exploration success

35% increase in reserves

24% reduction in operating costs

$10.57 per boe FD&A cost

cequence energy ltd

2012 Annual Report

HIGHLIGHTS

	Three months ended December 31			Year ended December 31		
(000s except per share and per unit amounts)	**2012**	2011	% Change	**2012**	2011	% Change
Financial ($)						
Production revenue [(1)]	**21,939**	23,527	(7)	**75,650**	101,996	(26)
Comprehensive income (loss)	**666**	(15,598)	104	**(17,673)**	(20,158)	(12)
Per share, basic and diluted	**(0.00)**	(0.10)	100	**(0.10)**	(0.14)	(29)
Funds flow from operations [(2)]	**11,603**	10,002	16	**33,724**	42,262	(20)
Per share, basic and diluted	**0.06**	0.06	–	**0.19**	0.29	(34)
Production volumes						
Natural gas (Mcf/d)	**47,125**	47,203	–	**47,137**	47,825	(1)
Crude oil (bbls/d)	**583**	503	16	**622**	575	8
Natural gas liquids (bbls/d)	**515**	509	1	**512**	464	10
Total (boe/d)	**8,951**	8,879	1	**8,990**	9,010	–
Sales prices						
Natural gas, including realized hedges ($/Mcf)	**3.49**	3.59	(3)	**2.67**	4.03	(34)
Crude oil ($/bbl)	**86.78**	97.15	(11)	**85.02**	92.60	(8)
Natural gas liquids ($/bbl)	**45.83**	73.19	(37)	**54.76**	71.99	(24)
Total ($/boe)	**26.64**	28.80	(8)	**22.99**	31.02	(26)
Operating Netback ($/boe)						
Price	**26.64**	28.80	(8)	**22.99**	31.02	(26)
Royalties	**(1.88)**	(3.75)	(50)	**(1.45)**	(4.18)	(65)
Transportation	**(1.76)**	(1.93)	(9)	**(2.04)**	(2.18)	(6)
Operating costs	**(6.55)**	(8.60)	(24)	**(7.43)**	(9.02)	(18)
Operating netback	**16.45**	14.52	13	**12.07**	15.64	(22)
Capital Expenditures ($)						
Capital expenditures	**23,997**	56,335	(57)	**91,658**	149,601	(39)
Net acquisitions (dispositions) [(4)]	**644**	–	100	**(13,258)**	(23,023)	(42)
Total capital expenditures	**24,641**	56,335	(56)	**78,400**	126,578	(38)
Net debt and working capital (deficiency) [(3)]	**(45,869)**	(51,442)	(11)	**(45,869)**	(51,442)	(11)
Weighted average shares outstanding (basic and diluted)	**194,224**	161,818	20	**178,209**	147,558	21
Undeveloped land (net acres)	**204,215**	254,400	(20)	**204,215**	254,400	(20)

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

(2) Funds flow from operations is calculated as cash flow from operating activities before adjustments for decommissioning liabilities expenditures and net changes in non-cash working capital. For the twelve months ended December 31, 2012, funds flow from operations included a $3,347 termination fee (net of transaction costs) related to an unsuccessful acquisition.

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

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

Message to Shareholders

In 2012, Cequence focused its efforts on increasing its asset value through the delineation of the Montney liquids-rich gas pool at Simonette and on expanding its resource base through exploration in the Deep Basin. We believe that our efforts were successful and that the Company is well-positioned for near-term production growth and longer-term value creation.

Simonette Montney

The scale of Montney reserve additions at Simonette affirms the size and quality of the resource. The 2012 drilling program was designed primarily to delineate the Montney resource base with 5.0 net Montney horizontal wells drilled and completed at Simonette, resulting in the addition of 23 million boe of proved plus probable reserves in 2012. The Simonette Montney now accounts for a total of 55 million boe or reserves or 60 percent of our total corporate reserves.

Successful drilling in 2012 resulted in the average Montney reserves per horizontal well increasing by more than 20 percent from the 2011 year-end independent reserve report. The average Montney well, according to the December 31, 2012 reserve report by GLJ Petroleum Consultants Ltd., has 4.7 bcf of raw natural gas, 99,000 bbls of condensate and 42,000 bbls of other NGLs, making these wells clearly economic at today's natural gas prices

In February 2013, Cequence announced it had reached an agreement to acquire the Simonette Montney interests of its partner in 33 gross (16.5 net) sections of Montney rights at Simonette and 2.7 net sections at Resthaven. The transaction is expected to close in the middle of next month. Cequence believes that the expansion and consolidation of its contiguous Montney land position at Simonette has significant present and future economic and strategic value. Upon closing, Cequence will own approximately 89 net Montney sections at Simonette. Based on an expectation of four wells per section, we expect that full development will see up to 260 Montney wells drilled on our land base.

Exploration Success and Opportunity

In 2012 and early 2013, Cequence established two new plays at Simonette with successful horizontal wells drilled in the Falher and Dunvegan formations. Initial results are very promising and we believe there are up to 22 Dunvegan horizontal locations and 28 Falher horizontal locations on our land at Simonette. The liquids content and expected productivity of both plays result in break-even natural gas prices of approximately $2.00 per Mcf.

A significant portion of land at Simonette is prospective for some combination of the Montney, Falher, Wilrich and Dunvegan formations. Multi-zone development is expected to benefit the economics of all of the Company's development drilling through the use of common pad-sites and gathering facilities.

In addition to its core property at Simonette, over the past two years Cequence has accumulated 31 net sections of land at Ansell targeting an emerging prolific Wilrich play. Ansell is in a multi-zone area of the Deep Basin approximately 85 miles southeast of Simonette. Recently, competitors have experienced excellent Wilrich success in the area. In February 2013, Cequence announced a farm-out agreement to accelerate the exploration and development of its assets in the Ansell area. The first farm-out well was drilled in the first quarter of 2013 and preliminary results are expected by mid-year.

Reserves

Cequence added significant value through record reserve additions from its 2012 net capital program of $78.4 million, which delivered excellent finding and development costs. Proved plus probable finding, development and acquisition (FD&A) costs, including future development capital (FDC) were $10.57 per boe and proved FD&A costs including FDC were $12.93 per boe. These are excellent results, and both accomplishments rank Cequence favourably amongst its peers.

As a result of its capital efficiency, Cequence increased its total proved plus probable reserves by 35 percent year-over-year, to 91 million boe, and its total proved reserve by 32 percent to 46 million boe, at year-end 2012. Despite the decrease in natural gas prices in 2012, Cequence increased the net present value of the Company's proved plus probable reserves by 12 percent from the prior year to $797 million or $3.97 per share (using a discount rate of 10 percent). Approximately 85 percent of the year's proved plus probable reserve additions were in the Montney, which is the largest part of our development inventory.

The growth in reserves further substantiates management's views that the Company's assets contain significant resource potential driven by the scale of reserve additions in the Montney.

Cost Reductions

In 2012, we set out to reduce operating and total cash costs, and we are now one of the lowest-cost operators in the Western Canada Sedimentary Basin.

Cequence invested $25 million in infrastructure at Simonette in 2012, which will benefit the Company in the upcoming years in terms of operating costs and throughput capacity. The most significant component of this infrastructure spending was the Aux Sable project, completed in June 2012. The project has resulted in significant improvements to operating efficiencies and was the primary driver in reducing Simonette field operating costs to $3.81 per boe in the fourth quarter of 2012. Low operating costs combined with the high liquids content of Simonette natural gas resulted in fourth quarter 2012 field netbacks of $20.60 per boe despite an AECO spot price of $3.19 per Mcf.

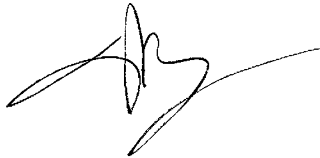
Sixty percent of corporate production is now from Simonette, and this has begun to transform the Company's corporate cost structure. Corporate operating costs of $6.55 per boe in the fourth quarter of 2012 represent a decrease of 24 percent from the fourth quarter of 2011. Corporate cash costs (operating, transportation, general and administrative, and interest expenses) of $10.65 per boe in the fourth quarter of 2012 decreased by 21 percent from 2011, ranking Cequence in the top quartile of gas-weighted operators in Canada. Our expectation is that our continued focus at Simonette will result in continued cost improvement in 2013.

Natural gas prices have rebounded from their low point in the spring of 2012 and the results began to materialize with improved corporate netbacks and cash flow in the fourth quarter of 2012. Cequence has taken advantage of the strengthening natural gas price to hedge approximately 50 percent of its natural gas production through the remainder of 2013 at an average price of $3.60 per Mcf, well above the average realized natural gas price of $2.67 in 2012. This should contribute to stronger funds from operations in 2013.

Outlook and Growth

Cequence has assembled a large inventory of Deep Basin opportunities through a challenging natural gas market. We have made great strides in our cost structure and entered 2013 with a strong balance sheet, including net debt of $45.9 million on bank lines of $100 million. We are encouraged by our initial winter drilling results, which have included successful wells in the Montney, Falher and Dunvegan. Cequence is poised for meaningful production growth beginning in the second quarter of 2013, coinciding with the completion of Simonette compression and gathering system expansion.

On behalf of the Board of Directors,



Paul Wanklyn
President and CEO
March 25, 2013

MANAGEMENT'S DISCUSSION AND ANALYSIS

This Management's Discussion and Analysis ("MD&A") of the financial and operating results of Cequence Energy Ltd. ("Cequence" or the "Company") should be read in conjunction with the Company's audited consolidated financial statements (the "Financial Statements") and related notes for the years ended December 31, 2012 and 2011.

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

This MD&A is dated March 7, 2013.

Basis of Presentation

The Financial Statements and comparative information have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB").

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

For fiscal 2012, the ratio between the average price of West Texas Intermediate ("WTI") crude oil at Cushing and NYMEX natural gas was approximately 33:1 ("Value Ratio"). The Value Ratio is obtained using the 2012 WTI average price of $94.14 (US$/Bbl) for crude oil and the 2012 NYMEX average price of $2.83 (US$/MMbtu) for natural gas. This Value Ratio is significantly different from the energy equivalency ratio of 6:1 and using a 6:1 ratio would be misleading as an indication of value.

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

Non-GAAP Measurements

Within the MD&A references are made to terms commonly used in the oil and gas industry, including netback, net debt and working capital (deficiency) and funds flow from operations.

Netback is not defined by IFRS in Canada and is referred to as a non-GAAP measure. Netback equals total revenue less royalties, operating costs and transportation costs. Management utilizes this measure to analyze operating performance.

Net debt and working capital (deficiency) is a non-GAAP term that is calculated as cash and net working capital less commodity contract assets and liabilities and demand credit facilities and excluding other liabilities. Cequence uses net debt and working capital deficiency as it provides an estimate of the Company's assets and obligations expected to be settled in cash.

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

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

Selected Financial Information

A reconciliation of cash flow from operating activities to funds flow from operations and other selected financial information is as follows:

	Three months ended December 31		Year ended December 31		
($000s)	**2012**	2011	**2012**	2011	2010
Cash flow from operating activities	**13,295**	6,743	**37,770**	36,700	17,240
Decommissioning liabilities expenditures	**80**	455	**904**	955	126
Proceeds from sale of commodity contracts	**–**	–	**–**	–	(3,386)
Net change in non-cash working capital	**(1,772)**	2,804	**(4,950)**	4,607	2,017
Funds flow from operations	**11,603**	10,002	**33,724**	42,262	15,997
Per share, basic and diluted ($)	**0.06**	0.06	**0.19**	0.29	0.23
Production revenue	**21,939**	23,527	**75,650**	101,996	54,570
Comprehensive income (loss)	**666**	(15,598)	**(17,673)**	(20,158)	(52,349)
Per share, basic and diluted ($)	**0.00**	(0.10)	**(0.10)**	(0.14)	(0.75)
Total assets	**519,324**	491,365	**519,324**	491,365	409,381
Demand credit facilities	**23,191**	11,618	**23,191**	11,618	56,739

Cequence recorded a comprehensive income (loss) of $666 and $(17,673) for the three and twelve months ended December 31, 2012, respectively. The Company's comprehensive loss for the twelve months ended December 31, 2012 was negatively impacted by low natural gas prices and impairments recognized on the Company's property and equipment, offset by gains realized on the sale of certain undeveloped land and natural gas weighted properties and the receipt of a $3,347 termination fee (net of transaction costs) related to an unsuccessful acquisition.

