# LONG RUN EXPLORATION LTD.

## Management's Discussion and Analysis

## December 31, 2013

# Management's Discussion and Analysis
***For the year ended December 31, 2013***

*This Management's Discussion & Analysis ("MD&A") of financial condition and results of operations of Long Run Exploration Ltd. ("Long Run", the "Company", "its" or "our") should be read in conjunction with the audited financial statements for the years ended December 31, 2013 and 2012. On October 23, 2012, the Company completed a plan of arrangement, the "Guide Arrangement", with Guide Exploration Ltd. ("Guide"). Comparative results prior to October 23, 2012 do not include the results of operations from the Guide properties.*

*The Company follows International Financial Reporting Standards ("IFRS"). Amounts shown in the MD&A are in Canadian dollars unless otherwise stated. All production volumes disclosed herein are sales volumes. Certain prior year amounts have been reclassified to conform to current year presentation.*

*The MD&A contains certain measures that do not have any standardized meaning as prescribed by IFRS and therefore are considered non-Generally Accepted Accounting Principles ("Non-GAAP") measures. Readers are cautioned that the MD&A should be read in conjunction with the disclosure in the Non-GAAP Measures and the Advisory sections located at the end of this document. The Advisory provides information on forward-looking statements and oil and natural gas information.*

*See the Abbreviations section at the end of this document for abbreviations used throughout.*

*This document is dated March 5, 2014.*

## Long Run's Strategy

Long Run is engaged in the development, acquisition, exploration and production of oil and natural gas in western Canada. Specifically, the Company is focused on controlled exploitation and strategic acquisitions within the Peace River and Edmonton regions of the Western Canadian Sedimentary Basin.

Long Run has assembled large land blocks and has invested in natural gas and crude oil infrastructure in its key areas so as to obtain operatorship, build up our multi-year inventory of locations and control of the facilities. The Company's near term strategy is to develop the potential of Long Run's oil resources, selectively explore on our current land base and maintain a continued strong focus on cost control and efficiencies. Additionally, Long Run will continue to pursue strategic asset and corporate acquisitions of crude oil and natural gas properties.

In 2014, the Company is transitioning its business model to a balanced intermediate producer paying a monthly dividend, while continuing to provide moderate per share growth to shareholders. This model is supported by operating and developing assets already in the Long Run portfolio of producing properties. Long Run expects to fund dividend payments and capital expenditures from its funds from operations.

## Annual Highlights

Highlights of results during the year ended December 31, 2013 include:

- Funds flow from operations was $230 million ($1.83 per share), a 78% increase (30% per share) over 2012 of $129 million ($1.41 per share).
- Production averaged 25,094 BOE/d, a 90% increase from 13,189 BOE/d in 2012, reflecting the results of our active drilling program and the production acquired from the October 23, 2012 Guide Arrangement.
- Long Run's proved plus probable reserves at December 31, 2013 of 97,683 MBOE increased 17% from 83,165 MBOE in 2012 as a result of new wells drilled and properties acquired.
- Capital expenditures of $276.5 million focused on the Peace River and Redwater areas, with successful drilling of 129 (125.2 net) wells.
- The Company completed two significant light oil acquisitions in the fourth quarter in the Peace River and Redwater areas for total consideration of $95 million. The acquisitions increased the Company's drilling locations, while adding infrastructure within our core areas. Combined production from the properties was approximately 1,800 BOE/d (70% liquids) at the closing dates.
- The Company announced plans to transition to a dividend plus moderate growth model. In January 2014, the Company declared its first monthly dividend of $0.0335 per share ($0.402 per share per year), which was paid in February 2014.

## Annual Results Overview

| ($000s, except per share amounts or unless otherwise noted) | Year Ended December 31 2013 | 2012 | 2011 |
|---|---|---|---|
| Funds flow from operations[1] | **230,109** | 128,719 | 74,666 |
| Per share, basic [1] | **1.83** | 1.41 | 1.18 |
| Per share, diluted[1] | **1.83** | 1.41 | 1.17 |
| Net earnings (loss) | **24,265** | (42,652) | (52,667) |
| Per share, basic | **0.19** | (0.47) | (0.83) |
| Per share, diluted | **0.19** | (0.47) | (0.83) |
| Production | | | |
| Liquids *(Bbl/d)* | **13,232** | 8,576 | 3,839 |
| Natural Gas *(Mcf/d)* | **71,170** | 27,679 | 11,822 |
| Total *(BOE/d)* | **25,094** | 13,189 | 5,809 |
| Prices, including derivatives | | | |
| Liquids *($/Bbl)* | **77.55** | 78.97 | 86.33 |
| Natural Gas *($/Mcf)* | **3.70** | 3.23 | 4.13 |
| Total *($/BOE)* | **51.63** | 58.99 | 66.96 |
| Revenues, before royalties | **475,562** | 276,605 | 142,822 |
| Capital expenditures | **276,571** | 196,320 | 139,233 |
| Net acquisitions (dispositions) | **108,762** | (164,151) | 38,945 |
| Total assets | **1,403,344** | 1,193,272 | 665,811 |
| Bank loan | **423,553** | 261,173 | 124,000 |
| Net debt[1] | **452,155** | 293,123 | 124,753 |
| Non-current financial liabilities, excluding bank loan | **3,876** | 12,155 | 5,369 |

[1] *See Non-GAAP Measures section.*

### 2013 compared to 2012

Funds flow from operations of $230.1 million in 2013 was $101.4 million higher than 2012, primarily due to increased production volumes attributable to our active drilling program and properties acquired in the Guide Arrangement.

Net earnings in 2013 were $24.3 million compared to net loss of $42.7 million in 2012. Net income in 2013 reflects the higher funds flow from operations, partially offset by a $48.3 million increase in depletion expense associated with the higher production volumes. The net earnings in 2013 included impairments of $13.0 million (2012 – $146.1 million), partially offset by an $11.2 million gain on disposal of properties (2012 – $87.1 million).

Funds flow from operations and net earnings prior to October 23, 2012 do not include the results of operations from the Guide properties, which were acquired as part of the Guide Arrangement.

### 2014 Plan

For 2014, the Company has approved a capital program of approximately $200 million and an initial monthly dividend of $0.0335 per share. Long Run's 2014 capital program will focus on developing current inventory in core areas, specifically in the Montney at Peace River and in the Viking at Redwater. The Company expects to drill 80 net oil wells. Average production volumes for 2014 is expected to be 26,300

BOE/d, weighted approximately 57% to liquids. The Company expects to fund 2014 dividend payments and capital expenditures from funds flow from operations.

## Reserves

The Company engaged Sproule Associates Limited ("Sproule") to provide an evaluation of the Company's proved and proved plus probable reserves as at December 31, 2013. The reserve estimates set forth below are based upon the Sproule's reserve report dated March 4, 2014. The reserve estimates represent Long Run's gross reserves, which are the Company's interest before deduction of royalties and without including any of our royalty interests. Reserve estimates are based on forecast prices and costs at December 31, 2013.

Reserves estimates were prepared in accordance with National Instruments 51-101 Standards of Disclosure ("NI 51-101"). Under NI 51-101, proved reserves are defined as reserves with a 90% probability that the actual reserves recovered will equal or exceed proven reserve estimates. Probable reserves are defined as reserves with 50% probability that the quantities actually recovered in the future will equal or exceed the proven plus probable reserve estimates.

Long Run's proved plus probable reserves at December 31, 2013 of 97,683 MBOE increased 17% over 2012, which included an 18% (6,539 MBOE) increase in liquids reserves and a 17% (47,874 MMcf) increase in natural gas reserves. The increase was the result of an active drilling program and additions from properties acquired.

**December 31, 2013 Reserves**[1]

| | Liquids *(MBbl)* | Natural Gas *(MMcf)* | Total *(MBOE)* |
|---|---|---|---|
| Proved | | | |
| Proved producing | 15,307 | 130,593 | 37,073 |
| Proved non-producing | 682 | 15,672 | 3,294 |
| Proved undeveloped | 12,098 | 61,368 | 22,325 |
| Total Proved | 28,087 | 207,633 | 62,692 |
| Probable | 14,712 | 121,669 | 34,990 |
| Total Proved Plus Probable | **42,799** | **329,302** | **97,683** |

**Reserves Reconciliation**[1]

| *(MBOE)* | Proved | Probable | Proved plus Probable |
|---|---|---|---|
| December 31, 2012 | 53,657 | 29,509 | 83,165 |
| Extensions | 1,261 | 1,800 | 3,061 |
| Infill drilling | 7,134 | 9,952 | 17,087 |
| Technical revisions | 3,386 | (8,879) | (5,494) |
| Discoveries | - | - | - |
| Acquisitions | 7,480 | 3,511 | 10,991 |
| Dispositions | (706) | (863) | (1,568) |
| Economic factors | (360) | (40) | (400) |
| Production | (9,159) | - | (9,159) |
| December 31, 2013 | **62,692** | **34,990** | **97,683** |

[1] *Amounts may not add due to rounding*

### Reserves Pricing

| | 2013 | | 2012 | |
|---|---|---|---|---|
| | WTI Oil *(US$/bbl)* | AECO Gas *(CDN$/mcf)* | WTI Oil *(US$/bbl)* | AECO Gas *(CDN$/mcf)* |
| 2013 | - | - | 90.71 | 3.35 |
| 2014 | 95.72 | 4.01 | 91.64 | 3.80 |
| 2015 | 93.62 | 4.17 | 92.30 | 4.18 |
| 2016 | 92.25 | 4.35 | 96.17 | 4.71 |
| 2017 - 2020 | 96.01 - 98.98 | 4.81 - 5.29 | 97.29 - 101.76 | 5.12 - 5.57 |
| 2021 - 2024 | 100.80 - 106.46 | 5.38 - 5.68 | 103.61 - 109.43 | 5.67 - 5.99 |
| Remainder | +1.8%/yr | +1.8%/yr | +1.8%/yr | +1.8%/yr |

Forecast prices, inflation, and exchange rates utilized by Sproule in its evaluation were an average of the forecast prices, inflation and exchange rates as published by Sproule, GLJ Petroleum Consultants Ltd. and McDaniel & Associates Consultants Ltd., as at December 31, 2013.

## Significant Properties

Long Run operates within two significant light oil areas, Peace River and Redwater. As well, the Company owns a significant natural gas property at Boyer in northern Alberta.

Development of the Peace River area, located in northern Alberta, is focused on the Montney oil resource play at Normandville and Girouxville. During 2013, Long Run invested $140.6 million into the Peace River, including the drilling of 50.0 net successful horizontal Montney oil wells at Girouxville and Normandville (100% success rate). For 2013, production averaged 10,256 BOE/d, consisting of 5,914 Bbl/d of liquids and 26,052 Mcf/d of natural gas. Long Run plans to drill 44 net oil wells in the area in 2014. The Company operates, transports, and processes all of its production within Peace River. Long Run acquired the Peace River area as part of the Guide Arrangement in October 2012.

In the Redwater area, located near Edmonton in Alberta, development is focused on the Viking oil resource play. During 2013, Long Run invested $101.4 million in the Redwater area, drilling 64.2 net horizontal Viking oil wells (100% success rate). For 2013, production averaged 5,703 BOE/d, consisting of 4,463 Bbl/d of liquids and 7,441 Mcf/d of natural gas. Long Run plans to drill up to 36 net wells in the Viking in 2014. The Company operates, transports, and processes most of its production within the Redwater area.

## Capital Investment

### Capital Expenditures, Acquisitions & Dispositions

| *($000s)* | **2013** | 2012 |
|---|---|---|
| Drilling and completion | **203,804** | 149,293 |
| Plant and facilities | **64,808** | 41,401 |
| Geological and geophysical | **3,260** | 3,612 |
| Other assets | **4,699** | 2,014 |
| Capital expenditures | **276,571** | 196,320 |
| Acquisitions – land & facilities | **16,916** | 14,090 |
| – properties | **109,051** | - |
| Dispositions | **(17,205)** | (178,241) |
| Capital investment | **385,333** | 32,169 |

**2013 Drilling Activity**

| | **2013 Wells** | | 2012 Wells | | Success Rate | |
|---|---|---|---|---|---|---|
| | **Gross** | **Net** | Gross | Net | **2013** *(net)* | 2012 *(net)* |
| Peace River | **54** | **52.0** | 5 | 5.0 | **98%** | 100% |
| Redwater | **66** | **64.2** | 63 | 59.4 | **100%** | 100% |
| Other | **9** | **9.0** | 3 | 3.0 | **78%** | 100% |
| | **129** | **125.2** | 71 | 67.4 | **98%** | 100% |
| Plato – sold in December 2012 | **-** | **-** | 61 | 53.0 | **-** | 100% |
| | **129** | **125.2** | 132 | 120.4 | **98%** | 100% |

**Capital Expenditures**

Capital expenditures in 2013 were $276.6 million compared to $196.3 million in 2012. In 2013, capital expenditures focused on oil development in the Peace River and Redwater areas. Of total capital expenditures, $140.6 million (51%) was spent in Peace River and $101.4 million (37%) was spent in Redwater. The Company drilled 129 (125.2 net) wells with a 98% success rate.

In 2012, capital expenditures primarily focused on development at Redwater and Plato, Saskatchewan. Of total capital expenditures, $91.1 million (46%) was spent in Redwater and $68.7 million (35%) was spent in Plato. The Company drilled 132 (120.4 net) wells with a 100% success rate. The Plato property was disposed of in December 2012, as discussed below.

**Acquisitions and Dispositions**

On October 16, 2013, the Company completed the acquisition of properties and associated infrastructure in the core areas of Redwater and Peace River for $49.7 million. At closing, the acquired properties were producing approximately 1,350 BOE/d (approximately 60% light oil). These properties provided additional Viking drilling opportunities at Redwater and bring key infrastructure complementary to existing Montney oil operations at Girouxville.

On December 12, 2013, Long Run completed the acquisition of light oil properties in the Redwater area for $45.1 million. The transaction provided additional Viking drilling opportunities, along with pipelines and facilities in the area. At closing, the acquired properties were producing 450 BOE/d (approximately 92% light oil).

On August 29, 2013, Long Run closed a sale which included the Company's remaining heavy oil and shallow gas properties in Saskatchewan. The disposition, in addition to a previous transaction which closed in the first quarter of 2013, provided Long Run with net aggregate proceeds of $13.0 million. Approximately 300 BOE/d of production was sold.

During December 2012, the Company disposed of properties in the Plato area in west central Saskatchewan for net proceeds of $175.9 million. Approximately 1,900 BOE/d of production was sold.

**Enhanced Oil Recovery**

Implementation of Enhanced Oil Recovery ("EOR") projects continues to move forward in the Peace River area at both Normandville and Girouxville. Water injection began at the Normandville pilot project on May 1, 2013, and at Girouxville during the fourth quarter of 2013. Computer modeling continues and initial response could occur in 2014. This EOR work will provide further visibility on ultimate recoveries from this project, with positive results leading to an expansion of the project in 2014 and beyond.

In the fourth quarter of 2013, Long Run implemented a pilot EOR scheme, injecting water into the Viking formation at Redwater. As with the Montney, further work is planned to define specific expectations for EOR in the Viking.

## Production

### Average Production by Product

| | **2013** | 2012 |
|---|---|---|
| Liquids *(Bbl/d)* | | |
| Light oil | **10,372** | 6,554 |
| Heavy oil | **1,518** | 1,015 |
| NGLs | **1,342** | 1,007 |
| Total | **13,232** | 8,576 |
| Natural Gas *(Mcf/d)* | **71,170** | 27,679 |
| Total *(BOE/d)* | **25,094** | 13,189 |

### Average Production by Area

| | **2013** | | | 2012 | | |
|---|---|---|---|---|---|---|
| | **Liquids** *(Bbl/d)* | **Natural Gas** *(Mcf/d)* | **Total** *(BOE/d)* | Liquids *(Bbl/d)* | Natural Gas *(Mcf/d)* | Total *(BOE/d)* |
| Peace River | **5,914** | **26,052** | **10,256** | 969 | 4,280 | 1,682 |
| Redwater | **4,463** | **7,441** | **5,703** | 4,393 | 8,459 | 5,803 |
| Boyer | **-** | **18,463** | **3,077** | - | 3,349 | 558 |
| Kaybob | **826** | **5,581** | **1,756** | 877 | 8,041 | 2,217 |
| Other | **2,029** | **13,633** | **4,302** | 1,075 | 2,938 | 1,565 |
| | **13,232** | **71,170** | **25,094** | 7,314 | 27,067 | 11,825 |
| Plato – Sold in Dec 2012 | **-** | **-** | **-** | 1,262 | 612 | 1,364 |
| | **13,232** | **71,170** | **25,094** | 8,576 | 27,679 | 13,189 |

In 2013, production averaged 25,094 BOE/d, an increase of 90% from 13,189 BOE/d in 2012. The production increases reflect results from an active drilling program, as well as production from the properties acquired in the Guide Arrangement on October 23, 2012.

