# Management's Discussion and Analysis
## Three months ended March 31, 2016

Strategic Oil & Gas Ltd. ("Strategic" or the "Company") is a publicly-traded oil and gas exploration and production company, with operations focused on light oil development in northern Alberta. The following is management's discussion and analysis ("MD&A") of Strategic's consolidated operating and financial results for the three months ended March 31, 2016, as well as information concerning the Company's future outlook based on currently available information. The MD&A was approved and authorized for issue by Strategic's board of directors on May 16, 2016. This MD&A should be read in conjunction with the Company's interim condensed consolidated financial statements for the three months ended March 31, 2016 and 2015, together with the accompanying notes, which have been prepared in accordance with International Financial Reporting Standards ("IFRS").

## FINANCIAL AND OPERATIONAL SUMMARY

| | Three months ended March 31 | | |
|---|---|---|---|
| **Financial ($thousands, except per share amounts)** | **2016** | 2015 | % change |
| Oil and natural gas sales | **4,705** | 10,422 | (55) |
| Funds from (used in) operations [1] | **(2,180)** | 1,439 | - |
| Per share basic & diluted [1] | **(0.00)** | 0.00 | - |
| Cash used in operating activities | **(1,474)** | (3,598) | (59) |
| Per share basic & diluted | **(0.00)** | (0.01) | - |
| Net loss | **(7,259)** | (8,610) | (16) |
| Per share basic & diluted | **(0.01)** | (0.02) | (50) |
| Capital expenditures (excluding acquisitions) | **8,296** | 7,526 | 12 |
| Bank debt (comparative figure is as of December 31, 2015) | **-** | 42,857 | (100) |
| Net working capital (debt) (comparative figure is as of December 31, 2015) [1] | **26,484** | (54,024) | - |
| **Operating** | | | |
| Average daily production | | | |
| Crude oil (bbl per day) | **1,546** | 2,394 | (35) |
| Natural gas (mcf per day) | **2,534** | 5,237 | (52) |
| Barrels of oil equivalent (boe per day) | **1,968** | 3,267 | (40) |
| Average prices | | | |
| Oil & NGL, before risk management ($ per bbl) | **30.22** | 41.98 | (28) |
| Oil & NGL, including risk management ($ per bbl) | **30.22** | 51.34 | (41) |
| Natural gas ($ per mcf) | **1.96** | 2.93 | (33) |
| Netback ($ per boe) [1] | | | |
| Oil and natural gas sales | **26.26** | 35.45 | (26) |
| Royalties | **(3.42)** | (5.08) | (33) |
| Operating expenses | **(22.44)** | (21.38) | 5 |
| Transportation expenses | **(0.72)** | (1.39) | (48) |
| Operating Netback | **(0.32)** | 7.60 | - |
| **Common Shares (thousands)** | | | |
| Common shares outstanding, end of period | **542,319** | 542,319 | - |
| Weighted average common shares (basic & diluted) | **542,319** | 542,319 | - |

(1) Funds from operations, net debt and operating netback are Non-GAAP measures; see "Non-GAAP measures" in this MD&A.

**About Strategic**

Strategic is a junior oil and gas company committed to becoming a premier northern oil and gas operator by exploiting its light oil assets primarily in northern Alberta. The Company relies on its extensive subsurface and reservoir experience to develop its asset base and grow production and cash flows while managing risk. The Company maintains control over its resource base through high working interest ownership in wells, construction and operation of its own processing facilities and a significant undeveloped land and opportunity base. Strategic's primary operating area is at Marlowe, Alberta. The Company also operates oil and gas production and processing facilities at Bistcho, Alberta and Cameron Hills in the Northwest Territories, as well as minor non-core oil properties in southern Alberta and Wyoming, USA.

**QUARTERLY SUMMARY**

- Strategic continued to implement operational efficiencies and reduce costs in the first three months of 2016, in response to low commodity prices. Operating costs dropped $2.3 million or 36% compared to the first quarter of 2015, while general and administrative ("G&A") costs were reduced by $0.8 million and transportation costs by $0.3 million.