Funds flow from operations was $11,603 for the three months ended December 31, 2012, compared to $10,002 for the three months ended December 31, 2011. The increase in funds flow from operations was achieved through reductions in royalties, transportation, general and administrative expenses and operating costs from the comparative period.

Funds flow from operations was $33,724 for twelve months ended December 31, 2012 compared to $42,262 for the twelve months ended December 31, 2011. The decrease in funds flow from operations is due largely to a 26 percent decrease in revenue resulting from lower realized oil and natural gas prices. The reduction in revenue was partially offset by lower royalties, transportation, general and administrative expenses, operating costs and the receipt of a termination fee.

Results of Operations

Production

Average production volumes, revenue and prices for the three and twelve month periods ended December 31, 2012 and 2011 are outlined below:

	Three months ended December 31		Year ended December 31	
	2012	2011	**2012**	2011
Natural gas (Mcf/d)	**47,125**	47,203	**47,137**	47,825
Crude oil (bbls/d)	**583**	503	**622**	575
Natural gas liquids (bbls/d)	**515**	509	**512**	464
Total (boe/d)	**8,951**	8,879	**8,990**	9,010
Total production (boe)	**823,492**	816,873	**3,290,340**	3,288,563

Production for the year ended December 31, 2012 averaged 8,990 boe/d and is comparable to production of 9,010 boe/d in 2011. Production for the three months ended December 31, 2012 averaged 8,951 boe/d and is comparable to production of 8,879 boe/d in the fourth quarter of 2011. Cequence's average production for the twelve months ended December 31, 2012 of 8,990 boe/d was consistent with its 2012 guidance of 8,800 boe/d.

Revenue

	Three months ended December 31		Year ended December 31	
($000s)	**2012**	2011	**2012**	2011
Revenue				
Natural gas	**15,453**	15,162	**46,189**	69,467
Realized gains (loss) on natural gas hedges	**(334)**	443	**(161)**	906
Total natural gas	**15,119**	15,605	**46,028**	70,373
Crude oil	**4,651**	4,492	**19,367**	19,429
Natural gas liquids	**2,169**	3,430	**10,255**	12,194
Total production revenue, gross of royalties	**21,939**	23,527	**75,650**	101,996
Average prices				
Natural gas ($/Mcf)	**3.56**	3.49	**2.68**	3.98
Realized natural gas hedge ($/Mcf)	**(0.07)**	0.10	**(0.01)**	0.05
Natural gas including hedge ($/Mcf)	**3.49**	3.59	**2.67**	4.03
Crude oil ($/bbl)	**86.78**	97.15	**85.02**	92.60
Natural gas liquids ($/bbl)	**45.83**	73.19	**54.76**	71.99
Average sales price before hedge ($/boe)	**27.05**	28.26	**23.04**	30.74
Average sales price including hedge ($/boe)	**26.64**	28.80	**22.99**	31.02
Benchmark pricing				
AECO-C spot (CDN$/Mcf)	**3.19**	3.19	**2.38**	3.64
WTI crude oil (US$/bbl)	**88.17**	94.03	**94.14**	95.05
Edmonton par price (CDN$/bbl)	**84.97**	98.17	**86.91**	95.57
US$/CDN$ exchange rate	**0.99**	0.98	**0.99**	1.01

Total production revenue, gross of royalties, was $21,939 in the fourth quarter of 2012 compared to $23,527 for the comparable period in 2011. The change in revenue is mainly attributable to a 4 percent decrease in realized prices before hedging and a decrease of $778 in realized hedging gains (loss). For the year ended December 31, 2012, production revenue, gross of royalties, decreased 26 percent to $75,650 from $101,996 in the prior year. The decrease in revenue is mainly attributable to the 25 percent decrease in realized prices before hedging and a decrease of $1,067 in realized hedging gains (loss).

Pricing

Cequence's production is approximately 87 percent natural gas and consequently, fluctuations in natural gas prices have a significant impact on the Company's revenue and funds flow. Canadian natural gas prices averaged $2.38 per Mcf in 2012, down 35 per cent from $3.64 per Mcf in 2011. Lower natural gas prices were largely attributed to record high North American production and inventory levels despite a reduction in North American natural gas drilling activity in 2012 in response to low natural gas prices. Improved horizontal well technology and associated gas from oil and liquids-rich gas development contributed to record high American production levels during 2012. In addition, the combination of record production and lower heating demand due to mild winter weather has resulted in a significant build in natural gas inventories.

Realized natural gas prices for the twelve months ended December 31, 2012 were $2.68 per Mcf, down 34 percent from the comparable period in 2011. Cequence realized a natural gas price including hedging gains for the fourth quarter of 2012 of $3.49 per Mcf, a decrease of 3 percent from the comparable period in 2011. Realized natural gas prices for the three and twelve months ended December 31, 2012 are above benchmark prices as much of the Company's natural gas sells at a premium to AECO due to the heat content of the gas.

Oil prices for the fourth quarter of 2012 were $86.78 per barrel, down 11 percent from the same time period in 2011. Oil prices for the twelve months ended December 31, 2012 were $85.02 per barrel, down 8 percent from the comparable period in 2011.

Natural gas liquids prices for the fourth quarter of 2012 were $45.83 per barrel, down 37 percent from the same time period in 2011. Natural gas liquids prices for the twelve months ended December 31, 2012 were $54.76 per barrel, down 24 percent from the comparable period in 2011. The decline in realized natural gas liquids prices was consistent with declines to benchmark NGL prices in 2012. In addition, the commencement of the Aux Sable arrangement resulted in additional ethane volumes 2012 which reduced the average realized NGL price. Under the Aux Sable Arrangement, Cequence has the option to ship unprocessed rich natural gas to the Aux Sable NGL extraction and fractionation plant in Channahon, IL. Cequence sells unprocessed rich natural gas at AECO and participates in the revenue from the natural gas liquids extracted at the Aux Sable facility and sold in the US market.

Commodity Price Management

	Three months ended December 31		Year ended December 31	
($000s)	**2012**	2011	**2012**	2011
Realized gains (loss) on commodity contracts	**(335)**	443	**(161)**	906
Unrealized gains (loss) on commodity contracts	**1,490**	(168)	**757**	–
Total	**1,155**	275	**596**	906

Cequence has a commodity price risk management program which provides the Company flexibility to enter into derivative and physical commodity contracts to protect future cash flows for planned capital expenditures. The Company has the following outstanding positions for commodity derivative financial instruments:

Term	Product	Type	Volume	Price	Basis
January 1, 2013 to December 31, 2013	Gas	Swap	2,000 GJ/day	$2.84	AECO
January 1, 2013 to December 31, 2013	Gas	Swap	2,500 GJ/day	$3.09	AECO
January 1, 2013 to December 31, 2013	Gas	Swap	2,500 GJ/day	$3.00	AECO
January 1, 2013 to December 31, 2013	Gas	Swap	5,000 GJ/day	$3.10	AECO
January 1, 2013 to December 31, 2013	Gas	Swap	2,500 GJ/day	$3.24	AECO
January 1, 2013 to December 31, 2013	Gas	Swap	2,500 GJ/day	$3.40	AECO
March 1, 2013 to December 31, 2013	Gas	Swap	2,500 GJ/day	$3.03	AECO
March 1, 2013 to December 31, 2013	Gas	Swap	2,500 GJ/day	$3.17	AECO
January 1, 2014 to September 30, 2014	Gas	Swap	2,500 GJ/day	$3.51	AECO
January 1, 2014 to December 31, 2014	Gas	Swap	2,500 GJ/day	$3.42	AECO
January 1, 2014 to December 31, 2014	Gas	Swap	2,500 GJ/day	$3.53	AECO
January 1, 2013 to December 31, 2013	Oil	Sold Call	200 bbls/day	$110.00 USD	WTI

Cequence has hedged approximately 40 percent (22,000 GJ/d) of its remaining 2013 natural gas production volumes at an average AECO price of $3.11 per GJ. Cequence has hedged approximately 12 percent (6,875 GJ/d) of estimated 2014 natural gas production volumes at an average price of $3.49 per GJ.

The fair value of the commodity contracts outstanding at December 31, 2012 was a current asset of $694 and a non-current asset of $63 (2011 – $nil).

Royalty Expense

	Three months ended December 31		Year ended December 31	
($000s)	**2012**	2011	**2012**	2011
Crown	**951**	2,518	**2,862**	10,845
Freehold / Overriding	**595**	545	**1,900**	2,898
	1,546	3,063	**4,762**	13,743
As a % of revenue, before hedging activity				
Crown	**4%**	11%	**4%**	11%
Freehold /Overriding	**3%**	2%	**2%**	3%
	7%	13%	**6%**	14%
Per unit of production ($/boe)				
Crown	**1.15**	3.08	**0.87**	3.30
Freehold /Overriding	**0.73**	0.67	**0.58**	0.88
	1.88	3.75	**1.45**	4.18

Royalty expense in the fourth quarter of 2012 was $1,546 or 7 percent of revenue compared to $3,063 or 13 percent of revenue in 2011. For the twelve months ended December 31, 2012, royalties as a percentage of revenue were 6 percent compared to 14 percent in the comparative period of 2011. The overall royalty rate has decreased in 2012 due to increased gas cost allowance, a greater percentage of Company's production from new wells that carry a royalty rate of 5 percent and lower royalty rates on certain production as a result of lower natural gas prices. The adjustments related to gas cost allowance are not recurring. The Company's royalties as percentage of revenue are consistent with expectations of approximately 7 to 9 percent for the year ended December 31, 2012.

Transportation Expense

	Three months ended December 31		Year ended December 31	
($000s)	**2012**	2011	**2012**	2011
Transportation ($)	**1,449**	1,580	**6,702**	7,153
Per unit of production ($/boe)	**1.76**	1.93	**2.04**	2.18

Transportation expense for the twelve months ended December 31, 2012 was $2.04 per boe, a decrease of 6 percent from the comparative period in 2012. In the fourth quarter of 2012, transportation expense decreased to $1.76 per boe from $1.93 per boe in the comparative period in 2011. The Company's transportation costs per boe are slightly higher than expectations of approximately $1.50 to $2.00 per boe for the year ended December 31, 2012.

Operating Costs

	Three months ended December 31		Year ended December 31	
($000s)	**2012**	2011	**2012**	2011
Operating costs ($)	**5,397**	7,022	**24,440**	29,673
Per unit of production ($/boe)	**6.55**	8.60	**7.43**	9.02

For the twelve months ended December 31, 2012, operating costs decreased to $7.43 per boe from $9.02 per boe in the comparative period in 2011. Operating costs for the fourth quarter of 2012 were $5,397 or $6.55 per boe compared to $7,022 or $8.60 per boe for the same period in 2011. Operating costs per boe decreased in the three and twelve months ended December 31, 2012 compared to the same periods in 2011 mainly due to lower costs on new wells drilled that comprise an increasing percentage of the Company's prodution, the sale of higher cost properties in 2011 and the commencement of the Aux Sable arrangement in the second quarter of 2012.

The third quarter of 2012 was the first full quarter with significant production volumes being sold under the Aux Sable Arrangement. Cequence realized slightly higher NGL volumes at Simonette and higher operating netbacks, through a reduction of processing fees of approximately $0.50 per Mcf on volumes sold under this arrangement when compared to the previous processing arrangements. The Company's operating costs per boe are in line with expectations of approximately $7.00 to $8.00 per boe for the year ended December 31, 2012.

