



Financial and Operating Highlights

(000's except per share amounts)	Three months ended December 31			Year ended December 31		
	2011	2010	% Change	2011	2010	% Change
Financial (\$)						
Production revenue ⁽¹⁾	\$ 23,527	\$ 22,352	5	\$ 101,996	\$ 54,570	87
Comprehensive loss ⁽²⁾	(15,598)	(23,206)	(33)	(20,158)	(52,349)	(61)
Per share, basic and diluted	(0.10)	(0.18)	(44)	(0.14)	(0.75)	(81)
Funds flow from operations ^{(2) (3)}	10,002	7,629	31	42,262	15,997	164
Per share, basic and diluted	0.06	0.06	–	0.29	0.23	26
Production volumes						
Natural gas (mcf/d)	47,203	38,702	22	47,825	22,956	108
Crude oil (bbls/d)	503	478	5	575	333	73
Natural gas liquids (bbls/d)	509	557	(9)	464	292	59
Total (boe/d)	8,879	7,485	19	9,010	4,451	102
Sales prices						
Natural gas, including realized hedges (\$/mcf)	\$ 3.59	\$ 4.40	(18)	4.03	\$ 4.63	(13)
Crude oil (\$/bbl)	97.15	77.24	26	92.60	74.12	25
Natural gas liquids (\$/bbl)	73.19	64.13	14	71.99	63.88	13
Total (\$/boe)	\$ 28.80	\$ 32.46	(11)	\$ 31.02	\$ 33.59	(8)
Operating Netbacks (\$/boe)						
Price	\$ 28.80	\$ 32.46	(11)	\$ 31.02	\$ 33.59	(8)
Royalties	(3.75)	(3.80)	(1)	(4.18)	(3.55)	18
Transportation	(1.93)	(2.25)	(14)	(2.18)	(2.68)	(19)
Operating costs	(8.60)	(10.20)	(16)	(9.02)	(10.90)	(17)
Operating netback	\$ 14.52	\$ 16.21	(10)	\$ 15.64	\$ 16.46	(5)
Capital expenditures	\$ 56,335	\$ 24,392	131	\$ 149,601	\$ 64,120	133
Corporate acquisitions ⁽²⁾	–	–	–	–	155,602	(100)
Property acquisitions (net) ⁽²⁾	–	(4,707)	(100)	(23,023)	43,157	N/A
Total capital expenditures	\$ 56,335	\$ 19,685	186	\$ 126,578	\$ 262,879	(52)
Net debt and working capital (deficiency) ⁽⁴⁾	(51,442)	(72,739)	(29)	(51,442)	(72,739)	(29)
Weighted average shares outstanding (basic and diluted)	161,818	127,258	27	147,558	69,713	112
Undeveloped land (net acres)	254,400	293,800	(13)	254,400	293,800	(13)

⁽¹⁾ Production revenue is presented gross of royalties and includes realized gain on commodity contracts.

⁽²⁾ 2010 figures have been restated from previously reported amounts resulting from the application of IFRS. See 'Adoption of International Financial Reporting Standards' section below.

⁽³⁾ Funds flow from operations is calculated as cash flow from operating activities before adjustments for decommissioning liability expenditures, proceeds from the sale of commodity contracts and net changes in non-cash working capital.

⁽⁴⁾ Net debt and working capital (deficiency) is calculated as cash and net working capital less commodity contract asset and demand credit facilities and excluding other liabilities.

Management's Discussion and Analysis

This Management's Discussion and Analysis ("MD & A") of the financial and operating results of Cequence Energy Ltd. ("Cequence" or the "Company") should be read in conjunction with the Company's audited consolidated financial statements (the "Financial Statements") and related notes for the years ended December 31, 2011 and 2010.

Additional information relating to the Company, including its MD & A for the prior year and the annual information form ("AIF") is available on SEDAR at www.sedar.com.

This MD & A is dated March 8, 2012.

BASIS OF PRESENTATION

The Financial Statements and comparative information have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB") and represent the first annual financial statements of the Company prepared in accordance with IFRS. The Company adopted IFRS in accordance with IFRS 1, "First-time Adoption of International Financial Reporting Standards" ("IFRS 1"). Previously, the Company prepared its Financial Statements in accordance with Canadian generally accepted accounting principles ("Canadian GAAP"). The financial information presented reflects the consolidated financial statements of Cequence.

The reporting and the measurement currency is the Canadian dollar. For the purpose of calculating unit costs, natural gas is converted to a barrel of oil equivalent ("boe") using six thousand cubic feet of natural gas equal to one barrel of oil unless otherwise stated. The term barrel of oil equivalent (boe) may be misleading, particularly if used in isolation. A boe conversion ratio for gas of 6 Mcf:1 boe is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead.

For fiscal 2011, the ratio between the average price of West Texas Intermediate ("WTI") crude oil at Cushing and NYMEX natural gas was approximately 24:1 ("Value Ratio"). The Value Ratio is obtained using the 2011 WTI average price of \$95.11 (US\$/Bbl) for crude oil and the 2011 NYMEX average price of \$4.03 (US\$/MMbtu) for natural gas. This Value Ratio is significantly different from the energy equivalency ratio of 6:1 and using a 6:1 ratio would be misleading as an indication of value.

Unless otherwise stated and other than per unit items, all figures are presented in thousands.

NON-GAAP MEASUREMENTS

Within the MD & A references are made to terms commonly used in the oil and gas industry. Netback is not defined by IFRS in Canada and is referred to as a non-GAAP measure. Netbacks equal total revenue less royalties, operating costs and transportation costs. Management utilizes this measure to analyze operating performance.

Management's Discussion and Analysis

Funds flow from operations is a non-GAAP term that represents cash flow from operating activities before adjustments for decommissioning liability expenditures, proceeds from the sale of commodity contracts and net changes in non-cash working capital. The Company evaluates its performance based on earnings and funds flow from operations. The Company considers funds flow from operations a key measure as it demonstrates the Company's ability to generate the cash flow necessary to fund future growth through capital investment and to repay debt. The Company's calculation of funds flow from operations may not be comparable to that reported by other companies. Funds flow from operations per share is calculated using the same weighted average number of shares outstanding used in the calculation of comprehensive income (loss) per share.

Non-GAAP financial measures do not have a standardized meaning prescribed by IFRS and are therefore unlikely to be comparable to similar measures presented by other issuers.

OVERVIEW

A summary of the Company's significant transactions that occurred in the current and prior periods is as follows:

2010 Transactions

On July 27, 2010, Cequence sold certain non-producing gas weighted properties in the Sinclair region of Northwest Alberta for total cash consideration of \$36,900, subject to final adjustments. A gain of \$18 resulted on the sale, recognized with other expense (income) in comprehensive income (loss) for the year ended December 31, 2010.

On August 19, 2010, the Company completed the sale of 3,200 shares on a CEE "flow-through" private placement basis at \$2.50 per share for gross proceeds of \$8,000, 870 shares on a CDE "flow-through" private placement basis at \$2.30 per share for gross proceeds of \$2,001 and 18,545 subscription receipts at a price of \$2.10 per subscription receipt for gross proceeds of \$38,945. On September 8, 2010, the subscription receipts were converted on a one for one basis, for no additional consideration and without further action, into common voting shares of the Company. On September 17, 2010, Cequence completed the sale of 2,500 common voting shares related to an over-allotment option on the subscription receipts offering discussed above at \$2.10 per share for gross proceeds of \$5,250. Total gross proceeds from the above issuances were \$54,196 and as at December 31, 2011, the Company has incurred all of the qualifying expenditures under the flow-through share agreements.

On September 8, 2010, the Company closed the acquisition of certain gas weighted properties located in the Simonette area of Northwest Alberta (the "Deep Basin Assets"). The purchase price, subject to final adjustments, was \$85,000. A decommissioning liability of \$7,703 has been recognized as part of the acquisition.

On September 10, 2010, the Company acquired all of the issued and outstanding shares of Temple Energy Inc. ("Temple"), a private oil and gas company, for consideration of 46,846 common voting shares. Under IFRS 3, the shares were valued based on Cequence's closing trading price on the TSX on September 10, 2010. The transaction was accounted for using the acquisition method whereby the assets acquired and liabilities assumed are recorded at their fair value as determined by reference to the relevant IFRS standards. The accounts of the Company include the results of Temple effective September 10, 2010. The purchase price allocation is as follows:

(\$000's)

Cost of Acquisition

Common shares (46,846 at \$2.03)	95,098
Total	95,098

(\$000's)

Fair Value of the Assets and Liabilities Acquired

Property and equipment	128,968
Fair value of commodity contracts	4,201
Bank debt	(36,423)
Working capital deficiency	(3,834)
Decommissioning liabilities	(10,184)
Deferred income tax assets – non-current	12,370
Total	95,098

On September 10, 2010, Cequence completed the sale of 2,950 common voting shares through a private placement to a major shareholder as well as certain management and directors of the Company at \$2.10 per share for total gross proceeds of \$6,195.

On November 30, 2010, the Company completed the sale, on a private placement basis, of 2,250 units at a price of \$2.00 per unit for total gross proceeds of \$4,500. Each unit entitles the holder to:

- one common voting share on a CDE “flow-through” basis;
- one warrant to purchase one common voting share on a CDE “flow-through” basis at any time on or after August 1, 2011 and prior to August 15, 2011 at a price set as a 10 percent premium to the 10 day volume weighted average trading price of the Company’s shares on the TSX for the period July 18, 2011 to July 29, 2011 (the “2011 Warrants”). The 2011 Warrants were exercised during the third quarter of 2011 (see ‘2011 Transactions’ section below); and
- one warrant to purchase one common voting share on a CDE “flow-through” basis at any time on or after August 1, 2012 and prior to August 15, 2012 at a price set as a 10 percent premium to the 10 day volume weighted average trading price of the Company’s shares on the TSX for the period July 18, 2012 to July 31, 2012 (the “2012 Warrants”).

Under the terms of the agreement, Cequence renounced \$3,000 of CDE expenditures in February 2011. As at December 31, 2011, the Company has incurred all of the qualifying CDE expenditures.

SUBSEQUENT EVENTS

On March 8, 2012, the 2012 Warrants (see '2010 Transactions' above) were cancelled at no cost to Cequence and no redress to the shareholder.

SELECTED FINANCIAL INFORMATION

\$(000's)	Year ended December 31		
	2011	2010	2009 ⁽⁴⁾
Production revenue ⁽¹⁾	\$ 101,996	\$ 54,570	\$ 27,983
Funds flow from operations ^{(2) (3)}	42,262	15,997	3,927
Per share – basic and diluted	0.29	0.23	0.19
Comprehensive loss ⁽²⁾	(20,158)	(52,349)	(8,654)
Per share – basic and diluted	(0.14)	(0.75)	(0.41)
Total assets ⁽²⁾	491,365	409,381	208,111
Demand credit facilities ⁽²⁾	11,618	56,739	–
Long-term debt related to investments	\$ –	\$ –	\$ 18,054

⁽¹⁾ Production revenue is presented gross of royalties and includes realized gain on commodity contracts.

⁽²⁾ 2010 figures have been restated from previously reported amounts resulting from the application of IFRS. See 'Adoption of International Financial Reporting Standards' section below.

⁽³⁾ Funds flow from operations is calculated as cash flow from operating activities before adjustments for decommissioning liability expenditures, proceeds from the sale of commodity contracts and net changes in non-cash working capital.

⁽⁴⁾ 2009 figures are presented in accordance with Canadian GAAP.

A reconciliation of cash flow from operating activities to funds flow from operations is as follows:

\$(000's)	Three months ended December 31		Year ended December 31	
	2011	2010	2011	2010
Cash flow from operating activities ⁽¹⁾	\$ 6,743	\$ 13,715	\$ 36,700	\$ 17,240
Decommissioning liabilities expenditures	455	21	955	126
Proceeds from sale of commodity contracts	–	(3,386)	–	(3,386)
Net change in non-cash working capital ⁽¹⁾	2,804	(2,721)	4,607	2,017
Funds flow from operations	\$ 10,002	\$ 7,629	\$ 42,262	\$ 15,997

⁽¹⁾ 2010 figures have been restated from previously reported amounts resulting from the application of IFRS. See 'Adoption of International Financial Reporting Standards' section below.

Cequence recorded a comprehensive loss of \$15,598 for the quarter ended December 31, 2011. Comprehensive income (loss) and funds flow from operations for the period were negatively impacted by low natural gas prices and impairments recognized on the Company's property and equipment at December 31, 2011 (see 'Depletion, Depreciation and Impairment' section below).

Funds flow from operations was \$10,002 for the quarter ended December 31, 2011 compared to funds flow from operations of \$7,629 for the quarter ended December 31, 2010. The increase in funds flow from operations is due largely to an increase in revenue resulting from the expanded production base of the Company and cost reductions, offset by lower realized natural gas prices for the period.

Management's Discussion and Analysis

RESULTS OF OPERATIONS

Average production volumes, revenue and prices for the three and twelve month periods ended December 31, 2011 and 2010 are outlined below:

	Three months ended December 31		Year ended December 31	
	2011	2010	2011	2010
Production				
Natural gas (Mcf/d)	47,203	38,702	47,825	22,956
Crude oil (bbls/d)	503	478	575	333
Natural gas liquids (bbls/d)	509	557	464	292
Total (boe/d)	8,879	7,485	9,010	4,451
Total production (boe)	816,873	688,579	3,288,563	1,624,519

\$(000's)

Revenue

Natural gas	\$	15,162	\$	14,054	\$	69,467	\$	34,800
Realized gains on natural gas contracts		443		1,621		906		3,956
Total natural gas		15,605		15,675		70,373		38,756
Crude oil		4,492		3,393		19,429		9,015
Natural gas liquids		3,430		3,284		12,194		6,799
Total production revenue, gross of royalties	\$	23,527	\$	22,352	\$	101,996	\$	54,570

Average prices

Natural gas (\$/Mcf)	\$	3.49	\$	3.95	\$	3.98	\$	4.15
Realized natural gas hedge (\$/Mcf)		0.10		0.45		0.05		0.48
Natural gas including realized hedge gains and losses (\$/Mcf)		3.59		4.40		4.03		4.63
Crude oil (\$/bbl)		97.15		77.24		92.60		74.12
Natural gas liquids (\$/bbl)		73.19		64.13		71.99		63.88
Average sales price before hedge (\$/boe)	\$	28.26	\$	30.11	\$	30.74	\$	31.16
Average sales price including hedge (\$/boe)	\$	28.80	\$	32.46	\$	31.02	\$	33.59

PRODUCTION

Production for the year ended December 31, 2011 averaged 9,010 boe/d compared to production of 4,451 boe/d in the comparable period of 2010. Production for the three months ended December 31, 2011 averaged 8,879 boe/d compared to production of 7,485 boe/d in the fourth quarter of 2010. The increase in production is due to new drilling and recompletions in 2010 and 2011.

REVENUE

Total production revenue, gross of royalties, was \$23,257 in the fourth quarter of 2011 compared to \$22,352 for the comparable period in 2010. The increase in revenue is mainly attributable to the 19 percent increase in production, offset by an 11 percent decrease in realized sales prices. For the year ended December 31, 2011, production revenue, gross of royalties, increased 87 percent to \$101,996 from \$54,570 in the prior year. The increase is a result of a 102 percent increase in production volumes, offset by an 8 percent decrease in realized sales prices.

PRICING

The realized natural gas prices for the three and twelve months ended December 31, 2011 are above prevailing market prices as much of the Company's natural gas sells at a premium to AECO due to the heat content of the gas. The Company also entered into a commodity contract effective February 1, 2011 for the sale of 5,000 gj per day of natural gas for a price of \$3.83 per gj and a commodity contract effective July 1, 2011 for the sale of 2,500 gj per day of natural gas for a price of \$4.00 per gj (see 'Commodity Price Management' below). Cequence's production is approximately 88 percent natural gas and consequently, fluctuations in natural gas prices have a significant impact on the Company's revenue.

Cequence realized a natural gas price including hedging gain (as described below) for the fourth quarter of 2011 of \$3.59 per Mcf, a decrease of 18 percent from the comparable period in 2010. Realized natural gas prices for the year ended December 31, 2011 were \$4.03 per Mcf, down 13 percent from the comparable period in 2010.

Oil prices for the fourth quarter of 2011 were \$97.15 per barrel, up 26 percent from the same time period in 2010. Oil prices for the year ended December 31, 2011 were \$92.60 per barrel, up 25 percent from the comparable period in 2010.

Natural gas liquids prices for the fourth quarter of 2011 were \$73.19 per barrel, up 14 percent from the same time period in 2010. Natural gas liquids prices for the year ended December 31, 2011 were \$71.99 per barrel, up 13 percent from the comparable period in 2010.

Benchmark natural gas prices were lower than the three and twelve month comparative periods in 2010. Benchmark crude oil and natural gas liquids prices were higher than the three and twelve month comparative periods in 2010. The following table details the Company's benchmark indices:

	Three months ended December 31		Year ended December 31	
	2011	2010	2011	2010
AECO-C spot (CDN\$/Mcf)	\$ 3.19	\$ 3.61	\$ 3.64	\$ 3.99
WTI crude oil (US\$/bbl)	94.03	85.16	95.05	79.51
Edmonton par price (CDN\$/bbl)	98.17	80.91	95.57	78.16
US\$/CDN\$ exchange rate	0.98	0.99	1.01	0.97

COMMODITY PRICE MANAGEMENT

	Three months ended December 31		Year ended December 31	
	2011	2010	2011	2010
Realized gain on commodity contracts	\$ 443	\$ 1,621	\$ 906	\$ 3,956
Unrealized loss on commodity contracts	(168)	(1,445)	-	(2,793)
Total	\$ 275	\$ 176	\$ 906	\$ 1,163

Management's Discussion and Analysis

Cequence has a commodity price risk management program which provides the Company flexibility to enter into derivative and physical commodity contracts to protect future cash flows for planned capital expenditures. The Company had a natural gas contract in place that expired on March 31, 2010 for the sale of 6,000 gj per day of natural gas for a price of \$7.85 per gj. The Company entered into a commodity contract effective February 1, 2011 for the sale of 5,000 gj per day of natural gas for a price of \$3.83 per gj which expired December 31, 2011 as well as a contract effective July 1, 2011 for the sale of 2,500 gj per day of natural gas for a price of \$4.00 per gj which expired October 31, 2011. The fair value of derivative commodity contracts at December 31, 2011 is \$nil compared to \$nil at December 31, 2010.

ROYALTY EXPENSE

\$(000's)	Three months ended December 31		Year ended December 31	
	2011	2010	2011	2010
Crown	\$ 2,518	\$ 1,783	\$ 10,845	\$ 4,476
Freehold / Overriding	545	833	2,898	1,293
	\$ 3,063	\$ 2,616	\$ 13,743	\$ 5,769

As a % of Revenue, Before Hedging Activity

Crown	11%	9%	11%	9%
Freehold / Overriding	2%	4%	3%	3%
	13%	13%	14%	12%

Per Unit of Production (\$/boe)

Crown	\$ 3.08	\$ 2.59	\$ 3.30	\$ 2.75
Freehold / Overriding	0.67	1.21	0.88	0.80
	\$ 3.75	\$ 3.80	\$ 4.18	\$ 3.55

Royalty expense in the fourth quarter of 2011 was \$3,063 or 13 percent of revenue compared to \$2,616 or 13 percent of revenue in the fourth quarter of 2010. For the year ended December 31, 2011, royalties as a percentage of revenue were 14 percent compared to 12 percent in the comparative period in 2010. The overall royalty rate has increased in the twelve months ended December 31, 2011 as compared to the same period in 2010 due to higher royalties on properties acquired in 2010. Royalties as a percentage of revenue are consistent with the Company's expectation of 12 to 14 percent of revenue for 2011. The Company expects, based on forecast oil and natural gas prices, that royalties will average approximately 11 to 13 percent of revenue in 2012.

A significant portion of the Company's production is in the Province of Alberta. Under the Alberta Royalty Framework ("ARF") the Crown royalty rate varies with production rates and commodity prices. The royalty rate expressed as a percentage of sales revenue will fluctuate from period to period due to the fact that the Alberta Reference Price can differ significantly from the commodity prices realized by the Company and that hedging gains and losses are not subject to royalties.

In addition to the basic underlying royalty structure (the ARF), Alberta has instituted additional features that impact the royalty paid on gas, particularly for newly drilled wells. These additional features include:

1. A one year flat 5 percent royalty period (18 months for horizontal wells) for each new well but capped at a cumulative production level of 500 MMcf for each new well; and
2. A Natural Gas Deep Drilling Holiday program that provides a royalty holiday value for new wells based on meterage drilled. This holiday feature further reduces the royalty for new wells to a minimum of 5 percent for a maximum 5 year period from on-stream date. This benefit sequentially follows the benefit under point (1) above.

TRANSPORTATION EXPENSE

\$(000's)	Three months ended December 31		Year ended December 31	
	2011	2010	2011	2010
Transportation (\$)	\$ 1,580	\$ 1,551	\$ 7,153	\$ 4,357
Per unit of production (\$/boe)	\$ 1.93	\$ 2.25	\$ 2.18	\$ 2.68

Transportation costs for the year ended December 31, 2011 were \$2.18 per boe, a decrease of 19 percent from the comparative period in 2010. In the fourth quarter of 2011, transportation costs decreased to \$1.93 per boe from \$2.25 per boe in the comparative period in 2010. Beginning in the fourth quarter of 2009, approximately 3,070 Mcf/d of natural gas is being shipped on the Alliance pipeline at a cost of \$1.50 per Mcf for sale at Chicago. This contract had a less significant effect on transportation costs per boe in the year ended December 31, 2011 compared to 2010 as the production base of the Company has grown by 102 percent in 2011 as compared to 2010. Transportation costs per boe are in line with Cequence's expectation of \$2.00 to \$2.50 per boe for 2011. Cequence expects transportation expense to average approximately \$1.50 to \$2.00 per boe in 2012.

OPERATING COSTS

\$(000's)	Three months ended December 31		Year ended December 31	
	2011	2010	2011	2010
Operating costs (\$)	\$ 7,022	\$ 7,023	\$ 29,673	\$ 17,700
Per unit of production (\$/boe)	\$ 8.60	\$ 10.20	\$ 9.02	\$ 10.90

For the year ended December 31, 2011, operating costs decreased to \$9.02 per boe from \$10.90 per boe in the comparative period in 2010. Operating costs during the fourth quarter of 2011 were \$7,022 or \$8.60 per boe compared to \$7,023 or \$10.20 per boe for the same time period in 2010. Operating costs per boe decreased in the three and twelve months ended December 31, 2011 compared to the same periods in 2010 due mainly to lower costs on new wells drilled and recompleted in 2011 and 2010 and on wells acquired through acquisitions in 2010 and 2011. Operating costs for the year ended December, 2011 are in line with Cequence's expectation of approximately \$9 to \$10 per boe for 2011. Cequence expects operating costs to continue to decrease to average \$8 to \$9 per boe in 2012.

