ROOSTER ENERGY LTD.

Consolidated Financial Statements

Years Ended December 31, 2013 and 2012

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Independent Auditors' Report

To the Shareholders
Rooster Energy Ltd.

We have audited the accompanying consolidated financial statements of Rooster Energy Ltd. and its subsidiaries, which comprise the consolidated balance sheets as at December 31, 2013 and December 31, 2012, and the consolidated statements of loss and comprehensive loss, statements of changes in shareholders' equity and statements of cash flows for the years ended December 31, 2013 and December 31, 2012, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

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We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Rooster Energy Ltd. and its subsidiaries as at December 31, 2013 and December 31, 2012, and their financial performance and their cash flows for the years ended December 31, 2013 and December 31, 2012 in accordance with International Financial Reporting Standards.

Collins Barrow Calgary LLP

CHARTERED ACCOUNTANTS

Calgary, Canada
April 25, 2014

Rooster Energy Ltd.
Consolidated Balance Sheets
(amounts in US dollars)

	Notes	December 31, 2013	2012
Assets			
Current assets			
Cash and cash equivalents	18	$ 964,040	$ 7,367,848
Restricted cash	4(c)	5,620,635	-
Accounts receivable	4(c)	4,071,505	8,262,786
Prepaid expenses and deposits	11	1,173,832	986,900
Assets held for sale	8	-	352,782
Total current assets		11,830,012	16,970,316
Exploration and evaluation assets	6	186,152	-
Property and equipment	7	95,208,469	72,135,945
Asset retirement deposits	10	300,000	3,762,000
Deferred income taxes	16(b)	-	3,709,000
Total assets		$ 107,524,633	$ 96,577,261
Liabilities and shareholders' equity			
Current liabilities			
Accounts payable and accrued liabilities	4(d)	19,839,404	9,105,700
Loans payable	9	27,469,712	-
Accrued interest payable	9	2,016,897	525,000
Liabilities associated with assets held for sale	8	-	193,527
Due to related parties	20	3,970,348	4,736,472
Asset retirement obligations	10	5,392,167	-
Total current liabilities		58,688,528	14,560,699
Long-term liabilities			
Loans payable	9	3,223,626	25,933,426
Financing warrants	9	1,092,000	1,067,000
Accrued interest payable	9	84,618	262,735
Deferred income taxes	16(b)	4,575,000	8,997,000
Asset retirement obligations	10	13,203,660	18,071,240
Total liabilities		80,867,432	68,892,100
Shareholders' equity			
Share capital	12	40,911,182	40,909,139
Contributed surplus	13	1,511,146	507,298
Deficit		(15,765,127)	(13,731,276)
Total shareholders' equity		26,657,201	27,685,161
Total liabilities and shareholders' equity		$ 107,524,633	$ 96,577,261

Subsequent events (note 22)
Commitments (notes 4(e), 19, 20, and 21)
Contingencies (note 21)

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

Approved by the Board:
(signed)"Paul Crilly " ***(signed)"Richard S. Buski "***

Rooster Energy Ltd.

Consolidated Statements of Loss and Comprehensive Loss

(amounts in US dollars)

	Notes	Year Ended December 31, 2013	2012
Revenue			
Petroleum and natural gas sales		$ 41,048,401	$ 34,221,262
Expenses			
Lease operating		12,349,985	11,909,649
Depreciation and depletion	7	8,708,209	8,417,986
Exploration and evaluation	7	2,483,731	3,734,313
General and administrative	14	4,987,092	3,356,020
Bad debt	4(c)	2,885,059	302,337
Stock-based compensation	13	1,005,891	507,298
Impairment expense (recovery), net	7	4,802,756	(82,080)
Asset retirement expense	7	586,305	452,351
Plug and abandonment	10	-	2,362,072
Transaction costs	5	-	812,451
Total expenses		37,809,028	31,772,397
Operating income		3,239,373	2,448,865
Unrealized gain (loss) on financing warrants	9	(25,000)	1,317,000
Finance expenses	15	(5,961,224)	(2,165,534)
Income before income taxes		(2,746,851)	1,600,331
Deferred income tax expense (recovery)			
Change in tax status		-	5,461,000
Subsequent to change in tax status		(713,000)	(173,000)
Total deferred income tax expense (recovery)	16(a)	(713,000)	5,288,000
Loss and comprehensive loss		$ (2,033,851)	$ (3,687,669)
Loss per share	17		
Basic		$ (0.02)	$ (0.04)
Diluted		$ (0.02)	$ (0.04)

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

Rooster Energy Ltd.

Consolidated Statements of Changes in Shareholders' Equity

(amounts in US dollars)

	Notes	Number of Common Shares [1]	Common Share Capital Stated Value	Number of Proportionate Voting Shares	Proportionate Voting Shares Stated Value	Contributed Surplus	Deficit	Total Shareholders' Equity
Balance, December 31, 2011		1,000	$ 12,250,000	-	$ -	$ -	$ (10,043,607)	$ 2,206,393
Reverse acquisition transactions	5, 12	40,393,823	(503,413)	65,071	29,162,552	-	-	28,659,139
Stock-based compensation	13	-	-	-	-	507,298	-	507,298
Loss for the year		-	-	-	-	-	(3,687,669)	(3,687,669)
Balance, December 31, 2012		40,394,823	$ 11,746,587	65,071	$ 29,162,552	$ 507,298	$ (13,731,276)	$ 27,685,161
Issued on cashless exercise of stock options	13	2,500	2,043	-	-	(2,043)	-	-
Stock-based compensation	13	-	-	-	-	1,005,891	-	1,005,891
Income for the year		-	-	-	-	-	(2,033,851)	(2,033,851)
Balance, December 31, 2013		40,397,323	$ 11,748,630	65,071	$ 29,162,552	$ 1,511,146	$ (15,765,127)	$ 26,657,201

[1] The authorized and issued share capital of the Company consists of 40,397,323 common shares and 65,071 Proportionate Voting Shares (1,000 to 1 conversion rights), for issued share capital on a fully diluted basis equivalent to 105,468,323 common shares.

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

Rooster Energy Ltd.
Consolidated Statements of Cash Flows
(amounts in US dollars)

	Notes	Year Ended December 31, 2013	2012
Cash and cash equivalents provided by (used in):			
Cash flows from operating activities			
Net loss		$ (2,033,851)	$ (3,687,669)
Adjustments for:			
Depreciation and depletion	7	8,708,209	8,417,986
Dry hole costs included in exploration and evaluation expenses	7	2,483,731	4,031,388
Impairment and asset retirement expense, net	7	5,389,061	370,271
Plug and abandonment	10	-	2,362,072
Stock-based compensation	13	1,005,891	507,298
Unrealized (gain) loss on financing warrants	9	25,000	(1,317,000)
Unrealized foreign exchange gain on related party credit facility	15	(92,909)	-
Accretion of note payable discount	15	1,618,355	255,016
Asset retirement obligation accretion	10	471,813	493,640
Deferred income tax expense (recovery)	16(a)	(713,000)	5,288,000
Funds generated from operations		16,862,300	16,721,002
Cash abandonment costs	10	(941,614)	(4,232,235)
Changes in non-cash working capital	18	7,245,243	(16,137,983)
Net cash flows provided by (used in) operating activities		23,165,929	(3,649,216)
Cash flows from investing activities			
Capital expenditures for exploration and evaluation assets	6	(186,152)	-
Capital expenditures for petroleum and natural gas properties	7	(36,150,178)	(32,170,437)
Capital expenditures for office furnishings and improvements	7	(25,228)	(38,268)
Exploration and evaluation expenditures related to dry holes	7	(2,483,731)	(4,031,388)
Proceeds relating to assets and liabilities held for sale	8	159,255	2,489,181
Cash acquired on business combination	5(a)	-	33,763
Changes in non-cash working capital	18	4,568,051	1,728,987
Net cash flows used in investing activities		(34,117,983)	(31,988,162)
Cash flows from financing activities			
Proceeds from issuance of share capital, net of issuance costs	12	-	20,122,951
Proceeds from loans payable	9	3,234,466	21,599,410
Repayment of loans payable	9	-	(415,797)
Increase in accrued interest payable	9	1,313,780	262,735
Changes in non-cash working capital	18	-	-
Net cash flows provided by financing activities		4,548,246	41,569,299
Net (decrease) increase in cash and cash equivalents		(6,403,808)	5,931,921
Cash and cash equivalents, beginning of year		7,367,848	1,435,927
Cash and cash equivalents, end of year	18	$ 964,040	$ 7,367,848

Supplemental cash flow information (note 18).

The accompanying notes are an integral part of these 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. 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 is traded on the TSX Venture Exchange under the symbol "COQ".

On April 30, 2012, the Company (formerly Probe Resources Ltd. ("Probe")) completed a series of transactions under which it acquired all of the membership interest of Rooster Energy, L.L.C., a privately held Louisiana limited liability company ("Rooster"). The acquisition of Rooster was accounted for as a reverse acquisition of the Company by Rooster, with Rooster being the continuing entity for accounting purposes, as the acquisition resulted in the issuance of voting shares such that control of the Company passed to Rooster Resources, LLC, the sole member of Rooster. In conjunction with the transactions, the combined entity was continued under the name Rooster Energy Ltd. See also note 5(a).

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

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (“IFRS”) as issued by the International Accounting Standards Board (“IASB”) and interpretations of the International Financial Reporting Interpretations Committee (“IFRIC”), and present the Company's financial position and financial performance as at and for the years ended December 31, 2013 and 2012.

These financial statements were authorized for issue by the Board of Directors on April 25, 2014.

(b) Changes in accounting policies

<u>Consolidation</u>

The Company adopted IFRS 10 *Consolidated Financial Statements* effective January 1, 2013. *IFRS 10* requires consolidation of an investee only if the investor possesses power over the investee, has exposure or rights to variable returns from its involvement with the investee and has the ability to use its power over the investee to affect its returns. The Company re-assessed its control conclusions and determined that there were no changes in the consolidation status of any of its subsidiaries.

<u>Joint Arrangements</u>

The Company adopted IFRS 11 *Joint Arrangements* effective January 1, 2013. *IFRS 11* establishes a principle-based approach to the accounting for joint arrangements by focusing on the rights and obligations of the arrangement and limits the application of proportionate consolidation to arrangements where sufficient rights and obligations are passed to the participants. The Company re-assessed its classification of its joint arrangements and determined that there were no changes in the accounting policies applied to its joint arrangements.

Fair Value Measurement

The Company adopted IFRS 13 *Fair Value Measurement* effective January 1, 2013. *IFRS 13* improves consistency and reduces complexity by providing a precise definition of fair value and a single source of fair value measurement and disclosure requirements. This standard defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Adoption of this standard had no significant impact on the Company's financial statement disclosures.

Disclosure

The Company adopted IFRS 12 *Disclosure of Interest in Other Entities* effective January 1, 2013. *IFRS 12* sets out the annual disclosure requirements for the Company's interests in subsidiaries, joint arrangements and associates. The adoption of *IFRS 12* had no impact on the amounts recognized in the Company's annual consolidated financial statements or note disclosures.

The Company adopted amendments to IFRS 7 *Financial Instruments: Disclosures* effective January 1, 2013. *IFRS 7* has been amended to require annual disclosure of information on rights to offset financial instruments and related arrangements. These amendments had no impact on the Company's financial statement disclosures.

(c) Basis of measurement

These financial statements have been prepared on the historical cost basis, except for certain financial assets and financial liabilities which are measured at fair value.

