AKITA DRILLING LTD.

# 2016 ANNUAL REPORT

# Corporate Profile

## AKITA Drilling Ltd. is a premier oil and gas drilling contractor with drilling operations throughout Western Canada.

**The Company strives to be the industry leader in customer relations, First Nations and Aboriginal partnerships, employee expertise, safety, equipment quality and drilling performance. In addition to conventional drilling, the Company specializes in pad and other purpose-built drilling rigs and is active in directional, horizontal and underbalanced drilling providing specialized drilling services to a broad range of independent and multinational oil and gas companies. AKITA currently employs, at full operations, approximately 600 people. The Company commands a fleet of 28 drilling rigs capable of operating in all depth ranges in Western Canada.**

# Contents



### Annual Meeting

The Annual General Meeting of Shareholders will be held at 10:00 a.m. on Tuesday, May 9, 2017 at the Westin Hotel, 320 – 4th Avenue S.W., Calgary, Alberta. Shareholders and other interested parties are encouraged to attend.

# Forward-looking Statements

From time to time AKITA Drilling Ltd. (“AKITA” or the “Company”) makes written and verbal forward-looking statements. These forward-looking statements include but are not limited to comments with respect to our objectives and strategies, financial condition, the results of our operations and our business, our outlook for our industry and our risk management discussion. Forward looking statements are typically identified with words such as “believe”, “expect”, “forecast”, “anticipate”, “intend”, “estimate”, “plan” and “project” and similar expressions of future or conditional events such as “will”, “may”, “should”, “could” or “would”.

By their nature these forward-looking statements involve numerous assumptions, inherent risks and uncertainties, both general and specific, and the risk that predictions and other forward-looking statements will not be achieved. We caution readers of this Annual Report not to place undue reliance on these forward-looking statements as a number of important factors could cause actual future results to differ materially from the plans, objectives, expectations, estimates and intentions expressed in such forward-looking statements.

Forward-looking statements may be influenced by the following factors: the level of exploration and development activity carried on by AKITA’s customers, world oil and North American natural gas prices, global liquified natural gas (LNG) demand, weather, access to capital markets and government policies. We caution that the foregoing list of important factors is not exhaustive and that when relying on forward-looking statements to make decisions with respect to AKITA, investors and others should carefully consider the foregoing factors as well as other uncertainties and events.

Additional information about these and other factors can be found under the “Business Risks and Risk Management” section of the Management’s Discussion and Analysis of this 2016 Annual Report for AKITA.

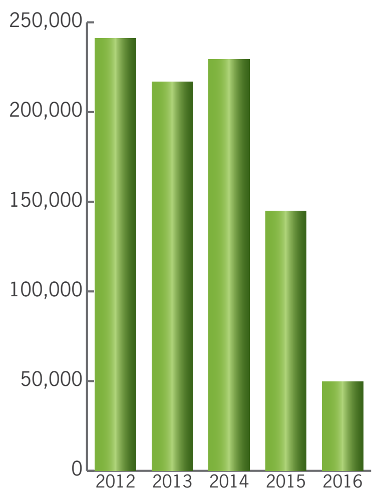
On the cover:
Rig 25, drilling in the OIl Sands, Christina Lake area.

AKITA’s business strategy is driven by a commitment to creating shareholder value through the provision of excellent equipment and high quality service. Most of AKITA’s newer rigs have been built to meet specialized demands.

All photo credits in this annual report: F. Biggeman

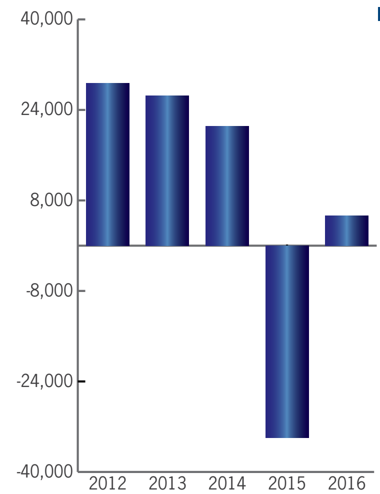
# Operational Performance

## Adjusted Revenues
(000's)



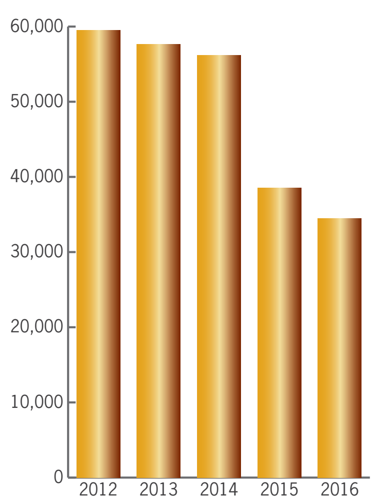

*In 2016, adjusted revenue was 66% lower than 2015 adjusted revenue due to decreased rig activity coupled with reduced day rates resulting from low commodity prices for crude oil and natural gas.*

## Net Earnings (Loss)
($000's)



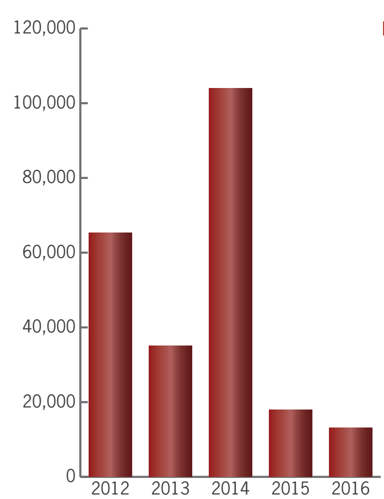

*AKITA net earnings in 2016 were boosted by contract cancellation revenue. 2015 net earnings included an asset impairment expense.*

## Funds Flow from Continuing Operations
(000's)




*Annual funds flow for 2016 was 10% lower than in 2015 due to weaker drilling activity but was still sufficient to fund capital expenditures and pay dividends.*

## Capital Expenditures
($000's)

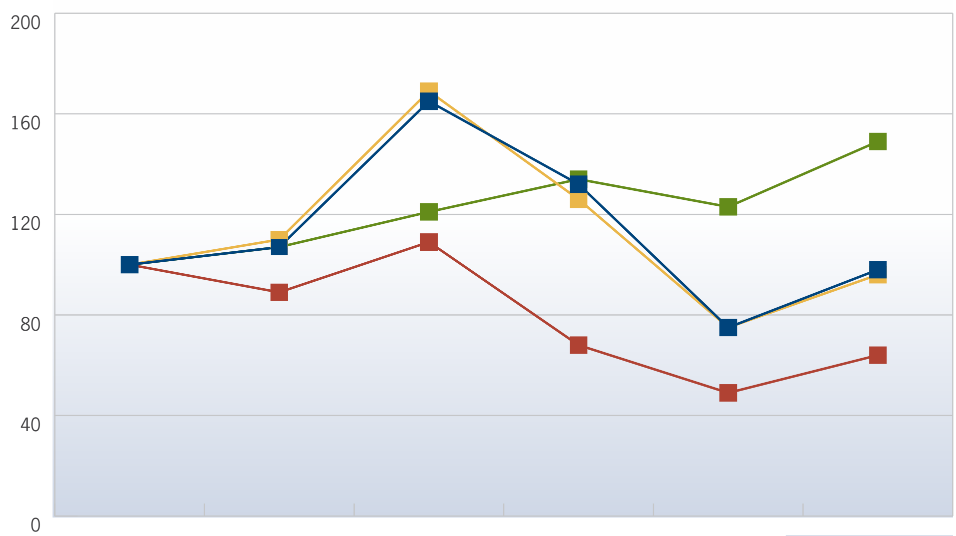



*AKITA's 2016 capital expenditure program was scaled back from 2015 and consisted of capital maintenance as well as select rig upgrades. The Company began construction of a new AC double pad rig in Q4 of 2016.*

# Share Performance

### Five Year Total Return on $100 Investment

*The graph to the right compares the cumulative return over the last five years on Class A Non-Voting shares and Class B Common shares of the Company from December 31, 2011 with the cumulative total return of the S&P/TSX Composite Stock Index and the TSX Oil & Gas Drilling Sub-Index over the same period, assuming reinvestment of dividends.*




| | Dec 31 2011 | Dec 31 2012 | Dec 31 2013 | Dec 31 2014 | Dec 31 2015 | Dec 31 2016 |
|---|---|---|---|---|---|---|
| AKITA Class A Non-Voting | 100 | 107 | 165 | 132 | 75 | 98 |
| AKITA Class B Common | 100 | 110 | 169 | 126 | 75 | 96 |
| S&P/TSX Composite Index | 100 | 107 | 121 | 134 | 123 | 149 |
| TSX Oil & Gas Drilling Sub-Index | 100 | 89 | 109 | 68 | 49 | 64 |

### Share Performance

| | | 2012 | 2013 | 2014 | 2015 | 2016 |
|---|---|---|---|---|---|---|
| Weighted average number of Class A Non-Voting and Class B Common shares | | 17,988,552 | 17,969,415 | 17,948,502 | 17,945,661 | 17,945,661 |
| Market prices for Class A Non-Voting shares | High | $ 11.89 | $ 16.61 | $ 17.86 | $ 12.56 | $ 9.20 |
| | Low | $ 9.21 | $ 10.30 | $ 11.15 | $ 6.10 | $ 5.88 |
| | Close | $ 10.50 | $ 15.79 | $ 12.40 | $ 6.79 | $ 8.45 |
| Volume | | 2,103,087 | 3,345,199 | 2,093,823 | 1,603,746 | 930,748 |
| Market prices for Class B Common shares | High | $ 11.39 | $ 16.79 | $ 18.30 | $ 13.30 | $ 11.00 |
| | Low | $ 9.94 | $ 10.65 | $ 11.75 | $ 6.87 | $ 7.11 |
| | Close | $ 11.00 | $ 16.50 | $ 12.00 | $ 6.87 | $ 8.53 |
| Volume | | 16,683 | 18,393 | 21,019 | 32,326 | 18,674 |

### Dividend History

AKITA began paying dividends to shareholders in 1996. It is the current intention of the Board of Directors to continue to pay quarterly dividends in the future. Nevertheless, the payment of any dividend is at the discretion of the Board of Directors and depends upon the financial condition of the Company and other factors.

| | 2012 | 2013 | 2014 | 2015 | 2016 |
|---|---|---|---|---|---|
| Dividends paid per share ($) | 0.28 | 0.32 | 0.34 | 0.34 | 0.34 |

# Letter to the Shareowners

Linda A. Southern-Heathcott
Chairman of the Board

Karl Ruud
President and
Chief Executive Officer

AKITA Drilling Ltd.'s net income for the year ended December 31, 2016 was $5,329,000 (net income of $0.30 per share (basic and diluted)) on revenue of $61,061,000 compared to a net loss of $33,965,000 or a $1.89 loss per share (basic and diluted) on revenue of $112,488,000 in 2015. Results in 2016 included significant contract cancellation revenue of $28,250,000 ($20,609,000 after tax) while 2015 included an asset impairment expense of $41,968,000 (after tax effect of $30,748,000). The Company had a net loss from routine operations of $15,280,000 (net loss of $0.84 per share) in 2016 compared to a net loss from routine operations of $3,217,000 (net loss of $0.18 per share) in 2015. Funds flow from operations for the current year was $34,500,000 compared to $38,510,000 in 2015, while net cash from operating activities for 2016 was $11,892,000 compared to $41,507,000 in 2015.

The Canadian drilling industry faced significant challenges in 2016. Average crude oil prices for the year declined 11% from 2015, after declining 48% from 2014 to 2015. This significant decline over the last two years has caused large reductions in the capital budgets of oil companies and therefore, significantly fewer opportunities for drilling companies. For AKITA, these market conditions resulted in the Company generating the fewest operating days in the Company's 24 year history. Furthermore, the Company's results were impacted by a significant reduction in day rates across the industry.

During 2016, AKITA had two primary focuses; the management of discretionary spending and the retention of experienced field hands. Despite record low utilization and operating margins, the Company grew its cash balance through the year, ending the year with $14 million in cash, up from $9 million in 2015, and increased working capital from $16 million in 2015 to $35 million at the end of 2016. The Company upgraded four rigs in 2016, increasing depth capacities and move efficiencies on these rigs and also began construction of a new AC heavy pad double rig in the fourth quarter that is scheduled to be completed in July of 2017. The second focus of the Company in 2016, crew retention, was important to the Company in order to keep as many field employees working through the downturn as financially possible. This commitment to our employees has put AKITA in the enviable position of having enough experienced people to crew its rigs as demand picks up in 2017, as is expected to be the case.

AKITA maintains a commitment to safety that permeates all levels of the organization. Since inception, AKITA's annual safety performance has been amongst the best in the industry. AKITA's 2016 total reportable accident frequency (often referred to as "TRIF") was the best in the Company's history, showing a 20% improvement over the Company's previous record. To help achieve this, field employees complete extensive safety training and must meet current industry certification standards and managers, employees and subcontractors are all required to understand and accept their responsibility for maintaining a safe working environment.

On November 22, 2016, the Canadian Association of Oilwell Drilling Contractors ("CAODC") released its 2017 industry drilling forecast, estimating 23% average rig utilization compared to 17% actual average rig utilization in 2016, and 4,665 wells in 2017, up from 3,562 in 2016. The 2017 forecast was based upon commodity price assumptions of US $53 per barrel for crude oil and CAD $3.00 per mcf for natural gas. This forecasted increase in the number of wells to be drilled in 2017 is positive; however, it is still 14% below 2015 figures and 58% below 2014. The Company anticipates that 2017 will be another challenging year, but is optimistic that this growth trend will continue based on recent positive news surrounding pipelines and Canada's ability to move crude oil to markets.

Despite 2016 proving to be a very difficult year, AKITA's Board of Directors has maintained a quarterly dividend to shareowners in the amount of $.085 cents per share.

We would like to express a special thanks to AKITA's employees for their adaptability, hard work and commitment to excellence during these difficult market conditions. We would also like to express our appreciation to our partners, customers and suppliers who worked closely with us during 2016 to come up with innovative solutions for working through these challenging times. Finally, we wish to acknowledge the contribution of our directors, whose thoughtful counsel and guidance have helped to create and maintain a strong and successful Company, and the AKITA Shareowners for their continued support and confidence in the Company.

On behalf of the Board of Directors,

Linda A. Southern-Heathcott
Chairman of the Board

Karl A. Ruud
President and Chief Executive Officer

March 3, 2017

# Management's Discussion & Analysis

The following sets out management's discussion and analysis ("MD&A") of the consolidated financial position as at December 31, 2016 and 2015, and consolidated results of operations, cash flows and changes in shareholders' equity for AKITA Drilling Ltd. and its subsidiaries (collectively referred to as "AKITA" or the "Company") for the years ended December 31, 2016 and 2015. The information included in this MD&A is intended to assist readers in analyzing the financial affairs of the Company. In addition to the information in this section, AKITA's audited consolidated financial statements for 2016 and 2015, including the notes thereto, found on pages 32 to 61 of this Annual Report, provide information on the Company's financial position, results of its operations, cash flows and changes in shareholders' equity. The information in this MD&A was approved by AKITA's Board of Directors on March 3, 2017, and incorporates all relevant considerations to that date.

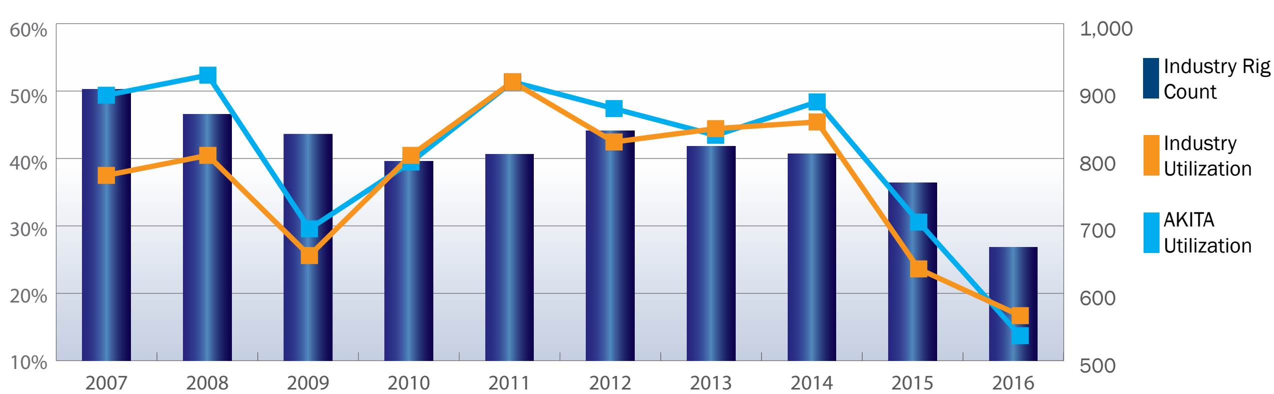
Management has prepared this MD&A as well as the accompanying consolidated financial statements and the notes thereto. All financial information is reported in Canadian dollars.

## Introduction and General Overview

AKITA is a premier Canadian oil and gas drilling contractor. During 2016, the Company conducted operations in British Columbia, Alberta and Saskatchewan. The Company strives to be the industry leader in customer relations, First Nations and Aboriginal partnerships, employee expertise, safety, equipment quality and drilling performance. In addition to conventional drilling, the Company specializes in purpose-built drilling rigs, including self-moving pad rigs, and is active in directional, horizontal and underbalanced drilling, providing specialized drilling services to a broad range of independent and multinational oil and gas companies and potash producers. All of the Company's 28 rigs were located in Western Canada at December 31, 2016.

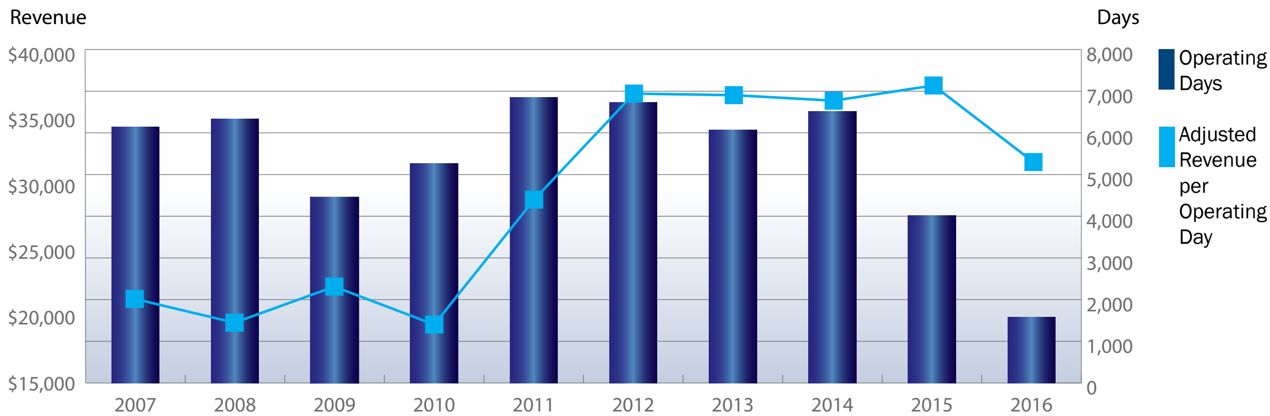
With a singular focus on the provision of drilling services, a commitment to rigorous crew training, rig maintenance and safety processes and adherence to a leading quality assurance – quality control program, AKITA's strategy has been to ensure it is well positioned to meet the most demanding requirements of global operators who offer long lasting resource based drilling programs. The Company has utilized this strategy to enhance its development of pad rigs designed for both heavy oil and unconventional natural gas formations.

