Stock-based compensation	11	-	-	-	-	-	78,597	-	78,597
Loss for the period		-	-	-	-	-	-	(4,454,107)	(4,454,107)
Balance, June 30, 2016		263,110,502	\$ 94,779,040	60,989	\$ 27,333,142	\$ (77,545,026)	\$ 3,952,477	\$ (51,142,812)	\$ (2,623,179)

<sup>(1)</sup> As at June 30, 2016, the issued share capital of the Company consists of 263,110,502 common shares and 60,989 Proportionate Voting Shares (1,000 to 1 conversion rights), for issued share capital on a fully diluted basis equivalent to 324,099,502 common shares (prior to the exercise of 17,453,836 stock options and 13,429,819 warrants.)

*The accompanying notes are an integral part of these condensed interim consolidated financial statements.*

## Condensed Interim Consolidated Statements of Cash Flows

(unaudited - amounts in US dollars)

	Notes	Three Months Ended June 30,		Six Months Ended June 30,	
		2016	2015	2016	2015
<b>Cash provided by (used in):</b>					
<b>Cash flows from operating activities</b>					
Net loss		\$ (1,124,731)	\$ (3,527,701)	\$ (4,454,107)	\$ (4,445,955)
Adjustments for:					
Depreciation and depletion	6	865,846	1,958,081	1,910,256	3,725,768
Bad debt	4(b)	10,942	-	63,817	17,174
Stock-based compensation	11	51,966	934,966	78,597	1,121,029
Unrealized loss on commodity contracts	4(d)	1,157,923	4,139,789	8,173,165	4,837,654
Unrealized gain on financing warrants	8	-	-	-	(1,000)
Unrealized foreign exchange (gain) loss on related party credit facility	12	(9,385)	43,000	165,570	(253,518)
PIK interest on senior secured notes	12	1,144,450	-	1,358,672	-
Accretion of loans payable discount	12	(524,089)	1,016,304	(119,805)	1,998,801
Gain on debt revaluation	12	-	(376,780)	-	(376,780)
Asset retirement obligation accretion	9	247,409	321,975	502,487	649,516
Gain on asset retirement obligations	9	(1,807,484)	(2,308,657)	(1,746,401)	(3,359,099)
Asset retirement expense		-	555,641	-	-
Deferred income tax recovery		(577,599)	(1,396,000)	(2,356,000)	(1,791,000)
Funds generated from operations		(564,750)	1,360,618	3,576,251	2,122,590
Cash abandonment costs	9	(6,364,309)	(4,964,875)	(8,663,073)	(7,254,250)
Changes in non-cash working capital	14	(3,800,555)	(5,657,143)	291,111	(3,830,080)
Changes in deferred revenue	9	1,107,281	(826,782)	877,544	(1,690,600)
Changes in decommissioning contracts receivable	9	7,369,791	5,146,046	8,037,765	8,197,317
Change in accrued interest payable	8	539,967	598,832	1,075,700	1,131,575
<b>Net cash flows provided by (used in) operating activities</b>		<b>(1,712,575)</b>	<b>(4,343,304)</b>	<b>5,195,298</b>	<b>(1,323,448)</b>
<b>Cash flows from investing activities</b>					
Capital expenditures for petroleum and natural gas properties	6	(697,124)	(2,039,783)	(833,899)	(3,647,493)
Capital expenditures for well service equipment		-	(99,094)	-	(99,094)
Acquisition of petroleum and natural gas properties	6	-	-	-	(18,420)
Capital expenditures for office furnishings and improvements	6	(4,433)	(10,221)	(4,433)	(28,255)
Changes in non-cash working capital	14	455,663	(625,450)	(664,358)	(175,425)
<b>Net cash flows used in investing activities</b>		<b>(245,894)</b>	<b>(2,774,548)</b>	<b>(1,502,690)</b>	<b>(3,968,687)</b>
<b>Cash flows from financing activities</b>					
Proceeds from loans payable	8	2,179,963	63,001,619	2,179,963	63,001,619
Repayment of loans payable	8	(906,776)	(45,518,728)	(6,261,739)	(46,296,819)
Payment of waiver fee	16	-	-	(493,333)	-
Repayment of advances from related parties	16	-	-	-	(271,758)
<b>Net cash flows provided by (used in) financing activities</b>		<b>1,273,186</b>	<b>17,482,891</b>	<b>(4,575,110)</b>	<b>16,433,042</b>
<b>Net (decrease) increase in cash</b>		<b>(685,282)</b>	<b>10,365,039</b>	<b>(882,502)</b>	<b>11,140,907</b>
<b>Cash, beginning of period</b>		<b>1,237,425</b>	<b>913,538</b>	<b>1,434,645</b>	<b>137,670</b>
<b>Cash, end of period</b>	14	<b>\$ 552,143</b>	<b>\$ 11,278,577</b>	<b>\$ 552,143</b>	<b>\$ 11,278,577</b>

Supplemental cash flow information (note 14)

The accompanying notes are an integral part of these condensed interim consolidated financial statements.

## 1. General business description

Rooster Energy Ltd. (the "Company") is an independent company engaged in the acquisition, development and exploration of petroleum and natural gas and the delivery of well intervention services, including well plugging and abandonment. The Company's principal areas of operation are in the US Gulf of Mexico. The Company is incorporated in Canada under the British Columbia Corporations Act and its shares are publically traded on the TSX Venture Exchange under the symbol "COQ".

The address and principal place of business of the Company is 16285 Park Ten Place, Suite 120, Houston, Texas, USA, 77804.

## 2. Basis of preparation

### (a) Statement of compliance and basis of presentation

The condensed interim consolidated financial statements for Rooster Energy, Ltd. as at June 30, 2016, and for the three and six months ended June 30, 2016, should be read in conjunction with the audited consolidated financial statements as at December 31, 2015, and for the year ended December 31, 2015. The condensed interim consolidated financial statements are prepared using the same accounting policies and methods of computation as disclosed in the annual consolidated financial statements.

These condensed interim consolidated financial statements have been prepared in accordance with International Accounting Standard 34 Interim Financial Reporting ("IAS 34"), as issued by the International Accounting Standards Board ("IASB"). Accordingly, certain financial information and disclosures normally included in annual financial statements prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the IASB have been omitted or condensed.

These condensed interim financial statements are presented in US dollars, except as otherwise noted, which is the functional currency of the Company and its subsidiaries.

These condensed interim consolidated financial statements were approved and authorized for issue by the Board of Directors on August 25, 2016.

### (b) Going concern

For the six months ended June 30, 2016, the Company incurred a loss of \$4,454,107 (June 30, 2015: \$4,445,955), has a working capital deficit of \$21,963,279 (December 31, 2015: \$17,546,018) and an accumulated deficit of \$51,142,812 (December 31, 2015: \$46,688,705). These events and conditions indicate a material uncertainty that may cast significant doubt about the Company's ability to continue as a going concern.

The ability of the Company to continue as a going concern is dependent upon its ability to generate future profitable operations and obtain financing and renegotiate financing to meet its obligations and repay its liabilities in the normal course of business when they become due, and to generate sufficient funds to

continue its capital activities. The Company has taken steps to address the Company's liquidity situation during 2016, which are further discussed in note 4(c).

The accompanying financial statements have been prepared on a going concern basis that assumes the Company will be able to realize its assets and discharge its liabilities and commitments in the normal course of operations. Accordingly, the financial statements do not include adjustments that would be necessary to the presentation and carrying amounts of assets and liabilities in the Company, were it not able to continue operations and such adjustments and reclassifications could be material.

#### **(c) Basis of consolidation**

These condensed interim consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries, Rooster Energy, L.L.C.; Rooster Petroleum LLC; Rooster Oil & Gas LLC; Probe Resources US Ltd.; Cochon Properties, LLC and Morrison Well Services, LLC.

#### **(d) Use of estimates and judgements**

The preparation of condensed interim financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, earnings and expenses. Actual results may differ from these estimates.

Estimates and judgments are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Accounting estimates will, by definition, seldom equal the actual results. Revisions to accounting estimates are recognized in the period in which the estimates are revised and in any future years affected.

There have been no significant changes in the Company's critical accounting estimates and assumptions applied during the six months ended June 30, 2016, relative to those disclosed in the Company's most recent annual audited consolidated financial statements as at and for the year ended December 31, 2015.