Peace River production in 2013 increased 27% to 10,256 BOE/d from 8,070 BOE/d in October 2012, when the property was acquired, reflecting active drilling in the area since the acquisition. Redwater production averaged 5,703 BOE/d in 2013, compared to 5,803 BOE/d during 2012. Prior to the Guide Arrangement in October 2012, the Company redeployed capital spending to the Plato area, which resulted in production declines at Redwater during the latter half of 2012. After the Guide Arrangement and sale of the Plato area, the Company focused capital spending on the Redwater area. In the fourth quarter of 2013, production averaged 6,285 BOE/d, a 25% increase over the same period in the prior year.

Production at Boyer was acquired in October 2012 as part of the Guide Arrangement. In October of 2012, Boyer production averaged 20,839 Mcf/d (3,473 BOE/d). There were no new wells drilled in Boyer in 2013. Production at Kaybob for 2013 reflects natural declines as there were no new wells drilled in the area.

## Commodity Pricing

| | **2013** | 2012 |
|---|---|---|
| Benchmark pricing | | |
| WTI *($US/Bbl)* | **97.99** | 94.15 |
| Edmonton Light Sweet *($CAD/Bbl)* | **93.05** | 86.42 |
| AECO *($/Mcf)* | **3.17** | 2.39 |
| Cdn$/US$ exchange rate | **1.03** | 1.00 |
| Prices, excluding derivatives | | |
| Liquids *($/Bbl)* | | |
| Light oil | **82.58** | 81.15 |
| Heavy oil | **68.85** | 61.37 |
| NGLs | **72.45** | 72.28 |
| Total | **79.98** | 78.00 |
| Natural Gas *($/Mcf)* | **3.37** | 2.80 |
| Total *($/BOE)* | **51.92** | 57.30 |
| Prices, including derivatives | | |
| Liquids *($/Bbl)* | **77.55** | 78.97 |
| Natural Gas *($/Mcf)* | **3.70** | 3.23 |
| Total *($/BOE)* | **51.63** | 58.99 |

The Company's financial results are influenced by fluctuations in commodity prices and Canadian price differentials. Long Run's average liquids price for 2013 was $79.98/Bbl, an increase of $1.98/Bbl over the prior year. Higher benchmark West Texas Intermediate pricing and a higher $US to $CAD exchange rate were partially offset by wider field differentials. The Company's 2012 liquids price does not reflect the current production mix due to the October 2012 Guide Arrangement.

Long Run's natural gas price increased $0.57/Mcf in 2013 to $3.37/Mcf, reflecting the strengthening of benchmark AECO pricing. The Company's natural gas price reflects premiums received for the liquids content included in the natural gas production.

The Company enters into financial derivative contracts for the purpose of protecting funds flow from operations from the volatility of commodity prices. During 2013, Long Run's liquids price including derivative contracts was $77.55/Bbl, which included a realized loss of $2.43/Bbl. The Company's natural gas price including derivatives of $3.70/Mcf included a realized gain of $0.33/Mcf.

# Operating Results

## Operating Netback & Funds Flow from Operations

| | 2013 | | 2012 | |
|---|---|---|---|---|
| | $000s | $/BOE | $000s | $/BOE |
| Revenues | **475,562** | **51.92** | 276,605 | 57.30 |
| Royalties | **(55,133)** | **(6.02)** | (29,096) | (6.03) |
| | **420,429** | **45.90** | 247,509 | 51.27 |
| Realized gain (loss) on derivatives | **(2,689)** | **(0.29)** | 8,149 | 1.69 |
| Transportation costs | **(20,520)** | **(2.24)** | (9,975) | (2.06) |
| Operating costs | **(126,637)** | **(13.83)** | (70,328) | (14.57) |
| Operating netback[1] | **270,583** | **29.54** | 175,355 | 36.33 |
| General and administrative | **(25,349)** | **(2.77)** | (36,734) | (7.61) |
| Interest | **(14,790)** | **(1.61)** | (9,005) | (1.87) |
| Exploration expenses | **(247)** | **(0.03)** | (230) | (0.05) |
| Capital and other taxes | **(88)** | **(0.01)** | (667) | (0.14) |
| Funds flow from operations[1] | **230,109** | **25.12** | 128,719 | 26.66 |

*[1] See Non-GAAP Measures section.*

During 2013, funds flow from operations increased $101.4 million from 2012 due to the following:

- Higher liquids and natural gas production attributable to successful drilling results and properties acquired in the Guide Arrangement, increased revenue by $189.3 million;

- Higher liquids and natural gas prices, excluding derivative contracts, increased revenue by $9.7 million; and

- General and administrative expenses decreased $11.4 million primarily due to $20.2 million of Guide Arrangement transaction costs incurred in 2012. Excluding these transaction costs, general and administrative expenses have decreased from $3.43/BOE in 2012 to $2.77/BOE in 2013, reflecting synergies of the Guide Arrangement.

Partially offset by:

- Higher operating and transportation expenses of $56.3 million and $10.5 million, respectively, resulted from the increase in production volumes. On a per unit basis, operating expenses decreased $0.74/BOE to $13.83/BOE due to a higher proportion of production from lower cost properties, including properties acquired in the Guide Arrangement;

- Royalties associated with increased revenue were $26.0 million higher, averaging 11.6% of revenue in 2013 compared to 10.5% in 2012;

- Financial derivative contracts generated a realized loss of $2.7 million in 2013, compared to a realized gain of $8.1 million in 2012. In 2013, the realized gain of $8.5 million on natural gas derivative contracts was more than offset by the $11.7 million loss realized on crude oil contracts; and

- Higher interest expense of $5.9 million related to a higher average debt balance outstanding in 2013.

## Other Income & Expenses

| *($000s)* | **2013** | 2012 |
|---|---|---|
| Unrealized gain (loss) on derivatives | **(11,735)** | 7,451 |
| Share-based compensation | **(4,379)** | (5,530) |
| Accretion | **(6,110)** | (2,019) |
| Depletion and depreciation | **(170,696)** | (122,352) |
| Gain on dispositions | **11,161** | 87,149 |
| Impairments | **(13,000)** | (146,102) |
| Deferred income tax (expense) recovery | **(11,085)** | 10,032 |
| | **(205,844)** | (171,371) |
| Funds flow from operations[1] | **230,109** | 128,719 |
| Net earnings (loss) | **24,265** | (42,652) |

[1] *See Non-GAAP Measures section.*

In comparing 2013 with 2012:

- An unrealized loss on financial derivative contracts of $11.7 million during 2013 replaced an unrealized gain on financial derivative contracts of $7.5 million during 2012. Unrealized losses of $3.2 million on crude oil derivative contracts and $8.7 million on natural gas derivative contracts were recorded in 2013 reflecting increases in the forward commodity prices.

- Depletion and depreciation expense increased $48.3 million due to the increase in production volumes, partially offset by a decrease in the depletion rate. The depletion rate for 2013 was $18.65/BOE, compared to $25.35/BOE in 2012. The 2013 depletion rate reflects the impact of the Guide Arrangement and the impairment of oil and natural gas properties recorded at December 31, 2012.

- The gain on the disposition of assets in 2013 of $11.2 million was primarily attributable to the sale of the Company's remaining Saskatchewan assets in August. The gain on disposition of $87.1 million recognized in 2012 was related primarily to the farm out and sale of properties in west central Saskatchewan.

- An impairment of oil and natural gas properties in 2013 was recognized at Kaybob for $13.0 million as a result of capital spending on facilities that did not add additional reserves. In 2012, an impairment of $146.1 million was recognized at Kaybob and Redwater, attributable to a weakening of the future price forecasts at the time and a reduction of the estimated reserve volumes at Kaybob.

- Deferred income tax of $11.1 million was recorded in 2013 on earnings before tax of $35.4 million. A deferred tax recovery of $10.0 million was recognized in 2012 on a loss before tax of $52.0 million.

In determining deferred income tax expense, the Company's effective tax rate differs from the Canadian statutory tax rate due to permanent differences that primarily arise due to share-based compensation costs. The Company's statutory tax rate is 25%.

## Summary of Quarterly Results

| ($000s, except per share or unless otherwise noted) | 2013 Q4 | 2013 Q3 | 2013 Q2 | 2013 Q1 | 2012 Q4 | 2012 Q3 | 2012 Q2 | 2012 Q1 |
|---|---|---|---|---|---|---|---|---|
| Funds flow from operations [1] | **55,934** | 62,304 | 63,227 | 48,644 | 38,407 | 26,546 | 34,385 | 29,381 |
| Per share, basic [1] | **0.45** | 0.50 | 0.50 | 0.39 | 0.33 | 0.32 | 0.41 | 0.35 |
| Per share, diluted [1] | **0.44** | 0.50 | 0.50 | 0.39 | 0.33 | 0.32 | 0.41 | 0.35 |
| Net earnings (loss) | **(5,531)** | 9,524 | 21,099 | (827) | (56,590) | (4,747) | 17,506 | 1,179 |
| Per share, basic & diluted | **(0.04)** | 0.08 | 0.17 | (0.01) | (0.49) | (0.06) | 0.21 | 0.01 |
| Production | | | | | | | | |
| Liquids *(Bbl/d)* | **14,771** | 13,187 | 12,587 | 12,358 | 11,995 | 7,854 | 8,291 | 6,133 |
| Natural Gas *(Mcf/d)* | **73,392** | 72,634 | 71,058 | 67,516 | 56,453 | 18,214 | 19,548 | 16,288 |
| Total *(BOE/d)* | **27,003** | 25,293 | 24,431 | 23,611 | 21,405 | 10,890 | 11,549 | 8,848 |
| Prices, including derivatives | | | | | | | | |
| Liquids *($/Bbl)* | **70.94** | 86.16 | 80.67 | 73.03 | 75.49 | 77.67 | 80.68 | 85.15 |
| Natural Gas *($/Mcf)* | **4.04** | 3.23 | 3.89 | 3.63 | 4.19 | 2.44 | 1.94 | 2.29 |
| Total *($/BOE)* | **49.78** | 54.29 | 53.29 | 49.12 | 53.99 | 61.34 | 61.57 | 64.92 |
| Revenues, before royalties | **124,816** | 129,923 | 117,210 | 103,613 | 99,000 | 60,094 | 64,025 | 53,486 |
| Capital expenditures | **41,637** | 93,137 | 38,878 | 102,919 | 58,340 | 29,192 | 44,615 | 64,173 |
| Net acquisitions (divestitures) | **86,328** | 3,331 | 1,158 | 17,945 | (169,731) | (138) | 466 | 5,252 |

[1] *See Non-GAAP Measures section.*

The Company's funds flow from operations is significantly impacted by changes in production volumes, fluctuations in commodity prices and realized gains and losses on financial derivative contracts. In addition to these items, net earnings are impacted by impairments and unrealized gains and losses on financial derivative contracts. Acquisitions and divestitures can also have a significant impact on Long Run's results. Funds flow from operations and net earnings prior to October 23, 2012 do not include the results of operations from the Guide properties, which were acquired as part of the Guide Arrangement.

### Fourth Quarter 2013 compared to Third Quarter 2013

Fourth quarter production averaged 27,003 BOE/d, up 7% from 25,293 BOE/d in the third quarter. The increased production reflects successful drilling programs during the year and the October 2013 Redwater and Peace River property acquisition. Production in Peace River was 11,500 BOE/d in the fourth quarter, an increase of 14% over the third quarter. At Redwater, production was 6,285 BOE/d in the fourth quarter, an increase of 7% over the third quarter.

In the fourth quarter, funds flow from operations was $55.9 million ($0.44/share), compared to $62.3 million ($0.50/share) in the third quarter. The benefits from higher production volumes and higher natural gas prices were more than offset by declines in liquids prices.

The net loss in the fourth quarter was $5.5 million compared to net earnings of $9.5 million during the third quarter. The decrease in net earnings reflects the impairment recorded at Kaybob and the after-tax impact of the lower funds flow from operations during the quarter.

Capital expenditures in the fourth quarter were $41.6 million, a decrease from $93.1 million in the third quarter of 2013 resulting from fewer wells drilled. Capital spending at Peace River was $27.3 million with 11 (9.5 net) wells being drilled. In Redwater, capital spending was $9.8 million with 1 (1.0 net) well drilled and the implementation of an EOR pilot. The Company incurred $86.3 million in net acquisitions in the fourth quarter primarily for Redwater and Peace River acquisitions in October and December.

### Fourth Quarter 2013 compared to Fourth Quarter 2012

Fourth quarter of 2013 average production of 27,003 BOE/d increased 5,598 BOE/d from 2012 primarily due to the Company's successful drilling programs and the October 2013 property acquisition as discussed above. Fourth quarter 2012 production included production from the Guide properties post October 23, 2012.

Funds flow from operations for the fourth quarter of 2013 of $55.9 million increased $17.5 million from 2012, primarily due to higher production volumes and lower G&A expenses, partially offset by lower realized prices, and higher operating expenses associated with the production increase.

The net loss for the fourth quarter of 2013 was $5.5 million, compared to a net loss of $56.6 million in 2012. The increase in 2013 funds flow from operations, an unrealized gain on financial derivative contracts and lower impairments, were partially offset by a lower gain on disposal of assets and increased depletion expense.

Capital expenditures in the fourth quarter of 2013 were $41.6 million, a $16.7 million decrease from 2012. In 2013, there were 13 (11.5 net) wells drilled versus 29 (26.5) drilled in 2012. The Company's fourth quarter of 2013 net acquisitions of $86.3 million compared to net dispositions of $169.7 million in 2012, which included the disposal of its west central Saskatchewan Plato properties.

## Liquidity and Capital Resources

### Bank Debt & Net Debt

| ($000s) | **December 31, 2013** | December 31, 2012 |
|---|---|---|
| Bank debt | **423,553** | 261,173 |
| Working capital deficiency | **28,602** | 31,950 |
| Net debt[1] | **452,155** | 293,123 |

[1] *See Non-GAAP Measures section.*

The Company's bank debt and net debt at December 31, 2013 have increased from December 31, 2012 as a result of planned capital expenditures and strategic acquisitions. Capital expenditures of $276.6 million and net acquisitions of $108.8 million were funded by funds flow from operations of $230.1 million and bank debt of $155.3 million. The capital intensive nature of the Company's activities generally results in the Company carrying a working capital deficit, as reflected in the net debt calculation. The Company maintains sufficient unused credit facilities to satisfy working capital deficiencies.

The Company currently has credit facilities of $475.0 million, consisting of a $445.0 million revolving syndicated facility and a $30.0 million operating facility. In December 2013, the borrowing base under the credit facility was increased from $430.0 million to $475.0 million, recognizing the increase in the Company's reserve base. Total borrowings permitted under these facilities cannot exceed the borrowing base, which is determined by the lenders on a semi-annual basis or upon the occurrence of a material adverse effect. At December 31, 2013, the Company had $51.4 million of unused capacity on its credit facilities.

During the semi-annual review of the borrowing base in May 2013, the termination date of the facility was extended to May 31, 2016. In conjunction with the extension, the Company determined that as it does not intend to repay the facility within the next twelve months, the bank debt should be classified as long term on the statement of financial position. While the Company does not anticipate a reduction to the borrowing base below the level of bank debt currently outstanding, there is no assurance that the borrowing base will be maintained at current levels until May 31, 2016.

The credit facilities contain covenants relating to bank debt and total debt to trailing 12 month EBITDA, interest coverage, permitted dispositions and permitted hedging. EBITDA is defined in the credit facilities as earnings before interest, exploration expenses, taxes, depletion and depreciation, and other non-cash items. The bank covenants require a senior debt to EBITDA ratio of less than 3:1 (December 31, 2013 – 1.7:1) and a total debt to EBITDA ratio of less than 3.5:1 (December 31, 2013 – 1.7:1). The interest coverage ratio, defined as EBITDA to interest expense, must be at least 3.5:1 (December 31, 2013 – 16.6:1). At December 31, 2013, the Company was in compliance with all covenants, obligations, and conditions of its credit agreement.