Oil and gas contract drilling activity is cyclical and is affected by numerous factors, most importantly world crude oil prices and North American natural gas prices. Overall demand for AKITA's drilling services declined significantly in 2016 compared to 2015 as illustrated in the accompanying rig utilization chart.



In 2016, AKITA's utilization dropped below the industry average as the Company was unwilling to work rigs for day rates that the Company felt were uneconomical.

The decrease in revenue per day in 2016 as seen in the following chart was directly related to industry wide pricing pressure on day rates due to limited opportunities to put rigs to work. Historically, AKITA's revenue per day has been tied to the number of new build rigs operating under term contracts as these rigs demand premium rates.




*Note: Revenue has been calculated under Canadian Generally Accepted Accounting Principles ("Canadian GAAP") for the years 2007 to 2009 and under International Financial Reporting Standards ("IFRS") for the years 2010 to 2016. Each of these methods of calculating revenue has been consistently applied from year to year. However, readers of this MD&A should be aware that the two methods of calculating revenue are not entirely consistent with each other. Amounts reported for the years 2012 to 2016 have been adjusted to include the Company's proportionate share of revenue from joint ventures in addition to revenue reported in the financial statements. See commentary in "Basis of Analysis in this MD&A, Non-GAAP and Additional GAAP Items" on page 27.*

## Fleet and Utilization

The following table summarizes rig changes that occurred in 2016:

| | Gross | Net |
|---|---|---|
| Number of rigs at December 31, 2015 | 31 | 28.225 |
| Rebuild and redeploy heavy singles | 2 | 2.000 |
| Purchase of partners' ownership % in two joint venture rigs | - | 0.525 |
| Decommissioning of rigs | (5) | (4.000) |
| Number of rigs at December 31, 2016 | 28 | 26.750 |

In 2016, the Company rebuilt and deployed two heavy single rigs that were constructed with a combination of spare parts and new components. These single rigs each have a 1,900 metre depth capacity and feature integrated top drives. Also during 2016, five rigs were decommissioned and moved into spare equipment. In the fourth quarter of 2016, the Company began construction of a new AC double pad rig.

During 2016, three of the Company's joint venture partners entered into an agreement with AKITA whereby they agreed to sell their ownership interest in two rigs to AKITA in exchange for settlement of outstanding payable balances on those and other joint venture operations. As a result of these sales to AKITA, the Company became the 100% owner of two former joint venture rigs. Weak market conditions were the contributing factors that necessitated this divestiture by the joint venture partners. AKITA remains committed to the health of its joint ventures and the success of its joint venture partners. As a result of AKITA purchasing the partners' interest in these two rigs, the remaining four joint venture rigs with these partners are well positioned for future success and are financially stable.

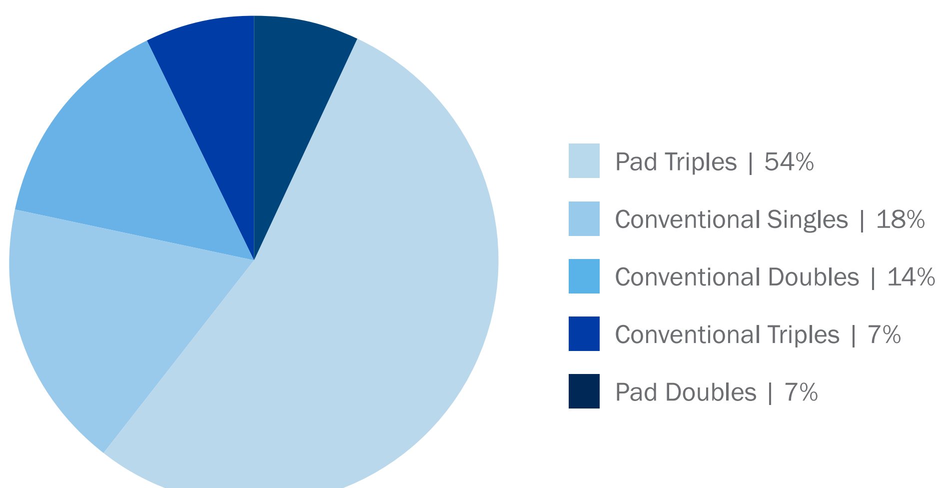
Utilization rates are a key statistic for the drilling industry since they measure revenue volume and influence pricing. During 2016, AKITA achieved 1,583 operating days, which is the lowest in the Company's history, and which corresponds to a utilization rate of 14%, compared to 2015 utilization of 31%, and 3% below the 2016 industry average of 17%.

The drilling industry is seasonal, with activity typically building in the fall and peaking during the winter months, at which time areas with muskeg conditions freeze sufficiently to allow the movement of rigs and other heavy equipment. The peak drilling season ends with "spring break-up", at which time drilling operations are curtailed due to seasonal road bans (temporary prohibitions on road use) and restricted access to agricultural land.

In addition to traditional seasonal impacts, the business of AKITA may be affected at various times in two important ways as a result of warmer than normal temperatures. First, increases in overall temperatures would have the effect of shortening the winter drilling season. A secondary impact on AKITA of warmer than normal temperatures is related to a reduced demand for natural gas for heating. To the extent that warmer weather impacts the demand for natural gas including the resultant lower natural gas prices for many of AKITA's customers, those customers might reduce natural gas drilling programs, which in turn might reduce the demand for AKITA's services.

A significant shift in drilling has occurred in recent years with respect to the type of equipment preferred by AKITA's customers. Specifically, there has been a shift away from conventional rigs, requiring trucks to relocate from well to well, towards the use of pad rigs with self-moving systems which allow the rig to move itself within a set of well locations, usually referred to as a "pad". Moreover, pad rigs typically drill wells in "batches", whereby a series of surface holes are drilled, followed by one or more series of intermediate holes and a final series of main holes. This style of drilling, as opposed to drilling each well from start to finish prior to moving, provides significant efficiency gains when used in appropriate applications. Pad rigs are also less impacted by seasonal fluctuations as they can work throughout spring break-up provided they are in place before travel bans commence in the spring.

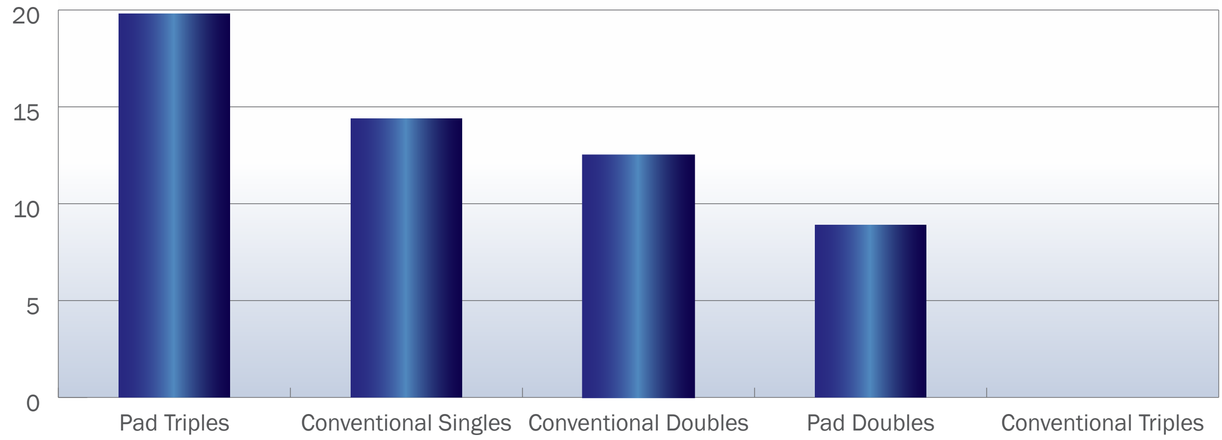
**Drilling Fleet Summary at December 31, 2016**



From time to time, the Company enters into drilling contracts for extended terms. At December 31, 2016, AKITA had two rigs with multi-year contracts, one of which expires in 2017 and the other in 2018.

AKITA's competitive position is affected by the overall size of the Canadian drilling fleet and the level of customer demand. At December 31, 2016, there were 668 drilling rigs registered with the CAODC (December 31, 2015 – 765). AKITA's drilling fleet of 28 rigs represented 4.2% of the total Canadian drilling fleet at December 31, 2016 (December 31, 2015 – 4.1%).

The following graph illustrates AKITA's 2016 drilling rig utilization rates according to rig type:




*Note: Drilling rig utilization rates are average rates based upon the number of days in a year a rig is operating, excluding move days.*

## Revenue and Operating & Maintenance Expenses

| $Millions | 2016 | 2015 | Change | % Change |
|---|---|---|---|---|
| Revenue per financial statements | 61.1 | 112.5 | (51.4) | (46%) |
| Contract cancellation revenue | (28.3) | - | (28.3) | N/A |
| Proportionate share of revenue from joint ventures (1) | 17.0 | 32.5 | (15.5) | (48%) |
| Adjusted revenue (1) | 49.8 | 145.0 | (95.2) | (66%) |

| $Millions | 2016 | 2015 | Change | % Change |
|---|---|---|---|---|
| Operating and maintenance expenses per financial statements | 24.2 | 74.0 | (49.8) | (67%) |
| Proportionate share of operating and maintenance expenses from joint ventures (1) | 10.7 | 20.8 | (10.1) | (49%) |
| Adjusted operating and maintenance expenses (1) | 34.9 | 94.8 | (59.9) | (63%) |

| $Millions | 2016 | 2015 | Change | % Change |
|---|---|---|---|---|
| Adjusted revenue (1) | 49.8 | 145.0 | (95.2) | (66%) |
| Adjusted operating and maintenance expenses (1) | 34.9 | 94.8 | (59.9) | (63%) |
| Adjusted operating margin (1) (2) | 14.9 | 50.2 | (35.3) | (70%) |

| $Dollars | 2016 | 2015 | Change | % Change |
|---|---|---|---|---|
| Adjusted revenue per operating day (1) | 31,447 | 36,102 | (4,655) | (13%) |
| Adjusted operating and maintenance expenses per operating day (1) | 22,015 | 23,620 | (1,605) | (7%) |
| Adjusted operating margin per operating day (1) (2) | 9,432 | 12,482 | (3,050) | (24%) |

*(1) Proportionate share of revenue from joint ventures, adjusted revenue, proportionate share of operating & maintenance expenses from joint ventures, adjusted operating & maintenance expenses, adjusted operating margin, adjusted revenue per operating day, adjusted operating & maintenance expenses per operating day and adjusted operating margin per operating day are non-GAAP financial measures. See commentary in "Basis of Analysis in this MD&A, Non-GAAP and Additional GAAP Items on page 27.*

*(2) Adjusted operating margin is the difference between adjusted revenue and adjusted operating & maintenance expenses.*

Adjusted revenue of $49,781,000 in 2016 was 66% lower than the 2015 adjusted revenue of $144,951,000, primarily as a result of decreased rig activity coupled with reduced day rates. During 2016, the Company's revenue included a material contract cancellation fee. This fee has been excluded in the Company's adjusted revenue and adjusted operating margin, and adjusted operating margin per operating day analysis. The Company's pad triple rigs saw the largest decrease in operating days which were heavily affected by the suspension of oil sands operations due to both low crude oil prices and the Fort McMurray wildfires. Adjusted revenue was also lower on a per operating day basis, decreasing to $31,447 per operating day in 2016 from $36,102 per operating day in 2015, as a result of increased competition for limited opportunities in 2016.

Adjusted operating and maintenance costs are tied to activity levels and amounted to $34,850,000 or $22,015 per operating day during 2016 compared to $94,834,000 or $23,620 per operating day for the prior year. The reduction in operating and maintenance costs, when considered on a totals basis, is directly related to the lower level of activity in 2016 compared to 2015. The decrease on a per day basis is a result of cost cutting measures that were started in 2015 and affected the full year in 2016.

The Company's adjusted operating margin for 2016 was $14,931,000 ($9,432 per operating day), compared to $50,117,000 ($12,482 per operating day) in 2015. Lower drilling activity was the key factor behind the reduction in operating margin from 2015 to 2016. On a per day basis, reduced day rates in 2016 drove the operating margin per day lower than in 2015.

AKITA provided drilling services to 29 different customers in 2016 (2015 - 27 different customers), including three customers that each provided more than 10% of AKITA's adjusted revenue for the year (2015 – three customers).

## Depreciation and Amortization Expense

| $Millions | 2016 | 2015 | Change | % Change |
|---|---|---|---|---|
| Depreciation and amortization expense | 24.0 | 36.7 | (12.7) | (35%) |

Drilling rigs are generally depreciated using the unit of production method. Depreciation is typically calculated for each rig's major components resulting in an average useful life of 3,600 operating days per rig, subject to annual minimum imputed activity levels. In certain instances where rigs are inactive for extended periods, however, the Company's depreciation rate is accelerated. Major rig upgrades are depreciated over the remaining useful life of the related component or to the date of the next major upgrade, whichever is sooner. Major rig inspection and overhaul expenditures are depreciated on a straight-line basis over three years.

The decrease in depreciation and amortization expense to $23,959,000 during 2016 from $36,748,000 during 2015 was attributable to fewer operating days in 2016. On a per operating day basis, depreciation increased from $9,153 per operating day in 2015 to $15,135 per operating day in 2016 as a result of more inactive rigs incurring depreciation relating to minimum imputed activity levels in 2016. Drilling rig depreciation accounted for 96% of total depreciation and amortization expense in 2016 (2015 – 97%).

## Selling and Administrative Expenses

| $Millions | 2016 | 2015 | Change | % Change |
|---|---|---|---|---|
| Selling and administrative expenses per financial statements | 12.5 | 15.1 | (2.6) | (17%) |
| Proportionate share of selling and administrative expenses from joint ventures (1) | 0.2 | 0.4 | (0.2) | (50%) |
| Adjusted selling and administrative expenses (1) | 12.7 | 15.5 | (2.8) | (18%) |

*(1) Proportionate share of selling and administrative expenses from joint ventures and adjusted selling and administrative expenses are non-GAAP financial measures. See commentary in "Basis of Analysis in this MD&A, Non-GAAP and Additional GAAP Items on page 27.*

Adjusted selling and administrative expenses decreased to $12,702,000 in 2016 from $15,524,000 in 2015. The reduction in adjusted selling and administrative expenses (as well as selling and administrative expenses per the financial statements) is a direct result of cost cutting measures implemented by the Company impacting the full year of 2016 compared to 2015 when the cost cutting initiatives were started but did not impact the full year. Adjusted selling and administrative expenses equated to 25.5% of adjusted revenue in 2016, compared to 10.7% of adjusted revenue in 2015, as a result of decreased adjusted revenue and the fixed nature of selling and administrative expenses.

The single largest component of adjusted selling and administrative expenses was salaries and benefits which accounted for 55% of these expenses in 2016 (2015 – 57%).

## Asset Impairment

| $Millions | 2016 | 2015 | Change | % Change |
|---|---|---|---|---|
| Asset impairment loss | - | 42.0 | (42.0) | (100%) |

International Accounting Standard 36, "Impairment of Assets", requires an entity to consider both internal and external factors when assessing whether there are indications of asset impairment at each reporting period. At December 31, 2016, there were no internal indicators of impairment and an external indicator of impairment, namely the price of crude oil, still exists. Despite the positive trend in oil prices in the second half of 2016, crude oil prices remained low when compared to 2014. At December 31, 2016, significant market uncertainty still exists as to the extent and duration of the recovery of oil prices. This uncertainty impacts the earnings potential of the Company's cash generating units ("CGUs"), therefore an asset impairment test was performed at December 31, 2016.

The accuracy of asset impairment testing is affected by estimates and judgments in respect of the inputs and parameters that are used to determine recoverable amounts. In performing its asset impairment test at December 31, 2016, management determined value in use for each of its CGUs using estimated discounted cash flows, which included estimates of future cash flows, expectations regarding cash flow variability, a determination of the discount rate and consideration of the recoverable amount and salvage value of each CGU. IFRS considers this approach to constitute a Level 3 hierarchy in its determination of value.

Upon completion of its asset impairment testing, the Company concluded that there was no impairment, nor reversal of previous impairment, required at December 31, 2016.

## Equity Income from Joint Ventures

| $Millions | 2016 | 2015 | Change | % Change |
|---|---|---|---|---|
| Proportionate share of revenue from joint ventures (1) | 17.0 | 32.5 | (15.5) | (48%) |
| Proportionate share of operating and maintenance expenses from joint ventures (1) | 10.7 | 20.8 | (10.1) | (49%) |
| Proportionate share of selling and administrative expenses from joint ventures (1) | 0.2 | 0.4 | (0.2) | (50%) |
| Equity income from joint ventures | 6.1 | 11.3 | (5.2) | (46%) |

*(1) Proportionate share of revenue from joint ventures, proportionate share of operating & maintenance expenses from joint ventures and proportionate share of selling and administrative expenses from joint ventures are Non-GAAP financial measures. See commentary in "Basis of Analysis in this MD&A, Non-GAAP and Additional GAAP Items" on page 27.*

The Company provides the same drilling services and utilizes the same management, financial and reporting controls for its joint venture activities as it does for its wholly-owned operations. The analyses of these activities are incorporated throughout the relevant sections of this MD&A. Joint venture activities are often located in some of the most prospective regions in Canada. Two thirds of AKITA's joint ventures utilize pad drilling rigs.

## Other Income (Loss)

| $Millions | 2016 | 2015 | Change | % Change |
|---|---|---|---|---|
| Total other income (loss) | 1.0 | (0.4) | 1.4 | 350% |

Interest income increased to $965,000 in 2016 from $130,000 in 2015 due primarily to interest accrued ($764,000) on the receivable portions of the contract cancellation revenue referenced earlier. The remainder relates to interest earned on cash balances.

During 2016, the Company recorded interest expense of $163,000 (2015 – $356,000) related to the future cost of the Company's unfunded defined benefit pension plan. Interest expense in 2015 also included interest on the Company's indebtedness which was fully repaid in 2015.

During 2016, the Company disposed of non-core assets resulting in a gain of $90,000. AKITA disposed of several non-core assets in 2015, resulting in a $657,000 loss.

In 2016, amounts reported as "Net Other Gains" of $148,000 included miscellaneous income. In 2015, "Net Other Gains" of $462,000 included $267,000 of foreign exchange amounts related to forward exchange contracts settled in 2015 and miscellaneous income of $195,000.

## Income Tax Expense (Recovery)

| $Millions, except income tax rate (%) | 2016 | 2015 | Change | % Change |
|---|---|---|---|---|
| Current tax recovery | (2.3) | (2.7) | 0.4 | 15% |
| Deferred tax expense (recovery) | 4.5 | (7.9) | 12.4 | 157% |
| Total income tax expense (recovery) | 2.2 | (10.6) | 12.8 | 121% |
| Effective income tax rate | 29.2% | 23.7% | | |

AKITA had an income tax expense of $2,206,000 in 2016 compared to a tax recovery of $10,579,000 in 2015. The change in current tax recovery resulted from a slightly lower loss for tax purposes in the year when comparing 2016 to 2015. The increase in deferred tax is due to an asset impairment expense recorded in 2015 that created a significant deferred tax recovery in 2015.

## Net Income (Loss), Funds Flow and Net Cash from Operating Activities

| $Millions | 2016 | 2015 | Change | % Change |
|---|---|---|---|---|
| Net income (loss) | 5.3 | (34.0) | 39.3 | 116% |
| Funds flow from operations (1) | 34.5 | 38.5 | (4.0) | (10%) |

*(1) Funds flow from operations is an additional GAAP measure under IFRS. See commentary in "Basis of Analysis in this MD&A, Non-GAAP and Additional GAAP Items" on page 27.*

During 2016, the Company recorded net income of $5,329,000 (net earnings of $0.30 per Class A Non-Voting and Class B Common Share (basic and diluted)) compared to a net loss of $33,965,000 (net loss of $1.89 per Class A Non-Voting and Class B Common Share (basic and diluted)) in 2015. Funds flow from operations decreased to $34,500,000 in 2016 from $38,510,000 in 2015.

