# Lone Pine Resources Inc.
# Lone Pine Resources Canada Ltd.

## Condensed Interim Combined and Consolidated Financial Statements (Unaudited)

## As at and for the Three and Six Months Ended June 30, 2016

Dated: August 29, 2016

# CONDENSED COMBINED AND CONSOLIDATED STATEMENTS OF FINANCIAL POSITION (UNAUDITED)

| *As at* *($000s)* | Note | **June 30, 2016** | December 31, 2015 |
|---|---|---|---|
| **ASSETS** | | | |
| Cash and cash equivalents | 17 | **1,599** | 13,021 |
| Accounts receivable | | **4,569** | 6,582 |
| Inventory | | **348** | 471 |
| Prepaid expenses and other assets | | **840** | 1,139 |
| Derivative instruments – current | 17 | **5,016** | 9,531 |
| **Total current assets** | | **12,372** | 30,744 |
| Exploration and evaluation | 4 | **23,820** | 48,314 |
| Property and equipment | 5 | **117,549** | 115,272 |
| Derivative instruments | 17 | **—** | 3,918 |
| Other assets | | **644** | 657 |
| **Total assets** | | **154,385** | 198,905 |
| **LIABILITIES** | | | |
| Accounts payable and accrued liabilities | | **6,332** | 8,945 |
| Derivative instruments – current | 17 | **160** | — |
| Current portion of decommissioning liability | 8 | **3,500** | 3,500 |
| **Total current liabilities** | | **9,992** | 12,445 |
| Preferred shares | 7 | **163,903** | 166,171 |
| Preferred shares – conversion liability | | **26,450** | 26,450 |
| Derivative instruments | 17 | **1,514** | — |
| Decommissioning liabilities | 8 | **65,574** | 67,002 |
| Other liabilities | | **895** | 899 |
| **Total Liabilities** | | **268,328** | 272,967 |
| **SHAREHOLDERS' DEFICIT** | | | |
| Share capital | 9 | **73,912** | 73,912 |
| Contributed surplus | | **1,024,768** | 1,024,623 |
| Accumulated deficit | | **(1,212,910)** | (1,172,884) |
| Accumulated other comprehensive income ("AOCI") | | **287** | 287 |
| **Total Deficit** | | **(113,943)** | (74,062) |
| **Total liabilities and shareholders' deficit** | | **154,385** | 198,905 |

See accompanying notes to the condensed interim combined and consolidated financial statements.

## CONDENSED COMBINED AND CONSOLIDATED STATEMENTS OF LOSS AND COMPREHENSIVE LOSS (UNAUDITED)

| | | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|---|
| *($000s)* | Note | **2016** | 2015 | **2016** | 2015 |
| **REVENUE** | | | | | |
| Oil and natural gas revenue | | **9,151** | 11,591 | **16,354** | 21,361 |
| Royalties | | **(924)** | (323) | **(1,573)** | (869) |
| Oil and natural gas revenue, net of royalties | | **8,227** | 11,268 | **14,781** | 20,492 |
| Unrealized loss on derivative instruments | 17 | **(10,959)** | (6,650) | **(10,107)** | (10,231) |
| Realized gain on derivative instruments | 17 | **2,539** | 3,063 | **6,124** | 7,443 |
| | | **(193)** | 7,681 | **10,798** | 17,704 |
| **EXPENSES** | | | | | |
| Operating | 12 | **5,026** | 3,290 | **11,456** | 8,135 |
| General and administrative | 13 | **2,450** | 3,368 | **5,154** | 6,994 |
| Depletion and depreciation | 5 | **5,043** | 6,042 | **9,701** | 12,124 |
| Exploration and evaluation | 4 | **8** | 40 | **34** | 142 |
| Loss on sale of property and equipment – net | | **73** | 195 | **73** | 195 |
| Impairment loss | 4,5 | **25,190** | 1,703 | **25,065** | 2,939 |
| Loss (gain) on foreign exchange | 7 | **506** | (2,288) | **(10,142)** | 9,594 |
| Finance costs | 14 | **4,351** | 3,955 | **8,824** | 7,785 |
| Reorganization | 15 | **116** | 1,305 | **392** | 1,315 |
| Transaction costs | 16 | **267** | — | **267** | — |
| Total expenses - net | | **43,030** | 17,610 | **50,824** | 49,223 |
| **Net loss and comprehensive loss** | | **(43,223)** | (9,929) | **(40,026)** | (31,519) |

See accompanying notes to the condensed interim combined and consolidated financial statements.