### Convertible Debentures

On January 28, 2014, the Company issued convertible unsecured subordinated debentures (the "Convertible Debentures") in the principal amount of $75.0 million at par. The Convertible Debentures bear interest at an annual rate of 6.40%, payable semi-annually in arrears. Prior to maturity on January 29, 2019, the Convertible Debentures are convertible into common shares at a conversion price of $7.40 per common share, subject to adjustments in certain events. The net proceeds of the offering were initially used to reduce bank debt, and may be withdrawn as needed to fund the on-going capital expenditure programs and for general corporate purposes.

## Share Capital

| # of units (000s) | **March 3, 2014** | **December 31, 2013** | December 31, 2012 |
|---|---|---|---|
| Common Shares | **110,217** | **110,143** | 110,107 |
| Non-Voting Convertible Shares | **15,513** | **15,513** | 15,513 |
| Options | **9,862** | **10,266** | 8,042 |
| Warrants[1] | **2,300** | **2,300** | 2,300 |

*[1] Each common share purchase warrant ("Warrant") entitles the holder to purchase 0.4167 of a common share at an exercise price of $3.10 per 0.4167 of a share until September 15, 2014. The exchange ratio and exercise price are subject to adjustment in certain events, including upon the payment of dividends by the Company. The Warrants are not exercisable until the twenty-day volume weighted average trading price of the common shares exceeds $12.00 per share.*

During 2013, there were 36,000 common shares issued on the exercise of stock options, and no changes to the non-voting convertible shares. The Company granted 2.9 million stock options in 2013, with an average exercise price of $4.51 per share. At December 31, 2013, there were 125.6 million common shares and non-voting convertible shares outstanding.

## Dividends

As discussed previously, the Company is transitioning its business model to a dividend plus moderate growth model. Long Run has established an initial monthly dividend to shareholders of $0.0335 per share ($0.402 per share per year). Dividends are payable on Common Shares and Non-Voting Convertible Shares. The first monthly dividend of $0.0335 per share was declared January 15, 2014 and paid to shareholders on February 14, 2014 ($4.2 million). On February 13, 2014, Long Run declared a monthly dividend of $0.0335 per share to be paid on March 14, 2014 to shareholders on record on February 28, 2014 (ex-dividend date of February 26, 2014).

Long Run's dividend rate is subject to Board approval and will be reviewed regularly. Factors and conditions potentially impacting the monthly dividend rate include production volumes, current and future commodity prices, commodity hedging, foreign exchange rates, and acquisition opportunities.

## Capital Structure

Long Run's capital structure consists of debt plus equity. The Company's primary capital management objective is to maintain a strong statement of financial position. A strong statement of financial position is expected to provide the Company with financial flexibility and access to capital.

The Company currently targets net debt to funds flow from operations at or below 1.5 times and debt to debt plus equity at or below 0.4 times. While the Company may exceed these ratios from time to time, efforts are made after a period of variation to bring the measures back in line. The Company may adjust capital spending, adjust the dividend rate, issue equity, issue new debt or repay existing debt in response to changes in the business environment.

At December 31, 2013, net debt to funds flow from operations was 2.0 times and debt to debt plus equity was 0.4 times. For calculations of these metrics, see note 11 to the financial statements for the year ended December 31, 2013. At December 31, 2013, net debt to funds flow was higher than internal targets due primarily to the $86.3 million in net acquisitions made in the fourth quarter. The ratio is expected to be closer to the target by the end of 2014, based upon anticipated annual funds flow, capital spending and dividend payments.

The Company believes that it has access to sufficient capital through operating activities, external debt and equity sources, and undrawn committed credit facilities to meet 2014 guidance on capital spending and dividend payments.

# Contractual Obligations and Contingencies and Related Parties

## Contractual Obligations

| ($000s) | 2014 | 2015 | 2016 | 2017 | 2018 | Thereafter | Total |
|---|---|---|---|---|---|---|---|
| Bank loan | - | - | 423,553 | - | - | - | 423,553 |
| Operating leases | 2,771 | 2,742 | 2,679 | 4,415 | 6,156 | 53,946 | 72,709 |
| Firm transportation agreements | 2,970 | 1,782 | 958 | 422 | 238 | 228 | 6,598 |
| Capital commitments | 10,332 | - | - | - | - | - | 10,332 |
| | 16,073 | 4,524 | 427,190 | 4,837 | 6,394 | 54,174 | 513,192 |

Operating lease payments are primarily for office space, firm transportation agreements relate to the transportation of natural gas, and capital commitments include contracts for drilling rig services. During the fourth quarter of 2013, the Company entered into a ten year lease for office space commencing in July 2017.

Other than the operating leases, the Company has no off-balance sheet financing arrangements.

Subsequent to December 31, 2013, the Company issued $75.0 million principal amount of Convertible Debentures that are due on January 29, 2019.

## Contingencies

The Company is involved in various claims and legal actions arising in the normal course of business. The Company does not expect that the outcome of these proceedings will have a material adverse effect on the Company as a whole.

## Related Party Transactions

A director of the Company and the corporate secretary are partners of the Company's legal counsel Burnet, Duckworth & Palmer LLP ("BDP"). For the year December 31, 2013, general and administrative expenses included amounts of $0.5 million (2012 – $1.9 million) charged to the Company by BDP.

# Risk Management

Long Run is engaged in the development, acquisition, exploration and production of oil and natural gas in western Canada. The oil and gas business is inherently risky and there is no assurance that hydrocarbons will be discovered and economically produced. The Company is exposed to a number of risks, both financial and operational, through the pursuit of its strategic objectives. Some of these risks impact the oil and natural gas industry as a whole, and others are unique to the Company’s operations. Actively managing these risks improves the ability to effectively execute our business strategy. Additional discussion on the Company’s risks can be found in the Annual Information Form.

Financial risks associated with the petroleum industry include fluctuations in commodity prices, interest rates, currency exchange rates and the cost of goods and services. Operational risks include reservoir performance uncertainties, competition, and regulatory, environment and safety concerns.

## Commodity Price and Interest Rate Risk

Commodity risk includes uncertainty arising from possible movements in commodity prices and interest rates, and the impact of such movements on the future performance of the business. Commodity price and interest rate movements could adversely affect the value of the Company’s financial assets, liabilities

and expected future cash flows. To partially mitigate exposure to commodity price risk and interest rate risk, the Company enters into various financial derivative instruments.

The Company has entered into crude oil and natural gas derivative contracts, including costless collars, fixed price, calls and call swaptions. The Company currently has contracts for crude oil volumes of 8,467 Bbl/d for 2014 and 1,158 Bbl/d for 2015. As well, the Company currently has average natural gas volumes of 41.2 MMcf/d contracted for 2014 and 34.2 MMcf/d for 2015. Further details on the derivative contracts can be found in notes 15 and 18 of the financial statements for the year ended December 31, 2013.

In 2013, the Company realized a $2.7 million loss as a result of its commodity price risk management. The Company's gain of $8.5 million on natural gas financial derivative contracts was more than offset by an $11.7 million loss on crude oil contracts. In 2013, the Company recognized unrealized losses on both natural gas and crude oil financial derivative contracts of $8.7 million and $3.2 million, respectively. The gain/loss on financial derivative contracts was determined based on counterparty valuations, and reviewed by the Company for reasonability considering such factors as commodity forward strip prices and historical volatilities. When assessing the potential impact of price changes on contracts outstanding at December 31, 2013, it is estimated that a $1.00/Bbl change in the price of oil would change the unrealized gain or loss by approximately $3.1 million, while a $0.10/GJ change in the price of natural gas would change the unrealized gain or loss by approximately $0.9 million.

On January 28, 2014, the Company issued $75.0 million principal amount of convertible debentures at par. The convertible debentures bear an annual interest rate of 6.40%, payable semi-annually in arrears. Prior to maturity on January 29, 2019, the convertible debentures are convertible into Long Run common shares at a conversion price of $7.40 per common share, subject to adjustment in certain events. The fixed rate of interest on the debentures minimizes the Company's exposure to fluctuations in interest rates.

### Third Party Credit Risk

Credit risk is the risk that a customer or counterparty will fail to perform an obligation or fail to pay amounts due, causing a financial loss. The Company may be exposed to third party credit risk through its contractual arrangements with current or future industry partners, marketers of its production, counterparties to financial derivative contracts, and other parties. In the event such entities fail to meet their contractual obligations to the Company, such failures may have a material adverse effect on the Company's business, financial condition, results of operations and prospects.

In addition, poor credit conditions in the industry and of industry partners may impact a partner's willingness to participate in the Company's ongoing capital program, potentially delaying the program and the results of such program until the Company finds a suitable alternative partner.

Credit risk is managed through credit assessments before contract initiation and by ensuring product sales and delivery contracts are diversified among well-known and financially strong crude oil and natural gas marketers. Additional security such as parental guarantees or letters of credit may be obtained. Financial derivative contracts are entered into with counterparties who are major Canadian financial institutions having investment grade credit ratings.

### Liquidity Risk

Liquidity risk arises through excess financial obligations due over available financial assets at any point in time. The Company is exposed to liquidity risk, as well risks related to the continued availability of debt and equity financing at acceptable terms. 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.

The Company anticipates making substantial capital expenditures for the acquisition, exploration, development and production of oil and natural gas reserves in the future. The Company also anticipates

making monthly dividend payments. As future capital expenditures and dividend payments may be financed out of cash generated from operations, borrowings and possible future issuances of equity, the Company's ability to do so is dependent on, among other factors, the overall state of the capital markets, the Company's credit rating, if applicable, interest rates, tax burdens due to new tax laws, and investor appetite for investments in the energy industry and for the Company's securities in particular. Furthermore, if the Company's revenues or reserves decline it could result in a reduction of the borrowing base under the credit facility.

There can be no assurance that debt or equity financing, or cash generated by operations, will be available or sufficient to meet the Company's operating, capital or dividend requirements. If debt or equity financing is available, there is no assurance that it will be on terms acceptable to the Company.

The Company's objective in managing liquidity risk is to maintain sufficient capital in order to meet its liquidity requirements at any point in time. The Company manages these risks by maintaining a statement of financial position with prudent levels of debt, measured by debt to funds flow from operations and debt to equity ratios.

### Operational Risks

Long Run is engaged in the exploration, development, acquisition and production of crude oil and natural gas. The oil and gas business is inherently risky and there is no assurance that hydrocarbon reserves will be discovered and economically produced. Operational risks include estimation of oil and gas reserves, estimation of the value of acquisitions, reservoir performance uncertainties, pipeline restrictions, facility capacity restrictions, and operational risk related to non-operated properties. Long Run operates within a highly competitive area, and faces competition for acquisition of reserves and undeveloped land, access to supplier services, and for qualified personnel.

Long Run mitigates these risks by employing qualified personnel and management, utilizing current technology for reserve identification and estimation, utilizing independent engineering consultants, and maintaining operational control over the majority of our operations.

### Regulatory, Environmental and Safety Risks

The Company is subject to regulation pursuant to a variety of federal, provincial and local laws and regulations. Compliance with such legislation can require significant expenditures and a breach may result in the imposition of fines and penalties, some of which may be material.

All phases of the oil and natural gas business present environmental and safety risks and hazards that can result in damage to property and the environment, and which may cause personal injury. Environmental legislation is evolving in a manner expected to result in stricter standards and enforcement, larger fines and liability, and potentially increased capital expenditures and operating costs. Additional regulatory risks arise from uncertainties in obtaining regulatory approvals.

The determination of the Company's income and other tax liabilities requires interpretation of complex laws and regulations, often involving multiple jurisdictions. All tax filings are subject to audit and potential reassessment.

Long Run mitigates these risks by employing qualified personnel and management, utilizing third party specialists as required, and by maintaining an acceptable level of property loss and business interruption insurance. The Company has a health and safety program which provides training and education to field employees, operators and contractors.

Implementation of strategies for reducing greenhouse gases to meet the limits required could have a material impact on the nature of oil and gas operations, including those of the Company. Given the evolving nature of the debate related to climate change and the control of greenhouse gases and resulting requirements, it is not possible to predict either the nature of those requirements or the impact on the Company and its operations and financial condition.

## Critical Accounting Judgments, Estimates and Accounting Policies

The Company is required to make judgments, estimates and assumptions in the application of accounting policies that could have a significant impact on its financial results. Actual results may differ from those estimates and those differences may be material. The estimates and assumptions used are subject to updates based on experience and the application of new information.

### Oil and Natural Gas Accounting

All expenditures incurred, after the Company has obtained the legal right to explore, associated with the exploration for and development of oil and gas properties are capitalized whether successful or not. Exploration and evaluation costs are capitalized and accumulated pending determination of technical feasibility and commercial viability. Exploration and evaluation assets are not depleted. For property and equipment, the aggregate of net capitalized costs and estimated future development costs is amortized using the unit-of-production method based on estimated proved and probable oil and gas reserves.

Oil and gas accounting relies on the estimated proved and probable reserves believed to be recoverable from the oil and gas properties. Determination of reserves is a complex process involving judgments, estimates and decisions based on available geological, engineering, production and other relevant economic data. These estimates are subject to change as economic conditions change and ongoing production and development activities provide new information. The Company's reserves are evaluated annually by an independent firm and by the Company on a quarterly basis. Reserve estimates are critical to the following accounting estimates:

- Calculation of unit of production depletion. Proved and probable reserve estimates are used to determine the depletion rate applied to each unit of production; and
- Impairment of oil and gas assets. Estimated future cash flows are determined using proved and probable reserve estimates.

An increase (decrease) in estimated proved and probable oil and gas reserves would result in a reduction (increase) in depletion expense. A decrease (increase) in estimated future development costs would result in a reduction (increase) in depletion expense.

The calculation of proved and probable reserves is affected by events, including the following:

- Changes to commodity prices;
- Production performance of wells;
- Changes to reservoir performance and pressures;
- New geological and geophysical data;
- Competitor production practices; and
- Changes to government regulations

As circumstances change and additional data becomes available, revisions are made to these estimates.

Property and equipment may be excluded from depletion until capable of operating in the manner intended. The estimated fair value of these assets is included in impairment calculations.

### Impairment Calculations

The Company is required to test the carrying value of exploration and evaluation assets for impairment if facts and circumstances suggest the carrying amount exceeds the recoverable amount, and when these assets are transferred to property and equipment. The Company is required to test the carrying value of oil and natural gas assets for impairment when indications of impairment exist.

The recoverable amount of an asset is the greater of its value in use and its fair value less costs to sell. The recoverable amount is determined for an individual asset, unless the asset does not generate cash inflows that are largely independent of those from other assets or groups of assets. If this is the case, the recoverable amount is determined for the cash-generating unit to which the asset belongs. The amount by which the carrying value exceeds the recoverable amount of an asset is charged to earnings. An impairment recognized in prior periods for an asset other than goodwill is reversed if there has been a change in facts and circumstances since the last impairment loss was recognized.

The recoverable amount of an oil and gas asset is based on estimates of fair value, reserves, production rates, petroleum and natural gas prices, future costs, recent market transactions, and other relevant assumptions. By their nature, these estimates are subject to measurement uncertainty and the impact on the financial statements could be material.

A decrease in estimated proved and probable oil and gas reserves values could reduce the recoverable amount of a cash generating unit and result in an impairment. A subsequent increase in estimated proved oil and gas reserves values could increase the recoverable amount of a cash generating unit and reverse the impairment, net of the depletion that would have been recognized had the impairment not been recognized. Further discussion is provided below.

### Business Combinations

Business acquisitions are accounted for using the acquisition method. Under this method, the consideration transferred is allocated to the assets acquired and the liabilities assumed based on their fair values at the time of acquisition. In determining the fair value of the assets and liabilities, Long Run is often required to make assumptions and estimates, such as reserves, future commodity prices, fair value of undeveloped land, discount rates, decommissioning liabilities and possible outcomes of any assumed contingencies.

### Decommissioning Liabilities

The Company is required to provide for future abandonment and site restoration costs. The Company must estimate these costs in accordance with existing laws, contracts or other policies. These estimated costs are capitalized to exploration and evaluation assets or property and equipment, as applicable. The costs capitalized to property and equipment are depleted into earnings based on units of production. The estimate of future removal and site restoration costs involves a number of estimates related to timing of abandonment, determination of economic life of the asset, costs associated with abandonment and site restoration, and review of potential abandonment methods.