### **3. Significant accounting policies**

There were no new or amending accounting standards or interpretations adopted during the six months ended June 30, 2016, that had a material effect on the Company's condensed interim consolidated financial statements, or any changes to future accounting pronouncements during the six months ended June 30, 2016 that would have a material effect on the Company's financial statements in addition to these disclosed in the Company's audited consolidated financial statements as at December 31, 2015.

### **4. Financial instruments and risk management**

#### **(a) Fair value of financial instruments**

The fair values of restricted cash, accounts receivable, accounts payable and accrued liabilities, current



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As at June 30, 2016 and for the three and six months ended June 30, 2016  
(all tabular amounts are in US Dollars, unless otherwise stated)

portion of loans payable and current portion of due to related parties, approximate their carrying values due to the short-term maturity of those instruments. The fair value of the note receivable approximates its carrying value. The Company's long-term loans payable bear interest at rates approximating interest for equivalent debt instruments and, accordingly, loans payable and related long term portion of accrued interest payable and long term portion of due to related parties approximate fair values.

**(b) Credit risk**

Credit risk is the risk of financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its contractual obligations. The maximum exposure to credit risk at June 30, 2016, and December 31, 2015, is as follows:

	June 30, 2016	December 31, 2015
Cash	\$ 552,143	\$ 1,434,645
Restricted cash	3,951,342	3,585,011
Accounts receivable	14,042,957	17,424,561
Commodity contracts	-	8,173,165
Decommissioning contracts receivable	50,882,544	44,208,511
Note Receivable	4,299,534	4,234,712
Asset retirement deposits	1,507,458	1,873,789
	<b>\$ 75,235,978</b>	<b>\$ 80,934,394</b>

Cash

Cash is comprised of bank balances. The Company manages the credit exposure related to cash by selecting financial institutions with high credit ratings and monitors short-term deposits to ensure an adequate rate of return. Given these credit ratings, management does not expect any counterparty to fail to meet its obligations.

Restricted cash

As at June 30, 2016, the Company had \$3,951,342 (December 31, 2015: \$3,585,011) in restricted cash, representing cash collateral for performance bonds for specific well and facility abandonments that must be completed within the next 12 months (note 9).

Accounts receivable

All of the Company's operations are conducted in the United States. The Company's exposure to credit risk is influenced mainly by the individual characteristics of each customer and/or partner. Significant changes in industry conditions and risks that negatively impact customers' or partners' ability to generate cash flow will increase the risk of not collecting receivables. Management believes the risk is mitigated by the size and reputation of the companies to which they extend credit.

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 As at June 30, 2016 and for the three and six months ended June 30, 2016  
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During the six month period ended June 30, 2016, the Company sold a substantial portion of its petroleum and natural gas to two (June 30, 2015: three) customers. Sales to those customers aggregated approximately \$4.9 million or approximately 85% of total revenue (June 30, 2015: \$4.3 million and 71%). At June 30, 2016, amounts due from those customers included in accounts receivable totalled approximately \$1.0 million (June 30, 2015: \$0.75 million).

During the six month period ending June 30, 2016, the Company earned a substantial portion of Well Services revenue from one customer (June 30, 2015: one). Sales to this customer aggregated approximately \$1.1 million or approximately 36% of total revenue (June 30, 2015: \$3.2 million and 84%). At June 30, 2016, amounts due from this customer included in accounts receivable totalled approximately \$0.6 million (June 30, 2015: \$0.9 million).

The Company historically has not experienced any collection issues related to these customers. The credit rating of the customers is closely monitored by the Company's management to ensure no collection issues arise.

When determining whether past due accounts are collectible, the Company factors in the past credit history of the counterparties. The Company considers all amounts greater than 90 days as past due.

Management has evaluated receivables for collectability and as such, has recorded an allowance for doubtful accounts totalling \$726,376 (December 31, 2015: \$662,559). Bad debt expense for the three month period ended June 30, 2016 totalled \$10,942 (June 30, 2015: \$nil), and for the six month period ended June 30, 2016 totalled \$63,817 (June 30, 2015: \$17,174). Bad debt expense for 2016 and 2015 primarily relates to an allowance for non-payment of operating and abandonment costs by joint operations partners. The Company has reviewed its remaining past due accounts receivable balances and expects the accounts to be fully collectible.

As at June 30, 2016, and December 31, 2015, the Company's accounts receivable was comprised of the following:

	<b>June 30, 2016</b>	<b>December 31, 2015</b>
Petroleum and natural gas revenue	\$ 1,379,841	\$ 1,745,917
Well services revenue	1,489,116	4,748,458
Decommissioning contracts revenues	8,555,037	7,888,812
Joint operation receivables	3,345,338	3,703,933
	14,769,333	18,087,120
Allowance for doubtful accounts	(726,376)	(662,559)
Total accounts receivable	\$ 14,042,957	\$ 17,424,561

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(all tabular amounts are in US Dollars, unless otherwise stated)

As of June 30, 2016, and December 31, 2015, the Company's accounts receivables were aged as follows:

	June 30, 2016	December 31, 2015
Current (0 - 30 days)	\$ 12,659,703	\$ 13,745,727
31 to 60 days	460,572	1,799,216
61 to 90 days	88,751	1,347,033
Past due (greater than 90 days)	1,560,307	1,195,144
Allowance for doubtful accounts	(726,376)	(662,559)
<b>Total accounts receivable</b>	<b>\$ 14,042,957</b>	<b>\$ 17,424,561</b>

*Commodity contracts*

The Company is subject to credit risk associated with its commodity contracts should the counterparties default. The Company manages the credit risk exposure related to commodity contracts by selecting investment grade counterparties and by not entering into contracts for trading or speculative purposes.

Decommissioning contracts receivable (note 9)

The Company has entered into plugging and abandonment contracts in which the Company assumed asset retirement obligations (the "ARO") in exchange for fixed fees from counterparties which will be paid to the Company as the plugging and abandonment work is completed. As a result, the Company is exposed to credit risk by the counterparties to pay future aggregate payments. Decommissioning activities that trigger these reimbursement payments will occur over several years. Failure of the counterparties to make any payment when due, or a material downgrade in their credit ratings, could have a material adverse effect on the Company and its financial condition. Management believes the counterparties are credit worthy and therefore there is virtual certainty that the reimbursement will occur. Under IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, reimbursements are recognized up to the amount of the asset retirement obligation. The contract receivable is assessed for impairment at each reporting period.

Asset retirement deposits

Asset retirement deposits (note 9) consist of amounts deposited to secure a performance bond related to asset retirement obligations. The exposure to credit risk has been assessed by management to be minimal.

**(c) Liquidity risk**

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they are due. The Company's approach to managing liquidity is to ensure it will have sufficient liquidity to meet its liabilities when due.

The Company's trade accounts payable are normally due within 30 - 60 days from receipt of invoice.

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The Company's accounts payable and accrued liabilities as of June 30, 2016, and December 31, 2015, were aged as follows:

	<b>June 30, 2016</b>	<b>December 31, 2015</b>
Current (0 - 30 days)	\$ 11,529,897	\$ 15,232,530
31 to 60 days	684,980	1,373,803
61 to 90 days	43,660	-
Greater than 90 days	30,116	16,285
<b>Total accounts payable and accrued liabilities</b>	<b>\$ 12,288,653</b>	<b>\$ 16,622,618</b>

The repayment terms relating to the Company's due to related parties are disclosed in note 16.

The repayment terms relating to the Company's loans payable are disclosed in note 8.

The Company is also subject to future commitments and contingencies as disclosed in note 15. Refer to note 4(e) for the Company's management of capital.

At June 30, 2016, and December 31, 2015, the Company had a working capital deficiency of \$21,963,279 and \$17,546,018, respectively. During 2016, management has taken a number of steps to address the Company's liquidity situation. On March 14, 2016, the Company entered into the First Amendment, which waived all of the financial and performance covenants of the Amended and Restated Note Purchase Agreement (the "A&R NPA") and scheduled loan amortization for the quarters ending March 31, 2016, and June 30, 2016. Refer to note 8(i) for further discussion of the First Amendment.

Subsequent to June 30, 2016, the Company entered into the Second Amendment, as further discussed in note 18, which extended the waiver for the financial and performance covenants of the A&R NPA for the quarters ending September 30, 2016, and December 31, 2016.