## CONDENSED COMBINED AND CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY (DEFICIT) (UNAUDITED)

| *($000s)* | Note | Share Capital Amount | Capital Surplus | Accumulated Deficit | Accumulated other Comprehensive Income | Total Deficit |
|---|---|---|---|---|---|---|
| Balance at December 31, 2015 | | 73,912 | 1,024,623 | (1,172,884) | 287 | (74,062) |
| Share-based compensation | 10 | — | **145** | — | — | **145** |
| Net loss | | — | — | **(40,026)** | — | **(40,026)** |
| Balance at June 30, 2016 | | **73,912** | **1,024,768** | **(1,212,910)** | **287** | **(113,943)** |

| *($000s)* | Note | Share Capital Amount | Capital Surplus | Accumulated Deficit | Accumulated other Comprehensive Income | Total Deficit |
|---|---|---|---|---|---|---|
| Balance at December 31, 2014 | | 73,912 | 1,023,364 | (1,112,990) | 287 | (15,427) |
| Share-based compensation | 10 | — | 837 | — | — | 837 |
| Net loss | | — | — | (31,519) | — | (31,519) |
| Balance at June 30, 2015 | | 73,912 | 1,024,201 | (1,144,509) | 287 | (46,109) |

See accompanying notes to the condensed interim combined and consolidated financial statements.

## CONDENSED COMBINED AND CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

| | | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|---|
| *($000s)* | Note | **2016** | 2015 | **2016** | 2015 |
| **OPERATING ACTIVITIES** | | | | | |
| Net (loss) earnings | | **(43,223)** | (9,929) | **(40,026)** | (31,519) |
| Adjustments for non-cash items: | | | | | |
| Unrealized foreign exchange (gain) loss | 7 | **504** | (2,287) | **(10,071)** | 9,593 |
| Unrealized loss on derivative instruments | 17 | **10,959** | 6,650 | **10,107** | 10,231 |
| Depletion and depreciation | 5 | **5,043** | 6,042 | **9,701** | 12,124 |
| Accretion and financing charges | 14 | **4,167** | 3,714 | **8,462** | 7,293 |
| Impairment loss | 4,5 | **25,190** | 1,703 | **25,065** | 2,939 |
| Share-based compensation | 10 | **45** | 429 | **137** | 837 |
| Amortization of deferred costs | | **103** | 150 | **201** | 300 |
| Exploration and evaluation expense | 4 | **8** | 40 | **34** | 142 |
| Loss on sale of property and equipment | | **73** | 195 | **73** | 195 |
| Settlements of decommissioning liabilities | 8 | **245** | (185) | **(2,742)** | (811) |
| Other, net | | **(163)** | (440) | **(188)** | (265) |
| Change in non-cash working capital | 11 | **(1,043)** | (3,078) | **1,681** | (3,845) |
| Net cash from operating activities | | **1,908** | 3,004 | **2,434** | 7,214 |
| **FINANCING ACTIVITIES** | | | | | |
| Long-term debt issuance costs | | **(71)** | (45) | **(71)** | (45) |
| Net cash (used in) from financing activities | | **(71)** | (45) | **(71)** | (45) |
| **INVESTING ACTIVITIES** | | | | | |
| Exploration and evaluation expenditures | 4 | **(685)** | (9,534) | **(7,873)** | (9,631) |
| Property and equipment expenditures | 5 | **(532)** | (485) | **(4,073)** | (1,688) |
| Proceeds on sale of property and equipment | | **20** | 150 | **20** | 150 |
| Change in non-cash working capital | 11 | **(3,216)** | (69) | **(1,859)** | 381 |
| Net cash used in investing activities | | **(4,413)** | (9,938) | **(13,785)** | (10,788) |
| Change in cash and cash equivalents | | **(2,576)** | (6,979) | **(11,422)** | (3,619) |
| Cash and cash equivalents beginning of period | | **4,175** | 18,618 | **13,021** | 15,258 |
| **Cash and cash equivalents end of period** | | **1,599** | 11,639 | **1,599** | 11,639 |

See accompanying notes to condensed interim combined and consolidated financial statements.

# NOTES TO THE CONDENSED INTERIM COMBINED AND CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

For the three and six months ended June 30, 2016 and 2015

### 1. COMBINED REPORTING ENTITIES

Lone Pine Resources Inc. (“Lone Pine Resources”) was incorporated under the laws of the state of Delaware, United States. Lone Pine Resources Canada Ltd. (“LPR Canada”) was incorporated under the laws of the province of Alberta, Canada. In these condensed interim combined and consolidated financial statements (the “Interim Financial Statements”), Lone Pine Resources and LPR Canada are collectively referred as the “Company” or “Lone Pine”.