- The Company closed an offering of convertible debentures (the "Debentures") on February 29, 2016 for net proceeds of $92.6 million after transaction costs. The Debentures have a 5-year term, bear interest at 8% payable semi-annually (subject to, at the Company's option, being paid-in-kind in equivalent principal amount of Debentures for the first two years) and are convertible into common shares of Strategic at a price of $0.09 per share. Proceeds from the offering were used to repay existing credit facilities, the bridge loan from the Company's major shareholder and fund the winter capital program. Strategic had $26.5 million in working capital at March 31, 2016 which will fund ongoing operating and capital activities in the near term and provide collateral for $4.6 million in letters of credit outstanding.

- Strategic executed an asset swap in the Bistcho area, assuming a 100% working interest in the Bistcho gas processing facility and 14 wells capable of production, and assigning 68 wellbores to its joint venture partner. As a result of this swap the Company will avoid significant near-term decommissioning liabilities at Bistcho and increase its corporate liability management ratio to over 2.0.

- Average daily production decreased 40% to 1,968 boe/d from 3,267 boe/d for the first quarter of 2015, due to the shut-in of the Bistcho/Cameron Hills property in February 2015 due to low commodity prices and a lack of drilling activity to offset natural production declines at Marlowe. Several planned workover and recompletion operations were deferred in the first quarter to preserve capital.

- Despite the cost reductions achieved, operating netbacks decreased to $(0.32)/boe from $7.60/boe for the three months ended March 31, 2015, primarily as a result of declines in realized oil and natural gas prices of 28% and 33% respectively. Funds used in operations were $2.2 million for the three months ended March 31, 2016, compared to funds from operations of $1.4 million for the first quarter of 2015. The lower prices combined with reduced production levels led to the negative funds flow in the current quarter.

- Capital expenditures of $8.3 million for the quarter were focused on a four well drilling program designed to preserve undeveloped lands, increase reserves and further delineate the Muskeg play at Marlowe. The drilling results yielded a 1,060 boe/d production test at a horizontal well and a core taken from a vertical well which identified 12.6 metres of net oil pay in the Muskeg zone. These positive results have extended the commercial limits and confirmed the significant productivity of the Muskeg play.

- Also included in capital expenditures is the acquisition of 8 sections of undeveloped land in south Marlowe along the Muskeg trend from a third party for nominal consideration. Drilling activity in the first quarter has held these lands for a five year period.

**PERFORMANCE OVERVIEW, STRATEGY AND OUTLOOK**

Strategic was active in the first quarter of 2016, drilling 4 Muskeg wells which significantly enhanced the Company's understanding of the Marlowe asset base. The Company also closed a major financing transaction, eliminating its bank debt and providing financial stability, as well as initial funding for development.

Commodity prices were extremely low in the current period, with WTI oil prices averaging US$33.45/bbl. Strategic responded to this challenging environment by reducing operating, transportation and G&A costs by $3.4 million or 38% compared to the first quarter of 2015. Runtime on the Muskeg wells has steadily increased, enabling the Company to minimize decline rates without significant workover expenditures.

The Company now believes it has delineated a significant portion of the 100% owned Muskeg resource at Marlowe and is committed to creating long-term value for shareholders through a disciplined spending approach on scalable drilling programs on its asset base. Strategic has successfully reduced drilling days and completion costs per well while increasing well performance and run time. The Company is in the planning stages for the next phase of development at Marlowe, which will be a capital spending program of approximately $15-20 million to drill, complete and tie-in up to 4 Muskeg horizontal wells in the second half of 2016.

**ADVISORIES**

**Basis of presentation**

This discussion and analysis of Strategic's oil and natural gas production and related performance measures is presented on a working-interest, before royalty basis. For the purpose of calculating unit information, the Company's production and reserves are reported in barrels of oil equivalent ("boe"). Boe may be misleading, particularly if used in isolation. A boe conversion ratio for natural gas of 6 Mcf: 1 boe has been used, which is based on an energy equivalency conversion method primarily applicable at the burner tip and does not necessarily represent a value equivalency at the wellhead. As the value ratio between natural gas and crude oil based on the current prices of natural gas and crude oil is significantly different from the energy equivalency of 6:1, utilizing a conversion on a 6:1 basis may be misleading as an indication of value.