(d) Functional and presentation currency

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

(e) Basis of consolidation

These 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 and Probe Resources US Ltd.

(f) Use of estimates and judgments

The preparation of 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, income 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 recorded in the period in which the estimates are revised and in any future years affected.

The following discussion sets forth management's most critical estimates and assumptions in determining the value of assets, liabilities and equity:

Depletion and valuation of property and equipment

The amounts recorded for depletion and depreciation of components of property and equipment and the valuation of property and equipment are based on estimates. These estimates include proved and probable reserves, future production rates, future petroleum and natural gas prices, future development costs, remaining lives and periods of future benefits of the related assets and other relevant assumptions.

The Company's reserve estimates are evaluated annually pursuant to the parameters and guidelines stipulated under *National Instrument 51-101 - Standards of Disclosure for Oil and Gas Activities*. Changes in reserve estimates impact the financial results of the Company as reserves and estimated future development costs are used to calculate depletion and are also used in impairment calculations.

The discount rate used to calculate the net present value of cash flows for impairment testing is based on estimates of market conditions, recent asset sales and an approximate Company and industry peer group weighted average cost of capital. Changes in the general economic environment could result in significant changes to this estimate.

The determination of cash-generating units requires judgment in defining the smallest identifiable group of assets that generate cash inflows that are largely independent of the cash inflows from other assets or groups of assets. Cash-generating units are determined by similar geological structure, shared infrastructure, geographical proximity, commodity type, similar exposure to market risks and materiality.

Asset retirement obligations

The value of asset retirement obligations depends on estimates of current risk-free interest rates, future restoration and reclamation expenditures and the timing of those expenditures. Actual costs and cash outflows can differ from estimates because of changes in laws and regulations, public expectations, market conditions, discovery and analysis of site conditions and changes in technology.

Valuation of accounts receivable

The valuation of accounts receivable is based on management's best estimate of collectability and provision for doubtful accounts.

Stock options and warrants

The expected amounts recorded relating to the fair value of stock options and warrants granted are based on estimates of the expected future volatility of the Company's share price (based on historical and/or peer group volatility), market price of the Company's shares and risk-free interest rate at the grant date (based on government bonds), expected lives of the instruments (based on historical experience and general option holder behaviour), expected forfeiture rates (based on historical experience and general option holder behaviour), expected dividends and other relevant assumptions.

Income taxes

The amounts recorded for deferred income taxes are based on estimates as to the timing of the reversal of temporary differences and tax rates currently substantively enacted. They are also based on estimates of the probability of the Company utilizing certain tax pools and assets which, in turn, is dependent on estimates of proved and probable reserves, production rates, future petroleum and natural gas prices and changes in legislation, tax rates and interpretations by taxation authorities. The availability of tax pools is subject to audit and interpretation by taxation authorities.

Joint arrangements

The Company is party to various jointly controlled assets, processing, operating and other agreements in conjunction with its crude oil and natural gas processing activities. The revenues and expenses allocated between partners are governed by the terms of these agreements and are subject to interpretation and audit by the applicable parties.

(g) Determination of fair values

The fair values of assets and liabilities recognized in business combinations and used in impairment assessments are based on market values. The market value of property and equipment and exploration and evaluation assets are based on the estimated amount for which property and equipment could be exchanged on the acquisition date between a willing buyer and a willing seller in an arm’s length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently and without compulsion.

The market value of petroleum and natural gas interests (included in property and equipment) are estimated with reference to the discounted cash flows expected to be derived from petroleum and natural gas production based on external and Company reserve reports. The risk-adjusted discount rate used is specific to the assets with reference to general market conditions, as outlined in note 7.

The determination of fair values related to financial instruments are disclosed in note 4(b). The assumptions used in the determination of fair values related to stock-based compensation and warrants are disclosed in note 13 and 9, respectively.

3. Significant accounting policies

The accounting policies set out below have been applied consistently by the Company to the periods presented in these financial statements.

Certain comparative amounts have been reclassified to conform with the current year's presentation.

(a) Principles of consolidation

These consolidated financial statements include the accounts of the Company and its subsidiaries. All significant intercompany transactions and balances have been eliminated. Changes in the parent's ownership in subsidiaries, when control is maintained, are accounted for as equity transactions.

(b) Subsidiaries

A subsidiary is an entity controlled by the Company. Control exists when the Company has the power, directly or indirectly, to govern the financial and operational policies of an entity to obtain benefits from its activities. In assessing control, potential voting rights that are presently exercisable are taken into account.

The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases.

(c) Business combinations

Business combinations are accounted for using the acquisition method. The acquired identifiable net assets are measured at their fair value at the date of acquisition. Any excess of the purchase price over the fair value of the net assets acquired is recognized as goodwill. Following initial recognition, goodwill is recognized at cost less any accumulated impairment losses. Any deficiency of the purchase price below the fair value of the net assets acquired is recorded as a gain in net earnings. Associated transaction costs are expensed when incurred.

(d) Joint arrangements

Many of the Company's petroleum and natural gas activities involve jointly controlled assets and are conducted under joint operating agreements. The financial statements include the Company's proportionate share of these jointly controlled assets, liabilities, revenue, and related costs.

(e) Foreign currency

Foreign currency transactions are initially recorded using the functional currency rates prevailing at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies are re-translated at the functional currency rates of exchange prevailing at the end of each reporting period. These differences are recognized in the statement of income (loss). Non-monetary items measured at historical cost in a foreign currency are translated using the exchange rates at the dates of the initial transactions and are not re-translated. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined. The majority of the Company's transactions occur in U.S. dollars and, therefore, the Company has minimal foreign exchange gains or losses.

(f) Cash and cash equivalents

The Company considers all highly liquid investment instruments purchased with a maturity of three months or less to be cash equivalents.

(g) Financial instruments

(i) *Classification and measurement*

Financial instruments are measured at fair value on initial recognition of the instrument. Measurement in subsequent periods depends on whether the financial instrument has been classified as “fair value through income (loss)”, “loans and receivables”, “available-for-sale”, “held-to-maturity”, or “financial liabilities measured at amortized cost”.

Financial assets and financial liabilities at “fair value through income (loss)” are either classified as “held for trading” or “designated at fair value through income (loss)” and are measured at fair value with changes in fair value recognized in the income statement. The Company has designated cash and cash equivalents and escrowed restricted cash, and any notional commodity or interest rate contracts as “held for trading” and "designated at fair value through income (loss),” respectively.

Financial assets and financial liabilities classified as “loans and receivables”, “held-to-maturity”, or “financial liabilities measured at amortized cost” are measured at amortized cost using the effective interest method of amortization. “Loans and receivables” are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. “Held-to-maturity” financial assets are non-derivative investments that an entity has the positive intention and ability to hold to maturity. “Financial liabilities measured at amortized cost” are those financial liabilities that are not designated as “fair value through income (loss)” and that are not derivatives. The Company has designated restricted cash and accounts receivable as “loans and receivables” and accounts payable and accrued liabilities, loans payable, accrued interest payable and due to related parties as “financial liabilities measured at amortized cost”. The Company has no assets classified as "held-to-maturity".

Financial assets classified as “available-for-sale” are measured at fair value, with changes in fair value recognized in other comprehensive income. “Available-for-sale” financial assets are non-derivatives that are either designated in this category or not classified in any of the other categories. The Company currently has no assets classified as “available-for-sale”.

(ii) *Derivative financial instruments*

The Company may enter into certain financial derivative contracts in order to manage the exposure to market risks from fluctuations in commodity prices. The Company's policy is not to utilize derivative financial instruments for speculative purposes. Any outstanding financial derivative contracts are classified as “fair value through income (loss)”.

Embedded derivatives are separated from the host contract and accounted for separately if the economic characteristics and risks of the host contract and the embedded derivative are not closely related, a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative, and the combined instrument is not measured at fair value through the statement of income. Changes in the fair value of separable embedded derivatives are recorded in the statement of income (loss).

The warrants associated with the Company's senior secured notes included in loans payable have been identified as derivative liabilities. Derivative financial liabilities are recorded upon recognition and subsequently at each balance sheet date at fair value, with changes in fair value being recognized in earnings.

(iii) *Transaction costs*

Transaction costs related to financial instruments classified as fair value through income (loss) are expensed as incurred. All other transaction costs related to financial instruments are recorded as part of the instrument and are amortized using the effective interest method.

(iv) *Impairment*

The Company assesses at each balance sheet date whether there is objective evidence that financial assets, other than those designated as "fair value through the statement of income" are impaired. When impairment has occurred, the cumulative loss is recognized in the statement of income. For financial assets carried at amortized cost, the amount of the impairment loss recognized is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the financial asset's original effective interest rate. When an "available-for-sale" financial asset is considered to be impaired, cumulative gains or losses previously recorded in other comprehensive income are reclassified to the statement of income in the period. Impairment losses may be reversed in subsequent periods.

(h) Equity instruments

Common shares and proportionate voting shares are classified as equity. Incremental costs directly attributable to the issue of these shares are recognized as a deduction from equity, net of any tax effects.

(i) Assets and liabilities held for sale

Non-current assets are classified as held for sale if their carrying amounts will be recovered through a sale transaction rather than through continuing use. This condition is met when the sale is highly probable and the asset is available for immediate sale in its present condition. Non-current assets classified as held for sale are measured at the lower of the carrying amount and fair value less costs to sell, with impairments recognized in net income (loss) in the period determined. Non-current assets held for sale and any associated liabilities are presented as current assets and liabilities within the consolidated balance sheet. Assets held for sale are not depleted or depreciated.

(j) Exploration and evaluation expenditures and property and equipment

(i) *Exploration and evaluation assets*

Pre-license expenditures incurred before the Company has obtained legal rights to explore an area are expensed. Seismic costs and unsuccessful drilling and related land costs are also expensed.

Exploration and evaluation costs include the costs of acquiring licenses, exploratory drilling, geological and geophysical activities, acquisition of mineral and surface rights and technical studies and asset retirement obligations. Exploration and evaluation costs are capitalized as exploration and evaluation assets when the technical feasibility and commercial viability of extracting petroleum and natural gas reserves have yet to be determined. Exploration and evaluation assets are measured at cost, net of impairments, and are not depleted or depreciated. Exploration and evaluation assets, net of any impairment loss, are transferred to property and equipment when proved and/or probable reserves are determined to exist, or expensed if no reserves are found.

Farm-ins, exchanges or swaps that involve only exploration and evaluation assets are accounted for at cost.

Expired lease costs are expensed as part of exploration and evaluation expenses as they occur.

(ii) *Property and equipment*

All costs directly associated with the development and production of petroleum and natural gas interests are capitalized on an area-by-area basis as petroleum and natural gas interests and are measured at cost less accumulated depletion and depreciation and net impairment losses. Dry hole costs are expensed when incurred and included in exploration and evaluation expenses. These costs include expenditures for areas where technical feasibility and commercial viability has been determined. These costs also include property acquisitions with proved and/or probable reserves, development drilling, completion, gathering and infrastructure, asset retirement obligations and transfers of exploration and evaluation assets.

Costs of replacing parts of property and equipment are capitalized when they increase the future economic benefits embodied in the specific asset to which they relate. All other expenditures are expensed as incurred. The carrying amount of any replaced or sold component is derecognized. The costs of the day-to-day servicing of property and equipment are expensed when incurred.