Lone Pine is an independent oil and natural gas exploration, development and production company based in Calgary, Alberta, Canada with operations exclusively in Canada. The principal office of Lone Pine is located at 640 – 5th Avenue S.W., Calgary, Alberta.

Lone Pine’s reserves, producing properties and exploration prospects are located primarily in the provinces of Alberta, British Columbia and Quebec, and in the Northwest Territories. The Company conducts certain of its operating activities jointly with others through unincorporated joint arrangements and these Interim Financial Statements reflect only the Company’s share of assets, liabilities, revenues and expenses under these arrangements. The Company conducts all of its principal business in one reportable segment.

On June 23, 2016, Lone Pine and Arsenal Energy Inc. (“Arsenal”), an oil and natural gas exploration and production company listed on the Toronto Stock Exchange entered into a definitive agreement, which was subsequently amended on August 2, 2016, (the “Arrangement Agreement”) to effect a business combination by way of a plan of arrangement (the “Arrangement”) under the *Business Corporations Act* (Alberta). The Arrangement will bring together Lone Pine and Arsenal under a new parent corporation, now formed as Prairie Provident Resources Inc. ("Prairie Provident"), of which Lone Pine and Arsenal will become direct or indirect wholly-owned subsidiaries. Completion of the Arrangement will result in the shareholders of Lone Pine and Arsenal receiving common shares of Prairie Provident in substitution for their existing shares, with Prairie Provident in turn holding the combined undertakings of Lone Pine and Arsenal. Upon completion, former Lone Pine common shareholders, preferred shareholders and other stakeholders together will hold 77% of the fully-diluted Prairie Provident shares, and former Arsenal shareholders (including shares issued before closing in settlement of outstanding Arsenal incentive plan awards) will hold 23%. Completion of the Arrangement is subject to various conditions as set out in the Arrangement Agreement, including approval by the requisite majorities of Lone Pine Resources shareholders and LPR Canada securityholders at special meetings scheduled for September 8, 2016, approval of at least 66⅔% of votes cast of the Arsenal securityholders at a special meeting also scheduled for September 8, 2016, approval of the Court of Queen's Bench of Alberta pursuant to section 193 of the *Business Corporations Act* (Alberta), and approval by the Toronto Stock Exchange of the listing of the Prairie Provident common shares.

Lone Pine may be subject to a termination fee of $1.5 million payable to Arsenal if the Arrangement is not completed in certain circumstances. Conversely, Arsenal may be subject to a termination fee of $1.5 million or $2.75 million payable to Lone Pine if the Arrangement is not completed in certain circumstances. The Arrangement is expected to be completed on September 12, 2016.

## 2. BASIS OF PRESENTATION

### (a) Statement of Compliance

These Interim Financial Statements have been prepared in accordance with International Accounting Standard (“IAS”) 34 – *Interim Financial Reporting*.

The Interim Financial Statements should be read in conjunction with the audited annual combined and consolidated financial statements of Lone Pine as at and for the year ended December 31, 2015 and the notes thereto (the “Annual Financial Statements”). The Interim Financial Statements have been prepared on a basis consistent with the accounting, estimation and valuation policies described in the Annual Financial Statements.

The Interim Financial Statements were approved and authorized for issue by the Audit and Reserves Committee of the Board of Directors of Lone Pine on August 29, 2016.

### (b) Basis of Measurement

The Interim Financial Statements have been prepared on the historical cost basis except that derivative financial instruments are measured at fair value.

### (c) Functional and Presentation Currency

The Interim Financial Statements are presented in Canadian dollars, which is the Company’s functional currency.

### (d) Use of Estimates and Judgements

The preparation of financial statements in conformity with International Financial Reporting Standards (“IFRS”) requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, revenues and expenses. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimates are revised and in any future periods affected.

Information about significant areas of estimation uncertainty and critical judgements in applying accounting policies are outlined in the Annual Financial Statements.

## 3. SIGNIFICANT ACCOUNTING POLICIES

The Company’s significant accounting policies under IFRS are presented in Note 3 to the Annual Financial Statements. Certain information and disclosures normally required to be included in the notes to the Annual Financial Statements prepared in accordance with IFRS have been condensed or omitted in the Interim Financial Statements. Certain comparative amounts have been reclassified to conform to the current year’s presentation.