If the Company is unable to restructure the financial and performance covenants of the A&R NPA or extend the term of the Second Amendment on or before the end of the fiscal quarter ending December 31, 2016, then the Company may be in default of one or more of the covenants and the balance of Senior Secured Notes will become current; in that event the holders of the Senior Secured Notes may exercise their remedies against the Company. No assurances can be given that the Company will be able to reach agreement with the holders of the Senior Secured Notes on the consequences of any possible default at that time and in that event the Company may not be able to continue as a going concern.

**(d) Market risk**

Market risk is the risk that changes in market prices, such as commodity prices, interest rates and foreign exchange rates will affect the Company's net income or the value of financial instruments. The objective of the Company is to manage and mitigate market risk exposures within acceptable limits, while maximizing

returns.

#### *Foreign currency risk*

Prices received by the Company for petroleum and natural gas are generally denominated in US dollars. The Company has nominal working capital and other financial instruments amounts denominated in currencies other than US dollars other than the subordinated secured credit facility which is denominated in Canadian dollars ("CAD") (note 8(iii)), and had no forward exchange rate contracts in place as at or during the six month period ended June 30, 2016, or the year ended December 31, 2015. Shares of the Company are traded in Canadian dollars.

A 5% change in the US-CAD exchange rates would change the Company's net loss for the six months ended June 30, 2016, by approximately \$62,300, based on the outstanding balance of the subordinated secured credit facility at June 30, 2016.

#### *Interest rate risk*

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates. The Company is exposed to interest rate risk to the extent that changes in market interest rates impact floating rate borrowings. At June 30, 2016, the Senior Secured Notes (note 8(i)) bear interest at a floating interest rate and therefore are subject to interest rate risk. The Company had no interest rate swaps or financial contracts in place as at or during the six months ended June 30, 2016 and 2015.

For the six months ended June 30, 2016, a 100 basis points change to the effective interest rate would change net loss by approximately \$187,800.

#### *Commodity price risk*

The nature of the Company's operations results in exposure to fluctuations in commodity prices. Commodity prices for petroleum and natural gas are impacted by global economic events that dictate the levels of supply and demand. Natural gas prices are also influenced by US demand and the corresponding North American supply and, recently, by liquefied natural gas and shale gas prices. Petroleum prices are generally determined in global markets. Management continuously monitors commodity prices and may consider instruments to manage exposure to these risks when it deems appropriate.

The Company may hedge some petroleum and natural gas sales through the use of various financial derivative forward sales contracts and physical sales contracts when deemed appropriate. The Company does not apply hedge accounting for these contracts.

For derivative commodity contracts, the Company records unrealized gains and losses on these contracts on the balance sheet as assets or liabilities with changes in fair value recorded in the statement of loss. Realized gains and losses are determined based on the differential between the daily settlement price and the monthly fixed price and are recognized in loss as the contracts are settled.

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As a condition to the First Amendment, on March 16, 2016, the Company fixed the price on derivative commodity contracts with settlement dates in April, May, and June 2016, and terminated all derivative commodity contracts with settlement dates on or after July 1, 2016. The Company received a lump sum termination payment of \$5,605,313 and then applied \$4.0 million of the proceeds to reduce the principal balance of the Senior Secured Notes. As at June 30, 2016, there were no commodity contracts outstanding. Refer to note 18 for the hedges entered into subsequent to June 30, 2016.

The Company's risk management activities resulted in total realized gains of \$1,157,923 for the three months ended June 30, 2016 (June 30, 2015: \$1,751,890). Due to the realization of gains, unrealized losses on commodity contracts of \$1,157,923 were recognized during the three months ended June 30, 2016 (June 30, 2015: \$4,139,789). The realized gains for the six months ended June 30, 2016 totalled \$8,956,369, (June 30, 2015: \$4,113,450). Due mainly to the realization of gains, unrealized losses on commodity contracts \$8,173,165 were recognized during the six months ended June 30, 2016 (June 30, 2015: \$4,139,789). As at June 30, 2016, the fair value of all derivative commodity contracts was \$nil (December 31, 2015: \$8,173,165).

**(e) Capital management**

The Company's capital management policy is to maintain an adequate capital base that optimizes the Company's ability to grow, to maintain investor and creditor confidence and to provide a platform to create value for its shareholders. The Company maintains a flexible capital structure to maximize its ability to pursue petroleum and natural gas exploration opportunities and sustain the future development of the business. The Company monitors the level of risk associated for each capital project to balance the proportion of debt and equity in its capital structure. The Company's management is responsible for managing the Company's capital and does so through quarterly meetings and regular reviews of financial information. The Company's Board of Directors are responsible for overseeing this process. The Company considers working capital to form its capital structure and strives to maintain positive working capital. When working capital deficits arise in the normal course of operations, the Company responds by minimizing capital and operating expenses and, when prudent, through selective asset divestitures until adequate working capital is restored.

The Company's working capital deficiency is as follows:

	<b>June 30, 2016</b>	<b>December 31, 2015</b>
Current assets	\$ 61,721,663	\$ 59,246,609
Current liabilities	(83,684,942)	(76,792,626)
<b>Working capital deficiency</b>	<b>\$ (21,963,279)</b>	<b>\$ (17,546,018)</b>

The Company is required to meet certain financial covenants relating to its loans payable as further discussed in note 8. There was no changes to the Company's approach to capital management during the six months ended June 30, 2016 other than under the First Amendment, the Company funds its business

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operations in accordance with a lender-approved budget.

## 5. Exploration and evaluation assets and expenses

	June 30, 2016	December 31, 2015
Balance, beginning of period	\$ 242,172	\$ 207,172
Exploration and evaluation expenditures	-	35,000
Balance, end of period	\$ 242,172	\$ 242,172

Exploration and evaluation assets include undeveloped properties, seismic and other assets that management has not fully evaluated for technical feasibility and commercial viability. Capital expenditures represent the Company's share of costs incurred on exploration and evaluation assets during the period. Transfers to property and equipment, if any, represent successful drilling and related costs for which technical feasibility and commercial viability are determined to exist.

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## 6. Property and equipment

Property and equipment consists of the following:

	Petroleum and natural gas interests	Machinery & Equipment	Office furnishings and improvements	Total
<b>Cost</b>				
Balance at December 31, 2014	\$ 164,955,296	\$ 33,310,138	\$ 757,881	\$ 199,023,315
Additions	14,765,604	103,229	13,749	14,882,581
Asset acquisition	-	-	-	-
Grant of ORRI as part of debt refinancing	(2,383,355)	-	-	(2,383,355)
Asset retirement obligations	2,092,071	-	-	2,092,071
Balance at December 31, 2015	\$ 179,429,615	\$ 33,413,367	\$ 771,630	\$ 213,614,612
Additions	833,899	-	4,433	838,332
Asset retirement obligations	983,168	-	-	983,168
Balance at June 30, 2016	\$ 181,246,682	\$ 33,413,367	\$ 776,062	\$ 215,436,111

	Petroleum and natural gas interests	Machinery & Equipment	Office furnishings and improvements	Total
<b>Depletion, depreciation and impairment</b>				
Balance at December 31, 2014	\$ 69,691,984	\$ 21,937,630	\$ 610,110	\$ 92,239,724
Depletion and depreciation	2,977,801	3,197,484	69,130	6,244,415
Impairment and asset retirement expense	31,250,050	-	-	31,250,050
Balance at December 31, 2015	\$ 103,919,835	\$ 25,135,114	\$ 679,240	\$ 129,734,189
Depletion and depreciation	592,383	1,286,684	31,190	1,910,256
Dispositions	-	-	-	-
Balance at June 30, 2016	\$ 104,512,218	\$ 26,421,798	\$ 710,430	\$ 131,644,446
<b>Net book value</b>				
December 31, 2015	\$ 75,509,780	\$ 8,278,253	\$ 92,389	\$ 83,880,422
June 30, 2016	\$ 76,734,464	\$ 6,991,569	\$ 65,632	\$ 83,791,665

The calculation of depletion and depreciation for the six month period ended June 30, 2016, included estimated future development costs of \$40,664,001 (December 31, 2015: \$41,497,900) associated with the development of the Company's proved and probable reserves.

The Company has not capitalized any interest or general and administrative expenses during the six months ended June 30, 2016, or the year ended December 31, 2015.