Increases in the estimated decommissioning costs increase the corresponding charges of accretion and depletion to net earnings. A decrease in discount rates increases the decommissioning liability, which decreases the accretion charged to net earnings. Actual expenditures incurred are charged against the accumulated decommissioning liability.

### Fair Value of Financial Derivatives

The fair value of financial derivatives is based on fair values provided by the counterparties with whom the transactions were completed. By their nature, these estimates and assumptions are subject to measurement uncertainty and the effect on the financial statements of changes in such estimates in future years could be significant.

### Income Tax Accounting

The determination of the Company's income and other tax liabilities requires interpretation of complex laws and regulations often involving multiple jurisdictions. All tax filings are subject to audit and potential reassessment subsequent to the financial statement reporting period. Accordingly, the actual income tax asset or liability may differ significantly from that estimated and recorded by management.

### Adoption of New Accounting Policies

As required by IFRS, the Company adopted the following new accounting standards as of January 1, 2013:

- IFRS 10 Consolidated Financial Statements;
- IFRS 11 Joint Arrangements;
- IFRS 12 Disclosure of Interests in Other Entities;
- IFRS 13 Fair Value Measurement; and
- IAS 28 Investments in Associates and Joint Ventures

The adoption of these standards did not have an impact on the Company's financial results. Further details of these standards, as well as details of future accounting pronouncements, can be found in note 4 of the financial statements for the year ended December 31, 2013.

## Control Environment

### Disclosure Controls and Procedures

The Company's Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO") 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 CEO and CFO by others, particularly during the period in which the annual and interim 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. Such officers have evaluated, or caused to be evaluated under their supervision, the effectiveness of the Company's disclosure controls and procedures at the financial year end of the Company and have concluded that the Company's disclosure controls and procedures are effective at the financial year end of the Company for the foregoing purposes.

### Internal Controls over Financial Reporting

The CEO and CFO have designed, or caused to be designed under their supervision, internal controls over financial reporting to provide reasonable assurance regarding the reliability of the Company's financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles applicable to the Company. Such officers have evaluated, or caused to be evaluated under their supervision, the effectiveness of the Company's internal controls over financial reporting at the financial year end of the Company and have concluded that the Company's internal controls over financial reporting are effective at the financial year end of the Company for the foregoing purposes.

The Company is required to disclose any change in the Company's internal controls over financial reporting that occurred during the Company's most recent interim period that has materially affected, or is reasonably likely to materially affect, the Company's internal controls over financial reporting. No material changes in the Company's internal controls over financial reporting were identified during such period that have materially affected, or are reasonably likely to materially affect, the Company's internal controls over financial reporting.

It should be noted that a control system, including the Company's disclosure and internal controls and procedures, no matter how well conceived, can provide only reasonable, but not absolute, assurance that the objectives of the control system will be met and it should not be expected that the disclosure and internal controls and procedures will prevent all errors or fraud.

## Detailed Quarterly Results

| | 2013 | | | | 2012 | | | |
|---|---|---|---|---|---|---|---|---|
| | Q4 | Q3 | Q2 | Q1 | Q4 | Q3 | Q2 | Q1 |
| **Funds flow from operations** [1] *($000s)* | 55,934 | 62,304 | 63,227 | 48,644 | 38,407 | 26,546 | 34,385 | 29,381 |
| Per share, basic [1] | 0.45 | 0.50 | 0.50 | 0.39 | 0.33 | 0.32 | 0.41 | 0.35 |
| Per share, diluted [1] | 0.44 | 0.50 | 0.50 | 0.39 | 0.33 | 0.32 | 0.41 | 0.35 |
| **Net earnings (loss)** *($000's)* | (5,531) | 9,524 | 21,099 | (827) | (56,590) | (4,747) | 17,506 | 1,179 |
| Per share, basic & diluted | (0.04) | 0.08 | 0.17 | (0.01) | (0.49) | (0.06) | 0.21 | 0.01 |
| **Capital** *($000's)* | | | | | | | | |
| Drilling and completion | 30,750 | 72,746 | 19,541 | 80,767 | 46,623 | 18,957 | 30,374 | 53,339 |
| Plant and facilities | 8,760 | 18,699 | 17,697 | 19,652 | 10,590 | 9,149 | 12,003 | 9,659 |
| Geological and geophysical | 566 | 601 | 779 | 1,314 | 772 | 1,007 | 999 | 834 |
| Other assets | 1,561 | 1,091 | 861 | 1,186 | 355 | 79 | 1,239 | 341 |
| Capital expenditures | 41,637 | 93,137 | 38,878 | 102,919 | 58,340 | 29,192 | 44,615 | 64,173 |
| Net acquisitions (dispositions) | 86,328 | 3,331 | 1,158 | 17,945 | (169,731) | (138) | 466 | 5,252 |
| Capital Investment | 127,965 | 96,468 | 40,036 | 120,864 | (111,391) | 29,054 | 45,081 | 69,425 |
| **Wells Drilled** *(net)* | | | | | | | | |
| Peace | 9.5 | 19.5 | 4.0 | 19.0 | 5.0 | - | - | - |
| Redwater | 1.0 | 26.6 | 8.0 | 28.6 | 12.0 | 4.0 | 12.6 | 30.8 |
| Other | 1.0 | 4.0 | - | 4.0 | - | 3.0 | - | - |
| Total | 11.5 | 50.1 | 12.0 | 51.6 | 17.0 | 7.0 | 12.6 | 30.8 |
| Plato – disposed 2012 | - | - | - | - | 9.5 | 14.0 | 9.0 | 20.5 |
| | 11.5 | 50.1 | 12.0 | 51.6 | 26.5 | 21.0 | 21.6 | 51.3 |
| **Production** | | | | | | | | |
| Liquids *(Bbl/d)* | | | | | | | | |
| Light oil | 11,811 | 10,322 | 9,802 | 9,528 | 9,125 | 6,057 | 6,310 | 4,702 |
| Heavy oil | 1,440 | 1,387 | 1,669 | 1,581 | 1,538 | 1,128 | 868 | 518 |
| NGLs | 1,520 | 1,478 | 1,116 | 1,249 | 1,332 | 669 | 1,113 | 913 |
| Total | 14,771 | 13,187 | 12,587 | 12,358 | 11,995 | 7,854 | 8,291 | 6,133 |
| Natural Gas *(Mcf/d)* | 73,392 | 72,634 | 71,058 | 67,516 | 56,453 | 18,214 | 19,548 | 16,288 |
| Total *(BOE/d)* | 27,003 | 25,293 | 24,431 | 23,611 | 21,405 | 10,890 | 11,549 | 8,848 |
| **Production by Area** *(BOE/d)* | | | | | | | | |
| Peace River | 11,500 | 10,101 | 9,952 | 9,453 | 6,691 | - | - | - |
| Redwater | 6,285 | 5,875 | 5,444 | 5,195 | 5,050 | 6,023 | 6,748 | 5,411 |
| Boyer | 2,861 | 3,241 | 3,274 | 2,938 | 2,220 | - | - | - |
| Kaybob | 1,851 | 1,923 | 1,426 | 1,847 | 2,118 | 2,044 | 2,657 | 1,968 |
| Other | 4,506 | 4,153 | 4,335 | 4,178 | 3,615 | 1,182 | 959 | 558 |
| Total | 27,003 | 25,293 | 24,431 | 23,611 | 19,694 | 9,249 | 10,364 | 7,937 |
| Plato – disposed 2012 | - | - | - | - | 1,711 | 1,641 | 1,185 | 911 |
| | 27,003 | 25,293 | 24,431 | 23,611 | 21,405 | 10,890 | 11,549 | 8,848 |

[1] *See Non-GAAP Measures section.*

| | 2013 | | | | 2012 | | | |
|---|---|---|---|---|---|---|---|---|
| | Q4 | Q3 | Q2 | Q1 | Q4 | Q3 | Q2 | Q1 |
| **Benchmark pricing** | | | | | | | | |
| WTI *($US/Bbl)* | 97.46 | 105.83 | 94.20 | 94.37 | 88.18 | 92.22 | 93.49 | 102.93 |
| Edmonton Light Sweet *($CAD/Bbl)* | 86.58 | 104.98 | 92.33 | 88.19 | 83.99 | 84.33 | 83.95 | 92.23 |
| AECO *($/Mcf)* | 3.53 | 2.43 | 3.53 | 3.20 | 3.21 | 2.29 | 1.90 | 2.15 |
| Cdn$/US$ exchange rate | 1.05 | 1.04 | 1.02 | 1.01 | 0.99 | 1.00 | 1.01 | 1.00 |
| Prices, excluding derivatives | | | | | | | | |
| Liquids *($/Bbl)* | | | | | | | | |
| Light oil | 75.06 | 95.47 | 83.70 | 76.69 | 76.24 | 80.28 | 82.79 | 89.64 |
| Heavy oil | 62.69 | 87.40 | 71.52 | 55.10 | 57.89 | 59.77 | 64.03 | 71.13 |
| NGLs | 69.21 | 76.05 | 68.91 | 75.33 | 67.08 | 62.24 | 74.95 | 84.60 |
| Total | 73.25 | 92.44 | 80.78 | 73.79 | 72.87 | 75.78 | 79.77 | 87.34 |
| Natural Gas *($/Mcf)* | 3.73 | 2.65 | 3.73 | 3.37 | 3.35 | 2.44 | 1.94 | 2.29 |
| Total *($/BOE)* | 50.24 | 55.84 | 52.72 | 48.76 | 50.27 | 59.98 | 60.92 | 66.43 |
| **Prices, including derivatives** | | | | | | | | |
| Liquids *($/Bbl)* | 70.94 | 86.16 | 80.67 | 73.03 | 75.49 | 77.67 | 80.68 | 85.15 |
| Natural Gas *($/Mcf)* | 4.04 | 3.23 | 3.89 | 3.63 | 4.19 | 2.44 | 1.94 | 2.29 |
| Total *($/BOE)* | 49.78 | 54.29 | 53.29 | 49.12 | 53.99 | 61.34 | 61.57 | 64.92 |
| **Netback** *($/BOE)* | | | | | | | | |
| Revenues | 50.24 | 55.84 | 52.72 | 48.76 | 50.27 | 59.98 | 60.92 | 66.43 |
| Royalties | (7.33) | (6.61) | (4.38) | (5.55) | (6.36) | (5.87) | (5.52) | (6.06) |
| Realized gain (loss) on derivatives | (0.46) | (1.54) | 0.57 | 0.36 | 3.72 | 1.36 | 0.65 | (1.51) |
| Transportation costs | (2.00) | (2.50) | (2.36) | (2.11) | (2.27) | (2.04) | (1.94) | (1.76) |
| Operating costs | (13.36) | (14.45) | (13.98) | (13.53) | (11.78) | (18.20) | (15.35) | (15.86) |
| Operating Netback | 27.09 | 30.74 | 32.57 | 27.93 | 33.58 | 35.23 | 38.76 | 41.24 |
| G&A | (2.82) | (2.31) | (2.47) | (3.51) | (11.86) | (6.68) | (3.90) | (3.21) |
| Interest | (1.73) | (1.56) | (1.63) | (1.52) | (1.96) | (1.84) | (2.06) | (1.41) |
| Corporate Netback | 22.54 | 26.87 | 28.47 | 22.90 | 19.76 | 26.71 | 32.80 | 36.62 |
| **Funds Flow from Operations**[1] *($000s)* | | | | | | | | |
| Revenues | 124,816 | 129,923 | 117,210 | 103,613 | 99,000 | 60,094 | 64,025 | 53,486 |
| Royalties | (18,213) | (15,377) | (9,753) | (11,790) | (12,521) | (5,882) | (5,814) | (4,879) |
| Realized gain (loss) on derivatives | (1,145) | (3,585) | 1,285 | 756 | 7,320 | 1,362 | 682 | (1,215) |
| Transportation costs | (4,971) | (5,816) | (5,250) | (4,483) | (4,474) | (2,048) | (2,037) | (1,416) |
| Operating costs | (33,198) | (33,614) | (31,083) | (28,742) | (23,195) | (18,238) | (16,128) | (12,767) |
| | 67,289 | 71,531 | 72,409 | 59,354 | 66,130 | 35,288 | 40,728 | 33,209 |
| G&A | (7,017) | (5,378) | (5,493) | (7,461) | (23,351) | (6,696) | (4,100) | (2,587) |
| Interest | (4,300) | (3,633) | (3,634) | (3,223) | (3,864) | (1,844) | (2,161) | (1,136) |
| Other | (38) | (216) | (55) | (26) | (508) | (202) | (82) | (105) |
| | 55,934 | 62,304 | 63,227 | 48,644 | 38,407 | 26,546 | 34,385 | 29,381 |

[1] *See Non-GAAP Measures section.*

## Non-GAAP Measures

The MD&A contains terms commonly used in the oil and natural gas industry, such as funds flow from operations, funds flow from operations per share, and net debt. Management believes that funds flow from operations and net debt are useful financial measures which assist in demonstrating the Company's ability to fund capital expenditures necessary for future growth or to repay debt. These terms are not defined by IFRS and therefore may not be comparable to similar measures presented by other companies. These terms should not be considered an alternative to, or more meaningful than, cash provided by operating activities or net earnings as determined in accordance with IFRS as an indicator of Long Run's performance.

### Net Debt

| *($000s)* | **December 31, 2013** | December 31, 2012 |
|---|---|---|
| Bank debt | **423,553** | 261,173 |
| Working capital deficiency | | |
| Accounts payable and accrued liabilities | **89,606** | 91,821 |
| Cash | **-** | (3,803) |
| Accounts receivable | **(53,433)** | (48,912) |
| Prepaid expenses and deposits | **(7,571)** | (7,156) |
| Net Debt | **452,155** | 293,123 |

### Annual Funds Flow from Operations

| *($000s)* | **2013** | 2012 |
|---|---|---|
| Cash flow from operating activities | **234,256** | 136,036 |
| Change in non-cash working capital | **(8,117)** | (8,121) |
| Abandonment costs | **3,970** | 804 |
| Funds flow from operations | **230,109** | 128,719 |
| Weighted average outstanding shares *(000s)* | | |
| - Basic | **125,622** | 91,126 |
| - Diluted | **125,778** | 91,126 |
| Funds flow from operations per share *($/share)* | | |
| - Basic | **1.83** | 1.41 |
| - Diluted | **1.83** | 1.41 |

## Quarterly Funds Flow from Operations

| | 2013 | | | | 2012 | | | |
|---|---|---|---|---|---|---|---|---|
| *($000s)* | **Q4** | Q3 | Q2 | Q1 | Q4 | Q3 | Q2 | Q1 |
| Cash flow from operating activities | **65,932** | 61,756 | 60,835 | 45,733 | 43,325 | 31,417 | 27,941 | 33,353 |
| Change in non-cash working capital | **(11,758)** | (266) | 1,958 | 1,949 | (5,722) | (4,871) | 6,444 | (3,972) |
| Abandonment costs | **1,760** | 814 | 434 | 962 | 804 | - | - | - |
| Funds flow from operations | **55,934** | 62,304 | 63,227 | 48,644 | 38,407 | 26,546 | 34,385 | 29,381 |
| Weighted average outstanding shares *(000s)* | | | | | | | | |
| - Basic | **125,629** | 125,620 | 125,620 | 125,620 | 115,421 | 82,969 | 82,969 | 82,969 |
| - Diluted | **126,245** | 125,620 | 125,620 | 125,620 | 115,421 | 83,016 | 83,061 | 83,121 |
| Funds flow from operations per share *($/share)* | | | | | | | | |
| - Basic | **0.45** | 0.50 | 0.50 | 0.39 | 0.33 | 0.32 | 0.41 | 0.35 |
| - Diluted | **0.44** | 0.50 | 0.50 | 0.39 | 0.33 | 0.32 | 0.41 | 0.35 |

## Advisory

### Forward-Looking Statements

Statements that are not historical facts may be considered forward looking statements, including management's assessment of future plans, operations and strategies, development plans and strategy, drilling plans and the timing thereof, ability to pay a sustainable dividend and deliver moderate per share growth, budgeted 2014 capital expenditures, projected 2014 average production and expected commodity mix, pricing assumptions, anticipated drilling activity, expected effects of recent acquisition, timing of water injection and initial response thereto at Girouxville and Normandville, anticipated funding of dividends and capital expenditures with funds flow from operations, expected decline in net debt to funds flow ratio, access to sufficient capital to meet guidance, expectation that the outcome of claims and proceedings will not have a material adverse effect on the Company, and timing of implementation of pilot project at Redwater, timing of borrowing base review for credit facilities and expectation that debt will not be repaid in the next twelve months, expectation that the Company maintains sufficient credit facilities to satisfy its working capital deficiency and has access to sufficient capital to meet spending forecasts, plans to review the dividend policy regularly, anticipated monthly dividend payments and method of funding the dividend and capital expenditures and the effect of commodity risk management strategies.