Management's Discussion and Analysis

OPERATING NETBACKS

	Three months ended December 31		Year ended December 31	
	2011	2010	2011	2010
Production revenue ⁽¹⁾	\$ 28.80	\$ 32.46	\$ 31.02	\$ 33.59
Royalty expense	(3.75)	(3.80)	(4.18)	(3.55)
Transportation expense	(1.93)	(2.25)	(2.18)	(2.68)
Operating costs	(8.60)	(10.20)	(9.02)	(10.90)
Netback, \$/boe	\$ 14.52	\$ 16.21	\$ 15.64	\$ 16.46
Netback, excluding realized hedge gains (losses), \$/boe	\$ 13.98	\$ 13.86	\$ 15.36	\$ 14.03

⁽¹⁾ Production revenue is presented gross of royalties and includes realized gain on commodity contracts.

Cequence's netback for the fourth quarter of 2011 decreased to \$14.52 per boe from \$16.21 per boe in 2010. For the year ended December 31, 2011, the netback decreased to \$15.64 per boe from \$16.46 per boe in the comparative period in 2010. In comparison to 2010, the decrease in the netback in the year ended December 31, 2011 is primarily due to a lower realized sales price resulting from the expiry of the Company's 6,000 gj per day commodity contract at March 31, 2010, decreases in benchmark natural gas prices from 2010 to 2011 and an increase in royalty expense. The decrease above was partially offset by improvements to transportation expense and operating costs.

Prior to hedging, Cequence's netbacks were higher than the prior year as the decrease in the average sales price and increase to royalty expense was more than offset by improvements in transportation expense and operating costs.

GENERAL AND ADMINISTRATIVE EXPENSES

\$(000's)	Three months ended December 31		Year ended December 31	
	2011	2010	2011	2010
G&A expenses (\$)	\$ 1,665	\$ 2,224	\$ 7,325	\$ 5,544
Total G&A (\$/boe)	\$ 2.04	\$ 3.23	\$ 2.23	\$ 3.41

For the year ended December 31, 2011, general and administrative ("G&A") expenses increased to \$7,325 from \$5,544 in the comparative period in 2010. On a per barrel basis, G&A costs decreased for the year ended December 31, 2011 to \$2.23 per boe compared to \$3.41 per boe in 2010 as the production base of the Company has increased from the prior year.

G&A expenses were \$1,665 or \$2.04 per boe for the three months ended December 31, 2011. On a per barrel basis, G&A expenses decreased 37 percent from the same period in 2010 as a result of increased sales volumes. G&A expenses for the year ended December 31, 2011 are in line with Cequence's expectation of approximately \$2.00 to \$2.25 per boe for the year ended December 31, 2011. The Company expects G&A expenses to average approximately \$2.00 to \$2.50 per boe in 2012.

FINANCE COSTS

\$(000's)	Three months ended December 31		Year ended December 31	
	2011	2010	2011	2010
Interest expense (\$)	\$ 224	\$ 741	\$ 1,928	\$ 1,426
Accretion expense on decommissioning liabilities (\$) ⁽¹⁾	174	231	905	495
Amortization of transaction costs on financial instruments (\$) ⁽¹⁾	–	139	443	169
Total Finance Costs (\$)	\$ 398	\$ 1,111	\$ 3,276	\$ 2,090
Per unit of production (\$/boe)	\$ 0.49	\$ 1.61	\$ 1.00	\$ 1.29
Per unit of production, excluding accretion expense and amortization of transaction costs (\$/boe)	\$ 0.27	\$ 1.08	\$ 0.59	\$ 0.88

⁽¹⁾ 2010 figures have been restated from previously reported amounts resulting from the application of IFRS. See 'Adoption of International Financial Reporting Standards' section below.

Finance costs for the three months ended December, 2011 were \$398 compared to \$1,111 for the comparative period in 2010. Included in finance costs for the three months ended December 31, 2011 is \$nil of amortization related to transaction costs on the establishment and renewal of the Company's credit facilities (2010 – \$139) as well as accretion expense on decommissioning liabilities of \$174 (2010 – \$231). Finance costs net of the amortization and accretion described above were \$224 for the three months ended December 31, 2011, compared to \$741 for the comparative period in 2010.

Finance costs for the year ended December 31, 2011 were \$3,276 compared to \$2,090 for the comparative period in 2010. Included in finance costs for the year ended December 31, 2011 is \$443 of amortization related to transaction costs on the establishment and renewal of the Company's credit facilities (2010 – \$169) as well as accretion expense on decommissioning liabilities of \$905 (2010 – \$495). Finance costs net of the amortization and accretion described above were \$1,928 for the year ended December 31, 2011, compared to \$1,426 for the comparative period in 2010.

The Company's debt increased late in the third quarter of 2010, as debt was assumed on the acquisition of Temple and used in part to pay the cash consideration for the Deep Basin Assets. This resulted in interest expense increasing in the twelve month period ended December 31, 2011 as compared to the same period in 2010.

DEPLETION, DEPRECIATION AND IMPAIRMENT

\$(000's)	Three months ended December 31		Year ended December 31	
	2011	2010	2011	2010
Depletion and depreciation expense (\$) ⁽¹⁾	\$ 10,186	\$ 9,517	\$ 41,228	\$ 24,076
Impairment (\$) ⁽¹⁾	18,332	28,597	18,332	58,483
Total depletion, depreciation and impairment	\$ 28,518	\$ 38,114	\$ 59,560	\$ 82,559
Per unit of production (\$/boe)	\$ 34.91	\$ 55.35	\$ 18.11	\$ 50.82
Per unit of production, excluding impairment (\$/boe)	\$ 12.47	\$ 13.82	\$ 12.54	\$ 14.82

⁽¹⁾ 2010 figures have been restated from previously reported amounts resulting from the application of IFRS. See 'Adoption of International Financial Reporting Standards' section below.

Management's Discussion and Analysis

Depletion and depreciation expense for the three and twelve month periods ended December 31, 2011 was \$10,186 or \$12.47 per boe and \$41,228 or \$12.54 per boe, respectively. Depletion and depreciation rates are lower than in the comparable periods in 2010 due mainly to drilling in 2011 and the acquisitions of Peloton, Temple and the Deep Basin Assets, which were completed at a lower cost per boe than Cequence's existing resource base.

Impairment expense for the three and twelve months ended December 31, 2011 was \$18,332 compared to \$28,597 and \$58,483 for the three and twelve months ended December 31, 2010, respectively. Impairment in 2011 and 2010 resulted largely from declining natural gas prices as well as from the application of IFRS standards, which are more restrictive than those under Canadian GAAP (see 'Adoption of International Financial Reporting Standards' section below) and require that impairment tests be performed on individual cash generating units as per the table below. Substantially all of the Company's planned capital expenditures in 2012 and actual expenditures in 2011 are in the Deep Basin CGU.

	2011	2010
	Impairment	Impairment
Northeast British Columbia	\$ 4,770	\$ 17,445
Peace River Arch	13,562	37,046
Deep Basin	-	-
Total	\$ 18,332	\$ 54,491

PROVISIONS

Decommissioning liabilities

Total decommissioning liabilities at December 31, 2011 were \$28,135 compared to \$26,130 at December 31, 2010. Net additions to decommissioning liabilities in the year ended December 31, 2011 totalled \$2,005 which relates to liabilities assumed on the acquisition of assets, liabilities sold on the sale of properties, as well as to drilling activity, facility additions, accretion expense and changes in estimates.

Onerous contracts

As at December 31, 2011, the Company recognized a provision related to an onerous lease contract of \$1,138 (December 31, 2010 – \$nil). The provision for onerous lease contract represents the present value of the future lease obligations that the Company is presently obligated to make under a non-cancellable onerous operating lease contract, less revenue expected to be earned on the lease, including estimated future sub-lease revenue.

STOCK-BASED COMPENSATION

The Company recognizes stock-based compensation expense for stock options. For the year ended December 31, 2011, Cequence recorded \$6,758 (2010 – \$2,863) in stock-based compensation expense related to stock options and performance warrants, as applicable, with a corresponding increase to contributed surplus.

The Company issued 4,221 stock options in the year ended December 31, 2011. Total stock-based compensation expense of \$6,866 was determined using the Black-Scholes option pricing model and will be expensed over the three year vesting period of the options. During the year ended December 31, 2011, 240 stock options were forfeited and 600 stock options were exercised.

COMMON SHARES OUTSTANDING

Issued common voting shares (000's)	Number	Stated Value
Balance, December 31, 2010 ⁽¹⁾	128,750	\$ 452,526
Common shares	13,398	38,183
Flow-through shares	2,100	5,985
Common shares on exercise of stock options	600	1,794
Common shares on exercise of the 2011 Warrants	2,250	8,663
Common shares	11,960	46,046
Flow-through shares	2,110	8,124
Flow-through shares private placement	688	2,649
Share issue costs, net of taxes of \$1,531	-	(4,599)
Balance, December 31, 2011	161,856	\$ 559,371
Warrants, December 31, 2010	4,500	\$ -
Warrants exercised	(2,250)	-
Warrants, December 31, 2011	2,250	\$ -

⁽¹⁾ 2010 amounts have been restated from previously reported amounts resulting from the application of IFRS. See 'Adoption of International Financial Reporting Standards' section below.

On March 17, 2011, the Company completed the sale of 13,398 common voting shares at a price of \$2.85 per share for total gross proceeds of \$38,183.

On March 17, 2011, the Company completed the sale of 2,100 common voting shares on a CEE "flow-through" basis at \$3.50 per share for total gross proceeds of \$7,350. Under the terms of the respective agreements, Cequence is required to renounce \$7,350 of CEE expenditures in February 2012. As at December 31, 2011, the Company has incurred all of the qualifying CEE expenditures. In accordance with IFRS, the above transaction resulted in an increase to share capital of \$5,985 and the recognition of an obligation related to flow-through shares of \$1,365 included with other liabilities in the consolidated balance sheet at December 31, 2011.

On June 20, 2011, a total of 600 stock options were exercised resulting in the issuance of 600 common voting shares at \$1.99 per share for total gross proceeds of \$1,194. The exercise of stock options further resulted in a reduction to contributed surplus of \$600 and a commensurate increase to share capital to account for stock based compensation previously expensed related to the exercised options.

On August 15, 2011, 2,250 warrants were exercised for 2,250 common voting shares on a CDE "flow-through" basis at \$4.36 per share for total gross proceeds of \$9,801. The shares were issued on exercise of the 2011 Warrants, as disclosed in the Financial Statements for the year ended December 31, 2011. In accordance with the exercise of the 2011 Warrants, 1,500 common voting shares initially held in escrow were released on August 15, 2011. The exercise of the 2011 Warrants also qualifies the remaining 2,250 2012 Warrants for exercise in 2012. Under the terms of the respective agreement, Cequence is required to renounce \$9,801 of CDE expenditures in February 2012. As at December 31, 2011, the Company has incurred all of the qualifying CDE expenditures. In accordance with IFRS, the above transaction resulted in an increase to share capital of \$8,663 and the recognition of an obligation related to flow-through shares of \$1,138 included with other liabilities in the consolidated balance sheet at December 31, 2011.

Management's Discussion and Analysis

On August 18, 2011, the Company completed the sale of 11,960 common voting shares at a price of \$3.85 per share for total gross proceeds of \$46,046.

On August 18, 2011, the Company completed the sale of 2,110 common voting shares on a CEE "flow-through" basis at \$4.75 per share for total gross proceeds of \$10,023. Under the terms of the respective agreements, Cequence is required to renounce \$10,023 of CEE expenditures in February 2012. As at December 31, 2011, the Company has incurred all of the qualifying CEE expenditures. In accordance with IFRS, the above transaction resulted in an increase to share capital of \$8,124 and the recognition of an obligation related to flow-through shares of \$1,899 included with other liabilities in the consolidated balance sheet at December 31, 2011.

On October 5, 2011, the Company completed the sale of 688 common voting shares on a CDE "flow-through" basis at \$4.36 per share for total gross proceeds of \$3,000. Under the terms of the respective agreements, Cequence is required to renounce \$3,000 of CDE expenditures in February 2012. As at December 31, 2011, the Company has incurred all of the qualifying CDE expenditures. In accordance with IFRS, the above transaction resulted in an increase to share capital of \$2,649 and the recognition of an obligation related to flow-through shares of \$351 included with other liabilities in the consolidated balance sheet at December 31, 2011.

As at December 31, 2011, there were no issued or outstanding non-voting shares (December 31, 2010 – none).

As of the date of this MD&A, Cequence had the following securities outstanding: 161,856 common voting shares and 13,214 stock options.

CAPITAL EXPENDITURES

\$(000's)	Three months ended December 31		Year ended December 31	
	2011	2010	2011	2010
Property acquisitions ^{(1) (2)}	\$ –	\$ (182)	\$ 22,150	\$ 84,728
Property dispositions ⁽¹⁾	–	(4,525)	(45,173)	(41,571)
Land, net	1,014	2,876	13,242	6,217
Geological & geophysical and capitalized overhead	2,327	1,515	3,623	3,528
Drilling, completions and workovers	38,160	17,543	93,667	46,599
Equipment and facilities	14,557	2,432	38,678	7,731
Office furniture & equipment	277	26	391	45
Total capital expenditures	\$ 56,335	\$ 19,685	\$ 126,578	\$ 107,277

⁽¹⁾ Figures represent the cash proceeds from the sale of assets and cash paid for the acquisition of assets, as applicable.

⁽²⁾ 2010 amounts have been restated from previously reported amounts resulting from the application of IFRS. See 'Adoption of International Financial Reporting Standards' section below.

For the year ended December 31, 2011, drilling, completion and workover expenditures totalled \$93,667 which included the drilling of 13 gross (10.0 net) horizontal wells and 4 gross (3.3 net) vertical wells as well as the completion of 12 gross (10.0 net) horizontal wells and 5 gross (3.6 net) vertical wells. For the year ended December 31, 2010, drilling, completion and workover expenditures included the drilling and completion of 5.6 net horizontal wells and 3.8 net vertical wells. Facility expenditures in the year ended December 31, 2011 of \$38,678 were directed towards compression and gathering facilities in the Deep Basin.

On March 23, 2011, the Company closed the sale of certain oil and gas properties located in central Alberta for total cash consideration of \$22,000, subject to adjustments. The sale resulted in a gain recognized in comprehensive income (loss) of \$2,116.

On April 15, 2011, the Company closed the sale of certain oil and gas properties located in Northwest Alberta for total cash consideration of \$7,500, subject to adjustments. The sale resulted in a gain recognized in comprehensive income (loss) of \$1,835.

On June 10, 2011, the Company closed the acquisition of certain gas weighted properties located in Northeast British Columbia for total cash consideration of \$22,200, subject to adjustments. A decommissioning liability of \$1,539 has been recognized as part of the acquisition.

On September 8, 2011, the Company closed the sale of certain oil and gas properties located in Northeast British Columbia for total cash consideration of \$13,982, subject to adjustments. The sale resulted in a gain recognized in comprehensive income (loss) of \$1,126.

Sequence has budgeted capital expenditures of \$92,000 for 2012, excluding acquisitions and dispositions, which will be directed towards the drilling of an expected 10 net horizontal wells. Capital expenditures will be funded out of cash flow, existing credit lines and the sale of properties expected to close in the first quarter of 2012.

INCOME TAXES

At December 31, 2011, a deferred income tax asset of \$48,316 (December 31, 2010 – \$47,340) has been recognized as the Company believes, based on estimated cash flows, its realization is probable. At December 31, 2011, Sequence has the following tax pools:

Classification	Amount \$(000's)
CEE	\$ 189,650
UCC	117,042
Non-capital losses	94,637
COGPE	90,883
CDE	62,121
SRED	22,704
Share issue costs	9,480
ITCs	3,981
Other	98
	\$ 591,296

The Company's non-capital losses expire \$6,812 in 2012, \$4,512 in 2013 and \$83,313 in 2024 and thereafter.

Management's Discussion and Analysis

On August 19, 2010, the Company completed the sale of 3,200 common voting shares on a CEE "flow-through" private placement basis at \$2.50 per share for gross proceeds of \$8,000 as well as 870 common voting shares on a CDE "flow-through" private placement basis at \$2.30 per share for gross proceeds of \$2,001, resulting in a total issuance of 4,070 common voting shares for total gross proceeds of \$10,001. In accordance with the terms of the agreement and pursuant to certain provisions of the Income Tax Act (Canada), the Company renounced, for income tax purposes, development expenditures of \$2,001 and exploration expenditures of \$8,000 to the holders of the flow-through common shares effective December 31, 2010. Deferred tax of approximately \$2,506 associated with renouncing the expenditures was recorded on the date of renunciation in the first quarter of 2011, the obligation on flow-through shares of \$1,454 was drawn down and the difference was recognized as deferred income tax expense (recovery) in comprehensive income (loss). As at December 31, 2011, the Company has incurred all of the qualifying expenditures.

On November 30, 2010, the Company completed the sale of 2,250 units at \$2.00 per unit for total gross proceeds of \$4,500, which included 2,250 common voting shares on a CDE "flow-through" private placement basis. In accordance with the terms of the agreement and pursuant to certain provisions of the Income Tax Act (Canada), the Company renounced, for income tax purposes, development expenditures of \$3,000 to the holders of the flow-through common shares effective December 31, 2010. Deferred tax of approximately \$752 associated with renouncing the expenditures was recorded on the date of renunciation in the first quarter of 2011, obligation on flow-through shares of \$409 was drawn down and the difference was recognized as deferred income tax expense (recovery) in comprehensive income (loss). As at December 31, 2011, the Company has incurred all of the qualifying expenditures.

Based on the Company's expected cash flow and available tax pools, Cequence does not expect to be taxable for the next three years.

INVESTMENTS

As at December 31, 2009, the Company held long-term floating rate notes ("MAV 2" notes) issued as a result of the restructuring discussed below. At December 31, 2008, the Company held the original Canadian asset-backed commercial paper ("ABCP") with an original cost of \$24,147. These investments matured during the third quarter of 2007 but, as a result of the liquidity issues in the ABCP market, did not settle on maturity.

On January 21, 2009, the Pan-Canadian Investors Committee announced that the restructuring had been completed to extend the maturity of the ABCP to provide for a maturity similar to that of the underlying assets. As a result, the Company received new replacement MAV 2 notes with a total face value of \$24,142.

On August 25, 2010, the Company completed the sale of its entire interest in MAV 2 notes for net proceeds of \$13,453 (net of transaction costs of \$96) which represents approximately \$0.68 per \$1.00 of face value for the Class A1 notes, \$0.58 per \$1.00 of face value for the Class A2 notes, \$0.33 per \$1.00 of face value for the Class B notes and \$0.05 per \$1.00 of face value for the Class C notes. This has resulted in a loss on MAV 2 notes recognized in comprehensive income (loss) of \$281 for the year ended December 31, 2010.

On March 31, 2009, the Company's bank provided the Company with an additional credit facility to provide liquidity in respect to the MAV 2 notes. All proceeds from the sale of MAV 2 notes were used to repay this facility. The balance of the facility was paid with available cash and the long-term debt related to investments facility was closed. The effective interest rate for the year ended December 31, 2010 was 1.19 percent. Interest expense on long-term debt related to investments included as finance costs in comprehensive income (loss) for the year ended December 31, 2010 was \$129.

LIQUIDITY AND CAPITAL RESOURCES

The Company has established two credit facilities with a syndicate of Canadian chartered banks. Credit facility A is a \$100,000 extendible revolving term credit facility by way of prime loans, U.S. Base Rate Loans, Banker's Acceptances and Libor Loans. Credit facility B is a \$10,000 operating facility by way of prime loans, U.S. Base Rate Loans, Banker's Acceptances and letters of credit. Prime loans and U.S. Base Rate Loans on these facilities bear interest at the bank prime rate or U.S. Base Rate, respectively, plus 1.0 percent to 2.5 percent on a sliding scale, depending on the Company's debt to adjusted EBITDA ratio (ranging from being less than or equal to 1.0:1.0 to greater than 2.5:1.0). Banker's Acceptances, Libor Loans and letters of credit on these facilities bear interest at the Banker's Acceptance rate, Libor rate or letter of credit rate, as applicable, plus 2.0 percent to 3.5 percent based on the same sliding scale as above. The credit facilities may be extended and revolve beyond the initial one-year period, if requested by the Company and accepted by the lenders. If the credit facilities do not continue to revolve, the facilities will convert to a 366-day non-revolving term loan facility.

Both credit facilities, and the amount available for draws under the facilities, are subject to periodic review by the bank and are secured by a general assignment of book debts and a \$250,000 demand debenture with a first floating charge over all assets of the Company. The Company is permitted to hedge up to 67 percent of its production under the lending agreement. As at December 31, 2011, the Company has drawn \$11,618 under the extendible revolving term credit facility and \$nil under the operating facility (December 31, 2010 – \$57,125 and \$nil for the revolving and operating facilities, respectively) and is in compliance with all covenants. The next scheduled review is to take place in May 2012. During the year ended December 31, 2011 the Company capitalized transaction costs related to its credit facilities of \$57 (December 31, 2010 – \$555).

NET DEBT AND WORKING CAPITAL (DEFICIENCY)

Net debt and working capital (deficiency) is calculated as cash and net working capital less commodity contract asset and demand credit facilities and excluding other liabilities, as follows:

\$(000's)	As at December 31, 2011	As at December 31, 2010
Demand credit facilities	\$ (11,618)	\$ (56,739)
Accounts payable and accrued liabilities	(64,467)	(36,240)
Cash	380	1,321
Accounts receivable	21,032	16,439
Deposits and prepaid expenses – current	3,231	2,480
Net debt and working capital (deficiency)	\$ (51,442)	\$ (72,739)

Management's Discussion and Analysis

CONTRACTUAL OBLIGATIONS

	2012	2013	2014	2015	2016+	Total
Office leases	\$ 1,217	1,133	922	187	–	\$ 3,459
Drilling services	2,138	2,138	–	–	–	4,276
Pipeline transportation	1,699	1,699	1,699	1,554	–	6,651
Total	\$ 5,054	4,970	2,621	1,741	–	\$ 14,386

The Company acquired a pipeline transportation contract in a property acquisition that expires on November 30, 2015.

During the year ended December 31, 2011, the Company entered into a drilling service agreement whereby the Company has committed to use a drilling rig for 360 days over the two years following commencement of use of the drilling rig at current market rates. The commitment is drawn down when the rig is in use, whether by Cequence or third parties. Cequence expects to meet the commitment in the required time.

During the year ended December 31, 2011, the Company entered into a drilling service agreement whereby the Company made a deposit of \$3,500 to obtain a right of first refusal on the use of two drilling rigs over the five years following the date that use of the rigs commences. The deposit is to be drawn down as the Company incurs costs related to the use of the drilling rigs and \$285 has been drawn down at December 31, 2011. Cequence expects to reduce the deposit by \$759 in the twelve months ended December 31, 2012, which amount is included with deposits and prepaid expenses in the consolidated balance sheet. The portion of the outstanding deposit expected to be drawn down in the period subsequent to December 31, 2012 of \$2,456 is carried as a non-current asset in the consolidated balance sheet as at December 31, 2011.