Management makes estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the consolidated financial statements and revenues and expenses during the reporting period. Management reviews these estimates, including those related to accruals, environmental and decommissioning liabilities, income taxes, and the determination of proved and probable reserves on an ongoing basis. Changes in facts and circumstances may result in revised estimates and actual results may differ from these estimates.

**Non-GAAP measures**

The Company utilizes the following terms for measurement within the MD&A that do not have a standardized meaning or definition as prescribed by IFRS and therefore may not be comparable with the calculation of similar measures by other entities.

"Funds from operations" is a term used to evaluate operating performance and assess leverage. The Company considers funds from operations an important measure of its ability to generate funds necessary to finance operating activities, capital expenditures and debt repayments if any. Funds from operations are calculated based on cash flow from operating activities before changes in non-cash working capital and decommissioning expenditures. Funds from operations as presented is not intended to represent cash flow from operating activities, net earnings, or other measures of financial performance calculated in accordance with IFRS.

The following table reconciles funds from (used in) operations to cash used in operating activities:

| | Three months ended March 31 | |
|---|---|---|
| **($thousands)** | **2016** | 2015 |
| Cash used in operating activities | **(1,474)** | (3,598) |
| Expenditures on decommissioning liabilities | **488** | 4,177 |
| Changes in non-cash working capital | **(1,194)** | 860 |
| Funds (used in) from operations | **(2,180)** | 1,439 |

"Operating Netback" is used to evaluate operating performance of crude oil and natural gas assets. The term netback is calculated as oil and gas sales revenue excluding realized and unrealized gains and losses on risk management contracts, less royalties, and production costs. There is no IFRS measurement that would be directly comparable to operating netbacks.

"Net debt" is used to assess capital requirements and leverage, as well as evaluate funds available for capital spending programs and operations. Net debt is calculated as convertible debentures less working capital, or plus the working capital deficiency.

## RESULTS OF OPERATIONS

### Production

| | Three months ended March 31 | |
|---|---|---|
| **Average daily production volumes** | **2016** | 2015 |
| Oil & NGL (bbl/d) | **1,546** | 2,394 |
| Natural gas (mcf/d) | **2,534** | 5,237 |
| Total (boe/d) | **1,968** | 3,267 |

Average daily oil & NGL production for the three months ended March 31, 2016 decreased by 35% from the comparative period in 2015, due to a lack of production drilling over the past year, minor facility downtime and reduced workover activity in 2016. As a result of low commodity prices in the current period, planned workover and recompletion activities were deferred in order to preserve capital.

Natural gas production volumes for the three months ended March 31, 2016 decreased 52% from the comparative period in 2015 due to the shut-in of the Bistcho/Cameron Hills property in February 2015, as well as some facility downtime and a lack of drilling activity at Marlowe.

**Revenue**

| ($thousands, except where noted) | Three months ended March 31 2016 | 2015 |
|---|---|---|
| Sales | | |
| Oil & NGL | **4,253** | 9,043 |
| Natural gas | **452** | 1,379 |
| Oil and natural gas sales | **4,705** | 10,422 |
| Unrealized gain (loss) on risk management contracts | - | (1,643) |
| Realized gain (loss) on risk management contracts | - | 2,017 |
| | **4,705** | 10,796 |
| Average prices (1) | | |
| Oil & NGL, before realized gain (loss) on risk management contracts ($/bbl) | **30.22** | 41.98 |
| Oil & NGL, including realized gain (loss) on risk management contracts ($/bbl) | **30.22** | 51.34 |
| Natural gas ($/mcf) | **1.96** | 2.93 |
| Price per boe before realized gain (loss) on risk management contracts ($/boe) | **26.26** | 35.45 |
| Reference prices | | |
| Oil – WTI ($US/bbl) | **33.45** | 48.63 |
| Edmonton par ($/bbl) | **40.80** | 51.94 |
| Natural gas – AECO Daily Index ($/MMBtu) | **1.83** | 2.74 |

(1) Average prices do not include unrealized losses on risk management contracts.