Farm-ins, exchanges or swaps of property and equipment are measured at fair value unless the transaction lacks commercial substance, or neither the fair value of the asset received nor the asset given up can be reliably estimated. When fair value is not used, the cost of the acquired asset is measured at the carrying amount of the asset given up. Any gains or losses from the divestiture of property and equipment are recorded in income (loss).

(iii) *Depletion and depreciation*

Petroleum and natural gas interests are depleted on an area-by-area basis using the unit-of-production method by reference to the ratio of production in the year to the related proved and probable reserves, taking into account estimated future development costs. Production and reserves of natural gas are converted to equivalent barrels of crude oil on the basis of six thousand cubic feet of natural gas to one barrel of oil. Changes in estimates used in prior periods that affect the unit-of-production calculations, such as revisions to proved and probable reserves, do not give rise to prior period adjustments and are dealt with on a prospective basis.

Processing facilities and well equipment are depleted using the unit-of-production method along with the related reserves when the assets are designed to have a life similar to the reserves of the related wells. Where facilities and equipment, including major components, have differing useful lives, they are depreciated separately on a straight-line basis over the estimated useful life of the facilities and equipment and other related components.

(iv) *Office furnishings and improvements*

Office furnishings and improvements are stated at cost less accumulated depreciation. Depreciation is computed using the straight-line method over the estimated useful lives of the assets which range from 3 to 10 years.

(k) Impairment of non-financial assets

The carrying amounts of the Company's non-financial assets, other than exploration and evaluation assets, are reviewed for indicators of impairment at each reporting date. If indicators of impairment exist, the recoverable amount of the asset is estimated.

For the purposes of assessing impairment, property and equipment is grouped into cash-generating units ("CGUs"), defined as the lowest levels for which there are separately identifiable independent cash inflows. Goodwill, if any, is allocated to the CGUs that are expected to benefit from the synergies of the business combination creating the goodwill.

The recoverable amount of a CGU is the greater of its fair value less costs of disposal and its value in use. Fair value is determined to be the amount for which the asset could be sold in an arm's length transaction between knowledgeable and willing parties. Fair value less costs of disposal may be determined using discounted future net cash flows of proved and probable reserves using forecast prices and costs and including future development costs. These cash flows are discounted at an appropriate discount rate which would be applied by a market participant. Value in use is determined by estimating the present value of the future net cash flows to be derived from the continued used of the cash-generating unit in its present form. These cash flows are discounted at a rate based on the time value of money and risks specific to the CGU.

An impairment loss is recorded if the carrying amount of an asset or its CGU exceeds its recoverable amount. An impairment loss recorded in respect of a CGU is allocated first to reduce the carrying amount of any goodwill allocated to the CGU and then to reduce the carrying amounts of the other assets in the CGU on a pro rata basis.

Exploration and evaluation assets are assessed for impairment when they are reclassified to property and equipment or when facts and circumstances suggest that the carrying amount exceeds the recoverable amount. Exploration and evaluation assets are tested for impairment separately. If, at any time, it is determined that the Company has no future exploration plans and commercial production cannot be achieved in relation to an area, the associated costs are written down to the estimated recoverable amount, and the amount of the write-down is expensed.

Impairment losses recorded in prior years are assessed at each reporting date for any indications that the loss has decreased or no longer exists. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depletion and depreciation, if no impairment loss had been recorded. A goodwill impairment loss is not reversed.

(l) Provisions and contingent liabilities

Provisions and contingent liabilities are recorded by the Company when it has a legal or constructive obligation as a result of past events, it is probable that an outflow of economic resources will be required to settle the obligation and a reliable estimate can be made of the amount of that obligation. Provisions are stated at the present value of the expenditure expected to settle the obligation. The obligation is not recorded and is disclosed as a contingent liability if it is not probable that an outflow will be required, if the amount cannot be estimated reliably or if the existence of the outflow can only be confirmed by the occurrence of a future event.

(m) Asset retirement obligations

Asset retirement obligations are recorded for plugging, abandonment and reclamation obligations associated with the Company's exploration and evaluation assets and property and equipment. The best estimate of the future expenditure required to settle the obligation at the balance sheet date is recorded on a discounted basis using a pre-tax risk-free interest rate. The future cash flow estimates are adjusted to reflect the risks specific to the liability. The value of the obligation is added to the carrying amount of the associated exploration and evaluation or property and equipment asset and is depleted or depreciated in accordance with the Company's applicable depletion and depreciation policies. The initial provision is recorded as a liability and accreted over time through charges to finance expenses, with actual expenditures charged against the accumulated obligation. Changes in the future cash flow estimates resulting from revisions to the estimated timing or amount of undiscounted cash flows or the discount rate are recognized as changes in the asset retirement obligations and related asset. Actual plugging and abandonment expenditures up to the recorded liability at the time are charged against the provision as the costs are incurred. Any differences between the recorded provision and the actual costs incurred are recorded as income or expense.

(n) Leases

Leases that transfer substantially all of the benefits and risks of ownership to the Company are accounted for at the commencement of the lease term as finance leases and recorded as property and equipment at the fair value of the leased asset, or, if lower, at the present value of the minimum lease payments, together with an offsetting liability. Finance charges are allocated to each period so as to achieve a constant rate of interest on the remaining balance of the liability and are charged directly against income. Capitalized leased assets are depreciated over the estimated useful life of the asset to the Company. All other leases are accounted for as operating leases and the lease costs are expensed as incurred.

(o) Revenue recognition

Oil, natural gas and NGL revenues are recognized when production is sold to a purchaser at a determinable price, delivery has occurred, title has transferred and collectability of the revenue is probable. Revenue represents the Company's share and is recorded net of royalty obligations to governments and other mineral interest owners.

The costs associated with the delivery, including operating and maintenance costs and transportation are recorded in the same period in which the related revenues are earned and recorded.

The volumes of petroleum and natural gas sold may differ from the volumes to which the Company is entitled based on its interests in the properties. These differences create imbalances that are recognized as a liability only when the estimated remaining reserves will not be sufficient to enable the under-produced owner to recoup its entitled share through production. The liability is priced based on current market prices. No receivables are recorded for those volumes where the Company has received less than its share of production. If an imbalance exists at the time the wells' reserves are depleted, settlements are made among the joint interest owners under a variety of arrangements.

(p) Stock-based compensation

Stock options granted to directors, officers and employees under the Company's stock option plan are accounted for using the fair value method under which compensation expense is recorded based on the estimated fair value of the options at the grant date using the Black-Scholes option pricing model. Consultants are classified as employees when the individual is deemed an employee for legal or tax purposes or provides services similar to those performed by a direct employee.

The Company measures share-based payments to non-employees at the fair value of the goods or services received at the date of receipt of the goods or services. If the fair value of the goods and services cannot be measured reliably, the value of the options/warrants granted are measured using the Black-Scholes option pricing model.

Each tranche in an award is considered a separate award with its own vesting period and grant date fair value. Compensation cost is expensed over the vesting period with a corresponding increase in contributed surplus. When stock options are exercised, the cash proceeds along with the amount previously recorded as contributed surplus are recorded as share capital. A forfeiture rate is estimated on the grant date and is adjusted to reflect the actual number of forfeitures as they occur.

(q) Finance income and expenses

Finance income, consisting of interest income, is recorded as it accrues in the statement of income (loss), using the effective interest method.

Finance expenses comprise interest expense on borrowings, accretion of debt discount, accretion of the discount on asset retirement obligations and impairment losses recorded on financial assets.

Borrowing costs incurred for the construction of qualifying assets are capitalized during the period of time that is required to complete and prepare the assets for their intended use or sale. A qualifying asset is one that takes a substantial period of time to get ready for use or sale.

Where funds are borrowed specifically to finance a project, the amount capitalized represents the actual borrowing costs incurred. Where the funds used to finance a project form part of general borrowings, the amount capitalized is calculated using a weighted average of rates applicable to relevant general borrowings of the Company during the period.

All other borrowing costs are expensed in the period in which they are incurred using the effective interest method.

(r) Income taxes

Income tax expense comprises current and deferred tax. Income tax expense is recorded in the statement of income except to the extent that it relates to items recorded directly in equity or other comprehensive income.

Current tax is the expected tax payable on the taxable income for the year plus any adjustment to tax payable in respect of previous years.

Deferred tax is recorded using the liability method, providing for temporary differences between the carrying amounts of assets and liabilities and the amounts used for taxation purposes. Deferred tax liabilities are generally recorded for all taxable temporary differences. Deferred tax assets are generally recorded for all deductible temporary differences to the extent that it is probable that taxable income will be available against which those deductible temporary differences can be utilized.

Deferred tax is not recorded on the initial recognition of assets or liabilities in a transaction that is not a business combination, and at the time of the transaction affects neither the accounting profit nor taxable profit or loss. In addition, deferred tax is not recorded for taxable temporary differences arising on the initial recognition of goodwill.

Deferred tax is measured at the tax rates that are expected to be applied to temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date. Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset and they relate to income taxes levied by the same taxation authority on the same taxable entity, or on different taxable entities, where there is the intention to settle current tax liabilities and assets on a net basis or their tax assets and liabilities will be realized simultaneously.

Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realized. Unrecognized deferred tax assets are reassessed at each reporting period and are recognized to the extent that it has become probable that future profit will allow the deferred tax asset to be recovered and/or carrying value of temporary differences exceed their tax basis.

(s) Income (loss) per share

Income (loss) per share is calculated by dividing net income or loss by the weighted average of number of common and proportionate voting shares outstanding during the period. The Company computes the dilutive impact of common and proportionate voting shares assuming the proceeds received from the pro forma exercise of in-the-money stock options plus the unamortized portion of stock-based compensation are used to purchase common shares at average market prices during the period.

(t) Recent accounting pronouncements

Financial instruments

(i) The IASB intends to replace IAS 39, “Financial Instruments: Recognition and Measurement” (“IAS 39”) with IFRS 9, “Financial Instruments” (“IFRS 9”). IFRS 9 will be published in several phases, of which the first phase has been published.

IFRS 9 addresses the classification and measurement of financial assets. IFRS 9 replaces the guidance on 'classification and measurement' of financial instruments in IAS 39 – Financial Instruments – Recognition and Measurement. The new standard requires a consistent approach to the classification of financial assets and replaces the numerous categories of financial assets in IAS 39 with two categories, measured at either amortized cost or at fair value. For financial liabilities, the standard retains most of the IAS 39 requirements, but where the fair value option is taken, the part of a fair value change due to an entity's own credit risk is recorded in other comprehensive income rather than the statement of profit and loss, unless this creates an accounting mismatch. It also includes a new general hedge accounting model.

The mandatory effective date of IFRS 9 has been deferred pending the finalization of the new impairment model and limited amendments to the classification and measurement requirements. IFRS 9, in its current form, as described above, is available for early adoption until IFRS 9R is finalized. IFRS 9 is being assessed to determine its impact on the Company's results and financial position.

(ii) The IASB amended IAS 39 to allow hedge accounting to continue in a situation where a derivative, which has been designated as a hedging instrument, is novated to effect clearing with a central counterparty as a result of laws or regulation, if specific conditions are met (in this context, a novation indicates that parties to a contract agree to replace their original counterparty with a new one). The amendment is effective for annual periods beginning on or after January 1, 2014 and is not anticipated to have a material impact on the Company's results or financial position.