Operating Netback

	Three months ended December 31		Year ended December 31	
($/boe)	**2012**	2011	**2012**	2011
Production revenue [1]	**26.64**	28.80	**22.99**	31.02
Royalty expense	**(1.88)**	(3.75)	**(1.45)**	(4.18)
Transportation expense	**(1.76)**	(1.93)	**(2.04)**	(2.18)
Operating costs	**(6.55)**	(8.60)	**(7.43)**	(9.02)
Operating netback, $/boe	**16.45**	14.52	**12.07**	15.64
Operating netback, excluding realized hedges , $/boe	**16.86**	13.98	**12.13**	15.36

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

Cequence's netback for the fourth quarter of 2012 increased to $16.45 per boe from $14.52 per boe in 2011. The increase in operating netback for the three months ended December 31, 2012 is mainly due to decreases in expenses more than offsetting the 8 percent decrease in realized price. For the twelve months ended December 31, 2012, the netback decreased to $12.07 per boe from $15.64 per boe in the comparative period in 2011. The decrease in operating netback for the twelve months ended December 31, 2012 is primarily due to decreases in natural gas prices that resulted in a lower production revenue of $8.03 per boe including decreases of $0.32 per boe in realized hedging gains (loss). The decreases above were partially offset by improvements to royalty expense, transportation expense and operating costs.

General and Administrative Expenses

	Three months ended December 31		Year ended December 31	
($000s)	**2012**	2011	**2012**	2011
G&A expenses ($)	**1,519**	1,665	**7,105**	7,325
Per unit of production ($/boe)	**1.85**	2.04	**2.16**	2.23

Total general and administrative costs for the three months ended December 31, 2012 and the year ended 2012 were consistent with the prior year as the size and nature of the business have not changed significantly. The Company's G&A expenses per boe for the year ended December 31, 2012 are consistent with expectations of approximately $2.00 to $2.50 per boe for the year ended December 31, 2012.

Finance Costs

	Three months ended December 31		Year ended December 31	
($000s)	**2012**	2011	**2012**	2011
Interest expense	**404**	224	**2,000**	1,928
Accretion expense on provisions	**202**	174	**725**	905
Amortization of transaction costs on financial instruments	**–**	–	**–**	443
Total finance costs	**606**	398	**2,725**	3,276
Per unit of production ($/boe)	**0.74**	0.49	**0.83**	1.00
Interest per unit of production, ($/boe)	**0.49**	0.27	**0.61**	0.59

Finance costs for the three months ended December 31, 2012 were $606 compared to $398 for the comparative period in 2011. Finance costs for the twelve months ended December 31, 2012 were $2,725 compared to $3,276 for the comparative period in 2011. The decrease is mainly due to $443 of amortization related to transaction costs on the establishment and renewal of the Company's credit facilities being expensed for the twelve months ended 2011.

Other Income

	Three months ended December 31		Year ended December 31	
($000s)	**2012**	2011	**2012**	2011
Gain on sale of property and equipment	**–**	–	**(20,390)**	(5,077)
Termination fee net of transactions	**(39)**	–	**(3,347)**	–
Provisions related to onerous contracts	**–**	1,138	**–**	1,138
Other	**(20)**	(22)	**(57)**	(74)
Total other income	**(59)**	1,116	**(23,794)**	(4,013)

In 2012, Cequence disposed of non-producing oil and gas assets for total proceeds of $20,662 resulting in a gain of $20,390.

In June 2012, Cequence and Open Range Energy Corp. ("Open Range") entered into an arrangement agreement whereby Cequence agreed to acquire all of the outstanding common shares of Open Range. In July 2012, Open Range accepted a superior proposal from another publicly traded Canadian oil and gas company and in accordance with the terms of the arrangement agreement, Open Range paid to Cequence a termination fee of $4,600. Transaction costs of $1,253 were incurred by the Company with respect to this arrangement agreement during 2012. The net amount of $3,347 has been included in other income for the twelve months ended December 31, 2012.

Depletion, Depreciation and Impairment

	Three months ended December 31		Year ended December 31	
($000s)	**2012**	2011	**2012**	2011
Depletion and depreciation expense	**9,345**	10,186	**39,564**	41,228
Impairment	**1,113**	18,332	**26,894**	18,332
Total depletion, depreciation and impairment	**10,458**	28,518	**66,458**	59,560
Per unit of production ($/boe)	**12.70**	34.91	**20.20**	18.11
Per unit of production, excluding impairment ($/boe)	**11.35**	12.47	**12.02**	12.54

Depletion and depreciation expense for the three and twelve months ended December 31, 2012 was $10,458 ($12.70 per boe) and $66,458 ($20.20 per boe), respectively. Depletion and depreciation rates excluding impairment are similar to the comparable period in 2011 as there have not been significant changes to Cequence's resource base during this time.

Impairment expense for the three and twelve months ended December 31, 2012 was $1,113 and $26,894, respectively, compared to $18,332 for the three and twelve months ended December 31, 2011. Impairments recognized in 2012 are mainly the results of declining benchmark natural gas prices and minimal capital expenditures in the Northeast British Columbia and Peace River Arch cash generating units ("CGU"). Substantially all of the Company's capital expenditures in the past two years have been on the Deep Basin CGU. The following represents impairment recognized per CGU in the three and twelve months ended December 31, 2012 and 2011:

	Three months ended December 31		Year ended December 31	
($000s)	**2012**	2011	**2012**	2011
Northeast British Columbia	**–**	4,770	**14,931**	4,770
Peace River Arch	**1,113**	13,562	**11,963**	13,562
Deep Basin	**–**	–	**–**	–
Total	**1,113**	18,332	**26,894**	18,332

Provisions

Decommissioning liabilities

Total decommissioning liabilities at December 31, 2012 were $32,564 compared to $28,135 at December 31, 2011. The following table summarizes the changes in decommissioning liabilities for the years ended December 31, 2012 and 2011:

(000s)	**2012**	2011
Balance, beginning of year	**28,135**	26,130
Acquisitions	**417**	1,539
Property dispositions	**(533)**	(7,135)
Accretion expense	**730**	905
Liabilities incurred	**1,775**	3,217
Abandonment costs incurred	**(904)**	(955)
Revisions in estimated cash flows	**2,078**	(21)
Revisions due to change in discount rates	**866**	4,455
Balance, end of year	**32,564**	28,135

Onerous contracts

As at December 31, 2012, the Company recognized a provision related to an onerous lease contract of $812 (2011 – $1,138). The provision for onerous lease contract represents the present value of the future lease obligations that the Company is presently obligated to make under a non-cancellable onerous operating lease contract, less revenue expected to be earned on the lease, including estimated future sub-lease revenue.

Share Based Payments

The Company recognizes share based payment expense for stock options. For the twelve months ended December 31, 2012, Cequence recorded $5,717 (2011 – $6,758) in share based payment expense related to stock options with a corresponding increase to contributed surplus.

		2012		2011
	Number of options (000s)	**Weighted average exercise price ($)**	Number of options (000s)	Weighted average exercise price ($)
Outstanding, beginning of year	**13,094**	**2.54**	9,713	1.99
Granted	**5,118**	**1.30**	4,221	3.69
Forfeited	**(923)**	**2.20**	(240)	1.99
Exercised	**–**	**–**	(600)	1.99
Outstanding, end of year	**17,289**	**2.19**	13,094	2.54

Common Shares Outstanding

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

Issued common voting shares (000s)	Number	Stated Value
Balance, December 31, 2010	128,750	$ 452,526
Common shares	25,358	84,229
Flow-through common shares	4,898	16,758
Common shares on exercise of stock options	600	1,794
Common shares on exercise of warrants	2,250	8,663
Share issue costs, net of taxes of $1,531	–	(4,599)
Balance, December 31, 2011	161,856	$ 559,371
Common shares	**21,269**	**25,523**
Flow-through common shares	**17,485**	**24,429**
Share issue costs, net of taxes of $874	**–**	**(2,620)**
Balance, December 31, 2012	**200,610**	**$ 606,703**

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

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

On August 18, 2011, the Company completed the sale of 11,960 common voting shares at a price of $3.85 per share for total gross proceeds of $46,046 and 2,110 common voting shares on a CEE "flow-through" basis at $4.75 per share for total gross proceeds of $10,023. Under the terms of the respective agreement and pursuant to certain provisions of the Income Tax Act (Canada), Cequence is required to renounce $10,023 of CEE expenditures in February 2012. As at December 31, 2011, the Company has incurred all of the qualifying CEE expenditures. The above transaction resulted in an increase to share capital of $8,124 and the recognition of an obligation related to flow-through shares of $1,899 included with other liabilities in the consolidated balance sheet at December 31, 2011.

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

On June 20, 2012, the Company completed the sale of 11,684 common voting shares at a price of $1.20 per share for gross proceeds of $14,020. On July 12, 2012, the Company further completed the sale of 1,252 common voting shares at a price of $1.20 per share for gross proceeds of $1,503 related to the exercise of an over-allotment option on the above issuance.

On June 20, 2012, the Company completed the sale of 4,850 common voting shares on a CEE "flow-through" basis at $1.45 per share for gross proceeds of $7,033 as well as 3,800 common voting shares on a CDE "flow-through" basis at $1.32 per share for gross proceeds of $5,016, resulting in a total issuance of 8,650 common voting shares for total gross proceeds of $12,049. The above transaction resulted in an increase to share capital of $10,380 and the recognition of an obligation related to flow-through shares of $1,669 included with other liabilities at December 31, 2012. In accordance with the terms of the related agreements, the Company is required to renounce, for income tax purposes, exploration expenditures of $7,033 and development expenditures of $5,016 to the holders of the flow-through common shares effective December 31, 2012. As at December 31, 2012, the Company has incurred all qualifying CEE and CDE expenditures.

On June 22, 2012, the Company completed the sale, on a private placement basis, of 8,333 common voting shares at a price of $1.20 per share for gross proceeds of $10,000.

On December 5, 2012, the Company completed the public sale of 8,560 common voting shares on a CEE "flow-through" basis at $1.87 per share for gross proceeds of $16,007. On December 21, 2012, the Company completed a private placement sale of 275 common voting shares to certain officers and directors on a CEE "flow-through" basis at $1.87 per share for gross proceeds of $514. The private placement transaction has been recorded at the exchange amount, which is the amount of consideration established and agreed to by the related parties, and is equal to fair value. The above transactions resulted in an increase to share capital of $14,048 and the recognition of an obligation related to flow-through shares of $2,473 included with other liabilities at December 31, 2012. In accordance with the terms of the related agreements, the Company is required to renounce, for income tax purposes, exploration expenditures of $16,521 to the holders of the flow-through common shares effective December 31, 2012. As at December 31, 2012, the Company has yet to incur any qualifying CEE expenditures.

Issued warrants (000s)	Number	Stated Value
Balance, December 31, 2010	4,500	$ –
Exercised	(2,250)	–
Balance, December 31, 2011	2,250	$ –
Cancelled	**(2,250)**	–
Balance, December 31, 2012	**–**	**$** –

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

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

On August 15, 2011, 2,250 2011 Warrants were exercised for 2,250 common voting shares on a CDE "flow-through" basis at $4.36 per share for total gross proceeds of $9,801. The exercise of the 2011 Warrants also qualifies the remaining 2,250 2012 Warrants for exercise in 2012. Cequence renounced $9,801 of CDE expenditures in February 2012. The above transaction resulted in an increase to share capital of $8,663 and the recognition of an obligation related to flow-through shares of $1,138 included with other liabilities in the consolidated balance sheet at December 31, 2011.

On March 8, 2012, the Company's 2012 Warrants were cancelled at no cost to Cequence and no redress to the shareholder.

As of the date of this MD&A, Cequence had the following securities outstanding: 200,610 common voting shares and 17,289 stock options.