The Company is currently evaluating the impact of new standards and updates on its financial statements as outlined in the Annual Financial Statements.

## 4. EXPLORATION AND EVALUATION ASSETS

| *($000s)* | |
|---|---|
| Cost Balance – December 31, 2015 | 77,384 |
| Additions | **8,616** |
| Transfers to oil and gas property and equipment (Note 5) | **(8,086)** |
| Exploration and evaluation expense | **(34)** |
| Cost Balance – June 30, 2016 | **77,880** |
| | |
| Provision for impairment – December 31, 2015 | (29,070) |
| Impairment loss | **(24,990)** |
| Provision for impairment – June 30, 2016 | **(54,060)** |
| | |
| Net book value – December 31, 2015 | 48,314 |
| Net book value – June 30, 2016 | **23,820** |

Exploration and evaluation ("E&E") assets consist of the Company's undeveloped land and exploration and pilot projects which are pending the determination of proven or probable reserves.

Due to successful drilling in the Wheatland area and additional development prospects from the proposed Arrangement with Arsenal, along with a prolonged period of political uncertainty around oil and gas development in the province of Quebec, management has shifted its exploration and development priorities, which in turn triggered an impairment indicator related to E&E assets in the Quebec exploratory area as at June 30, 2016. The impairment assessment resulted in the recognition of $25.0 million of impairment in the three and six months ended June 30, 2016 against the Quebec exploratory area to a recoverable amount of $13.0 million based on its value in use.

Impairment recognized in the three months ended June 30, 2015 of $1.7 million related to the write-off of certain undeveloped lands and pre-drill cost that Lone Pine no longer intended to explore in light of low commodity prices.

## 5. PROPERTY AND EQUIPMENT

| *(In $000s)* | Production and Development | Office Equipment | Total |
|---|---|---|---|
| Cost: | | | |
| Balance at December 31, 2015 | 350,735 | 3,833 | 354,568 |
| Additions – property and equipment | **3,925** | **150** | **4,075** |
| Disposals | **(188)** | **—** | **(188)** |
| Transfers from E&E assets (Note 4) | **8,086** | **—** | **8,086** |
| Balance at June 30, 2016 | **362,558** | **3,983** | **366,541** |
| | | | |
| Accumulated impairment, depletion and depreciation: | | | |
| Balance at December 31, 2015 | (237,149) | (2,147) | (239,296) |
| Depletion and depreciation | **(9,320)** | **(271)** | **(9,591)** |
| Impairment loss | **(200)** | **—** | **(200)** |
| Disposals | **95** | **—** | **95** |
| Balance at June 30, 2016 | **(246,574)** | **(2,418)** | **(248,992)** |
| | | | |
| Net book value: | | | |
| At December 31, 2015 | 113,586 | 1,686 | 115,272 |
| At June 30, 2016 | **115,984** | **1,565** | **117,549** |

As at June 30, 2016, the Company assessed its production and development assets for indicators of impairment. Based on the assessment, no indicators of impairment were noted.

During the three and six months ended June 30, 2016, the Company recorded impairment of $0.2 million on the write down of certain surplus equipment. The 2016 year to date impairment loss includes a recovery of $0.1 million recorded first quarter of 2016 as a result of an increase in the net realizable value of inventory.

In the first quarter of 2015, a $1.2 million impairment loss was recognized for changes in estimated decommissioning liabilities of certain properties with a carrying value of nil.

## 6. LONG-TERM DEBT

As at both June 30, 2016 and December 31, 2015, Lone Pine had no outstanding long-term debt. Under the Company's credit facility, $5.2 million of letters of credit have been issued as at June 30, 2016 (December 31, 2015 - $4.5 million).

On June 17, 2016, the Company renewed and amended its credit facility with a syndicate of banks (the "Amended Credit Facility"). Under the Amended Credit Facility, Lone Pine has a $35 million syndicated revolving term facility and a $10 million operating facility, which mature one year after the term-out date. Annually prior to the applicable term-out date, subject to the lenders' approval, Lone Pine may extend the term-out date by 364 days. The next term-out date was set at May 30, 2017; as such the maturity date of Amended Credit Facility is May 30, 2018. The Amended Credit Facility is collateralized by a demand debenture from LPR Canada and each of its restricted subsidiaries in the amount of $500 million granting a first priority security interest over all present and after-acquired personal property and a first floating charge over all other present and after-acquired property, together with a fixed charge and mortgage over its existing borrowing base assets. A fixed charge and mortgage over after-acquired borrowing base assets will only be granted under certain circumstances.