At each quarter end, the Company considers whether or not there are any indications of asset impairment or impairment recovery. If there are such indications, the Company tests its CGUs for impairment /



recovery. The recoverable amount of each cash-generating unit is estimated based on fair value less costs of disposal. The estimate of fair value less costs of disposal is determined using forecasted discounted proved plus probable before tax cash flows, using escalating forward pricing and net of future development costs, as obtained from an independently prepared reserve report at each year end, with the quarter ends being updated internally by management. In determining the appropriate discount rate, the Company considers acquisition metrics of recent transactions completed on assets similar to those in the specific CGU and an approximate cost of capital for potential acquirers of the Company or the Company's CGUs.

At June 30, 2016, management determined that there were no indications of impairment. Therefore no impairment testing was performed.

## **7. Note Receivable**

On March 12, 2014, the Company received a promissory note from a significant shareholder and director in the principal amount of \$4 million, with interest at the rate of 3.25% per annum. Accrued interest receivable on the note totalled \$299,534 at June 30, 2016 (\$234,712 at December 31, 2015). The maturity on this promissory note is tied to the maturity of a note payable to this shareholder. The note will mature on June 25, 2019 (see Note 8(iv)).

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## 8. Loans payable and warrants

Loans payable at June 30, 2016, and December 31, 2015, consisted of the following:

	June 30, 2016	December 31, 2015
Senior secured notes amended and restated June 25, 2015 for \$60,000,000 (the "Senior Secured Notes") (i)	\$ 52,897,979	\$ 56,512,783
Subordinated notes payable dated April 26, 2012 for \$6,463,000 ("Subordinated Note #1") (ii)	5,466,038	5,355,969
Subordinated secured credit facility dated October 11, 2013 for CAD \$4,000,000 ("Subordinated Note #2") (iii)	2,155,403	1,930,499
Subordinated secured credit facility dated March 7, 2014 for \$7,150,000 ("Subordinated Note #3")(iv)	5,782,719	5,631,781
Promissory notes dated June 25, 2015 for \$4,881,364, with interest at 3.25% per annum, with monthly payments of \$456,519, and matured on May 25, 2016 (v)	-	2,204,707
Promissory note dated May 16, 2016 for \$578,250, with interest at 3.50% per annum, with monthly payments of \$58,775, and mature on March 16, 2017 (v)	521,217	-
Promissory note dated June 23, 2016 for \$1,601,713, with interest at 3.50% per annum, with monthly payments of \$148,240, and mature on May 25, 2017 (v)	1,601,713	-
	\$ 68,425,069	\$ 71,635,738
Less: Short-term portion (1)	(13,266,930)	(17,204,707)
Long-term portion	\$ 55,158,139	\$ 54,431,031

(1) The short-term portion has been adjusted to reflect additional cash flows from the decommissioning contract entered into in June 2016 (note 9), which will be used to settle a portion of the Senior Secured Notes.

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The loans payable at June 30, 2016, are scheduled to mature as follows:

Next 12 months	\$ 13,266,930
Next 13 - 24 months	\$ 46,646,105
Next 25 - 36 months	<u>16,687,800 (i)</u>
Total	<u>\$ 76,600,835</u>

(i) assumes a future USD/CAD exchange rate of \$0.7687 for the CAD denominated credit facility

(i) Senior Secured Notes

All Senior Secured Notes terms remain unchanged from the disclosure in the Company's audited consolidated financial statements as at December 31, 2015 except as follows:

On March 14, 2016, the Company entered into the First Amendment and Waiver to the A&R NPA (the "First Amendment"), effective December 31, 2015. Pursuant to the First Amendment, all of the financial and performance covenants of the A&R NPA and scheduled loan amortization were waived for the fiscal quarters ending March 31, 2016, and June 30, 2016. In exchange for the waiver, the Company paid a waiver fee in the amount of \$493,333 on March 14, 2016. The First Amendment was accounted for as a modification of the original financial liability for accounting purposes with no gain or loss recorded in the income statement. The waiver fee was netted against the principal amount of the Senior Secured Notes and is being accreted over the term of the Senior Secured Notes up to the principal amount on maturity using the effective interest method. For the six months ended June 30, 2016, (\$480,143) was recorded as accretion on Senior Secured Notes.

Under the First Amendment, the cash interest rate on Senior Secured Notes remains unchanged. In addition to the cash interest, from and after March 14, 2016 until June 30, 2016, an 8.0% interest is paid in kind ("PIK Interest") (see also note 18). All PIK Interest is capitalized and compounded by increasing the outstanding principal amount of the Senior Secured Notes. The accrued PIK interest was \$1,358,672 for the six months ended June 30, 2016.

Principal payments will start on the 10th business day following the end of each calendar month occurring on or after July 31, 2016. The principal payments will be based upon excess cash generated after lender-approved operating and capital expenditures. At June 30, 2016, the Company expects to make principal payments of \$11,144,000 within the next twelve months. Accordingly, this has been included in the current portion of loans payable in the Company's consolidated balance sheet.

Under the First Amendment, the Company's general and administrative costs are not allowed to exceed stipulated limits for the fiscal quarter ending March 31, 2016, and each fiscal quarter thereafter. The Company shall comply with the terms of a budget approved by the Senior Secured Noteholders (the "Approved Budget").

At June 30, 2016, the Company was not in compliance with the terms of the Approved Budget in accordance with the First Amendment. On July 14, 2016, the Company obtained a waiver for the

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Approved Budget default and financial and performance covenants set forth in the A&R NPA, as further discussed in note 18. The waiver was agreed by the Senior Secured Noteholders prior to June 30, 2016. As such, the current portion of the Senior Secured Notes only includes the principal amounts the Company expects to pay in the next 12 months.

Subsequent to June 30, 2016, the Company entered into the Second Amendment, as further discussed in note 18, which extended the waiver for the financial and performance covenants of the A&R NPA for the third and fourth fiscal quarters of 2016.

Refer to note 12 for the interest and accretion expenses for the three and six months ended June 30, 2016 and 2015.

(ii) Subordinated Note #1

The subordinated note payable ("Subordinated Note #1") totalling \$6,463,000 is due to a significant shareholder of the Company. As at September 1, 2015, this shareholder ceased to be a significant shareholder of the Company.

As a result of the A&R NPA (note 8(i)), the Subordinated Note #1 maturity date was extended to June 25, 2019 and the interest rate remained at 15.5% per annum. The modified Subordinated Note #1 was accounted for as an extinguishment for accounting purposes and resulted in a gain on modification of \$980,882. The Subordinated Note #1 was re-measured at its fair value on the date of modification with an effective interest rate of 23%. The fair value of \$5,253,583 was estimated using discounted cash flows, and the difference between the fair value and the carrying amount, prior to the modification, was allocated as a gain on modification.

The restructured Subordinated Note #1 is being accreted over the term up to the principal amount on maturity, using the effective interest rate method, with \$110,070 recorded as accretion for the six month period ended June 30, 2016.

Refer to note 12 for the interest and accretion expenses for the three and six months ended June 30, 2016 and 2015.

(iii) Subordinated Note #2

On October 11, 2013, the Company entered into a subordinated secured credit facility ("Subordinated Note #2") with significant shareholders and/or directors of the Company that provides for borrowing up to CAD \$8.0 million to be used for general corporate purposes. As at September 1, 2015, one of the noteholders, who funded 60% of the credit facility, ceased to be a significant shareholder of the Company. The initial advance was CAD \$4.0 million (less a 2% original issue discount and administrative fees of \$10,000) resulting in net proceeds of \$3,234,466. In addition, the Company also paid a consent fee of \$450,000. The credit facility is fully subordinated to the Senior Secured Notes (note 8(i)). The credit facility is secured only by the oil and gas properties and proceeds therefrom owned by Rooster Oil and Gas, LLC. No further

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amounts have been drawn on the credit facility as at or subsequent to June 30, 2016.

As a result of the A&R NPA (note 8(i)), the Subordinated Note #2 maturity date was extended to June 25, 2019 and the interest rate remained at 9% per annum. The modified Subordinated Note #2 was accounted for as an extinguishment for accounting purposes and resulted in a gain on modification of \$787,137. The Subordinated Note #2 was re-measured at its fair value on the date of modification with an effective interest rate of 23%. The fair value of \$2,041,003 was estimated using discounted cash flows, and the difference between the fair value and the carrying amount, prior to the modification, was allocated as a gain on modification. The restructured Subordinated Note #2 is being accreted over the term up to the principal amount on maturity, using the effective interest rate method, with \$99,330 recorded as accretion for the six month period ended June 30, 2016.