During the first quarter of 2016, the Company recorded contract cancellation revenue of $28,250,000 ($20,609,000 net of tax) related to the cancellation of a multi-year contract. This contract cancellation revenue had a significant impact on the Company's financial performance, resulting in net income of $5,329,000. Excluding the contract cancellation revenue, the Company generated a net loss from routine operations of $15,280,000 compared to a net loss from routine operations of $3,217,000 in 2015 (net loss $33,965,000 plus $30,748,000 (tax effected asset impairment expense)). Weak market conditions were the primary factor for the significant decrease in results from routine operations. Funds flow from operations was affected by the contract cancellation revenue and weaker market conditions in 2016. Funds flow from operations was not affected by the asset impairment expense in 2015 as this is a non-cash item.

The following table reconciles funds flow from operations and net cash from operating activities:

| $Millions | 2016 | 2015 | Change | % Change |
|---|---|---|---|---|
| Funds flow from operations (1) | 34.5 | 38.5 | (4.0) | (10%) |
| Change in non-cash working capital | (17.4) | 14.9 | (32.3) | (217%) |
| Equity income from joint ventures | (6.1) | (11.3) | 5.2 | 46% |
| Current income tax recovery | (2.3) | (2.7) | 0.4 | 15% |
| Income tax recoverable | 3.3 | 2.4 | 0.9 | 38% |
| Interest paid and other | (0.1) | (0.3) | 0.2 | 67% |
| Net cash from operating activities | 11.9 | 41.5 | (29.6) | (71%) |

*(1) Funds flow from operations is an additional GAAP measure under IFRS. See commentary in "Basis of Analysis in this MD&A, Non-GAAP and Additional GAAP Items" on page 27.*

## Summary of Quarterly Results

The following table shows key selected quarterly financial information for the Company:

| (Dollars in thousands, except per share) | Three Months Ended | | | | |
|---|---|---|---|---|---|
| (Unaudited) | Mar. 31 | Jun. 30 | Sep. 30 | Dec. 31 | Annual Totals |
| **2016** | | | | | |
| **Revenue** | **41,991** | **3,646** | **6,616** | **8,808** | **61,061** |
| **Net income (loss)** | **18,173** | **(4,062)** | **(4,668)** | **(4,114)** | **5,329** |
| **Earnings (loss) per share (basic and diluted) ($)** | **1.01** | **(0.23)** | **(0.26)** | **(0.23)** | **0.30** |
| **Funds flow from operations (1)** | **25,368** | **2,688** | **2,197** | **4,247** | **34,500** |
| **Cash flow from (used in) operations** | **12,843** | **2,219** | **(2,158)** | **(1,012)** | **11,892** |
| 2015 | | | | | |
| Revenue | 46,715 | 22,536 | 22,021 | 21,216 | 112,488 |
| Net income (loss) | 4,218 | (1,620) | (7,581) | (28,982) | (33,965) |
| Earnings (loss) per share (basic and diluted) ($) | 0.23 | (0.09) | (0.42) | (1.61) | (1.89) |
| Funds flow from operations (1) | 14,059 | 9,072 | 8,225 | 7,154 | 38,510 |
| Cash flow from operations | 6,015 | 25,011 | 6,325 | 4,156 | 41,507 |
| 2014 | | | | | |
| Revenue | 54,342 | 28,365 | 36,556 | 46,011 | 165,274 |
| Net income | 10,150 | 2,081 | 3,854 | 4,994 | 21,079 |
| Earnings per share (basic and diluted) ($) | 0.57 | 0.12 | 0.21 | 0.27 | 1.17 |
| Funds flow from operations (1) | 17,665 | 10,609 | 10,942 | 16,979 | 56,195 |
| Cash flow from operations | 5,127 | 28,789 | 4,641 | 2,065 | 40,622 |

*(1) Funds flow from operations is an additional GAAP measure under IFRS. See commentary in "Basis of Analysis in this MD&A, Non-GAAP and Additional GAAP Items" on page 27.*

Key trends over the past 12 quarters, after giving consideration to the seasonal nature of AKITA's operations, are as follows:

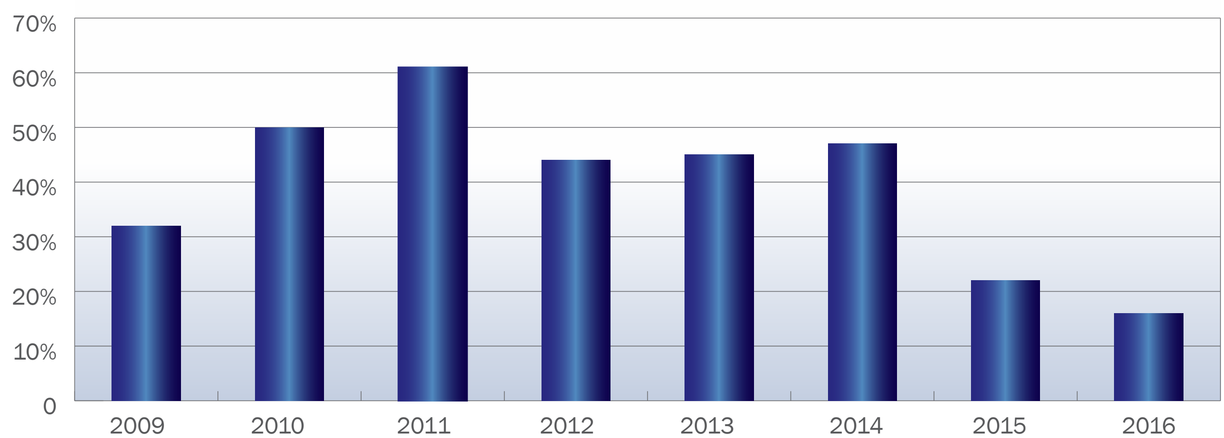
- Activity levels, which are directly correlated to revenue, net income and funds flow from operations(1) peaked in Q1 2014 and have been steadily declining since then, with 2015 Q2 to Q4 seeing little seasonal fluctuation and 2016 having the lowest activity in Q2 and a gradual strengthening in Q3 and Q4 but still well below historical averages;
- Adjusted operating margin(2) per operating day which influences both net income and funds flow from operations(1) had been generally decreasing during 2015 and 2016 due to an overall change in rig mix. During 2016, weak market conditions resulted in a general decline for adjusted operating margins per operating day; and
- Net cash from operating activities is not directly correlated to market strength on a quarterly basis. Changes in the balance of this account are tied to the timing of changes in various non-cash working capital accounts.

*(1) Funds flow from operations is an additional GAAP measure under IFRS. See commentary in "Basis of Analysis in this MD&A, Non-GAAP and Additional GAAP Items" on page 27.*

*(2) Adjusted operating margin is the difference between adjusted revenue and adjusted operating & maintenance expenses.*

## Fourth Quarter Analysis

**Q4 Canadian Drilling Rig Utilization**




During the fourth quarter of 2016, rig activity for the Company achieved 491 operating days compared to 656 operating days during the corresponding period in 2015. The decrease in operating days compared to the corresponding quarter in 2015 was due to lower activity for both conventional and pad rigs, although on a proportionate basis, conventional rigs were affected more severely. The decrease in the quarterly operating days resulted in lower revenue of $8,808,000 ($14,288,000 on an adjusted revenue basis) when compared to fourth quarter 2015 revenue of $21,216,000 ($26,888,000 on an adjusted revenue basis). Lower revenue per operating day also impacted the Company's total revenue, as adjusted revenue per operating day decreased to $29,100 in the fourth quarter of 2016, compared to $40,988 adjusted revenue per operating day in 2015. This decrease can be attributable to both a change in the rig mix as well as industry pricing pressures. Operating and maintenance expenses decreased during the fourth quarter of 2016 to $11,341,000 on an adjusted basis from $18,457,000 on an adjusted basis during the corresponding quarter of 2015, as a result of lower rig activity in the fourth quarter of 2016. On a per operating day basis, operating and maintenance expenses dropped 18% from 2015 to 2016 as a result of the rig mix and cost cutting initiatives. This decrease on a per operating day basis was smaller than the 29% decrease in revenue per operating day and therefore operating margin per operating day decreased to $6,002 per operating day in 2016 from $12,852 in 2015, representing a 53% reduction in operating margin per operating day.

Please refer to "Basis of Analysis in this MD&A, Non-GAAP and Additional GAAP Items on page 27 for commentary on adjusted revenue, adjusted operating and maintenance expenses and adjusted margin.

AKITA incurred a net loss of $4,114,000 (net loss of $0.23 per Class A Non-Voting and Class B Common Share (basic and diluted)) for the fourth quarter of 2016 compared to a net loss of $28,982,000 or $1.61 loss per share (basic and diluted) in the fourth quarter of 2015. Funds flow from operations decreased to $4,247,000 in the fourth quarter of 2016 from $7,154,000 in the corresponding quarter in 2015. The fourth quarter of 2015 included an asset impairment loss of $33,768,000, while no asset impairment occurred in 2016.

At December 31, 2016, AKITA had $34,907,000 in working capital (working capital ratio of 4.49:1) including $14,250,000 in cash, compared to a working capital of $16,002,000 (working capital ratio of 2.45:1) and $9,369,000 cash for the previous year.

## Three Year Annual Financial Summary

The following table highlights AKITA's annual financial results for the last three years:

**Three Year Summary**

| ($Thousands, except per share) (Unaudited) | 2016 | 2015 | 2014 |
|---|---|---|---|
| Revenue | 61,061 | 112,488 | 165,274 |
| Net income (loss) | 5,329 | (33,965) | 21,079 |
| Earnings (loss) per share (basic and diluted) | 0.30 | (1.89) | 1.17 |
| Dividends per Class A Non-Voting and Class B Common share | 0.34 | 0.34 | 0.34 |
| Funds flow from operations (1) | 34,500 | 38,510 | 56,195 |
| Net cash from operating activities | 11,892 | 41,507 | 40,622 |
| Year-end working capital (deficiency) | 34,907 | 16,002 | (5,028) |
| Year-end shareholders' equity | 219,646 | 220,200 | 259,841 |
| Year-end total assets | 257,907 | 254,516 | 340,926 |

*(1) Funds flow from operations is an additional GAAP measure under IFRS. See commentary in "Basis of Analysis in this MD&A, Non-GAAP and Additional GAAP Items" on page 27.*

## Liquidity and Capital Resources

At December 31, 2016, AKITA had $34,907,000 in working capital including $14,250,000 in cash and no bank indebtedness, compared to a working capital of $16,002,000, including $9,369,000 in cash at December 31, 2015. In 2016, AKITA generated $11,892,000 cash from operating activities. Cash was also generated from joint venture distributions ($6,753,000), from reductions in cash balances restricted for loan guarantees ($3,009,000) and from proceeds on sales of assets ($202,000). During the same period, cash was used for capital expenditures ($10,775,000)(1) and payment of dividends ($6,100,000)(1).

*(1) Readers should be aware that the use of cash in any given period for capital expenditures or payment of dividends does not necessarily coincide with the accounting treatment when reported on an accrual basis.*

The Company chooses to maintain a conservative Statement of Financial Position due to the cyclical nature of the industry. In addition to its cash balances, the Company has an operating loan facility with its principal banker totalling $100,000,000 that is available until 2020. The interest rate on the facility varies based upon the actual amounts borrowed and ranges from 0.45% to 1.45% over prime interest rates or 1.45% to 2.45% over guaranteed notes, depending on the preference of the Company. The Company did not have any borrowings from this facility at December 31, 2016 or December 31, 2015.

As part of the loan facility agreement, the Company must adhere to the following financial covenants:

- Funded debt to EBITDA shall not be greater than 3.00 to 1;
- EBITDA to interest expense shall not be less than 3.00 to 1; and
- Tangible assets to funded debt shall not be less than 2.25 to 1.

Readers should be aware that each of funded debt, EBITDA, interest expense and tangible assets have specifically set out definitions in the loan facility agreement and are not necessarily defined by or consistent with either GAAP or determinations by other users for other purposes.

From time to time, the Company makes major purchases from non-Canadian suppliers in connection with its capital expenditures. AKITA purchases forward currency contracts in order to minimize the risk of currency translation adjustments associated with these purchases. At December 31, 2016 and 2015, the Company did not have any forward currency contracts.

The Company did not have an outstanding normal course issuer bid during 2016 or 2015.

The following table provides a summary of contractual obligations for the Company:

| **Contractual Obligations**<br>$Thousands | **Total** | Less than 1 year | 1 – 3 years | 4 – 5 years | After 5 years |
|---|---|---|---|---|---|
| Operating leases (1) | **2,545** | 837 | 1,708 | Nil | Nil |
| Purchase obligations | **650** | 325 | 325 | Nil | Nil |
| Capital expenditure commitments | **827** | 827 | Nil | Nil | Nil |
| Long-term pension obligations | **4,303** | Note | Note | Note | Note |
| Total contractual obligations | **8,325** | 1,989 | 2,033 | Nil | Nil |

*(1) In 2016, the annual cost for this lease is $773,000. The lease expires on December 31, 2019.*

*Note: Timing of pension payments is dependent upon retirement dates for respective employees. The cost for year one ranges from $90,000 to $191,000, for year two from $90,000 to $242,000 and from year 3 and beyond, $90,000 to $315,000.*

## Property, Plant and Equipment

Capital expenditures totalled $13,193,000 in 2016 ($17,960,000 in 2015). Capital spending in 2016 was as follows; $4,723,000 for certifications and overhauls, $1,776,000 for drill pipe and drill collars, $3,206,000 for rig equipment and upgrades and $3,361,000 in loans and payables assumed by the Company upon the acquisition of three joint venture partners' percentage ownership of two joint venture rigs. The balance of capital expenditures was for other equipment. The cost incurred during 2015 for capital was $9,727,000 for completion of a rig construction project, $3,878,000 for certifications and overhauls, $2,544,000 in rig equipment for existing rigs, $1,490,000 for drill pipe and drill collars and $321,000 on other equipment.

During 2016, the Company sold ancillary assets for $202,000 that resulted in a gain of $90,000. During 2015, AKITA sold ancillary assets for $1,093,000 for a loss of $657,000.

## Financial Instruments

The Company's financial assets and liabilities include cash, accounts receivable, restricted cash, accounts payable, accrued liabilities and financial instruments. Fair values approximate carrying values unless otherwise stated.

The Company is exposed to changes in foreign exchange rates as the cost of capital expenditures or financial instruments priced in foreign currency may fluctuate due to changing rates. To mitigate this risk, from time to time, the Company enters into foreign exchange forward contracts. The Company uses hedges only for the purpose of reducing foreign currency exposure and does not use hedges for speculative or other purposes. The Company did not have any forward exchange contracts in place at December 31, 2016 or 2015.

Despite the effect of weak commodity prices for crude oil and natural gas on AKITA's customers, management continues to consider the credit risk associated with accounts receivable to be generally low as substantially all counterparties are well-established and financed oil and gas companies. AKITA has conservative credit-granting procedures and in certain situations requires customers to make advance payment prior to provision of services or takes other measures to mitigate credit risk. Provisions have been estimated by management and are included in the accounts to recognize potential bad debts.

## Off Balance Sheet Transactions

AKITA has not entered into any arrangements that involve off balance sheet transactions.

## Related Party Transactions

AKITA is affiliated with the ATCO Group of companies and with Spruce Meadows, an equestrian show jumping facility, through its majority shareholder. All related party transactions in 2016 and 2015 were made in the normal course of business with regular payment terms and have been recorded at the paid amounts. Operating purchases totalled $436,000 and included sponsorship and advertising ($351,000) and other miscellaneous purchases ($85,000). At December 31, 2016, the remaining commitment of the Company's multi-year sponsorship and advertising contract with Spruce Meadows was $650,000. Costs incurred related to this contract during 2016 were $325,000 (2015 - $325,000). Costs and related services are consistent with parties dealing at arm's length.

The Company incurred legal fees of $42,000 (December 31, 2015 - $59,000) during the year for services related to various legal matters with a law firm of which a director of the Company was a partner at December 31, 2016. At December 31, 2016, $1,200 (December 31, 2015 - $1,000) of this amount was included in accounts payable.

The Company is related to its joint ventures. The accompanying table summarizes transactions and annual balances with its joint ventures. These transactions were made in the normal course of business with regular payment terms and have been recorded at the paid amounts.

| $Thousands | 2016 | 2015 |
|---|---|---|
| Revenue | 111 | 30 |
| Operating and maintenance expenses | 2,241 | 4,866 |
| Selling and administrative expenses | 289 | 553 |
| Year-end accounts payable | 1,180 | 1,872 |

## Class A and Class B Share Dividends

| Per share | 2016 | 2015 | Change | % Change |
|---|---|---|---|---|
| Dividends per share ($) | 0.34 | 0.34 | 0.00 | 0% |

During 2016, AKITA declared dividends totalling $6,100,000 ($0.34 per share) on its Class A Non-Voting Shares and Class B Common Shares, compared to $6,101,000 ($0.34 per share) for 2015. The payment of any dividends is at the discretion of the Board of Directors and depends upon the financial condition of AKITA and other factors. Since the inception of the quarterly dividend program in 1997, dividends have been paid in each quarter of every year and the dividend rate has never been decreased. The most recent dividend was declared on March 3, 2017 with a dividend rate of $0.085 per share.

## Class A Non-Voting and Class B Common Shares

**Authorized**
An unlimited number of Class A Non-Voting Shares
An unlimited number of Class B Common Shares

| **Issued** | Class A Non-Voting | | Class B Common | | Total | |
|---|---|---|---|---|---|---|
| $Thousands (except per share and option amounts) | Number of Shares | Consideration | Number of Shares | Consideration | Number of Shares | Consideration |
| December 31, 2015 | 16,291,877 | 22,505 | 1,653,784 | 1,366 | 17,945,661 | 23,871 |
| December 31, 2016 | 16,291,877 | 22,505 | 1,653,784 | 1,366 | 17,945,661 | 23,871 |
| Exercisable options at Dec. 31, 2016 | 586,000 | | | | | |
| Unexercisable options at Dec. 31, 2016 | 293,500 | | | | | |

At March 3, 2017, the Company had 16,291,877 Class A Non-Voting Shares and 1,653,784 Class B Common Shares outstanding. At that date, there were also 879,500 stock options outstanding, of which 586,000 were exercisable.

## Accounting Estimates

The preparation of AKITA's consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent liabilities as at the date of the consolidated financial statements as well as reported amounts for revenue and expenses for the year. Estimates and judgments are continually evaluated and are based upon historical experience and other factors including expectations of future events that are believed to be reasonable in the circumstances. Actual outcomes could differ materially from these estimates.

The Company makes assumptions relating to transactions that were incomplete at the Statement of Financial Position date. Depending on the actual transaction, total assets and liabilities of the Company as well as results of operations including net income could be either understated or overstated as a result of differences between amounts accrued for incomplete transactions and the subsequent actual balances.

The preparation of AKITA's consolidated financial statements requires management to make significant estimates relating to the useful lives of drilling rigs. Drilling rigs are depreciated using the unit of production method. Depreciation is calculated using a detailed approach based on major components, and typically results in an average useful life of 3,600 operating days per rig, subject to annual minimum imputed activity levels. In certain instances in which rigs are inactive for extended periods, however, the depreciation rate is accelerated.

AKITA's depreciation estimates do not have any effect on the changes to financial condition for the Company, as depreciation is a non-cash item. However, total assets and results of operations, including net income, could be either understated or overstated as a result of excessively high or low depreciation estimates.