RELATED PARTIES

An executive of the Company is a member of the board of directors of an entity that is a supplier of seismic services to Cequence. The Company incurred a total of \$26 with this vendor in the year ended December 31, 2011 (2010 – \$11). These transactions have been recorded at the exchange amount, which is the amount of consideration established and agreed to by the related parties, and is equal to fair value. As at December 31, 2011, no amounts are included in accounts payable and accrued liabilities related to these transactions (December 31, 2010 – \$5).

DISCLOSURE CONTROLS AND INTERNAL CONTROLS OVER FINANCIAL REPORTING

The President and Chief Executive Officer and the Vice President, Finance and Chief Financial Officer are responsible for designing internal controls over financial reporting or causing them to be designed under their supervision in order to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with IFRS. The Company's Chief Executive Officer and Chief Financial Officer have designed, or caused to be designed under their supervision, disclosure controls and procedures to provide reasonable assurance that: (i) material information relating to the Company is made known to the Company's Chief Executive Officer and Chief Financial Officer by others, particularly during the period in which the annual filings are being prepared; and (ii) information required to be disclosed by the Company in its annual filings, interim filings or other reports filed or submitted by it under securities legislation is recorded, processed, summarized and reported within the time period specified in securities legislation.

The Committee of Sponsoring Organizations (“COSO”) framework provides the basis for management’s design of internal controls over financial reporting. Management and the Board work to mitigate the risk of a material misstatement in financial reporting; however, a control system, no matter how well conceived or operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met and it should not be expected that the disclosure and internal control procedures will prevent all errors or fraud.

As at December 31, 2011, the Chief Executive Officer and the Chief Financial Officer have concluded, based on their evaluation of the design and operating effectiveness of the Company’s disclosure controls and internal controls over financial reporting (“ICFR”) that disclosure controls and ICFR are effective.

QUARTERLY INFORMATION

FINANCIAL

(\$ thousands except per share data)	2011 Q4	2011 Q3	2011 Q2	2011 Q1	2010 Q4	2010 Q3	2010 Q2	2010 Q1
Production revenue ⁽¹⁾	\$ 23,527	\$ 27,144	\$ 27,293	\$ 24,032	\$ 22,352	\$ 12,951	\$ 9,174	\$ 10,093
Royalties	3,063	3,872	3,565	3,243	2,616	1,340	699	1,114
Operating expenses	7,022	8,471	7,439	6,741	7,023	4,410	3,392	2,875
Transportation expenses	1,580	1,861	1,883	1,829	1,551	1,223	840	744
Comprehensive loss ⁽²⁾	(15,598)	(1,884)	(701)	(1,975)	(23,205)	(10,598)	(4,029)	(14,517)
Per share – basic ⁽²⁾	(0.10)	(0.01)	(0.00)	(0.02)	(0.18)	(0.15)	(0.10)	(0.37)
Per share – diluted ⁽²⁾	(0.10)	(0.01)	(0.00)	(0.02)	(0.18)	(0.15)	(0.10)	(0.37)
Funds flow from operations ⁽²⁾⁽³⁾	10,002	10,438	12,042	9,780	7,629	1,672	2,197	4,498
Per share – basic ⁽²⁾	0.06	0.07	0.08	0.07	0.06	0.02	0.05	0.11
Per share – diluted ⁽²⁾	0.06	0.07	0.08	0.07	0.06	0.02	0.05	0.11
Capital expenditures, net	56,335	31,222	16,470	45,574	24,392	8,309	5,057	26,412
Acquisitions, net ⁽²⁾⁽⁴⁾	–	(15,513)	14,134	(21,644)	(4,707)	47,534	–	279
Total expenditures	\$ 56,335	\$ 15,709	\$ 30,604	\$ 23,930	\$ 19,685	\$ 55,843	\$ 5,057	\$ 26,691

⁽¹⁾ Production revenue is presented gross of royalties and includes realized gain on commodity contracts.

⁽²⁾ 2010 figures have been restated from previously reported amounts resulting from the application of IFRS. See ‘Adoption of International Financial Reporting Standards’ section below.

⁽³⁾ Funds flow from operations is calculated as cash flow from operating activities before adjustments for decommissioning liability expenditures, proceeds from the sale of commodity contracts and net changes in non-cash working capital.

⁽⁴⁾ Figures represent the cash proceeds from the sale of assets and cash paid for the acquisition of assets, as applicable.

Management's Discussion and Analysis

OPERATIONS	2011 Q4	2011 Q3	2011 Q2	2011 Q1	2010 Q4	2010 Q3	2010 Q2	2010 Q1
Production volumes								
Natural gas (Mcf/d)	47,203	52,694	48,785	42,514	38,702	23,674	16,559	12,592
Oil (bbls/d)	503	514	599	686	478	332	253	268
NGLs (bbls/d)	509	536	396	413	557	342	184	78
Total (boe/d)	8,879	9,833	9,125	8,185	7,485	4,619	3,197	2,444
Average selling price								
Natural gas (\$per Mcf)	3.59	4.04	4.30	4.21	4.40	4.13	4.21	6.83
Oil (\$per bbl)	97.15	87.65	97.80	88.38	77.24	70.47	70.22	76.80
NGLs (\$per bbl)	73.19	69.34	80.15	66.12	64.13	57.33	72.07	71.81
Combined (\$per boe)	28.80	30.00	32.87	32.62	32.46	30.47	31.53	45.88
Royalties (\$per boe)	3.75	4.28	4.29	4.40	3.80	3.15	2.40	5.06
Operating expenses (\$per boe)	8.60	9.36	8.96	9.15	10.20	10.38	11.66	13.07
Transportation (\$per boe)	1.93	2.06	2.27	2.48	2.25	2.88	2.88	3.38
Netback (\$per boe)	14.52	14.30	17.35	16.59	16.21	14.06	14.59	24.37

ADOPTION OF INTERNATIONAL FINANCIAL REPORTING STANDARDS

The Financial Statements and comparative information have been prepared in accordance with IFRS as issued by the IASB and represent the first annual financial statements of the Company prepared in accordance with IFRS. The Company adopted IFRS in accordance with IFRS 1. Previously, the Company prepared its Financial Statements in accordance with Canadian GAAP. The adoption of IFRS has not had a material impact on the Company's operations, strategic decisions, cash flow or capital expenditures.

The Company's IFRS accounting policies are provided in Note 2 to the Financial Statements. In addition, Note 4 to the Financial Statements presents reconciliations between the Company's 2010 Canadian GAAP results and the 2010 IFRS results. The reconciliations include the Consolidated Balance Sheets as at January 1, 2010, and December 31, 2010, and the Consolidated Statements of Comprehensive Loss, Changes in Equity and Cash Flows for the year ended December 31, 2010.

The following provides summary reconciliations of Cequence's 2010 Canadian GAAP and IFRS results, along with a discussion of the significant IFRS accounting policy changes.

Summary Balance Sheet Reconciliations

As at January 1, 2010

(\$000's)	Canadian GAAP	DD&A	Impairment	Decommissioning liabilities	Other ⁽¹⁾	IFRS
Current assets	30,605	–	–	–	–	30,605
Investments	13,920	–	–	–	–	13,920
Exploration and evaluation assets	–	29,411	–	–	–	29,411
Property and equipment	158,011	(29,411)	(6,791)	–	–	121,809
Deferred income taxes	5,575	–	1,717	813	(424)	7,681
Total assets	208,111	–	(5,074)	813	(424)	203,426
Current liabilities	23,599	–	–	–	(36)	23,563
Long-term debt related to investments	18,204	–	–	–	–	18,204
Provisions	4,059	–	–	3,251	–	7,310
Shareholders' equity	162,249	–	(5,074)	(2,438)	(388)	154,349
Total liabilities and shareholders' equity	208,111	–	(5,074)	813	(424)	203,426

⁽¹⁾ Other includes adjustments related to flow-through share issuances affecting current liabilities and shareholders' equity and the reclassification of the current portion of deferred income taxes to long-term.

As at December 31, 2010

(\$000's)	Canadian GAAP	DD&A	Cumulative Impairment	Decommissioning liabilities	Business Combinations	Other ⁽¹⁾	IFRS
Current assets	20,240	–	–	–	–	–	20,240
Property and equipment	409,955	8,356	(65,274)	105	(13,827)	2,486	341,801
Deferred income taxes	26,441	–	–	–	5,645	15,254	47,340
Total assets	456,636	8,356	(65,274)	105	(8,182)	17,740	409,381
Current liabilities	93,365	–	–	–	–	1,682	95,047
Provisions	14,622	–	–	3,265	8,599	(356)	26,130
Shareholders' equity	348,649	8,356	(65,274)	(3,160)	(16,781)	16,414	288,204
Total liabilities and shareholders' equity	456,636	8,356	(65,274)	105	(8,182)	17,740	409,381

⁽¹⁾ Other includes adjustments related to: flow-through share issuances affecting current liabilities and shareholders' equity; adjustments related to the sale of assets in 2010 affecting PP&E, decommissioning liabilities and shareholders' equity; adjustments related to transaction costs on financial instruments affecting current liabilities and shareholders' equity; and the deferred income tax effect of the aggregate of the above adjustments, other than deferred income tax on business combinations, at December 31, 2010.

Management's Discussion and Analysis

Summary of Comprehensive Loss Reconciliation

(\$000's)	2010				
	Annual	Q4	Q3	Q2	Q1
Comprehensive loss as reported under Canadian GAAP	\$ (14,518)	\$ (6,122)	\$ (3,620)	\$ (3,751)	\$ (1,025)
Differences increasing (decreasing) reported amounts:					
Depletion, depreciation and impairment	(50,127)	(25,490)	(7,486)	673	(17,824)
Finance costs on decommissioning liabilities	90	54	24	8	4
Transaction costs on financial instruments	386	(139)	525	-	-
Business combinations	(3,623)	(400)	(2,578)	(645)	-
Gain (loss) on sale of assets	2,842	2,824	18	-	-
Deferred tax on above	12,601	6,068	2,519	(314)	4,328
Comprehensive loss as reported under IFRS	\$ (52,349)	\$ (23,205)	\$ (10,598)	\$ (4,029)	\$ (14,517)
Per share, basic and diluted	\$ (0.75)	\$ (0.18)	\$ (0.15)	\$ (0.10)	\$ (0.37)

Summary of Funds Flow From Operations Reconciliation

(\$000's)	2010				
	Annual	Q4	Q3	Q2	Q1
Funds flow from operations as reported under Canadian GAAP ⁽¹⁾	\$ 19,065	\$ 8,029	\$ 3,695	\$ 2,842	\$ 4,498
Differences increasing (decreasing) reported amounts:					
Transaction costs on financial instruments	555	-	555	-	-
Business combinations	(3,623)	(400)	(2,578)	(645)	-
Funds flow from operations as reported under IFRS ⁽¹⁾	\$ 15,997	\$ 7,629	\$ 1,672	\$ 2,197	\$ 4,498
Per share, basic and diluted	\$ 0.23	\$ 0.06	\$ 0.02	\$ 0.05	\$ 0.11

⁽¹⁾ A non-GAAP measure, which is defined under the 'Non-GAAP Measurements' section of this MD&A.

Accounting Policy Changes

The following discussion explains the significant differences between Cequence's Canadian GAAP accounting policies and those applied by the Company under IFRS. IFRS policies have been retrospectively and consistently applied except where specific IFRS 1 optional and mandatory exemptions permitted an alternative treatment upon transition to IFRS for first-time adopters.

The most significant changes to the Company's accounting policies relate to the accounting for oil and gas assets. Under Canadian GAAP, Cequence followed Accounting Guidelines 16, "Oil and Gas Accounting – Full Cost" ("AcG 16") of Canadian GAAP in which all costs directly associated with the acquisition of, the exploration for, and the development of oil and natural gas reserves were capitalized on a country-by-country cost centre basis. Costs accumulated within each country cost centre were depleted using the unit-of-production method based on proved reserves determined using estimated future prices and costs. Upon transition to IFRS, the Company was required to adopt new accounting policies for oil and gas assets, including exploration and evaluation costs and development costs.

Under IFRS, exploration and evaluation costs are those expenditures for an area where technical feasibility and commercial viability has not yet been determined. Development costs include those expenditures for areas where technical feasibility and commercial viability has been determined. The technical feasibility and commercial viability of extracting a mineral resource is considered to be determinable when proven reserves are determined to exist and are capable of economic production. Cequence adopted the IFRS 1 exemption whereby the Company deemed its January 1, 2010 IFRS oil and gas asset costs to be equal to its Canadian GAAP historical property, plant and equipment net book value. Accordingly, the Company evaluated its existing asset base and reclassified from the full cost pool to exploration and evaluation assets those assets that met the definition of exploration and evaluation assets at the date of transition to IFRS. The remaining full cost pool was allocated to development and production assets pro rata using proved plus probable reserve values. The Company chose to base the opening balance sheet allocation of production and development assets as well as to base its depletion and impairment assessment under IFRS on proved plus probable reserves as Cequence believes that this provides the most meaningful measure of the value of the Company's asset base. Under IFRS, exploration and evaluation costs are presented as exploration and evaluation assets and development costs are presented within property and equipment on the Consolidated Balance Sheet.

Exploration and Evaluation ("E&E") expenditures

Exploration and evaluation assets at January 1, 2010 were deemed to be \$29,411 in accordance with the Company's policies and IFRS 6, "Exploration for and Evaluation of Mineral Resources" ("IFRS 6"). This resulted in a reclassification of \$29,411 from property and equipment to exploration and evaluation assets on Cequence's Consolidated Balance Sheet as at January 1, 2010. As at December 31, 2010, the Company recognized no exploration and evaluation assets as the assets recognized at January 1, 2010 were sold during 2010 and no further assets met the definition of exploration and evaluation assets during 2010.

Management's Discussion and Analysis

Depletion and Depreciation

Development costs at January 1, 2010 were deemed to be \$121,809, representing the full cost pool balance under Canadian GAAP less the amount allocated to E&E assets discussed above and net of impairment recognized on transition to IFRS as discussed below. Consistent with Canadian GAAP, these costs are capitalized as property and equipment under IFRS.

Under Canadian GAAP, the Company depleted the full cost pool based on proved reserves. Under IAS 16, "Property, plant and equipment" ("IAS 16"), the Company has elected to deplete property and equipment based on proved plus probable reserves. This has resulted in a decrease to depletion and depreciation of \$8,356 for the year ended December 31, 2010 with a commensurate decrease to deficit.

Impairment

Under Canadian GAAP, impairment of the full cost pool was assessed by comparing the carrying amount of the full cost pool to the sum of undiscounted cash flows expected from the production of proved reserves. If the carrying amount of the full cost pool was determined to not be recoverable based on this test, impairment was recognized to the extent that the carrying amount of the full cost pool exceeded the sum of discounted cash flows expected from the production of proved plus probable reserves. Impairments under Canadian GAAP were not reversed.

Under IAS 36, "Impairment of Assets" ("IAS 36"), impairment is assessed by comparing the carrying amount of property and equipment to the sum of discounted cash flows expected from the production of proved plus probable reserves for each individual cash generating unit ("CGU") assessed by the Company. CGUs are defined as the smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets. To the extent that capitalized expenditures are not expected to be recovered, the excess of the carrying amount over the recoverable amount is recognized immediately in comprehensive income (loss).

Where an impairment loss subsequently reverses, the carrying amount of the asset (or CGU) is increased to the revised estimate of its recoverable amount, but only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or depletion, if no impairment loss had been recognized.

The application of IFRS resulted in an aggregate impairment loss which reduced property and equipment by \$58,483 at December 31, 2010, including a \$3,992 impairment of exploration and evaluation assets (January 1, 2010 – \$6,791) with a commensurate increase to deficit. The recoverable amount of each CGU was estimated based on the higher of the value in use and the fair value less cost to sell. The estimate of fair value less cost to sell was determined using discounted proved plus probable forecasted cash flows, with escalating prices and future development costs, as obtained from the Company's reserve reports, adjusted for internal estimates and results, as applicable. The prices used to estimate the fair value less cost to sell are those used by independent industry reserve engineers.

Disposals

Under Canadian GAAP, no gain or loss was recognized on the sale of oil and gas properties unless the sale resulted in a change of 20 percent or more to the depletion rate applied to the full cost pool. No such provision exists under IFRS. This resulted in an increase to gain on sale of assets of \$2,842 for the year ended December 31, 2010 with a commensurate decrease to deficit and an increase to property and equipment of \$2,486 at December 31, 2010.

Decommissioning Liabilities

Under Canadian GAAP, accretion expense was calculated through the application of a credit-adjusted risk-free rate to the Company's discounted decommissioning liabilities. Liabilities were not re-measured to reflect period end discount rates.

Under IFRS, decommissioning liabilities are measured at the present value of management's best estimate of expenditures required to settle the present obligation at the balance sheet date. Subsequent to the initial measurement, the liabilities are adjusted at the end of each period to reflect the passage of time and changes in the estimated future cash flows underlying the liability as well as changes to the discount rate. The increase in the provision due to the passage of time is recognized as finance costs whereas increases or decreases due to changes in the estimated future cash flows or changes in the discount rate are capitalized. Further, IAS 37, "Provisions, Contingent Liabilities and Contingent Assets" ("IAS 37") requires the application of a risk-free rate in determining the amount of accretion to be included with finance costs in comprehensive income (loss) for the period.

In conjunction with the IFRS 1 exemption regarding oil and gas assets discussed above, Cequence was required to re-measure its decommissioning liabilities upon transition to IFRS and recognize the difference in deficit. The application of this exemption resulted in a \$3,251 increase to the provisions on Cequence's Consolidated Balance Sheet as at January 1, 2010 and a corresponding increase to deficit.

The application of IFRS further resulted in an incremental increase to provisions of \$8,257 as at December 31, 2010 and an increase to property and equipment of \$105 at December 31, 2010.

Flow-through shares

Under Canadian GAAP, the proceeds from the issuance of flow-through shares were recognized as shareholders' equity. Further, the tax basis of assets related to expenditures incurred to satisfy flow-through share obligations was not reduced until the renunciation of the related tax pools, at which time, the expected tax effect of the renunciation had the effect of increasing deferred income tax liability and reducing shareholders' equity.

Under IFRS, the difference between the value of a flow-through share issuance and the value of a common share issuance is initially accrued as an obligation on issuance of the flow-through shares. Pursuant to the terms of the flow-through share agreements, the tax deductions associated with the expenditures are renounced to the subscribers. Accordingly, on renunciation with the Canada Revenue Agency, a deferred tax liability is recorded equal to the estimated amount of deferred income taxes payable by the Company. As a result of the renunciations, the obligation on issuance of flow-through shares is reduced and the difference is recognized in comprehensive income (loss).

Management's Discussion and Analysis

The above differences resulted in an increase to shareholders' equity of \$1,277, an increase to deficit of \$1,665 and the recognition of an obligation on issuance of flow-through shares included with other liabilities of \$388, at January 1, 2010. This further resulted in a decrease to share capital for the year ended December 31, 2010 of \$1,556 and the recognition of an obligation on flow-through shares included with other liabilities on the consolidated balance sheet of \$2,068 as at December 31, 2010.

Business combinations

The Company has applied the business combinations exemption in IFRS 1 to not apply IFRS 3, "Business Combinations" ("IFRS 3") retrospectively to past business combinations. Accordingly, the Company has not restated business combinations that took place prior to the date of transition to IFRS.

Under Canadian GAAP, transaction costs related to business combinations were capitalized as part of the purchase equation. Under IFRS 3, transaction costs on business combinations are expensed as incurred. Also, under Canadian GAAP, shares issued as consideration in a business combination were valued based on the weighted average trading price surrounding the date of announcement of the transaction. Under IFRS 3, such shares are valued as at the acquisition date. Further, the determination of fair value assigned to assets and liabilities at the date of acquisition differs from Canadian GAAP due to the application of IFRS as opposed to Canadian GAAP in determining such fair values.

The aggregate differences related to the expensing of transaction costs under IFRS 3 versus capitalization under Canadian GAAP resulted in an increase to comprehensive loss of \$3,623 for the year ended December 31, 2010 and a commensurate increase to deficit. The above adjustments under IFRS 3 further resulted in an aggregate decrease to property and equipment of \$13,827 as at December 31, 2010 and an aggregate decrease to share capital of \$13,158 as at December 31, 2010.

Other exemptions and mandatory exceptions

Other significant exemptions and mandatory exceptions taken by Cequence as at January 1, 2010 on transition to IFRS are as follows:

Share-based payment transactions: The Company has elected to apply IFRS 2, "Share-based Payments" ("IFRS 2") to equity instruments granted after November 7, 2002 that have not vested by January 1, 2010.

Borrowing costs: The Company has applied the borrowing costs exemption in IFRS to not apply IAS 23, "Borrowing Costs" ("IAS 23") retrospectively to past borrowing costs related to transactions that took place prior to January 1, 2010.

Estimates: Hindsight was not used to create or revise estimates and accordingly the estimates previously made by the Company under Canadian GAAP are consistent with their application under IFRS.

The remaining IFRS exemptions and mandatory exceptions were not applicable or material to the preparation of Cequence's Consolidated Balance Sheet at the date of transition to IFRS on January 1, 2010.

FUTURE ACCOUNTING PRONOUNCEMENTS

The Company has reviewed new and revised accounting pronouncements that have been issued but are not yet effective.

As of January 1, 2015, the Company will be required to adopt IFRS 9, "Financial Instruments", which is the result of the first phase of the IASB's project to replace IAS 39, "Financial Instruments: Recognition and Measurement". The new standard replaces the current multiple classification and measurement models for financial assets and liabilities with a single model that has only two classification categories: amortized cost and fair value.

As of January 1, 2013, Cequence will be required to adopt the following standards and amendments, as issued by the IASB:

- IFRS 10, "Consolidated Financial Statements", which is the result of the IASB's project to replace Standing Interpretations Committee 12, "Consolidation – Special Purpose Entities" and the consolidation requirements of IAS 27, "Consolidated and Separate Financial Statements". The new standard eliminates the current risk and rewards approach and establishes control as the single basis for determining the consolidation of an entity.
- IFRS 11, "Joint Arrangements", which is the result of the IASB's project to replace IAS 31, "Interest in Joint Ventures". The new standard redefines joint operations and joint ventures and requires joint operations to be proportionately consolidated and joint ventures to be equity accounted. Under IAS 31, joint ventures could be proportionately accounted.
- IFRS 12, "Disclosure of Interests in Other Entities", which outlines the required disclosures for interests in subsidiaries and joint arrangements. The new disclosures require information that will assist financial statement users to evaluate the nature, risks and financial effects associated with an entity's interests in subsidiaries and joint arrangements.
- IFRS 13, "Fair Value Measurement", which provides a common definition of fair value, establishes a framework for measuring fair value under IFRS and enhances the disclosures required for fair value measurements. The standard applies where fair value measurements are required and does not require new fair value measurements.