Refer to note 16 for the accrued interest payable balances at June 30, 2016, and December 31, 2015. Refer to note 12 for the interest and accretion expenses for the three and six months ended June 30, 2016 and 2015.

(iv) Subordinated Note #3

Effective March 7, 2014, the Company entered into an additional second lien credit facility ("Subordinated Note #3") with a related party who is a significant shareholder and director of the Company, for borrowing of up to \$10 million. The initial advance was \$4.4 million, before an original issue discount of 10%, for a funded amount equal to \$4 million. During the year ended December 31, 2014, the Company drew an additional \$2.75 million on the second lien credit facility, before an original issue discount of 10%, for a funded amount of \$2.5 million. In addition, the Company paid a consent fee of \$214,500. The second lien credit facility is fully subordinated to the Senior Secured Notes (note 8(i)). The credit facility is secured only by the oil and gas properties and proceeds therefrom owned by Rooster Oil and Gas, LLC.

As a result of the A&R NPA (note 8(i)), the Subordinated Note #3 maturity date was extended to June 25, 2019 and the interest rate remained at 9% per annum. The modified Subordinated Note #3 was accounted for as an extinguishment for accounting purposes and resulted in a gain on modification of \$1,410,161. The Subordinated Note #3 was re-measured at its fair value on the date of modification with an effective interest rate of 23%. The fair value of \$5,491,383 was estimated using discounted cash flows, and the difference between the fair value and the carrying amount, prior to the modification, was allocated as a gain on modification. The restructured Subordinated Note #3 is being accreted over the term up to the principal amount on maturity, using the effective interest rate method, with \$150,938 recorded as accretion for the period ended June 30, 2016.

Refer to note 16 for the accrued interest payable balances at June 30, 2016 and December 31, 2015. Refer to note 12 for the interest and accretion expenses for the three and six months ended June 30, 2016 and 2015.

(v) Promissory note

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In June 2015, the Company executed three promissory notes with a bank to finance a portion of its insurance premiums in the aggregate amount of \$4,881,364. All three promissory notes bore interest at 3.25% per annum, required monthly payments totalling \$456,519 and matured in May 2016. The promissory notes were secured by the unearned premiums of the insurance policies being financed. These notes were paid in full in May 2016.

In May and June 2016, the Company executed two new promissory notes with a bank to finance a portion of its insurance premiums in the aggregate amount of \$578,250 and \$1,601,713, respectively. The promissory note executed in May requires monthly payments of \$58,775 and matures in March 2017. The promissory note executed in June requires monthly payments of \$148,240 and matures in May 2017. Both these notes bear interest at 3.50% per annum and are secured by the unearned premiums of the insurance policies being financed.

Refer to note 12 for the interest expenses for the three and six months ended June 30, 2016 and 2015.

(vi) Warrants

On October 22, 2012 the Company issued warrants to holders of certain senior secured notes of the same date. These warrants were exercisable for up to 9 million common shares of the Company at an exercise price of US\$1.00 per share until October 22, 2017. Effective November 17, 2014, when the related senior secured notes were paid in full, the warrant holders received an additional 4,429,813 warrants for a total of 13,429,813 warrants outstanding. The exercise price was adjusted for all warrants to US\$0.67 per warrant. No warrants have been exercised as at June 30, 2016.

Due to the warrants' conversion terms, the warrants meet the definition of a derivative instrument and are classified as a liability for accounting purposes. The warrants are measured at fair value at each balance sheet date using a Level 2 fair value hierarchy. The fair value of the warrants on the grant date was determined using the Black-Scholes model with the following assumptions:

	June 30, 2016	December 31, 2015
Risk-free interest rate	0.45%	1.08%
Expected life (years)	1.31	1.81
Expected volatility	50.0%	50.0%
Expected annual dividend yield	0.00%	0.00%
Stock price	US \$0.02	US \$0.02
Exercise price	US \$0.67	US \$0.67
Fair value per warrant	US \$0.00	US \$0.00

## 9. Asset retirement obligations and deposits

Asset retirement obligations were determined by management and were based on the Company's net ownership interest in petroleum and natural gas assets, the estimated future costs to reclaim and abandon the wells and facilities, and the estimated timing of when the costs will be incurred.

The following table summarizes changes in the asset retirement obligations for the six month period ended June 30, 2016, and the year ended December 31, 2015:

	June 30, 2016	December 31, 2015
Asset retirement obligations, beginning of period	\$ 58,627,501	\$ 89,444,429
Liabilities incurred	13,888,943	-
Liabilities settled	(8,663,073)	(23,877,719)
Revisions to estimates	1,806,024	(3,501,951)
Gain on asset retirement obligations	(1,746,401)	(4,815,928)
Accretion (unwinding of discount)	502,487	1,378,670
Asset retirement obligations, end of period	\$ 64,415,480	\$ 58,627,501
Less: Short-term portion	(44,257,748)	(30,768,877)
Long-term portion	\$ 20,157,732	\$ 27,858,624

The Company has the ability to utilize its own well services business unit to abandon a portion of its asset retirement obligations. The estimated inflated undiscounted cash flows required to settle the provisions at June 30, 2016, are approximately \$67.8 million (December 31, 2015: \$62.5 million), which has been discounted using risk-free rates ranging from 1.5% to 2.55% (December 31, 2015: 1.50% to 2.55%). These obligations are to be settled based on the economic lives of the underlying assets, which currently extend up to 26 years into the future and will be funded from general corporate resources as well as from the decommissioning contracts receivable (see below) at the time of abandonment.

In June 2016, the Company entered into a new decommissioning contract in the Gulf of Mexico. The revenues under the contract will be approximately \$21.8 million when the work is completed. The increase of asset retirement obligations of \$13.9 million in 2016 reflects the estimated costs for the decommissioning work under this contract. The decommissioning contracts receivable has been increased by the same amount in accordance with IAS 37. Refer to the following page under decommissioning contracts receivable for further discussion of IAS 37.

At June 30, 2016 and December 31, 2015, the Company had a \$5,458,800 cash deposit held as security by the surety of the supplemental bonds that are required by the Bureau of Ocean Energy Management (BOEM) on the ARO for properties owned by Rooster Petroleum, LLC and Probe Resources US Ltd. prior to April 30, 2012. These funds are restricted for use in meeting Probe Resources US Ltd.'s asset retirement obligations specific to those properties and will be released upon satisfactory completion of plugging and abandonment operations for specific wells and/or structures as the work is completed. The Company is

required to abandon certain fields covered by this bond within the next 12 months. As a result, \$3,951,342 of the deposit has been classified as short-term and included in restricted cash as at June 30, 2016 (December 31, 2015: \$3,585,011) (note 4(b)).

#### **Decommissioning contracts receivable**

The Company entered into plugging and abandonment contracts (the “decommissioning contracts”) in which the Company assumed asset retirement obligations in exchange for fixed fees from counterparties aggregating approximately \$151.0 million which will be paid to the Company as the plugging and abandonment work is completed. Of the total asset retirement obligations of the Company at June 30, 2016, the estimated inflated undiscounted cash flows required to settle the decommissioning contracts are approximately \$53.8 million (December 31, 2015: \$48.7 million), which has been discounted using a risk-free rate of 1.50% (2015: 1.50%), with a corresponding reimbursement recorded as decommissioning contracts receivable at the time the contracts were entered into. Under IAS 37 Provisions, Contingent Liabilities and Contingent Assets, reimbursements are recognized up to the amount of the asset retirement obligations. Decommissioning activities that trigger the reimbursement payments will occur over several years and will be funded from the decommissioning contracts receivable. Any payments that exceed actual costs of abandonment are recorded as decommissioning contracts revenue on the statement of loss.

As part of the terms of the decommissioning contracts, the counterparties made advance payments to the Company which were not based on decommissioning activities being performed. These amounts have been recorded as deferred revenues and are being amortized as decommissioning contracts revenues as abandonment work is performed. The Company received \$2.0 million advance payment from a counterparty during the six month period ended June, 30, 2016 (June 30, 2015: \$nil). Of the total deferred revenues received by the Company at June 30, 2016, \$9,441,921 remained to be amortized.