At each reporting date, the Company assesses whether there are indicators of asset impairment. If such indicators exist, the Company performs an asset impairment test, and if required, recognizes an impairment loss calculated as the lesser of the difference between the amortized cost of the asset and the present value of the estimated future cash flows or the recoverable amount. The carrying amount of the asset is reduced by the impairment loss. Please refer to the section "Asset Impairment" on page 12 for further information.

AKITA's asset impairment estimates do not have any effect on the changes to financial condition for the Company, as any asset write-down would be a non-cash item. However, total assets and results of operations including net income could be overstated as a result of projections of discounted future cash flows that are too high.

A significant estimate used in the preparation of AKITA's consolidated financial statements relates to the long-term defined benefit pension liability for certain employees and retired employees that was recorded as $4,303,000 at December 31, 2016 (2015 - $3,794,000). Changes in AKITA's pension liability estimates do not have any effect on the changes to financial condition for the Company, since the defined benefit pension is a non-cash item. However, total liabilities and results of operations including net income could be either understated or overstated as a result of pension estimates that are either too high or too low. AKITA utilizes the services of a third party to assist in the actuarial estimate of the Company's pension expense and liability. For 2016, a key assumption is the 3.6% discount rate (2015 – 3.9%).

The Company makes assumptions relating to deferred income taxes, including future tax rates, timing of reversals of timing differences and the anticipated tax rules that will be in place when timing differences reverse. Consequently, total liabilities of the Company as well as results of operations including net income could be either understated or overstated.

## Commitments

From time to time, the Company may provide guarantees for bank loans to joint venture partners in respect of sales of rig interests to joint venture partners. At December 31, 2016, AKITA provided $2,969,000 in deposits with its bank for those purposes (December 31, 2015 - $5,978,000). These funds have been classified as "restricted cash" on the Consolidated Statements of Financial Position.

## Business Risks and Risk Management

The following information is a summary only of certain risk factors relating to the business of AKITA and should be read in conjunction with the detailed information appearing elsewhere in this document. Shareholders and potential shareholders should consider carefully the information contained herein including the following risk factors.

**Competition**

The contract drilling industry is highly competitive and includes a large number of drilling contractors with varied rig fleets. Drilling contracts are usually awarded through a competitive bid process with pricing and rig suitability and availability being primary drivers in the bid process. Other factors that influence the bid process include: proximity of rig to drilling program, mobility and efficiency of the rig; experience and quality of service provided by rig crews; safety record of the rig as well as the contractor as a whole; and the adaptability of equipment to utilize new technologies. Rigs can be moved from one region to another depending on the competitive environment within that region and therefore a contractor's competitive advantage in a region can be quickly eroded by other contractors moving in equipment from other regions. Reduced levels of activity in the oil and gas industry can also increase competition and therefore lower day rates.

AKITA has a diversified fleet of rigs that compete in most major Canadian market segments. The Company has developed and maintains a comprehensive set of standards in terms of equipment design, quality assurance and quality control programs and operating procedures. Customer relations is an important aspect to a service-based business and AKITA has always emphasized having a strong set of business relationships with customers that are active throughout all phases of the business cycle. Often, these customers are some of the largest oil and gas producers that operate in the Western Canadian market.

AKITA continually upgrades its drilling fleet to ensure that it is able to meet ongoing and evolving customer requirements. The Company has a rigorous ongoing maintenance program designed to minimize rig down time and maximize customer satisfaction. AKITA is also API Q2 certified, a quality management system developed by the American Petroleum Institute. AKITA operates its rigs utilizing employees that are well trained, knowledgeable and motivated to comply with the highest safety standards. AKITA uses a comprehensive set of training programs to help to achieve this result.

**Dependence on Major Customers**

In 2016, AKITA earned 46.2% of total adjusted revenue from three major customers. These were the only customers who individually provided over 10% of the Company's adjusted revenue for the 2016 fiscal year. The loss of one or more major customers or a significant reduction in the business done with any customer without offsetting new revenue could have a material adverse effect on AKITA's business, results of operations and prospects.

**Seasonal Nature of Industry**

In Canada, the level of activity in the contract drilling industry, particularly for conventional rigs, is influenced by seasonal weather patterns. Spring break-up, which typically occurs between mid-March and mid-June, makes the ground unstable leaving many secondary roads temporarily incapable of supporting the weight of heavy equipment, thereby reducing drilling activity levels. In addition, during excessively rainy periods, equipment moves may be delayed, thereby adversely affecting revenue.

Typically, there is greater demand for contract drilling services in the winter drilling season as freezing permits the movement and operation of heavy equipment. Drilling activities tend to increase in the fall as the ground begins to freeze and peak in the winter months of November through February as areas having muskeg conditions also become accessible to drilling operations. Variability in the weather can therefore create unpredictability in activity and rig utilization rates. Unseasonably warm weather, which could limit access to drilling sites, could have a material adverse effect on the Company's business, financial condition, results of operations and cash flows.

AKITA's mitigation strategies to reduce the impact of seasonality include the strategic positioning of conventional rigs within its markets to reduce this impact, particularly at the end of each winter drilling season. Pad rigs are less susceptible to the seasonal nature of the industry as they are typically capable of continuing their drilling programs once they are rigged up on a pad.

**Volatility of Industry Conditions**

The demand, pricing and terms for contract drilling services are dependent upon the level of industry activity for Canadian crude oil and natural gas exploration and development. Industry conditions are influenced by numerous factors which AKITA does not control including (without limitation): current crude oil and natural gas prices; expectations about future crude oil and natural gas prices; the cost of exploring for, producing and delivering crude oil and natural gas; the expected rates of decline in current production for AKITA's customers; discovery rates of new oil and gas reserves by AKITA's customers; available pipeline and other oil and gas transportation capacity; weather conditions; political, regulatory and economic conditions; influences from special interest groups; the use of energy generated from sources that are not crude oil or natural gas based; the ability of oil and gas companies to raise equity capital or debt financing; and technological advances in the exploration and production of crude oil and natural gas.

The level of activity in the Canadian oil and gas exploration and production industry is volatile. No assurance can be given that the expected trends in oil and gas exploration and production activities will continue or that demand for contract drilling services will reflect the level of activity in the industry. Current global economic events and uncertainty have significantly affected, and may continue to significantly affect, commodity pricing. Any prolonged substantial reduction in crude oil and natural gas prices would likely continue to affect oil and gas production levels and therefore adversely affect the demand for drilling services by oil and gas customers. Any elimination or curtailment of government incentives or adverse changes in government regulation could have a significant impact on the contract drilling industry in Canada or in individual provinces. These factors could lead to a further decline in demand for AKITA's services which would result in a material adverse effect on AKITA's business, financial condition, results of operations and cash flow.

The Company's Board of Directors and management are cognizant of the potentially volatile nature of the industry in which AKITA operates. Consequently, the financial affairs of the Company are managed in a conservative fashion, including maintaining a conservative Statement of Financial Position. Major capital expenditures are frequently tied to long-term contracts to minimize the risk of capital not being recovered on a timely basis.

**Drilling Rig Technology**

Complex drilling programs for the exploration and development of conventional and unconventional crude oil and natural gas reserves in North America demand high performance drilling rigs. The ability of contract drilling companies to meet this demand will depend upon continuous improvement of technology, such as move systems, control systems, automation, drive systems, mud systems and top drives designed to improve drilling efficiency. AKITA's ability to deliver equipment and services that are more efficient than those of its competitors is important to its continued success. There is no assurance that competitors will not achieve technological improvements that are more advantageous, timely or cost efficient than improvements developed by AKITA.

AKITA has not sought or obtained patent or similar protection in respect of any drilling rigs, equipment or technology it has developed independently. In the future, AKITA may seek patents or other similar protections in respect of particular equipment and technology, however, there are no assurances that AKITA will be successful in such efforts. Competitors may also develop similar equipment and technology to that of AKITA thereby adversely affecting AKITA's competitive advantage. Additionally, there can be no assurance that certain equipment or technology developed by AKITA may not be subject to future patent infringement claims or other similar matters which could result in litigation, the requirement to pay licensing fees or other results that could have a material adverse effect on the business, results of operations and financial condition of AKITA.

**Labour**

The contract drilling industry is dependent upon attracting, developing and maintaining a skilled and safe workforce. During periods of peak activity levels, AKITA may be faced with a lack of sufficient personnel to operate AKITA's equipment. AKITA is also faced with the challenge of retaining employees during periods of low utilization. The Company's financial results depend, at least in part, upon its ability to attract, develop and maintain a skilled work force, while maintaining a cost structure that varies with activity levels. In the recent downturn, the Company mitigated this labour risk by employing a crew retention program, whereby additional crews were rotated on active rigs, to ensure the Company was well positioned for recovery.

A number of AKITA's key customers evaluate the ability of contract drilling companies to provide and maintain a high standard of safe operations prior to selecting a drilling contractor for the provision of drilling services. AKITA's financial success is related to its ability to continue to meet those expectations.

**Capital Overbuild in Contract Drilling Industry**

Drilling rigs have a long life span. Further, there is a significant lag between the time a decision to build a rig is made and when construction is complete. These two factors contribute to the supply of rigs in the industry not always aligning with the demand for drilling rigs. High demand typically spurs greater capital expenditures by drilling contractors which may, in turn, lead to excessive supply in future periods. A potential capital overbuild could lead to a general reduction in utilization and revenue rates in the industry as a whole, which would have a material effect on AKITA's business, financial condition, results of operations and cash flows.

**Access to Additional Financing**

AKITA may find it necessary in the future to obtain additional debt or equity financing to support ongoing operations, undertake capital expenditures or undertake acquisitions or other business combination activities. There can be no guarantee that AKITA will have access to the required capital as it's ability to do so is dependent on, among other factors, the overall state of capital markets, interest rates, the state of the oil and gas industry, as well as the appetite for investment in the oilfield drilling industry. An inability to obtain necessary financing on terms that are acceptable to AKITA could limit AKITA's growth and could have a material adverse effect on AKITA's business, financial conditions and future cash flows.

**Environmental Regulations**

AKITA's operations are subject to numerous laws, regulations and guidelines governing the management, transportation and disposal of hazardous substances and other waste materials and otherwise relating to the protection of the environment and health and safety. These laws, regulations and guidelines include those relating to spills, releases, emissions and discharges of hazardous substances or other waste materials into the environment, requiring removal or remediation of pollutants or contaminants and imposing civil and criminal penalties for violations. Some of the laws, regulations and guidelines that apply to AKITA's operations also authorize the recovery of natural resource damages by the governmental authorities, injunctive relief and the imposition of stop, control, remediation and abandonment orders. The costs arising from compliance with such laws, regulations and guidelines may be material to AKITA. The trend in environmental regulation has been to impose more restrictions and limitations on activities that may impact the environment, including the generation and disposal of wastes and the use and handling of chemical substances. These restrictions and limitations have increased operating costs for both AKITA and AKITA's customers. Any regulatory changes that impose additional environmental restrictions or requirements on AKITA or AKITA's customers could adversely affect AKITA through either increased operating costs, decreased demand for AKITA's services, or both.

Certain oilfield related activities have been controversial. In recent years, development of oil sands, the use of hydraulic fracturing on sedimentary rock formations and transportation of crude oil and natural gas each encountered opposition. Curtailment or cancellation of these types of activities could reduce demand for AKITA's services.

While AKITA maintains liability insurance, including insurance for environmental claims, there can be no assurance that insurance will continue to be available to AKITA on commercially reasonable terms, that the possible types of liabilities that may be incurred by AKITA will be covered by AKITA's insurance, or that the dollar amount of such liabilities will not exceed AKITA's policy limits. Even a partially uninsured claim, if successful and of sufficient magnitude, could have a material adverse effect on AKITA's business, results of operations and prospects.

**Key Management**

The success and growth of AKITA are dependent upon AKITA's key management personnel. The loss of services of any such persons without suitable replacements could have a material adverse effect on the business and operations of the Company. While this risk is mitigated by ongoing succession planning, no assurance can be provided that AKITA will be able to retain key management members.

**Risk Management**

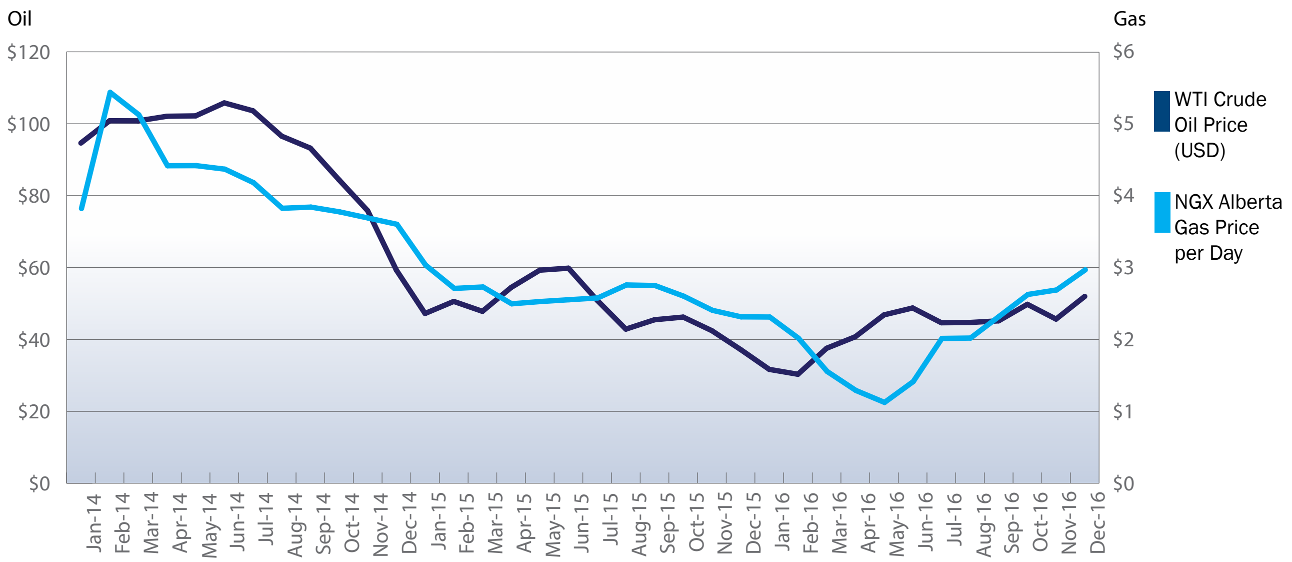
AKITA manages its risks by:

- maintaining a conservative Statement of Financial Position that includes a low cost structure for the Company including limited use of financial leverage;
- having its Risk Management committee deliberate periodically to assess, evaluate and develop a plan to deal with the risk conditions for the Company;
- developing an annual strategic business plan and budget to help determine the levels of capital and operating expenditures;
- continuously developing long-term relationships with a core base of customers who maintain ongoing drilling programs during all phases of the economic cycle;
- obtaining multi-year rig contracts whenever possible, but especially when tailoring rig construction or reconfiguration to customer demand;
- maintaining an efficient fleet of rigs through a meticulous ongoing maintenance program;
- continually upgrading its rig fleet;
- employing well-trained, experienced and responsible employees;
- ensuring that all employees comply with clearly defined safety standards;
- improving the skills of its employees through training programs;
- maintaining effective systems of internal control to safeguard assets and ensure timely and accurate reporting of financial results;

- maintaining comprehensive insurance policies with respect to its operations;
- reducing environmental risk through the implementation of industry-leading standards, policies and procedures; and
- developing and maintaining succession plans to provide for smooth transitions in the event of key personnel turnover.

## Future Outlook and Strategy

The drilling industry is cyclical and certain key factors that have an impact on AKITA's results are beyond management's control. Like other drilling contractors, AKITA is exposed to the effects of fluctuating oil and gas prices and changes in the exploration and development budgets of its customers.




The effect of extended low commodity prices for crude oil and natural gas have been significant on the drilling industry, as reduced capital spending by oil and gas companies has resulted in fewer opportunities in the drilling industry and significant pricing pressure on day rates. The downward trend in the prices of crude oil and natural gas that began in 2014 has shown signs of stabilizing and even reversing slightly over the second half of 2016 as can be seen in the above chart. This slight upward trend has increased demand in all rig categories from the latter half of 2015 and the first half of 2016. Although this increase in demand is a positive sign, there is still significant uncertainty as to the longer term pricing trend in commodity prices.

Management anticipates that 2017 will be another challenging year for the Company and the drilling industry as a whole. Increased activity may result in crew shortages in the industry, as many workers have left the industry. Also, there will be capital spending requirements to reactivate rigs that have been down for extended periods. The most significant factor that will impact 2017 financial performance will be the day rates that rigs are able to achieve. Over the last two years, the erosion of day rates has been significant, resulting in spot day rates that are at or below cost. Before there is a meaningful recovery in day rates, there will have to be a threshold of rigs operating in the industry. Despite increased activity forecast for 2017, this threshold may not be reached in the coming year, causing margins to remain low.

AKITA has a number of key strengths that will help improve the opportunities available to the Company in the coming year, including:

- financial flexibility to pursue opportunities that may require significant capital investment in rig upgrades. At December 31, 2016, AKITA had $34,907,000 in working capital including a considerable cash balance and no long-term debt or bank borrowings. Further, the Company has access to a $100,000,000 bank facility, if required, in the event that an opportunity is identified that will provide for growth;
- a large fleet of pad triples specifically designed for heavy oil drilling, a segment of the market that is anticipated to be very active this year;
- the ability to crew the rigs expected to go to work in 2017 with experienced crews as a result of retention programs undertaken during the market slowdown;
- strong customer relationships with a core group of customers that are capable of operating in all portions of the business cycle.

## Disclosure Controls and Internal Controls Over Financial Reporting

As of December 31, 2016, the Company's management evaluated the effectiveness of the Company's disclosure controls and procedures as required by the Canadian Securities Administrators ("CSA"). This evaluation was performed under the supervision of, and with the participation of the President and Chief Executive Officer ("CEO") and the Vice President, Finance and Chief Financial Officer ("CFO").

Disclosure controls and procedures are designed to provide reasonable assurance that information required to be disclosed in documents filed with the securities regulatory authorities is recorded, processed, summarized and reported on a timely basis. The controls also seek to assure that this information is accumulated and communicated to management, including the CEO and CFO, as appropriate, to allow timely decisions on required disclosure.

Based on this evaluation, the CEO and CFO have concluded that the Company's disclosure controls and procedures were effective at December 31, 2016.

As of December 31, 2016, management evaluated the effectiveness of the Company's internal control over financial reporting as required by the CSA. This evaluation was performed utilizing the framework developed by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO Framework"), as revised effective May 14, 2013 under the supervision of, and with the participation of the CEO and CFO.

The Company's internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements in accordance with IFRS.

Based on this evaluation, the CEO and CFO have concluded that the Company's internal control over financial reporting was effective at December 31, 2016.

There was no change in the Company's internal control over financial reporting that occurred during the period that began on October 1, 2016 and ended December 31, 2016 that materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting. There was also no change in the Company's internal control over financial reporting that has occurred since December 31, 2016.

## Basis of Analysis in the MD&A, Non-GAAP and Additional GAAP Items

The Company reports its joint venture activities in the financial statements in accordance with IFRS 11 "Joint Arrangements". In determining the classification of its Joint Arrangements, AKITA considers whether the Joint Arrangements are structured through separate vehicles, if the legal form of the separate vehicles confers upon the parties direct rights to assets and obligations for liabilities relating to the Joint Arrangements, whether the contractual terms between the parties confer upon them rights to assets and obligations for liabilities relating to the arrangements as well as if other facts and circumstances lead to rights for assets and obligations for liabilities being conferred upon the parties to the Joint Arrangement prior to concluding that AKITA's joint ventures are properly classified as joint ventures rather than joint operations. Under IFRS 11, AKITA is required to report its joint venture assets, liabilities and financial activities using the equity method of accounting. However, for purposes of analysis in this MD&A, the proportionate share of assets, liabilities and financial activities is included as non-GAAP financial measure ("Adjusted") where appropriate. The Company provides the same drilling services and utilizes the same management, financial and reporting controls for its joint venture activities as are in place for its wholly-owned operations. None of AKITA's joint ventures are individually material in size when considered in the context of AKITA's overall operations.