Capital Expenditures

	Three months ended December 31		Year ended December 31	
($000s)	**2012**	2011	**2012**	2011
Property acquisitions [1]	**644**	–	**7,404**	22,150
Property dispositions [1]	**–**	–	**(20,662)**	(45,173)
Land	**335**	1,014	**1,201**	13,242
Geological & geophysical and capitalized overhead	**418**	2,327	**4,046**	3,623
Drilling, completions and workovers	**19,827**	38,160	**60,926**	93,667
Equipment and facilities	**3,406**	14,557	**25,360**	38,678
Office furniture & equipment	**11**	277	**125**	391
Total capital expenditures	**24,641**	56,335	**78,400**	126,578

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

Net capital expenditures for the year ended December 31, 2012 decreased to $78.4 million from $126.6 million in 2011. Cequence reduced capital expenditures in 2012 in response to lower natural gas prices throughout 2012.

For the twelve months ended December 31, 2012, drilling, completion and workover expenditures totalled $60,926 which included the drilling of 7.0 gross (5.8 net) horizontal wells as well as the completion of 8.0 gross (5.7 net) horizontal wells. For the twelve months ended December 31, 2011, drilling, completion and workover expenditures totalled $93,667 and included the drilling of 13 gross (10.0 net) horizontal wells and 4 gross (3.3 net) vertical wells as well as the completion of 12 gross (10.0 net) horizontal wells and 5 gross (3.6 net) vertical wells.

Equipment and facility expenditures in the twelve months ended December 31, 2012 of $25,360 were directed towards completion of the meter station and tie in to the Alliance pipeline related to the Aux Sable Arrangement discussed above as well as to compression and gathering facilities in the Deep Basin.

During the twelve months ended December 31, 2012, the Company closed the sale of certain undeveloped land and gas-weighted properties located in the Deep Basin and Northwest Alberta for total cash consideration of $20,662, subject to final adjustments. The sales resulted in a gain recognized in comprehensive loss of $20,390.

During the year ended December 31, 2011, the Company completed sales of certain oil and gas properties in Alberta and British Columbia for total cash consideration of $43,482, subject to final adjustments. The sales resulted in a gain recognized in comprehensive loss of $5,077.

The Company's total capital expenditures for the twelve months ended December 31, 2012 were $3,400 greater than previously issued guidance of $75,000, mainly due to the acceleration of the Company's winter drilling program. Specifically, Cequence accelerated certain drilling and completion operations planned for the first quarter of 2013 into the fourth quarter of 2012 due to equipment availability and timing.

Cequence has budgeted net capital expenditures of $49,000 for the first six months of 2013, including acquisitions and dispositions, which will be directed towards the drilling operations at Simonette. A $5,500 facility expansion is planned for the Simonette compression and dehydration facility, along with additional pipeline looping to reduce existing bottlenecks. Capital expenditures will be funded out of cash flow, proceeds from the December equity financing, existing credit lines and potential asset sales. The Company continually monitors fluctuations in natural gas prices and will adjust budgeted discretionary capital spending based on short to medium term natural gas prices.

Income Taxes

At December 31, 2012, a deferred income tax asset of $44,266 (December 31, 2011 – $48,316) has been recognized as the Company believes, based on estimated cash flows, its realization is probable. At December 31, 2012, Cequence has the following tax pools:

Classification	Amount ($000s)
Canadian exploration expense	201,302
Non-capital losses	147,873
Undepreciated capital cost	95,995
Canadian oil and gas property expense	71,357
Canadian development expense	55,557
Scientific research and experimental development tax credit	22,704
Share issue costs	9,531
Investment tax credits	3,981
	608,300

The Company's non-capital losses expire $4,512 in 2013 and $143,361in 2019 and thereafter.

In accordance with the terms of the related agreements and pursuant to certain provisions of the Income Tax Act (Canada), the Company renounced, for income tax purposes, development expenditures of $14,301 and exploration expenditures of $17,373 to the holders of flow-through common shares effective December 31, 2011. Deferred tax of approximately $7,919 associated with renouncing the expenditures was recorded on the date of renunciation in the first quarter of 2012, the related obligation on flow-through shares of $4,958 was drawn down and the difference was recognized as deferred income tax expense (recovery). As at December 31, 2011, the Company had incurred all of the qualifying expenditures.

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

Liquidity and Capital Resources

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

In order to maintain or adjust the capital structure, Cequence may issue new common shares, issue new debt or replace existing debt, adjust capital expenditures and acquire or dispose of assets. The Company monitors net debt to cash flow as one measure of the Company's ability to manage its debt levels under current operating conditions. In 2012, Cequence used funds flow of $33,724 million, equity financings (net of share issue costs) of $50,598 and disposed of non-producing assets for proceeds of $20,662 to finance its capital expenditures.

Cequence expects to finance its budgeted 2013 first half capital expenditures through cash flow and bank debt. Management has not yet determined second half capital expenditures but is expected to do so in the second quarter following a review of winter drilling results and forecast natural gas prices.

The Company has two credit facilities with a syndicate of Canadian chartered banks. Credit facility A is a $90,000 (December 31, 2011 – $100,000) extendible revolving term credit facility by way of prime loans, U.S. Base Rate Loans, Banker's Acceptances and Libor Loans. Credit facility B is a $10,000 (December 31, 2011 – $10,000) operating facility by way of prime loans, U.S. Base Rate Loans, Banker's Acceptances and letters of credit. Prime loans and U.S. Base Rate Loans on these facilities bear interest at the bank prime rate or U.S. Base Rate, respectively, plus 1.0 percent to 2.5 percent on a sliding scale, depending on the Company's debt to adjusted EBITDA ratio (ranging from being less than or equal to 1.0:1.0 to greater than 2.5:1.0). Banker's Acceptances, Libor Loans and letters of credit on these facilities bear interest at the Banker's Acceptance rate, Libor rate or letter of credit rate, as applicable, plus 2.0 percent to 3.5 percent based on the same sliding scale as above. The credit facilities may be extended and revolve beyond the initial one-year period, if requested by the Company and accepted by the lenders. If the credit facilities do not continue to revolve, the facilities will convert to a 366-day non-revolving term loan facility.

Both credit facilities, and the amount available for draws under the facilities, are subject to periodic review by the bank and are secured by a general assignment of book debts and a $250,000 demand debenture with a first floating charge over all assets of the Company. As at December 31, 2012, the Company has drawn $23,191 under the extendible revolving term credit facility and $nil under the operating facility (December 31, 2011 – $11,618 and $nil for the revolving and operating facilities, respectively) and is in compliance with all covenants. The effective interest rate, including standby fees and commitment fees, for the year ended December 31, 2012 was 4.41 percent (2011 – 5.40 percent). The credit facility was renewed in November 2012 with the next scheduled review to take place in May 2013.

Net Debt and Working Capital (Deficiency)

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

($000s)	As at December 31, 2012	As at December 31, 2011
Demand credit facilities	**(23,191)**	(11,618)
Accounts payable and accrued liabilities	**(42,190)**	(64,467)
Cash	**–**	380
Accounts receivable	**16,084**	21,032
Deposits and prepaid expenses – current	**3,428**	3,231
Net debt and working capital (deficiency)	**(45,869)**	(51,442)

Cequence's net debt and working capital (deficiency) of $45,869 at December 31, 2012 (2011 – $51,442) was below its 2012 guidance of $58,000 mainly due to proceeds from the December 2012 flow-through common share offerings.

Contractual Obligations

	2013	2014	2015	2016	2017+	Total
Office leases	1,133	922	187	–	–	2,242
Drilling services	1,903	–	–	–	–	1,903
Pipeline transportation	1,684	1,684	1,541	–	–	4,909
Total	4,720	2,606	1,728	–	–	9,054

The pipeline transportation contract expires on November 30, 2015.

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

During the year ended December 31, 2011, the Company entered into a drilling service agreement whereby the Company made a deposit of $3,500 to obtain a right of first refusal on the use of two drilling rigs over the five years following the date that use of the rigs commences. The deposit is to be applied as the Company incurs costs related to the use of the drilling rigs and $1,020 has been drawn down at December 31, 2012. Cequence expects to reduce the deposit by $579 in the year ended December 31, 2013, which amount is included with deposits and prepaid expenses at December 31, 2012. The portion of the outstanding deposit expected to be drawn down in the period subsequent to December 31, 2013 of $1,901 is carried as a non-current asset at December 31, 2012.

Related Parties

An executive of the Company is a member of the board of directors of an entity that is a supplier of seismic services to Cequence. The Company incurred a total of $nil with this vendor in the year ended December 31, 2012 (2011 – $26). These transactions have been recorded at the exchange amount, which is the amount of consideration established and agreed to by the related parties, and is equal to fair value. As at December 31, 2012, no amounts are included in accounts payable and accrued liabilities related to these transactions (2011 – $nil).

Subsequent Event

On February 25, 2013, the Company entered into agreements to acquire interests in oil and gas properties located in the Simonette and Resthaven areas of Alberta. As consideration for the assets, Cequence will transfer its interest in its non-operated oil and gas properties located in the Fir area, and issue an aggregate of 10,300,000 Cequence common shares to the Corporation. Completion of the transaction is expected to occur in mid April 2013 and is subject to the satisfaction of several conditions, including receipt of the applicable court, stock exchange and regulatory approvals as well as the approval by the vendor's shareholders. There can be no assurance provided that this transaction will close as described.

Disclosure Controls and Internal Controls Over Financial Reporting

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

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

As at December 31, 2012, the Chief Executive Officer and the Chief Financial Officer have concluded, based on their evaluation of the design and operating effectiveness of the Company's disclosure controls and internal controls over financial reporting ("ICFR") that disclosure controls and ICFR are effective.

Quarterly Information

Financial

($ thousands except per share data)	2012 Q4	2012 Q3	2012 Q2	2012 Q1	2011 Q4	2011 Q3	2011 Q2	2011 Q1
Production revenue [1]	**21,939**	**17,814**	**16,032**	**19,864**	23,527	27,144	27,293	24,032
Royalties expense	**1,546**	**992**	**118**	**2,176**	3,063	3,872	3,565	3,243
Transportation expense	**1,449**	**1,801**	**1,661**	**1,791**	1,580	1,861	1,883	1,829
Operating costs	**5,397**	**5,627**	**6,554**	**6,862**	7,022	8,471	7,439	6,741
Comprehensive income (loss)	**666**	**(3,824)**	**(6,579)**	**(7,936)**	(15,598)	(1,884)	(701)	(1,975)
Per share – basic & diluted	**(0.00)**	**(0.02)**	**(0.04)**	**(0.05)**	(0.10)	(0.01)	(0.00)	(0.02)
Funds flow from operations [2]	**11,603**	**10,803**	**4,563**	**6,755**	10,002	10,438	12,042	9,780
Per share – basic & diluted	**0.06**	**0.06**	**0.03**	**0.04**	0.06	0.07	0.08	0.07
Capital expenditures, net	**23,997**	**16,818**	**9,909**	**40,934**	56,335	31,222	16,470	45,574
Net acquisitions (dispositions) [3]	**644**	**20**	**(2,980)**	**(10,942)**	–	(15,513)	14,134	(21,644)
Total capital expenditures	**24,641**	**16,838**	**6,929**	**29,992**	56,335	15,709	30,604	23,930

[1] Production revenue is presented gross of royalties and includes realized gains (loss) on commodity contracts.

[2] Funds flow from operations is calculated as cash flow from operating activities before adjustments for decommissioning liabilities expenditures, proceeds from the sale of commodity contracts and net changes in non-cash working capital.

[3] Represents the cash proceeds from the sale of assets and cash paid for the acquisition of assets, as applicable.