The Company is currently evaluating the impact of adoption of these standards and thus, the effect on Cequence's Consolidated Financial Statements at the time of adoption is not currently determinable.

APPLICATION OF CRITICAL ACCOUNTING ESTIMATES

The significant accounting policies used by Cequence are disclosed in note 2 to the Financial Statements. Certain accounting policies require that management make appropriate decisions with respect to the formulation of estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. Management reviews its estimates on a regular basis. The emergence of new information and changed circumstances may result in actual results or changes to estimate amounts that differ materially from current estimates. The following discussion identifies the critical accounting policies and practices of the Company and helps to assess the likelihood of materially different results being reported.

Management's Discussion and Analysis

RESERVES

Oil and gas reserves are estimates made using all available geological and reservoir data, as well as historical production data. All of the Company's reserves were evaluated and reported on by an independent qualified reserves evaluator. However, revisions can occur as a result of various factors including: actual reservoir performance, change in price and cost forecasts or a change in the Company's plans. Reserve changes will impact the financial results as reserves are used in the calculation of depletion and are used to assess whether asset impairment occurs. Reserve changes also affect other non-GAAP measurements such as finding and development costs, recycle ratios and net asset value calculations.

DEPLETION

The net carrying value of development and production assets plus future development costs on proved plus probable reserves is depleted using the unit of production method based on proved and probable reserves, gross of royalties, as determined by independent engineers, on an area by area basis. An increase in estimated proved plus probable reserves would result in a reduction in depletion expense. A decrease in estimated future development costs would also result in a reduction in depletion expense.

EXPLORATION AND EVALUATION ASSETS

Exploration and evaluation costs, including the costs of acquiring licenses and directly attributable costs, are initially capitalized as exploration and evaluation assets to the extent that they do not relate to a field with proven reserves attributed. The costs are accumulated in cost centers by field or exploration area pending determination of technical feasibility and commercial viability.

Exploration and evaluation assets are assessed for impairment if sufficient data exists to determine technical feasibility and commercial viability, or if facts and circumstances suggest that the carrying amount exceeds the recoverable amount.

The technical feasibility and commercial viability of extracting a mineral resource is considered to be determinable when proven reserves are determined to exist and are capable of economic production. A review of each exploration field is carried out, at least annually, to ascertain whether proven reserves have been discovered that are capable of economic production. Upon determination of proven reserves, exploration and evaluation assets attributable to those reserves are first tested for impairment and then reclassified from exploration and evaluation assets to development and production assets included in property and equipment.

DEVELOPMENT AND PRODUCTION COSTS

Items of property and equipment, which include oil and gas development and production assets, are measured at cost less accumulated depletion and depreciation and accumulated impairment losses.

Development and production assets are grouped into Cash Generating Units ("CGUs") for impairment testing. CGUs are defined as the smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets. The Company evaluates the geography, geology, production profile and infrastructure of its assets in determining its CGUs. Based on this assessment, Cequence's CGUs are generally composed of significant development areas. The Company reviews the composition of its CGUs at each reporting date to assess whether any changes are required in light of new facts and circumstances.

When significant parts of an item of property and equipment, including oil and natural gas interests, have different useful lives, they are accounted for as separate items (major components).

Gains and losses on disposal of an item of property and equipment, including oil and natural gas interests, are determined by comparing the proceeds from disposal with the carrying amount of the related property and equipment and are recognized net within "other expense (income)" in comprehensive income (loss).

IMPAIRMENT

The carrying amounts of all assets, other than financial assets and deferred tax assets, are reviewed at each reporting date to determine whether there is indication of an impairment loss. If any such indication exists, the asset's recoverable amount is estimated.

For any asset that does not generate largely independent cash flows, the recoverable amount is determined for the CGU to which the asset belongs. If the carrying amount of an asset (or CGU) exceeds its recoverable amount, the asset (or CGU) is written down.

The recoverability of the carrying amount of an exploration and evaluation asset is dependent on successful development and commercial exploitation, or alternatively, sale of the respective area of interest. Where a potential impairment is indicated, assessment is performed for each field or area to which the exploration and evaluation expenditure is attributed. To the extent that capitalized expenditures are not expected to be recovered, the excess of the carrying amount over the recoverable amount is recognized immediately in comprehensive income (loss).

The recoverable amount of a development and production asset (or CGU) or other intangible asset (or CGU) is determined as the higher of its value in use and fair value less cost to sell. Value in use is determined by estimating future cash flows after taking into account the risks specific to the asset (or group of assets within a CGU) and discounting them to their present value using a pre-tax discount rate that reflects the current market assessment of the time value of money. In determining fair value less cost to sell, an appropriate valuation model is used. These calculations are corroborated by external valuation metrics or other available fair value indicators wherever possible.

Where the carrying amount of a development and production asset (or CGU) or other intangibles asset exceeds its recoverable amount, the excess is recognized immediately in comprehensive income (loss).

Where an impairment loss subsequently reverses, the carrying amount of the asset (or CGU) is increased to the revised estimate of its recoverable amount, but only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or depletion, if no impairment loss had been recognized.

Management's Discussion and Analysis

DECOMMISSIONING LIABILITIES

The Company records a liability for the fair value of legal obligations associated with the retirement of petroleum and natural gas assets. The liability is equal to the discounted fair value of the obligation in the period in which the asset is recorded with an equal offset to the carrying amount of the asset. The liability then accretes to its fair value with the passage of time and the accretion is recognized as finance costs in the consolidated financial statements. The total amount of the decommissioning liability is an estimate based on the Company's net ownership interest in all wells and facilities, the estimated costs to abandon and reclaim the wells and facilities and the estimated timing of the costs to be incurred in future periods. The total amount of the estimated cash flows required to settle the decommissioning liabilities, the timing of those cash flows and the discount rate used to calculate the present value of those cash flows are all estimates subject to measurement uncertainty. Any change in these estimates would impact the decommissioning liabilities and the accretion expense.

STOCK BASED COMPENSATION

The Company has a stock option plan and issues stock options and performance warrants to directors, officers, employees and other service providers. Compensation costs attributable to stock options and performance warrants granted are measured at fair value at the date of grant and are expensed over the vesting period, using a graded vesting schedule, with a corresponding increase in contributed surplus. When stock options and performance warrants are exercised, the cash proceeds together with the amount previously recorded as contributed surplus is recorded as share capital. The Company incorporates an estimated forfeiture rate for stock options and performance warrants that will not vest, and adjusts for actual forfeitures as they occur.

INCOME TAXES

The determination of income and other tax assets and liabilities requires interpretation of complex laws and regulations. All tax filings are subject to audit and potential reassessment after the lapse of considerable time. Accordingly, the actual income tax asset may differ significantly from that estimated and recorded by management.

The recognition of a deferred income tax asset is also based on estimates of whether it is probable that the Company is able to realize these assets. This estimate, in turn, is based on estimates of proved and probable reserves, future oil and natural gas prices, royalty rates and costs. Changes in these estimates could materially impact comprehensive income (loss) and the deferred income tax asset recognized.

ACQUISITIONS

The allocation of the purchase price of business combinations to the net assets acquired at the respective acquisition dates are based on estimates of numerous factors affecting valuation including discount rates, proved and probable reserves, future petroleum and natural gas prices and other factors.

COMMODITY CONTRACTS

The fair value of commodity contracts and the resultant unrealized gain (loss) on commodity contracts is based on estimates of future natural gas prices.

OTHER ESTIMATES

The accrual method of accounting requires management to incorporate certain estimates including estimates of revenues, royalties, capital, drilling credits and operating costs as at a specific reporting date, but for which actual revenues and costs have not yet been received. In addition, estimates are made on capital projects which are in progress or recently completed where actual costs have not been received by the reporting date. The Company obtains the estimates from the individuals with the most knowledge of the activity and from all project documentation received. The estimates are reviewed for reasonableness and compared to past performance to assess the reliability of the estimates. Past estimates are compared to actual results in order to make informed decisions on future estimates.

FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

The Company's financial instruments, including derivative financial instruments and embedded derivative financial instruments, recognized in the consolidated balance sheet consist of cash, accounts receivable, commodity contracts, demand credit facilities and accounts payable and accrued liabilities.

The Company's accounts receivable, demand credit facilities and accounts payable and accrued liabilities approximate their carrying values due to their short terms to maturity and the floating interest rate on the Company's debt.

The Company is engaged in the exploration, development, production and acquisition of crude oil and natural gas. This business is inherently risky and there is no assurance that hydrocarbon reserves will be discovered and economically produced. Financial risks associated with the petroleum industry include fluctuations in commodity prices, interest rates and currency exchange rates along with the credit risk of the Company's industry partners. Operational risks include reservoir performance uncertainties, the reliance on operators of the Company's non-operated properties, competition, environmental and safety issues, and a complex and changing regulatory environment.

The primary risks and how the Company mitigates them are as follows:

Commodity price and exchange rate volatility

Revenues and consequently cash flows fluctuate with commodity prices and the U.S. / Canadian dollar exchange rate. Commodity prices are determined on a global basis and circumstances that occur in various parts of the world are outside of the control of the Company. The Company protects itself from fluctuations in prices by maintaining an appropriate hedging strategy, diversifying its asset mix and strengthening its balance sheet in order to take advantage of low price environments by making strategic acquisitions. Cequence enters into commodity price contracts to actively manage the risks associated with price volatility and thereby protect the Company's cash flows used to fund its capital program. Comprehensive income (loss) for the year ended December 31, 2011 includes \$906 of realized gains and \$nil of unrealized losses on these transactions.

Management's Discussion and Analysis

Cequence is also exposed to fluctuations in the exchange rate between the Canadian and U.S. dollar. Most commodity prices are based on U.S. dollar benchmarks that results in the Company's realized prices being influenced mainly by the U.S. / Canadian currency exchange rates. As at December 31, 2011, the Company has a pipeline commitment in U.S. dollars and sells certain quantities of natural gas in the U.S. dollar. There are no other forward contracts, foreign exchange contracts or other significant items denominated in foreign currencies.

Interest rate risk

The Company is exposed to interest rate risk to the extent that changes in market interest rates impact its borrowings under the floating rate credit facilities. The floating rate debt is subject to interest rate cash flow risk, as the required cash flows to service the debt will fluctuate as a result of changes in market rates. The Company has no interest rate swaps or financial contracts in place as at or during the year ended December 31, 2011.

Based on debt outstanding at December 31, 2011, a 1 percent change in interest rates, with all other variables held constant, would result in a change in comprehensive income (loss) of \$116 (\$85 after tax).

Credit risk

Credit risk is the risk of financial loss to the Company if a counterparty to a financial instrument fails to meet its contractual obligations. The company is exposed to credit risk with respect to its accounts receivable and cash.

The majority of the Company's accounts receivable are due from joint venture partners in the oil and gas industry and from marketers of the Company's petroleum and natural gas production. The Company mitigates its credit risk by entering into contracts with established counterparties that have strong credit ratings and reviewing its exposure to individual counterparties on a regular basis. At December 31, 2011, the Company has an allowance for doubtful accounts of \$551 (2010 – \$490).

Liquidity Risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they are due. The nature of the oil and gas industry is capital intensive and the Company maintains and monitors a certain level of cash flow to finance operating and capital expenditures. The Company believes it has sufficient credit facilities to satisfy its financial obligations as they come due.

The Company's ongoing liquidity is impacted by various external events and conditions, including commodity price fluctuations and the global economic environment.

The timing of cash flows relating to financial liabilities as at December 31, 2011 is as follows:

	< 1 Year	1 – 2 Years	2 – 5 Years	Thereafter
Demand credit facilities	–	–	11,618	–
Accounts payable and accrued liabilities	64,467	–	–	–
	64,467	–	11,618	–

Access to Capital Risk

The Company anticipates making substantial capital expenditures for the acquisition, exploration, development and production of oil and natural gas reserves in the future. As the Company's revenues may decline as a result of decreased commodity pricing, it may be required to reduce capital expenditures. In addition, uncertain levels of near term industry activity coupled with the present global credit crisis exposes the Company to additional access to capital risk. There can be no assurance that debt or equity financing, or cash generated by operations will be available or sufficient to meet these requirements or for other corporate purposes or, if debt or equity financing is available, that it will be on terms acceptable to the Company. The inability of the Company to access sufficient capital for its operations could have a material adverse effect on the Company's business, financial condition, results of operations and prospects.

Operational Matters

The ownership and operation of oil and natural gas wells, pipelines and facilities involves a number of operating and natural hazards which may result in blowouts, environmental damage and other unexpected or dangerous conditions resulting in damage to the Company's natural gas and oil properties and assets, as well as possible liability to third parties. The Company may become liable for damages arising from such events against which it cannot insure or against which it may elect not to insure because of high premium costs or other reasons. Costs incurred to repair such damage or pay such liabilities will reduce the cash flow of the Company. The Company employs prudent risk management practices and maintains suitable liability insurance.

Environmental Concerns

The oil and natural gas industry is subject to environmental regulation pursuant to local, provincial and federal legislation. A breach of such legislation may result in the imposition of fines or issuance of clean up orders in respect of Cequence or its working interests. Such legislation may be changed to impose higher standards and potentially more costly obligations on Cequence. Furthermore, management believes the federal political parties appear to favor new programs for environmental laws and regulation, particularly in relation to the reduction of emissions, and there is no assurance that any such programs, laws or regulations, if proposed and enacted, will not contain emission reduction targets which Cequence cannot meet, and financial penalties or charges could be incurred as a result of the failure to meet such targets. In particular there is uncertainty regarding the Federal Government's future regulation of air emissions.

Regulatory Risk

There can be no assurance that government royalties, income tax laws, environmental laws and regulatory requirements relating to the oil and gas industry will not be changed in a manner which adversely affects the Company or its shareholders. Although the Company has no control over these regulatory risks, it continuously monitors changes in these areas by participating in industry organizations and conferences, exchanging information with third party experts and employing qualified individuals to assess the impact of such changes on the Company's financial and operating results.

Management's Discussion and Analysis

CURRENT ECONOMIC CONDITIONS

Recent market events and conditions, including disruptions in the international credit markets and other financial systems and the deterioration of global economic conditions, have caused significant volatility to commodity prices. These conditions persisted throughout 2010 and 2011, causing a loss of confidence in the global credit and financial markets and resulted in the collapse of, and government intervention in, major banks, financial institutions and insurers and created a climate of greater volatility, less liquidity, widening of credit spreads, a lack of price transparency, increased credit losses and tighter credit conditions. Notwithstanding various actions by governments, concerns about the general condition of the capital markets, financial instruments, banks, investment banks, insurers and other financial institutions caused the broader credit markets to further deteriorate and stock markets to decline substantially. These factors have negatively impacted company valuations and will impact the performance of the global economy going forward. Petroleum and natural gas prices are expected to remain volatile for the near future as a result of market uncertainties over the supply and demand of these commodities due to the current state of the world economies, the intensification and broadening of North African and Middle East protest movements, OPEC actions and the ongoing global credit and liquidity concerns.

OUTLOOK INFORMATION

Cequence provided 2012 guidance on February 14, 2012. Capital expenditures for 2012 are expected to be funded from cash flow from operations, available bank lines and proceeds from the sale of assets expected to close in the first quarter of 2012.

Cequence's current guidance for 2012 is as follows:

	2012
Average 2012 production, BOE/d ⁽¹⁾	9,800
Exit 2012 production, BOE/d ⁽¹⁾	10,000
Capital expenditures 2012 (\$000's) ⁽²⁾	92,000
Planned net dispositions (\$000's) ⁽³⁾	(11,000)
Operating costs (\$ per boe) ⁽⁴⁾	\$8.05
Royalties (% revenue)	12
Crude – WTI (US\$/bbl)	\$101.00
Natural gas – AECO (Cdn\$/GJ)	\$2.50
Funds flow (\$)	\$ 37 million
December 31, 2012 Net debt (\$)	\$ 90 million
Basic shares outstanding, Dec. 31, 2012	161.86 million

Notes:

- ⁽¹⁾ Production figures are presented without giving effect to any anticipated production curtailments.
- ⁽²⁾ Excludes the planned \$11 million in net dispositions of non-core assets and undeveloped land discussed below.
- ⁽³⁾ Includes the planned disposition of non-core assets with no attributed production for approximately \$17 million and the planned acquisition of undeveloped land for approximately \$6 million.
- ⁽⁴⁾ Assumes that the previously disclosed Aux Sable project commences April 1, 2012.

The Company closely monitors fluctuations in natural gas prices and will adjust the 2012 budget if facts and circumstances require.

FORWARD-LOOKING STATEMENTS

Certain statements contained within this MD & A constitute forward-looking statements. These statements relate to future events or the Company's future performance. All statements other than statements of historical fact may be forward-looking statements. Forward-looking statements are often, but not always, identified by the use of words such as "seek", "anticipate", "budget", "plan", "continue", "estimate", "expect", "forecast", "may", "will", "project", "predict", "potential", "targeting", "intend", "could", "might", "should", "believe", and similar expressions. Forward-looking statements in this MD & A include, but are not limited to, statements with respect to: the potential impact of implementation of the Alberta Royalty Framework on Cequence's condition and projected 2012 capital investments; projections with respect to growth of natural gas production; the projected impact of land access and regulatory issues; projections relating to the volatility of crude oil and natural gas prices in 2012 and beyond and reasons therefore; the Company's projected capital investment levels for 2012 and the source of funding therefore; the effect of the Company's risk management program, including the impact of derivative financial instruments; the Company's defence of lawsuits; the impact of the climate change initiatives on operating costs; the impact of Western Canada pipeline constraints. Readers are cautioned not to place undue reliance on forward-looking statements, as there can be no assurance that the plans, intentions or expectations upon which they are based will occur.

By their nature, forward-looking statements involve numerous assumptions, known and unknown risks and uncertainties, both general and specific, that contribute to the possibility that the predictions, forecasts, projections and other forward-looking statements will not occur, which may cause the Company's actual performance and financial results in future periods to differ materially from any estimates or projections of future performance or results expressed or implied by such forward-looking statements. These assumptions, risks and uncertainties include, among other things: volatility of and assumptions regarding oil and natural gas prices; assumptions based upon Cequence's current guidance; fluctuations in currency and interest rates; product supply and demand; market competition; risks inherent in the Company's marketing operations, including credit risks; imprecision of reserves estimates and estimates of recoverable quantities of oil, natural gas and liquids from resource plays and other sources not currently classified as proved; the Company's ability to replace and expand oil and gas reserves; the Company's ability to generate sufficient cash flow from operations to meet its current and future obligations; the Company's ability to access external sources of debt and equity capital; the timing and cost of well and pipeline constructions; the Company's ability to secure adequate product transportation; changes in royalty, tax, environmental and other laws or regulations or the interpretations of such laws or regulations; risks associated with existing and potential future lawsuits and regulatory actions made against the Company; and other risks and uncertainties described from time to time in the reports and filings made with securities regulatory authorities by Cequence. Statements relating to "reserves" are deemed to be forward-looking statements, as they involve the implied assessment, based on certain estimates and assumptions that the resources and reserves described can be profitably produced in the future.



Management's Discussion and Analysis

The forward looking statements contained herein concerning production, sales prices, and capital spending are based on Cequence's 2012 capital program. The material assumptions supporting the 2012 capital program are: i) 2012 annual production of approximately 9,800 boe/day; ii) a \$2.50 Cdn\$/gj AECO gas price; iii) capital spending of approximately \$92,000.

Financial outlook information contained in this MD & A about prospective results of operations, financial position or cash flows is based on assumptions about future events, including economic conditions and proposed courses of action, based on management's assessment of the relevant information currently available. The purpose of such financial outlook is to enrich this MD&A. Readers are cautioned that such financial outlook information contained in this MD & A should not be used for purposes other than for which it is disclosed herein.

Although Cequence believes that the expectations represented by such forward-looking statements are reasonable, there can be no assurance that such expectations will prove to be correct. Readers are cautioned that the foregoing list of important factors is not exhaustive. Furthermore, the forward-looking statements contained in this MD & A are made as of the date of this MD & A and, except as required by law, Cequence does not undertake any obligation to update publicly or to revise any of the included forward-looking statements, whether as a result of new information, future events or otherwise. The forward-looking statements contained in this MD & A are expressly qualified by this cautionary statement.

Independent Auditor's Report

To the Shareholders of Cequence Energy Ltd.:

We have audited the accompanying consolidated financial statements of Cequence Energy Ltd., which comprise the consolidated balance sheets as at December 31, 2011 and 2010 and January 1, 2010, and the consolidated statements of comprehensive loss, changes in equity and cash flows for the years ended December 31, 2011 and 2010, and the notes to the consolidated financial statements.

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.

AUDITOR'S 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 auditor's 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.

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 Cequence Energy Ltd. as at December 31, 2011 and 2010 and January 1, 2010, and its financial performance and its cash flows for the years ended December 31, 2011 and 2010 in accordance with International Financial Reporting Standards.