Adjusted operating margin, adjusted revenue per operating day, adjusted operating and maintenance expenses per operating day and adjusted operating margin per operating day are not recognized GAAP measures under IFRS. Management and certain investors may find such operating margin data to be a useful measurement tool, as it provides an indication of the profitability of the business prior to the influence of depreciation, overhead expenses, financing costs and income taxes. Management and certain investors may find "per operating day" measures for adjusted revenue and adjusted operating margin indicate pricing strength while adjusted operating and maintenance expenses per operating day demonstrates a degree of cost control and provides a proxy for specific inflation rates incurred by the Company. Readers should be cautioned that in addition to the foregoing, other factors, including the mix of rigs that are utilized between conventional and pad and singles, doubles and triples can also influence these results. Readers should also be aware that AKITA includes standby revenue in its determination of "per operating day" results.

Funds flow from operations is considered an additional GAAP item under IFRS. AKITA's method of determining funds flow from operations may differ from methods used by other companies and includes cash flow from operating activities before working capital changes, equity income from joint ventures, and income tax amounts paid or recovered during the period. Management and certain investors may find funds flow from operations to be a useful measurement to evaluate the Company's operating results at year-end and within each year, since the seasonal nature of the business affects the comparability of non-cash working capital changes both between and within periods.

## Forward-Looking Statements

From time to time AKITA makes forward-looking statements. These statements include but are not limited to comments with respect to AKITA's objectives and strategies, financial condition, results of operations, the outlook for industry and risk management discussions.

By their nature, these forward-looking statements involve numerous assumptions, inherent risks and uncertainties, both general and specific, and therefore carry the risk that the predictions and other forward-looking statements will not be realized. Readers of this MD&A are cautioned not to place undue reliance on these statements as a number of important factors could cause actual future results to differ materially from the plans, objectives, estimates and intentions expressed in such forward-looking statements.

Forward-looking statements may be influenced by factors such as the level of exploration and development activity carried on by AKITA's customers; world crude oil prices and North American natural gas prices; global liquified natural gas (LNG) demand; weather; access to capital markets; and government policies. We caution that the foregoing list of factors is not exhaustive and that while relying on forward-looking statements to make decisions with respect to AKITA, investors and others should carefully consider the foregoing factors as well as other uncertainties and events prior to making a decision to invest in AKITA. Except where required by law, the Company does not undertake to update any forward-looking statement, whether written or oral, that may be made from time to time by it or on its behalf.

## Upcoming Accounting Standard Changes

Certain new or amended standards or interpretations have been issued by the International Accounting Standards Board ("IASB") or the International Financial Reporting Interpretations Committee ("IFRIC") that are not required to be adopted in the current period. The Company has not early adopted these standards or interpretations. The standards which the Company anticipates may have a material effect on the consolidated financial statements or note disclosures are described below. The Company is currently evaluating the impact of these new standards on its financial statements.

IFRS 9, "Financial Instruments", amends the classification and measurement of financial assets and introduces a new expected loss impairment model. This standard is effective for annual periods beginning on or after January 1, 2018, and shall be applied retrospectively.

IFRS 15, "Revenue from Contracts with Customers", replaces the previous guidance on revenue recognition and provides a framework to determine when to recognize revenue and at what amount. The new standard is effective for annual periods beginning on or after January 1, 2018, and shall be applied retrospectively.

IFRS 16, "Leases" replaces the previous guidance on leases and sets out the principles for the recognition, measurement, presentation, and disclosure of leases for both parties to a contract. The new standard is effective for annual periods beginning on or after January 1, 2019, and shall be applied retrospectively.

There are no other standards or interpretations that have been issued, but are not yet effective, that the Company anticipates will have a material effect on the consolidated financial statements once adopted.

## Other Information

Additional information is provided by the Company in its Annual Information Form, Notice of Annual Meeting and Information Circular all dated March 3, 2017. Copies of these documents including additional copies of the Annual Report for the year ended December 31, 2016 may be obtained upon request from the Vice President, Finance and Chief Financial Officer of the Company at 1000, 311 – 7th Avenue S.W., Calgary, Alberta, T2P 2Z1 or at www.sedar.com.

AKITA DRILLING LTD.

# Relentlessly Pursuing Excellence

We're committed to excellence in all that we do – whether on the job, in the boardroom or in the community. Our path to success is rooted in the relationships we build with all of our stakeholders, from the customers and shareholders we serve to the 600+ individuals we employ.


**AKITA Rig 28 drilling in the Wood Buffalo area**

# Management's Responsibility for Financial Reporting

The accompanying consolidated financial statements of AKITA Drilling Ltd., Management's Discussion and Analysis and other information relating to AKITA contained in this Annual Report are the responsibility of management and have been approved by the Board of Directors. The consolidated financial statements have been prepared in accordance with accounting policies detailed in the notes to the consolidated financial statements and are in conformity with International Financial Reporting Standards (also referred to as "IFRS") using methods appropriate for the industry in which the Company operates. Where necessary, management made estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as at the date of the financial statements including estimates related to transactions and operations that were incomplete at year-end, the useful lives of drilling rigs and other assets, the measurement of the defined benefit pension liability, assumptions around future income tax calculations and the measurement of asset impairments. Financial information throughout this Annual Report is consistent with the consolidated financial statements except as noted.

Management ensures the integrity of the consolidated financial statements by maintaining a system of internal control. This system of internal control is based on the control criteria framework of the Committee of Sponsoring Organizations of the Treadway Commission published in their report titled, Internal Control – Integrated Framework, as revised effective May 14, 2013. The system is designed to provide reasonable assurance that transactions are executed as authorized and accurately recorded; that assets are safeguarded; and that accounting records are sufficiently reliable to permit the preparation of financial statements that conform in all material respects with accounting principles generally accepted in Canada. The Company maintains disclosure controls and procedures designed to ensure that information required to be disclosed in reports is disclosed, processed and summarized and reported within specified time periods. Internal controls are monitored through self-assessments and are reinforced through a Code of Business Conduct, which sets forth the Company's commitment to conduct business with integrity, and within both the letter and the spirit of the law.

PricewaterhouseCoopers LLP, the Company's independent auditors, have conducted an examination of the consolidated financial statements and have had full access to the Audit Committee. Their report appears on page 31.

The Board of Directors, through its Audit Committee comprised of three independent directors as defined in National Instrument 52-110 – Audit Committees ("NI 52-110"), and one director who is exempt from the independence requirements of NI 52-110, oversees management's responsibilities for financial reporting. The Audit Committee meets regularly with management and the independent auditors to discuss auditing and financial matters and to gain assurance that management is carrying out its responsibilities.

Karl A. Ruud
President and Chief Executive Officer

Darcy Reynolds
Vice President, Finance and Chief Financial Officer

# Independent Auditor's Report

pwc

**To the Shareholders of AKITA Drilling Ltd.**

We have audited the accompanying consolidated financial statements of AKITA Drilling Ltd. and its subsidiaries, which comprise the consolidated statements of financial position as at December 31, 2016 and December 31, 2015 and the consolidated statements of net income (loss) and comprehensive income (loss), changes in shareholders' equity and cash flows for the years then ended, and the related notes, which comprise a summary of significant accounting policies and other explanatory information.

## Management's responsibility for the consolidated financial statements

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

## 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 AKITA Drilling Ltd. and its subsidiaries as at December 31, 2016 and December 31, 2015 and their financial performance and their cash flows for the years then ended in accordance with International Financial Reporting Standards.

PricewaterhouseCoopers LLP

Chartered Professional Accountants
Calgary, Alberta
March 3, 2017

# Consolidated Statements of Financial Position

| $Thousands | | December 31, 2016 | December 31, 2015 |
|---|---|---|---|
| **Assets** | | | |
| **Current Assets** | | | |
| Cash and cash equivalents | Note 6 | $ 14,250 | $ 9,369 |
| Accounts receivable | Note 7 | 28,220 | 14,310 |
| Income taxes recoverable | | 2,356 | 3,279 |
| Prepaid expenses and other | | 74 | 75 |
| | | 44,900 | 27,033 |
| **Non-current Assets** | | | |
| Restricted cash | Note 8 | 2,969 | 5,978 |
| Other long-term assets | | 894 | 917 |
| Investments in joint ventures | Note 9 | 3,252 | 3,941 |
| Property, plant and equipment | Note 10 | 205,892 | 216,647 |
| **Total Assets** | | $ 257,907 | $ 254,516 |
| **Liabilities** | | | |
| **Current Liabilities** | | | |
| Accounts payable and accrued liabilities | Note 11 | 8,468 | 9,506 |
| Dividends payable | Note 12 | 1,525 | 1,525 |
| | | 9,993 | 11,031 |
| **Non-current Liabilities** | | | |
| Financial instruments | Note 7 | 41 | 117 |
| Deferred income taxes | Note 13 | 23,702 | 19,203 |
| Deferred share units | Note 14 | 222 | 171 |
| Pension liability | Note 15 | 4,303 | 3,794 |
| **Total Liabilities** | | 38,261 | 34,316 |
| **Shareholders' Equity** | | | |
| Class A and Class B shares | Note 16 | 23,871 | 23,871 |
| Contributed surplus | | 4,285 | 3,946 |
| Accumulated other comprehensive loss | | (366) | (244) |
| Retained earnings | | 191,856 | 192,627 |
| **Total Equity** | | 219,646 | 220,200 |
| **Total Liabilities and Equity** | | $ 257,907 | $ 254,516 |

Approved by the Board,

Director

Director

# Consolidated Statements of Net Income (Loss) and Comprehensive Income (Loss)

| $Thousands except per share amounts | | Year Ended December 31 2016 | 2015 |
|---|---|---|---|
| **Revenue** | Note 17 | $ 61,061 | $ 112,488 |
| **Costs and Expenses** | | | |
| Operating and maintenance | Note 18 | 24,169 | 74,031 |
| Depreciation and amortization | Note 10 | 23,959 | 36,748 |
| Asset impairment loss | | - | 41,968 |
| Selling and administrative | Note 18 | 12,502 | 15,128 |
| Total costs and expenses | | 60,630 | 167,875 |
| Revenue less costs and expenses | | 431 | (55,387) |
| **Equity Income from Joint Ventures** | Note 9 | 6,064 | 11,264 |
| **Other Income (Loss)** | | | |
| Interest income | | 965 | 130 |
| Interest expense | | (163) | (356) |
| Gain (loss) on sale of assets | | 90 | (657) |
| Net other gains | | 148 | 462 |
| Total other income (loss) | | 1,040 | (421) |
| Income (loss) before income taxes | | 7,535 | (44,544) |
| Income tax expense (recovery) | Note 13 | 2,206 | (10,579) |
| **Net Income (Loss) for the Year Attributable to Shareholders** | | 5,329 | (33,965) |
| Other comprehensive income (loss) | | (122) | 36 |
| **Comprehensive Income (Loss) for the Year Attributable to Shareholders** | | $ 5,207 | $ (33,929) |
| **Net Income (Loss) per Class A and Class B Share** | Note 19 | | |
| Basic | | $ 0.30 | $ (1.89) |
| Diluted | | $ 0.30 | $ (1.89) |

# Consolidated Statements of Changes in Shareholders' Equity

| | Attributable to the Shareholders of the Company | | | | | | |
|---|---|---|---|---|---|---|---|
| $Thousands | Class A Non-Voting Shares | Class B Common Shares | Total Class A and Class B Shares | Contributed Surplus | Accumulated Other Comprehensive Income (Loss) | Retained Earnings | Total Equity |
| **Balance at December 31, 2014** | $ 22,505 | $ 1,366 | $ 23,871 | $ 3,557 | $ (280) | $232,693 | $259,841 |
| Net loss for the year | - | - | - | - | - | (33,965) | (33,965) |
| Remeasurement of pension liability | - | - | - | - | 36 | - | 36 |
| Stock options charged to expense | - | - | - | 389 | - | - | 389 |
| Dividends | - | - | - | - | - | (6,101) | (6,101) |
| **Balance at December 31, 2015** | $ 22,505 | $ 1,366 | $ 23,871 | $ 3,946 | $ (244) | $192,627 | $220,200 |
| Net income for the year | - | - | - | - | - | 5,329 | 5,329 |
| Remeasurement of pension liability | - | - | - | - | (122) | - | (122) |
| Stock options charged to expense | - | - | - | 339 | - | - | 339 |
| Dividends | - | - | - | - | - | (6,100) | (6,100) |
| **Balance at December 31, 2016** | **$ 22,505** | **$ 1,366** | **$ 23,871** | **$ 4,285** | **$ (366)** | **$191,856** | **$219,646** |

# Consolidated Statements of Cash Flows

| $Thousands | | Year Ended December 31 2016 | 2015 |
|---|---|---|---|
| **Operating Activities** | | | |
| Net income (loss) | | $ 5,329 | $ (33,965) |
| Non-cash items included in net income: | | | |
| Depreciation and amortization | Note 10 | 23,959 | 36,748 |
| Asset impairment loss | | - | 41,968 |
| Deferred income tax expense (recovery) | Note 13 | 4,543 | (7,863) |
| Defined benefit pension plan expense | Note 15 | 432 | 492 |
| Stock options and deferred share units expense | Note 14 | 402 | 509 |
| (Gain) loss on sale of assets | | (90) | 657 |
| Unrealized foreign currency loss | | - | 73 |
| Unrealized gain on financial guarantee contracts | | (75) | (109) |
| Funds flow from operations | | 34,500 | 38,510 |
| Change in non-cash working capital | Note 23 | (17,405) | 14,859 |
| Equity income from joint ventures | Note 9 | (6,064) | (11,264) |
| Post-employment benefits | | (60) | (115) |
| Interest paid | | (2) | (215) |
| Income tax recoverable | Note 13 | (2,337) | (2,717) |
| Income tax recovered | | 3,260 | 2,449 |
| **Net cash from operating activities** | | 11,892 | 41,507 |
| **Investing Activities** | | | |
| Capital expenditures | Note 10 | (13,193) | (17,960) |
| Change in non-cash working capital | Note 23 | 2,418 | (8,122) |
| Distributions from investments in joint ventures | Note 9 | 6,753 | 13,537 |
| Change in cash restricted for loan guarantees | | 3,009 | 3,403 |
| Proceeds on sale of assets | | 202 | 1,093 |
| **Net cash used in investing activities** | | (811) | (8,049) |
| **Financing Activities** | | | |
| Change in operating loan facility | | - | (20,000) |
| Dividends paid | Note 12 | (6,100) | (6,101) |
| Loan commitment fee paid | | (100) | - |
| **Net cash used in financing activities** | | (6,200) | (26,101) |
| **Increase in cash and cash equivalents** | | 4,881 | 7,357 |
| Cash and cash equivalents, beginning of year | | 9,369 | 2,012 |
| **Cash and Cash Equivalents, End of Year** | | $ 14,250 | $ 9,369 |

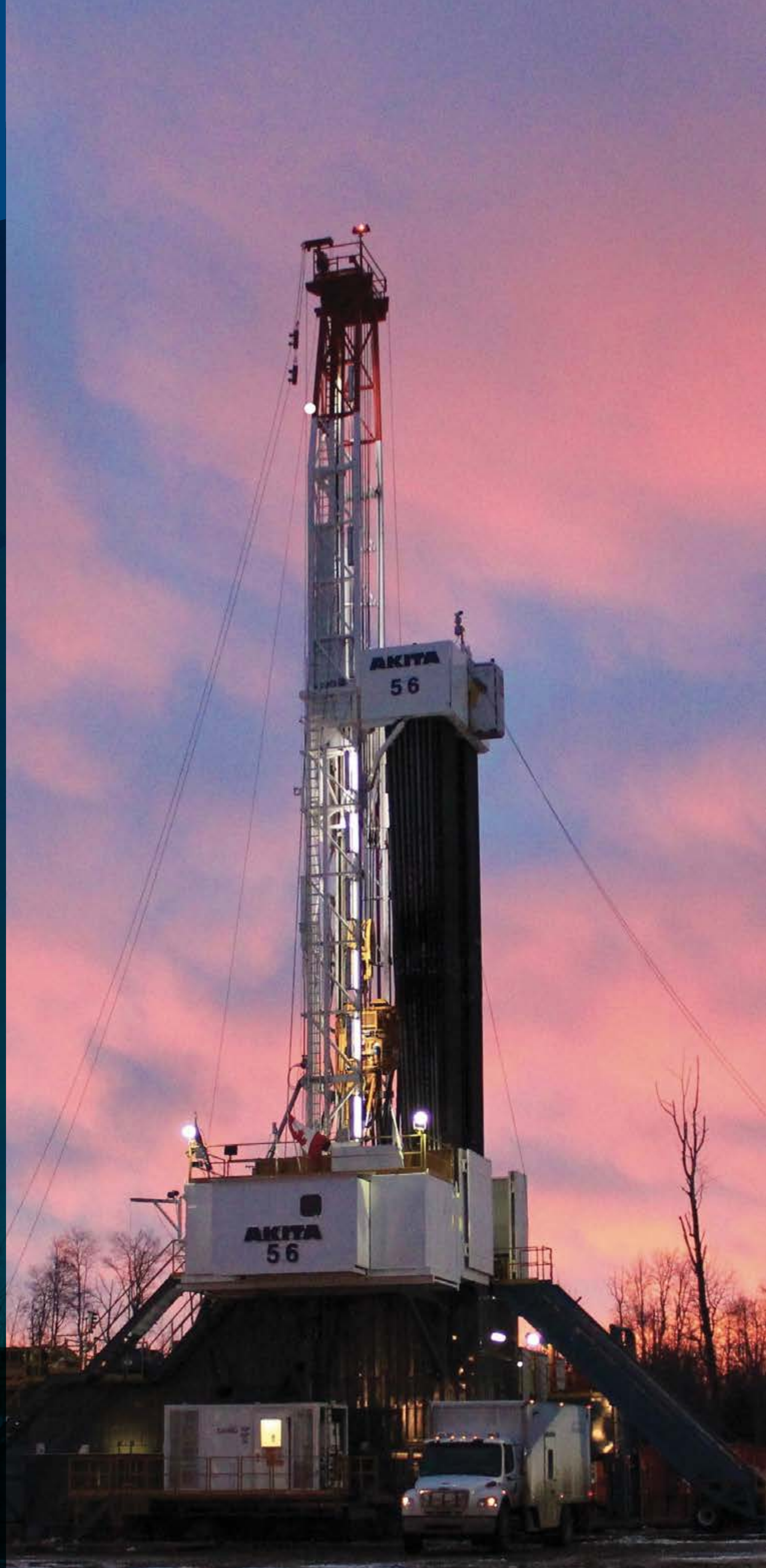
AKITA DRILLING LTD.

# Responsible to Our Shareholders

Our shareholders are fundamental to our ongoing success as a premier quality drilling company.

Our commitment to you is to:

- Ensure AKITA is governed using a first-class governance structure;
- Be disciplined in our finances, with limited use of leverage to acknowledge the cyclicality of the industry in which we operate;
- Develop and maintain a modern, efficient rig fleet;
- Ensure an ongoing stream of dividend payments that are both consistent and increasing over the long-term whenever possible.




**AKITA Rig 56 drilling at Dawson Creek, BC**

# Notes to the Consolidated Financial Statements - Index

# Notes to the Consolidated Financial Statements

For the years ended December 31, 2016 and December 31, 2015

## 1. General Information

AKITA Drilling Ltd. and its subsidiaries (the "Company" or "AKITA") provide contract drilling services, primarily to the oil and gas industry. From time to time, the Company is involved in other forms of drilling related to potash mining and the development of storage caverns. The Company owns and operates 28 drilling rigs (26.75 net) in Canada.