These forward-looking statements sometimes include words to the effect that management believes or expects a stated condition or result. All estimates and statements that describe the Company's objectives, goals or future plans are forward-looking statements. Since forward-looking statements address future events and conditions, by their very nature they involve inherent risks and uncertainties including, without limitation, risks associated with oil and natural gas exploration, development, exploitation, production, marketing and transportation, loss of markets, volatility of commodity prices, currency fluctuations, imprecision of reserve estimates, environmental risks, competition from other producers, inability to retain drilling rigs and other services, incorrect assessment of the value of acquisitions, failure to realize the anticipated benefits of acquisitions, delays resulting from or inability to obtain required regulatory approvals and ability to access sufficient capital from internal and external sources. The payment of a dividend by the Company is subject to declaration thereof by the board of directors and continuation of the dividend policy will be subject to and dependent on the Company's cash flow and other expenditures, including capital expenditures. As a consequence, Long Run's actual results may differ materially from those expressed in, or implied by, the forward-looking statements.

Forward-looking statements or information are based on a number of factors and assumptions which have been used to develop such statements and information but which may prove to be incorrect. Although the Company believes that the expectations reflected in such forward-looking statements or information are reasonable, undue reliance should not be placed on forward-looking statements because the Company can give no assurance that such expectations will prove to be correct. In addition to other factors and assumptions which may be identified in this document, assumptions have been made regarding, among other things: the impact of increasing competition; the general stability of the economic and political environment in which the Company operates; the timely receipt of any required regulatory approvals; the ability of the Company to obtain qualified staff, equipment and services in a timely and cost efficient manner; drilling results; the ability of the operator of the projects which the Company has an interest in to operate the field in a safe, efficient and effective manner; the ability of the Company to obtain financing on acceptable terms; field production rates and decline rates; the ability to replace and expand oil and natural gas reserves through acquisition, development and exploration; the timing and costs of pipeline, storage and facility construction and expansion and the ability of the Company to secure adequate product transportation; future oil and natural gas prices; currency, exchange and interest rates; the regulatory framework regarding royalties, taxes and environmental matters in the jurisdictions in which the Company operates; and the ability of the Company to successfully market its oil and natural gas products.

Readers are cautioned that the foregoing list of factors and assumptions is not exhaustive. Additional information on these and other factors that could affect Long Run's operations and financial results are included elsewhere herein and in reports on file with Canadian securities regulatory authorities and may be accessed through the SEDAR website (www.sedar.com), or at Long Run's website (www.longrunexploration.com). Furthermore, the forward-looking statements contained herein are made as at the date hereof and Long Run 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, except as may be required by applicable securities laws.

### Oil & Natural Gas Information

Petroleum and natural gas reserves and volumes are converted to a common unit of measure on a basis of six thousand cubic feet of natural gas to one barrel of oil. BOEs may be misleading, particularly if used in isolation. The forgoing conversion ratio is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead. Given that the value ratio based on the current price of crude oil as compared to natural gas is significantly different than the energy equivalency of six to one, utilizing a conversion on a six to one basis may be misleading as an indication of value.

## Abbreviations

| Oil and Natural Gas Liquids | | Natural Gas | |
|---|---|---|---|
| MBbl | thousand barrels | MMcf | million cubic feet |
| MMBbl | million barrels | Mcf/d | thousand cubic feet per day |
| Bbl/d | barrels per day | MMcf/d | million cubic feet per day |
| NGLs | natural gas liquids | Mmbtu | million British Thermal Units |
| BOE | barrels of oil equivalent | | |
| BOE/d | barrels of oil equivalent per day | | |
| Liquids | light oil, heavy oil, and NGLs | | |

## Additional Information

Additional information relating to Long Run, including Long Run's Annual Information Form, can be accessed on-line on SEDAR at www.sedar.com, or from the Company's website at www.longrunexploration.com.

# LONG RUN EXPLORATION LTD.

## Financial Statements

## December 31, 2013

**Management's Responsibility for Financial Reporting**

The accompanying financial statements and all information in this report are the responsibility of management. Management has prepared the financial statements in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board. In the opinion of management, the financial statements have been prepared within acceptable limits of materiality and, when necessary, management has made informed judgments and estimates in accounting for transactions that were not complete at the statement of financial position date. When alternative accounting methods exist, management has chosen those it deems most appropriate in the circumstances as indicated in the notes to the financial statements. Financial information contained elsewhere in this report has been prepared and reviewed by management to ensure it is consistent with the financial statements.

Management has established systems of internal controls over financial reporting to provide reasonable assurance regarding the reliability of the Company's financial reporting and the preparation of financial statements for external purposes in accordance with International Financial Reporting Standards.

The Audit and Reserves Committees are appointed by the Board of Directors, and are comprised of directors that are not employees of the Company. The Audit Committee meets regularly with management, as well as the external auditors, to discuss internal controls over the financial reporting process, auditing matters and financial reporting issues, to satisfy itself that each party is discharging its responsibilities, and to review the financial statements and the external auditors' report. The Board of Directors has approved the financial statements.

(signed)
Bill Andrew
Chairman and Chief Executive Officer

(signed)
Corine Bushfield
Vice President Finance and
Chief Financial Officer

March 5, 2014

## INDEPENDENT AUDITORS' REPORT

To the Shareholders of Long Run Exploration Ltd.

We have audited the accompanying financial statements of Long Run Exploration Ltd. which comprise the statements of financial position as at December 31, 2013 and December 31, 2012, and the statements of earnings, comprehensive income, changes in equity and cash flows for the years ended December 31, 2013, and December 31, 2012, and a summary of significant accounting policies and other explanatory information.

### Management's responsibility for the financial statements

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

### Auditors' responsibility

Our responsibility is to express an opinion on these 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 financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditors consider internal control relevant to the entity's preparation and fair presentation of the 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 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 financial statements present fairly, in all material respects, the financial position of Long Run Exploration Ltd. as at December 31, 2013 and December 31, 2012, and its financial performance and its cash flows for the years ended December 31, 2013, and December 31, 2012, in accordance with International Financial Reporting Standards.

Ernst & Young LLP

Chartered Accountants
Calgary, Canada
March 5, 2014

## Statement of Financial Position

| *($000s)* | **December 31, 2013** | December 31, 2012 |
|---|---|---|
| **ASSETS** | | |
| CURRENT | | |
| Cash | **-** | 3,803 |
| Accounts receivable | **53,433** | 48,912 |
| Deposits and prepaid expenses | **7,571** | 7,156 |
| Fair value of financial derivatives *(note 15)* | **1,024** | 15,318 |
| | **62,028** | 75,189 |
| Exploration and evaluation assets *(note 6)* | **10,758** | 20,936 |
| Property and equipment *(note 5, 7)* | **1,184,351** | 939,713 |
| Deferred income tax asset *(note 13)* | **146,207** | 157,292 |
| Fair value of financial derivatives *(note 15)* | **-** | 142 |
| | **1,403,344** | 1,193,272 |
| **LIABILITIES** | | |
| CURRENT | | |
| Accounts payable and accrued liabilities | **89,606** | 91,821 |
| Bank loan *(note 9)* | **-** | 261,173 |
| Fair value of financial derivatives *(note 15)* | **14,919** | 9,341 |
| | **104,525** | 362,335 |
| Bank loan *(note 9)* | **423,553** | - |
| Decommissioning liabilities *(note 8)* | **254,413** | 233,100 |
| Fair value of financial derivatives *(note 15)* | **3,876** | 12,155 |
| | **786,367** | 607,590 |
| **SHAREHOLDERS' EQUITY** | | |
| Share capital *(note 10)* | **657,666** | 657,455 |
| Contributed surplus *(note 10)* | **23,377** | 16,558 |
| Retained earnings (deficit) | **(64,066)** | (88,331) |
| | **616,977** | 585,682 |
| | **1,403,344** | 1,193,272 |

Commitments and contingencies *(note 17)*
Subsequent events *(note 18)*

*See accompanying notes to the financial statements.*

Approved on behalf of the Board of Directors:

(signed)
Patricia Newson
Director

(signed)
Brad Munro
Director

## Statement of Earnings and Comprehensive Income

| *($000s, except share and per share amounts)* | Year ended December 31 2013 | 2012 |
|---|---|---|
| **INCOME** | | |
| Petroleum and natural gas revenue | **475,562** | 276,605 |
| Royalties | **(55,133)** | (29,096) |
| | **420,429** | 247,509 |
| Gain (loss) on financial derivatives | | |
| - realized *(note 15)* | **(2,689)** | 8,149 |
| - unrealized *(note 15)* | **(11,735)** | 7,451 |
| | **406,005** | 263,109 |
| **EXPENSES** | | |
| Operating | **126,637** | 70,328 |
| Transportation | **20,520** | 9,975 |
| General and administration *(note 12)* | **25,349** | 36,734 |
| Share-based compensation *(note 10)* | **4,379** | 5,530 |
| Interest | **14,790** | 9,005 |
| Accretion *(note 8)* | **6,110** | 2,019 |
| Depletion and depreciation *(note 7)* | **170,696** | 122,352 |
| Exploration expenses | **247** | 230 |
| Gain on disposal of assets *(note 7)* | **(11,161)** | (87,149) |
| Impairments *(note 7)* | **13,000** | 146,102 |
| | **370,567** | 315,126 |
| **EARNINGS (LOSS) BEFORE TAX** | **35,438** | (52,017) |
| Income Taxes | | |
| Capital and other taxes | **88** | 667 |
| Deferred income tax expense (recovery) *(note 13)* | **11,085** | (10,032) |
| | **11,173** | (9,365) |
| **NET EARNINGS (LOSS) AND COMPREHENSIVE INCOME (LOSS)** | **24,265** | (42,652) |
| **NET EARNINGS (LOSS) AND COMPREHENSIVE INCOME (LOSS) PER SHARE** *(note 10)* | | |
| Basic | **0.19** | (0.47) |
| Diluted | **0.19** | (0.47) |

*See accompanying notes to the financial statements.*

## Statement of Changes in Shareholders' Equity

| *($000s)* | **Share Capital** | **Contributed Surplus** | **Retained Earnings (Deficit)** | **Total** |
|---|---|---|---|---|
| | *(note 10)* | *(note 10)* | | |
| January 1, 2012 | 485,727 | 10,446 | (45,679) | 450,494 |
| Shares issued upon Guide Arrangement *(note 5)* | 171,130 | - | - | 171,130 |
| Share-based compensation | - | 6,433 | - | 6,433 |
| Options exercised | 598 | (321) | - | 277 |
| Comprehensive loss | - | - | (42,652) | (42,652) |
| December 31, 2012 | 657,455 | 16,558 | (88,331) | 585,682 |
| Share-based compensation | - | 6,868 | - | 6,868 |
| Options exercised | 211 | (49) | - | 162 |
| Comprehensive earnings | - | - | 24,265 | 24,265 |
| December 31, 2013 | **657,666** | **23,377** | **(64,066)** | **616,977** |

*See accompanying notes to the financial statements.*

## Statement of Cash Flows

| *($000s)* | Year ended December 31<br>**2013** | <br>2012 |
|---|---|---|
| **Cash provided by (used in):** | | |
| **OPERATING ACTIVITIES** | | |
| Net earnings (loss) | **24,265** | (42,652) |
| Items not requiring cash: | | |
| Unrealized (gain) loss on financial derivatives *(note 15)* | **11,735** | (7,451) |
| Share-based compensation | **4,379** | 5,530 |
| Accretion | **6,110** | 2,019 |
| Depletion and depreciation | **170,696** | 122,352 |
| Gain on disposal of assets | **(11,161)** | (87,149) |
| Impairments *(note 7)* | **13,000** | 146,102 |
| Deferred income tax expense (recovery) *(note 13)* | **11,085** | (10,032) |
| Abandonment costs *(note 8)* | **(3,970)** | (804) |
| Change in non-cash working capital *(note 16)* | **8,117** | 8,121 |
| | **234,256** | 136,036 |
| **INVESTING ACTIVITIES** | | |
| Capital expenditures *(note 6,7)* | **(276,571)** | (196,320) |
| Acquisitions *(note 5,7)* | **(125,967)** | (14,090) |
| Dispositions *(note 7)* | **17,205** | 178,241 |
| Change in non-cash working capital *(note 16)* | **(15,268)** | (4,063) |
| | **(400,601)** | (36,232) |
| **FINANCING ACTIVITIES** | | |
| Issuance of common shares, net of costs *(note 10)* | **162** | 277 |
| Bank loan | **162,380** | (103,859) |
| | **162,542** | (103,582) |
| **CHANGE IN CASH** | **(3,803)** | (3,778) |
| **CASH, BEGINNING OF YEAR** | **3,803** | 7,581 |
| **CASH, END OF YEAR** | **-** | 3,803 |
| **SUPPLEMENTAL INFORMATION** | | |
| Cash interest paid | **15,179** | 8,502 |
| Cash taxes paid | **73** | 725 |

*See accompanying notes to financial statements.*

# Notes to the Financial Statements
## For the year ended December 31, 2013

## 1. REPORTING ENTITY

Long Run Exploration Ltd. ("Long Run" or the "Company"), is incorporated under the *Business Corporations Act* (Alberta).

The business of the Company is the exploration for and development and acquisition of, petroleum and natural gas properties in western Canada.

The principal address of the Company is located at 400, 250 Second Street SW, Calgary, Alberta, T2P 0C1. Long Run's outstanding common shares and convertible debentures are listed on the Toronto Stock Exchange under the symbols "LRE" and "LRE.DB", respectively.

## 2. BASIS OF PRESENTATION

These financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS").

The financial statements have been prepared on the historical cost basis except where noted in the accounting policies. The financial statements are presented in Canadian dollars.

Certain prior year amounts have been reclassified to conform to current year presentation.

The financial statements were authorized for issue by the Board of Directors on March 5, 2014.

## 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

*Estimates, assumptions and judgements*

The preparation of financial statements in conformity with IFRS requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates. Revisions to accounting estimates are recognized in the period in which the estimates are revised and in any future periods affected.

The amounts recorded for exploration and evaluation assets, property and equipment, depletion and depreciation and impairment testing are based on estimates of proven and probable reserves, production rates, oil and natural gas prices, future costs, future prices, and other relevant assumptions. As well, the cash generating unit ("CGU") to which an asset belongs is subject to the judgement of management.

Assumptions that are valid at the time of reserves estimation may change significantly when new information becomes available. Changes in forward price estimates, production costs or recovery rates may change the economic status of reserves. Changes in the economic environment could result in significant changes to the discount rate used to calculate net present values.

Business combinations are accounted for using the acquisition method. Under this method, the consideration transferred is allocated to the assets acquired and the liabilities assumed based on the fair values at the time of acquisition. In determining the fair value of the assets and liabilities, Long Run is often required to make assumptions and estimates, such as reserves, future commodity prices, fair value of undeveloped land, discount rates, decommissioning liabilities and possible outcome of any assumed contingencies.

The provision for decommissioning liabilities is based on estimates of costs and expected plans for remediation. Actual costs may differ from those estimated due to changes in laws and regulations, technology, market and other conditions.

Accruals for revenue, royalties and costs are prepared based on estimates when actual amounts are not yet known. Share-based compensation amounts are determined using certain assumptions (see note 10).

The fair value of financial derivatives is based on fair values provided by the counterparties with whom the transactions were completed. By their nature, these estimates and assumptions are subject to measurement uncertainty and the effect on the financial statements of changes in such estimates in future years could be significant.

The provision for income and other tax liabilities, requiring the interpretation of complex laws and regulations which are subject to change, is subject to measurement uncertainty. The recognition of income tax assets requires a determination of the likelihood that they will be realized from future taxable earnings.

*Cash and cash equivalents*

Cash and cash equivalents may include highly liquid short-term investments with initial maturities of three months or less. They are recorded at cost which approximates fair market value.