Of the total fixed fees of the decommissioning contracts of \$151.0 million, approximately \$73.5 million has been paid to the Company and an additional \$1.5 million has been invoiced through June 30, 2016. The remaining amount to be collected of \$76.0 million, less the estimated future abandonment costs to be incurred of \$52.5 million, is approximately \$23.5 million, which, when combined with the recognition of deferred revenues, represents the approximate future decommissioning contracts revenue to be earned from the decommissioning contracts subsequent to June 30, 2016. The Company expects to receive \$59.6 million of the \$76.0 million remaining over the next 12 months.



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## 10. Prepaid expenses

Prepaid expenses consist of the following:

	June 30, 2015	December 31, 2015
Prepaid insurance	\$ 1,988,848	\$ 2,763,727
Prepaid bonds	245,483	303,347
Prepaid inventory	404,772	394,262
Prepaid other	405,749	192,793
<b>Total prepaid expenses</b>	<b>\$ 3,044,852</b>	<b>\$ 3,654,129</b>

## 11. Share capital

Authorized

The authorized share capital of the Company consists of an unlimited number of common shares, proportionate voting shares, and preferred shares.

Common and proportionate voting shares issued

The following table summarizes the changes in common shares and proportionate voting shares outstanding:

<b>Shares issued and outstanding</b>	<b>No. of Shares</b>	<b>Stated Value</b>
<b>Common shares</b>		
Outstanding, December 31, 2015 and June 30, 2016	263,110,502	\$ 92,949,630
<b>Proportionate voting shares</b>		
Outstanding, December 31, 2015 and June 30, 2016	60,989	\$ 29,162,552
<b>Total share capital stated value</b>		
December 31, 2015 and June 30, 2016		\$ 122,112,182

The common shares may at any time, at the option of the holder, be converted into proportionate voting shares of the Company on the basis of 1,000 common shares for one proportionate voting share for no consideration. Each issued and outstanding proportionate voting share may at any time, at the option of the holder, be converted into 1,000 common shares of the Company for no consideration. The common shares and proportionate voting shares have the same rights and are equal in all respects as if they were shares of one class only. For purposes of voting and dividend rights, the proportionate voting shares are multiplied by 1,000, equal to the conversion ratio.

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Stock Options

The Company has a stock option plan in compliance with the TSX's policy for granting stock options. Under the plan, the number of shares reserved for issuance of options may not exceed 64,819,900 common shares. Fully dilutive shares means the computed common shares assuming all proportionate voting shares were converted to common shares. At June 30, 2016, there remained available for future issuance 47,366,064 stock options. The exercise price of each option shall not be less than the market price of the Company's stock at the date of grant. The vesting term of options under the plan is determined by the Company's Board of Directors. The maximum exercise period of options granted under the Plan is ten years following the grant date.

A summary of the changes in the outstanding options awarded under the Company's stock option plan is as follows:

	June 30, 2016		December 31, 2015	
	Number of options	Weighted avg exercise price	Number of options	Weighted avg exercise price
Balance, beginning of period	18,239,190	CAD \$0.37	9,193,404	CAD \$0.66
Options granted	-		10,545,963	CAD \$0.14
Options forfeited	(785,354)	CAD \$0.61	(1,500,177)	CAD \$0.54
Balance, end of period	17,453,836	CAD \$0.36	18,239,190	CAD \$0.37

The following table summarizes the outstanding and exercisable options as at June 30, 2016:

Grant Date	Number Outstanding	Remaining Contractual Life	Exercise Price	Expiry Date	Number Exercisable
Jun. 05, 2012	3,275,114	6.00 years	US \$0.50	Jun. 05, 2022	3,275,114
Sep. 11, 2013	3,632,759	7.25 years	US \$0.82	Sep. 11, 2023	2,421,839
US \$41,775.00	300,000	8.00 years	US \$0.61	US \$45,428.00	200,000
US \$42,130.00	10,245,963	8.75 years	US \$0.14	US \$45,783.00	10,245,963
	17,453,836				16,142,916

During the six months ended June 30, 2016, \$78,597 was recorded as stock-based compensation (June 30, 2015: \$1,121,029), with a corresponding increase in contributed surplus.

Notes to the Condensed Interim Consolidated Financial Statements  
As at June 30, 2016 and for the three and six months ended June 30, 2016  
(all tabular amounts are in US Dollars, unless otherwise stated)

## 12. Finance expense

Finance expense consists of the following:

	Notes	Three Months Ended June 30,		Six Months Ended June 30,	
		2016	2015	2016	2015
Interest expense on Senior Secured Notes	8(i)	\$ 1,859,731	\$ 1,525,281	\$ 3,789,509	\$ 3,004,031
Interest expense on subordinated Note #1	8(ii)	253,224	249,755	506,448	496,766
Interest expense on subordinated Note #2	8(iii)	69,590	74,449	134,946	145,414
Interest expense on subordinated Note #3	8(iv)	249,564	249,564	499,129	496,386
Interest expense on promissory notes	8(v)	5,195	10,474	19,787	20,333
Accretion of discount on Senior Secured Notes	8(i)	(710,896)	841,984	(480,143)	1,682,708
PIK interest on Senior Secured Notes	8(i)	1,144,450	-	1,358,672	-
Accretion of discount on subordinated Note #1	8(ii)	56,590	35,429	110,070	66,574
Accretion of discount on subordinated Note #2	8(iii)	52,614	73,707	99,330	125,300
Accretion of discount on subordinated Note #3	8(iv)	77,603	64,984	150,938	124,019
Unrealized foreign exchange					
loss (gain) on subordinated Note #2	8(iii)	(9,385)	43,000	165,570	(253,518)
Gain on modification of debts	8	-	(376,780)	-	(376,780)
Accretion of asset retirement obligations	9	247,409	321,975	502,487	649,516
Other		4,462	32,099	3,322	32,099
Total finance expense		3,300,152	3,145,921	6,860,064	6,212,848
Interest income		(32,411)	(31,852)	(64,822)	(64,466)
Total finance expense, net		\$ 3,267,741	\$ 3,114,069	\$ 6,795,243	\$ 6,148,382

Notes to the Condensed Interim Consolidated Financial Statements  
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### 13. Loss per share

The following table summarizes the weighted average number of common shares used in calculating loss per share:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Weighted average common shares outstanding, diluted	324,099,502	324,099,502	324,099,502	324,099,502
Effect of stock options and warrants	-	-	-	-
Weighted average common shares outstanding, diluted	324,099,502	324,099,502	324,099,502	324,099,502

Basic loss per share figures for the three and six months ended June 30, 2016 and 2015 have been calculated using the weighted average number of common shares outstanding plus the weighted average number of proportionate voting shares outstanding at the conversion ratio of 1,000 common shares for each outstanding proportionate voting share. All outstanding options and warrants were excluded from the calculation of diluted loss per share for the three and six months ended June 30, 2016 and 2015, as they were anti-dilutive.

### 14. Supplemental cash flow information

Changes in non-cash working capital, excluding non-cash changes for the increase in restricted cash, comprise the following:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Sources (uses) of cash:				
Accounts receivable	\$ (9,161,948)	\$ (3,957,998)	\$ 3,317,788	\$ (2,941,523)
Prepaid expenses	(782,710)	(3,854,650)	609,277	(2,842,164)
Accounts payable and accrued liabilities	6,006,623	1,015,724	(4,333,964)	289,474
Current portion of due to related parties	593,143	514,331	33,652	1,488,708
Changes in non-cash working capital	\$ (3,344,892)	\$ (6,282,593)	\$ (373,248)	\$ (4,005,505)
Related to operating activities	\$ (3,800,555)	\$ (5,657,143)	\$ 291,111	\$ (3,830,080)
Related to investing activities	455,663	(625,450)	(664,358)	(175,425)
	\$ (3,344,892)	\$ (6,282,593)	\$ (373,248)	\$ (4,005,505)

The Company made interest payments in the amounts of \$1,864,926 (2015: \$1,567,854) and \$3,809,296 (2015: \$ 3,056,463) during the three and six months ended June 30, 2016, respectively.

The Company paid no income taxes during the three and six months ended June 30, 2016 and 2015.

## **15. Commitments and contingencies**

There were no material changes to the commitments and contingencies during the six months ended June 30, 2016, as compared to those disclosed in the Company's annual audited consolidated financial statements for the year ended December 31, 2015.