The Company conducts certain rig operations via joint ventures with Aboriginal and First Nations partners whereby rig assets are jointly owned. While joint venture interests are at least 50% owned by the Company, in each case the joint venture is governed on a joint basis.

The contract drilling business in which the Company operates is subject to seasonal fluctuations primarily due to weather conditions affecting the ability to move rigs and other heavy equipment. Historically, rig utilization in the first quarter of the calendar year is the highest. Lower activity levels that result from warmer weather which necessitates travel bans on certain public roads characterize the second quarter while the summer drilling season begins when road bans are lifted. Activity typically builds throughout the fall and peaks during the winter months.

The Company is a limited liability company incorporated and domiciled in Alberta, Canada. The address of its registered office is 1000, 333 – 7th Avenue SW, Calgary, Alberta. The Company is listed on the Toronto Stock Exchange. The Company is controlled by Sentgraf Enterprises Ltd. and its controlling share owner, the Southern family.

## 2. Basis of Preparation

The consolidated financial statements for the year ended December 31, 2016 have been prepared in accordance with International Financial Reporting Standards ("IFRS").

Items included in the financial statements of each of the Company's consolidated entities are measured using the currency of the primary economic environment in which the entity operates (the "functional currency"). These consolidated financial statements are presented in Canadian dollars.

The policies applied in these consolidated financial statements are based on IFRS issued and effective as of March 3, 2017, the date that the Company's Board of Directors approved the financial statements.

## 3. Significant Accounting Policies

### Basis of Measurement

These consolidated financial statements have been prepared under the historical cost convention, as modified by the revaluation of certain financial assets and liabilities (including derivative instruments) at fair value through the Consolidated Statements of Net Income and Comprehensive Income.

**Consolidation**

The financial statements of the Company consolidate the accounts of AKITA and its subsidiaries. All inter-company transactions, balances and unrealized gains and losses from inter-company transactions are eliminated on consolidation.

Subsidiaries are entities over which the Company has control. The Company controls an entity when the Company is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. Subsidiaries are fully consolidated from the date on which control is transferred to the Company and are deconsolidated from the date that control ceases.

**Joint Arrangements**

The Company has assessed the nature of its joint arrangements and determined them to be joint ventures. Joint ventures are accounted for using the equity method of accounting.

Under the equity method, interests in joint ventures are initially recognized at cost and adjusted thereafter to recognize the Company's share of the post-acquisition profits or losses and movements in other comprehensive income. When the Company's share of losses in a joint venture equals or exceeds its interests in that joint venture (which includes any long-term interests that, in substance, form part of the Company's net investment in that joint venture), the Company does not recognize further losses, unless it has incurred obligations or made payments on behalf of the joint venture. Unrealized gains on transactions between the Company and its joint ventures are eliminated to the extent of the Company's interest in its joint ventures. Unrealized losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred.

The accounting policies of the joint ventures are consistent with the policies described herein.

**Revenue Recognition**

Revenue resulting from the supply of contracted services is recorded by the percentage of completion method. On daywork contracts, work in progress is measured based upon the passage of time. On meterage contracts, work in progress is based upon the depth drilled. The receipt of unearned contract revenue is recorded as deferred revenue until the contracted passage of time has occurred or the targeted depth has been realized.

Certain revenue is comprised of the fair value of the consideration received or receivable from the construction and related sale of rigs in the ordinary course of the Company's activities and is recorded using the percentage of completion method based upon costs incurred, the passage of time relative to the anticipated length of the project and an estimate of work performed relative to future work required to complete the project.

Interest income is recognized on a time-proportion basis using the effective interest method.

**Financial Instruments**

*Recognition and measurement*

The Company's financial assets and liabilities include cash and cash equivalents, term deposits, restricted cash, accounts receivable, operating loan facility, accounts payable and accrued liabilities, and financial instruments. Due to the short-term nature of the Company's financial instruments, fair values approximate carrying values unless otherwise stated.

*Classification*

At initial recognition, the Company classifies its financial instruments in the following categories depending on the purpose for which the instruments were acquired:

i. Loans and receivables: Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Loans and receivables are initially recognized at the amount expected to be received less, when material, a discount to reduce the loans and receivables to fair value. Subsequently, loans and receivables are measured at amortized cost using the effective interest method less a provision for impairment.

   The Company's loans and receivables are comprised of cash, term deposits, restricted cash and trade receivables.

ii. Financial assets at fair value through profit or loss: Financial assets at fair value through profit or loss are financial assets held for trading. Derivatives are also categorized as held for trading unless they are designated as hedges.

   The Company's financial assets at fair value through profit or loss consist of unrealized gains on forward exchange contracts.

iii. Financial liabilities at amortized cost: Financial liabilities at amortized cost are initially recognized at the amount required to be paid less, when material, a discount to reduce the payables and accrued liabilities to fair value. Subsequently, financial liabilities at amortized cost are measured at amortized cost using the effective interest method.

   The Company's financial liabilities at amortized cost include accounts payable and accrued liabilities and its operating loan facility.

iv. Financial liabilities at fair value through profit or loss: The Company's financial liabilities at fair value through profit or loss are comprised of unrealized losses on forward exchange contracts and financial guarantee contracts.

*Impairment of financial assets*

At each reporting date, the Company assesses whether there is objective evidence that a financial asset is impaired. If such evidence exists, the Company recognizes an impairment loss calculated as the difference between the amortized cost of the loan or receivable and the present value of the estimated future cash flows, discounted using the instrument's original effective interest rate. The carrying amount of the asset is reduced by this amount either directly or indirectly through an allowance account.

The criteria used to determine if there is objective evidence of an impairment loss include:

i. Significant financial difficulty of the obligor;

ii. Delinquencies in interest or principal payments; and

iii. High degree of probability that the borrower will enter bankruptcy or other financial reorganization.

Impairment losses on financial assets carried at amortized cost are reversed in subsequent periods if the amount of the loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized.

**Translation of Foreign Currencies**

*Functional currency*

The financial statements of entities that have functional currencies different from that of the Company are translated into Canadian dollars as follows: assets and liabilities – at the closing rate as of the date of the statement of financial position, and income and expenses – at the average rate during the period as this is considered a reasonable approximation to actual rates. All resulting changes are recognized in other comprehensive income as cumulative translation adjustments.

*Transactions and balances*

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Generally, foreign exchange gains and losses resulting from the settlement of foreign currency transactions and from the translation at the period-end exchange rates of monetary assets and liabilities denominated in currencies other than the Company's functional currency are recognized in the Statement of Net Income and Comprehensive Income.

**Cash and Cash Equivalents**

Cash and cash equivalents are comprised of cash and bank guaranteed highly liquid short-term investments with original maturities of three months or less.

**Term Deposits**

Term deposits are bank guaranteed highly liquid short-term investments held for greater than three months.

**Property, Plant and Equipment**

Property, plant and equipment are stated at cost less accumulated depreciation and impairment.

Cost includes expenditures directly attributable to the acquisition of the item. The cost of assets constructed by the Company includes the cost of all materials and services used in the construction and direct labour on the project. Costs cease to be capitalized as soon as the asset is ready for productive use. Subsequent costs associated with equipment upgrades that result in increased capabilities or performance enhancements of property, plant and equipment are capitalized. Costs incurred to repair or maintain property, plant and equipment are charged to expense as incurred. The carrying amount of a replaced asset is derecognized when replaced.

Depreciation is provided on property, plant and equipment excluding land. Depreciation methods and rates have been selected so as to amortize the net cost of each asset over its expected useful life to its estimated residual value. The estimated useful lives, residual values and depreciation methods are reviewed at the end of each annual reporting period.

Drilling rigs are depreciated using the unit of production method. Depreciation is calculated for each of the rig's major components resulting in an average useful life of 3,600 operating days per rig. Major renovations are depreciated over the remaining useful life of the related asset or to the date of the next major renovation, whichever is sooner. Drilling rigs are subject to certain minimum annual depreciation.

Major inspection and overhaul expenditures are depreciated on a straight-line basis over three years.

Drill pipe and other ancillary drilling equipment are depreciated using a straight-line basis at rates varying from 6% to 50% per annum.

Furniture, fixtures and equipment are depreciated using a straight-line basis at 10% per annum.

Buildings are depreciated using the declining balance method at rates varying from 4% to 10% per annum.

**Impairment of Property, Plant and Equipment**

The Company considers both internal and external factors when assessing whether there are indicators of asset impairment at each reporting period. If indicators of asset impairment exist then the Company performs an asset impairment test, and if required, recognizes an asset impairment loss for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less cost to dispose and value in use, being the present value of the expected future cash flows of the relevant assets or Cash Generating Units ("CGUs").

For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separate identifiable cash flows into CGUs. The CGUs for the Company's drilling rigs are:

- Hydraulic singles;
- Heavy singles;
- Tele-doubles;
- Heavy triples;
- A.C. tele-double pad rigs;
- A.C. oil sands pad rigs;
- D.C. pad rigs; and
- A.C. deep gas pad rigs.

Assets that have an indefinite useful life are not subject to amortization and are tested for impairment annually.

**Dividend Distribution**

Dividend distribution to the Company's shareholders is recognized as a liability in the Company's financial statements in the period in which the Company's Board of Directors approves the dividends.

**Provisions**

Provisions are recognized when the Company has a legal or constructive obligation as a result of past events, and it is more likely than not that an outflow of resources will be required to settle the obligation and the amount can be reliably estimated.

Provisions are measured at the present value of management's best estimate of the expenditure required to settle the obligation at the Statement of Financial Position date. The discount rate used to determine the present value reflects current market assessments of the time value of money and the risks specific to the liability. The provision's increase in each period reflecting the passage of time is recognized as a finance cost.

The Company performs evaluations to identify onerous contracts and, where applicable, records provisions for such contracts.

**Income Taxes**

Income taxes are comprised of current and deferred income taxes. Income taxes are recognized in the Statement of Net Income and Comprehensive Income except to the extent that they relate to items recognized directly in equity in which case the income taxes are also recognized directly in equity.

Current taxes are calculated by reference to the amount of income taxes payable or recoverable in respect of the taxable profit or loss for the period using tax rates and tax laws that have been enacted or substantively enacted at the end of the reporting period. Current taxes are recognized as liabilities (or assets) to the extent that they are unpaid (or refundable).

The Company records deferred income taxes using the liability method of accounting for income taxes. Under this method, deferred tax assets and liabilities are determined based on differences between financial reporting and tax bases of assets and liabilities, and are measured using tax rates that are enacted or substantively enacted at the Statement of Financial Position date and are expected to apply when the deferred tax asset is realized or liability is settled. Deferred tax assets are recognized to the extent that it is probable that the assets can be recovered. Deferred tax assets and liabilities are presented as non-current assets or liabilities.

**Employee Future Benefits**

The Company has a defined contribution pension plan that covers substantially all of its employees. Under the provisions of the plan, the Company contributes 5% of regular earnings for eligible employees on a current basis. In addition, employees having eligible terms of service are subject to admission into the Company's group RRSP. The Company makes contributions on behalf of these plans to a separate entity and has no legal or constructive obligations to pay further contributions if the plans do not hold sufficient assets to pay the employee benefits relating to employee service in current or prior periods.

Contributions to the Company's defined pension contribution plan and the group RRSP are recognized as employee benefit expense when they are due.

The Company has also established a defined benefit pension plan for certain employees and retired employees. The defined benefit plan, which provides for pensions based upon the age of the retiree at the date of retirement, is non-contributory and unfunded. Actuarial valuation of the defined benefit plan is carried out annually or if circumstances change.

The liability recognized in the Statement of Financial Position in respect of the defined benefit pension plan is the present value of the defined benefit obligation at the Statement of Financial Position date. The cost of the defined benefit plan is determined using the projected unit credit method. The defined benefit obligation is determined by discounting the estimated future cash outflows using interest rates of high-quality Canadian denominated corporate bonds that have terms to maturity approximating the terms of the related pension liability. Past service costs are recognized in net income when incurred. Post-employment benefits expense is comprised of the interest on the net defined benefit liability calculated using a discount rate based on market yields on high quality bonds and the current service cost. Remeasurements consisting of actuarial gains and losses, the actual return on plan assets (excluding the net interest component) and any change in the asset ceiling are recognized in other comprehensive income.

### Share Capital

Class A Non-Voting and Class B Common shares are classified as equity. Incremental costs attributable to the issue of new shares or options are recorded as a reduction in equity, net of income taxes.

Shares repurchased by the Company are recorded as a reduction of shareholders' equity based upon the consideration paid, including any directly incremental costs, net of income taxes. All shares repurchased by the Company are cancelled upon repurchase.

### Earnings per Share

Basic earnings per share is calculated by dividing the net income for the period attributable to equity owners of the Company by the weighted average number of Class A Non-Voting and Class B Common shares outstanding during the period.

Diluted earnings per share is calculated by adjusting the weighted average number of Class A Non-Voting and Class B Common shares outstanding to assume conversion of all dilutive potential Class A Non-Voting shares, typically stock options granted to directors and employees. The calculation is performed for the stock options to determine the number of shares that could have been acquired at fair value (determined as the average quarterly or annual, as appropriate, market share price of the Company's outstanding Class A Non-Voting shares) based on the monetary value of the subscription rights attached to outstanding stock options. The number of shares calculated as above is compared with the number of shares that would have been issued assuming the exercise of stock options.

### Share-based Compensation Plans

The Company has three share-based compensation plans. Stock options qualify as an equity-settled share-based payment plan while deferred share units ("DSUs") and share appreciation rights ("SARs") qualify as cash-settled share-based payment plans. For all three of the share-based compensation plans, associated services received are measured at fair value and are calculated by multiplying the number of options, DSUs or SARs expected to vest with the fair value of one option, DSU or SAR as of the grant date.

i. Stock options: Subject to the approval of the Company's Board of Directors, the Company's Corporate Governance, Nomination, Compensation and Succession Committee may designate directors, officers, employees and other persons providing services to the Company to be granted options to purchase Class A Non-Voting shares.

   The vesting provisions and exercise period (which cannot exceed 10 years) are determined at the time of the grant. Each tranche is considered a separate award with its own vesting period and grant date fair value. The fair value of each tranche is measured at the date of grant using either the Binomial or the Black Scholes option pricing model. The number of awards expected to vest is reviewed at least annually, with any impact being recognized immediately.

ii. DSUs: The Company has a cash-settled share-based long-term incentive compensation plan for certain employees. Each DSU granted equates to one Class A Non-Voting share and entitles the holder to receive a cash payment equal to the Company's share price on the payment date. DSU holders are entitled to share in dividends which are credited as additional DSUs at each dividend payment date. DSUs vest immediately but are not exercisable until resignation or retirement from management and/or the Board of Directors.

Units issued under the Company's DSU plan are measured at fair value using the intrinsic value method when granted and subsequently re-measured at each reporting date using the Company's Class A Non-Voting share price at the reporting date with the associated expense recognized in general and administrative expense. The Company assumes a zero forfeiture rate.

iii. SARs: SARs may be granted to directors, officers and key employees of the Company. The vesting provisions (which range from three to eight years) and exercise period (which cannot exceed 10 years) are determined at the time of grant. The holder is entitled on exercise to receive a cash payment from the Company equal to any increase in the market price of the Class A Non-Voting shares over the base value of the SAR exercised. The base value is equal to the closing price of the Class A Non-Voting shares on the day before the grant.

The fair value of the services received is recognized as selling and administrative expense. In the case of equity-settled share-based payment plans, the selling and administrative expense results in a corresponding increase in contributed surplus over the vesting period of the respective plan. When stock options are exercised, shares are issued and the amount of the proceeds, together with the amount recorded in contributed surplus, is recognized in share capital. For cash-settled share-based payment plans, a corresponding liability is recognized. The fair value of the cash-settled share-based payment plans is remeasured at each Statement of Financial Position date through the Statement of Net Income and Comprehensive Income until settlement.

### Additional GAAP Measure

Funds flow from operations is an additional GAAP measure under IFRS. AKITA's method of determining funds flow from operations may differ from methods used by other companies and involves including cash flow from operating activities before working capital changes. Management and certain investors may find funds flow from operations to be a useful measurement to evaluate the Company's operating results at year-end and within each year since the seasonal nature of the business affects the comparability of non-cash working capital changes both between and within periods.

## 4. Significant Accounting Estimates and Judgments

The preparation of these consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent liabilities as at the date of the financial statements as well as the reported amounts for revenue and expenses during the period. Estimates and judgments are continually evaluated and are based upon historical experience and other factors, including expectations of future events that are believed to be reasonable in the circumstances. Actual outcomes could differ materially from these estimates.

### Asset Impairment Indicators

International Accounting Standard 36, "Impairment of Assets", requires an entity to consider both internal and external factors when assessing whether there are indications of asset impairment at each reporting period. At December 31, 2016, there were no internal indicators of impairment and an external indicator of impairment, namely the price of crude oil, still exists. Despite the positive trend in oil prices in the second half of 2016, crude oil prices remain low at December 31, 2016, and significant market uncertainty still exists. This uncertainty impacts the earnings potential of the Company's CGUs, therefore an asset impairment test was performed at December 31, 2016.

Upon completion of its asset impairment testing, the Company concluded that there was no asset impairment required at December 31, 2016 (2015 - $41,968,000). The Company also concluded that there were no reversals of previous asset impairments required at December 31, 2016.

The accuracy of asset impairment testing is affected by estimates and judgments in respect of the inputs and parameters that are used to determine recoverable amounts. In performing its asset impairment test at December 31, 2016, management determined value in use for each of its CGUs using estimated discounted cash flows, which included estimates of future cash flows, expectations regarding cash flow variability, a determination of the discount rate and consideration of the recoverable amount and salvage value of each CGU. At December 31, 2015, management determined recoverable amounts for its CGUs using a combination of value in use and fair value less costs to dispose. IFRS considers this approach to constitute a Level 3 hierarchy in its determination of value.

The primary bases for the asset impairment test performed at December 31, 2016, were the 2017 budget and business plan inputs as well as subsequent internal forecasts. Cash flows were determined for each of the Company's CGUs while consideration was also given to other corporate assets in the Company's 2016 asset impairment test. The asset impairment testing performed at December 31, 2015, used similar bases including the 2016 budget.

Additional significant assumptions used in AKITA's asset impairment test at December 31, 2016, included potential contribution margin growth rates, potential cost inflation increases, the discount rate of 10%, the projected forecast period of 10 years, and a salvage value of 20%. At December 31, 2016, two rigs were reclassified between CGUs based on a review of the functional nature of the rigs.

The recoverable amount for each of the Company's CGUs that were impaired at December 31, 2015, were as follows:

| CGU | Recoverable Amount Based on Value in Use |
|---|---|
| Heavy singles | $ 3,919 |
| Tele-doubles | 17,140 |
| A.C. deep gas pad rigs | 27,002 |
| A.C. ultra-deep gas pad rigs | 31,710 |
| D.C. pad rigs | 35,389 |
| Heavy triples | 6,591 |
| Total | $ 121,751 |

Asset impairment testing is subject to numerous assumptions, inherent risks and uncertainties, both general and specific, and the risk that these assumptions will not be realized. As a result, a sensitivity analysis was performed at December 31, 2016, and December 31, 2015, to recognize that additional outcomes are possible, which included changing cash flows and using different discount rates. As rigs are long-lived assets, no sensitivity adjustment was made for the projected forecast period. The sensitivity analysis performed at December 31, 2016, and December 31, 2015, resulted in changes to the CGUs' recoverable amounts, however as the base case test represented management's best estimates, these sensitivity changes were not included in the recoverable amounts used in the 2016, asset impairment testing or the 2015 asset impairment loss reported.