(iii) The IASB amended IAS 32, "Financial Instruments: Presentation" ("IAS 32") to clarify certain requirements for offsetting financial assets and liabilities. The amendment addresses the meaning and application of the concepts of legally enforceable right of set-off and simultaneous realization and settlement. IAS 32 relates to presentation and disclosures. The amendment is effective for annual periods beginning on or after January 1, 2014 and is not anticipated to have a material impact on the Company's results or financial position.

Disclosure

The IASB amended IAS 36, "Impairment of Assets" ("IAS32") to require disclosure of the recoverable amount of an asset (including goodwill) or a CGU when an impairment loss has been recognized or reversed in the period. When the recoverable amount is based on fair value less costs to sell, the valuation techniques and key assumptions must also be disclosed. The amendment is effective for annual periods beginning on or after January 1, 2014 and is being assessed to determine its impact on the Company's results and financial position.

4. Financial instruments and risk management

(a) Overview

The Company's activities expose it to a variety of financial risks that arise as a result of its exploration, development, production, and financing activities including credit risk, liquidity risk and market risk.

This note presents information about the Company's exposure to each of the above risks, the Company's objectives, policies and processes for measuring and managing risk, and the Company's management of capital. Further quantitative disclosures are included throughout these financial statements.

The Company employs risk management strategies and polices to ensure that any exposure to risk are in compliance with the Company's business objectives and risk tolerance levels. While the Company has the overall responsibility for the establishment and oversight of the Company's risk management framework, the Company's management has the responsibility to administer and monitor these risks.

(b) Fair value of financial instruments

The fair values of cash and cash equivalents, restricted cash, accounts receivable, accounts payable and accrued liabilities, current portion of loans payable, and due to related parties, approximate their carrying values due to the short-term maturity of those instruments. The Company's long-term loans payable bear interest at a rate approximating interest for equivalent debt instruments and, accordingly, approximate fair value.

The fair values of any notional derivative contracts, such as forward contracts, collars and swaps, are determined by discounting the difference between the contracted prices and published forward price curves as at the balance sheet date, using the remaining contracted petroleum and natural gas volumes and a risk-free interest rate (based on published government rates) adjusted for the Company's non-performance risk of the counterparty.

The significance of inputs used in making fair value measurements for financial instruments carried at fair value are examined and classified according to a fair value hierarchy. Fair values of assets and liabilities included in Level 1 are determined by reference to quoted prices in active markets for identical assets and liabilities. Assets and liabilities in Level 2 include valuations using inputs other than quoted prices for which all significant outputs are observable, either directly or indirectly, and are based on valuation models and techniques where the inputs are derived from quoted indices. Level 3 valuations are based on inputs that are unobservable and significant to the overall fair value measurement.

Cash and cash equivalents are measured at fair value based on a Level 1 designation. Financing warrants are measured using a Level 2 designation.

The valuation of the Company's assets and liabilities measured on a recurring basis by the above fair value hierarchy at December 31, 2013 and 2012, are as follows:

	Total	Level 1	Level 2	Level 3
December 31, 2013				
Assets				
Cash and cash equivalents	$ 964,040	$ 964,040	$ -	$ -
Liabilities				
Financing warrants	$ 1,092,000	$ -	$ 1,092,000	$ -

December 31, 2012				
Assets				
Cash and cash equivalents	$ 7,367,848	$ 7,367,848	$ -	$ -
Liabilities				
Financing warrants	$ 1,067,000	$ -	$ 1,067,000	$ -

(c) 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 December 31, 2013 and 2012, is as follows:

	December 31,	
	2013	**2012**
Cash and cash equivalents	$ 964,040	$ 7,367,848
Restricted cash	5,620,635	-
Accounts receivable	4,071,505	8,262,786
Asset retirement deposits	300,000	3,762,000
	$ 10,956,180	$ 19,392,634

Cash and cash equivalents

Cash and cash equivalents may include cash bank balances and short-term deposits. The Company manages the credit exposure related to cash and cash equivalents 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 of December 31, 2013 the Company has $5,620,635 in restricted cash including $3,462,000 of cash collateral for performance bonds for specific well and facility abandonments that must be completed within the next 12 months (note 10). In addition, restricted cash includes $2,158,635 of disputed revenue proceeds held in escrow related to Vermilion Area Block 376 #A-3 and A-4 wells (note 21), with the offsetting amount included in accounts payable and accrued liabilities. All funds are held in financial institutions with high credit ratings and as such, management does not expect any credit risk losses.

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.

During the years ended December 31, 2013 and 2012, the Company sold a substantial portion of its product to two customers. Sales to those customers aggregated approximately $33.8 million or approximately 82% of total revenue (2012 - $25.4 million and 75%). At December 31, 2013, amounts due from those customers included in accounts receivable totalled approximately $2.2 million (2012 - $2.6 million), all of which has been collected subsequent to December 31, 2013.

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

Joint venture receivables are typically collected within one to three months of the joint venture bill being issued to the partner. The Company attempts to reduce the risk from joint venture receivables by obtaining partner approval of significant capital and operating expenditures prior to expenditure and issuing cash calls to partners for capital projects before they commence. The Company does not typically obtain collateral or letters of credit from purchasers of the Company's petroleum and natural gas production or joint venture partners; however, the Company does have the ability to withhold production or imbalance production from joint venture partners in the event of non-payment. The receivables are from participants in the petroleum and natural gas sector, and collection of the outstanding balances is dependent on industry factors such as commodity price fluctuations, escalating costs and the risk of unsuccessful drilling. In addition, further risk exists with joint venture partners, as disagreements occasionally arise that increase the potential for non-collection. Amounts recorded from joint venture partners are based on the Company's interpretation of underlying agreements and may be subject to joint approval. The Company has recorded balances due from its joint venture partners based on costs incurred and its interpretation of allowable expenditures. Any adjustment required as a result of joint venture audits are recorded in the period of settlement with joint venture partners.

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.

As of December 31, 2013 and 2012, substantially all of the Company's accounts receivable are due from petroleum and natural gas purchasers and joint operation partners. Management has evaluated receivables for collectability and as such, has recorded an allowance for doubtful accounts at December 31, 2013 and 2012 totalling $3,187,396 and $302,337, respectively. Bad debt expense for the years ended December 31, 2013 and 2012 totalled $2,885,059 and $302,337, respectively. Bad debt expense for 2013 and 2012 primarily relates to an allowance for non-payment of operating costs and capital expenditures by a joint interest partner (notes 19 and 21).

As of December 31, 2013 and 2012, the Company's accounts receivable was comprised of the following:

	December 31,			
		2013		2012
Petroleum and natural gas revenue	$	2,432,759	$	4,317,749
Joint operation receivables		4,826,142		4,247,374
		7,258,901		8,565,123
Allowance for doubtful accounts		(3,187,396)		(302,337)
Total accounts receivable	$	4,071,505	$	8,262,786

As of December 31, 2013 and 2012, the Company’s accounts receivables were aged as follows:

	December 31,			
		2013		2012
Current (0 - 30 days)	$	4,062,088	$	5,659,043
31 to 60 days		33,199		136,245
61 to 90 days		53,068		52,996
Past due (greater than 90 days)		3,110,546		2,716,839
Allowance for doubtful accounts		(3,187,396)		(302,337)
Total accounts receivable	$	4,071,505	$	8,262,786

Asset retirement deposits

Asset retirement deposits (note 10) consist of amounts deposited to secure a performance bond related to asset retirement obligations which were acquired by the Company in connection with the Probe transaction (note 5(a)). The exposure to credit risk has been assessed by management to be minimal.

(d) 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 ongoing liquidity is impacted by various external events and conditions, including commodity price fluctuations and global economic conditions. The Company’s short-term financial liabilities consist of accounts payable and accrued liabilities, accrued interest payable and loans payable.

Accounts payable consists of invoices payable to trade suppliers for professional fees, office expenses, interest, and capital expenditures. Accounts payable also consist of royalties and field operating activities related to the production of the Company's petroleum and natural gas interests. By nature, the petroleum and natural gas industry is very capital intensive. As a result, the Company prepares annual capital expenditure budgets and utilizes authorizations for expenditures to manage capital expenditures. The Company’s trade accounts payable are normally due within 30 – 60 days from receipt of invoice.

The Company's accounts payable and accrued liabilities as of December 31, 2013 and 2012 are aged as follows:

	December 31,	
	2013	2012
Current (0 - 30 days)	$ 7,960,672	$ 7,422,323
31 to 60 days	1,729,709	1,374,172
61 to 90 days	6,307,520	73,067
Greater than 90 days	3,841,503	236,138
Total accounts payable and accrued liabilities	$ 19,839,404	$ 9,105,700

At December 31, 2013, the Company had a working capital deficiency of $46,858,516, including outstanding loans payable amounts which are due within the current year. In addition, a significant portion of the Company's accounts payable were past due, and the Company was not in compliance with required debt covenants under its senior secured notes at December 31, 2013 (see notes 9 and 22).

Management has taken a number of steps subsequent to December 31, 2013 to address the Company's liquidity situation, including entering into two significant acquisition agreements which are anticipated to contribute significant additional positive cash flows and cost synergies. In addition, the Company obtained an additional second lien credit facility for $10 million, which has enabled the Company to reduce its accounts payable balances outstanding at December 31, 2013. The Company is also currently engaged in discussions for a new credit facility, and may pursue issuing additional equity following the anticipated closing of the acquisitions in May 2014. (See also note 22.)

Management believes that these transactions, combined with the Company's ongoing positive cash flows from operating activities and the continued support of its major shareholders, will be sufficient to fund its ongoing operations and fund its capital expenditures program over the upcoming year.

The repayment terms relating to the Company's due to related parties are further discussed in note 20.

The repayment terms relating to the Company's loans payable are further discussed in note 9.

The Company is also subject to future commitments as disclosed in notes 4(e) and 19.

Refer also to note 4(f) on the Company's management of capital.

(e) 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 had nominal working capital amounts denominated in currencies other than US dollars other than the related party subordinated secured credit facility which is denominated in Canadian dollars ("CAN") (note 9), and had no forward exchange rate contracts in place as of or during the years ended December 31, 2013 or 2012. Shares of the Company are traded in Canadian dollars.

A 5% change in the US-CDN exchange rates would increase (decrease) the Company's net loss for the year ended December 31, 2013 by approximately $107,000, based on the outstanding balance of the related party subordinated secured credit facility at December 31, 2013.

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. The Company's loans payable at December 31, 2013 are at fixed interest rates (note 9) and therefore are not subject to interest rate risk. The Company had no interest rate swaps or financial contracts in place as of or during the twelve month period ended December 31, 2013.

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 economically 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. The Company's production is usually sold using "spot" or near term contracts, with prices fixed at the time of transfer of custody or on the basis of a monthly average market price. The Company, however, may give consideration in certain circumstances to the appropriateness of entering into long-term, fixed price sales contracts.

The Company entered into certain fixed price contracts during 2013. These contracts have been entered into for the purpose of physical delivery of a non-financial item; therefore, the physical delivery contracts are not fair valued. Settlements on these contracts are included in petroleum and natural gas revenue as they occur. The Company currently does not have any derivative financial commodity contracts.

The Company's fixed price contracts, net to its respective working interests, included the following contracts:

As of December 31, 2013, the Company has one fixed price physical delivery contract outstanding pursuant to which it has agreed to sell certain quantities of natural gas and crude oil. Specifically, for the period November 1, 2013, through April 30, 2014, the Company contracted to sell 350 barrels per day of crude oil at a fixed price of $98.49 per barrel.