*Financial instruments*

All financial assets excluding derivatives are classified as loans or receivables and are accounted for on an amortized cost basis. All financial liabilities excluding derivatives are classified as other liabilities and are accounted for on an amortized cost basis. Financial instruments recognized on the Company's statement of financial position are deemed to approximate their estimated fair values.

Financial derivatives that have not been designated as accounting hedges are classified as fair value through profit or loss. Financial derivatives are recorded and carried on the statement of financial position at fair value with actual amounts received or paid on the settlement of the financial derivative instrument recorded in income.

At each reporting date, the Company determines whether transfers have occurred between levels in the fair value hierarchy by reassessing the level of classification for each financial asset and financial liability measured or disclosed at fair value in the financial statements. Assessment of the significance of a particular input to the fair value measurement requires judgement and may affect the placement within the fair value hierarchy.

*Joint operations*

The Company's petroleum and natural gas activities may be conducted jointly with others. Joint operations, whereby the jointly controlling parties have rights to the assets and obligations for the liabilities of the arrangement, are accounted for using proportionate consolidation. The financial statements reflect only the Company's proportionate interest in such activities.

*Exploration and evaluation assets*

Expenditures incurred before the Company has obtained the legal right to explore are expensed in the statement of earnings as exploration expense.

Exploration and evaluation assets reflect expenditures for an area where technical feasibility and commercial viability has not yet been determined. Expenditures, including land acquisition, geological and geophysical, drilling and completion costs are capitalized and accumulated pending determination of technical feasibility and commercial viability. Evaluation and exploration assets are not depleted. When assets are determined to be technically feasible and commercially viable, the accumulated costs are tested for impairment within the CGU and the recoverable amount is transferred to property and equipment.

Exploration and evaluation assets are also assessed for impairment if facts and circumstances suggest the carrying amount exceeds the recoverable amount.

*Property and equipment*

Property and equipment are stated at cost less accumulated depletion and depreciation, and accumulated impairments.

*Petroleum and natural gas properties*

Property and equipment includes transfers of exploration and evaluation assets, property acquisitions, facilities, directly attributable overhead and share-based compensation expenses, as well as land acquisition, geological and geophysical, drilling and completion costs incurred within an area considered to be technically feasible and commercially viable.

Property and equipment is depleted on the unit of production method using estimated gross proven and probable petroleum and natural gas reserves, determined annually by independent professional engineers. Petroleum and natural gas reserves are converted to a common unit of measure on an energy equivalent basis of six mcf of gas to one barrel of oil. Estimated future development costs necessary to bring the reserves into production are included in the depletion calculation. Assets may be excluded from depletion until capable of operation. Undeveloped land is amortized into the depletable base over the term of the leases.

Reserves are the remaining quantities of oil, natural gas and related substances from known accumulations estimated to be recoverable from a given date forward. The estimates of reserves are determined from drilling, geological, geophysical and engineering data based on established technology and specified economic conditions. The guidelines for the determination and classification of reserves are outlined in the Canadian Oil and Gas Evaluation Handbook.

Proven plus probable reserve estimate is defined as a “best estimate” of the remaining recoverable quantities of oil, natural gas and related substances. This estimate should best represent the expected outcome with no optimism or conservatism. In probabilistic terms, there should be at least a 50 percent probability that the quantities actually recovered in the future will equal or exceed the proven plus probable reserve estimate.

Property and equipment is tested for impairment when indications of impairment exist.

*Assets held for sale*

Non-current assets, or disposal groups consisting of assets and liabilities, are classified as held for sale if their carrying amounts will be recovered through a sale transaction rather than through continuing use. This condition is met when the sale is highly probable and the asset is available for immediate sale in its present condition.

Assets classified as held for sale are measured at the lower of the carrying amount and fair value less costs to sell, with impairments recognized in net earnings in the period measured. Assets and disposal groups held for sale are presented in current assets and liabilities on the statement of financial position.

*Disposals*

Any gain or loss on the disposal of assets, including oil and natural gas properties, determined as the difference between the net disposal proceeds and the carrying amount of the asset, is recognized in the statement of earnings.

*Non-monetary transactions*

Non-monetary transactions for the acquisition or disposal of property and equipment are measured at fair value, unless the transaction lacks commercial substance or fair value cannot be reliably measured.

*Goodwill*

Goodwill, at the time of acquisition, represents the excess of the purchase price of a business over the fair value of net assets acquired. When the excess is negative, it is recognized immediately in the statement of earnings.

Goodwill, measured at cost less accumulated impairments, is tested for impairment annually. For purposes of impairment testing, goodwill acquired in a business combination is allocated to the CGUs that are expected to benefit from the synergies of the combination and tested for impairment at the operating segment level. An impairment of goodwill is not reversed.

*Business combinations*

Transactions for the purchase of assets, where the assets acquired are deemed to constitute a business, are accounted for as business combinations. Using the acquisition method, identifiable assets acquired and liabilities assumed are measured at their acquisition-date fair values. Transaction costs related to the acquisition are expensed in the statement of earnings.

*Impairments*

The recoverable amount of an asset is the greater of its value in use and its fair value less costs to sell. If the recoverable amount is less than the carrying value, the asset is considered to be impaired. The recoverable amount is determined for an individual asset, unless the asset does not generate cash inflows that are largely independent of those from other assets or groups of assets. If this is the case, the recoverable amount is determined for the CGU to which the asset belongs.

In assessing value in use, estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and risks specific to the asset. Value in use is generally computed by reference to the present value of the future cash flows expected to be derived from proven and probable reserves.

Fair value less costs to sell is the amount obtainable from the sale of an asset in an arm's length transaction between knowledgeable and willing parties, less the costs of disposal. Available fair value indicators, such as recent market transaction information, and appropriately discounted cash flow valuation models are used in determining fair value less costs to sell.

An impairment is recognized in the statement of earnings. An impairment recognized in respect of a CGU is allocated first to reduce the carrying amount of any goodwill allocated to the CGU and subsequently to other assets in the CGU. An impairment recognized in prior periods for an asset other than goodwill is reversed if there has been a change in facts and circumstances used to determine the asset's recoverable amount since the last impairment was recognized, such that the impairment no longer exists or has decreased. An impairment is only reversed to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depletion and depreciation, if no impairment had been recognized.

*Leases*

The Company's leases are classified as either finance or operating. Finance leases are those which transfer substantially all the benefits and risks of ownership to the lessee. Assets acquired under finance leases are depleted along with property and equipment. Obligations recorded under finance leases are reduced by the principal portion of lease payments as incurred and the imputed interest portion of finance lease payments is charged to interest expense. Payments under operating leases are expensed as incurred.

*Decommissioning liabilities*

Decommissioning liabilities arise from the legal obligation to abandon and reclaim property, plant and equipment incurred upon acquisition, construction, development and/or normal use of the asset. The initial liability is measured at the discounted value of the estimated costs to reclaim and abandon using a risk free rate, subsequently adjusted for the accretion of discount and changes in expected costs. The decommissioning cost is capitalized as part of exploration and evaluation assets or property and equipment, as applicable. The costs capitalized to property and equipment are depleted into earnings based on units of production. Actual costs incurred upon settlement of the obligations are charged against the liability.

*Revenue recognition*

Petroleum and natural gas sales are recognized when delivery of the product has been completed and title passes to an external party.

*Share-based compensation*

The grant date fair values of share-based compensation awards are recognized over the vesting periods of the awards, with an offsetting credit to contributed surplus. The Black-Scholes option pricing model is used to calculate the fair value of the stock options granted. The estimated forfeiture rate is adjusted to reflect the actual number of options that vest. Consideration paid by optionees on the exercise of stock options is credited to share capital, together with the related share-based compensation previously included in contributed surplus.

*Cash settled compensation*

From time to time the company may choose to award employees and directors with performance based incentives derived from the performance of the Company's share price. Such plans are settled in cash, measured at fair value at the end of each reporting period, and are recorded as a liability on the statement of financial position, with changes in fair value included in the statement of earnings.

# Notes to the Financial Statements
## For the year ended December 31, 2013

*Income taxes*

Income tax expense is recognized in the statement of earnings, except to the extent it relates to items recognized directly in equity, in which case the related income tax is also recognized in equity.

Deferred tax is recognized using the statement of financial position method. Under this method, deferred income tax assets and liabilities are recognized based on differences between the financial reporting and tax bases of assets and liabilities, and measured using the substantively enacted tax rates and laws that will be in effect when the differences are expected to reverse. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in the period in which the change is substantively enacted. Deferred income tax assets and liabilities are presented as non-current.

Deferred tax is not recognized on the initial recognition of assets or liabilities in a transaction that is neither a business combination nor an event resulting in income or expense. Deferred tax is not recognized for taxable temporary differences arising on the initial recognition of goodwill. A deferred tax asset is recognized only to the extent it is probable that future taxable profits will be available against which the asset can be utilized.

*Flow-through shares*

The Company may finance a portion of its exploration and development activities through the issuance of flow-through shares. Under the terms of the flow-through share agreements, the tax attributes of the related expenditures are renounced to subscribers. To recognize the foregone tax benefits to the Company, a deferred tax expense is recognized in the statement of earnings when the expenditures are incurred and the renouncement has been filed. The deferred tax expense recognized is offset by the premium received for the flow-through shares, with the premium being initially recorded as a liability in the statement of financial position.

*Earnings per share*

Basic earnings per share amounts are calculated by dividing the net earnings by the weighted average number of common shares outstanding during the period. Diluted earnings per share is determined by adjusting the earnings and the weighted average number of common shares outstanding using the treasury stock method for the effects of dilutive instruments such as outstanding stock options.

*Provisions*

A provision is recognized if, as a result of a past event, the Company has a present, legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are measured using the best estimate of the expenditure required to settle the obligation.

## 4. CHANGES IN ACCOUNTING POLICIES

Effective January 1, 2013, the Company adopted the following new accounting standards. The adoption of these standards did not have a material impact on the Company's financial statements.

- IFRS 13, *Fair Value Measurement,* establishes consistent guidance for fair value measurements and disclosures, when fair value is required or permitted by IFRS. While there has been no change to the Company's methodology for determining the fair value of its financial assets and liabilities, fair value disclosures have been expanded in note 15.

- IFRS 10, *Consolidated Financial Statements,* replaced the consolidation requirements in SIC-12 *Consolidation – Special Purpose Entities* and IAS 27 *Consolidated and Separate Financial Statements.* IFRS 10 provides a single consolidation model that applies to all entities, building on existing principles by identifying the concept of control as the determining factor in whether an entity should be consolidated within the financial statements of the parent company.

- IFRS 11, *Joint Arrangements,* establishes a principles-based approach to accounting for joint arrangements, focusing on the rights and obligations of the arrangement, rather than its legal form. Joint operations, whereby the jointly controlling parties have rights to the assets and obligations for the liabilities of the arrangement, are accounted for using proportionate consolidation. Joint ventures, whereby the jointly controlling parties have rights to the net assets of the arrangement, are accounted for using the equity method. The Company currently only has joint operations.

- IFRS 12, *Disclosure of Interests in Other Entities,* contains enhanced disclosure requirements about an entity's interests in subsidiaries, joint arrangements and associates, as well as new disclosure requirements about unconsolidated structured entities.

- IAS 28, *Investments in Associates and Joint Ventures,* was amended as a consequence of the issuance of IFRS 10, IFRS 11 and IFRS 12. The amended IAS 28 sets out the requirements for the application of the equity method when accounting for investments in associates and joint ventures.

*Future Accounting Pronouncements*

The Company will be required to adopt the following:

- IAS 36, *Impairment of Assets,* was amended regarding disclosures of the recoverable amounts of CGUs with impairment. This amendment must be adopted January 1, 2014 and is expected to result in additional disclosures if impairments are recognized.

- IFRS 9, *Financial Instruments*, the first phase of the project to replace IAS 39, *Financial Instruments: Recognition and Measurement* has been issued but the adoption date has been deferred from January 1, 2015. A new date will be decided upon when the entire IFRS 9 project is closer to completion. The new standard replaces the current multiple classification and measurement models for financial assets and liabilities with a single model that has only two classifications: amortized cost and fair value. Portions of the standard remain in development and the full impact of the standard on the Company's financial statements will not be known until the project is complete.

## 5. BUSINESS COMBINATIONS

*Acquisition of oil and natural gas properties in the Peace and Redwater areas*

On October 16, 2013, the Company purchased interests in certain assets in the Peace and Redwater areas of Alberta. Details of the transaction are as follows:

| *($000s)* | |
|---|---|
| Property and equipment | **62,461** |
| Decommissioning liabilities | **(12,786)** |
| Fair value of net assets | **49,675** |
| Cash consideration paid | **49,675** |

Following the acquisition, property and equipment and the decommissioning liabilities were increased by $12.8 million, reflecting the calculation of decommissioning liabilities using a risk free discount rate, compared to a credit adjusted discount rate used to determine fair value.

The financial statements incorporate the operations of the acquired properties commencing October 16, 2013. During the period October 16, 2013 to December 31, 2013, the Company recorded revenues of $5.9 million and net earnings of $0.5 million in respect of these assets.

Had the transaction closed on January 1, 2013, management estimates that revenue and net earnings would have increased by an additional $29.0 million and $1.5 million, respectively. In determining these amounts, management assumed the fair values on the date of acquisition would have been the same if the acquisition had occurred on January 1, 2013.

*Acquisition of oil and natural gas properties in the Redwater area*

On December 12, 2013, the Company purchased interests in certain assets in the Redwater area of Alberta. Details of the transaction are as follows:

| *($000s)* | |
|---|---|
| Property and equipment | **47,519** |
| Decommissioning liabilities | **(2,404)** |
| Fair value of net assets | **45,115** |
| Cash consideration paid | **45,115** |

Following the acquisition, property and equipment and the decommissioning liabilities were increased by $2.6 million, reflecting the calculation of decommissioning liabilities using a risk free discount rate, compared to a credit adjusted discount rate used to determine fair value.

The financial statements incorporate the operations of the acquired properties commencing December 13, 2013. During the period December 13, 2013 to December 31, 2013, the Company recorded revenues of $0.7 million and net earnings of $Nil in respect of these assets.

Had the transaction closed on January 1, 2013, management estimates that revenue and net earnings would have increased by an additional $16.0 million and $3.6 million, respectively. In determining these amounts, management assumed the fair values on the date of acquisition would have been the same if the acquisition had occurred on January 1, 2013.

# Notes to the Financial Statements
## For the year ended December 31, 2013

*Arrangement with Guide Exploration Ltd.*

On October 23, 2012, the Company completed a plan of arrangement (the "Guide Arrangement") with Guide Exploration Ltd. ("Guide"). Details of the transaction are as follows:

| *($000s)* | |
|---|---|
| Exploration and evaluation assets | 16,221 |
| Property and equipment | 406,299 |
| Deferred tax asset | 107,110 |
| Working capital deficiency | (23,361) |
| Financial derivatives | (7,575) |
| Bank loan | (241,032) |
| Decommissioning liabilities | (86,100) |
| Other liabilities | (432) |
| Fair value of net assets | 171,130 |
| | |
| Consideration: | |
| Common shares (42,569,632 Common Shares at $4.02 per share) | 171,130 |

Following completion of the Guide Arrangement, property and equipment and the decommissioning liabilities were increased by $83.3 million, reflecting the calculation of decommissioning liabilities using a risk free discount rate, compared to a credit adjusted discount rate used to determine fair value.

The purchase price allocation was based on the best estimates of management, giving consideration to cash flows from oil and gas reserves estimated by independent reserve evaluators and the fair value of undeveloped land estimated internally.

Transaction costs, including salary and employee expenses, of $20.2 million related to the Guide Arrangement were included in the statement of earnings as a general and administrative expense.

The financial statements incorporated the operations of the Guide properties commencing October 23, 2012. During the period October 23, 2012 to December 31, 2012, the properties acquired contributed revenues of $40.0 million and net earnings of $3.0 million.

Had the business combination with Guide closed on January 1, 2012, management estimates that the corporate activity of Guide, adjusted for the property and equipment, deferred tax and decommissioning obligation values determined on the date of completion of the Guide Arrangement, would have increased revenues and the net loss during the year ended December 31, 2012 by $148.0 million and $2.0 million, respectively.