The Company currently has an aggregate of approximately \$47 million posted in surety bonds in favor of Bureau of Ocean Energy Management (BOEM) and third parties (predecessors in lease title) to secure the performance of lease obligations including satisfaction of asset retirement obligations. BOEM recently ordered the Company to post additional supplemental bonds of approximately \$5 million covering certain specific leases. The Company is of the opinion that the leases at issue are sufficiently bonded. The Company has been in negotiations with BOEM in an attempt to reduce the amounts and/or waive the requirement, however we have been unsuccessful to date and there can be no assurance that we will be able to secure additional bonds. In that event, BOEM may take additional actions against the Company that could negatively impact oil and gas operations and the ability of the Company to continue as a going concern.

## **16. Other related party transactions**

The Company has transactions with related parties, including field services, rental of equipment, the reimbursement of operating expenses, and the payment of certain administrative services at terms determined by management.

Notes to the Condensed Interim Consolidated Financial Statements  
As at June 30, 2016 and for the three and six months ended June 30, 2016  
(all tabular amounts are in US Dollars, unless otherwise stated)

Balances due to (from) related parties at June 30, 2016, and December 31, 2015, are as follows:

<b>Balances due to (from) related parties</b>	<b>Notes</b>	<b>June 30, 2016</b>	<b>December 31, 2015</b>
Due to related parties <sup>(1)</sup>		\$ 11,854,698	\$ 11,821,046
Subordinated note payable #2 <sup>(2)</sup>	8(iii)	862,161	772,200
Accrued interest payable on subordinated note #2 <sup>(2)</sup>	8(iii)	302,501	232,524
Subordinated note payable #3	8(iv)	5,782,719	5,631,781
Accrued interest payable on subordinated note #3	8(iv)	2,225,195	1,726,066
Note and accrued interest receivable	7	(4,299,534)	(4,234,712)

(1) Represents amounts payable to related parties in the ordinary course of business for operating expenses and capital expenditures. Payments are made as cash flows allow within the constraints of the Note Purchase Agreement (note 8(i)). The amounts are unsecured, non-interest bearing, and have no fixed terms of repayment.

(2) Sixty percent of the subordinated note #2 was due to a significant shareholder of the Company. As at September 1, 2015, this shareholder ceased to be a significant shareholder of the Company. At December 31, 2015, accrued interest payable on this former significant shareholder was \$348,785. The remaining forty percent of the subordinated #2 is held by another significant shareholder of the Company, for which accrued interest payable at June 30, 2016 and December 31, 2015 was \$302,501 and \$232,524, respectively.

Purchases from related parties were considered by management to be in the normal course of business and transacted on terms equivalent to those that would have prevailed in an arm's length transaction. Purchases from related parties during the three and six months ended June 30, 2016 totalled \$615,049 (2015: \$828,731) and \$2,407,375 (2015: \$2,477,165), respectively.

## 17. Segment information

The Company is a petroleum and natural gas and exploration company with an integrated down-hole and subsea plugging and abandonment service business. As at June 30, 2016 and 2015, the Company has two reportable segments: petroleum and natural gas, and well services. The Company's operations are located in the shallow waters off the southern coast of Louisiana and Texas. Management monitors the operating results of each segment separately for the purpose of making decisions about resource allocation and performance assessment. The Corporate segment does not represent an operating segment and is included for informational purposes only. Corporate segment expenses consist of public company costs as well as salaries, stock-based compensation and office and administrative costs relating to corporate employees.

Notes to the Condensed Interim Consolidated Financial Statements  
As at June 30, 2016 and for the three and six months ended June 30, 2016  
(all tabular amounts are in US Dollars, unless otherwise stated)

Segmented income (loss) and capital expenditures for the three months ended June 30, 2016

Three months ended June 30, 2016	Petroleum and natural gas	Well Services	Corporate allocations	Intercompany eliminations	Consolidated
<b>Revenue</b>					
Petroleum and natural gas	\$ 3,053,592	\$ -	\$ -	\$ -	\$ 3,053,592
Production handling	252,296	-	-	-	252,296
Well services	-	3,863,900	-	(2,017,828)	1,846,072
Decommissioning contracts	-	3,056,523	-	-	3,056,523
Revenue before the following	3,305,888	6,920,423	-	(2,017,828)	8,208,483
Realized gain on commodity contracts	1,157,923	-	-	-	1,157,923
Unrealized loss on commodity contracts	(1,157,923)	-	-	-	(1,157,923)
<b>Total revenue</b>	<b>3,305,888</b>	<b>6,920,423</b>	<b>-</b>	<b>(2,017,828)</b>	<b>8,208,483</b>
<b>Expenses</b>					
Lease operating	4,038,289	-	-	(36,757)	4,001,532
Cost of well services	-	2,537,446	-	(1,350,871)	1,186,575
Depreciation and depletion	305,541	545,240	15,066	-	865,846
Repairs and maintenance	-	136,973	-	-	136,973
General and administrative	266,050	1,406,414	524,258	-	2,196,721
Bad debt	10,942	-	-	-	10,942
Stock-based compensation	9,059	-	42,907	-	51,966
<b>Total expenses</b>	<b>4,629,882</b>	<b>4,626,072</b>	<b>582,231</b>	<b>(1,387,628)</b>	<b>8,450,556</b>
<b>Operating income (loss)</b>	<b>(1,323,993)</b>	<b>2,294,350</b>	<b>(582,231)</b>	<b>(630,200)</b>	<b>(242,073)</b>
Gain on asset retirement obligations	-	1,807,484	-	-	1,807,484
Finance expense	(3,265,407)	(2,334)	-	-	(3,267,741)
<b>Income (loss) before income taxes</b>	<b>\$ (4,589,400)</b>	<b>\$ 4,099,501</b>	<b>\$ (582,231)</b>	<b>\$ (630,200)</b>	<b>\$ (1,702,330)</b>
<b>Capital Expenditures</b>	<b>\$ 697,124</b>	<b>\$ -</b>	<b>\$ 4,433</b>	<b>\$ -</b>	<b>\$ 701,557</b>

Notes to the Condensed Interim Consolidated Financial Statements  
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Segmented income (loss) and capital expenditures for the six months ended June 30, 2016

Six months ended June 30, 2016	Petroleum and natural gas	Well Services	Corporate allocations	Intercompany eliminations	Consolidated
<b>Revenue</b>					
Petroleum and natural gas	\$ 5,787,156	\$ -	\$ -	\$ -	\$ 5,787,156
Production handling	278,676	-	-	-	278,676
Well services	-	5,486,435	-	(2,263,184)	3,223,251
Decommissioning contracts	-	4,685,915	-	-	4,685,915
Revenue before the following	6,065,832	10,172,351	-	(2,263,184)	13,974,999
Realized gain on commodity contracts	8,956,369	-	-	-	8,956,369
Unrealized loss on commodity contracts	(8,173,165)	-	-	-	(8,173,165)
<b>Total revenue</b>	<b>6,849,035</b>	<b>10,172,351</b>	<b>-</b>	<b>(2,263,184)</b>	<b>14,758,202</b>
<b>Expenses</b>					
Lease operating	7,480,428	-	-	(49,037)	7,431,391
Cost of well services	-	3,858,716	-	(1,607,593)	2,251,123
Depreciation and depletion	592,383	1,286,684	31,190	-	1,910,256
Repairs and maintenance	-	190,268	-	-	190,268
General and administrative	630,358	3,078,225	885,432	-	4,594,015
Bad debt	63,817	-	-	-	63,817
Stock-based compensation	(7,217)	-	85,814	-	78,597
<b>Total expenses</b>	<b>8,759,769</b>	<b>8,413,893</b>	<b>1,002,436</b>	<b>(1,656,630)</b>	<b>16,519,468</b>
<b>Operating income (loss)</b>	<b>(1,910,734)</b>	<b>1,758,457</b>	<b>(1,002,436)</b>	<b>(606,554)</b>	<b>(1,761,266)</b>
Gain on asset retirement obligations	-	1,746,401	-	-	1,746,401
Finance expense	(6,791,431)	(3,812)	-	-	(6,795,243)
<b>Income (loss) before income taxes</b>	<b>\$ (8,702,164)</b>	<b>\$ 3,501,046</b>	<b>\$ (1,002,436)</b>	<b>\$ (606,554)</b>	<b>\$ (6,810,107)</b>
<b>Capital Expenditures</b>	<b>\$ 833,899</b>	<b>\$ -</b>	<b>\$ 4,433</b>	<b>\$ -</b>	<b>\$ 838,332</b>