For the period January 1, 2013 through June 30, 2013, the Company contracted to sell approximately 300 net barrels per day of crude oil at a fixed price of $102.03 per barrel.

For the period April 1, 2013 through October 31, 2013, the Company contracted to sell approximately 2,200 MMBtu per day of natural gas at a fixed price of $3.60 per MMBtu.

For the period July 1, 2013 through October 31, 2013, the Company was obligated to sell approximately 4,000 MMBtu per day of natural gas at a fixed price of $3.86 per MMBtu. During the quarter ended September 30, 2013, the Company agreed to unwind the portion of this contract covering August 1, 2013 through October 31, 2013 for gross proceeds of approximately $59,000.

For the period October 1, 2013 through October 31, 2013, the Company contracted to sell crude oil volumes produced at its Vermillion 376 field (approximately 1,000 barrels per day) at a fixed price of $100.89 per barrel.

(f) Capital management

The Company's capital management policy is to maintain a strong 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 monitors its capital based on projected cash flow from operations and anticipated capital expenditures. In order to manage its capital structure, the Company prepares annual capital expenditure and operating budgets, which are updated as necessary. The annual and updated budgets are prepared by the Company's management and approved by the Company's Board of Directors. The budget results are regularly reviewed and updated as required.

In order to maintain or adjust the capital structure, the Company may also seek additional debt or equity financing and adjust its capital spending to manage its current and projected capital structure. The Company's ability to raise additional financing is impacted by external conditions, including future commodity prices and the global economic situation. The Company continually monitors business conditions including changes in economic conditions, the risk of its drilling programs, forecasted commodity prices, and potential corporate or asset acquisitions. See also liquidity risk disclosures in note 4(d).

The Company's working capital (deficiency) surplus is as follows:

	December 31,	
	2013	**2012**
Current assets	$ 11,830,012	$ 16,970,316
Current liabilities	(58,688,528)	(14,560,699)
Total	$ (46,858,516)	$ 2,409,617

The Company is required to meet certain financial covenants relating to its loans payable as further discussed in note 9. The Company is not subject to any other externally imposed capital requirements. There has been no change to management's approach to managing capital during the year ended December 31, 2013.

5. Acquisitions

(a) Business combination

On April 30, 2012, the Company completed the reverse acquisition transactions with Probe (see note 1). The purpose of the acquisition was to provide opportunity to participate in the exploration and development of Probe's assets in the shallow waters of the Gulf of Mexico.

The acquisition by Rooster resulted from and was part of an arrangement agreement between Probe and Rooster Resources, LLC, Morrison Energy Group, LLC, The K2 Principal Fund LP and Rooster Probe GOM Oil & Gas Ltd. ("Canco") to merge or amalgamate Canco with Probe and then subsequently exercise an option (the "Rooster Option") then held by Canco to acquire all of the membership interest of Rooster from Rooster Resources, LLC, and complete the reverse acquisition by Rooster. As part of the arrangement agreement and in conjunction with the amalgamation and exercise of the Rooster Option, Canco completed a private placement of 34,543,400 subscription receipts at a price of CDN $0.60 each for net proceeds of $20,122,951 (gross proceeds of CDN $20,726,040), a portion of which were sold to directors and officers or their companies on the same terms as arms' length parties. The agents with respect to the offering received a commission equal to 3.2% of the gross proceeds of the offering. Each of the subscription receipts of Canco issued pursuant to the offering was then exchanged for one common share of Canco for no additional consideration.

Probe then acquired all of the issued and outstanding common shares of Canco in exchange for, at the election of the holder, either one Probe common share (issued at a price of CDN $0.60 per common share) or one-thousandth of one proportionate voting share (issued at a price of $600.00 per whole proportionate voting share). The 3,546,106,667 Probe shares were consolidated on a 250 to 1 basis (resulting in there being 14,184,423 post consolidation Probe shares outstanding and Probe changed its name to "Rooster Energy Ltd." Probe issued 26,210,400 post-consolidation common shares and 8,333 proportionate voting shares on acquisition of Canco. On April 30, 2012 the amalgamation with Canco was approved.

The Company exercised the Rooster Option and acquired all of the membership interests of Rooster from Rooster Resources, LLC, in exchange for 56,738 proportionate voting shares.

Following the completion of all of the steps described above, the Company had 40,394,823 common shares and 65,071 proportionate voting shares outstanding. A maximum of 8,078,964 common shares are reserved for future issuance pursuant to the Company's incentive stock option plan.

Additional transaction costs expensed totalled $812,451 for the year ended December 31, 2012.

The acquisition of Rooster was accounted for as a reverse acquisition of the Company with Rooster being the continuing entity for accounting purposes, as the transactions resulted in the issuance of voting shares such that control of the combined entities passed to the shareholders of Rooster. Accordingly, the consolidated equity is that of Rooster. The total common share and proportionate voting share consideration was valued at $8,536,188, based on the estimated fair value of the Probe common shares outstanding immediately prior to the reverse acquisition.

The fair market values assigned to the net assets acquired from Probe were as follows:

Cash and cash equivalents	$	33,763
Prepaid expenses and deposits		153,078
Accounts receivable		471,193
Asset retirement deposits		3,762,000
Property and equipment		14,932,966
Accounts payable and accrued liabilities		(1,864,550)
Notes payable		(6,463,000)
Asset retirement obligations		(2,489,262)
	$	8,536,188

As of the closing date of the acquisition, Probe had tax pools and deductions available to reduce future taxable income in excess of the fair values assigned to the assets and liabilities acquired. The Company evaluated Probe's estimated future cash flows and determined that future realization of these tax pools and deductions was not probable as of the acquisition date, and accordingly, no deferred tax amount was recognized.

The accounts of the Company include the results of Probe from April 30, 2012, the closing date of the business combination.

(b) Property acquisition

On March 31, 2012, the Company purchased certain petroleum and natural gas interests in the Vermillion 376 field for $850,000 ($113,178 receivable after interim net revenue and expense adjustments), with an effective date of January 1, 2012. The purpose of the acquisition was to obtain the petroleum and natural gas interests surrounding the Company's areas of interest in the Gulf of Mexico. Net revenues have been recorded from the March 31, 2012 closing date onwards. The transaction has been accounted for as a business combination using the acquisition method, whereby the net assets acquired and the liabilities assumed are recorded at fair value. Acquisition related costs were recognized as an expense in the period.

The net purchase price was allocated based on management's assessment of the fair value of the net assets acquired as follows:

Petroleum and natural gas interests	$	1,235,477
Asset retirement obligations		(1,348,655)
	$	(113,178)

The revenue, operating results and net earnings (loss) attributable to the acquisitions from the closing dates to December 31, 2012, as well as the pro forma consolidated revenue, operating results and net earnings (loss) giving effect to the acquisitions as if they had occurred on January 1, 2012, are not practicable to determine. The operations attributable to the acquisitions are not managed as separate business units or divisions and general business overhead and other costs are not allocated or identified on a specific entity basis. Any such allocation would be arbitrary and would require significant assumptions and estimates about what management's intent would have been during those periods.

6. Exploration and evaluation assets and expenses

	December 31,	
	2013	**2012**
Balance, beginning of year	$ -	$ -
Exploration and evaluation expenditures	186,152	-
Transfers to property and equipment	-	-
Balance, end of year	$ 186,152	$ -

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.

Exploration and evaluation expenses are charged to income (loss) and include pre-license seismic and other pre-license evaluation costs incurred, net of any recoveries from joint venture partners, and transfers from property and equipment related to unsuccessful drilling costs (note 6).

7. Property and equipment

	Petroleum and natural gas interests	Office furnishings and improvements	Total
Cost			
Balance at January 1, 2012	$ 59,463,066	$ 565,892	$ 60,028,958
Additions	36,201,825	38,268	36,240,093
Non-cash additions from Probe transaction (note 5 (a))	14,932,966	-	14,932,966
Dispositions (note 8)	(2,791,777)	-	(2,791,777)
Transfers to assets held for sale (note 8)	(3,968,381)	-	(3,968,381)
Transfers to exploration and evaluation expenses related to dry holes	(4,031,388)	-	(4,031,388)
Asset retirement obligations (note 10)	4,163,599	-	4,163,599
Balance at December 31, 2012	$ 103,969,910	$ 604,160	$ 104,574,070
Additions	38,633,909	25,228	38,659,137
Transfers to exploration and evaluation expenses related to dry holes	(2,483,731)	-	(2,483,731)
Asset retirement obligations (note 10)	994,388	-	994,388
Balance at December 31, 2013	$ 141,114,476	$ 629,388	$ 141,743,864
Depletion, depreciation and impairment			
Balance at January 1, 2012	$ 27,243,987	$ 304,252	$ 27,548,239
Dispositions (note 8)	(282,772)	-	(282,772)
Transfers to assets held for sale (note 8)	(3,615,599)	-	(3,615,599)
Depletion and depreciation for the year	8,355,531	62,455	8,417,986
Impairment and asset retirement expense	370,271	-	370,271
Balance at December 31, 2012	$ 32,071,418	$ 366,707	$ 32,438,125
Depletion and depreciation for the year	8,646,027	62,182	8,708,209
Impairment and asset retirement expense	5,389,061	-	5,389,061
Balance at December 31, 2013	$ 46,106,506	$ 428,889	$ 46,535,395
Net book value			
December 31, 2012	$ 71,898,492	$ 237,453	$ 72,135,945
December 31, 2013	$ 95,007,970	$ 200,499	$ 95,208,469

The calculation of depletion and depreciation for the year ended December 31, 2013 included estimated future development costs of $55,340,000 (December 31, 2012 - $40,247,000) 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 years ended December 31, 2013 or 2012.

At December 31, 2013 and 2012, the Company tested its CGUs for impairment. The recoverable amount of each cash-generating unit was estimated based on fair value less costs to sell. The estimate of fair value less costs of disposal was determined using forecasted proved plus probable before tax cash flows, discounted at 10%, using escalating forward pricing and net of future development costs, as obtained from an independently prepared reserve report. In determining the appropriate discount rate, the Company considered 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.

During the years ended December 31, 2013 and 2012, the Company recognized impairment and asset retirement expense, net of reversals, for the following cash generating units:

	December 31,	
	2013	**2012**
Chandeleur Sound Block 63	$ (5,198)	$ 166,409
East Cameron Block 129	89,258	312,289
Eugene Island Block 172	-	167,467
Glaveston Block 223	5,021	614,120
Grand Isle Block 70	3,851,175	-
High Island Block 115	31,536	80,678
High Island Block 141	714,050	-
High Island Block 201	237,531	-
High Island Block A494	-	(1,824,073)
Ship Shoal Block 189 (note 8)	-	521,426
South Timbalier Block 99/112	11,882	(70,659)
South Timbalier Block 198	27,162	-
Vermillion Block 175	431,214	(397,125)
Vermillion Block 375	4,740	330,563
West Cameron Block 215	(6,417)	438,980
Other	(2,893)	30,196
Total impairment and asset retirement expense, net	5,389,061	370,271
Less: asset retirement expense	(586,305)	(452,351)
Total impairment, net	$ 4,802,756	$ (82,080)

Net impairments (recoveries) and asset retirement expense were recorded in the consolidated statements of loss in the respective periods. The net impairments were required due to a combination of lower forecasted commodity prices, downward revision of estimated reserves and/or changes in estimates, which resulted in the fair value less costs of disposal of the applicable CGUs being less than their carrying amounts. Asset retirement expense comprise impairments, net of reversals, related to revisions to asset retirement obligations for which CGUs were fully impaired in prior years.