**Useful Lives of Drilling Rigs**

The preparation of AKITA's financial statements requires management to make significant estimates relating to the useful lives of drilling rigs. Depreciation is calculated for each of the rig's major components resulting in an average useful life of 3,600 operating days per rig. Drilling rigs are depreciated using the unit of production method. Assuming a 10% difference in the actual useful lives of drilling rigs compared to the accounting estimate of useful life and based upon actual drilling days achieved for the year ended December 31, 2016, drilling rig depreciation could be either increased or decreased by $2,268,000 (2015 - $3,539,000). AKITA's depreciation expense does not have any effect on the changes to the financial condition for the Company, as depreciation is a non-cash item.

**Defined Benefit Pension Liability**

Significant estimates used in the preparation of AKITA's financial statements relate to the measurement of the non-current defined benefit pension liability for selected employees and retired employees that was recorded as $4,303,000 at December 31, 2016 (December 31, 2015 - $3,794,000). AKITA's pension liability estimates do not have any effect on the changes to the financial condition for the Company, as the defined benefit pension is a non-cash liability. However, total liabilities and results of operations including net income could be either understated or overstated as a result of pension estimates that are either too high or too low. AKITA utilizes the services of a third party to assist in the actuarial estimate of the Company's defined benefit pension expense and liability. For 2016, a key assumption is the discount rate of 3.6% (2015 – 3.9%). From the perspective of a sensitivity analysis, a 1% decrease in the discount rate would result in a $617,000 increase in the defined benefit obligation while a 1% increase in the discount rate would result in a $509,000 decrease in the defined benefit obligation. Additionally, if members' lives should be one year longer than actuarial expectations, the defined benefit obligation would increase by $75,000.

**Deferred Income Taxes**

The Company makes assumptions relating to the measurement of deferred income taxes, including future tax rates, timing of reversals of timing differences and the anticipated tax rules that will be in place when timing differences reverse. Consequently, total liabilities of the Company as well as results of operations including net income could be either understated or overstated.

**Incomplete Transactions**

The Company makes assumptions relating to transactions that were incomplete at the Statement of Financial Position date. Depending on the actual transaction, total assets and liabilities of the Company as well as results of operations including net income could be either understated or overstated as a result of differences between amounts accrued for incomplete transactions and the subsequent actual balances.

## 5. Capital Disclosures

**Capital Management**

The Company has determined capital to include long-term debt and share capital. The Company's objectives when managing capital are:

- to safeguard the Company's ability to continue as a going concern, so that it can continue to provide returns for shareholders and benefits for other stakeholders, and
- to augment existing resources in order to meet growth requirements.

The Company manages the capital structure and makes adjustments to it in light of changes in economic conditions and the risk characteristics of the underlying assets. In order to maintain or adjust the capital structure, the Company may adjust the amount of dividends paid to shareholders, repurchase shares, issue new shares or sell assets.

## 6. Cash and Cash Equivalents

Cash and cash equivalents is comprised of the following:

| $Thousands | December 31 2016 | December 31 2015 |
|---|---|---|
| Cash | $ 5,729 | $ 9,369 |
| Short-term bank deposits | 8,521 | - |
| Cash and cash equivalents | $ 14,250 | $ 9,369 |

## 7. Financial Instruments

**Operating Loan Facility**

The Company has an operating loan facility with its principal banker. The facility totals $100,000,000 with the term ending in 2020.

The interest rate on the facility varies based upon the actual amounts borrowed, but ranges from 0.45% to 1.45% over prime interest rates or 1.45% to 2.45% over guaranteed notes, depending on the preference of the Company. Security for this facility includes a General Security Agreement covering all current and future assets.

At December 31, 2016, and December 31, 2015, the Company had not drawn on its loan facility.

The Company is in compliance with its operating loan facility covenants.

**Contracts Measured at Fair Value**

*Financial guarantee contracts*

The Company guarantees bank loans made to joint venture partners and has provided an assignment of monies on deposit with respect to these loans. The Company has recorded the loan guarantee benefit at its fair value of $41,000 (December 31, 2015 - $117,000). The fair value measurement of the financial guarantee benefit has a fair value hierarchy of Level 2 whereby fair value was determined based on a valuation model that utilized indirect observable market data.

**Financial Instrument Risk Exposure and Management**

The Company is exposed to various risks associated with its financial instruments. These risks are categorized as credit risk, liquidity risk, commodity risk, foreign currency risk and interest rate risk.

*Credit risk*

The credit risk associated with accounts receivable is generally considered low since the Company has conservative credit-granting procedures and in certain circumstances may require customers to make advance payment prior to the provision of services or take other measures to help reduce credit risk. Management has estimated provisions to recognize potential impairments, which have been included in the accounts.

In 2016, one of AKITA's customers elected to cancel a multi-year contract that was scheduled to continue to 2019. As a result of the contract cancellation, AKITA received $9,578,000 in contract cancellation fees during the first quarter of 2016. The remaining contract cancellation fees of $20,068,000 have been recorded as accounts receivable.

The Company's accounts receivable shows no significant credit risk exposure in the balances outstanding at December 31, 2016, and December 31, 2015. Terms of the Company's contracts generally require payment within 30 days.

| $Thousands | December 31 2016 | December 31 2015 |
|---|---|---|
| Within 30 days | $ 6,726 | $ 11,560 |
| 31 to 60 days | 1,203 | 2,411 |
| 61 - 90 days | 269 | 402 |
| Over 90 days | 4 | (13) |
| Allowance for doubtful accounts | (50) | (50) |
| Total trade accounts receivable | 8,152 | 14,310 |
| Contract cancellation fees | 20,068 | - |
| Accounts receivable | $ 28,220 | $ 14,310 |

*Liquidity risk*

The Company is exposed to liquidity risk through its working capital balance. At December 31, 2016 and December 31, 2015, this risk was limited by having substantial cash balances and positive cash flows from operations. All working capital amounts at December 31, 2016, and December 31, 2015, are due within one year.

*Commodity risk*

The Company is exposed to the effects of fluctuating crude oil and natural gas prices as well as the resultant changes in the exploration and development budgets of its customers.

*Foreign currency risk*

The Company is exposed to changes in foreign exchange rates as capital expenditures or financial instruments may fluctuate due to changing rates.

*Interest rate risk*

The Company is exposed to interest rate risk through its operating loan facility and through its investment in short-term bank deposits.

**Significant Customers**

During 2016, three customers (2015 – three customers) each provided more than 10% of the Company's revenue. While the loss of one or more of these customers may have a material adverse effect on the financial results of the Company, in management's assessment, the future viability of the Company is not dependent upon these major customers.

## 8. Restricted Cash

| $Thousands | December 31 2016 | December 31 2015 |
|---|---|---|
| Balance held in bank liquid deposit instruments | $ 2,969 | $ 5,978 |

During 2014, the Company guaranteed bank loans made to joint venture partners totaling $5,648,000 for a period of four years. During 2016, the Company has provided an assignment of monies on deposit totaling $2,969,000 with respect to these loans.

From time to time, the restricted cash balance is reduced to reflect joint venture partner loan repayments. During 2016, the Company acquired its joint ventures partners' 15% interest in Rig 22 and used the related restricted cash balance to pay out the joint venture partners' loans.

The Company's security from its partners for these guarantees includes interests in specific rig assets. The Company has recorded the loan guarantee benefit at its fair value.

## 9. Investments in Joint Ventures

The Company conducts certain rig operations via joint ventures with Aboriginal or First Nations partners whereby rig assets are jointly owned. Currently, there are 13 different Aboriginal or First Nations groups with equity investments in eight of AKITA's rigs. These equity investments are facilitated through joint venture agreements. Each joint venture operates the rig with the joint venture partners owning a share of each rig directly. The equity ownership for each Aboriginal or First Nations partner varies between rigs and groups and ranges from 5% to 50% per group per rig.

While joint venture interests are at least 50% owned by the Company, in each case the joint venture is governed on a joint basis. The Company accounts for the joint venture interests using the equity method of accounting. The following table lists the Company's active joint ventures.

| Joint Ventures | Operating Location | Ownership Interest |
|---|---|---|
| Akita Wood Buffalo Joint Venture 22 | Canada | 85% (1) |
| Akita Wood Buffalo Joint Venture 25 | Canada | 85% |
| Akita Wood Buffalo Joint Venture 26 | Canada | 85% |
| Akita Wood Buffalo Joint Venture 27 | Canada | 85% |
| Akita Wood Buffalo Joint Venture 28 | Canada | 70% |
| Akita Wood Buffalo Joint Venture 33 | Canada | 62.5% (1) |
| Akita Sahtu Joint Venture 51 | Canada | 50% (2) |
| Akita Equtak Joint Venture 60 | Canada | 50% (2) |
| Akita Equtak Joint Venture 61 | Canada | 50% |
| Akita Equtak Joint Venture 63 | Canada | 50% (2) |

(1) *During the fourth quarter of 2016, the Company acquired its joint venture partners' 15% interest in Rig 22 and 37.5% interest in Rig 33 and as at December 31, 2016, owns 100% of both rigs. As a result of this acquisition Akita Wood Buffalo Joint Venture 22 and Akita Wood Buffalo Joint Venture 33 do not have any continuing operations.*

(2) *At December 31, 2016, rigs 51, 60, and 63 have been delisted with the Canadian Association of Oilwell Drilling Contractors. The related joint ventures have continuing operations as the Company and its joint venture partners continue to jointly own the rig assets.*

**Continuity of Investments in Joint Ventures**

| $Thousands | Investments in Joint Ventures |
|---|---|
| Balance as at December 31, 2014 | $ 6,214 |
| Net income for the year ended December 31, 2015 | 11,264 |
| Distributions for the year ended December 31, 2015 | (13,537) |
| Balance as at December 31, 2015 | 3,941 |
| **Net income for the year ended December 31, 2016** | **6,064** |
| **Distributions for the year ended December 31, 2016** | **(5,247)** |
| **Divestiture of investment in joint ventures** | **(1,506)** |
| **Balance as at December 31, 2016** | **$ 3,252** |

**Summarized Joint Venture Financial Information**

This summarized financial information is a reconciliation of the Company's investments in joint ventures to the aggregate of the amounts included in the IFRS financial statements of the joint ventures which include both the Company's and joint venture partners' interests.

| | **December 31, 2016** | | | December 31, 2015 | | |
|---|---|---|---|---|---|---|
| $Thousands | **AKITA %** | **JV Partner %** | **Total** | AKITA % | JV Partner % | Total |
| Cash | **$ 1,297** | **$ 357** | **$ 1,654** | $ 1,268 | $ 406 | $ 1,674 |
| Other current assets | **3,861** | **887** | **4,748** | 5,447 | 1,117 | 6,564 |
| Non-current assets | **55** | **-** | **55** | 55 | - | 55 |
| **Total Assets** | **5,213** | **1,244** | **6,457** | 6,770 | 1,523 | 8,293 |
| **Total Liabilities** | **1,961** | **467** | **2,428** | 2,829 | 598 | 3,427 |
| **Net Assets** | **$ 3,252** | **$ 777** | **$ 4,029** | $ 3,941 | $ 925 | $ 4,866 |

| | **Year ended December 31, 2016** | | | Year ended December 31, 2015 | | |
|---|---|---|---|---|---|---|
| $Thousands | **AKITA %** | **JV Partner %** | **Total** | AKITA % | JV Partner % | Total |
| Revenue | **$ 14,070** | **$ 6,329** | **$ 20,399** | $ 32,463 | $ 10,157 | $ 42,620 |
| Net income and comprehensive income | **$ 6,064** | **$ 1,131** | **$ 7,195** | $ 11,264 | $ 3,242 | $ 14,506 |

## 10. Property, Plant and Equipment

| Cost<br>$Thousands | | Land and Buildings | | Drilling Rigs | | Other | | Total |
|---|---|---|---|---|---|---|---|---|
| Balance as at December 31, 2014 | $ | 4,302 | $ | 458,157 | $ | 8,937 | $ | 471,396 |
| Additions | | - | | 17,701 | | 259 | | 17,960 |
| Disposals | | - | | (10,001) | | (882) | | (10,883) |
| Impairment loss | | - | | (59,795) | | - | | (59,795) |
| Balance as at December 31, 2015 | | 4,302 | | 406,062 | | 8,314 | | 418,678 |
| **Additions** | | **-** | | **13,066** | | **127** | | **13,193** |
| **Disposals** | | **-** | | **(13,193)** | | **(477)** | | **(13,670)** |
| **Balance as at December 31, 2016** | **$** | **4,302** | **$** | **405,935** | **$** | **7,964** | **$** | **418,201** |

| Accumulated Depreciation<br>$ Thousands | | Land and Buildings | | Drilling Rigs | | Other | | Total |
|---|---|---|---|---|---|---|---|---|
| Balance as at December 31, 2014 | $ | 1,191 | $ | 185,134 | $ | 6,026 | $ | 192,351 |
| Disposals | | - | | (8,250) | | (882) | | (9,132) |
| Depreciation expense | | 82 | | 35,389 | | 1,168 | | 36,639 |
| Impairment loss | | - | | (17,827) | | - | | (17,827) |
| Balance as at December 31, 2015 | | 1,273 | | 194,446 | | 6,312 | | 202,031 |
| **Disposals** | | **-** | | **(13,088)** | | **(469)** | | **(13,557)** |
| **Depreciation expense** | | **78** | | **22,828** | | **929** | | **23,835** |
| **Balance as at December 31, 2016** | **$** | **1,351** | **$** | **204,186** | **$** | **6,772** | **$** | **212,309** |

| Net Book Value<br>$ Thousands | | Land and Buildings | | Drilling Rigs | | Other | | Total |
|---|---|---|---|---|---|---|---|---|
| As at December 31, 2014 | $ | 3,111 | $ | 273,023 | $ | 2,911 | $ | 279,045 |
| As at December 31, 2015 | $ | 3,029 | $ | 211,616 | $ | 2,002 | $ | 216,647 |
| **As at December 31, 2016** | **$** | **2,951** | **$** | **201,749** | **$** | **1,192** | **$** | **205,892** |

At December 31, 2016, the Company had $2,420,000 in Property, Plant and Equipment that was not being depreciated, as these assets were under construction (December 31, 2015 – $106,000).

In addition to depreciation on its Property, Plant and Equipment, the Company had amortization expense of $124,000 for the year ended December 31, 2016 (2015 - $108,000).

## 11. Accounts Payable and Accrued Liabilities

Accounts payable and accrued liabilities is comprised of the following:

| $Thousands | December 31 2016 | December 31 2015 |
|---|---|---|
| Trade payables | $ 4,306 | $ 3,213 |
| Statutory liabilities | 3,791 | 5,982 |
| Accrued expenses | 229 | 211 |
| Post-employment benefits | 142 | 100 |
| Accounts payable and accrued liabilities | $ 8,468 | $ 9,506 |

## 12. Dividends per Share

The following table provides a history of dividends over the past two years:

| Declaration Date | Payment Date | Per Share ($) | Total ($000's) |
|---|---|---|---|
| March, 2015 | April, 2015 | 0.085 | 1,525 |
| May, 2015 | July, 2015 | 0.085 | 1,525 |
| July, 2015 | October, 2015 | 0.085 | 1,525 |
| November, 2015 | January, 2016 | 0.085 | 1,525 |
| March, 2016 | April, 2016 | 0.085 | 1,525 |
| May, 2016 | July, 2016 | 0.085 | 1,525 |
| July, 2016 | October, 2016 | 0.085 | 1,525 |
| November, 2016 | January, 2017 | 0.085 | 1,525 |

## 13. Income Taxes

Income tax expense is comprised of the following:

| | Year Ended | |
|---|---|---|
| $Thousands | December 31 2016 | December 31 2015 |
| Current tax recovery | $ (2,337) | $ (2,716) |
| Deferred tax expense (recovery) | 4,543 | (7,863) |
| Total income tax expense (recovery) | $ 2,206 | $ (10,579) |

The following table reconciles the income tax expense using a weighted average Canadian federal and provincial rate of 26.92% (2015 – 26.14%) to the reported tax expense. The rate increase is due to more of the Company's revenue being earned in provinces with higher tax rates. The reconciling items represent, aside from the impact of tax rate differentials and changes, non-taxable benefits or non-deductible expenses arising from permanent differences between the local tax base and the financial statements.

| $Thousands | Year Ended December 31 2016 | Year Ended December 31 2015 |
|---|---|---|
| Income (loss) before income taxes | $ 7,535 | $ (44,544) |
| Expected income tax at the statutory rate | 2,029 | (11,646) |
| Add (deduct): | | |
| Change in income tax rates | 130 | 1,202 |
| Permanent differences | 134 | 141 |
| Return to provision adjustment | 61 | (68) |
| Other | (148) | (208) |
| Income tax expense (recovery) | $ 2,206 | $ (10,579) |

Deferred income taxes are the result of temporary differences between the carrying amounts of certain assets and liabilities in the financial statements and their tax bases. No portion of deferred income taxes is expected to be recovered within 12 months.

| **Deferred Income Taxes** $Thousands | **Property, plant and equipment** | **Defined benefit pension plan benefits** | **Other** | **Total** |
|---|---|---|---|---|
| Balance as at December 31, 2014 | $ 27,353 | $ (870) | 570 | 27,053 |
| Credited to net income | (7,653) | (173) | (37) | (7,863) |
| Charged to other comprehensive income | - | 13 | - | 13 |
| Balance as at December 31, 2015 | 19,700 | (1,030) | 533 | 19,203 |
| **Charged (credited) to net income** | **4,686** | **(109)** | **(34)** | **4,543** |
| **Credited to other comprehensive income** | **-** | **(44)** | **-** | **(44)** |
| **Balance as at December 31, 2016** | **$ 24,386** | **$ (1,183)** | **$ 499** | **$ 23,702** |

## 14. Stock-based Compensation Plans

### a. Stock options

The following table summarizes stock options reserved, granted and available for future issuance:

| (Number of options) | December 31 2016 | December 31 2015 |
|---|---|---|
| Reserved under current stock option plan | 1,700,000 | 1,700,000 |
| | | |
| Balance at beginning of year | 655,800 | 760,800 |
| Granted during the year | (197,500) | (105,000) |
| Available for future issuance | 458,300 | 655,800 |

A summary of the status of the Company's stock options as of December 31, 2016, and 2015, and changes during the years ended on those dates is presented below:

| | 2016 | | 2015 | |
|---|---|---|---|---|
| | Options | Weighted Average Exercise Price ($) | Options | Weighted Average Exercise Price ($) |
| Options outstanding at January 1 | 682,000 | $ 11.90 | 577,000 | $ 12.20 |
| Options granted | 197,500 | 7.13 | 105,000 | 10.28 |
| Options outstanding at December 31 | 879,500 | $ 10.83 | 682,000 | $ 11.90 |
| | | | | |
| Options exercisable at December 31 | 586,000 | $ 11.32 | 459,500 | $ 11.38 |

The following table summarizes outstanding stock options at December 31:

| | | 2016 | | | 2015 | | |
|---|---|---|---|---|---|---|---|
| Vesting Period (Years) | Exercise Price | Number Outstanding | Remaining Contractual Life (years) | Number Exercisable | Number Outstanding | Remaining Contractual Life (years) | Number Exercisable |
| 5 | $ 9.87 | 150,000 | 3.2 | 150,000 | 150,000 | 4.2 | 150,000 |
| 3 | 10.32 | 6,000 | 4.2 | 6,000 | 6,000 | 5.2 | 6,000 |
| 5 | 10.32 | 91,000 | 4.2 | 91,000 | 91,000 | 5.2 | 91,000 |
| 5 | 10.86 | 97,500 | 5.2 | 97,500 | 97,500 | 6.2 | 78,000 |
| 5 | 13.81 | 102,500 | 6.7 | 82,000 | 102,500 | 7.7 | 61,500 |
| 5 | 16.02 | 130,000 | 7.7 | 78,000 | 130,000 | 8.7 | 52,000 |
| 5 | 10.28 | 105,000 | 8.2 | 42,000 | 105,000 | 9.2 | 21,000 |
| 5 | $ 7.13 | 197,500 | 9.3 | 39,500 | | | |
| Weighted Average Contractual Life | | | 9.0 | | | 6.8 | |