## Notes to the Financial Statements
### For the year ended December 31, 2013

## 6. EXPLORATION AND EVALUATION ASSETS

| *($000s)* | **December 31, 2013** | December 31, 2012 |
|---|---|---|
| Balance, beginning of year | **20,936** | - |
| Guide Arrangement *(note 5)* | **-** | 16,221 |
| Additions | **5,176** | 4,715 |
| Transfers to property and equipment | **(15,354)** | - |
| Balance, end of year | **10,758** | 20,936 |

## 7. PROPERTY AND EQUIPMENT

| *($000s)* | **December 31, 2013** | December 31, 2012 |
|---|---|---|
| Property & equipment cost | **1,769,893** | 1,345,940 |
| Accumulated depletion, depreciation & impairments | **(585,542)** | (406,227) |
| Net book value | **1,184,351** | 939,713 |

### *Property & Equipment Cost*

| *($000s)* | **December 31, 2013** | December 31, 2012 |
|---|---|---|
| Balance, beginning of year | **1,345,940** | 749,517 |
| Additions | **258,561** | 227,209 |
| Acquisitions, including decommissioning costs | **169,023** | 14,090 |
| Transfers from exploration and evaluation assets | **15,354** | - |
| Guide Arrangement | **-** | 489,581 |
| Disposals | **(18,985)** | (134,457) |
| Balance, end of year | **1,769,893** | 1,345,940 |

### *Accumulated Depletion, Depreciation & Impairments*

| *($000s)* | **December 31, 2013** | December 31, 2012 |
|---|---|---|
| Balance, beginning of year | **(406,227)** | (163,691) |
| Depletion and depreciation expense | **(170,696)** | (122,352) |
| Disposals | **4,381** | 23,932 |
| Impairments | **(13,000)** | (144,116) |
| Balance, end of year | **(585,542)** | (406,227) |

During 2013, the Company acquired lands and oil and natural gas properties for cash consideration of $126.0 million (2012 – $14.1 million).

Proceeds of $17.2 million were received on the disposition of assets during 2013, of which $12.4 million was received on the sale of producing assets in Saskatchewan. A gain on disposal of $7.7 million was recognized on this transaction.

As at December 31, 2013, undeveloped land of $26.1 million (December 31, 2012 – $31.4 million) has been excluded from, and future development costs of $666.7 million (December 31, 2012 – $562.4 million) have been added into, costs subject to depletion.

During 2012, the Company completed a farm-out agreement with an industry partner on lands in the west central area of Saskatchewan. Upon completion, the Company recognized a gain of $11.4 million. In addition, the Company disposed of properties, including the farm-out properties in west central Saskatchewan, for proceeds of $178.2 million, resulting in a net gain on disposal of assets of $75.8 million.

For the year ended December 31, 2013, the Company recorded an impairment of $13 million related to property and equipment (December 31, 2012 – $146.1 million). In 2013, an impairment was recorded for the Kaybob CGU, resulting primarily from capital spending on facilities that did not result in additional reserves. In 2012, impairments of $144.1 million were recorded for the Kaybob and Redwater CGUs, resulting primarily from a weakening of the future price forecasts and a reduction of the estimated reserve volumes at Kaybob. In addition, a goodwill impairment of $2.0 million was recognized in 2012.

In 2013, the recoverable amounts of the Company's CGUs were estimated at fair value less costs to sell, based on the net present value of the after-tax cash flows from oil and gas reserves, using reserves estimated by independent reserve evaluators, and the fair value of undeveloped land. The net present values of the cash flows from oil and gas reserves at December 31, 2013 were calculated using an after-tax discount rate of 10%, a CDN$/US$ exchange rate of 0.95 CDN$ to 1.0 US$, and the following forward commodity price estimates:

| | WTI Oil *(US$/bbl)* | AECO Gas *(CDN$/mcf)* |
|---|---|---|
| 2014 | 95.72 | 4.01 |
| 2015 | 93.62 | 4.17 |
| 2016 | 92.25 | 4.35 |
| 2017 | 96.01 | 4.81 |
| 2018 | 96.59 | 4.99 |
| 2019 | 97.50 | 5.18 |
| 2020 | 98.98 | 5.29 |
| 2021 | 100.80 | 5.38 |
| 2022 | 102.64 | 5.48 |
| 2023 | 104.54 | 5.58 |
| 2024 | 106.46 | 5.68 |
| Remainder | +1.8%/yr | +1.8%/yr |

## Notes to the Financial Statements
### For the year ended December 31, 2013

## 8. DECOMMISSIONING LIABILITIES

| ($000s) | December 31, 2013 | December 31, 2012 |
|---|---|---|
| Balance, beginning of year | **233,100** | 42,171 |
| Accretion expense | **6,110** | 2,019 |
| Liabilities acquired | **43,056** | 169,382 |
| Liabilities incurred | **8,442** | 7,814 |
| Disposal of liabilities | **(8,560)** | (8,060) |
| Settlement of liabilities | **(3,970)** | (804) |
| Change in estimates | **(23,765)** | 20,578 |
| Balance, end of year | **254,413** | 233,100 |

The Company's decommissioning liabilities result from net ownership interests in petroleum and natural gas assets including well sites, gathering systems and processing facilities. The Company estimates the total undiscounted amount of cash flows required to settle its decommissioning liabilities is approximately $404.0 million (December 31, 2012 – $349.0 million), which will be incurred over the next 40 years. At December 31, 2013, the Company used a risk free rate of 3.0% and an inflation rate of 2.0% to calculate the present value of the decommissioning liabilities (December 31, 2012 – 2.5% and 2.0%, respectively).

## 9. AVAILABLE CREDIT FACILITIES

The Company has credit facilities of $475.0 million, consisting of a $445.0 million revolving syndicated facility and a $30.0 million operating facility. Total borrowings permitted under these facilities cannot exceed the borrowing base, which is determined by the lenders on a semi-annual basis or upon the occurrence of a material adverse effect. On May 3, 2013, the termination date was extended to May 31, 2016.

In conjunction with the extension of the credit facility to May 2016, the Company determined it does not intend to repay the facility in the next 12 months and does not anticipate a reduction to the borrowing base below the level of bank debt currently outstanding. As a result, the bank debt has been classified as long-term on the December 31, 2013 statement of financial position. The next annual review will occur prior to May 31, 2014.

Security for the credit facilities includes a demand debenture for $1.0 billion which provides for a first ranking security interest and floating charge over all of the assets and property of the Company. At December 31, 2013, an amount of $423.6 million was drawn against the credit facilities (December 31, 2012 – $261.2 million).

The credit facilities bear interest at the prime rate or Libor rate, plus a margin, and in respect of banker's acceptances requires the payment of a stamping fee equal to a margin. The margins range from 1.00% per annum to 4.00% per annum, based upon the Company's debt to earnings before interest, taxes, exploration expenses, and all non-cash items including depletion, depreciation and amortization ("EBITDA") ratio. For the year ended December 31, 2013, the effective interest rate, including standby and other fees, was 4.4% (2012 – 4.6%).

As at December 31, 2013, the Company is in compliance with all covenants, obligations and conditions of its credit agreement, which include covenants relating to debt to EBITDA, interest coverage, permitted dispositions, and permitted hedging.

## 10. SHAREHOLDERS' EQUITY

The Company is authorized to issue an unlimited number of Common Shares, Common Non-Voting Shares, Non-Voting Convertible Shares and First Preferred Shares without nominal or par value.

The holders of the Non-Voting Convertible Shares are entitled to receive dividends declared thereon equally, on a share-for-share basis, with the holders of Common Shares. The holders of Non-Voting Convertible Shares are entitled to attend meetings of shareholders, but are not entitled to vote. In the event of liquidation, dissolution or winding up of the affairs of the Company, the holders of the Non-Voting Convertible Shares are entitled to receive an amount per share equal to the fair market value of any property received as consideration by the Company for the issuance of the shares, before any amount is distributed to holders of the Common Shares. The Non-Voting Convertible Shares may not be transferred to a control person, meaning a person or company holding more than 20% of the voting securities of the Company. Holders of Non-Voting Convertible Shares may convert each share into one Common Share, provided the holder would not become a control person of the Company after the conversion, or upon a change in control of the Company, and are automatically converted on a transfer of the share to a person that would not be a control person of the Company after giving effect to such transfer. The Company has the right to require holders of the Non-Voting Convertible Shares to convert all issued and outstanding shares to Common Shares three years after the date the Non-Voting Convertible Shares were issued.

### *Share Capital*

| *($000s)* | **December 31, 2013** | December 31, 2012 |
|---|---|---|
| Common Shares | **551,403** | 551,192 |
| Non-Voting Convertible Shares | **106,263** | 106,263 |
| | **657,666** | 657,455 |

### *Common Shares*

| | **December 31, 2013** | | December 31, 2012 | |
|---|---|---|---|---|
| *(000s)* | **Number of shares** | **Amount $** | Number of shares | Amount $ |
| Balance, beginning of year | **110,107** | **551,192** | 67,355 | 378,774 |
| Issued on exercise of stock options | **36** | **162** | 81 | 277 |
| Transfer from contributed surplus on exercise of stock options | **-** | **49** | - | 321 |
| Issued for shares of Guide *(note 5)* | **-** | **-** | 42,570 | 171,130 |
| Issued on conversion of Non-Voting Convertible Shares | **-** | **-** | 101 | 690 |
| Balance, end of year | **110,143** | **551,403** | 110,107 | 551,192 |

# Notes to the Financial Statements
## For the year ended December 31, 2013

### Non-Voting Convertible Shares

| (000s) | December 31, 2013 Number of shares | December 31, 2013 Amount $ | December 31, 2012 Number of shares | December 31, 2012 Amount $ |
|---|---|---|---|---|
| Balance, beginning of year | **15,513** | **106,263** | 15,614 | 106,953 |
| Cancelled on conversion to Common Shares | **-** | **-** | (101) | (690) |
| Balance, end of year | **15,513** | **106,263** | 15,513 | 106,263 |

The Company can require the holders of the Non-Voting Convertible Shares to convert to Common Shares after June 30, 2014.

### Warrants

| # of Warrants (000s) | December 31, 2013 | December 31, 2012 |
|---|---|---|
| Balance, beginning of year | **2,300** | - |
| Issued upon Guide Arrangement | **-** | 2,300 |
| Balance, end of year | **2,300** | 2,300 |

Each warrant entitles the holder to acquire 0.4167 Common Shares of the Company at an exercise price of $3.10 per 0.4167 of a share until September 15, 2014. The exchange ratio and exercise price are subject to adjustment upon the payment of dividends by the Company. The warrants are not exercisable until the twenty-day volume weighted average trading price of the Common Shares exceeds $12.00 per share.

### Contributed Surplus

| ($000s) | December 31, 2013 | December 31, 2012 |
|---|---|---|
| Balance, beginning of year | **16,558** | 10,446 |
| Share-based compensation cost | **6,868** | 6,433 |
| Transfer to share capital on exercise of options | **(49)** | (321) |
| Balance, end of year | **23,377** | 16,558 |

### Share Option Plan

The Company has a share option plan which provides for the grant of options to purchase Common Shares of the Company. The exercise price of each option may not be less than the closing price of the Company's Common Shares on the trading day immediately preceding the date of grant. Compensation expense is recognized as the options vest. Unless otherwise determined by the board of directors, vesting occurs one third on each of the next three anniversaries of the date of the grant. The options expire five years from the date of grant. The maximum number of Common Shares issuable on exercise of options outstanding is limited to 10% of the issued and outstanding Common Shares.

# Notes to the Financial Statements
## For the year ended December 31, 2013

| | **December 31, 2013** | | December 31, 2012 | |
|---|---|---|---|---|
| | **Number of Options *(000s)*** | **Weighted Average Exercise Price ($)** | Number of Options *(000s)* | Weighted Average Exercise Price ($) |
| Outstanding, beginning of year | **8,042** | **4.49** | 4,849 | 6.70 |
| Forfeited | **(679)** | **4.45** | (86) | 7.67 |
| Exercised | **(36)** | **4.49** | (178) | 3.75 |
| Cancelled | **-** | **-** | (4,585) | 6.79 |
| Granted | **2,939** | **4.51** | 8,042 | 4.49 |
| Outstanding, end of year | **10,266** | **4.50** | 8,042 | 4.49 |

For the 10.3 million options outstanding at December 31, 2013, the option exercise prices range from $4.03 to $5.30 per option. The weighted average exercise price is $4.50 per option and the weighted average remaining life of the options is 4.0 years. There are 2.5 million options exercisable at December 31, 2013 with an exercise price of $4.49.

The fair value of options granted under the Company's share option plan is determined using a Black-Scholes Option Pricing Model. The following assumptions were made during the year ended December 31, 2013: risk-free interest rate of 1.0 - 1.7%; dividend yield of 0 - 8.0%; volatility factor of the market price of the Company's Common Shares of 35 - 44%; and expected option lives of two to four years. Options granted during the year ended December 31, 2013 had an average fair value of $1.27 per option.

All of the unexercised options outstanding on October 23, 2012 were cancelled in conjunction with the Guide Arrangement.

### *Earnings Per Share*

| | **Year ended December 31** | |
|---|---|---|
| | **2013** | 2012 |
| Net earnings (loss) *($000s)* | **24,265** | (42,652) |
| Weighted average number of shares *(000s)* | | |
| Shares outstanding, beginning of year | **125,620** | 82,969 |
| Shares options exercised | **2** | 15 |
| Issue of shares under Guide Arrangement | **-** | 8,142 |
| Weighted average shares outstanding - basic | **125,622** | 91,126 |
| Weighted average shares outstanding - diluted | **125,778** | 91,126 |
| Basic and diluted earnings (loss) per share | **0.19** | (0.47) |

The diluted weighted average number of shares is calculated by assuming the proceeds that arise from the exercise of outstanding and in the money options are used to purchase common shares of the Company at their average market price during the period. For the year ended December 31, 2013, 156,000 options (2012 – Nil options) have been included in the calculation of the diluted earnings per share.

# Notes to the Financial Statements
## For the year ended December 31, 2013

## 11. CAPITAL RISK MANAGEMENT

The Company's primary capital management objective is to maintain a strong statement of financial position, affording the Company financial flexibility to achieve goals of continued growth and access to capital. The basis for the Company's capital structure is dependent on the Company's expected business growth and changes in the business environment. To manage the capital structure, the Company may adjust capital spending, issue new shares, issue new debt or repay existing debt.

In managing its capital structure, the Company monitors financial metrics as indicators of overall financial strength. The financial metrics the Company currently monitors include net debt to funds flow from operations and debt to debt plus equity.

The Company's objective is to maintain net debt to funds flow from operations at or below a ratio of 1.5. While the Company may exceed this rate from time to time, efforts are made after a period of variation to bring the measure back in line.

The Company's strategy concerning capitalization is to utilize more equity than debt. This is measured by targeting debt to debt plus equity at a ratio at or below 0.4. As at December 31, 2013, the Company redefined equity to include contributed surplus.

### *Net Debt to Funds Flow from Operations*

| *($000s, except ratios)* | **December 31, 2013** | December 31, 2012 |
|---|---|---|
| Net Debt | | |
| Bank loan | **423,553** | 261,173 |
| Accounts payable and accrued liabilities | **89,606** | 91,821 |
| Cash | **-** | (3,803) |
| Accounts receivable | **(53,433)** | (48,912) |
| Deposits and prepaid expenses | **(7,571)** | (7,156) |
| Net Debt | **452,155** | 293,123 |
| Funds Flow from Operations - Quarter Ended | | |
| Petroleum and natural gas revenue | **124,816** | 99,000 |
| Royalties | **(18,213)** | (12,521) |
| Gain (loss) on financial derivatives - realized | **(1,145)** | 7,320 |
| Operating expenses | **(33,198)** | (23,195) |
| Transportation expenses | **(4,971)** | (4,474) |
| General and administration, excluding non-cash expenses | **(7,017)** | (23,351) |
| Interest | **(4,300)** | (3,864) |
| Exploration expenses | **(32)** | (230) |
| Capital and other taxes | **(6)** | (278) |
| Funds Flow from Operations - Quarter Ended | **55,934** | 38,407 |
| Funds Flow from Operations - Annualized *(Quarterly x 4)* | **223,736** | 153,628 |
| Net Debt to Funds Flow from Operations *(target <= 1.5)* | **2.0** | 1.9 |

# Notes to the Financial Statements
## For the year ended December 31, 2013

### *Debt to Debt plus Equity*

| *($000s, except ratios)* | **December 31, 2013** | December 31, 2012 |
|---|---|---|
| Debt | | |
| Bank loan | **423,553** | 261,173 |
| Debt plus Equity | | |
| Bank loan | **423,553** | 261,173 |
| Shareholders' equity | **616,977** | 585,682 |
| Debt plus Equity | **1,040,530** | 846,855 |
| Debt to Debt plus Equity *(target <= 0.4)* | **0.41** | 0.31 |

## 12. GENERAL AND ADMINISTRATION EXPENSES

| | **Year ended December 31** | |
|---|---|---|
| *($000s)* | **2013** | 2012 |
| Salary and employee | **27,067** | 26,085 |
| Other | **14,354** | 17,981 |
| Gross expenses | **41,421** | 44,066 |
| Capitalized costs | **(13,691)** | (6,704) |
| Operating recoveries | **(2,381)** | (628) |
| General and administration | **25,349** | 36,734 |

During 2012, salary and employee costs of $12.1 million and other general and administration expenses of $8.1 million were incurred relating to the Guide Arrangement.