Operational

	2012 Q4	2012 Q3	2012 Q2	2012 Q1	2011 Q4	2011 Q3	2011 Q2	2011 Q1
Production volumes								
Natural gas (Mcf/d)	**47,125**	**46,641**	**45,042**	**49,924**	47,203	52,694	48,785	42,514
Oil (bbls/d)	**583**	**606**	**618**	**684**	503	514	599	686
NGLs (bbls/d)	**515**	**516**	**535**	**459**	509	536	396	413
Total (boe/d)	**8,951**	**8,895**	**8,660**	**9,464**	8,879	9,833	9,125	8,185
Average selling price								
Natural gas ($/Mcf)	**3.49**	**2.61**	**2.11**	**2.44**	3.59	4.04	4.30	4.21
Oil ($/bbl)	**86.78**	**83.38**	**79.92**	**89.58**	97.15	87.65	97.80	88.38
NGLs ($/bbl)	**45.83**	**41.89**	**59.54**	**76.63**	73.19	69.34	80.15	66.12
Total ($/boe)	**26.64**	**21.77**	**20.34**	**23.07**	28.80	30.00	32.87	32.62
Operating netback ($/boe)								
Price	**26.64**	**21.77**	**20.34**	**23.07**	28.80	30.00	32.87	32.62
Royalties	**(1.88)**	**(1.13)**	**(0.15)**	**(2.53)**	(3.75)	(4.28)	(4.29)	(4.40)
Transportation	**(1.76)**	**(2.20)**	**(2.11)**	**(2.08)**	(1.93)	(2.06)	(2.27)	(2.48)
Operating costs	**(6.55)**	**(6.88)**	**(8.32)**	**(7.97)**	(8.60)	(9.36)	(8.96)	(9.15)
Operating netback	**16.45**	**11.56**	**9.76**	**10.49**	14.52	14.30	17.35	16.59

Future Accounting Pronouncements

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

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

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

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

The Company is currently evaluating the impact of adoption of these standards and the effect on Cequence's consolidated financial statements has not yet been determined.

Application of Critical Accounting Estimates

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

Reserves

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

Depletion

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

Exploration and Evaluation Assets

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

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

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

Development and Production Costs

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

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

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

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

Impairment

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

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

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

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

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

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

Decommissioning Liabilities

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

Share Based Payments

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

Income Taxes

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

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

Acquisitions

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

Commodity Contracts

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

Other Estimates

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

Financial Instruments and Risk Management

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

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

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

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

Commodity Price and Exchange Rate Volatility

Revenues and consequently cash flows fluctuate with commodity prices and the U.S. / Canadian dollar exchange rate. Commodity prices are determined on a global basis and circumstances that occur in various parts of the world are outside of the control of the Company. The Company protects itself from fluctuations in prices by maintaining an appropriate hedging strategy, diversifying its asset mix and strengthening its balance sheet in order to take advantage of low price environments by making strategic acquisitions. Cequence enters into commodity price contracts to actively manage the risks associated with price volatility and thereby protect the Company's cash flows used to fund its capital program. Comprehensive loss for the year ended December 31, 2012 includes ($161) of realized gains (loss) (2011 – $906) and $757 (2011 – $nil) of unrealized gains (loss) on these transactions.

Cequence is also exposed to fluctuations in the exchange rate between the Canadian and U.S. dollar. Most commodity prices are based on U.S. dollar benchmarks that results in the Company's realized prices being influenced mainly by the U.S. / Canadian currency exchange rates. As at December 31, 2012, the Company has a pipeline commitment in U.S. dollars and sells certain quantities of natural gas in U.S. dollars. There are no other forward contracts, foreign exchange contracts or other significant items denominated in foreign currencies.

Interest Rate Risk

The Company is exposed to interest rate risk to the extent that changes in market interest rates impact its borrowings under the floating rate credit facilities. The floating rate debt is subject to interest rate cash flow risk, as the required cash flows to service the debt will fluctuate as a result of changes in market rates. The Company has no interest rate swaps or financial contracts in place as at or during the year ended December 31, 2012.

As at December 31, 2012 a 1 percent change in interest rates on the Company's outstanding debt, with all other variables constant, would result in a change in comprehensive loss of $232 ($174 after tax) (2011 – $116 ($85 after tax)).

Credit Risk

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

The majority of the Company's accounts receivable are due from joint venture partners in the oil and gas industry and from marketers of the Company's petroleum and natural gas production. The Company mitigates its credit risk by entering into contracts with established counterparties that have strong credit ratings and reviewing its exposure to individual counterparties on a regular basis. At December 31, 2012, the Company has an allowance for doubtful accounts of $515 (2011 – $551).

Liquidity Risk

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

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

The expected timing of cash flows relating to financial liabilities as at December 31, 2012 is as follows:

	< 1 Year	1 – 2 Years	2 – 5 Years	Thereafter
Demand credit facilities	–	–	23,191	–
Accounts payable and accrued liabilities	42,190	–	–	–
	42,190	–	23,191	–

Access to Capital Risk

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

Operational Matters

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

Environmental Concerns

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

Regulatory Risk

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

Current Economic Conditions

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

Outlook Information

Cequence provided guidance for the six months ended June 30, 2013 on February 4, 2013. Capital expenditures for 2013 are expected to be funded from funds flow from operations, available bank lines and proceeds from 2012 equity raises:

	2013
Average production, BOE/d [(1)]	10,000
Capital expenditures ($)	49 million
Operating costs ($ per boe)	6.75
Royalties (% revenue)	8
Crude oil – WTI (US$/bbl)	91.00
Natural gas – AECO (Cdn$/GJ)	3.00
Funds flow from operations ($) [(2)]	26 million
Annualized funds flow from operations ($)	52 million
June 30, 2013 net debt and working capital deficiency ($) [(3)]	71 million
Basic shares outstanding	200.6 million

(1) Comprised of 51.8 mmcf/d of natural gas and 1,370 boe/d of oil and liquids

(2) Funds flow from operations is calculated as cash flow from operating activities before adjustments for decommissioning liabilities expenditures and net changes in non-cash working capital.

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

The Company closely monitors fluctuations in natural gas prices and will adjust the 2013 budget if facts and circumstances require.

Subsequent Event

On February 25, 2013, the Company entered into agreements to acquire interests in oil and gas properties located in the Simonette and Resthaven areas of Alberta. As consideration for the assets, Cequence will transfer its interest in its non-operated oil and gas properties located in the Fir area, and issue an aggregate of 10,300,000 Cequence common shares to the Corporation. Completion of the transaction is expected to occur in mid April 2013 and is subject to the satisfaction of several conditions, including receipt of the applicable court, stock exchange and regulatory approvals as well as the approval by the vendor's shareholders. There can be no assurance provided that this transaction will close as described.

Forward-Looking Statements

Certain statements contained within this MD&A constitute forward-looking statements. These statements relate to future events or the Company's future performance. All statements other than statements of historical fact may be forward-looking statements. Forward-looking statements are often, but not always, identified by the use of words such as "seek", "anticipate", "budget", "plan", "continue", "estimate", "expect", "forecast", "may", "will", "project", "predict", "potential", "targeting", "intend", "could", "might", "should", "believe", and similar expressions. Forward-looking statements in this MD&A include, but are not limited to, statements with respect to: the potential impact of implementation of the Alberta Royalty Framework on Cequence's condition and projected 2013 capital investments; projections with respect to growth of natural gas production; the projected impact of land access and regulatory issues; projections relating to the volatility of crude oil and natural gas prices in 2013 and beyond and reasons therefore; the Company's projected capital investment levels for 2013 and the source of funding therefore; the effect of the Company's risk management program, including the impact of derivative financial instruments; the Company's defence of lawsuits; the impact of the climate change initiatives on operating costs; the impact of Western Canada pipeline constraints. Readers are cautioned not to place undue reliance on forward-looking statements, as there can be no assurance that the plans, intentions or expectations upon which they are based will occur.

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

The forward looking statements contained herein concerning production, sales prices, and capital spending are based on Cequence's six months ended June 30, 2013 capital program. The material assumptions supporting the 2013 capital program are: i) production of approximately 10,000 boe/day; ii) a $3.00 Cdn$/GJ AECO gas price; iii) capital spending of approximately $49,000.

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

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

Management's Responsibility for Financial Information

The accompanying financial statements and all information in the MD&A have been prepared by management and approved by the Board of Directors of Cequence Energy. The financial statements have been prepared in accordance with International Financial Reporting Standards and, where appropriate, reflect management's best estimates and judgments. Management is responsible for the accuracy, integrity and objectivity of the financial statements within reasonable limits of materiality and for the consistency of financial data included in the text of the MD&A with that in the financial statements.

To assist management in the discharge of these responsibilities, the Company maintains a system of internal controls designed to provide reasonable assurance that accounting records are reliable, transactions are properly authorized and assets are safeguarded from loss or unauthorized use. The Audit Committee is appointed by the Board of Directors, with all of its members being independent directors. The Audit Committee meets with management, as well as with the external auditors, to satisfy itself that management is properly discharging its financial reporting responsibilities and to review the financial statements and the auditor's report. The Audit Committee reports its findings to the Board of Directors for consideration in approving the financial statements for presentation to the shareholders. The external auditors have direct access to the Audit Committee of the Board of Directors.

The financial statements have been audited independently by Deloitte LLP on behalf of the Company in accordance with generally accepted auditing standards. Their report outlines the nature of their audits and expresses their opinion on the financial statements.

"signed"
Paul Wanklyn
President and Chief Executive Officer
March 7, 2013

"signed"
Dave Gillis
Chief Financial Officer

Independent Auditor's Report

To the Shareholders of Cequence Energy Ltd.

We have audited the accompanying consolidated financial statements of Cequence Energy Ltd., which comprise the consolidated balance sheets as at December 31, 2012 and December 31, 2011, and the consolidated statements of comprehensive loss, changes in equity and cash flows for the years then ended, and notes to the consolidated financial statements.

Management's Responsibility for the Consolidated Financial Statements

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

Auditor's Responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Cequence Energy Ltd. as at December 31, 2012 and December 31, 2011, and its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards.

Deloitte LLP

Chartered Accountants

March 7, 2013

Calgary, Canada

Consolidated Balance Sheets

(Expressed in thousands of Canadian dollars)

	December 31, 2012	December 31, 2011
	$	$
ASSETS		
CURRENT		
Cash	–	380
Accounts receivable (Note 6)	**16,084**	21,032
Deposits and prepaid expenses (Note 18)	**3,428**	3,231
Commodity contracts (Note 19)	**694**	–
	20,206	24,643
Exploration and evaluation assets (Note 4)	**13,829**	6,221
Property and equipment (Note 4)	**439,059**	409,729
Deposits and prepaid expenses (Note 18)	**1,901**	2,456
Commodity contracts (Note 19)	**63**	–
Deferred income taxes (Note 14)	**44,266**	48,316
	519,324	491,365
LIABILITIES		
CURRENT		
Demand credit facilities (Note 5)	**23,191**	11,618
Accounts payable and accrued liabilities (Note 7)	**42,190**	64,467
Other liabilities (Note 8)	**4,459**	5,289
	69,840	81,374
Provisions (Note 13)	**33,059**	28,942
	102,899	110,316
CONTINGENCIES AND COMMITMENTS (Note 18)		
SUBSEQUENT EVENT (Note 23)		
SHAREHOLDERS' EQUITY		
Share capital (Note 15)	**606,703**	559,371
Contributed surplus	**22,556**	16,839
Deficit	**(212,834)**	(195,161)
	416,425	381,049
	519,324	491,365

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

APPROVED BY THE BOARD

"signed"
Donald Archibald, Director

"signed"
Brian Felesky, Director

Consolidated Statements of Comprehensive Loss

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

	Year ended December 31, 2012	2011
	$	$
REVENUE		
Production revenue (Note 9)	**71,049**	87,347
Gain on derivative financial instruments (Note 19)	**596**	906
	71,645	88,253
EXPENSES		
Depletion, depreciation and impairment (Note 4)	**66,458**	59,560
General and administrative (Note 12)	**7,105**	7,325
Finance costs (Note 11)	**2,725**	3,276
Operating costs	**24,440**	29,673
Share based payment (Note 16)	**5,717**	6,758
Transportation	**6,702**	7,153
Other income (Note 10)	**(23,794)**	(4,013)
	89,353	109,732
LOSS BEFORE INCOME TAXES	**(17,708)**	(21,479)
INCOME TAXES (Note 14)	**(35)**	(1,321)
NET LOSS AND COMPREHENSIVE LOSS	**(17,673)**	(20,158)
Loss per share, basic and diluted (Note 17)	**$ (0.10)**	$ (0.14)

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

Consolidated Statements of Changes in Equity

(Expressed in thousands of Canadian dollars)