Deloitte & Touche LLP
Chartered Accountants
Calgary, Alberta

March 8, 2012

Consolidated Balance Sheets

(Expressed in thousands of Canadian dollars)

	December 31, 2011 \$	December 31, 2010 ⁽¹⁾ \$	January 1, 2010 ⁽¹⁾ \$
ASSETS			
CURRENT			
Cash	380	1,321	18,128
Accounts receivable (Note 8)	21,032	16,439	10,144
Deposits and prepaid expenses (Note 20)	3,231	2,480	913
Commodity contracts (Note 21)	–	–	1,420
	24,643	20,240	30,605
Investments (Note 5)	–	–	13,920
Exploration and evaluation assets (Note 6)	6,221	–	29,411
Property and equipment (Note 6)	409,729	341,801	121,809
Deposits and prepaid expenses (Note 20)	2,456	–	–
Deferred income taxes (Note 16)	48,316	47,340	7,681
	491,365	409,381	203,426
LIABILITIES			
CURRENT			
Demand credit facilities (Note 7)	11,618	56,739	–
Accounts payable and accrued liabilities (Note 9)	64,467	36,240	23,175
Other liabilities (Note 10)	5,289	2,068	388
	81,374	95,047	23,563
Long-term debt related to investments (Note 5)	–	–	18,204
Provisions (Note 15)	28,942	26,130	7,310
	110,316	121,177	49,077
CONTINGENCIES AND COMMITMENTS (Note 20)			
SUBSEQUENT EVENTS (Note 25)			
SHAREHOLDERS' EQUITY			
Share capital (Note 17)	559,371	452,526	269,185
Contributed surplus	16,839	10,681	7,818
Deficit	(195,161)	(175,003)	(122,654)
	381,049	288,204	154,349
	491,365	409,381	203,426

⁽¹⁾ Refer to note 4 for effects of adoption of IFRS

APPROVED BY THE BOARD

“Donald Archibald” Donald Archibald, Director

“Brian Felesky” Brian Felesky, Director

Consolidated Statements of Comprehensive Loss

(Expressed in thousands of Canadian dollars except per share amounts)

	Year ended 2011	December 31, 2010 ⁽¹⁾
	\$	\$
REVENUE		
Production revenue (Note 11)	87,347	44,845
Gain on derivative financial instruments (Note 21)	906	1,163
	88,253	46,008
EXPENSES		
Depletion, depreciation and impairment (Note 6)	59,560	82,559
General and administrative (Note 14)	7,325	5,544
Finance costs (Note 13)	3,276	2,090
Operating costs	29,673	17,700
Stock-based compensation (Note 18)	6,758	2,863
Transportation	7,153	4,357
Other expense (income) (Note 12)	(4,013)	1,031
	109,732	116,144
INCOME (LOSS) BEFORE INCOME TAXES	(21,479)	(70,136)
INCOME TAXES (Note 16)	(1,321)	(17,787)
NET LOSS AND COMPREHENSIVE LOSS	(20,158)	(52,349)
Loss per share, basic and diluted (Note 19)	\$ (0.14)	\$ (0.75)

⁽¹⁾ Refer to note 4 for effects of adoption of IFRS

Consolidated Statements of Changes in Equity

(Expressed in thousands of Canadian dollars)

	Year ended December 31,	
	2011	2010 ⁽¹⁾
	\$	\$
SHARE CAPITAL		
Common Shares		
Balance, beginning of year	452,526	269,185
Proceeds from shares issued in public offerings (Note 17)	98,338	–
Flow-through share private placement (Note 17)	2,649	12,433
Subscription receipts (Note 17)	–	44,195
Shares issued in business combinations (Note 4)	–	123,920
Common share private placement (Note 17)	–	6,195
Shares issued on exercise of stock options (Note 17)	1,794	–
Shares issued on exercise of the 2011 Warrants (Note 17)	8,663	–
Share issue costs, net of tax of \$1,531 (2010 – \$1,178)	(4,599)	(3,402)
Balance, end of year	559,371	452,526
CONTRIBUTED SURPLUS		
Balance, beginning of year	10,681	7,818
Stock-based compensation expense (Note 18)	6,758	2,863
Exercise of stock options (Note 17)	(600)	–
Balance, end of year	16,839	10,681
DEFICIT		
Balance, beginning of year	(175,003)	(122,654)
Comprehensive loss	(20,158)	(52,349)
Balance, end of year	(195,161)	(175,003)
TOTAL EQUITY	381,049	288,204

⁽¹⁾ Refer to note 4 for effects of adoption of IFRS

Consolidated Statements of Cash Flows

(Expressed in thousands of Canadian dollars)

	Year ended 2011	December 31, 2010 ⁽¹⁾
	\$	\$
CASH FLOWS RELATED TO THE FOLLOWING ACTIVITIES:		
OPERATING		
Net loss	(20,158)	(52,349)
Adjustments for non-cash items:		
Depletion, depreciation and impairment	59,560	82,559
Finance costs related to decommissioning liabilities (Note 15)	905	495
Stock-based compensation (Note 18)	6,758	2,863
Loss on investments (Note 5)	-	281
Gain on sale of commodity contracts (Note 21)	-	(219)
Amortization of transaction costs on financial instruments (Note 13)	443	169
Unrealized loss (gain) on derivative financial instruments	-	2,793
Write-down of loan premium and other derivative financial instruments	-	32
Provisions related to onerous contracts (Note 15)	1,138	-
Gain on sale of assets (Note 6)	(5,077)	(2,842)
Deferred income tax (recovery)	(1,307)	(17,785)
	42,262	15,997
Decommissioning liabilities expenditures (Note 15)	(955)	(126)
Proceeds from sale of commodity contracts (Note 21)	-	3,386
Net change in non-cash working capital (Note 22)	(4,607)	(2,017)
	36,700	17,240
INVESTING		
Property and equipment and exploration and evaluation assets expenditures	(149,601)	(64,120)
Acquisitions	(22,150)	(84,728)
Proceeds from sale of assets	45,173	41,571
Proceeds from sale of investments	-	13,457
Net change in non-cash working capital (Note 22)	24,976	2,353
	(101,602)	(91,467)
FINANCING		
Proceeds from demand credit facilities (Note 7)	46,305	36,169
Repayment of demand credit facilities (Note 7)	(91,812)	(20,451)
Transaction costs on financial instruments (Note 7)	(57)	(555)
Repayment of long-term debt related to investments	-	(18,054)
Issue of common shares (Note 17)	115,597	64,891
Share issue costs (Note 17)	(6,130)	(4,580)
Net change in non-cash working capital (Note 22)	58	-
	63,961	57,420
NET DECREASE IN CASH	(941)	(16,807)
CASH, BEGINNING OF YEAR	1,321	18,128
CASH, END OF YEAR	380	1,321
SUPPLEMENTARY INFORMATION		
Income taxes paid	14	-
Interest paid	1,852	2,242

⁽¹⁾ Refer to note 4 for effects of adoption of IFRS

Notes to the Consolidated Financial Statements

(All figures expressed in thousands except per share amounts unless otherwise noted)

1. NATURE AND DESCRIPTION OF THE COMPANY

Cequence Energy Ltd. (the "Company" or "Cequence") is incorporated under the laws of Alberta with common shares that are widely held and listed on the Toronto Stock Exchange ("TSX"). Cequence is engaged in the acquisition, exploration and production of petroleum and natural gas reserves in Western Canada. The registered office of the Company is located at Suite 3100, 525 - 8th Ave. SW, Calgary, Alberta, T2P 1G1.

These consolidated financial statements ("consolidated financial statements") include all assets, liabilities, revenues and expenses of Cequence and its wholly-owned subsidiary, 1175043 Alberta Ltd. Effective January 1, 2011, Cequence Acquisitions Ltd., a wholly-owned subsidiary of the Company, was amalgamated with Cequence and the combined entity was continued as Cequence Energy Ltd.

2. SIGNIFICANT ACCOUNTING POLICIES

Statement of compliance and authorization

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 represent the first annual financial statements of the Company prepared in accordance with IFRS. The Company adopted IFRS in accordance with IFRS 1, "First-time Adoption of International Financial Reporting Standards" ("IFRS 1"). Refer to note 4 for a discussion of the effects of adoption of the above noted standards.

The consolidated financial statements were authorized for issue by the Company's Board of Directors on March 8, 2012.

Basis of presentation

The consolidated financial statements have been prepared using historical costs, except for financial instruments carried at fair value, on a going concern basis and have been presented in Canadian dollars, which is also the Company's functional currency, rounded to the nearest thousand. The accounting policies set out below have been applied consistently in all material respects.

Basis of consolidation

The consolidated financial statements include the accounts of the Company and its consolidated subsidiaries, which are the entities over which the Company has control. Control exists when the Company has the power to govern the financial and operating policies of an entity so as to obtain benefit from its activities. All intercompany transactions and balances are eliminated on consolidation.

Business combinations

The acquisition method of accounting is used to account for acquisitions of subsidiaries and assets that meet the definition of a business under IFRS. The cost of an acquisition is measured as the fair value of the assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange. Acquisition-related costs are recognized in comprehensive income (loss) as incurred. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date. The excess of the cost of acquisition over the fair value of the identifiable assets and liabilities acquired and contingent liabilities for which a provision is provided is recorded as goodwill. If the cost of acquisition is less than the fair value of the net assets of the subsidiary acquired, the difference is recognized immediately in comprehensive income (loss). Results of subsidiaries are included in the consolidated statement of comprehensive income (loss) from the closing date of acquisition.

Financial instruments

A financial instrument is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity. Financial assets and financial liabilities are recognized on the consolidated balance sheet at the time the Company becomes a party to the contractual provisions. Upon initial recognition, financial instruments are measured at fair value. Measurement in subsequent periods is dependent on the classification of the financial instrument.

The Company has made the following classifications:

- Cash and investments are classified as financial assets recorded at fair value through profit or loss and are carried at fair value. Gains and losses from revaluation are recognized in comprehensive income (loss).
- Accounts receivable are classified as loans and receivables and are initially measured at fair value plus directly attributable transaction costs. Subsequently, they are recorded at amortized cost using the effective interest method.
- Demand credit facilities, accounts payable and accrued liabilities and long-term debt related to investments are classified as other liabilities and are initially measured at fair value less directly attributable transaction costs. Subsequently, they are recorded at amortized cost using the effective interest method.
- Derivative instruments, including embedded derivative instruments, that do not qualify as hedges, or are not designated as hedges on the consolidated balance sheet, including commodity contracts, are classified as fair value through profit or loss and are recorded and carried at fair value with changes in fair value recognized in comprehensive income (loss). Derivative instruments are used by the Company to manage economic exposure to market risks relating to commodity prices. Cequence's policy is to not utilize derivative financial instruments for speculative purposes.

Transaction costs related to financial instruments classified as fair value through profit or 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.

Notes to the Consolidated Financial Statements

(All figures expressed in thousands except per share amounts unless otherwise noted)

Contracts that are entered into for the purpose of the receipt or delivery of a non-financial item in accordance with the Company's expected purchase, sale or usage requirements (such as physical delivery commodity contracts) do not qualify as financial instruments and thus, are accounted for in accordance with other applicable standards and are not accounted for on the consolidated balance sheet.

IFRS establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The three levels of the fair value hierarchy are described below:

Level 1: Values based on quoted prices in active markets that are accessible at the measurement date for identical assets or liabilities.

Level 2: Values based on quoted prices in markets that are not active or model inputs that are observable either directly or indirectly for substantially the full term of the asset or liability.

Level 3: Values based on prices or valuation techniques that require inputs that are both unobservable and significant to the overall fair value measurement.

When the inputs used to measure fair value fall within different levels of the hierarchy, the level within which the fair value measurement is categorized is based on the lowest level input that is significant to the fair value measure in its entirety.

Impairment of financial assets

Financial assets, other than those classified as fair value through profit or loss, are assessed for indicators of impairment at the end of each reporting period. Financial assets are considered to be impaired when there is objective evidence that, as a result of one or more events that occurred after the initial recognition of the financial asset, the estimated future cash flows of the investment have been negatively affected.

For financial assets carried at amortized cost, the amount of the impairment loss recognized in comprehensive income (loss) 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.

The carrying amount of the financial asset is reduced by the impairment loss directly for all financial assets with the exception of trade receivables, where the carrying amount is reduced through the use of an allowance account. When a trade receivable is considered uncollectible, it is written off against the allowance account. Subsequent recoveries of amounts previously written off are recognized in comprehensive income (loss). Changes in the carrying amount of the allowance accounts are recognized in comprehensive income (loss).

Property and equipment and exploration and evaluation assets

Recognition and measurement

Exploration and evaluation expenditures

Exploration and evaluation costs, including the costs of acquiring licenses and directly attributable costs, are initially capitalized as exploration and evaluation assets to the extent that they do not relate to a field with proven reserves attributed. The costs are accumulated in cost centers by field or exploration area pending determination of technical feasibility and commercial viability.

Exploration and evaluation assets are assessed for impairment if sufficient data exists to determine technical feasibility and commercial viability, or if facts and circumstances suggest that the carrying amount exceeds the recoverable amount.

The technical feasibility and commercial viability of extracting a mineral resource is considered to be determinable when proven reserves are determined to exist and are capable of economic production. A review of each exploration field is carried out, at least annually, to ascertain whether proven reserves have been discovered that are capable of economic production. Upon determination of proven reserves, exploration and evaluation assets attributable to those reserves are first tested for impairment and then reclassified from exploration and evaluation assets to development and production assets included in property and equipment.

Other intangible costs

Costs of data purchased to formulate strategy for license applications, such as seismic data, and asset purchases are accumulated and capitalized as other intangible assets to the extent that they are incurred prior to obtaining related licenses and do not relate to a field with proven reserves attributed.

Development and production costs

Items of property and equipment, which include oil and gas development and production assets, are measured at cost less accumulated depletion and depreciation and accumulated impairment losses, net of any reversals.

Development and production assets are grouped into Cash Generating Units ("CGUs") for impairment testing. CGUs are defined as the smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets. The Company evaluates the geography, geology, production profile and infrastructure of its assets in determining its CGUs. Based on this assessment, Cequence's CGUs are generally composed of significant development areas. The Company reviews the composition of its CGUs at each reporting date to assess whether any changes are required in light of new facts and circumstances.

When significant parts of an item of property and equipment, including oil and natural gas interests, have different useful lives, they are accounted for as separate items (major components).

Gains and losses on disposal of an item of property and equipment, including oil and natural gas interests, are determined by comparing the proceeds from disposal with the carrying amount of the related property and equipment and are recognized net within "other expense (income)" in comprehensive income (loss).

Notes to the Consolidated Financial Statements

(All figures expressed in thousands except per share amounts unless otherwise noted)

Subsequent costs

Costs incurred subsequent to the determination of technical feasibility and commercial viability and the costs of replacing parts of property and equipment are recognized as oil and natural gas interests only when they increase the future economic benefits embodied in the specific asset to which they relate. All other expenditures are recognized in comprehensive income (loss) as incurred. Such capitalized oil and natural gas interests generally represent costs incurred in developing proved and/or probable reserves and bringing in or enhancing production from such reserves, and are accumulated on a field or area basis. The carrying amount of any replaced or sold component is derecognized. The costs of the day-to-day servicing of property and equipment are recognized as operating costs in comprehensive income (loss) as incurred.

Depletion and depreciation

The net carrying value of development and production assets plus future development costs on proved plus probable reserves is depleted using the unit of production method based on proved and probable reserves, gross of royalties, as determined by independent engineers, on an area by area basis. For the purpose of this calculation, production and reserves of petroleum and natural gas are converted to a common unit of measurement on the basis of their relative energy content, where six thousand cubic feet of natural gas equates to one barrel of oil. Costs are only depleted once production in a given area begins.

Cequence depletes separately, where applicable, any significant components within development and production assets, such as fields, processing facilities and pipelines, which are significant in relation to the total cost of a development and production asset and have a different useful life than such assets.

Other property and equipment and other intangible assets are amortized over 3 to 5 years on a straight line basis.

Impairment

The carrying amounts of all assets, other than financial assets and deferred tax assets, are reviewed at each reporting date to determine whether there is indication of an impairment loss. If any such indication exists, the asset's recoverable amount is estimated.

For any asset that does not generate largely independent cash flows, the recoverable amount is determined for the CGU to which the asset belongs. If the carrying amount of an asset (or CGU) exceeds its recoverable amount, the asset (or CGU) is written down.

The recoverability of the carrying amount of an exploration and evaluation asset is dependent on successful development and commercial exploitation, or alternatively, sale of the respective area of interest. Where a potential impairment is indicated, assessment is performed for each field or area to which the exploration and evaluation expenditure is attributed. To the extent that capitalized expenditures are not expected to be recovered, the excess of the carrying amount over the recoverable amount is recognized immediately in comprehensive income (loss).

The recoverable amount of a development and production asset (or CGU) or other intangible asset (or CGU) is determined as the higher of its value in use and fair value less cost to sell. Value in use is determined by estimating future cash flows after taking into account the risks specific to the asset (or group of assets within a CGU) and discounting them to their present value using a pre-tax discount rate that reflects the current market assessment of the time value of money. In determining fair value less cost to sell, an appropriate valuation model is used. These calculations are corroborated by external valuation metrics or other available fair value indicators wherever possible.

Where the carrying amount of a development and production asset (or CGU) or other intangibles asset (or CGU) exceeds its recoverable amount, the excess is recognized immediately in comprehensive income (loss).

Where an impairment loss subsequently reverses, the carrying amount of the asset (or CGU) is increased to the revised estimate of its recoverable amount, but only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or depletion, if no impairment loss had been recognized.

Provisions

Provisions are recognized when the Company has a present obligation as a result of a past event that can be estimated with reasonable certainty and are measured at the amount that the Company would rationally pay to be relieved of the present obligation. To the extent that provisions are estimated using a present value technique, such amounts are determined by discounting the expected future cash flows at a risk-free pre-tax rate and adjusting the liability for the risks specific to the liability.

Decommissioning liabilities

The Company records the present value of the estimated cost of legal and constructive obligations to restore operating locations in the period in which the obligation arises. The nature of restoration activities includes the removal of facilities, abandonment of wells and restoration of affected areas. Provision is made for the estimated cost of restoration and capitalized in the relevant asset category.

Decommissioning liabilities are measured at the present value of management's best estimate of the expenditure required to settle the present obligation at the balance sheet date. Subsequent to the initial measurement, the obligations are adjusted at the end of each period to reflect the passage of time and changes in the estimated future cash flows underlying the obligation as well as changes to the discount rate. The increase in the provision due to the passage of time is recognized as finance cost whereas increases or decreases due to changes in the estimated future cash flows or changes in the discount rate are capitalized. Actual costs incurred upon settlement of the decommissioning liabilities are charged against the decommissioning liabilities.

Notes to the Consolidated Financial Statements

(All figures expressed in thousands except per share amounts unless otherwise noted)

Onerous contracts

Present obligations arising under onerous contracts are recognized and measured as provisions. An onerous contract is considered to exist where the Company has a contract under which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received from the contract.

Borrowing costs

Borrowing costs incurred for the acquisition or construction of qualifying assets are capitalized during the period of time that is required to complete and prepare the asset for its intended use or sale. Assets are considered to be qualifying assets when this period of time is substantial (greater than 12 months).

The interest rate used to determine the amount of borrowing costs to be capitalized is the weighted average interest rate applicable to the Company's outstanding borrowings during the period.

All other borrowing costs are recognized in comprehensive income (loss) as finance costs in the period in which they are incurred.

Jointly controlled assets

A significant portion of the Company's oil and natural gas activities involve jointly controlled assets and any related liabilities incurred. The consolidated financial statements include the Company's share of these jointly controlled assets and liabilities and a proportionate share of the relevant revenues and related costs, classified according to their nature.

Share-based payments

The Company has a stock option plan and issues stock options and performance warrants to directors, officers, employees and other service providers. Compensation costs attributable to stock options and performance warrants granted are measured at fair value at the date of grant and are expensed over the vesting period, using a graded vesting schedule, with a corresponding increase in contributed surplus. When stock options and performance warrants are exercised, the cash proceeds together with the amount previously recorded as contributed surplus are recorded as share capital. The Company incorporates an estimated forfeiture rate for stock options and performance warrants that will not vest, and subsequently adjusts for actual forfeitures as they occur.

Revenue

Revenue from the sale of petroleum and natural gas is recognized when the risks and rewards of ownership of the product are transferred to the customer, based on volumes delivered to customers at contractual delivery points and rates. The costs associated with the delivery, including operating and maintenance costs, transportation and production-based royalty expenses are recognized in the same period in which the related revenue is earned and recorded. Revenue is measured net of related royalties.

Revenue from interest income is recognized as it accrues, using the effective interest method.

Flow-through shares

The Company, from time to time, issues flow-through shares to finance a portion of its capital expenditure program. Pursuant to the terms of the flow-through share agreements, the tax deductions associated with the expenditures are renounced to the subscribers. The difference between the value ascribed to flow-through shares issued and the value that would have been received for common shares at the date of issuance of the flow-through shares is initially recognized as a liability on the consolidated balance sheet. When the expenditures are renounced and incurred, the liability is drawn down, a deferred income tax liability is recorded equal to the estimated amount of deferred income tax payable by the Company as a result of the renunciation, and the difference is recognized as income tax expense in comprehensive income (loss).

Earnings per share

Basic per share amounts are computed by dividing the net income (loss) by the weighted average number of common shares outstanding during the period. Diluted per share amounts are calculated giving effect to the potential dilution that would occur if stock options and warrants were exercised. The dilutive effect of stock options and warrants is calculated with the assumption that proceeds received from the exercise of options and warrants for which the exercise price is less than the market price plus the unamortized portion of stock-based compensation are used to repurchase common shares at the average market price for the period.

Government grants

The Company receives government grants in the form of drilling royalty credits.

Government grants are not recognized until there is reasonable assurance that the Company will comply with the conditions attached to them and that the grants will be received.

Government grants whose primary condition is that the Company should purchase, construct or otherwise acquire non-current assets are deducted from the cost of the related assets. The net amount is amortized to income over the useful life of the related assets in accordance with the Company's relevant policies.

Taxation

Income tax expense represents the sum of the tax currently payable and deferred tax.

Current tax

The tax currently payable is based on taxable income for the year. Taxable income differs from income as reported in the consolidated statement of comprehensive income (loss) because of items of income or expense that are taxable or deductible in other years and items that are never taxable or deductible. The Company's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the end of the reporting period.

Deferred tax

Deferred tax is recognized on temporary differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable income. Deferred tax liabilities are generally recognized for all taxable temporary differences.

Notes to the Consolidated Financial Statements

(All figures expressed in thousands except per share amounts unless otherwise noted)

Deferred tax assets are generally recognized for all deductible temporary differences to the extent that it is probable that taxable profits will be available against which those deductible temporary differences can be utilized. Such deferred tax assets and liabilities are not recognized if the temporary difference arises from goodwill or from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither taxable income nor the accounting income.

The carrying amount of deferred tax assets is reviewed at the end of each reporting period and reduced to the extent that it is no longer probable that sufficient taxable income will be available to allow all or part of the asset to be recovered.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply in the period in which the liability is settled or the asset realized, based on tax rates (and tax laws) that have been enacted or substantively enacted by the end of the reporting period. The measurement of deferred tax liabilities and assets reflects the tax consequences that would follow from the manner in which the Company expects, at the end of the reporting period, to recover or settle the carrying amount of its assets and liabilities.

Deferred tax assets and liabilities are offset when there is a legally enforceable right to set off current tax assets against current tax liabilities and when they relate to income taxes levied by the same taxation authority and the Company intends to settle its current tax assets and liabilities on a net basis.

Current and deferred tax for the period

Current and deferred tax are recognized as an expense or income in comprehensive income (loss), except when they relate to items that are recognized outside profit or loss (whether in other comprehensive income or directly in equity), in which case the tax is also recognized outside profit or loss, or where they arise from the initial accounting for a business combination. In the case of a business combination, the tax effect is included in the accounting for the business combination.