As at June 30, 2016, the Company was in compliance with all covenants under the Amended Credit Facility.

## 7. LPR CANADA PREFERRED SHARES

At June 30, 2016, the preferred shares (the "Preferred Shares") liability was $163.9 million (December 31, 2015 – $166.2 million). During the three and six months ended June 30, 2016, $0.5 million unrealized loss (2015 – $2.3 million gain) and $10.2 million of unrealized gain (2015 – $9.6 million loss) was recognized, respectively, related to the translation of the US dollar denominated Preferred Shares at prevailing rates.

## 8. DECOMMISSIONING LIABILITIES

| *($000s)* | |
|---|---|
| Total Balance – December 31, 2015 | 70,502 |
| Liabilities incurred | **736** |
| Payments | **(2,742)** |
| Accretion | **578** |
| Total Balance – June 30, 2016 | **69,074** |

| | |
|---|---|
| Comprised of: | |
| Current portion – June 30, 2016 | **3,500** |
| Long-term portion – June 30, 2016 | **65,574** |

| | |
|---|---|
| Current portion – December 31, 2015 | 3,000 |
| Long-term portion – December 31, 2015 | 67,002 |

The Company has estimated the undiscounted total future liabilities of approximately $110.3 million (December 31, 2015 – $111.8 million). Liability payments are estimated over the next 55 years with the majority of costs expected to be incurred over the next 25 years.

Decommissioning liabilities at June 30, 2016 were determined using risk-free rates of 0.7% – 2.2% (December 31, 2015 – 0.7% - 2.2%) and an inflation rate of 1.7% (December 31, 2015 – 1.7%).

## 9. SHARE CAPITAL

### (a) Units Outstanding

| *(000s of units)* | Number of Shares |
|---|---|
| **Lone Pine Resources Common Shares** | |
| Class A Common Shares | **24,986** |
| Class B Multiple Voting Shares | **75,000** |
| Balance at December 31, 2015 and June 30, 2016 | **99,986** |

| *(000s of units)* | Number of Shares |
|---|---|
| **LPR Canada Common Shares** | |
| Class A Voting Common Shares | **24,986** |
| Class C multiple voting common shares | **—** |
| Balance at December 31, 2015 and June 30, 2016 | **24,986** |

### (b) Consolidated and Combined Common Share Capital

| *($000s)* | |
|---|---|
| Balance at December 31, 2015 and June 30, 2016 | **73,912** |

## 10. SHARE-BASED COMPENSATION

During the three and six months ended June 30, 2016, Lone Pine did not issue any share-based incentive awards. Outstanding restricted shares units (RSUs) were issued in 2014. Vested RSUs will only be settled and redeemed upon a corporate change that (i) directly or indirectly ascribes a value to the shares and (ii) provides liquidity to the holders of shares. A corporate change is defined in the equity incentive plan, which generally includes events that result in a change of control, sale of all or substantially all of the Company's assets or liquidation of the Company. As at June 30, 2016 and December 31, 2015, none of the RSUs outstanding were exercisable. Upon closing of the Arrangement (Note 1), RSUs will be settled in exchange for Prairie Provident common shares with the vested portion of RSUs settling shortly after closing and the unvested portion settling subsequent to the January 31, 2017 vesting date.

The number of RSUs outstanding is as follows:

| | Directors | Officer and Employees | Total |
|---|---|---|---|
| Outstanding – December 31, 2015 | 271,967 | 1,578,128 | 1,850,095 |
| Cancellations – terminations | — | (27,239) | (27,239) |
| Outstanding – June 30, 2016 | 271,967 | 1,550,889 | 1,822,856 |
| Weighted average fair value per RSU at grant date: | $2.13 | $2.07 | $2.08 |

For the three and six months ended June 30, 2016, share-based compensation of a nominal amount (2015 – $0.3 million) and $0.1 million (2015 – $0.7 million), respectively was included in general and administrative expense net of a nominal amount of capitalized share based compensation. A nominal amount of share-based compensating was included in operating expense for the three and six months ended June 30, 2016 and June 30, 2015.