Impairment reversals during 2013 and 2012 related to increases in fair value less costs of disposal as a result of positive technical revisions to reserves for the respective CGUs.

The following table outlines the prices used in the December 31, 2013 impairment calculations:

	Oil $US/BBL	NGL $US/BBL	Natural Gas $US/MCF
2014	107.38	73.78	3.92
2015	102.50	68.34	3.84
2016	96.96	64.49	3.84
2017	92.74	55.38	3.85
2018	87.55	44.73	3.91
2019	83.77	44.75	4.01
2020	83.70	41.68	4.06
2021	83.39	44.60	4.03
2022	83.08	42.07	4.01
2023	82.87	41.15	3.99
Thereafter	Escalation rate of approximately 2.0% per year		

The following table outlines the prices used in the December 31, 2012 impairment calculations:

	Oil $US/BBL	NGL $US/BBL	Natural Gas $US/MCF
2013	104.09	33.07	3.74
2014	103.50	33.39	4.06
2015	101.51	39.91	4.25
2016	99.66	38.73	4.43
2017	98.18	40.40	4.64
2018	97.16	43.66	4.90
2019	96.94	42.32	5.45
2020	96.93	39.57	6.13
2021	96.45	37.40	6.63
2022	96.32	37.38	6.56
Thereafter	Escalation rate of approximately 2.0% per year		

For the purposes of the impairment calculations, adjustments were made to the benchmark prices contained in the independent reserve report to reflect varied delivery points and quality differentials in the products delivered.

8. Assets held for sale

Assets held for sale of $352,782 at December 31, 2012 comprised the carrying value, net of accumulated depletion and depreciation and provision for impairment, relating to petroleum and natural gas interests, facilities and equipment in the Ship Shoal 189 field. The asset sale agreement was entered into in November 2012 and closed in two stages, on November 5, 2012 and January 10, 2013. Total sale proceeds were $2,648,436, of which $2,489,181 was received on November 5, 2012, and the remaining proceeds of $159,255 on January 10, 2013. The asset retirement obligation of $193,527 related to the remaining assets is shown as liabilities associated with assets held for sale at December 31, 2012. The carrying value was written down during the year ended December 31, 2012, to the estimated proceeds less costs to sell and a $521,426 impairment charge recorded (note 7).

9. Loans payable and warrants

Loans payable at December 31, 2013 and December 31, 2012 consist of the following:

	December 31, 2013	December 31, 2012
Senior secured notes dated October 22, 2012 for $22,500,000 with interest at 12% payable quarterly, due October 22, 2014, secured by first priority security interest on all assets (i)	$ 21,006,712	$ 19,470,426
Related party note payable dated April 26, 2012, with an initial maturity date of April 26, 2014 and subordinated to senior secured notes, with interest at 14.5% per annum, interest payable at maturity, and secured by certain petroleum and natural gas properties (ii)	6,463,000	6,463,000
Related party subordinated secured credit facility dated October 11, 2013 for CDN $4,000,000, payable 181 days following repayment of the senior secured notes, subordinated to the senior secured notes, with interest at 9% due quarterly, and secured by certain petroleum and natural gas properties (iii)	3,223,626	-
	$ 30,693,338	$ 25,933,426
Less: Short-term portion	(27,469,712)	-
Long-term portion	$ 3,223,626	$ 25,933,426

The loans payable at December 31, 2013 are scheduled to mature as follows:

2014	$ 27,469,712
2015	3,223,626
2016	-
Total	$ 30,693,338

(i) On October 22, 2012, the Company entered into a Note Purchase Agreement and issued Senior Secured Notes (the "Notes") in the amount of $22,500,000 due on October 22, 2014.

The Notes are secured by a first priority security interest, lien and mortgage on all assets, including petroleum and natural gas leases and proceeds therefrom. The Notes bear interest at a stated rate equal to 12% per annum with interest payments due quarterly. The Notes are due and payable on October 22, 2014. No holder of the Notes is a related party to Rooster nor is any holder a chartered bank, trust company or treasury bank. The obligation is required to be repaid in cash and is not convertible into common shares of the Company. The Company also incurred $900,590 in loan origination fees.

In connection with this financing, the Company also entered into a Warrant Purchase Agreement with the holders of the Notes pursuant to which it agreed to issue warrants exercisable for up to 9,000,000 common shares of the Company at an exercise price of US$1.00 per common share until October 22, 2017. The warrants are subject to mandatory exercise or conversion, as applicable, in the event that certain conditions are satisfied, including that the trading price of the Company's common shares is equal to or greater than 150% of the warrant exercise price for a period of thirty (30) consecutive trading days and that the Company has its common shares listed on a U.S. Exchange. The warrants are also eligible to be exercised on a "cashless" basis in which case no payment of the exercise price is required. Instead the holder receives shares that reflect the intrinsic value of the warrants, which are priced using the average closing price over the five preceding trading days. Therefore, the warrants meet the definition of a derivative instrument and are classified as a liability for accounting purposes. No warrants have been exercised as at or subsequent to December 31, 2013.

This financing arrangement contains a debt security and a warrant feature. Therefore, on issuance, the financing arrangement was bifurcated between the financial liability and the warrant feature. As at October 22, 2012, the $21,599,410 issuance proceeds, net of loan origination fees, were recorded, with $19,215,410 allocated as loans payable and the remaining $2,384,000 relating to the warrants classified as derivative liabilities. This allocation resulted in an effective interest rate of 21.34% for the loans payable component. This interest rate is comparable with debt yields for mid-sized petroleum and natural gas entities with similar operations.

The warrants were measured at fair value on initial recognition and at each subsequent 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:

	December 31, 2013	December 31, 2012	October 22, 2012 (issuance date)
Risk-free interest rate	1.75%	0.73%	0.78%
Expected life (years)	3.81	4.81	5
Expected volatility	50.0%	50.0%	50.0%
Expected annual dividend yield	0.00%	0.00%	0.00%
Stock price	$0.55	$0.50	$0.75
Exercise price	$1.00	$1.00	$1.00
Fair value per warrant	$0.12	$0.12	$0.27

Changes in fair value are recognized in income (loss) as unrealized gain (loss) on financing warrants. The loans payable component, net of the loan origination fees, is measured at amortized cost using the effective interest rate method, and is being accreted over two years to the principal value on maturity, with a corresponding non-cash charge to income. See also note 15.

The following table shows the changes in the financing arrangement balances:

	Loans payable	Financing warrants	Total
Balance, October 22, 2012	$ 19,215,410	$ 2,384,000	$ 21,599,410
Accretion	255,016	-	255,016
Unrealized gain on revaluation	-	(1,317,000)	(1,317,000)
Balance, December 31, 2012	19,470,426	1,067,000	20,537,426
Accretion	1,536,286	-	1,536,286
Unrealized loss on revaluation	-	25,000	25,000
Balance, December 31, 2013	$ 21,006,712	$ 1,092,000	$ 22,098,712

The Company is required to meet certain covenants including a quarterly collateral coverage covenant under the terms of the Note Payable Agreement. The collateral coverage ratio, which is a non-IFRS measure, is defined as the ratio between the value of proved developed producing reserves, as defined in the Note Purchase Agreement, plus cash and cash equivalents, to the outstanding unpaid principal and unpaid accrued interest of the Notes plus any outstanding accounts payable.

During the year ended December 31, 2013, the Company negotiated an amendment to the Note Purchase Agreement. Pursuant to same, the Company and the Note holders agreed to covenant revisions related to altering the approved plan of drilling by the Company. The Company also received approval to enter into a subordinated secured credit facility for borrowings up to CDN $8.0 million, as more specifically described below (note 9(iii)). The Company paid a consent fee of $450,000 to the Note holders and legal fees incurred by the Note holders which are included in the discount on the related party subordinated credit facility (note 9(iii)).

As at December 31, 2013, the Company was not in compliance with all covenants, obligations and conditions under the Note Payable Agreement as further discussed in note 22.

Unpaid interest of $690,000 and $525,000 has been included in accrued interest payable at December 31, 2013 and 2012, respectively.

(ii) The related party note payable totalling $6,463,000 at December 31, 2013 and 2012 is due to a significant shareholder of the Company. Accrued interest payable totalling $1,326,897 at December 31, 2013 and $262,735 at December 31, 2012 is due at maturity. The initial maturity date is April 26, 2014 subject to other terms of the agreement. However, pursuant to an intercreditor subordination agreement, the principal amount of the note plus accrued interest is subordinate to the Note Purchase Agreement (note 9(i)) and therefore payment is not required prior to repayment of amounts due under the Note Purchase Agreement on October 22, 2014. Accordingly, the respective debt and accrued interest amounts are classified as current liabilities at December 31, 2013.

Prior to the Note Purchase Agreement, the related party note bore interest at Libor plus 5% per annum. As a result of the Note Purchase Agreement, the related party note payable bears interest at the Senior Secured Notes rate of 12% plus 2.5%.

(iii) Effective October 11, 2013, the Company has entered into a First Amendment to the Note Purchase Agreement. Pursuant to same, the Company and the Note holders agreed to covenant revisions related to altering the approved plan of drilling by the Company. The Company also received approval to enter into a subordinated secured credit facility for borrowings up to CDN $8.0 million, as more specifically described below. The Company paid a consent fee of $450,000 to the Note holders and legal fees incurred by the Note holders (note 9(i)).

On October 11, 2013, the Company entered into a subordinated secured credit facility with two related parties who are significant shareholders and/or directors of the Company that provides for borrowing up to CDN $8.0 million to be used for general corporate purposes. The initial advance under the credit facility was CDN $4.0 million (less a 2% original issue discount and administrative fees of $10,000) resulting in net proceeds of $3,234,466. The discount is being accreted over the term of the facility up to the principal amount on maturity using the effective interest rate method, with $82,069 recorded as accretion for the year ended December 31, 2013. The interest rate is 9% on all advances, and the credit facility matures 181 days following full satisfaction of the terms of the existing Note Purchase Agreement, as amended. Additionally, it is secured only by certain oil and gas properties and proceeds therefrom owned by Probe Resources US Ltd. The net proceeds of the initial advance were used to pay certain accounts payable. No further amounts have been drawn on the facility as at or subsequent to December 31, 2013.

(iv) During the year ended December 31, 2012, the Company obtained a bridge loan for $15,000,000 (of which $8,000,000 was drawn) bearing interest at 8% plus 2% discount on advances, which was due and paid on October 23, 2012 and was secured by certain petroleum and natural gas properties. The bridge loan was due to related parties who are significant shareholders and/or directors of the Company. Interest of $316,054 was paid to the related parties and is included in finance expenses. In connection with the bridge loan, the Company paid a 2% loan origination fee totalling $180,000, which is included in finance expenses at December 31, 2012 (note 15).