	Year ended December 31, 2012	2011
	$	$
SHARE CAPITAL		
Common Shares (Note 15)		
Balance, beginning of year	**559,371**	452,526
Proceeds from shares issued in public offerings	**39,514**	98,338
Proceeds from shares issued in private placements	**10,438**	2,649
Shares issued on exercise of stock options	**–**	1,794
Shares issued on exercise of the 2011 Warrants	**–**	8,663
Share issue costs, net of tax of $874 (2011 – $1,531)	**(2,620)**	(4,599)
Balance, end of year	**606,703**	559,371
CONTRIBUTED SURPLUS		
Balance, beginning of year	**16,839**	10,681
Share based payment expense (Note 16)	**5,717**	6,758
Exercise of stock options (Note 15)	**–**	(600)
Balance, end of year	**22,556**	16,839
DEFICIT		
Balance, beginning of year	**(195,161)**	(175,003)
Comprehensive loss	**(17,673)**	(20,158)
Balance, end of year	**(212,834)**	(195,161)
TOTAL EQUITY	**416,425**	381,049

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

Consolidated Statements of Cash Flows

(Expressed in thousands of Canadian dollars)

	Year ended December 31, 2012	2011
	$	$
CASH FLOWS RELATED TO THE FOLLOWING ACTIVITIES:		
OPERATING		
Net loss	**(17,673)**	(20,158)
Adjustments for non-cash items:		
Depletion, depreciation and impairment	**66,458**	59,560
Finance costs related to provisions (Note 11)	**725**	905
Share based payments (Note 16)	**5,717**	6,758
Amortization of transaction costs on financial instruments (Note 11)	**–**	443
Unrealized gain on derivative financial instruments (Note 19)	**(757)**	–
Costs related to onerous contracts (Note 13)	**(321)**	1,138
Gain on sale of assets (Note 4)	**(20,390)**	(5,077)
Deferred income tax recovery (Note 14)	**(35)**	(1,307)
Decommissioning liabilities expenditures (Note 13)	**(904)**	(955)
Net change in non-cash working capital (Note 20)	**4,950**	(4,607)
	37,770	36,700
INVESTING		
Property and equipment and exploration and evaluation assets expenditures	**(91,658)**	(149,601)
Acquisitions	**(7,404)**	(22,150)
Proceeds from sale of assets	**20,662**	45,173
Net change in non-cash working capital (Note 20)	**(22,186)**	24,976
	(100,586)	(101,602)
FINANCING		
Proceeds from demand credit facilities (Note 5)	**41,521**	46,305
Repayment of demand credit facilities (Note 5)	**(29,948)**	(91,812)
Transaction costs on demand credit facilities (Note 5)	**–**	(57)
Issue of common shares (Note 15)	**54,092**	115,597
Share issue costs (Note 15)	**(3,494)**	(6,130)
Net change in non-cash working capital (Note 20)	**265**	58
	62,436	63,961
NET DECREASE IN CASH	**(380)**	(941)
CASH, BEGINNING OF YEAR	**380**	1,321
CASH, END OF YEAR	**–**	380
SUPPLEMENTARY INFORMATION		
Income taxes paid	**–**	14
Interest paid	**2,061**	1,852

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

Notes to the Consolidated Financial Statements

Year ended December 31, 2012 with 2011 comparatives
(All figures expressed in thousands except per share amounts unless otherwise noted)

1. Nature and Description of the Company

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

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

2. Significant Accounting Policies

Statement of compliance and authorization

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS"), as issued by the International Accounting Standards Board ("IASB").

The consolidated financial statements were authorized for issue by the Company's Board of Directors on March 7, 2013.

Basis of presentation

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

Basis of consolidation

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

Business combinations

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

Financial instruments

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

The Company has made the following classifications:

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

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

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

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

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

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

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

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

Impairment of financial assets

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

For financial assets carried at amortized cost, the amount of the impairment loss recognized in comprehensive income (loss) is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the financial asset's original effective interest rate.

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

Property and equipment and exploration and evaluation assets

Recognition and measurement

Exploration and evaluation expenditures

Pre-license costs, geological and geophysical costs are recognized in comprehensive income (loss) as incurred.

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

The Company enters into E&E farm-in arrangements to fund a portion of the partner's (farmor's) exploration and/or future development expenditures ("carried interests"). These expenditures are reflected in the consolidated financial statements when the exploration and development work progresses. For E&E farm-out arrangements where the farmee correspondingly undertakes to fund carried interests as part of the consideration no gain or loss is recognized by the Company.

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

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

Development and production costs

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

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

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

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

Subsequent costs

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

Depletion and depreciation

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

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

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

Impairment

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

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

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

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

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

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

Provisions

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

Decommissioning liabilities

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

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

Onerous contracts

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

Jointly controlled assets

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

Share based payments

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

Revenue

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

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

Flow-through shares

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

Earnings per share

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

Taxation

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

Current tax

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

Deferred tax

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

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

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

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

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

Current and deferred tax for the period

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

Significant accounting judgments, estimates and assumptions

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

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

Note 4: Property and equipment and exploration and evaluation assets

Note 13: Provisions

Note 16: Share based payment plans

Note 18: Contingencies and commitments

Note 19: Financial instruments and risk management

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

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

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

Costs associated with acquiring oil and natural gas licenses and exploratory drilling are accumulated as E&E assets pending determination of technical feasibility and commercial viability. Establishment of technical feasibility and commercial viability is subject to judgement which management has determined to be based on the allocation of commercial reserves to the exploration area. Upon determination of commercial reserves, E&E assets attributable to those reserves are first tested for impairment and then reclassified from E&E assets to development and production assets included in property and equipment.

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

The amounts recorded for deferred income tax assets and deferred tax expense (recovery) are based on estimates of the probability of the Company utilizing certain tax pools and assets which, in turn, is dependent on estimates of proved and probable reserves, production rates, future petroleum and natural gas prices, and changes in legislation, tax rates and interpretations by taxation authorities.

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

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

3. Future Accounting Pronouncements

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

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

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

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

The Company is currently evaluating the impact of adoption of these standards and the effect on Cequence's consolidated financial statements has not yet been determined.

4. Property and Equipment and Exploration and Evaluation Assets

Cost:	Property and equipment	E&E assets	Total
Balance at December 31, 2010	420,368	–	420,368
Additions	144,918	6,221	151,139
Decommissioning obligation additions	7,651	–	7,651
Acquisitions	25,540	–	25,540
Disposals	(57,273)	–	(57,273)
Balance at December 31, 2011	541,204	6,221	547,425
Additions	**91,231**	**427**	**91,658**
Change in decommissioning obligation estimates	**4,720**	**–**	**4,720**
Acquisitions	**641**	**7,181**	**7,822**
Disposals	**(1,440)**	**–**	**(1,440)**
Balance at December 31, 2012	**636,356**	**13,829**	**650,185**

	Property and equipment	E&E assets	Total
Depletion, depreciation and impairment:			
Balance at December 31, 2010	(78,567)	–	(78,567)
Depletion and depreciation	(41,228)	–	(41,228)
Impairment loss	(18,332)	–	(18,332)
Disposals	6,652	–	6,652
Balance at December 31, 2011	(131,475)	–	(131,475)
Depletion and depreciation	**(39,564)**	**–**	**(39,564)**
Impairment loss	**(26,894)**	**–**	**(26,894)**
Disposals	**636**	**–**	**636**
Balance at December 31, 2012	**(197,297)**	**–**	**(197,297)**
Carrying amounts:			
At December 31, 2011	**409,729**	6,221	415,950
At December 31, 2012	**439,059**	**13,829**	**452,888**

Costs subject to depletion include $631,687 of estimated future capital costs (2011 – $426,485).

The Company's credit facilities are secured by a demand debenture with a first floating charge over all assets of the Company (see note 5).

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

Impairment

The Company reviewed each CGU comprising its property and equipment at December 31, 2012 for indicators of impairment and determined that indicators were present, related to decreases to future natural gas prices used to estimate the value in use and fair value less cost to sell of each of the Company's CGUs.

As a result, impairment tests were carried out at December 31, 2012. The recoverable amounts of each of the Company's CGUs at December 31, 2012 were estimated as their value in use, based on the net present value of discounted future cash flows from oil and gas reserves, as estimated by the Company's independent reserves evaluator. Consideration was also given to acquisition metrics of recent transactions completed on similar assets to those contained within the relevant CGU.

The benchmark escalated prices on which the December 31, 2012 impairment tests are based are as follows:

	Natural Gas AECO Spot	Condensate Edmonton Pentanes Plus	Crude Oil Edmonton Par
	($/mmbtu)	($/bbl)	($/bbl)
2013	3.38	96.63	85.00
2014	3.83	97.91	91.50
2015	4.28	97.76	94.00
2016	4.72	100.36	96.50
2017	4.95	100.36	96.50
2018	5.22	100.36	96.50
2019	5.32	101.44	97.54
2020	5.43	103.49	99.51
2021	5.54	105.58	101.52
2022	5.64	107.71	103.57

Prices increase at a rate of approximately 2.0 percent per year for natural gas, condensate and crude oil after 2022. Adjustments were made to the benchmark prices, for purposes of the impairment tests, to reflect varied delivery points and quality differentials in the products delivered.

Results of the Company's impairment tests at December 31, 2012 and 2011 are as follows:

	2012	2011
Northeast British Columbia	**14,931**	4,770
Peace River Arch	**11,963**	13,562
Deep Basin	**–**	–
Total	**26,894**	18,332

For the quarter ended December 31, 2012, a one percent increase in the discount rate applied to the Company's future estimated cash flows would result in an additional impairment of $1,057 (2011 – $4,220), whereas a ten percent decrease in forward benchmark natural gas prices would result in additional impairment of $5,484 (2011 – $21,838) recognized in comprehensive loss for the year ended December 31, 2012.

Sale of assets

During the year ended December 31, 2012, the Company completed the sales of certain undeveloped land and gas-weighted properties located in Northwest Alberta for total cash consideration of $20,662, subject to final adjustments. The sales resulted in a gain recognized in comprehensive loss of $20,390.

During the year ended December 31, 2011, the Company completed sales of certain oil and gas properties in Alberta and British Columbia for total cash consideration of $43,482, subject to final adjustments. The sales resulted in a gain recognized in comprehensive loss of $5,077.

5. Demand Credit Facilities

The Company has two credit facilities with a syndicate of Canadian chartered banks. Credit facility A is a $90,000 (December 31, 2011 – $100,000) extendible revolving term credit facility by way of prime loans, U.S. Base Rate Loans, Banker's Acceptances and Libor Loans. Credit facility B is a $10,000 (December 31, 2011 – $10,000) operating facility by way of prime loans, U.S. Base Rate Loans, Banker's Acceptances and letters of credit. Prime loans and U.S. Base Rate Loans on these facilities bear interest at the bank prime rate or U.S. Base Rate, respectively, plus 1.0 percent to 2.5 percent on a sliding scale, depending on the Company's debt to adjusted EBITDA ratio (ranging from being less than or equal to 1.0:1.0 to greater than 2.5:1.0). Banker's Acceptances, Libor Loans and letters of credit on these facilities bear interest at the Banker's Acceptance rate, Libor rate or letter of credit rate, as applicable, plus 2.0 percent to 3.5 percent based on the same sliding scale as above. The credit facilities may be extended and revolve beyond the initial one-year period, if requested by the Company and accepted by the lenders. If the credit facilities do not continue to revolve, the facilities will convert to a 366-day non-revolving term loan facility.

Both credit facilities, and the amount available for draws under the facilities, are subject to periodic review by the bank and are secured by a general assignment of book debts and a $250,000 demand debenture with a first floating charge over all assets of the Company. The Company is permitted to hedge up to 67 percent of its production under the lending agreement. As at December 31, 2012, the Company has drawn $23,191 under the extendible revolving term credit facility and $nil under the operating facility (December 31, 2011 – $11,618 and $nil for the revolving and operating facilities, respectively) and is in compliance with all covenants. The effective interest rate, including standby fees and commitment fees, for the year ended December 31, 2012 was 4.41 percent (2011 – 5.40 percent). The next scheduled review is to take place in May 2013.