## 11. SUPPLEMENTAL INFORMATION

### Cash Flow Presentation

Changes in non-cash working capital and interest paid are summarized:

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| *($000s)* | **2016** | 2015 | **2016** | 2015 |
| Source (use) of cash: | | | | |
| Accounts receivable | **523** | (186) | **2,013** | 59 |
| Prepaid expenses and other current assets | **190** | (230) | **422** | (279) |
| Accounts payable and accrued liabilities | **(4,972)** | (2,731) | **(2,613)** | (3,244) |
| | **(4,259)** | (3,147) | **(178)** | (3,464) |
| Related to operating activities | **(1,043)** | (3,078) | **1,681** | (3,845) |
| Related to investing activities | **(3,216)** | (69) | **(1,859)** | 381 |
| | **(4,259)** | (3,147) | **(178)** | (3,464) |
| Other: | | | | |
| Interest paid during the period | **150** | 104 | **284** | 270 |

## 12. OPERATING EXPENSE

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| *($000s)* | **2016** | 2015 | **2016** | 2015 |
| Lease operating expense | **3,286** | 3,098 | **8,160** | 6,927 |
| Transportation and processing | **1,310** | (171) | **2,430** | 203 |
| Production and property taxes | **430** | 363 | **866** | 1,005 |
| Operating expense | **5,026** | 3,290 | **11,456** | 8,135 |

## 13. GENERAL AND ADMINISTRATIVE COSTS

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| *($000s)* | **2016** | 2015 | **2016** | 2015 |
| Salaries and benefits | **1,314** | 1,324 | **2,803** | 2,760 |
| Share-based compensation | **49** | 253 | **143** | 656 |
| Office rents and leases | **347** | 404 | **691** | 803 |
| Professional fees | **606** | 752 | **1,221** | 1,835 |
| Other – office | **427** | 677 | **966** | 1,050 |
| | **2,743** | 3,410 | **5,824** | 7,104 |
| Amounts capitalized | **(293)** | (42) | **(670)** | (110) |
| General and administrative expense | **2,450** | 3,368 | **5,154** | 6,994 |

## 14. FINANCE COSTS

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| *($000s)* | **2016** | 2015 | **2016** | 2015 |
| Interest expense | **184** | 241 | **362** | 492 |
| Accretion – preferred shares | **3,878** | 3,371 | **7,884** | 6,635 |
| Accretion – decommissioning liabilities (Note 8) | **289** | 343 | **578** | 658 |
| Finance cost | **4,351** | 3,955 | **8,824** | 7,785 |

## 15. REORGANIZATION COSTS

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| *($000s)* | **2016** | 2015 | **2016** | 2015 |
| Salaries and benefits – terminations | **116** | 1,126 | **382** | 1,126 |
| Share-based compensation – terminations | **—** | 176 | **—** | 176 |
| Professional fees | **—** | 5 | **10** | 15 |
| Amortization and other cost | **—** | (2) | **—** | (2) |
| Reorganization cost | **116** | 1,305 | **392** | 1,315 |

## 16. TRANSACTION COSTS

Transaction costs are costs incurred to effect the Arrangement with Arsenal (Note 1). Transaction costs incurred in the three and six months ended June 30, 2016 of $0.3 million (2015 - $nil) include legal and professional fees.

## 17. FINANCIAL INSTRUMENTS, FAIR VALUES AND RISK MANAGEMENT

Financial instruments of Lone Pine consist of cash and cash equivalents, accounts receivable, accounts payable, borrowings under its credit facilities, derivative contracts, Preferred Shares and the conversion liability related to the Preferred Shares.

Cash and cash equivalents, derivative contracts and the conversion option within the Preferred Shares are classified as held for trading. The Preferred Shares conversion option is linked to and must be settled by delivery of LPR Canada common shares, which do not have quoted market prices in an active market and therefore cannot be reliably measured. Accounts receivable are classified as loans and receivables. The remaining instruments are considered other financial liabilities.

As of June 30, 2016, Lone Pine had $1.6 million of cash and $nil cash equivalents (December 31, 2015 – $4.0 million cash and $9.0 million of one-month guaranteed investment certificates).

### (a) Fair Value

The fair values of cash and cash equivalents, accounts receivable and accounts payable approximate their carrying amounts due to their short-term maturities. The fair value of the borrowings under Lone Pine's credit facilities approximates the carrying value (excluding deferred financing charges) as they bear floating market rates. The fair value of Preferred Shares as at June 30, 2016 is $128.3 million (December 31, 2015 – $127.3 million) compared to the carrying value of $163.9 million (December 31, 2015 – $166.2 million). The Company determined the fair value of the Preferred Shares by discounting future cash flows at market yields of corporate bonds of comparable credit characteristics and maturity and is therefore considered as level 3 under the fair value hierarchy (the fair value hierarchy is described in Note 3(f) of the Annual financial statements).