Segmented assets and liabilities as at June 30, 2016

As at June 30, 2016	Petroleum and natural gas	Well Services	Corporate allocations	Intercompany eliminations	Consolidated
Current assets	\$ 78,952,187	\$ 13,275,872	\$ -	\$ (30,506,396)	\$ 61,721,663
Decommissioning contracts receivable	-	10,752,175	-	-	10,752,175
Exploration and evaluation assets	242,172	-	-	-	242,172
Property and equipment	76,900,419	6,991,569	65,632	(165,955)	83,791,665
Note receivable	-	-	7,416,800	(3,117,267)	4,299,534
Asset retirement deposits	1,507,458	-	-	-	1,507,458
<b>Total assets</b>	<b>176,631,411</b>	<b>20,267,441</b>	<b>7,482,432</b>	<b>(33,789,618)</b>	<b>170,591,667</b>
Current liabilities	91,639,841	12,555,524	-	(20,510,422)	83,684,942
<b>Total liabilities</b>	<b>181,169,745</b>	<b>22,555,524</b>	<b>-</b>	<b>(30,510,422)</b>	<b>173,214,846</b>



Notes to the Condensed Interim Consolidated Financial Statements  
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Segmented income (loss) and capital expenditures for the three months ended June 30, 2015

Three months ended June 30, 2015	Petroleum and natural gas	Well Services	Corporate allocations	Intercompany eliminations	Consolidated
<b>Revenue</b>					
Petroleum and natural gas	\$ 6,650,150	\$ -	\$ -	\$ -	\$ 6,650,150
Production handling	45,755	-	-	-	45,755
Well services	-	6,909,597	-	(3,269,007)	3,640,590
Decommissioning contracts	-	1,627,089	-	1,050,147	2,677,236
Revenue before the following	6,695,905	8,536,686	-	(2,218,860)	13,013,731
Realized gain (loss) on commodity contracts	1,751,890	-	-	-	1,751,890
Unrealized gain (loss) on commodity contracts	(4,139,789)	-	-	-	(4,139,789)
<b>Total revenue</b>	<b>4,308,006</b>	<b>8,536,686</b>	<b>-</b>	<b>(2,218,860)</b>	<b>10,625,832</b>
<b>Expenses</b>					
Lease operating	5,384,030	-	-	-	5,384,030
Cost of well services	-	4,186,989	-	(1,891,959)	2,295,030
Depreciation and depletion	1,231,592	710,109	16,380	-	1,958,081
Repairs and maintenance	-	352,813	-	-	352,813
General and administrative	436,992	1,697,579	1,128,989	-	3,263,560
Stock-based compensation	252,487	-	682,479	-	934,966
Asset retirement expense	555,641	-	-	-	555,641
<b>Total expenses</b>	<b>7,860,742</b>	<b>6,947,490</b>	<b>1,827,848</b>	<b>(1,891,959)</b>	<b>14,744,121</b>
Operating income (loss)	(3,552,736)	1,589,196	(1,827,848)	(326,901)	(4,118,289)
Gain on asset retirement obligations	-	2,308,657	-	-	2,308,657
Finance expense	(3,114,069)	-	-	-	(3,114,069)
<b>Income (loss) before income taxes</b>	<b>\$ (6,666,805)</b>	<b>\$ 3,897,853</b>	<b>\$ (1,827,848)</b>	<b>\$ (326,901)</b>	<b>\$ (4,923,701)</b>
<b>Capital Expenditures</b>	<b>\$ 2,039,783</b>	<b>\$ 99,094</b>	<b>\$ 10,221</b>	<b>\$ -</b>	<b>\$ 2,149,098</b>

Notes to the Condensed Interim Consolidated Financial Statements  
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Segmented income (loss) and capital expenditures for the six months ended June 30, 2015

Six months ended June 30, 2015	Petroleum and natural gas	Well Services	Corporate allocations	Intercompany eliminations	Consolidated
<b>Revenue</b>					
Petroleum and natural gas	\$ 12,560,303	\$ -	\$ -	\$ -	\$ 12,560,303
Production handling	87,811	-	-	-	87,811
Well services	-	12,378,955	-	(5,067,138)	7,311,817
Decommissioning contracts	-	4,336,636	-	1,526,989	5,863,625
Revenue before the following	12,648,114	16,715,591	-	(3,540,149)	25,823,556
Realized gain on commodity contracts	4,113,450	-	-	-	4,113,450
Unrealized loss on commodity contracts	(4,837,654)	-	-	-	(4,837,654)
<b>Total revenue</b>	<b>11,923,910</b>	<b>16,715,591</b>	<b>-</b>	<b>(3,540,149)</b>	<b>25,099,352</b>
<b>Expenses</b>					
Lease operating	11,595,654	-	-	-	11,595,654
Cost of well services	-	8,318,605	-	(3,076,736)	5,241,869
Depreciation and depletion	1,975,113	1,714,100	36,555	-	3,725,768
Repairs and maintenance	-	528,029	-	-	528,029
General and administrative	1,268,161	3,194,752	1,855,588	-	6,318,501
Bad debt	17,174	-	-	-	17,174
Stock-based compensation	279,531	-	841,498	-	1,121,029
<b>Total expenses</b>	<b>15,135,633</b>	<b>13,755,486</b>	<b>2,733,641</b>	<b>(3,076,736)</b>	<b>28,548,024</b>
<b>Operating income (loss)</b>	<b>(3,211,723)</b>	<b>2,960,105</b>	<b>(2,733,641)</b>	<b>(463,413)</b>	<b>(3,448,672)</b>
Gain on asset retirement obligations	3,359,099	-	-	-	3,359,099
Unrealized gain (loss) on financial derivative	1,000	-	-	-	1,000
Finance expense	(6,148,382)	-	-	-	(6,148,382)
<b>Income (loss) before income taxes</b>	<b>\$ (6,000,006)</b>	<b>\$ 2,960,105</b>	<b>\$ (2,733,641)</b>	<b>\$ (463,413)</b>	<b>\$ (6,236,955)</b>
<b>Capital Expenditures</b>	<b>\$ 3,665,914</b>	<b>\$ 99,094</b>	<b>\$ 28,254</b>	<b>\$ -</b>	<b>\$ 3,793,262</b>

## 18. Subsequent Events

### *Second Amendment and Waiver to the A&R NPA*

On July 14, 2016, the Company entered into the Second Amendment and Waiver to the A&R NPA (the "Second Amendment"), effective June 30, 2016. The Second Amendment has waived (i) all defaults under the Approved Budget as stipulated in the First Amendment, (ii) the minimum EBITDAX and leverage ratio covenants of the A&R NPA for the fiscal quarter ending September 30, 2016, and (iii) the asset coverage ratio covenant for the fiscal quarter ending December 31, 2016. The scheduled loan amortization has been replaced with a requirement for principal repayments summing to no less than \$7,532,000 for the six months ending December 31, 2016. The Senior Secured Notes will continue to bear interest at a rate equal to Libor + 11.5% per annum (minimum of 13.0%) with interest payments due monthly. The Senior Secured Notes will also continue to bear additional PIK interest until December 31, 2016 at a rate of 8.0%. A payable-in-kind waiver fee in the amount of \$431,433 will be capitalized and compounded by automatically increasing the principal amount of the Senior Secured Notes effective June 30, 2016.

As a condition to the Second Amendment, on July 14, 2016, the Company entered into fixed price commodity swap agreements for 2,815,896 MMBTUs of natural gas production over a two-year period from August, 2016, through August, 2018; the fixed price is \$3.0125 per MMBTU, and the monthly floating prices will be based on the NYMEX final settlements.

If the Company is unable to restructure the financial and performance covenants of the A&R NPA or extend the term of the Second Amendment on or before the end of the fiscal quarter ending December 31, 2016, then the Company may be in default of one or more of the covenants and in that event the holders of the Senior Secured Notes may exercise their remedies against the Company. No assurances can be given that the Company will be able to reach agreement with the holders of the Senior Secured Notes on the consequences of any possible default at that time and in that event the Company may not be able to continue as a going concern.