Significant accounting judgments, estimates and assumptions

The preparation of the consolidated financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect the reported amount of assets, liabilities, and contingent liabilities at the date of the consolidated financial statements and reported amounts of revenues and expenses during the reporting period. Estimates and judgments are continuously evaluated and are based on management's experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

In particular, information about significant areas of estimation uncertainty considered by management in preparing the consolidated financial statements are described in the following notes:

Note 6: Property and equipment and exploration and evaluation assets

Note 15: Provisions

Note 18: Stock-based compensation plans

Note 20: Contingencies and commitments

Note 21: Financial instruments and risk management

Estimates of recoverable quantities of proved and probable reserves include judgmental assumptions regarding commodity prices, exchange rates, discount rates and production and transportation costs for future cash flows. It also requires interpretation of geological and geophysical models in order to make an assessment of the size, shape, depth and quality of reservoirs, and their anticipated recoveries. The economic, geological and technical factors used to estimate reserves may change from period to period. Changes in reported reserves can impact asset carrying values, the provision for decommissioning liabilities and the recognition of deferred tax assets, due to changes in expected future cash flows. Reserve estimates are prepared in accordance with the Canadian Oil and Gas Evaluation Handbook and are reviewed by third party reservoir engineers.

The amounts recorded for depletion and depreciation of property and equipment, the provision for decommissioning liabilities, and the valuation of property and equipment are based on estimates of proved and probable reserves, production rates, future petroleum and natural gas prices, future costs and the remaining lives and period of future benefit of the related assets.

The Company makes judgments in determining its CGUs and evaluates the geography, geology, production profile and infrastructure of its assets in making such determinations, which are based on estimates of reserves. Based on this assessment, Cequence's CGUs are generally composed of significant development areas. The Company reviews the composition of its CGUs at each reporting date to assess whether any changes are required in light of new facts and circumstances.

The amount recorded as decommissioning liabilities is based on current legal and constructive requirements, technology, price levels and expected plans for remediation. Actual costs and cash outflows can differ from estimates because of changes in laws and regulations, public expectations, market conditions, discovery and analysis of site conditions and changes in technology.

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.

The amounts recorded for deferred income tax assets and deferred tax expense (recovery) are 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 fair value of derivative contracts is estimated, wherever possible, based on quoted market prices, and if not available, on estimates from third-party brokers. Another significant assumption used by the Company in determining the fair value of derivatives is market data or assumptions that market participants would use when pricing the asset or liability, including assumptions about risk. The actual settlement of derivatives could differ materially from the value recorded and could impact future results.

The above judgments, estimates and assumptions relate primarily to unsettled transactions and events as of the date of the consolidated financial statements. Actual results could differ from these estimates and the differences could be material.

Notes to the Consolidated Financial Statements

(All figures expressed in thousands except per share amounts unless otherwise noted)

3. FUTURE ACCOUNTING PRONOUNCEMENTS

The Company has reviewed new and revised accounting pronouncements that have been issued but are not yet effective.

As of January 1, 2015, the Company will be required to adopt IFRS 9, "Financial Instruments", which is the result of the first phase of the IASB's project to replace IAS 39, "Financial Instruments: Recognition and Measurement". The new standard replaces the current multiple classification and measurement models for financial assets and liabilities with a single model that has only two classification categories: amortized cost and fair value.

As of January 1, 2013, Cequence will be required to adopt the following standards and amendments, as issued by the IASB:

- IFRS 10, "Consolidated Financial Statements", which is the result of the IASB's project to replace Standing Interpretations Committee 12, "Consolidation – Special Purpose Entities" and the consolidation requirements of IAS 27, "Consolidated and Separate Financial Statements". The new standard eliminates the current risk and rewards approach and establishes control as the single basis for determining the consolidation of an entity.
- IIFRS 11, "Joint Arrangements", which is the result of the IASB's project to replace IAS 31, "Interest in Joint Ventures". The new standard redefines joint operations and joint ventures and requires joint operations to be proportionately consolidated and joint ventures to be equity accounted. Under IAS 31, joint ventures could be proportionately accounted.
- IIFRS 12, "Disclosure of Interests in Other Entities", which outlines the required disclosures for interests in subsidiaries and joint arrangements. The new disclosures require information that will assist financial statement users to evaluate the nature, risks and financial effects associated with an entity's interests in subsidiaries and joint arrangements.
- IIFRS 13, "Fair Value Measurement", which provides a common definition of fair value, establishes a framework for measuring fair value under IFRS and enhances the disclosures required for fair value measurements. The standard applies where fair value measurements are required and does not require new fair value measurements.

The Company is currently evaluating the impact of adoption of these standards and thus, the effect on Cequence's consolidated financial statements at the time of adoption is not currently determinable.

4. TRANSITION TO IFRS

The Company has adopted IFRS effective January 1, 2010 (the "Transition Date") and has prepared its opening IFRS balance sheet as at that date. Prior to the adoption of IFRS, the Company prepared its financial statements in accordance with Canadian GAAP. The Company's consolidated financial statements for the year ending December 31, 2011 are the first annual financial statements that comply with IFRS. The Company has prepared its opening IFRS balance sheet by applying existing IFRS with an effective date of December 31, 2011 or prior.

a) Elected exemptions from full retrospective application

In preparing these consolidated financial statements in accordance with IFRS 1, "First-time Adoption of International Financial Reporting Standards" ("IFRS 1"), the Company has applied certain of the optional exemptions from full retrospective application of IFRS. The optional exemptions applied are described below.

i) Deemed cost for oil and gas assets

The Company has elected to measure oil and gas assets previously recorded in the full cost pool under Accounting Guidelines 16, "Oil and Gas Accounting – Full Cost" ("AcG 16") of Canadian GAAP at the Transition Date as follows:

- i) the Company evaluated its existing asset base and reclassified from the full cost pool to exploration and evaluation assets those assets that met the definition of exploration and evaluation assets at the Transition Date; and
- ii) the remaining full cost pool was allocated to development and production assets pro rata using proved plus probable reserve values.

ii) Decommissioning liabilities included in the cost of property and equipment

The Company has elected to measure decommissioning liabilities as at the Transition Date in accordance with IAS 37, "Provisions, Contingent Liabilities and Contingent Assets" ("IAS 37") and recognize directly in deficit the difference between that amount and the carrying amount of those liabilities at the Transition Date determined under Canadian GAAP.

iii) Business combinations

The Company has applied the business combinations exemption in IFRS 1 to not apply IFRS 3, "Business Combinations" ("IFRS 3") retrospectively to past business combinations. Accordingly, the Company has not restated business combinations that took place prior to the Transition Date.

iv) Share-based payment transactions

The Company has elected to apply IFRS 2, "Share-based Payments" ("IFRS 2") to equity instruments granted after November 7, 2002 that have not vested by the Transition Date.

v) Borrowing costs

The Company has applied the borrowing costs exemption in IFRS to not apply IAS 23, "Borrowing Costs" ("IAS 23") retrospectively to past borrowing costs related to transactions that took place prior to the Transition Date.

b) Mandatory exceptions to retrospective application

i) Estimates

Hindsight was not used to create or revise estimates and accordingly, the estimates previously made by the Company under Canadian GAAP are consistent with their application under IFRS.

Notes to the Consolidated Financial Statements

(All figures expressed in thousands except per share amounts unless otherwise noted)

c) Reconciliation of opening balance sheet as reported under Canadian GAAP to IFRS

The following is a reconciliation of the Company's balance sheet, including total shareholders' equity, reported in accordance with Canadian GAAP to its balance sheet in accordance with IFRS as at January 1, 2010:

	Canadian GAAP \$	Adjustments \$	Notes	IFRS \$
ASSETS				
CURRENT				
Cash	18,128	–		18,128
Accounts receivable	10,144	–		10,144
Deposits and prepaid expenses	913	–		913
Commodity contracts	1,420	–		1,420
	30,605	–		30,605
Investments	13,920	–		13,920
Exploration and evaluation assets	–	29,411	(i)	29,411
Property and equipment	158,011	(29,411)	(i)	121,809
	–	(6,791)	(ii)	–
Deferred income taxes	5,575	(424)	(iii)	7,681
	–	813	(v)	–
	–	1,717	(ii)	–
	208,111	(4,685)		203,426
LIABILITIES				
CURRENT				
Accounts payable and accrued liabilities	23,175	–		23,175
Other liabilities	–	388	(iv)	388
Deferred income taxes	424	(424)	(iii)	–
	23,599	(36)		23,563
Long-term debt related to investments	18,204	–		18,204
Provisions	4,059	3,251	(v)	7,310
	45,862	3,215		49,077
SHAREHOLDERS' EQUITY				
Share capital	267,908	1,277	(iv)	269,185
Contributed surplus	7,818	–		7,818
Deficit	(113,477)	(3,251)	(v)	(122,654)
	–	(6,791)	(ii)	–
	–	(1,665)	(iv)	–
	–	813	(v)	–
	–	1,717	(ii)	–
	162,249	(7,900)		154,349
	208,111	(4,685)		203,426

i) Reclassification to exploration and evaluation assets

The Company evaluated its existing asset base and reclassified from the full cost pool to exploration and evaluation assets those assets that met the definition of exploration and evaluation assets at the Transition Date in accordance with the Company's policies and IFRS 6, "Exploration for and Evaluation of Mineral Resources" ("IFRS 6"). The above resulted in a \$29,411 increase to exploration and evaluation assets and a commensurate decrease to property and equipment at the Transition Date.

ii) Deemed cost for oil and gas assets

As at the Transition Date, the Company tested all of its CGUs for impairment. The recoverable amount of each CGU was estimated based on the higher of the value in use and the fair value less costs to sell, being the fair value less cost to sell. The fair value less costs to sell was determined using discounted proved plus probable forecasted cash flows, with escalating prices and future development costs, as obtained from the Company's reserve report.

Based on the above assessment, the carrying amounts of the Company's CGUs were determined to be \$6,791 higher than their recoverable amounts, on an aggregate basis, and a corresponding impairment loss was recognized by reducing property and equipment by \$6,791 and increasing deficit by the same amount. The impairment loss resulted mainly from the adjustments discussed in Note 4(a)(i) as well as the application of IAS 36, "Impairment of Assets" ("IAS 36"), which has a more restrictive impairment test than under AcG 16 of Canadian GAAP.

The above adjustment resulted in a \$1,717 increase to deferred income tax assets with a corresponding decrease to the Company's deficit at the Transition Date.

iii) Current portion of deferred income tax

As required under Canadian GAAP, Cequence separately disclosed the portion of deferred tax related to current balances and those related to non-current balances in the consolidated balance sheet. IAS 1, "Presentation of Financial Statements" ("IAS 1") requires that all deferred taxes be presented as non-current on the balance sheet. This resulted in a decrease of \$424 to deferred income tax liability and a corresponding decrease to deferred income tax assets at the Transition Date.

iv) Flow-through shares

Under Canadian GAAP, the proceeds from the issuance of flow-through shares were recognized as shareholders' equity. Further, the tax basis of assets related to expenditures incurred to satisfy flow-through share obligations was not reduced until the renunciation of the related tax pools at which time, the expected tax effect of the renunciation had the effect of increasing the future income tax liability and reducing shareholders' equity. As at December 31, 2009, Cequence had \$2,025 in flow-through shares outstanding for which the related expenditures had been incurred. These expenditures were renounced in the first quarter of 2010, resulting in deferred tax of \$512.

Notes to the Consolidated Financial Statements

(All figures expressed in thousands except per share amounts unless otherwise noted)

Under IFRS, the difference between the fair value of a flow-through share issuance and the fair value of a common share issuance is initially accrued as an obligation on issuance of the flow-through shares. Pursuant to the terms of the flow-through share agreements, the tax deductions associated with the expenditures are renounced to the subscribers. Accordingly, on renunciation with the Canada Revenue Agency, a deferred tax liability is recorded equal to the estimated amount of deferred income taxes payable by the Company as a result of the renunciations, the obligation on issuance of the flow-through shares is reduced and the difference is recognized as income tax expense in comprehensive income (loss).

The above differences resulted in an increase to shareholders' equity of \$1,277, an increase to deficit of \$1,665 and the recognition of an obligation on issuance of flow-through shares included with other liabilities of \$388, at the Transition Date.

v) *Decommissioning Liabilities*

Under Canadian GAAP, decommissioning liabilities were discounted at a weighted average credit-adjusted risk-free interest rate of 7.47 percent. Under IAS 37, the estimated cash flows related to decommissioning liabilities have been discounted at a risk-free rate of 4.07 percent based on Government of Canada long-term benchmark bonds. This resulted in a \$3,251 increase to provisions with a corresponding increase to the Company's deficit at the Transition Date. This further resulted in an \$813 increase to deferred income tax assets with a corresponding decrease to the Company's deficit at the Transition Date.

d) **Reconciliation of subsequent balance sheets as reported under Canadian GAAP to IFRS**

The following is a reconciliation of the Company's balance sheet, including total shareholders' equity, reported in accordance with Canadian GAAP to its balance sheet in accordance with IFRS as at December 31, 2010:

	Canadian GAAP	Adjustments	Notes	IFRS
	\$	\$		\$
ASSETS				
CURRENT				
Cash	1,321	–		1,321
Accounts receivable	16,439	–		16,439
Deposits and prepaid expenses	2,480	–		2,480
	20,240	–		20,240
Property and equipment	409,955	(6,791)	4(c)(ii)	341,801
	–	8,356	(ii)	–
	–	(58,483)	(ii)	–
	–	105	(iii)	–
	–	(13,827)	(vi)	–
	–	2,486	(vii)	–
Deferred income taxes	26,441	20,899	(viii)	47,340
	456,636	(47,255)		409,381
LIABILITIES				
CURRENT				
Demand credit facilities	57,125	(386)	(v)	56,739
Accounts payable and accrued liabilities	36,240	–		36,240
Other liabilities	–	2,068	(iv)	2,068
	93,365	1,682		95,047
Provisions	14,622	3,251	4(c)(v)	26,130
	–	8,257	(iii)	–
	107,987	13,190		121,177
SHAREHOLDERS' EQUITY				
Share capital	465,963	1,277	4(c)(iv)	452,526
	–	(1,556)	(iv)	–
	–	(13,158)	(vi)	–
Contributed surplus	10,681	–		10,681
Deficit	(127,995)	(9,177)	4(c)	(175,003)
	–	8,356	(ii)	–
	–	(58,483)	(ii)	–
	–	90	(iii)	–
	–	386	(v)	–
	–	(3,623)	(vi)	–
	–	2,842	(vii)	–
	–	12,601	(viii)	–
	348,649	(60,445)		288,204
	456,636	(47,255)		409,381

Notes to the Consolidated Financial Statements

(All figures expressed in thousands except per share amounts unless otherwise noted)

i) *Reclassification to exploration and evaluation assets and impairment*

The change in recognition of property and equipment as exploration and evaluation assets based on the adoption of IFRS 6, as discussed in note 4(c)(i) did not result in a change to exploration and evaluation assets or to property and equipment as at December 31, 2010 as the exploration and evaluation assets recognized on the consolidated balance sheet at January 1, 2010 were sold during the year ended December 31, 2010.

Based on the Company's policy under IFRS 6, exploration and evaluation assets are reviewed for impairment when facts and circumstances suggest that the carrying amount exceeds the recoverable amount. This assessment resulted in an aggregate impairment loss of \$3,992 which did not reduce exploration and evaluation assets at December 31, 2010 as the exploration and evaluation assets recognized on the consolidated balance sheet at January 1, 2010 were sold during the year ended December 31, 2010.

ii) *Depletion, depreciation and impairment*

Under Canadian GAAP, the Company depleted the full cost pool based on proved reserves. Under IAS 16, "Property, plant and equipment" ("IAS 16"), the Company has elected to deplete property and equipment based on proved plus probable reserves. This has resulted in a decrease to depletion and depreciation of \$8,356 for the year ended December 31, 2010 with a commensurate decrease to deficit.

Under Canadian GAAP, impairment of the full cost pool was assessed by comparing the carrying amount of the full cost pool to the sum of undiscounted cash flows expected from the production of proved reserves. If the carrying amount of the full cost pool was determined to not be recoverable based on this test, impairment was recognized to the extent that the carrying amount of the full cost pool exceeded the sum of discounted cash flows expected from the production of proved plus probable reserves. Under IAS 36, impairment is assessed by comparing the carrying amount of property and equipment to the sum of discounted cash flows expected from the production of proved plus probable reserves for each individual CGU assessed by the Company. This resulted in an aggregate impairment loss which reduced property and equipment by \$58,483 at December 31, 2010, including an impairment to exploration and evaluation assets of \$3,992, prior to the sale of exploration and evaluation assets in the year ended December 31, 2010, discussed in note 4(d)(i), above with a commensurate increase to deficit.

iii) Decommissioning liabilities

Under Canadian GAAP, accretion expense was calculated through the application of a credit-adjusted risk-free rate to the Company's discounted decommissioning liabilities. Under IAS 37, the Company applied a risk-free rate in determining the amount of accretion to be included with finance costs in the statement of comprehensive income (loss) for the period. The above difference, along with changes to decommissioning liabilities discussed in note 4(d)(vi) resulted in a decrease to accretion expense included as finance costs in the consolidated statement of comprehensive income (loss) of \$90 for the year ended December 31, 2010 with a commensurate decrease to deficit. Such changes further resulted in an increase to provisions of \$8,257 as at December 31, 2010 and an increase to property and equipment of \$105 at December 31, 2010.

iv) Flow-through shares

The change in accounting for flow-through shares discussed in note 4(c)(iv) resulted in a decrease to share capital for the year ended December 31, 2010 of \$1,556 and the recognition of an obligation on flow-through shares included with other liabilities on the consolidated balance sheet of \$2,068 as at December 31, 2010.

v) Transaction costs on financial instruments

The Company's policy under Canadian GAAP was to expense all transaction costs as incurred. Under IAS 39, the Company is required to capitalize transaction costs on all financial instruments other than those classified as through profit or loss and amortize such costs using the effective interest rate method. This resulted in a decrease to demand credit facilities of \$386 for the year ended December 31, 2010 and a commensurate decrease to the deficit.

vi) Business combinations

Under Canadian GAAP, transaction costs related to business combinations were capitalized as part of the purchase equation. Under IFRS 3, transaction costs on business combinations are expensed as incurred. Also, under Canadian GAAP, shares issued as consideration in a business combination were valued based on the weighted average trading price surrounding the date of announcement of the transaction. Under IFRS 3, such shares are valued as at the acquisition date. Further, the determination of fair value assigned to assets and liabilities at the date of acquisition differs from Canadian GAAP due to the application of IFRS as opposed to Canadian GAAP in determining such fair values. These differences resulted in the following changes to Cequence's business combinations effected in the year ended December 31, 2010:

Notes to the Consolidated Financial Statements

(All figures expressed in thousands except per share amounts unless otherwise noted)

Peloton Exploration Corp. Acquisition

On June 11, 2010, the Company acquired all of the issued and outstanding shares of Peloton Exploration Corp. ("Peloton"), a private oil and gas company, for consideration of 12,059 common voting shares. Under IFRS 3, the shares were valued based on Cequence's closing trading price on the TSX on June 11, 2010. The transaction was accounted for using the acquisition method whereby the assets acquired and liabilities assumed are recorded at their fair value as determined by reference to the relevant IFRS standards. The accounts of the Company include the results of Peloton effective June 11, 2010.

The purchase price allocation with adjustments from Canadian GAAP to IFRS is as follows:

(\$000's)	Canadian		
Cost of Acquisition	GAAP	Adjustments	IFRS
Common shares (12,059 at \$2.39)	30,269	(1,447)	28,822
Transaction costs	645	(645)	–
Total	30,914	(2,092)	28,822

(\$000's)	Canadian		
Fair Value of the Assets and Liabilities Acquired	GAAP	Adjustments	IFRS
Property and equipment	29,319	(2,685)	26,634
Fair value of commodity contracts	339	–	339
Bank debt	(4,984)	–	(4,984)
Working capital deficiency	(1,031)	–	(1,031)
Decommissioning liabilities	(552)	(297)	(849)
Deferred income tax assets – non-current	7,918	795	8,713
Deferred income tax liabilities – current	(95)	95	–
Total	30,914	(2,092)	28,822

Temple Energy Inc. Acquisition

On September 10, 2010, the Company acquired all of the issued and outstanding shares of Temple Energy Inc. ("Temple"), a private oil and gas company, for consideration of 46,846 common voting shares. Under IFRS 3, the shares were valued based on Cequence's closing trading price on the TSX on September 10, 2010. The transaction was accounted for using the acquisition method whereby the assets acquired and liabilities assumed are recorded at their fair value as determined by reference to the relevant IFRS standards. The accounts of the Company include the results of Temple effective September 10, 2010.

The purchase price allocation with adjustments from Canadian GAAP to IFRS is as follows:

(\$000's)	Canadian		IFRS
Cost of Acquisition	GAAP	Adjustments	
Common shares (46,846 at \$2.03)	106,809	(11,711)	95,098
Transaction costs	2,838	(2,838)	–
Total	109,647	(14,549)	95,098

(\$000's)	Canadian		IFRS
Fair Value of the Assets and Liabilities Acquired	GAAP	Adjustments	
Property and equipment	143,990	(15,022)	128,968
Fair value of commodity contracts	4,201	–	4,201
Bank debt	(36,423)	–	(36,423)
Working capital deficiency	(3,834)	–	(3,834)
Decommissioning liabilities	(5,902)	(4,282)	(10,184)
Deferred income tax assets – non-current	8,798	3,572	12,370
Deferred income tax liabilities – current	(1,183)	1,183	–
Total	109,647	(14,549)	95,098

Deep Basin Acquisition

On September 8, 2010, the Company closed the acquisition of certain gas weighted properties located in the Simonette area of Northwest Alberta (the "Deep Basin Assets"). The purchase price, subject to final adjustments, was \$85,000 in cash. Under Canadian GAAP, the transaction was accounted for as an asset acquisition and the consideration was allocated to property and equipment and decommissioning liabilities. IFRS 3 has a broader view than Canadian GAAP as to what constitutes a business, and resultantly, the transaction was determined to be a business combination under IFRS.

The estimated purchase price allocation with adjustments from Canadian GAAP to IFRS is as follows:

(\$000's)	Canadian		IFRS
Cost of Acquisition	GAAP	Adjustments	
Cash consideration	85,000	–	85,000
Transaction costs	140	(140)	–
Total	85,140	(140)	85,000

(\$000's)	Canadian		IFRS
Fair Value of the Assets and Liabilities Acquired	GAAP	Adjustments	
Property and equipment	88,823	3,880	92,703
Decommissioning liabilities	(3,683)	(4,020)	(7,703)
Total	85,140	(140)	85,000

The aggregate differences related to the expensing of transaction costs under IFRS 3 versus capitalization under Canadian GAAP resulted in a decrease to comprehensive income (loss) of \$3,623 for the year ended December 31, 2010 and a commensurate increase to deficit. The above adjustments under IFRS 3 further result in an aggregate decrease to property and equipment of \$13,827 as at December 31, 2010 and an aggregate decrease to share capital of \$13,158 as at December 31, 2010.