10. Asset retirement obligations and deposits

Asset retirement obligations were determined by management and were based on the Company's net ownership interest, 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 years ended December 31, 2013 and 2012:

	December 31, 2013	2012
Asset retirement obligations, beginning of year	$ 18,071,240	$ 13,008,253
Liabilities incurred	282,193	223,914
Liabilities acquired (note 5)	-	3,837,917
Liabilities disposed (note 8)	-	(19,824)
Transfers to liabilities associated with assets held for sale (note 8)	-	(193,527)
Liabilities settled	(941,614)	(4,232,235)
Revisions to estimates and changes in discount rate	712,195	2,591,030
Loss on plug and abandonments	-	2,362,072
Accretion (unwinding of discount)	471,813	493,640
Asset retirement obligations, end of year	$ 18,595,827	$ 18,071,240
Less: Short-term portion	(5,392,167)	-
Long-term portion	$ 13,203,660	$ 18,071,240

The Company's asset retirement obligations result from its ownership interest in petroleum and natural gas assets, including well sites and gathering systems. The total asset retirement obligations are estimated based on the Company's net ownership interest in all wells and facilities, estimated costs to reclaim and abandon these wells and facilities and the estimated timing of the costs to be incurred in future years. The estimated inflated undiscounted cash flows required to settle the provisions, before considering salvage, are approximately $20.9 million (2012 - $21.6 million), which has been discounted using a risk-free rate of 2.55% (2012 - 2.55%). These obligations are to be settled based on the economic lives of the underlying assets, which currently extend up to 15 years into the future and will be funded from general corporate resources at the time of abandonment.

At December 31, 2013 and 2012, the Company had a $3,762,000 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 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, $3,462,000 of the deposit has been classified as short-term and included in restricted cash as at December 31, 2013 (note 4(c)).

During the year ended December 31, 2012, the Company incurred and expensed costs in excess of the previously recorded asset retirement obligation in the amount of $2,362,072 for the plugging operations of two wells at East Cameron 129, which is charged to income (loss) as plug and abandonment expense. The costs were due to unexpected downhole issues which required additional equipment and services.

11. Prepaid expenses and deposits

Prepaid expenses and deposits consist of the following:

	December 31,			
		2013		**2012**
Prepaid insurance	$	997,436	$	920,437
Prepaid bonds		83,916		-
Prepaid other		92,480		66,463
Total prepaid expenses and deposits	$	1,173,832	$	986,900

12. Share capital

(a) Authorized

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

(b) Issued

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

	Number of Shares		**Stated Value**
Common shares			
Outstanding, December 31, 2011	1,000	$	12,250,000
Probe common shares outstanding at December 31 2011 [(1)]	14,184,423		-
Elimination of Rooster voting shares	(1,000)		-
Subscription receipts issued, net of issuance costs	-		20,122,951
Issued on reverse acquisition transactions (note 5(a))	26,210,400		8,536,188
Allocation of stated value to proportionate voting shares	-		(29,162,552)
Outstanding, December 31, 2012	40,394,823	$	11,746,587
Issued on cashless exercise of stock options	2,500		2,043
Outstanding, December 31, 2013	40,397,323	$	11,748,630
Proportionate voting shares			
Outstanding, December 31, 2011	-	$	-
Issued on reverse takeover transaction (note 5(a))	65,071		29,162,552
Outstanding, December 31, 2012 and 2013	65,071	$	29,162,552
Total share capital stated value			
December 31, 2012		$	40,909,139
December 31, 2013		$	40,911,182

[(1)]Represents the number of common shares of Probe after 250:1 consolidation.

(c) In conjunction with the Probe transactions (note 5(a)), the Company received net capital of $20,122,951 through a subscription receipts offering and repaid $10 million of amounts due to related parties. As a result, the Company was released from its obligation as a guarantor on the line of credit and term loan for its then parent and affiliates. Share issuance costs incurred of $802,308 represent costs associated with agents' commissions of $678,095 and legal fees of $124,213.

Of the total subscription receipts issued, an aggregate of 18,941,700 subscription receipts were issued to related parties who were significant shareholders, directors, and/or officers of the Company on the same terms as outside parties.

(d) 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. The values assigned to the common shares and the proportionate voting shares at acquisition were based on the proportion of new shares issued in the reverse acquisition.

(e) During the year ended December 31, 2013, 6,666 stock options were exercised under a cashless exercise provision of the plan (note 13), whereby the Company issued 2,500 common shares in settlement of the stock options (December 31, 2012 – nil) (Note 13).

13. Stock-based compensation

The Company has a stock option plan under which options may be granted to employees, officers directors and consultants. As at December 31, 2013, the Company had 21,093,164 common shares authorized for issuance under the stock option plan.

On June 5, 2012, 4,820,645 stock options were granted with an exercise price of CDN $0.50. Additionally, on September 11, 2013, 4,532,759 of stock options were granted with an exercise price of CDN $0.82. Each stock option is exercisable to acquire one common share of the Company for a period of ten years and vests as to 1/3 on each of the 1st, 2nd and 3rd anniversary dates from the date of grant.

The Company's original stock option plan provided that a holder of an option may, rather than exercise such option, elect a cashless exercise of such option payable in common shares equalling the amount by which the value of an underlying common share at that time exceeded the exercise price of an option to acquire such share. On a cashless exercise, the holder of an option would receive a lesser amount of shares in lieu of paying the exercise price based on the market price of the shares on the exercise date, and withholding taxes, if the holder so elected. The Company's stock option plan was subsequently amended during 2013 to remove the cashless exercise feature for future option grants. In addition, the authorized number of shares for issuance under the plan was amended.

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

	Year ended December 31,			
	2013		2012	
	Number	Exercise Price(CDN$)	Number	Exercise Price(CDN$)
Outstanding, beginning of year	4,820,645	$ 0.50	-	$ -
Granted	4,532,759	0.82	4,820,645	0.50
Exercised (1)	(6,666)	0.50		
Forfeited	(53,334)	0.50		
Outstanding, end of year	9,293,404	$ 0.66	4,820,645	$ 0.50
Exercisable, end of year	1,586,882	$ 0.50	-	-

(1) The difference from the number of shares issued upon exercise of stock options (note 12) is due to the cashless exercise. The price of the Company's common shares at the date the stock options were exercised was CDN $0.80

The following table outlines the exercise price and years to expiry of all outstanding options, as well as the number of options exercisable as of December 31, 2013:

Options Outstanding			Options Exercisable	
Exercise Price (CDN$)	Number Outstanding	Remaining Life	Number Exercisable	Exercise Price
$0.50	4,760,645	8.4	1,586,882	$ 0.50
$0.82	4,532,759	9.7	-	$ -
Total	**9,293,404**	**9.0**	**1,586,882**	**$ 0.50**

The fair value of options granted were estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted average assumptions and resulting values:

For the year ended	December 31, 2013	December 31, 2012
Assumptions:		
Stock price (CDN$)	$ 0.82	$ 0.50
Exercise price (CDN$)	$ 0.82	$ 0.50
Risk free interest rate (%)	2%	2%
Expected life (years)	10	10
Expected volatility (%)	50%	50%
Estimated forfeiture rate (%)	5%	-
Expected dividend yield	-	-
Fair value of options granted (CDN$)	**$ 0.50**	**$ 0.31**
Share price on date of grant (CDN$)	**$ 0.82**	**$ 0.50**

During the years ended December 31, 2013 and 2012, $1,005,891 and $507,298, respectively, was recorded as stock-based compensation relating to stock options granted in 2013 and 2012, with a corresponding increase in contributed surplus.

14. Personnel expenses

The total remuneration for employees, officers and directors included in general and administrative expenses for 2013 and 2012 was as follows:

	Year Ended December 31, 2013		2012	
Salaries and fees	$	3,053,242	$	2,806,630
Stock-based compensation		1,005,891		507,298
Total employee remuneration	$	4,059,133	$	3,313,928

Key management personnel include senior officers and directors. Executive officers are paid a salary. The executive officers include the Chief Executive Officer and President, Chief Financial Officer/Controller, Vice President, Operations, and Vice President, Land and Legal. Key management personnel remuneration comprised the following:

	Year Ended December 31, 2013		2012	
Salaries and fees	$	1,694,225	$	1,583,833
Stock-based compensation		848,589		424,690
Total key management remuneration	$	2,542,814	$	2,008,523

15. Finance expenses

	Year Ended December 31, 2013	2012
Interest expense on senior secured notes (note 9(i))	$ 2,737,500	$ 525,000
Interest on loan payable to related party (note 9(ii))	1,064,161	262,735
Interest on related party subordinated secured credit facility (note 9(iii))	84,618	-
Interest expense on amounts due to related parties (note 20)	-	132,782
Loan origination fees on related party bridge loan (note 9(iv))	-	180,000
Interest on related party bridge loan (note 9(iv))	-	316,054
Accretion of discount on senior secured notes (note 9(i))	1,536,286	255,016
Accretion of discount on related party subordinated secured credit facility (note 9(iii))	82,069	-
Accretion of asset retirement obligations (note 10)	471,813	493,640
Foreign exchange gain on related party subordinated secured credit facility (note 9(iii))	(92,909)	-
Other	77,686	307
Total finance expenses	$ 5,961,224	$ 2,165,534

16. Income taxes

(a) Deferred income tax expense

The provision for income taxes differs from the results which would have been obtained by applying the combined federal and provincial income tax rate to the Company's income before income tax. The difference results from the following items:

	Year Ended December 31, 2013	Year Ended December 31, 2012
Income (loss) before income taxes	$ (2,746,851)	$ 1,600,331
Statutory tax rate:	35.0 %	35.0 %
Expected income tax expense (recovery)	(961,000)	560,000
Difference resulting from:		
Change in tax status	-	5,461,000
Stock-based compensation	324,000	178,000
Unrealized gain (loss) on financing warrants	9,000	(461,000)
Accretion of note payable discount (note 9(i))	367,000	63,000
Net loss allocated to member prior to change in tax status	-	891,000
Changes in permanent differences and other	(340,000)	610,000
Change in valuation allowance	(112,000)	(2,014,000)
Total income tax expense (recovery)	$ (713,000)	$ 5,288,000

The US federal rate is 35%. All of the Company's producing petroleum and natural gas interests are currently located offshore in US federal waters, and accordingly, no US state taxes have been applied.

In connection with the reverse acquisition of Probe (see note 5(a)), Rooster changed its tax status. As a result, the deferred tax liability consequence of the change in tax status in the amount of $5,461,000 was recorded in earnings for the year ended December 31, 2012.

Prior to the reverse acquisition, taxable income or loss of Rooster and its subsidiaries was included in the tax return of its member. Prior to April 30, 2012, Rooster was treated as a partnership for income tax purposes and, as such, its member was taxed separately on its share of Rooster's income whether or not that income was actually distributed.

(b) Deferred income tax assets and liabilities:

The components of the Company's deferred income tax liabilities (assets) and associated movements are as follows:

	December 31, 2012	Recognized in Income	December 31, 2013
Property and equipment assets	$ 12,860,000	$ 16,426,000	$ 29,286,000
Asset retirement obligations	(6,325,000)	(183,000)	(6,508,000)
US net operating losses	(2,151,000)	(16,057,000)	(18,208,000)
Canadian non-capital losses	(1,158,000)	(242,000)	(1,400,000)
Share issuance and other temporary differences	251,000	(545,000)	(294,000)
Valuation allowance	1,811,000	(112,000)	1,699,000
	$ 5,288,000	$ (713,000)	$ 4,575,000
Deferred income tax asset (1)(3)	$ (3,709,000)	$ 3,709,000	$ -
Deferred income tax liability (2)(3)	8,997,000	(4,422,000)	4,575,000
	$ 5,288,000	$ (713,000)	$ 4,575,000

(1) Probe Resources US, Ltd.