During the year ended December 31, 2012 the Company capitalized transaction costs related to its credit facilities of $nil (2011 – $57).

6. Accounts Receivable

	December 31, 2012	December 31, 2011
Trade receivables	**7,852**	13,015
Allowance for doubtful accounts	**(515)**	(551)
Net trade receivables	**7,337**	12,464
Accrued revenue	**7,627**	6,332
Other receivables	**1,120**	2,236
Total accounts receivable	**16,084**	21,032

7. Accounts Payable and Accrued Liabilities

	December 31, 2012	December 31, 2011
Accounts payable	**17,657**	36,267
Accrued liabilities	**24,533**	28,200
Total accounts payable and accrued liabilities	**42,190**	64,467

8. Other Liabilities

	December 31, 2012	December 31, 2011
Obligations related to onerous contracts – current (Note 13)	**317**	331
Obligations related to flow-through shares (Note 15)	**4,142**	4,958
Total other liabilities	**4,459**	5,289

9. Production Revenue

	Year ended December 31,	
	2012	2011
Sales of oil and natural gas	**75,811**	101,090
Royalties	**(4,762)**	(13,743)
Total production revenue	**71,049**	87,347

10. Other Income

	Year ended December 31, 2012	2011
Gain on sale of property and equipment	**(20,390)**	(5,077)
Termination fee net of transaction costs	**(3,347)**	–
Provisions related to onerous contracts (Note 13)	**–**	1,138
Other	**(57)**	(74)
Total other income	**(23,794)**	(4,013)

In June 2012, Cequence and Open Range Energy Corp. ("Open Range") entered into an arrangement agreement whereby Cequence agreed to acquire all of the outstanding common shares of Open Range. In July 2012, Open Range accepted a superior proposal from another publicly traded Canadian oil and gas company and in accordance with the terms of the arrangement agreement, Open Range paid to Cequence a termination fee of $4,600. Transaction costs of $1,253 were incurred by the Company with respect to this arrangement agreement during 2012. The net amount of $3,347 has been included in other income for the year ended December 31, 2012.

11. Finance Costs

	Year ended December 31, 2012	2011
Interest expense on demand credit facilities (including stand-by fees and commitment fees of $307 (2011 – $544))	**2,000**	1,928
Accretion expense on provisions	**725**	905
Amortization of transaction costs on financial instruments	**–**	443
Total finance costs	**2,725**	3,276

12. Compensation Costs And Key Management Personnel Expenses

Total wages, salaries, benefits and other personnel costs included in comprehensive loss for the year ended December 31, 2012 were $4,493 (2011 – $5,775).

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

	Year ended December 31, 2012	2011
Wages, salaries, benefits and other personnel costs	**1,137**	1,187
Share based payments [(i)]	**1,146**	2,495
Total remuneration	**2,283**	3,682

(i) Represents the total fair value of share based payment awards granted to officers and directors in the year of grant, as determined using a Black-Scholes option pricing model (see note 16).

13. Provisions

Decommissioning liabilities

The following table summarizes the changes in decommissioning liabilities for the years ended December 31, 2012 and 2011:

	2012	2011
Balance, beginning of year	**28,135**	26,130
Acquisitions	**417**	1,539
Property dispositions (Note 4)	**(533)**	(7,135)
Accretion expense	**730**	905
Liabilities incurred	**1,775**	3,217
Abandonment costs incurred	**(904)**	(955)
Revisions in estimated cash flows	**2,078**	(21)
Revisions due to change in discount rates	**866**	4,455
Balance, end of year	**32,564**	28,135

The Company's decommissioning liabilities result from its ownership in oil and natural gas assets including well sites, facilities and gathering systems. The total estimated, undiscounted cash flows, inflated at 2 percent, required to settle the obligations are $47,549 (2011 – $42,659). These cash flows have been discounted using a risk-free interest rate of 2.37 percent (2011 – 2.50 percent) based on Government of Canada long-term benchmark bonds. The Company expects these obligations to be settled in approximately 1 to 50 years (2011 – 2 to 30 years). As at December 31, 2012, no funds have been set aside to settle these liabilities.

Onerous contracts

As at December 31, 2012, the Company recognized a provision related to an onerous lease contract of $812 (2011 – $1,138). The provision for onerous lease contract represents the present value of the future lease obligations that the Company is presently obligated to make under a non-cancellable onerous operating lease contract, less revenue expected to be earned on the lease, including estimated future sub-lease revenue. The total estimated, undiscounted cash flows, required to settle the obligations are $830 (2011 – $1,164). These cash flows have been discounted using a risk-free interest rate of 1.20 percent (2011 – 0.99 percent) based on Government of Canada three year benchmark bonds.

Cequence expects to reduce the provision by $317 in the year ended December 31, 2013, which amount is included with other liabilities in the consolidated balance sheet (see note 8). The portion of the provision expected to be realized in the period subsequent to December 31, 2013 of $495 is carried with provisions as a non-current liability in the consolidated balance sheet as at December 31, 2012. During the year ended December 31, 2012, the Company recognized a reduction to finance costs of $5 (2011 – $nil) to account for accretion and changes in estimates and rates related to onerous contracts. The estimate may vary as a result of changes in the utilization of the lease premises and the sub-lease arrangements, where applicable. The unexpired term of the leases at December 31, 2012 is 31 months.

14. Income Taxes

The following table sets forth the components of the Company's deferred income tax asset:

	December 31, 2012	December 31, 2011
Excess (deficiency) of net book value of property and equipment and provisions over related tax pools	**(3,664)**	13,605
Non-capital loss carry-forwards	**36,969**	23,659
Scientific research and development expenses and investment tax credits	**8,602**	8,602
Other tax assets	**2,359**	2,450
Total net deferred income tax assets	**44,266**	48,316

At December 31, 2012, Cequence has total tax pools of $608,300 (2011 – $591,296) including non-capital loss carry-forwards, investment tax credit carry-forwards and Scientific Research and Experimental Development ("SRED") expenses available to reduce future years' income for tax purposes. Deferred income tax assets have been recognized to the extent that estimated future taxable profits are sufficient to realize the deferred income tax assets in the allowable timeframes. As at December 31, 2012, a deferred income tax asset has not been recognized on $18,600 (2011 – $18,600) of deductible temporary differences in respect of certain successored resources properties; the deductible temporary differences do not expire. The Scientific Research and Development expenses of approximately $22,704 available for carry-forward do not expire (2011 – $22,704). The non-capital loss carry-forwards expire in 1 to 20 years and the investment tax credit carry-forwards expire in 7 to 11 years.

Income tax expense differs from that which would be expected from applying the effective Canadian federal and provincial tax rates of 25.0 percent (2011 – 26.5 percent) to loss before income taxes as follows:

	Year ended December 31, 2012	2011
Expected income tax recovery	**(4,427)**	(5,692)
Effect of share based payments	**1,429**	1,791
Change in value of reserves and losses due to reassessments	**–**	(258)
Change in effective tax rate applied	**–**	1,039
Effect of renunciation of flow-through shares (Note 15)	**2,960**	1,395
Other	**3**	418
Deferred income tax recovery	**(35)**	(1,307)
Current income tax recovery	**–**	(14)
Income tax recovery	**(35)**	(1,321)

Movements in deferred income tax balances are as follows:

	Balance, Dec. 31, 2011	Recognized in comprehensive loss	Recognized in liabilities	Recognized in equity	**Balance Dec. 31, 2012**
Property and equipment and provisions	13,605	(12,121)	(4,959)	–	**(3,475)**
Unrealized gain on financial instruments	–	(189)	–	–	**(189)**
Non-capital losses	23,659	13,310	–	–	**36,969**
SRED expenses and investment tax credits	8,602	–	–	–	**8,602**
Other	2,450	(965)	–	874	**2,359**
Total	48,316	35	(4,959)	874	**44,266**

	Balance, Dec. 31, 2010	Recognized in comprehensive loss	Recognized in liabilities	Recognized in equity	Balance Dec. 31, 2011
Property and equipment and provisions	12,798	2,669	(1,862)	–	13,605
Non-capital losses	24,211	(552)	–	–	23,659
SRED expenses and investment tax credits	8,616	(14)	–	–	8,602
Other	1,715	(796)	–	1,531	2,450
Total	47,340	1,307	(1,862)	1,531	48,316

15. Share Capital

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

	Year ended December 31, 2012		Year ended December 31, 2011	
	Number	**Stated Value**	Number	Stated Value
	(000s)	**$**	(000s)	$
Issued common voting shares				
Balance, beginning of year	**161,856**	**559,371**	128,750	452,526
Common shares	**21,269**	**25,523**	25,358	84,229
Flow-through common shares	**17,485**	**24,429**	4,898	16,758
Common shares on exercise of stock options	–	–	600	1,794
Common shares on exercise of warrants	–	–	2,250	8,663
	200,610	**609,323**	161,856	563,970
Share issue costs, net of taxes of $874 (2011 – $1,531)	–	**(2,620)**	–	(4,599)
Balance, end of year	**200,610**	**606,703**	161,856	559,371
Warrants				
Balance, beginning of year	**2,250**	–	4,500	–
Cancelled	**(2,250)**	–	–	–
Exercised	–	–	(2,250)	–
Balance, end of year	–	–	2,250	–

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

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

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

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

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

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

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

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

On August 18, 2011, the Company completed the sale of 11,960 common voting shares at a price of $3.85 per share for total gross proceeds of $46,046 and 2,110 common voting shares on a CEE "flow-through" basis at $4.75 per share for total gross proceeds of $10,023. Under the terms of the respective agreements, Cequence is required to renounce $10,023 of CEE expenditures in February 2012. As at December 31, 2011, the Company has incurred all of the qualifying CEE expenditures. The above transaction resulted in an increase to share capital of $8,124 and the recognition of an obligation related to flow-through shares of $1,899 included with other liabilities in the consolidated balance sheet at December 31, 2011.

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

On March 8, 2012, the Company's 2012 Warrants were cancelled at no cost to Cequence and no redress to the shareholder.

On June 20, 2012, the Company completed the sale of 11,684 common voting shares at a price of $1.20 per share for gross proceeds of $14,020. On July 12, 2012, the Company further completed the sale of 1,252 common voting shares at a price of $1.20 per share for gross proceeds of $1,503 related to the exercise of an over-allotment option on the above issuance.

On June 20, 2012, the Company completed the sale of 4,850 common voting shares on a CEE "flow-through" basis at $1.45 per share for gross proceeds of $7,033 as well as 3,800 common voting shares on a CDE "flow-through" basis at $1.32 per share for gross proceeds of $5,016, resulting in a total issuance of 8,650 common voting shares for total gross proceeds of $12,049. The above transaction resulted in an increase to share capital of $10,380 and the recognition of an obligation related to flow-through shares of $1,669 included with other liabilities at December 31, 2012. In accordance with the terms of the related agreements and pursuant to certain provisions of the Income Tax Act (Canada), the Company is required to renounce, for income tax purposes, exploration expenditures of $7,033 and development expenditures of $5,016 to the holders of the flow-through common shares effective December 31, 2012. As at December 31, 2012, the Company has incurred all qualifying CEE and CDE expenditures.

On June 22, 2012, the Company completed the sale, on a private placement basis, of 8,333 common voting shares at a price of $1.20 per share for gross proceeds of $10,000.

On December 5, 2012, the Company completed the public sale of 8,560 common voting shares on a CEE "flow-through" basis at $1.87 per share for gross proceeds of $16,007. On December 21, 2012, the Company completed a private placement sale of 275 common voting shares to certain officers and directors on a CEE "flow-through" basis at $1.87 per share for gross proceeds of $514. The private placement transaction has been recorded at the exchange amount, which is the amount of consideration established and agreed to by the related parties, and is equal to fair value. The above transactions resulted in an increase to share capital of $14,048 and the recognition of an obligation related to flow-through shares of $2,473 included with other liabilities at December 31, 2012. In accordance with the terms of the related agreements and pursuant to certain provisions of the Income Tax Act (Canada), the Company is required to renounce, for income tax purposes, exploration expenditures of $16,521 to the holders of the flow-through common shares effective December 31, 2012. As at December 31, 2012, the Company has yet to incur any qualifying CEE expenditures.