Notes to the Consolidated Financial Statements

(All figures expressed in thousands except per share amounts unless otherwise noted)

vii) Gain (loss) on sale of assets

Under Canadian GAAP, no gain or loss was recognized on the sale of oil and gas properties unless the sale resulted in a change of 20 percent or more to the depletion rate applied to the full cost pool. No such provision exists under IFRS. This resulted in an increase to gain (loss) on sale of assets of \$2,842 for the year ended December 31, 2010 with a commensurate decrease to deficit and an increase to property and equipment of \$2,486 at December 31, 2010.

viii) Deferred tax

The above adjustments resulted in an increase to deferred tax assets of \$20,899 as at December 31, 2010 and an increase to deferred tax recovery of \$12,601 for the year ended December 31, 2010.

e) Reconciliation of comprehensive income (loss) under Canadian GAAP to IFRS

The following is a reconciliation of the Company's comprehensive income (loss) reported in accordance with Canadian GAAP to its comprehensive income (loss) in accordance with IFRS for the year ended December 31, 2010:

(\$000's)	Note	Year ended December 31, 2010
Comprehensive income (loss) as reported under Canadian GAAP		(14,518)
Differences increasing (decreasing) reported amounts:		
Depletion, depreciation and impairment	4 (d) (i) (ii)	(50,127)
Finance costs on decommissioning liabilities	4 (d) (iii)	90
Transaction costs on financial instruments	4 (d) (v)	386
Business combinations	4 (d) (vi)	(3,623)
Gain (loss) on sale of assets	4 (d) (vii)	2,842
Deferred tax on above	4 (d) (viii)	12,601
Comprehensive income (loss) as reported under IFRS		(52,349)

f) Reconciliation of cash flow under Canadian GAAP to IFRS

The following is a reconciliation of the Company's cash flows reported in accordance with Canadian GAAP to its cash flows in accordance with IFRS for the year ended December 31, 2010:

(\$000's)	Notes	Operating	Investing	Financing	Total
As reported under Canadian GAAP – December 31, 2010		20,308	(95,090)	57,975	(16,807)
Differences increasing (decreasing) reported amounts:					
Transaction costs on financial instruments	(i)	555	–	(555)	–
Business combinations	(ii)	(3,623)	3,623	–	–
As reported under IFRS – Dec. 31, 2010		17,240	(91,467)	57,420	(16,807)

i) Transaction costs on financial instruments

As discussed in note 4(d)(v), the Company's policy under Canadian GAAP was to expense transaction costs on financial instruments as incurred. These costs were included with cash flows related to operating activities in the consolidated statement of cash flows under Canadian GAAP. Under IFRS, such transaction costs are capitalized and amortized over the life of the related financial instrument. Presentation in the statement of cash flows under IFRS is to include such costs with cash flows related to financing activities. This resulted in an increase to cash flows related to operating activities of \$555 for the year ended December 31, 2010 with a commensurate decrease to cash flows related to financing activities.

ii) Business combinations

As discussed in note 4(d)(vi), the Company's policy under Canadian GAAP was to capitalize transaction costs related to business combinations. These costs were included with cash flows related to investing activities in the consolidated statement of cash flows under Canadian GAAP. Under IFRS, such transaction costs are expensed as incurred. Presentation in the statement of cash flows under IFRS is to include such costs with cash flows related to operating activities. This resulted in a decrease to cash flows related to operating activities of \$3,623 for the year ended December 31, 2010 with a commensurate increase to cash flows related to investing activities.

The application of IFRS further resulted in numerous changes to non-cash items in the consolidated statement of cash flows from the amounts reported under Canadian GAAP as well as reclassifications between asset acquisitions and corporate acquisitions included under investing activities resulting from changes discussed in note 4(d)(vi). These changes did not affect the classification of cash flows between operating, investing and financing.

5. INVESTMENTS AND LONG-TERM DEBT RELATED THERETO

As at December 31, 2009, the Company held long-term floating rate notes ("MAV 2" notes) issued as a result of the restructuring discussed below. At December 31, 2008, the Company held the original Canadian asset-backed commercial paper ("ABCP") with an original cost of \$24,147. These investments matured during the third quarter of 2007 but, as a result of the liquidity issues in the ABCP market, did not settle on maturity.

On January 21, 2009, the Pan-Canadian Investors Committee announced that the restructuring had been completed to extend the maturity of the ABCP to provide for a maturity similar to that of the underlying assets. As a result, the Company received new replacement MAV 2 notes with a total face value of \$24,142.

The following are the face value of the new notes received from the restructuring at December 31, 2009

		\$
MAV2	Class A1	6,700
MAV2	Class A2	14,149
MAV2	Class B	2,568
MAV2	Class C	725
		24,142

Notes to the Consolidated Financial Statements

(All figures expressed in thousands except per share amounts unless otherwise noted)

On August 25, 2010, the Company completed the sale of its entire interest in MAV 2 notes for net proceeds of \$13,453 (net of transaction costs of \$96) which represents approximately \$0.68 per \$1.00 of face value for the Class A1 notes, \$0.58 per \$1.00 of face value for the Class A2 notes, \$0.33 per \$1.00 of face value for the Class B notes and \$0.05 per \$1.00 of face value for the Class C notes. This has resulted in a loss on MAV 2 notes recognized in comprehensive income (loss) of \$281 for the year ended December 31, 2010.

A summary of changes to the carrying value is as follows:

	December 31, 2010
	\$
Opening balance	13,738
Principal repayments	(4)
Valuation loss on investments	(281)
Sale of investments	(13,453)
Ending balance	-

On March 31, 2009, the Company's bank provided the Company with an additional credit facility to provide liquidity in respect to the MAV 2 notes. The credit facility was structured to a maximum of \$18,054 available for draws under revolving credit facilities and \$18,054 was drawn at December 31, 2009.

All proceeds from the sale of MAV 2 notes were used to repay the long-term debt related to investments facility. The balance of the facility was paid with available cash and the long-term debt related to investments facility was closed. The effective interest rate for the year ended December 31, 2010 was 1.19 percent. Interest expense on long-term debt related to investments included as finance costs in comprehensive income (loss) for the year ended December 31, 2010 was \$129.

6. PROPERTY AND EQUIPMENT AND EXPLORATION AND EVALUATION ASSETS

	Property and equipment	Exploration and evaluation assets	Total
Cost or deemed cost:			
Balance at January 1, 2010	121,809	29,411	151,220
Additions	52,367	12,158	64,525
Acquisitions	248,043	-	248,043
Disposals	(1,851)	(41,569)	(43,420)
Balance at December 31, 2010	420,368	-	420,368
Additions	152,569	6,221	158,790
Acquisitions	25,540	-	25,540
Disposals	(57,273)	-	(57,273)
Balance at December 31, 2011	541,204	6,221	547,425

	Property and equipment	Exploration and evaluation assets	Total
Depletion, depreciation and impairment:			
Balance at January 1, 2010	–	–	–
Depletion and depreciation	(24,076)	–	(24,076)
Impairment loss	(54,491)	(3,992)	(58,483)
Disposals	–	3,992	3,992
Balance at December 31, 2010	(78,567)	–	(78,567)
Depletion and depreciation	(41,228)	–	(41,228)
Impairment loss	(18,332)	–	(18,332)
Disposals	6,652	–	6,652
Balance at December 31, 2011	(131,475)	–	(131,475)
Carrying amounts:			
At January 1, 2010	121,809	29,411	151,220
At December 31, 2010	341,801	–	341,801
At December 31, 2011	409,729	6,221	415,950

Costs subject to depletion include \$426,485 of estimated future capital costs (December 31, 2010 – \$250,830).

The Company's credit facilities are secured by a demand debenture with a first floating charge over all assets of the Company (see note 7).

Exploration and evaluation assets consist of the Company's exploration projects which are pending the determination of proven reserves that are capable of economic production. Costs consist primarily of undeveloped land and drilling costs until the drilling of the well is complete and proven reserves which are capable of economic production have been established.

Impairment

The Company reviewed each CGU comprising its property and equipment at December 31, 2011 for indicators of impairment and determined that indicators were present, related to decreases to future natural gas prices used to estimate the value in use and fair value less cost to sell of each of the Company's CGUs.

As a result, impairment tests were carried out at December 31, 2011. The recoverable amounts of each of the Company's CGUs at December 31, 2011 were estimated as their fair value less cost to sell, based on the net present value of discounted future cash flows from oil and gas reserves, as estimated by the Company's independent reserves evaluator. Consideration was also given to acquisition metrics of recent transactions completed on similar assets to those contained within the relevant CGU.

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(All figures expressed in thousands except per share amounts unless otherwise noted)

The benchmark escalated prices on which the December 31, 2011 impairment tests are based are as follows:

	Natural Gas	Condensate	Crude Oil
	AECO Sport (\$/mmbtu)	Edmonton Pentanes Plus (\$/bbl)	Edmonton Par (\$/bbl)
2012	3.49	107.76	97.96
2013	4.13	108.09	101.02
2014	4.59	105.06	101.02
2015	5.05	105.06	101.02
2016	5.51	105.06	101.02
2017	5.97	105.06	101.02
2018	6.21	106.49	102.40
2019	6.33	108.65	104.47
2020	6.46	110.84	106.58
2021	6.58	113.08	108.73

Prices increase at a rate of approximately 2.0 percent per year for natural gas, condensate and crude oil after 2021. Adjustments were made to the benchmark prices, for purposes of the impairment tests, to reflect varied delivery points and quality differentials in the products delivered.

Results of the Company's impairment tests at December 31, 2011 and 2010 are as follows:

	2011 Impairment	2010 Impairment⁽¹⁾
Northeast British Columbia	\$ 4,770	\$ 17,445
Peace River Arch	13,562	37,046
Deep Basin	-	-
Total	\$ 18,332	\$ 54,491

⁽¹⁾ See Note 4(d)(ii) for a discussion of impairment at December 31, 2010.

A one percent increase in the discount rate applied to the Company's future estimated cash flows would result in an additional impairment of \$4,220, whereas a ten percent decrease in forward benchmark natural gas prices would result in additional impairment of \$21,838 recognized in comprehensive income (loss) for the year ended December 31, 2011.

Sale of Assets

On July 27, 2010, the Company closed the sale of certain gas-weighted properties located in Northwest Alberta for total cash consideration of \$36,900, subject to final adjustments. The sale resulted in a gain recognized in comprehensive income (loss) of \$18.

On March 23, 2011, the Company closed the sale of certain oil and gas properties located in central Alberta for total cash consideration of \$22,000, subject to adjustments. The sale resulted in a gain recognized in comprehensive income (loss) of \$2,116.

On April 15, 2011, the Company closed the sale of certain oil and gas properties located in Northwest Alberta for total cash consideration of \$7,500, subject to adjustments. The sale resulted in a gain recognized in comprehensive income (loss) of \$1,835.

On September 8, 2011, the Company closed the sale of certain oil and gas properties located in Northeast British Columbia for total cash consideration of \$13,982, subject to adjustments. The sale resulted in a gain recognized in comprehensive income (loss) of \$1,126.

7. DEMAND CREDIT FACILITIES

As at January 1, 2010, the Company had established two credit facilities with a Canadian chartered bank; a \$40,000 revolving operating demand loan and a \$5,000 non-revolving acquisition/development demand loan. During the year ended December 31, 2010, the Company repaid all amounts owing and terminated the facilities.

During the year ended December 31, 2010, the Company established two credit facilities with a syndicate of Canadian chartered banks. Credit facility A is a \$100,000 extendible revolving term credit facility by way of prime loans, U.S. Base Rate Loans, Banker's Acceptances and Libor Loans. Credit facility B is a \$10,000 operating facility by way of prime loans, U.S. Base Rate Loans, Banker's Acceptances and letters of credit. Prime loans and U.S. Base Rate Loans on these facilities bear interest at the bank prime rate or U.S. Base Rate, respectively, plus 1.0 percent to 2.5 percent on a sliding scale, depending on the Company's debt to adjusted EBITDA ratio (ranging from being less than or equal to 1.0:1.0 to greater than 2.5:1.0). Banker's Acceptances, Libor Loans and letters of credit on these facilities bear interest at the Banker's Acceptance rate, Libor rate or letter of credit rate, as applicable, plus 2.0 percent to 3.5 percent based on the same sliding scale as above. The credit facilities may be extended and revolve beyond the initial one-year period, if requested by the Company and accepted by the lenders. If the credit facilities do not continue to revolve, the facilities will convert to a 366-day non-revolving term loan facility.

Both credit facilities, and the amount available for draws under the facilities, are subject to periodic review by the bank and are secured by a general assignment of book debts and a \$250,000 demand debenture with a first floating charge over all assets of the Company. The Company is permitted to hedge up to 67 percent of its production under the lending agreement. As at December 31, 2011, the Company has drawn \$11,618 under the extendible revolving term credit facility and \$nil under the operating facility (December 31, 2010 – \$57,125 and \$nil for the revolving and operating facilities, respectively) and is in compliance with all covenants. The effective interest rate, including standby fees and commitment fees, for the year ended December 31, 2011 was 5.40 percent (2010 – 4.56 percent). The next scheduled review is to take place in May 2012.

During the year ended December 31, 2011 the Company capitalized transaction costs related to its credit facilities of \$57 (December 31, 2010 – \$555).

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(All figures expressed in thousands except per share amounts unless otherwise noted)

A reconciliation of the Company's credit facilities to the amount presented on the consolidated balance sheet is as follows:

	December 31, 2011	December 31, 2010	January 1, 2010
Credit facilities	11,618	57,125	–
Less: transaction costs capitalized (net of accumulated amortization)	–	(386)	–
	11,618	56,739	–

8. ACCOUNTS RECEIVABLE

	December 31, 2011	December 31, 2010	January 1, 2010
Trade receivables	13,015	5,356	2,494
Less: allowance for doubtful accounts	(551)	(490)	(274)
Net trade receivables	12,464	4,866	2,220
Accrued revenue	6,332	9,082	4,111
Other receivables	2,236	2,491	3,813
Total accounts receivable	21,032	16,439	10,144

9. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

	December 31, 2011	December 31, 2010	January 1, 2010
Accounts payable	36,267	12,663	15,080
Accrued liabilities	28,200	23,577	8,095
Total accounts payable and accrued liabilities	64,467	36,240	23,175

10. OTHER LIABILITIES

	December 31, 2011	December 31, 2010	January 1, 2010
Obligations related to onerous contracts – current (Note 15)	331	–	–
Obligations related to flow-through shares (Note 17)	4,958	2,068	388
Total other liabilities	5,289	2,068	388

11. PRODUCTION REVENUE

	Year ended December 31,	
	2011	2010
Sales of oil and natural gas	101,090	50,614
Less: royalties	(13,743)	(5,769)
Total production revenue	87,347	44,845

12. OTHER EXPENSE (INCOME)

	Year ended December 31,	
	2011	2010
Gain on sale of property and equipment	(5,077)	(2,842)
Loss on investment in MAV 2 notes	-	281
Transaction costs on business combinations	-	3,623
Provisions related to onerous contracts (Note 15)	1,138	-
Other	(74)	(31)
Total other expense (income)	(4,013)	1,031

13. FINANCE COSTS

	Year ended December 31,	
	2011	2010
Interest expense on demand credit facilities (including stand-by fees and commitment fees of \$544 (2010 – \$162))	1,928	1,297
Interest expense on long-term debt related to investments	-	129
Accretion expense on decommissioning liabilities	905	495
Amortization of transaction costs on financial instruments	443	169
Total finance costs	3,276	2,090

14. COMPENSATION COSTS AND KEY MANAGEMENT PERSONNEL EXPENSES

Total wages, salaries, benefits and other personnel costs included in comprehensive income (loss) for the year ended December 31, 2011 were \$5,775 (2010 – \$4,266).

The aggregate expense of key management personnel, defined as the Company's chief executive officer, chief operating officer, chief financial officer and the Company's board of directors, was as follows:

	Year ended December 31,	
	2011	2010
Wages, salaries, benefits and other personnel costs	1,187	653
Share based payments ⁽ⁱ⁾	2,495	2,949
Total remuneration	3,682	3,602

⁽ⁱ⁾ Represents the total fair value of stock-based compensation awards granted to officers and directors in the year of grant, as determined using the Black-Scholes option pricing model (see note 18).

Notes to the Consolidated Financial Statements

(All figures expressed in thousands except per share amounts unless otherwise noted)

15. PROVISIONS

Decommissioning liabilities

The following table summarizes the changes in decommissioning liabilities for the years ended December 31, 2011 and 2010:

	December 31, 2011	December 31, 2010
Balance – beginning of year	26,130	7,310
Acquisitions	1,539	18,736
Property dispositions (Note 6)	(7,135)	(722)
Accretion expense	905	495
Liabilities incurred	3,217	837
Abandonment costs incurred	(955)	(126)
Revisions in estimated cash flows	(21)	(1,175)
Revisions due to change in discount rates	4,455	775
Balance – end of year	28,135	26,130

The Company's decommissioning liabilities result from its ownership in oil and natural gas assets including well sites, facilities and gathering systems. The total estimated, undiscounted cash flows, inflated at 2 percent, required to settle the obligations are \$42,659 (December 31, 2010 – \$44,359). These cash flows have been discounted using a risk-free interest rate of 2.50 percent (December 31, 2010 – 3.54 percent) based on Government of Canada long-term benchmark bonds. The Company expects these obligations to be settled in approximately 2 to 30 years. As at December 31, 2011, no funds have been set aside to settle these liabilities.

Onerous contracts

As at December 31, 2011, the Company recognized a provision related to an onerous lease contract of \$1,138 (December 31, 2010 – \$nil). The provision for onerous lease contract represents the present value of the future lease obligations that the Company is presently obligated to make under a non-cancellable onerous operating lease contract, less revenue expected to be earned on the lease, including estimated future sub-lease revenue. The total estimated, undiscounted cash flows, required to settle the obligations are \$1,164. These cash flows have been discounted using a risk-free interest rate of 0.99 percent based on Government of Canada three year benchmark bonds.

Cequence expects to reduce the provision by \$331 in the twelve months ended December 31, 2012, which amount is included with other liabilities in the consolidated balance sheet (see note 10). The portion of the provision expected to be realized in the period subsequent to December 31, 2012 of \$807 is carried with provisions as a non-current liability in the consolidated balance sheet as at December 31, 2011. The estimate may vary as a result of changes in the utilization of the lease premises and the sub-lease arrangements, where applicable. The unexpired term of the leases at December 31, 2011 is 43 months.

16. INCOME TAXES

- a) The following table sets forth the components of the Company's deferred income tax asset at December 31, 2011 and 2010 and January 1, 2010:

	December 31, 2011	December 31, 2010	January 1, 2010
Excess of net book value of property and equipment and provisions over related tax pools	13,605	12,798	(12,327)
Unrealized gain on financial instruments	-	-	(425)
Non-capital loss carry-forwards	23,659	24,211	10,228
Scientific research and development expenses and investment tax credits	8,602	8,616	8,943
Other tax assets	2,450	1,715	1,262
Total net deferred income tax assets	48,316	47,340	7,681

At December 31, 2011, Cequence has total tax pools of \$591,296 including non-capital loss carry-forwards, investment tax credit carry-forwards and Scientific Research and Experimental Development ("SRED") expenses available to reduce future years' income for tax purposes. Deferred income tax assets have been recognized to the extent that estimated future taxable profits are sufficient to realize the deferred income tax assets in the allowable timeframes. As at December 31, 2011, a deferred income tax asset has not been recognized on \$18,600 (December 31, 2010 – \$20,612) of deductible temporary differences in respect of certain successored resources properties; the deductible temporary differences do not expire. The Scientific Research and Development expenses of approximately \$22,704 available for carry-forward do not expire. The non-capital loss carry-forwards expire in 1 to 20 years and the investment tax credit carry-forwards expire in 8 to 12 years.

- b) Income tax expense differs from that which would be expected from applying the effective Canadian federal and provincial tax rates of 26.5 percent (2010 – 28 percent) to income (loss) before income taxes as follows:

	Year ended December 31, 2011	Year ended December 31, 2010
Expected income tax recovery	(5,692)	(19,680)
Effect of valuation allowance on investment in MAV 2 notes, net of interest	-	79
Effect of stock-based compensation	1,791	803
Change in value of reserves and losses due to reassessments	(258)	(1,110)
Change in effective tax rate applied	1,039	2,123
Effect of renunciation of flow-through shares (Note 17)	1,395	124
Other	418	(124)
Deferred income tax recovery	(1,307)	(17,785)
Current income tax recovery	(14)	(2)
Income tax recovery	(1,321)	(17,787)

Notes to the Consolidated Financial Statements

(All figures expressed in thousands except per share amounts unless otherwise noted)

c) Movements in deferred income tax balances are as follows:

	Balance, January 1, 2010	Recognized in comprehensive income (loss)	Recognized in liabilities	Recognized in equity	Acquired in business combinations	Balance, December 31, 2010
Property and equipment and provisions	(12,327)	17,781	(388)	–	7,732	12,798
Unrealized gain on financial instruments	(425)	1,703	–	–	(1,278)	–
Non-capital losses	10,228	(340)	–	–	14,323	24,211
SRED expenses and investment tax credits	8,943	(327)	–	–	–	8,616
Other	1,262	(1,032)	–	1,178	307	1,715
Total	7,681	17,785	(388)	1,178	21,084	47,340

	Balance, January 1, 2011	Recognized in comprehensive income (loss)	Recognized in liabilities	Recognized in equity	Acquired in business combinations	Balance, December 31, 2011
Property and equipment and provisions	12,798	2,669	(1,862)	–	–	13,605
Unrealized gain on financial instruments	–	–	–	–	–	–
Non-capital losses	24,211	(552)	–	–	–	23,659
SRED expenses and investment tax credits	8,616	(14)	–	–	–	8,602
Other	1,715	(796)	–	1,531	–	2,450
Total	47,340	1,307	(1,862)	1,531	–	48,316

17. SHARE CAPITAL

Cequence has an unlimited number of common voting shares and common non-voting shares with no par value.

	Year ended December 31, 2011		Year ended December 31, 2010	
	Number (000's)	Stated Value \$	Number (000's)	Stated Value \$
Issued common voting shares				
Balance, beginning of year	128,750	452,526	39,530	269,185
Corporate acquisition – Peloton	–	–	12,059	28,822
Flow-through share private placement	–	–	4,070	8,547
Subscription receipts	–	–	21,045	44,195
Corporate acquisition – Temple	–	–	46,846	95,098
Common share private placement	–	–	2,950	6,195
Flow-through share private placement	–	–	2,250	3,886
Common shares	13,398	38,183	–	–
Flow-through shares	2,100	5,985	–	–
Common shares on exercise of stock options	600	1,794	–	–
Common shares on exercise of the 2011 Warrants	2,250	8,663	–	–
Common shares	11,960	46,046	–	–
Flow-through shares	2,110	8,124	–	–
Flow-through share private placement	688	2,649	–	–
	161,856	563,970	128,750	455,928
Share issue costs, net of taxes of \$1,531 (2010 – \$1,178)	–	(4,599)	–	(3,402)
Balance, end of year	161,856	559,371	128,750	452,526
Warrants, beginning of year	4,500	–	–	–
Flow-through warrant private placement	–	–	4,500	–
Warrants exercised	(2,250)	–	–	–
Warrants, end of year	2,250	–	4,500	–

On June 11, 2010, the Company completed the acquisition of Peloton (see note 4(d)(vi)) and issued 12,059 common voting shares with a deemed value of \$2.39 per share for total deemed consideration of \$28,822.