(2) Rooster Energy, L.L.C., Rooster Petroleum, LLC and Rooster Oil & Gas, LLC

(3) During the year ending December 31, 2013, the Company elected to file consolidated tax returns allowing the deferred tax asset of Probe Resources US, Ltd. to be offset with the deferred tax liability of Rooster Energy, L.L.C., Rooster Petroleum, LLC and Rooster Oil & Gas, LLC

	December 31, 2011	Acquired in business combination	Recognized in profit or loss	Recognized directly in equity	December 31, 2012
Property and equipment assets	$ -	$ (444,000)	$ 13,304,000	$ -	$ 12,860,000
Asset retirement obligations	-	(871,000)	(5,454,000)	-	(6,325,000)
US net operating losses	-	(700,000)	(1,451,000)	-	(2,151,000)
Canadian non-capital losses	-	(1,158,000)	-	-	(1,158,000)
Canadian share issuance costs and other temporary differences	-	(451,000)	903,000	(201,000)	251,000
Valuation allowance	-	3,624,000	(2,014,000)	201,000	1,811,000
	$ -	$ -	$ 5,288,000	$ -	$ 5,288,000
Deferred income tax assets (1)	$ -	$ -	$ (3,709,000)	$ -	$ (3,709,000)
Deferred income tax liabilities (2)	-	-	8,997,000	-	8,997,000
	$ -	$ -	$ 5,288,000	$ -	$ 5,288,000

(1) Probe Resources US, Ltd.

(2) Rooster Energy, L.L.C., Rooster Petroleum, LLC and Rooster Oil & Gas, LLC

The amount and timing of reversals of temporary differences will be dependent upon a number of factors including the Company's future operating results. The US net operating losses are available for deduction against future taxable income until 2033.

Future tax benefits related to tax deductions in Canada for Rooster Energy, Ltd. have been offset with a valuation allowance, applied using a combined federal and provincial tax rate of 25%, due to the uncertainty of realization. The Canadian non-capital losses expire between 2030 and 2033.

As a result of fourth quarter drilling and additional reserves assigned at December 31, 2012, the Company assessed it was probable that a portion of its previously unrecognized deferred tax assets relating to its US operations would be realized, and accordingly, a decrease in the valuation allowance of $2,014,000 was recognized during the year ended December 31, 2012.

17. Loss per share

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

	Year Ended December 31,	
	2013	**2012**
Basic	105,466,967	100,776,437
Effect of dilutive stock options	-	-
Diluted	105,466,967	100,776,437

Basic loss per share figures for the years ended December 31, 2013 and 2012 have been calculated using the weighted average number of common shares (post-consolidation) 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. The total weighted average number of shares outstanding for the year ended December 31, 2012 was adjusted to reflect the equivalent number of Probe shares issued to Rooster shareholders upon the reverse acquisition transactions. All outstanding options and warrants were excluded from the calculation of diluted loss per share for the years ended at December 31, 2013 and 2012, as they were anti-dilutive.

18. Supplemental cash flow information

(a) Changes in non-cash working capital, excluding non-cash changes for the increase in restricted cash in 2013 and working capital balances acquired in the Probe acquisition in 2012, comprise the following:

	Year Ended December 31, 2013	Year Ended December 31, 2012
Source (uses) of cash:		
Restricted cash	$ (5,270,635)	$ -
Non-cash changes in restricted cash (note 4(e))	3,112,000	-
Accounts receivable	4,191,281	(3,278,088)
Prepaid expenses and deposits	(186,932)	77,078
Accounts payable and accrued liabilities	10,733,704	(537,562)
Non-cash changes in working capital from Probe transaction (note 5 (a))	-	(1,240,279)
Due to related parties	(766,124)	(9,430,145)
Changes in non-cash working capital	$ 11,813,294	$ (14,408,996)
Related to operating activities	$ 7,245,243	$ (16,137,983)
Related to investing activities	4,568,051	1,728,987
Related to financing activities	-	-
	$ 11,813,294	$ (14,408,996)

(b) Cash and cash equivalents is comprised of the following:

	December 31, 2013	December 31, 2012
Bank balances	$ 964,040	$ 7,367,848
Cash equivalents	-	-
	$ 964,040	$ 7,367,848

(c) Interest and income taxes paid

The Company made interest payments in the amounts of $2,572,500 and $Nil during the years ended December 31, 2013 and 2012, respectively.

The Company has not paid any income taxes during the years ended December 31, 2013 or 2012.

19. Commitments

(a) Operating leases

The Company leases its corporate headquarters in Houston, Texas, under a non-cancellable operating lease expiring in June 2017. The Company is obligated for the following rental payments under this lease at December 31, 2013:

2014	$ 202,464
2015	206,112
2016	209,760
2017	105,792
Total	$ 724,128

The Company also leases a field office facility in Abbeville, Louisiana under a non-cancellable operating lease expiring May 31, 2014. The monthly rent is $2,300.

(b) Production imbalances

Cash received by the Company for volumes of petroleum and natural gas sold may differ from the volumes to which the Company is entitled based on its interests in the properties. These differences create imbalances that are recognized as a liability only when the estimated remaining reserves will not be sufficient to enable the under-produced owner to recoup its entitled share through production, or in certain other circumstances (see restricted cash note 4(c)). No receivables are recorded for those volumes where the Company has received less than its share of production. If an imbalance exists at the time the wells reserves are fully depleted, settlements are made among the joint interest owners under a variety of arrangements. The Company is obligated to discharge imbalance positions from future production.

20. Other related party transactions

The Company has transactions with affiliates, including field services, rental of equipment, the reimbursement of operating expenses, and the payment of certain administrative services at terms determined by management. In addition, two parties, related to the Company by way of common directors and officers, are participating as to a 7.5% working interest in the drilling of a well in the US Gulf of Mexico.

Balances due to (from) related parties and related party transactions are as follows:

	December 31, 2013	December 31, 2012
Due to related parties (1)	$ 3,970,348	$ 4,736,472
Note payable due to related party (note 9(ii))	6,463,000	6,463,000
Accrued interest payable on note payable to related party (note 9(ii))	1,326,897	262,735
Note payable to related parties (note 9(iii))	3,223,626	-
Accrued interest payable on note payable to related party (note 9(iii))	84,618	-
Accounts receivable due from related parties participating in drilling of well	(265,547)	-
Total	$ 14,802,942	$ 11,462,207

(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 9(i)). The amounts are unsecured, non-interest bearing, and have no fixed terms of repayment.

	Year Ended December 31, 2013	Year Ended December 31, 2012
Purchases from related parties	$ 390,099	$ 2,265,930
Interest expense on amounts due to related parties (note 15)	-	132,782
Interest expense on note payable to related party (note 15)	1,064,161	262,735
Interest expense and origination fees on related party bridge loan (note15)	-	496,054
Interest expense on related party subordinated secured credit facility (note 15)	84,618	-
Total	$ 1,538,878	$ 3,157,501

Purchases from related parties during the years ended December 31, 2013 and 2012 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.

Additional related party transactions relating to the Company's related party loans payable are outlined in note 9.

21. Contingencies

Certain claims and counterclaims have been filed against the Company which arise in the normal course of business. Management has assessed these legal actions to be without merit and/or the Company expects to be fully indemnified, and the likelihood of loss to the Company is remote. Accordingly, no amounts have been accrued in the December 31, 2013 consolidated financial statements relating to these actions.

There is only one threatened or pending legal matter that, in the opinion of management, could have a material impact on the Company's consolidated results of operations, financial position or cash flows, as discussed below.

In 2012, the Company assigned a 25% participation interest in the Vermilion Area Block 376 #A-3 and #A-4 wells in consideration of the assignee paying it's agreed to proportionate share of the drilling, completion and lease operating costs. The assignee failed to pay certain invoiced amounts and on November 20, 2012 the Company, as operator of the wells, filed a lien in the amount of $2,264,701 against the interest in the wells. Additionally, on March 27, 2013, the Company filed an action to recover all amounts due per the lien in addition to unpaid lease operating expenses, damages, interest, attorney fees, etc. In response, the assignee of the interest and three of its affiliates filed counter-claims against the Company. The assignee et al also named certain officers and/or directors of the Company as defendants in the action and the Company has agreed to indemnify and defend those individuals as the claims asserted against each of them is based on the same facts and circumstances alleged against the Company. See also notes 4(c) and 19.

The Company asserts that it has valid defenses to the counter-claims and is of the opinion that it will not be subject to any material damage award in the matter.

22. Subsequent events

Effective March 7, 2014, the Company entered into membership interest contribution agreements whereby the Company will acquire all of the membership interests of Morrison Well Services, LLC ("Well Services") and Cochon Properties, LLC ("Cochon") for aggregate consideration of $125 million, with $95 million and $30 million relating to the acquisitions of Well Services and Cochon, respectively, subject to working capital adjustments as outlined in the membership interest contribution agreements. Of the total consideration, $10 million (plus or minus any working capital adjustments) is payable by the Company in cash, with the remaining amount payable by way of common shares of the Company. The number of Rooster common shares to be issued will equal that number obtained by dividing $115 million by the average daily closing price of the Rooster common shares on the TSX Venture Exchange for the 20 consecutive trading days ending on and including the date that is 10 business days prior to the special shareholder meeting to approve the transactions, subject to a floor price of CDN $0.40 and a cap of CDN $0.70. Pursuant to the transactions, Well Services and Cochon will each become a wholly-owned subsidiary of the Company. Well Services and Cochon are controlled by a related party who is a significant shareholder and director of the Company. The majority shareholder entitled to vote on the acquisitions has provided a support agreement to vote in favor of the acquisitions and that shareholder represents more than 51% of the Company's shares entitled to vote on the acquisitions. Closing of the transactions are expected to occur in the second quarter of fiscal 2014, subject to, among other conditions, receipt of required regulatory and shareholder approvals.

In order to enter into the membership interest contribution agreements, the Company obtained the consent of the holders of the Notes pursuant to a limited consent and forbearance agreement dated March 7, 2014 (the "Limited Consent"). Therein, the holders of the Notes and the Company acknowledged that the Company was in existing and continuing default of the collateral coverage ratio covenant of the Notes as at December 31, 2013. In order to allow for the acquisition of Cochon and Well Services, the Limited Consent provides that, the holders of the Notes will forbear from exercising certain rights and remedies under the Note Purchase Agreement and certain related documents in respect of the default until July 7, 2014, or such earlier date if certain events of insolvency or other customary events of default occur. The Company is also engaged in discussions for a new credit facility that would allow it to satisfy its obligations to the holders of the Notes and resolve its working capital deficiency (see also note 4 (d)). However, there can be no assurance that such credit facility will be made available on terms acceptable to the Company or at all.

Also effective March 7, 2014, the Company entered into an additional second lien credit facility with a related party who is a significant shareholder and director of the Company and who controls Cochon and Well Services, for borrowing of up to $10 million. The initial advance was $4.4 million, net of an original issue discount of 10%, for a funded amount equal to $4 Million. The credit facility is fully subordinated to the Company's Senior Secured Notes issued pursuant to the Note Purchase Agreement (note 9). Amounts drawn on the credit facility bear interest at 14% per annum, and are repayable 181 days after the full satisfaction of the Senior Secured Notes. The credit facility is secured by the Company's petroleum and natural gas properties and assets. No further amounts have been drawn on the facility subsequent to March 7, 2014.

In order to enter into the second lien credit facility, the Company obtained the consent of the holders of the Notes pursuant to a second amendment to the Note Purchase Agreement dated March 7, 2014, which provides for various conditions including the requirement for the Company to restrict any payments under the facility as provided for in a subordination agreement. In addition, the Company will be required to pay to the holders of the Notes, an amount equal to 3% of the principal amount repaid.