### b. Deferred share units

A summary of the status of the Company's deferred share unit plan as of December 31, 2016, and 2015, and changes during the years ended on those dates is presented below:

| | 2016 | | 2015 | |
|---|---|---|---|---|
| | Deferred Share Units (#) | Fair Value ($Thousands) | Deferred Share Units (#) | Fair Value ($Thousands) |
| Deferred share units outstanding at January 1 | 31,083 | $ 211 | 7,309 | $ 91 |
| Granted | - | - | 23,077 | 240 |
| Issued in lieu of dividends | 1,319 | 10 | 697 | 6 |
| Change in fair value | - | 53 | - | (126) |
| **Deferred share units outstanding at December 31** | 32,402 | $ 274 | 31,083 | $ 211 |
| Deferred share units allocated to: | | | | |
| Accounts payable and accrued liabilities | 6,134 | $ 52 | 5,985 | $ 40 |
| Non-current liabilities | 26,268 | 222 | 25,098 | 171 |
| **Deferred share units outstanding at December 31** | 32,402 | $ 274 | 31,083 | $ 211 |

### c. Shared-based compensation expense

| | Year Ended | |
|---|---|---|
| $Thousands | December 31 2016 | December 31 2015 |
| Stock option expense | $ 339 | $ 389 |
| Deferred share unit expense | 63 | 120 |
| Total | $ 402 | $ 509 |

The stock option expense was determined using the Binomial Model based on the following assumptions. Expected volatility is calculated by examining a historical 60 month (5 year) trading history up to the grant date, where significant outliers are excluded to provide a better estimate.

| | 2016 | 2015 |
|---|---|---|
| Risk-free interest rate | 0.75% | 1.04% |
| Expected volatility | 31.0% | 28.0% |
| Dividends yield rate | 4.03% | 2.55% |
| Option life | 5.4 years | 5.4 years |
| Weighted average share price | $ 7.13 | $ 10.28 |
| Forfeiture rate | 0.00% | 0.00% |
| Fair value of options | $ 1.47 | $ 2.18 |

## 15. Pension Liability

The Company obtains an actuarial valuation from an independent actuary subsequent to each year-end or if circumstances change. The most recent evaluation was dated January 16, 2017, and was utilized in measuring the December 31, 2016, balances.

| $Thousands | 2016 | 2015 |
|---|---|---|
| Actuarial present value of defined benefit obligation at January 1 | $ 3,854 | $ 3,426 |
| Interest cost | 160 | 142 |
| Current service cost | 272 | 320 |
| Benefits paid | (60) | (15) |
| Past-service cost - plan amendments | - | 30 |
| Unrealized actuarial (gain) loss | 167 | (49) |
| Actuarial present value of defined benefit obligation at December 31 | $ 4,393 | $ 3,854 |

**Pension Liability allocated to:**

| | | |
|---|---|---|
| Accounts payable and accrued liabilities | $ 90 | $ 60 |
| Non-current liabilities | 4,303 | 3,794 |
| Pension liability outstanding at December 31 | $ 4,393 | $ 3,854 |

Key Assumptions:

| | December 31 2016 | December 31 2015 |
|---|---|---|
| Discount rate | 3.6% | 3.9% |
| Anticipated retirement age of plan members | 61 to 65 years | 61 to 65 years |

The Company's pension expense is recorded in selling and administrative expenses and interest expense and is comprised of the following:

| | Year Ended | |
|---|---|---|
| $Thousands | December 31 2016 | December 31 2015 |
| Defined benefit plan | | |
| Interest cost | $ 160 | $ 142 |
| Service cost | 272 | 350 |
| Expense for defined benefit plan | 432 | 492 |
| Expense for defined contribution plan | 1,496 | 3,291 |
| | $ 1,928 | $ 3,783 |

## 16. Share Capital

**Authorized:**

- An unlimited number of Series Preferred shares, issuable in series, designated as First Preferred Shares, no par value
- An unlimited number of Series Preferred shares, issuable in series, designated as Second Preferred Shares, no par value
- An unlimited number of Class A Non-Voting shares, no par value
- An unlimited number of Class B Common shares, no par value

**Issued:**

- All issued shares are fully paid

| (Number of shares) | Class A Non-Voting | Class B Common | Total |
|---|---|---|---|
| Shares outstanding at December 31, 2015 | 16,291,877 | 1,653,784 | 17,945,661 |
| **Shares outstanding at December 31, 2016** | **16,291,877** | **1,653,784** | **17,945,661** |

Each Class B Common Share may be converted into one Class A Non-Voting Share at the shareholder's option.

In the event that an offer to purchase Class B Common Shares is made to all or substantially all holders of Class B Common Shares while at the same time an offer to purchase Class A Non-Voting Shares on the same terms and conditions is not made to the holders of Class A Non-Voting Shares, and holders of more than 50% of the Class B Common Shares do not reject the offer in accordance with the terms of AKITA's articles of incorporation, then the holders of Class A Non-Voting Shares will be entitled to exchange each Class A Non-Voting Share for one Class B Common Share for the purpose of depositing the resulting Class B Common Share pursuant to the terms of the takeover bid. The two classes of shares rank equally in all other respects.

The Company did not establish a normal course issuer bid in 2016 or 2015.

## 17. Revenue

Revenue is comprised of the following:

| | Year Ended | |
|---|---|---|
| $Thousands | **December 31 2016** | December 31 2015 |
| Contract drilling services | **$ 32,811** | $ 112,488 |
| Contract cancellation fees | **28,250** | - |
| Total revenue | **$ 61,061** | $ 112,488 |

## 18. Expenses by Nature

The Company presents certain expenses in the consolidated Statements of Net Income (Loss) and Comprehensive Income (Loss) by function. The following table presents those expenses by their nature:

| $Thousands | Year Ended December 31 2016 | Year Ended December 31 2015 |
|---|---|---|
| **Expenses** | | |
| Salaries, wages and benefits | $ 26,735 | $ 60,590 |
| Materials and supplies | 1,029 | 9,804 |
| Repairs and maintenance | 4,109 | 11,924 |
| External services and facilities | 4,798 | 6,841 |
| | $ 36,671 | $ 89,159 |
| **Allocated to:** | | |
| Operating and maintenance | $ 24,169 | $ 74,031 |
| Selling and administrative | 12,502 | 15,128 |
| | $ 36,671 | $ 89,159 |

## 19. Net Income (Loss) per Share

| | Year Ended December 31 2016 | Year Ended December 31 2015 |
|---|---|---|
| Net income (loss) ($Thousands) | $ 5,329 | $ (33,965) |
| Weighted average outstanding shares | 17,945,661 | 17,945,661 |
| Incremental shares for diluted earnings | 11,450 | - |
| Weighted average outstanding shares for diluted earnings per share | 17,957,111 | 17,945,661 |
| | | |
| Earnings (loss) per share - basic | $ 0.30 | $ (1.89) |
| Earnings (loss) per share - diluted | $ 0.30 | $ (1.89) |

For the year ended December 31, 2015, 682,000 of the outstanding shares that would have been issued under the Stock Option Plan were excluded in calculating the weighted average number of diluted shares as the Company incurred a net loss during the year and therefore the shares were considered anti-dilutive.

## 20. Segmented Information

The Company operates in one business segment and provides contract drilling services, primarily to the oil and gas industry. From time to time, the Company is involved in other forms of drilling related to potash mining and the development of storage caverns. Segment information is provided on the basis of geographic segments as the Company manages its business through two geographic regions – Canada and the United States. During 2016, and 2015, the Company operated only in Canada.

## 21. Related Party Transactions

All related party transactions were made in the normal course of business with regular payment terms and have been recorded at the amounts agreed upon with the related parties.

**a. ATCO Group and Spruce Meadows**

The Company is related to the ATCO Group of companies and to Spruce Meadows through its majority shareholder (see Note 1). The transactions and period end balances with those affiliates are presented below.

| | Year Ended | |
|---|---|---|
| $Thousands | December 31 2016 | December 31 2015 |
| Revenue (computer services, rent) | $ 84 | $ 76 |
| Purchases | | |
| Property, plant and equipment (wellsite trailers) | - | 203 |
| Operating (sponsorship and advertising (Note 22), other) | 351 | 495 |
| Selling and administrative | 1 | - |

**b. Joint ventures and joint venture partners**

The Company is related to its joint ventures. The joint ventures' transactions and period balances with AKITA are presented below:

| | Year Ended | |
|---|---|---|
| $Thousands | December 31 2016 | December 31 2015 |
| Revenue | $ 111 | $ 30 |
| Operating costs | 2,241 | 4,866 |
| Selling and administrative costs | 289 | 553 |
| Year end accounts receivable | 1,180 | 1,872 |

**c. Legal fees**

The Company incurred legal fees of $42,000 (2015 - $59,000) during the year for services related to various legal matters with a law firm of which a director of the Company was a partner at December 31, 2016. At December 31, 2016, $1,200 (December 31, 2015 - $1,000) of this amount was included in accounts payable.

**d. Key management compensation**

Key management includes the officers and directors of the Company. The compensation paid or payable to key management for services in the capacity as either officers or directors is shown below:

| | Year Ended | |
|---|---|---|
| $Thousands | December 31 2016 | December 31 2015 |
| Salaries, directors' fees and other short-term benefits | $ 2,022 | $ 2,119 |
| Post-employment benefits | 544 | 616 |
| Share-based payments | 453 | 634 |
| Year-end compensation payable | - | - |

## 22. Commitments and Contingencies

From time to time, the Company enters into drilling contracts with its customers that are for extended periods. At December 31, 2016, the Company had two rigs with multi-year contracts. Of these contracts, one is due to expire in 2017 and one in 2018.

The Company has entered into two contracts with a related party to provide sponsorship and advertising at an annual cost of $325,000.

The Company leases its office space at a cost of approximately $810,000 per year. This lease expires on December 31, 2019.

At December 31, 2016, the Company had capital expenditure commitments of $827,000 due in 2017 (2015 – $1,001,000 due in 2016).

## 23. Change in Non-Cash Working Capital

| | Year Ended | |
|---|---|---|
| $Thousands | December 31 2016 | December 31 2015 |
| **Change in non-cash working capital:** | | |
| Accounts receivable | $ (13,910) | $ 25,671 |
| Prepaid expenses and other | 1 | 109 |
| Accounts payable and accrued liabilities | (1,078) | (18,868) |
| Deferred revenue | - | (175) |
| **Change in non-cash working capital:** | $ (14,987) | $ 6,737 |
| **Pertaining to:** | | |
| Operations | $ (17,405) | $ 14,859 |
| Investing | 2,418 | (8,122) |
| **Change in non-cash working capital:** | $ (14,987) | $ 6,737 |

## 24. Accounting Changes Not Yet Adopted

Certain new or amended standards or interpretations have been issued by the International Accounting Standards Board or the International Financial Reporting Interpretations Committee that are not required to be adopted in the current period. The Company has not early adopted these standards or interpretations. The standards which the Company anticipates may have a material effect on the consolidated financial statements or note disclosures are described below. The Company is currently evaluating the impact of these new standards on its financial statements.

IFRS 9, “Financial Instruments”, amends the classification and measurement of financial assets and introduces a new expected loss impairment model. This standard is effective for annual periods beginning on or after January 1, 2018, and shall be applied retrospectively.

IFRS 15, “Revenue from Contracts with Customers”, replaces the previous guidance on revenue recognition and provides a framework to determine when to recognize revenue and at what amount. The new standard is effective for annual periods beginning on or after January 1, 2018, and shall be applied retrospectively.

IFRS 16, “Leases”, replaces the previous guidance on leases and sets out the principles for the recognition, measurement, presentation, and disclosure of leases for both parties to a contract. The new standard is effective for annual periods beginning on or after January 1, 2019, and shall be applied retrospectively.

There are no other standards or interpretations that have been issued, but are not yet effective, that the Company anticipates will have a material effect on the consolidated financial statements once adopted.

# 10 Year Financial Review

| $Thousands (except per share) | Annual Ranking | 2016 | 2015 | 2014 |
|---|---|---|---|---|
| **Summary of Operations** | | | | |
| Revenue | 10 | $ 61,061 | $ 112,488 | $ 165,274 |
| Income (loss) before income taxes | 9 | $ 7,535 | $ (44,544) | $ 28,121 |
| Income taxes (recovery) | 9 | $ 2,206 | $ (10,579) | $ 7,042 |
| Net income (loss) | 9 | $ 5,329 | $ (33,965) | $ 21,079 |
| As a percentage of average shareholders' equity | 9 | 2.4% | (14.2%) | 8.3% |
| Earnings (loss) per Class A and Class B shares (basic) | 9 | $ 0.30 | $ (1.89) | $ 1.17 |
| Funds flow from operations | 7 | $ 34,500 | $ 38,510 | $ 56,195 |
| As a percentage of average shareholders' equity | 9 | 15.7% | 16.0% | 22.2% |
| **Financial Position at Year End** | | | | |
| Working capital (deficiency) | 7 | $ 34,907 | $ 16,002 | $ (5,028) |
| Current ratio | 2 | 4.49:1 | 2.45:1 | 0.90:1 |
| Total assets | 4 | $ 257,907 | $ 254,516 | $ 340,926 |
| Shareholders' equity | 5 | $ 219,646 | $ 220,200 | $ 259,841 |
| per share | 5 | $ 12.24 | $ 12.27 | $ 14.48 |
| **Other** | | | | |
| Capital expenditures (net) | 9 | $ 13,193 | $ 17,960 | $ 103,949 |
| Depreciation and amortization | 6 | $ 23,959 | $ 36,748 | $ 30,200 |
| Dividends paid | 2 | $ 6,100 | $ 6,101 | $ 6,015 |
| per share | 1 | $ 0.34 | $ 0.34 | $ 0.34 |

*Note: Financial information has been calculated under Canadian GAAP for the years 2007 to 2009 and under IFRS for the years 2010 through 2016. Readers should be aware that these two sets of accounting standards are not consistent with each other. Revenue amounts reported for 2012 through 2016 include revenue solely generated by the Company from its wholly-owned operations.*

| 2013 | 2012 | 2011 | 2010 | 2009 | 2008 | 2007 |
|---|---|---|---|---|---|---|
| $ 168,111 | $ 203,440 | $ 199,934 | $ 145,138 | $ 106,263 | $ 137,246 | $ 141,962 |
| $ 35,682 | $ 38,413 | $ 31,762 | $ 10,932 | $ 11,901 | $ 20,133 | $ 28,667 |
| $ 9,167 | $ 9,658 | $ 8,409 | $ 3,462 | $ 3,521 | $ 7,147 | $ 7,525 |
| $ 26,515 | $ 28,755 | $ 23,353 | $ 7,470 | $ 8,380 | $ 14,847 | $ 20,752 |
| 11.3% | 13.5% | 12.1% | 4.1% | 4.2% | 7.7% | 11.5% |
| $ 1.48 | $ 1.60 | $ 1.29 | $ 0.41 | $ 0.46 | $ 0.81 | $ 1.14 |
| $ 57,619 | $ 59,474 | $ 42,895 | $ 32,798 | $ 23,960 | $ 34,149 | $ 37,143 |
| 24.6% | 28.0% | 22.3% | 17.9% | 12.0% | 17.6% | 20.6% |
| | | | | | | |
| $ 40,645 | $ 31,214 | $ 44,265 | $ 61,341 | $ 69,819 | $ 63,089 | $ 49,123 |
| 2.93:1 | 1.70:1 | 2.37:1 | 4.04:1 | 7.02:1 | 3.90:1 | 3.92:1 |
| $ 291,748 | $ 292,994 | $ 247,130 | $ 218,587 | $ 234,215 | $ 242,869 | $ 223,522 |
| $ 245,288 | $ 223,998 | $ 201,104 | $ 183,739 | $ 201,446 | $ 198,461 | $ 188,038 |
| $ 13.65 | $ 12.49 | $ 11.15 | $ 10.19 | $ 11.05 | $ 10.89 | $ 10.29 |
| | | | | | | |
| $ 35,113 | $ 65,356 | $ 54,509 | $ 36,293 | $ 11,835 | $ 14,622 | $ 33,505 |
| $ 26,825 | $ 24,342 | $ 20,933 | $ 24,540 | $ 17,476 | $ 16,667 | $ 15,164 |
| $ 5,567 | $ 5,038 | $ 5,066 | $ 5,079 | $ 5,105 | $ 5,111 | $ 5,117 |
| $ 0.32 | $ 0.28 | $ 0.28 | $ 0.28 | $ 0.28 | $ 0.28 | $ 0.28 |

AKITA DRILLING LTD.

# Proud of Our Partnerships

We take pride in our long history of working together with our Aboriginal and First Nations partners.

Our joint ventures:

- Provide financial rewards, employment and training opportunities for our partner organizations and their people;
- Use equity-based structures that bring long-term benefits to all participants;
- Enhance our ability to provide drilling services in some of Canada's most prospective regions.


**AKITA Rig 28 drilling in the Wood Buffalo area.**

# Corporate Information

## Directors

**Loraine M. Charlton**
Corporate Director,
Calgary, Alberta

**Linda A. Southern-Heathcott**
President and Chief Executive Officer,
Spruce Meadows Ltd.,
President, Team Spruce Meadows Inc.
Chairman of the Board,
AKITA Drilling Ltd.,
Calgary, Alberta

**Harish K. Mohan**
Corporate Director,
Calgary, Alberta

**Dale R. Richardson**
Vice President,
Sentgraf Enterprises Ltd.
Calgary, Alberta

**Karl A. Ruud**
President and Chief Executive Officer,
AKITA Drilling Ltd.,
Calgary, Alberta

**Nancy C. Southern**
Chairman, President and
Chief Executive Officer,
ATCO Ltd., Canadian Utilities Limited,
and CU Inc.,
Calgary, Alberta

**C. Perry Spitznagel, Q.C.**
Vice Chairman and
Managing Partner (Calgary),
Bennett Jones LLP,
Calgary, Alberta

**Henry G. Wilmot**
Corporate Director,
Calgary, Alberta

**Charles W. Wilson**
Corporate Director,
Boulder, Colorado

## Officers

**Raymond T. Coleman**
Senior Vice President

**Colin A. Dease**
Corporate Secretary

**Fred O. Hensel**
Vice President, Marketing

**Craig W. Kushner**
Director of Human Resources

**Darcy Reynolds**
Vice President, Finance and
Chief Financial Officer

**Karl A. Ruud**
President and Chief Executive Officer

## Head Office

**AKITA Drilling Ltd.,**
1000, 333 - 7th Avenue SW
Calgary, Alberta T2P 2Z1
403.292.7979

## Banker

**Alberta Treasury Branches**
Calgary, Alberta

## Counsel

**Bennett Jones LLP**
Calgary, Alberta

## Auditors

**PricewaterhouseCoopers LLP**
Calgary, Alberta

## Registrar and Transfer Agent

**CST Trust Company**
Calgary, Alberta and
Toronto, Ontario
1.800.387.0825

## Share Symbol / TSX

Class A Non-Voting (AKT.A)
Class B Common (AKT.B)

## Website

www.akita-drilling.com

## HEAD OFFICE

AKITA Drilling Ltd. | 1000, 333 - 7th Avenue SW, Calgary, Alberta T2P 2Z1 | www.akita-drilling.com