Average oil prices received are a function of the benchmark West Texas Intermediate ("WTI") oil price, less foreign exchange, transportation and quality differentials to arrive at Canadian dollar price received at delivery points in northern Alberta. WTI oil prices continued to decline in the first quarter of 2016 due to persistently high production levels in oil-exporting countries and global growth concerns. Strategic's average oil price for the first quarter of 2016 decreased by 28% from the corresponding period in 2015 due to a 31% decrease in WTI oil prices. Substantially all of the Company's natural gas is sold at the AECO Daily Index price, adjusted for fuel charges. Strategic's average natural gas prices for the first quarter of 2016 decreased by 33% from the corresponding period in 2015 due to lower AECO Daily index prices.

The Company's oil and natural gas revenues decreased to $4.7 million for the three months ended March 31, 2016 from $10.4 million for the respective comparative period in 2015. The decrease was due to a substantial decline in commodity prices and lower production levels stemming from a lack of drilling and recompletion activities in 2016.

**Risk management contracts**

The Company's net income and funds from operations are exposed to fluctuations in commodity prices, interest rates and foreign exchange rates. As part of its risk management program, Strategic may enter into financial commodity price management contracts for a portion of expected production levels, depending on current commodity prices, price volatility and the size and nature of the Company's capital spending programs. As at December 31, 2015 and March 31, 2016, Strategic had no commodity price risk management contracts in place. As a result, realized and unrealized gains on risk management contracts were $nil for the current period, compared to a realized gain of $2.0 million and an unrealized loss of $1.6 million for the first quarter of 2015.

**Royalties**

| ($thousands, except where noted) | Three months ended March 31 2016 | 2015 |
|---|---|---|
| Crown royalties | **562** | 1,401 |
| Freehold and overriding royalties | **51** | 94 |
| Total royalties | **613** | 1,495 |
| Per boe | **3.42** | 5.08 |
| Percentage of oil and natural gas sales | **13.0%** | 14.3% |

Royalty expense consists of royalties paid to provincial governments (including the effect of the Crown royalty initiative program), freehold land owners and overriding royalty owners. Royalty expense also includes the impact of gas cost allowance, which is the reduction of natural gas royalties payable to the Government of Alberta to recognize capital and operating expenditures incurred in the gathering and processing of its royalty share of production. Crown royalties on oil production are paid in product, which is taken in kind and marketed separately by the provincial government. Royalty rates in western Canada vary based on volume produced by individual wells, market oil prices and the area the production is derived from. Revenues from newly drilled wells benefit from a crown royalty reduction to five percent for the first year of production, up to a maximum of 500,000 Mcf of natural gas or 50,000 bbls of crude oil for a well up to 2,500 metres of total depth. The time frame and maximum production amounts are increased by six months and 100,000 Mcf or 10,000 bbls for each additional 500 metres of total depth. Strategic's wells are typically from 2,500 to 3,500 metres in total depth.

Royalties decreased to $0.6 million for the three months ended March 31, 2016 from $1.5 million for the comparative period in 2015 due to lower oil pricing used by the provincial government to calculate royalty rates. Royalties as a percentage of revenues decreased from 14.3% for the three months ended March 31, 2015 to 13.0% for the current quarter as a result of the reduction in oil prices from period to period, which affects the royalty rate on producing oil wells.

At current oil and gas prices, crown royalty rates on natural gas are 5-10%, compared to rates of 0-40% for Marlowe oil production, depending on well productivity and vintage. Strategic has analyzed the Modern Royalty Framework ("MRF") announced by the Alberta government in January 2016, which will replace the existing royalty regime beginning in 2017. The Company feels that the effect of the MRF on netbacks at Marlowe will be neutral to slightly positive, depending on commodity prices.