16. Share Based Payment Plans

Stock options

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

During the year ended December 31, 2012, the Company issued 5,118 stock options at prices ranging from $1.24 to $1.95 to employees and directors. The options have a five year life and one-third vest annually commencing one year following the grant date.

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

	2012	2011
Risk-free interest rate	**1.3% – 1.6%**	1.3% – 2.8%
Expected life of options	**5 years**	5 years
Expected volatility	**60%**	60%
Expected dividend rate	**0%**	0%
Expected forfeiture rate	**15%**	15%
Weighted average fair value	**$ 0.65**	$ 1.91

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

A summary of the status of the Company's stock option plan and changes during the year ended December 31, 2012 and 2011 is as follows:

		2012		2011
	Number of options	**Weighted average exercise price**	Number of options	Weighted average exercise price
	(000s)	**$**	(000s)	$
Outstanding, beginning of year	**13,094**	**2.54**	9,713	1.99
Granted	**5,118**	**1.30**	4,221	3.69
Forfeited	**(923)**	**2.20**	(240)	1.99
Exercised	**–**	**–**	(600)	1.99
Outstanding, end of year	**17,289**	**2.19**	13,094	2.54

The following table summarizes information about stock options outstanding at December 31, 2012:

		Options outstanding		Options exercisable	
	Weighted average exercise price	Number of options outstanding	Weighed average contractual life remaining	Number of options	Weighted average exercise price
	$	(000s)	(years)	(000s)	$
1.24 – 1.99	1.73	13,230	3.4	5,501	1.98
2.96 – 3.94	3.69	4,059	3.5	1,353	3.69
	2.19	17,289	3.4	6,854	2.32

During the year ended December 31, 2012, $5,717 (2011 – $6,758) in share based payment expense related to equity-settled stock options has been recognized in comprehensive loss.

17. Loss Per Share

Loss per share has been calculated based on the weighted average number of common shares outstanding during the year. No stock options or warrants have been included in the calculation of diluted shares outstanding for the year ended December 31, 2012 (2011 – none) as their inclusion would be anti-dilutive. The following table reconciles the denominators used for the basic and diluted loss per share calculations.

	Year ended December 31,	
	2012	2011
Basic weighted average shares	**178,209**	147,558
Effect of dilutive stock options and warrants	**–**	–
Diluted weighted average shares	**178,209**	147,558

18. Contingencies and Commitments

	2013	2014	2015	2016	2017+	Total
Office leases	1,133	922	187	–	–	2,242
Drilling services	1,903	–	–	–	–	1,903
Pipeline transportation	1,684	1,684	1,541	–	–	4,909
Total	4,720	2,606	1,728	–	–	9,054

The pipeline transportation contract expires on November 30, 2015.

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

During the year ended December 31, 2011, the Company entered into a drilling service agreement whereby the Company made a deposit of $3,500 to obtain a right of first refusal on the use of two drilling rigs over the five years following the date that use of the rigs commences. The deposit is to be applied as the Company incurs costs related to the use of the drilling rigs and $1,020 has been drawn down at December 31, 2012. Cequence expects to reduce the deposit by $579 in the year ended December 31, 2013, which amount is included with deposits and prepaid expenses at December 31, 2012. The portion of the outstanding deposit expected to be drawn down in the period subsequent to December 31, 2013 of $1,901 is carried as a non-current asset at December 31, 2012.

During the year ended December 31, 2012, the Company recognized $1,451 (2011 – $1,311) of expense related to office leases, included with general and administrative expense.

19. Financial Instruments and Risk Management

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

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

The Company's fair value hierarchy for those assets and liabilities measured at fair value as of December 31, 2012 comprises cash, which is considered a level 1 financial instrument and commodity contracts. Cequence's commodity contracts are measured at level 2 under the Company's fair value hierarchy as of December 31, 2012. The fair value of commodity contracts is determined by discounting the remaining contracted petroleum and natural gas volumes by the difference between the contracted price and published forward price curves as at the balance sheet date.

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

Market Risk

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

Commodity price risk

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

During the year ended December 31, 2012, the Company entered into several commodity derivative financial instrument contracts. The following information presents all outstanding positions for commodity derivative financial instruments at December 31, 2012:

Term	Product	Type	Volume	Price	Basis
January 1, 2013 to December 31, 2013	Gas	Swap	2,000 GJ/day	$2.84	AECO
January 1, 2013 to December 31, 2013	Gas	Swap	2,500 GJ/day	$3.09	AECO
January 1, 2013 to December 31, 2013	Gas	Swap	2,500 GJ/day	$3.00	AECO
January 1, 2013 to December 31, 2013	Gas	Swap	5,000 GJ/day	$3.10	AECO
January 1, 2013 to December 31, 2013	Gas	Swap	2,500 GJ/day	$3.24	AECO
January 1, 2013 to December 31, 2013	Gas	Swap	2,500 GJ/day	$3.40	AECO
January 1, 2014 to September 30, 2014	Gas	Swap	2,500 GJ/day	$3.51	AECO
January 1, 2013 to December 31, 2013	Oil	Sold Call	200 bbls/day	$110.00 USD	WTI

For the year ended December 31, 2012, realized loss from commodity derivative contracts recognized in comprehensive loss were $161 (2011 – $906 gain).

The fair value of the commodity contracts outstanding at December 31, 2012 was a current asset of $694, non-current asset of $63 (2011 – $nil).

For the year ended December 31, 2012 the Company recorded an unrealized gain of $757 from derivative commodity contracts (2011 – $nil).

As at December 31, 2012, an increase in gas price of $0.50/gj results in a decrease in the fair value of the commodity contracts of $3,475 ($2,606 after tax) and a commensurate decrease to comprehensive loss.

Foreign exchange risk

The Company is exposed to foreign currency fluctuations as crude oil and natural gas prices are referenced to U.S. dollar denominated prices. As at December 31, 2012 the Company had no forward, foreign exchange contracts in place, nor any significant working capital items denominated in foreign currencies (2011 – nil).

Interest rate risk

The Company is exposed to interest rate risk to the extent that changes in market interest rates impact its borrowings under the floating rate credit facilities. The floating rate debt is subject to interest rate cash flow risk, as the required cash flows to service the debt will fluctuate as a result of changes in market rates. The Company has no interest rate swaps or financial contracts in place as at or during the year ended December 31, 2012 (2011 – nil).

As at December 31, 2012 a 1 percent change in interest rates on the Company's outstanding debt, with all other variables constant, would result in a change in comprehensive loss of $232 ($174 after tax) (2011 – $116 ($85 after tax)).

Credit Risk

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

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

As at December 31, 2012, the accounts receivable balance was $16,084 of which $4,009 was past due. The Company considers all amounts greater than 90 days past due. These past due accounts are considered to be collectible, except as provided in the allowance for doubtful accounts. When determining whether past due accounts are uncollectible, the Company factors in the past credit history of the counterparties. At December 31, 2012, the Company has an allowance for doubtful accounts of $515 (2011 – $551). As at December 31, 2012, 44.0 percent (2011 – 33.0) of the total receivables balance is due from marketers of the Company's oil and natural gas production. A reconciliation of the Company's allowance for doubtful accounts is as follows:

	Year ended December 31,	
	2012	2011
Balance, beginning of year	**551**	490
Amounts collected	**(36)**	(37)
Amounts written off to accounts receivable	–	(4)
Additional provision	–	102
Balance, end of year	**515**	551

As at December 31, 2012, the maximum exposure to credit risk was $16,841 (2011 – $21,412) being the carrying value of the Company's accounts receivable and commodity contract assets.

Liquidity Risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they are due. The nature of the oil and gas industry is capital intensive and the Company maintains and monitors a certain level of cash flow to finance operating and capital expenditures. Refer to note 21 for disclosure related to the management of capital.

The expected timing of cash flows relating to financial liabilities as at December 31, 2012 is as follows:

	< 1 Year	1 – 2 Years	2 – 5 Years	Thereafter
Demand credit facilities	–	–	23,191	–
Accounts payable and accrued liabilities	42,190	–	–	–
	42,190	–	23,191	–

20. Changes in Non-Cash Working Capital

	Year ended December 31,	
	2012	2011
Accounts receivable	**4,948**	(4,593)
Deposits and prepaid expenses	**358**	(3,207)
Accounts payable and accrued liabilities	**(22,277)**	28,227
Net change in non-cash working capital	**(16,971)**	20,427
Allocated to:		
Operating activities	**4,950**	(4,607)
Investing activities	**(22,186)**	24,976
Financing activities	**265**	58
	(16,971)	20,427

21. Capital Management

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

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

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

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

At December 31, 2012 Cequence has a net debt and working capital deficiency of $45,869 (2011 – $51,442).

It is the Company's objective to maintain a net debt to annualized cash flow ratio of less than 2:1. As at December 31, 2012, the ratio was calculated as 1:1 (2011 – 1.3:1) based on annualized fourth quarter results.

The Company's current borrowing capacity is based on the lenders' semi-annual review of the Company's oil and natural gas reserves. The Company is also subject to various restrictions, including being permitted to hedge up to 67 percent of its production under the lending agreement. Compliance with these restrictions is monitored on a regular basis and at December 31, 2012 Cequence was in compliance with all such restrictions.

22. Related Parties

An executive of the Company is a member of the Board of Directors of an entity that is a supplier of seismic services to Cequence. The Company incurred a total of $nil with this vendor in the year ended December 31, 2012 (2011 – $26). These transactions have been recorded at the exchange amount, which is the amount of consideration established and agreed to by the related parties, and is equal to fair value. As at December 31, 2012, no amounts are included in accounts payable and accrued liabilities related to these transactions (2011 – $nil).

23. Subsequent Event

On February 25, 2013, the Company entered into agreements to acquire interests in oil and gas properties located in the Simonette and Resthaven areas of Alberta. As consideration for the assets, Cequence will transfer its interest in its non-operated oil and gas properties located in the Fir area, and issue an aggregate of 10,300,000 Cequence common shares to the Corporation. Completion of the transaction is expected to occur in mid April 2013 and is subject to the satisfaction of several conditions, including receipt of the applicable court, stock exchange and regulatory approvals as well as the approval by the vendor's shareholders. There can be no assurance provided that this transaction will close as described.

Corporate Information

Management

Paul Wanklyn
President & CEO

Howard Crone, P.Eng
Executive Vice President & COO

David Gillis, CA
Vice President, Finance & CFO

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

David P. Robinson
Vice President, Geology

Christopher C. Soby
Vice President, Land

Stephen R. Stretch
Vice President, Geophysics

Mike Stewart
Vice President, Operations

Erin Thorson, CMA
Controller

Directors

Don Archibald
Chairman

Peter Bannister
Paul Colborne
Robert C. Cook
Howard Crone
Brian Felesky
James K. Gray
Francesco Mele
Paul Wanklyn
Daryl Gilbert

Transfer Agent and Registrar

Valiant Trust Company
Calgary, Alberta

Head Office

Suite 3100, 525 8th Avenue SW
Calgary, AB T2P 1G1
T: 403-229-3050
F: 403-229-0603
E: info@cequence-energy.com
W: www.cequence-energy.com

Auditors

Deloitte & Touche LLP
Calgary, Alberta

Bankers

Canadian Imperial Bank of Commerce
Calgary, Alberta

National Bank of Canada
Calgary, Alberta

Bank of Montreal
Calgary, Alberta

Legal Counsel

Norton Rose Canada LLP
Calgary, Alberta

Evaluation Engineers

GLJ Petroleum Consultants
Calgary, Alberta

Stock Exchange Listing

Toronto Stock Exchange
Symbol: CQE

Suite 3100, 525 - 8th Avenue S.W.
Calgary, Alberta T2P 1G1

www.cequence-energy.com