Long Run has determined that the key management personnel of the Company consist of its vice-presidents and directors. Key management personnel compensation is comprised of the following:

| | **Year ended December 31** | |
|---|---|---|
| *($000s)* | **2013** | 2012 |
| Salaries and short-term benefits | **4,129** | 5,384 |
| Directors fees | **655** | 555 |
| Termination benefits | **768** | 3,843 |
| Included in general and administrative expenses | **5,552** | 9,782 |
| Share-based compensation | **2,207** | 3,215 |
| | **7,759** | 12,997 |

# Notes to the Financial Statements
## For the year ended December 31, 2013

## 13. INCOME TAXES

The provision for income tax differs from the amount that would have been expected if the reported earnings had been subject only to the statutory Canadian income tax rate of 25.0% (2012 – 25.1%). There have been no significant changes to the relevant Canadian federal or provincial tax rates during the year.

| | Year ended December 31 | |
|---|---|---|
| *($000s)* | **2013** | 2012 |
| Earnings (loss) before income tax | **35,438** | (52,017) |
| Corporate tax rate | **25.0%** | 25.1% |
| Expected tax expense (recovery) | **8,859** | (13,077) |
| Increase (decrease) in taxes resulting from: | | |
| Share-based compensation | **1,295** | 1,430 |
| Statutory tax rate changes | **700** | - |
| Impairment of goodwill | **-** | 499 |
| Non-deductible items | **225** | 1,023 |
| Deductible capital taxes | **(24)** | (184) |
| Other | **30** | 277 |
| Deferred income tax expense (recovery) | **11,085** | (10,032) |

The components of the deferred income tax asset are as follows:

| *($000s)* | **December 31, 2013** | December 31, 2012 |
|---|---|---|
| Property and equipment | **57,531** | 71,929 |
| Decommissioning liabilities | **43,907** | 45,767 |
| Non-capital losses | **24,334** | 21,192 |
| Alberta royalty tax deduction | **1,190** | 1,190 |
| Investment tax credits | **13,649** | 13,649 |
| Share issue costs | **1,153** | 2,048 |
| Financial derivatives | **4,443** | 1,517 |
| Deferred income tax asset | **146,207** | 157,292 |

Movements in the deferred tax asset during the year were as follows:

| | Year ended December 31 | |
|---|---|---|
| *($000s)* | **2013** | 2012 |
| Balance, beginning of year | **157,292** | 40,582 |
| Current year provision | **(11,085)** | 10,032 |
| Guide Arrangement | **-** | 107,110 |
| Flow-through share spending | **-** | (432) |
| Balance, end of year | **146,207** | 157,292 |

Deferred tax assets are recognized to the extent that it is probable that taxable profit will be available against which the deductible temporary differences and the carry-forward of unused tax losses can be utilized. The amount and timing of reversals of temporary differences will be dependent upon a number of factors, including the Company's future operating results.

At December 31, 2013 the Company has non-capital loss carry forward balances of approximately $97.0 million (December 31, 2012 – $84.0 million), of which $0.1 million expire in 2015, with the remainder beginning to expire in 2026.

Investment tax credit balances expire as follows: December 31, 2019 – $1.3 million, December 31, 2020 – $3.0 million, December 31, 2021 – $3.8 million, December 31, 2022 – $3.1 million, December 31, 2023 – $3.5 million, and December 31, 2024 – $3.5 million.

## 14. RELATED PARTY TRANSACTIONS

A director of the Company and the corporate secretary are partners of the Company's legal counsel, Burnet, Duckworth & Palmer LLP ("BDP"). For the year December 31, 2013, general and administrative expenses included amounts of $0.5 million (2012 – $1.9 million) charged to the Company by BDP. As at December 31, 2013, included in accounts payable is $0.2 million (2012 – $0.1 million).

## 15. FINANCIAL INSTRUMENTS AND FINANCIAL RISK MANAGEMENT

### *Fair Value of Financial Assets and Liabilities*

Fair value is defined as the price that would be received upon selling an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

The Company's financial instruments recognized in the statement of financial position consist of accounts receivable, accounts payable, bank loan and financial derivatives. The carrying values of accounts receivable and accounts payable approximate their fair values due to their short-term nature. The carrying value of the bank loan approximates fair value due to the floating interest rate on the facilities. The fair value of the financial derivatives is recognized on the statement of financial position as described below.

### *Financial Derivative Contracts*

The Company enters into financial derivative contracts for the purpose of protecting cash flows generated from operations from the volatility of commodity prices and changes in interest rates.

The Company has the following commodity financial contracts in place as at December 31, 2013:

| Natural Gas | Volume | Pricing |
|---|---|---|
| *Costless Collars* | | |
| January 1, 2014 – December 31, 2014 | 19,000 GJ/d | CDN $3.50 - $4.02/GJ |
| January 1, 2014 – March 31, 2015 | 13,000 GJ/d | CDN $3.50 - $3.75/GJ |

| Crude Oil | Volume | Pricing |
|---|---|---|
| *Costless Collars* | | |
| January 1, 2014 – June 30, 2014 | 1,000 Bbl/d | WTI US $95.00 - $98.00/Bbl |
| January 1, 2014 – December 31, 2014 | 2,000 Bbl/d | WTI US $88.00 - $92.50/Bbl |
| January 1, 2014 – December 31, 2014 | 2,000 Bbl/d | WTI US $88.00 - $92.60/Bbl |
| January 1, 2014 – December 31, 2014 | 1,650 Bbl/d | WTI US $95.00 - $98.80/Bbl |
| *Fixed Price* | | |
| January 1, 2014 – August 31, 2014 | 980 Bbl/d | WTI US $85.00/Bbl |
| *Calls* | | |
| January 1, 2014 – December 31, 2014 | 500 Bbl/d | WTI US $85.00/Bbl |
| January 1, 2014 – December 31, 2014 | 500 Bbl/d | WTI US $100.00/Bbl |
| January 1, 2015 – December 31, 2015 | 500 Bbl/d | WTI US $85.00/Bbl |
| *Call Swaptions* | | |
| September 1, 2014 – April 30, 2015 | 1,000 Bbl/d | WTI US $85.00/Bbl |
| September 1, 2014 – April 30, 2015 | 1,000 Bbl/d | WTI US $90.00/Bbl |

| Electricity | Volume | Pricing |
|---|---|---|
| January 1, 2014 – December 31, 2014 | 1.5 MW/h | CDN $67.75 MW/h |
| January 1, 2014 – December 31, 2014 | 1.5 MW/h | CDN $54.35 MW/h |
| January 1, 2015 – December 31, 2016 | 3.0 MW/h | CDN $49.50 MW/h |

**Interest Rate Swap**

Notional Amount CAD $75 million        Term: January 1, 2014 – January 5, 2014
Fixed rate 1.190% - Floating rate is reset against CAD-BA-CDOR monthly

### *Financial Derivative Contracts Financial Statement Recognition*

The Company recognizes the fair value of its financial derivative contracts on the statement of financial position each reporting period, with the change in fair value recognized as an unrealized gain or loss on the statement of earnings.

## Notes to the Financial Statements
### For the year ended December 31, 2013

The Company determines fair value using a hierarchy that prioritizes inputs depending upon the degree to which they are observable. The three levels of the fair value hierarchy are as follows:

- Level 1 - inputs represent quoted prices in active markets for identical assets or liabilities. Active markets are those in which transactions occur in sufficient frequency and volume to provide pricing information on an ongoing basis.
- Level 2 - inputs other than quoted prices used in Level 1 that are observable, either directly or indirectly as of the reporting date. Level 2 valuations are based on inputs which can be observed or corroborated in the market place from sources such as the New York Mercantile Exchange and the Natural Gas Exchange.
- Level 3 - inputs that are less observable, unavailable or where the observable data does not support the majority of the instrument's fair value.

The fair values of the Company's financial derivatives were determined using an income valuation approach based upon Level 3 inputs. The valuations, which were provided by the counterparties with whom the transactions were completed, were reviewed by the Company for reasonableness, giving consideration to factors such as the commodity forward price strips and historical volatilities. There have been no transfers between the hierarchy levels during the year.

| *($000s)* | **December 31, 2013** | December 31, 2012 |
|---|---|---|
| Assets - Fair value of financial derivatives | | |
| Current | **1,024** | 15,318 |
| Long-term | **-** | 142 |
| | **1,024** | 15,460 |
| Liabilities - Fair value of financial derivatives | | |
| Current | **14,919** | 9,341 |
| Long-term | **3,876** | 12,155 |
| | **18,795** | 21,496 |
| Net Liability | **(17,771)** | (6,036) |

Of the total December 31, 2013 financial liability, $14.9 million relates to 2014 and $3.9 million relates to 2015.

| *($000s)* | **Crude Oil** | **Natural Gas** | **Other** | **Total** |
|---|---|---|---|---|
| Year ended December 31, 2013 | | | | |
| Realized (gain) loss on financial derivatives | 11,739 | (8,525) | (525) | 2,689 |
| New contracts | (4,428) | 1,578 | - | (2,850) |
| Cancelled contracts | 5,357 | (22) | - | 5,335 |
| Change in value | (15,861) | (1,715) | 667 | (16,909) |
| Unrealized gain (loss) on financial derivatives | (3,193) | (8,684) | 142 | (11,735) |
| December 31, 2012 - Net Asset (Liability) | (13,910) | 8,234 | (360) | (6,036) |
| December 31, 2013 - Net Liability | **(17,103)** | **(450)** | **(218)** | **(17,771)** |

### *Market risk*

Market risk includes uncertainty arising from possible movements in commodity prices and interest rates, and the impact of such movements on the future performance of the business. Commodity price and interest rate movements could adversely affect the value of the Company's financial assets, liabilities and expected future cash flows. To partially mitigate exposure to commodity price risk and interest rate risk, the Company enters into various financial derivative instruments. The currently outstanding instruments are described above.

When assessing the potential impact of price changes on financial derivative contracts outstanding at December 31, 2013, it is estimated that a $1.00/Bbl change in the price of oil would change the unrealized gains or losses by approximately $3.1 million (December 31, 2012 – $2.4 million), while a $0.10/GJ change in the price of natural gas would change the unrealized gains or losses by approximately $0.9 million (December 31, 2012 – $1.5 million).

### *Credit risk*

Credit risk is the risk that a customer or counterparty will fail to perform an obligation or fail to pay amounts due, causing a financial loss. The Company's accounts receivable are with customers and partners in the oil and natural gas industry and are subject to normal credit risks. A portion of the Company's production is currently sold through partners under normal industry sale and payment terms.

During the year ended December 31, 2013, five third party purchasers each marketed more than 10% of the Company's petroleum and natural gas revenue. At December 31, 2013, approximately 32% of the accounts receivable balance is due from three customers (December 31, 2012 – 39%).

| Accounts Receivable *($000s)* | **December 31, 2013** | December 31, 2012 |
|---|---|---|
| Less than 90 days | **49,528** | 45,248 |
| Greater than 90 days | **3,905** | 3,664 |
| Total | **53,433** | 48,912 |

Counterparties to the Company's financial derivative contracts are major Canadian financial institutions, having investment grade credit ratings.

### *Liquidity risk*

Liquidity risk arises through excess financial obligations due over available financial assets at any point in time. The Company's objective in managing liquidity risk is to maintain sufficient capital in order to meet its liquidity requirements at any point in time. The Company believes that it has access to sufficient capital through internally generated cash flows, external equity sources, and to undrawn committed credit facilities to meet current spending forecasts. At December 31, 2013, $423.6 million was drawn against the Company's credit facilities, with $51.4 million of borrowing capacity available.

# Notes to the Financial Statements
## For the year ended December 31, 2013

### *Interest rate risk*

The Company is exposed to interest rate risk as changes in interest rates may affect future cash flows and the fair value of its financial instruments. The Company's primary debt facility has a floating interest rate that will fluctuate based on prevailing market conditions. Cash flows are sensitive to changes in interest rates on this instrument. Depending upon the amount of debt employed, the Company's strategy may include managing interest rate risk through the use of interest rate swaps. Based upon the interest rate swap outstanding as at December 31, 2013, a one percent change in the interest rate would be expected to impact the unrealized gain or loss on financial derivatives by approximately $Nil (December 31, 2012 – $0.8 million).

## 16. SUPPLEMENTAL CASH FLOW INFORMATION

### *Net Change in Non-Cash Working Capital*

| | Year ended December 31 | |
|---|---|---|
| *($000s)* | **2013** | 2012 |
| Source (use) of cash: | | |
| Accounts receivable | **(4,521)** | 13,095 |
| Deposits and prepaid expenses | **(415)** | (1,730) |
| Accounts payable and accrued liabilities | **(2,215)** | (7,307) |
| | **(7,151)** | 4,058 |
| Related to operating activities | **8,117** | 8,121 |
| Related to investing activities | **(15,268)** | (4,063) |
| | **(7,151)** | 4,058 |

## 17. COMMITMENTS AND CONTINGENCIES

### *Commitments*

| *($000s)* | **2014** | **2015** | **2016** | **2017** | **2018** | **Thereafter** | **Total** |
|---|---|---|---|---|---|---|---|
| Operating leases | 2,771 | 2,742 | 2,679 | 4,415 | 6,156 | 53,946 | 72,709 |
| Firm transportation agreements | 2,970 | 1,782 | 958 | 422 | 238 | 228 | 6,598 |
| Capital commitments | 10,332 | - | - | - | - | - | 10,332 |
| Total | 16,073 | 4,524 | 3,637 | 4,837 | 6,394 | 54,174 | 89,639 |

At December 31, 2013, the Company is committed under operating leases for office space, contracts related to the transportation of natural gas, and capital commitments for drilling rig services.

### *Litigation*

The Company is involved in various claims and legal actions arising in the normal course of business. The Company does not expect that the outcome of these proceedings will have a material adverse effect on the Company as a whole.

# Notes to the Financial Statements
## For the year ended December 31, 2013

## 18. SUBSEQUENT EVENTS

*Dividend policy*

On January 15, 2014, the Board of Directors declared the Company's first monthly dividend of $0.0335 per Common Share and per Non-Voting Convertible Share, which was paid on February 14, 2014. On February 13, 2014, the Board of Directors declared a monthly dividend of $0.0335 per Common Share and per Non-Voting Convertible Share, which will be paid on March 14, 2014. The dividend rate will be reviewed monthly and is conditional upon declaration by the Board of Directors. For the period January 1, 2014 to March 5, 2014, $8.4 million in dividends have been declared.

*Financial derivative contracts*

Subsequent to December 31, 2013, the Company entered into the following financial derivative contracts:

| **Natural Gas** | Volume | Pricing |
|---|---|---|
| *Costless Collar* | | |
| February 1, 2014 – December 31, 2014 | 10,000 GJ/d | CDN $3.50 - $3.90/GJ |
| January 1, 2015 – December 31, 2015 | 10,000 GJ/d | CDN $3.50 - $4.00/GJ |
| January 1, 2015 – December 31, 2015 | 10,000 GJ/d | CDN $3.50 - $4.00/GJ |
| January 1, 2015 – December 31, 2015 | 11,000 GJ/d | CDN $3.50 - $4.35/GJ |

*Convertible debenture*

On January 28, 2014, the Corporation issued $75.0 million principal amount of convertible unsecured subordinated debentures at par. The debentures bear an annual interest rate of 6.40%, payable semi-annually in arrears. Prior to maturity on January 29, 2019, the debentures are convertible into Common Shares at a conversion price of $7.40 per Common Share, subject to adjustment in certain events.