The Company's finance department is responsible for performing the valuation of financial instruments. The valuation process and results are reviewed and approved by management at least once every quarter, in line with the Company's quarterly reporting dates.

Cash and cash equivalents and derivative instruments are measured and recorded on Lone Pine's statement of financial position at fair value through profit and loss. Cash and cash equivalents and risk management contracts have been assessed on the fair value hierarchy. Cash is classified as Level 1, while cash equivalents and derivative contracts are classified as Level 2. During the six months ended June 30, 2016, there were no transfers among Levels 1, 2 and 3.

Derivatives are valued using valuation techniques with market observable inputs. The most frequently applied valuation techniques include forward pricing and swap models using present value calculations and third-party option valuation models. The models incorporate various inputs including the credit quality of counterparties, foreign exchange spot and forward rates, and forward rate curves of the underlying commodity. The fair values of the risk management contracts are net of a credit valuation adjustment attributable to derivative counterparty default risk or the Company's own default risk.

### (b) Risk Management

#### (i) Liquidity Risk

Liquidity risk is the risk that the Company will encounter difficulty in meeting obligations associated with financial liabilities. The Company addresses its liquidity risk through its capital management of cash, committed credit capacity along with its planned capital expenditure program. As outlined in Note 6, the Company has $45 million borrowing capacity under the Amended Credit Facility, of which $5.2 million was utilized as at June 30, 2016 for the issuance of letters of credit. The Company has determined that its current financial obligations are adequately funded from the available borrowing capacity and from cash flows derived from operations. Except for the redemption features of the Preferred Shares detailed in Note 8 of the Annual Financial Statements and non-current liabilities related to derivative instruments, all of the Company's financial liabilities are due within one year.

### (ii) Commodity Price Risk

Lone Pine enters into derivative instruments to manage its exposure to commodity price risk caused by fluctuations in commodity prices, which have served to protect and provide certainty on a portion of the Company's cash flows. The following table summarizes commodity derivative contracts as at June 30, 2016:

| Commodity Contract | Notional Quantity | Remaining Term | Reference | Weighted Average Price | Contract Type |
|---|---|---|---|---|---|
| Oil | 750 bbls/d | July 1, 2016 – December 31, 2016 | CDN$ WTI | $ 91.19 | Swap |
| Light Oil Differential | 1,000 bbls/d | July 1, 2016 – December 31, 2016 | CDN$ MSW[(1)] | $ (5.35) | Swap |
| Natural Gas | 4,300 GJ/d | July 1, 2016 – December 31, 2016 | AECO 7A Monthly Index | $ 2.37 | Swap |
| Oil | 350 bbls/d | July 1, 2016 – December 31, 2016 | CDN$ WTI | $ 58.00/ 67.50 | Collar |
| Oil | 250 bbls/d | July 1, 2016 – December 31, 2017 | CDN$ WTI | $ 65.00/ 75.00 | Collar |
| Oil | 500 bbls/d | January 1, 2017 – December 31, 2017 | CDN$ WTI | $ 87.78 | Swap |
| Light Oil Differential | 1,000 bbls/d | January 1, 2017 – December 31, 2017 | CDN$ MSW[(1)] | $ (5.70) | Swap |
| Natural Gas | 1,800 GJ/d | January 1, 2017 – December 31, 2017 | AECO 7A Monthly Index | $ 2.60 | Swap |
| Oil | 382 bbls/d | January 1, 2017 – December 31, 2017 | CDN$ WTI | $ 93.50 | Sold Call Option |
| Oil | 500 bbls/d | January 1, 2017 – December 31, 2017 | CDN$ WTI | $ 58.00/ 67.50 | Collar |
| Oil | 500 bbls/d | January 1, 2018 – December 31, 2018 | USD$WTI | $ 65.00 | Sold Call Option |
| Oil | 800 bbls/d | January 1, 2018 – December 31, 2018 | CDN$ WTI | $ 58.00/ 67.50 | Collar |