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On August 19, 2010, the Company completed the sale of 3,200 common voting shares on a CEE “flow-through” private placement basis at \$2.50 per share for gross proceeds of \$8,000 as well as 870 common voting shares on a CDE “flow-through” private placement basis at \$2.30 per share for gross proceeds of \$2,001, resulting in a total issuance of 4,070 common voting shares for total gross proceeds of \$10,001. In accordance with IFRS, the above transaction resulted in an increase to share capital of \$8,547 and the recognition of an obligation related to flow-through shares of \$1,454 included with other liabilities in the consolidated balance sheet at December 31, 2010. In accordance with the terms of the related agreements and pursuant to certain provisions of the Income Tax Act (Canada), the Company renounced, for income tax purposes, development expenditures of \$2,001 and exploration expenditures of \$8,000 to the holders of the flow-through common shares effective December 31, 2010. Deferred income tax of approximately \$2,506 associated with renouncing the expenditures was recorded on the date of renunciation in the first quarter of 2011, the obligation on flow-through shares of \$1,454 was drawn down and the difference was recognized as deferred income tax recovery in comprehensive income (loss). As at December 31, 2011, the Company has incurred all of the qualifying expenditures.

On August 19, 2010, the Company completed the sale of 18,545 subscription receipts at a price of \$2.10 per subscription receipt for total gross proceeds of \$38,945. The subscription receipts were convertible to Cequence common voting shares without further consideration upon the closing of the Deep Basin Assets acquisition (see note 4(d)(vi)). Upon closing of the Deep Basin Assets acquisition on September 8, 2010, the subscription receipts were converted on a one for one basis, for no additional consideration and without further action, into common voting shares of the Company. On September 17, 2010, Cequence completed the sale of 2,500 common voting shares related to an over-allotment option on the subscription receipts offering discussed above at \$2.10 per share for total gross proceeds of \$5,250.

On September 10, 2010, the Company completed the acquisition of Temple (see note 4(d)(vi)) and issued 46,846 common voting shares with a deemed value of \$2.03 per share for total deemed consideration of \$95,098.

On September 10, 2010, Cequence completed the sale of 2,950 common voting shares through a private placement to a major shareholder as well as certain management and directors of the Company at \$2.10 per share for total gross proceeds of \$6,195. The transaction has been recorded at the exchange amount, which is the amount of consideration established and agreed to by the related parties, and is equal to fair value. As at December 31, 2011 no amounts are included in accounts payable and accrued liabilities related to the transaction (December 31, 2010 – \$nil).

On November 30, 2010, the Company completed the sale, on a private placement basis, of 2,250 units at a price of \$2.00 per unit for total gross proceeds of \$4,500. Each unit entitles the holder to:

- one common voting share on a CDE “flow-through” basis;
- one warrant to purchase one common voting share on a CDE “flow-through” basis at any time on or after August 1, 2011 and prior to August 15, 2011 at a price set as a 10 percent premium to the 10 day volume weighted average trading price of the Company’s shares on the TSX for the period July 18, 2011 to July 29, 2011 (the “2011 Warrants”); and
- one warrant to purchase one common voting share on a CDE “flow-through” basis at any time on or after August 1, 2012 and prior to August 15, 2012 at a price set as a 10 percent premium to the 10 day volume weighted average trading price of the Company’s shares on the TSX for the period July 18, 2012 to July 31, 2012 (the “2012 Warrants”).

The purchaser unconditionally committed to exercise the 2011 Warrants prior to August 15, 2011 and Cequence exercised the option to hold 1,500 of the shares initially issued in escrow until such time as the 2011 Warrants were exercised. If the 2011 Warrants were not exercised, the shares held in escrow were to be cancellable at no cost to Cequence and no redress to the shareholder. The 2012 Warrants were conditional on the exercise of the 2011 Warrants and if the 2011 Warrants were not exercised in accordance with their terms, the 2012 Warrants were to become null and void. The 2011 Warrants were exercised in accordance with their terms in the year ended December 31, 2011 (see below). No value has been attributed to the 2011 Warrants or 2012 Warrants as the underlying common voting shares are issuable at a fixed premium to the prevailing value of the stock at the time of issuance. As at December 31, 2011, the Company has incurred all of the qualifying CDE expenditures.

The above transaction resulted in an increase to share capital of \$3,886 and the recognition of an obligation related to flow-through shares of \$614 included with other liabilities in the consolidated balance sheet at December 31, 2010. In accordance with the terms of the agreement and pursuant to certain provisions of the Income Tax Act (Canada), the Company renounced, for income tax purposes, development expenditures of \$3,000 to the holders of the flow-through common shares effective December 31, 2010. Deferred income tax of approximately \$752 associated with renouncing the expenditures was recorded on the date of renunciation in the first quarter of 2011, obligation on flow-through shares of \$409 was drawn down and the difference was recognized as deferred income tax recovery in comprehensive income (loss). As at December 31, 2011, the Company has incurred all of the qualifying expenditures.

On March 17, 2011, the Company completed the sale of 13,398 common voting shares at a price of \$2.85 per share for total gross proceeds of \$38,183.

On March 17, 2011, the Company completed the sale of 2,100 common voting shares on a CEE “flow-through” basis at \$3.50 per share for total gross proceeds of \$7,350. Under the terms of the respective agreements, Cequence is required to renounce \$7,350 of CEE expenditures in February 2012. As at December 31, 2011, the Company has incurred all of the qualifying CEE expenditures. The above transaction resulted in an increase to share capital of \$5,985 and the recognition of an obligation related to flow-through shares of \$1,365 included with other liabilities in the consolidated balance sheet at December 31, 2011.

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On June 20, 2011, a total of 600 stock options were exercised resulting in the issuance of 600 common voting shares at \$1.99 per share for total gross proceeds of \$1,194. The exercise of stock options further resulted in a reduction to contributed surplus of \$600 and a commensurate increase to share capital to account for stock based compensation previously expensed related to the exercised options.

On August 15, 2011, 2,250 2011 Warrants were exercised for 2,250 common voting shares on a CDE "flow-through" basis at \$4.36 per share for total gross proceeds of \$9,801. The shares were issued on exercise of the 2011 Warrants, as discussed above. In accordance with the exercise of the 2011 Warrants, 1,500 common voting shares initially held in escrow were released on August 15, 2011. The exercise of the 2011 Warrants also qualifies the remaining 2,250 2012 Warrants for exercise in 2012. Under the terms of the respective agreement, Cequence is required to renounce \$9,801 of CDE expenditures in February 2012. As at December 31, 2011, the Company has incurred all of the qualifying CDE expenditures. The above transaction resulted in an increase to share capital of \$8,663 and the recognition of an obligation related to flow-through shares of \$1,138 included with other liabilities in the consolidated balance sheet at December 31, 2011.

On August 18, 2011, the Company completed the sale of 11,960 common voting shares at a price of \$3.85 per share for total gross proceeds of \$46,046.

On August 18, 2011, the Company completed the sale of 2,110 common voting shares on a CEE "flow-through" basis at \$4.75 per share for total gross proceeds of \$10,023. Under the terms of the respective agreements, Cequence is required to renounce \$10,023 of CEE expenditures in February 2012. As at December 31, 2011, the Company has incurred all of the qualifying CEE expenditures. The above transaction resulted in an increase to share capital of \$8,124 and the recognition of an obligation related to flow-through shares of \$1,899 included with other liabilities in the consolidated balance sheet at December 31, 2011.

On October 5, 2011, the Company completed the sale of 688 common voting shares on a CDE "flow-through" basis at \$4.36 per share for total gross proceeds of \$3,000. Under the terms of the respective agreements, Cequence is required to renounce \$3,000 of CDE expenditures in February 2012. As at December 31, 2011, the Company has incurred all of the qualifying CDE expenditures. The above transaction resulted in an increase to share capital of \$2,649 and the recognition of an obligation related to flow-through shares of \$351 included with other liabilities in the consolidated balance sheet at December 31, 2011.

As at December 31, 2011, there were no issued or outstanding non-voting shares (December 31, 2010 – none).

18. STOCK BASED COMPENSATION PLANS

Stock options

The Company has a stock option plan for directors, officers, employees and consultants of the Company and its subsidiaries. The number of common shares granted with respect to options may not exceed a rolling maximum of 10 percent of the Company's outstanding common shares. Options typically vest over a three year period, expire five years from the date of grant and are settled by issuing shares of the Company.

During the year ended December 31, 2011, the Company issued 4,221 stock options at prices ranging from \$2.96 to \$3.94 to employees and directors. The options have a five year life and one third vest annually commencing one year following the grant date. The Company utilized a Black-Scholes option pricing model to price the options. During the year ended December 31, 2011, 240 options were forfeited and 600 options were exercised.

A summary of the inputs used to value stock options is as follows:

	December 31, 2011	December 31, 2010
	\$	\$
Risk-free interest rate	1.3% – 2.8%	1.9% – 2.9%
Expected life of options	5 years	5 years
Expected volatility	60%	50% – 60%
Expected dividend rate	0%	0%
Expected forfeiture rate	15%	6% – 15%
Weighted average fair value	1.91	1.00

Expected volatility is determined by reference to the Company's industry peers as, due largely to changes in the size and structure of the Company in recent years, this was determined to be a more meaningful measure than the historical volatility of the Company's shares.

A summary of the status of the Company's stock option plan and changes during the years ended December 31, 2011 and 2010 is as follows:

	December 31, 2011		December 31, 2010	
	Number of Options (000's)	Average Exercise Price, \$	Number of Options (000's)	Average Exercise Price, \$
Outstanding, beginning of year	9,713	1.99	839	4.40
Granted	4,221	3.69	10,958	1.92
Cancelled	–	–	(880)	3.50
Forfeited	(240)	1.99	(1,204)	2.72
Exercised (Note 17)	(600)	1.99	–	–
Outstanding, end of year	13,094	2.54	9,713	1.99

The following table summarizes information about stock options outstanding at December 31, 2011:

	Options Outstanding			Options Exercisable	
	Weighted Average Exercise Price, \$	Number of Options Outstanding (000's)	Weighted Average Contractual Life Remaining (years)	Number of Options (000's)	Weighted Average Exercise Price, \$
1.76 – 1.99	1.98	8,868	3.7	2,956	1.98
2.96 – 3.94	3.69	4,221	4.5	–	–
8.36	8.36	5	5.8	5	8.36
	2.54	13,094	4.0	2,961	1.99

Notes to the Consolidated Financial Statements

(All figures expressed in thousands except per share amounts unless otherwise noted)

During the year ended December 31, 2011, \$6,758 (2010 – \$2,721) in compensation expense related to equity-settled stock options has been recognized in comprehensive income (loss).

Performance warrants

As at December 31, 2009, the Company had a total of 5,200 performance warrants that were exercisable into a common, non-voting share of Cequence at a price of \$1.88. At the time the performance warrants were negotiated the market price of the Company's shares was \$1.48. The performance warrants were divided into three equal tranches with the first one-third having a four year term and vested if the 20 day weighted average share price of Cequence exceeded \$3.20. The second tranche had a 54 month term and vested if the 20 day weighted average share price of Cequence exceeded \$4.40. The final third of the performance warrants had a five year term and vested if the 20 day weighted average share price of Cequence exceeded \$5.60. The performance warrants were exercisable for non-voting shares of Cequence.

During the year ended December 31, 2010 these warrants were cancelled as part of the acquisition of Temple and any unrecognized stock based compensation expense was recognized in income. The cost to cancel the warrants of \$451 was recognized as a transaction cost and expensed (see note 4(d)(vi)).

During the year ended December 31, 2010, the Company recognized \$142 of stock based compensation for the performance warrants in comprehensive income (loss).

19. LOSS PER SHARE

Loss per share has been calculated based on the weighted average number of common shares outstanding during the period. The following table reconciles the denominators used for the basic and diluted loss per share calculations. No stock options or warrants have been included in the calculation of diluted shares outstanding for the year ended December 31, 2011 (2010 – none) as their inclusion would be anti-dilutive.

	Year ended December 31,	
	2011	2010
Basic weighted average shares	147,558	69,713
Effect of dilutive stock options and warrants	–	–
Diluted weighted average shares	147,558	69,713

20. CONTINGENCIES AND COMMITMENTS

	2012	2013	2014	2015	2016+	Total
Office leases	\$ 1,217	1,133	922	187	–	\$ 3,459
Drilling services	2,138	2,138	–	–	–	4,276
Pipeline transportation	1,699	1,699	1,699	1,554	–	6,651
Total	\$ 5,054	4,970	2,621	1,741	–	\$ 14,386

The Company has a pipeline transportation contract that expires on November 30, 2015.

During the year ended December 31, 2011, the Company entered into a drilling service agreement whereby the Company has committed to use a drilling rig for 360 days over the two years following commencement of use of the drilling rig at current market rates. The commitment is drawn down when the rig is in use, whether by Cequence or third parties. Cequence expects to meet the commitment in the required time.

During the year ended December 31, 2011, the Company entered into a drilling service agreement whereby the Company made a deposit of \$3,500 to obtain a right of first refusal on the use of two drilling rigs over the five years following the date that use of the rigs commences. The deposit is to be drawn down as the Company incurs costs related to the use of the drilling rigs and \$285 has been drawn down at December 31, 2011. Cequence expects to reduce the deposit by \$759 in the twelve months ended December 31, 2012, which amount is included with deposits and prepaid expenses in the consolidated balance sheet. The portion of the outstanding deposit expected to be drawn down in the period subsequent to December 31, 2012 of \$2,456 is carried as a non-current asset in the consolidated balance sheet as at December 31, 2011.

During the year ended December 31, 2011, the Company recognized \$1,311 (December 31, 2010 – \$940) of expense related to office leases, included with general and administrative expense in comprehensive income (loss).

21. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

The Company's financial instruments, including derivative financial instruments and embedded derivative financial instruments, recognized in the consolidated balance sheets consist of cash, accounts receivable, commodity contracts, demand credit facilities and accounts payable and accrued liabilities.

The Company's accounts receivable, demand credit facilities and accounts payable and accrued liabilities approximate their carrying values due to their short terms to maturity and the floating interest rate on the Company's debt.

The Company's fair value hierarchy for those assets and liabilities measured at fair value as of December 31, 2011 comprises cash, which is considered a level 1 financial instrument.

The nature of these financial instruments and the Company's operations expose the Company to market risk, credit risk and liquidity risk. The Company manages its exposure to these risks by operating in a manner that minimizes these risks. Senior management employs risk management strategies and policies to ensure that any exposure to risk is in compliance with the Company's business objectives and risk tolerance levels. The Board of Directors has overall responsibility for the establishment and oversight of the Company's risk management framework. The Board has established policies in setting risk limits and controls and monitors these risks in relation to market conditions.

a) Market risk

Market risk is the risk that changes in market prices, such as foreign exchange rates, commodity prices, and interest rates will affect the Company's comprehensive income (loss) to the extent the Company has outstanding financial instruments. The objective of the Company is to mitigate market risk exposures within acceptable limits, while maximizing returns.

Notes to the Consolidated Financial Statements

(All figures expressed in thousands except per share amounts unless otherwise noted)

Commodity price risk

The nature of the Company's operations results in exposure to fluctuations in commodity prices. Management continuously monitors commodity prices and initiates instruments to manage exposure to these risks when it deems appropriate. As a means of managing commodity price volatility, the Company enters into various derivative financial instrument agreements and physical contracts. Derivative financial instruments are marked-to-market and are recorded on the consolidated balance sheet as either an asset or liability with the change in fair value recognized in comprehensive income (loss).

On October 15, 2010, the Company completed the sale of its 2011 fixed price commodity contracts totalling 4,000 GJ/day at prices ranging from \$5.85 to \$6.20 per GJ for total proceeds of \$3,386. This resulted in a gain recognized in comprehensive income (loss) of \$219.

The Company had no outstanding positions for commodity derivative financial instruments at December 31, 2011.

For the year ended December 31, 2011 realized gains from commodity derivative contracts recognized in comprehensive income (loss) were \$906 compared to a gain of \$3,737 in the year ended December 31, 2010.

The fair value of the commodity contracts outstanding at December 31, 2011 was \$nil (December 31, 2010 – \$nil; January 1, 2011 – \$1,420). For the year ended December 31, 2011 the Company recorded an unrealized loss of \$nil from derivative commodity contracts compared to a loss of \$2,793 for the year ended December 31, 2010. An estimate of credit risk has been made in the valuation of all derivative commodity contracts.

Foreign exchange risk

The Company is exposed to foreign currency fluctuations as crude oil and natural gas prices are referenced to U.S. dollar denominated prices. As at December 31, 2011 the Company had no forward, foreign exchange contracts in place, nor any significant working capital items denominated in foreign currencies.

Interest rate risk

The Company is exposed to interest rate risk to the extent that changes in market interest rates impact its borrowings under the floating rate credit facilities. The floating rate debt is subject to interest rate cash flow risk, as the required cash flows to service the debt will fluctuate as a result of changes in market rates. The Company has no interest rate swaps or financial contracts in place as at or during the year ended December 31, 2011.

As at December 31, 2011 a 1 percent change in interest rates on the Company's outstanding debt, with all other variables constant, would result in a change in comprehensive income (loss) of \$116 (\$85 after tax).

b) Credit risk

Credit risk is the risk of financial loss to the Company if a counterparty to a financial instrument fails to meet its contractual obligation. The Company is exposed to credit risk with respect to its accounts receivable and cash.

The majority of the Company's accounts receivable are due from joint venture partners in the oil and gas industry and from marketers of the Company's petroleum and natural gas production. The Company mitigates its credit risk by entering into contracts with established counterparties that have strong credit ratings and reviewing its exposure to individual counterparties on a regular basis.

As at December 31, 2011, the accounts receivable balance was \$21,032 of which \$1,516 was past due. The Company considers all amounts greater than 90 days past due. These past due accounts are considered to be collectible, except as provided in the allowance for doubtful accounts. When determining whether past due accounts are uncollectible, the Company factors in the past credit history of the counterparties. At December 31, 2011, the Company has an allowance for doubtful accounts of \$551 (2010 – \$490). As at December 31, 2011, 33 percent of the total receivables balance is due from marketers of the Company's oil and natural gas production and 18 percent is due from a joint venture partner related to current drilling, completion and tie-in activities. A reconciliation of the Company's allowance for doubtful accounts is as follows:

	Year ended December 31, 2011	Year ended December 31, 2010
Balance, beginning of year	\$ 490	\$ 274
Amounts collected	(37)	(2)
Amounts written off to accounts receivable	(4)	(4)
Additional provision	102	222
Balance, end of year	\$ 551	\$ 490

As at December 31, 2011, the maximum exposure to credit risk was \$21,412 (2010 – \$17,760) being the carrying value of the Company's cash and accounts receivable.

c) Liquidity risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they are due. The nature of the oil and gas industry is capital intensive and the Company maintains and monitors a certain level of cash flow to finance operating and capital expenditures. Refer to note 23 for disclosure related to the management of capital.

The expected timing of cash flows relating to financial liabilities as at December 31, 2011 is as follows:

	< 1 Year	1 – 2 Years	2 – 5 Years	Thereafter
Demand credit facilities	–	–	11,618	–
Accounts payable and accrued liabilities	64,467	–	–	–
	64,467	–	11,618	–

Notes to the Consolidated Financial Statements

(All figures expressed in thousands except per share amounts unless otherwise noted)

22. CHANGES IN NON-CASH WORKING CAPITAL

	Year ended December 31,	
	2011	2010
	\$	\$
Accounts receivable	(4,593)	(1,693)
Deposits and prepaid expenses	(3,207)	274
Accounts payable and accrued liabilities	28,227	1,755
Net change in non-cash working capital	20,427	336
Allocated to:		
Operating activities	(4,607)	(2,017)
Investing activities	24,976	2,353
Financing activities	58	–
	20,427	336

23. CAPITAL MANAGEMENT

Cequence's objectives are to maintain a flexible capital structure in order to meet its financial obligations and to execute on strategic opportunities throughout the business cycle. The Company's capital comprises shareholders' equity, demand credit facilities and working capital. Cequence manages the capital structure and makes adjustments in light of economic conditions and the risk characteristics of the underlying assets.

In order to maintain or adjust the capital structure, Cequence may issue new common shares, issue new debt or replace existing debt, adjust capital expenditures and acquire or dispose of assets.

The Company evaluates its capital structure based on net debt to cash flow from operating activities and the current credit available to Cequence compared to its budgeted capital expenditures.

Net debt to cash flow provides a measure of the Company's ability to manage its debt levels under current operating conditions. The ratio is calculated as net debt, defined as current debt, long term debt and working capital excluding commodity derivative assets or liabilities and other liabilities, divided by cash flow from operations before decommissioning liabilities expenditures, proceeds from the sale of commodity contracts and changes in non-cash working capital for the most recent quarter.

At December 31, 2011 Cequence has a net debt and working capital deficiency of \$51,442 (December 31, 2010 – \$72,739).

It is the Company's objective to maintain a net debt to annualized cash flow ratio of less than 2:1. As at December 31, 2011, the ratio was calculated as 1.3:1 (December 31, 2010 – 2.4:1) based on annualized fourth quarter results.

The Company's current borrowing capacity is based on the lenders' semi-annual review of the Company's oil and natural gas reserves. The Company is also subject to various restrictions, including being permitted to hedge up to 67 percent of its production under the lending agreement. Compliance with these restrictions is monitored on a regular basis and at December 31, 2011 Cequence was in compliance with all such restrictions.

24. RELATED PARTIES

An executive of the Company is a member of the board of directors of an entity that is a supplier of seismic services to Cequence. The Company incurred a total of \$26 with this vendor in the year ended December 31, 2011 (2010 – \$11). These transactions have been recorded at the exchange amount, which is the amount of consideration established and agreed to by the related parties, and is equal to fair value. As at December 31, 2011, no amounts are included in accounts payable and accrued liabilities related to these transactions (December 31, 2010 – \$5).

25. SUBSEQUENT EVENTS

On March 8, 2012, the 2012 Warrants (see note 17) were cancelled at no cost to Cequence and no redress to the shareholder.

Corporate Information

Management

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President & CEO

Howard Crone, P.Eng
Executive Vice President & COO

David Gillis, CA
Vice President, Finance & CFO

James R. Jackson, P.Eng, CFA
Vice President, Engineering

David P. Robinson
Vice President, Geology

Christopher C. Soby
Vice President, Land

Stephen R. Stretch
Vice President, Geophysics

Mike Stewart
Vice President, Operations

Erin Thorson, CMA
Controller

Directors

Don Archibald
Chairman

Peter Bannister
Paul Colborne
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