(1) Settled on the monthly average Mixed Sweet Blend ("MSW") Differential to WTI

The following lists the fair value of all derivative contracts by commodity type in place at the following balance sheet dates:

| June 30, 2016 | Crude Oil | Natural Gas | Total |
|---|---|---|---|
| *($000s)* | | | |
| Derivative instruments – current asset | 5,016 | — | 5,016 |
| Derivative instruments – current liabilities | — | (160) | (160) |
| Derivative instruments – long-term liabilities | (1,450) | (64) | (1,514) |
| Total asset (liability) | 3,556 | (224) | 3,342 |

| December 31, 2015 | Crude Oil | Natural Gas | Total |
|---|---|---|---|
| *($000s)* | | | |
| Derivative instruments – current asset | 9,531 | — | 9,531 |
| Derivative instruments – long-term asset | 3,918 | — | 3,918 |
| Total asset | 13,449 | — | 13,449 |

The following shows the breakdown of realized and unrealized gains and losses recognized by commodity type for the three and six months ended June 30, 2016 and 2015:

| Three Months Ended June 30, 2016 | **Crude Oil** | **Natural Gas** | **Total** |
|---|---|---|---|
| *($000s)* | | | |
| Realized gain on derivative instruments | **2,239** | **300** | **2,539** |
| Unrealized loss on derivative instruments | **(10,130)** | **(829)** | **(10,959)** |
| Total loss | **(7,891)** | **(529)** | **(8,420)** |

| Three Months Ended June 30, 2015 | Crude Oil | Natural Gas | Total |
|---|---|---|---|
| *($000s)* | | | |
| Realized gain on derivative instruments | 3,063 | — | 3,063 |
| Unrealized loss on derivative instruments | (6,650) | — | (6,650) |
| Total loss | (3,587) | — | (3,587) |

| Six Months Ended June 30, 2016 | **Crude Oil** | **Natural Gas** | **Total** |
|---|---|---|---|
| *($000s)* | | | |
| Realized gains on derivative instruments | **5,733** | **391** | **6,124** |
| Unrealized loss on derivative instruments | **(9,884)** | **(223)** | **(10,107)** |
| Total gain (loss) | **(4,151)** | **168** | **(3,983)** |

| Six Months Ended June 30, 2015 | Crude Oil | Natural Gas | Total |
|---|---|---|---|
| *($000s)* | | | |
| Realized gain on derivative instruments | 7,443 | — | 7,443 |
| Unrealized loss on derivative instruments | (10,231) | — | (10,231) |
| Total loss | (2,788) | — | (2,788) |

Financial assets and financial liabilities are only offset if Lone Pine has the current legal right to offset and intends to settle on a net basis. Lone Pine's derivative instruments are subject to master netting agreements that create a legally enforceable right to offset by counterparty. The following is a summary of Lone Pine's financial assets and financial liabilities that were subject to offsetting as at June 30, 2016 and December 31, 2015. The net asset amounts represent the maximum exposure to credit risk for derivative instruments at each reporting date.

| June 30, 2016 *($000s)* | **Gross Assets (Liabilities)** | **Amount Offset Gross Assets (Liabilities)** | **Net Amount Presented** |
|---|---|---|---|
| Current: | | | |
| Derivative instruments assets | **9,246** | **(4,230)** | **5,016** |
| Derivative instruments liabilities | **(4,390)** | **4,230** | **(160)** |
| Long-term: | | | |
| Derivative instruments assets – long-term | **4,426** | **(4,426)** | **—** |
| Derivative instruments liabilities – long-term | **(5,940)** | **4,426** | **(1,514)** |

| December 31, 2015<br>*($000s)* | Gross Assets<br>(Liabilities) | Amount Offset<br>Gross Assets<br>(Liabilities) | Net Amount<br>Presented |
|---|---|---|---|
| Current: | | | |
| Derivative instruments assets | 16,758 | (7,227) | 9,531 |
| Derivative instruments liabilities | (7,227) | 7,227 | — |
| Long-term: | | | |
| Derivative instruments assets – long-term | 5,121 | (1,203) | 3,918 |
| Derivative instruments liabilities – long-term | (1,203) | 1,203 | — |

**18. COMMITMENTS**

As described in Note 22 of the Annual Financial Statements, effective December 8, 2015, Lone Pine entered into a farm-in and option agreement to farm-in certain lands in the Wheatland area. Under the farm-in arrangement, a minimum of $20 million of drilling and completion expenditures ("the Gross Capital Commitment") must be incurred on farm-in lands by December 31, 2016. Depending on the participation of the farmor, the Company's share of the expenditures may be between 50% and 100% of the Gross Capital Commitment. During the second quarter of 2016, the farm-in and option agreement was amended to allow more flexibility of the timing on drilling test wells and option wells throughout 2016 and 2017. The Gross Capital Commitment to be incurred by December 31, 2016 was unchanged at $20 million.