**Operating and transportation costs**

| | Three months ended March 31 | |
|---|---|---|
| **($thousands, except per boe amounts)** | **2016** | 2015 |
| Operating costs | **4,020** | 6,286 |
| Transportation costs | **129** | 408 |
| | **4,149** | 6,694 |
| Per boe | | |
| Operating | **22.44** | 21.38 |
| Transportation | **0.72** | 1.39 |
| | **23.16** | 22.77 |

Operating costs decreased to $4.0 million for the three months ended March 31, 2016 from $6.3 million for the first quarter of 2015 due to the shut-in of Bistcho/Cameron Hills in February 2015 and the Company's continued focus on cost reduction at Marlowe. Operating costs per boe increased by 5% to $22.44/boe for the current quarter from $21.38/boe for the comparative period in 2015 due to a 40% decrease in production levels partially offset by cost savings achieved. Operating costs at Marlowe are primarily fixed in nature, and will decrease as production volumes rise.

Unit transportation costs decreased from $1.39/boe for the three months ended March 31, 2015 to $0.72/boe for the first quarter of 2016, due to reduced natural gas production and a focus on transporting oil via the Company owned sales oil pipelines.

**Netbacks**

| ($/boe) | Three months ended March 31<br>**2016** | 2015 |
|---|---|---|
| Revenue | **26.26** | 35.45 |
| Royalties | **(3.42)** | (5.08) |
| Operating costs | **(22.44)** | (21.38) |
| Transportation costs | **(0.72)** | (1.39) |
| Operating netback | **(0.32)** | 7.60 |

Strategic's operating netback decreased to $(0.32)/boe for the three months ended March 31, 2016 from $7.60/boe for the comparative period in 2015, mostly due to the substantial drop in commodity prices, partially offset by lower royalty rates and reductions in unit transportation costs.

Strategic's focus area is Marlowe, which is 100% owned and operated by the Company. The Marlowe assets generated a netback of $4.27/boe in the first quarter of 2016 compared to $14.68/boe for the first three months of 2015 as a result of low oil and natural gas prices and reduced production levels, which increased unit operating costs. The corporate netback is negatively affected by high operating costs at the Company's minor oil properties and fixed costs at Bistcho/Cameron Hills, which was shut in earlier in 2015 due to low commodity prices. The breakdown of Strategic's operating netback for the three months ended March 31, 2016 is as follows:

| **Operating netback ($/boe)** | Marlowe | Other | Total |
|---|---|---|---|
| Revenue | 26.48 | 21.13 | **26.26** |
| Royalties | (3.54) | (0.59) | **(3.42)** |
| Operating costs | (17.96) | (128.87) | **(22.44)** |
| Transportation costs | (0.71) | (0.94) | **(0.72)** |
| Operating netback | 4.27 | (109.27) | **(0.32)** |

**General and administrative expense**

| ($thousands, except per boe amounts) | Three months ended March 31<br>**2016** | 2015 |
|---|---|---|
| Gross general and administrative expense | **1,715** | 2,784 |
| Overhead recoveries | **(90)** | (214) |
| Capitalized G&A | **(208)** | (338) |
| Net general and administrative expenses | **1,417** | 2,232 |
| Per boe | **7.91** | 7.59 |

General and administrative ("G&A") expense for the current quarter decreased to $1.4 million from $2.2 million for the first quarter of 2015 due to a lower staff count and reduced consulting fees, professional fees and office costs, partially offset by a reduction in overhead recoveries related to the shut-in of Bistcho/Cameron Hills in February 2015 and lower capitalized G&A. G&A in the prior period was affected by $0.5 million in severance costs. G&A expenses per boe increased by $0.32/boe due to costs being spread over lower production levels.

**Finance expense**

| ($thousands) | Three months ended March 31<br>**2016** | 2015 |
|---|---|---|
| Interest expense | **726** | 579 |
| Interest expense on convertible debentures | **632** | - |
| Accretion of decommissioning liabilities | **267** | 262 |
| Accretion on promissory notes | **19** | - |
| Accretion on debentures | **189** | - |
| Total | **1,833** | 841 |

Interest expense increased to $1.8 million in the first quarter of 2016 from $0.8 million for the comparative quarter in 2015 primarily due to interest paid on the short-term loan received from the Company's major shareholder and the issuance of convertible debentures on February 29, 2016. In addition to debenture interest incurred, an accretion expense is recorded to bring the debenture liability up to the face value of the debentures over the 5-year term. As at March 31, 2016, the bank debt and short-term loan were both repaid in full using proceeds from the debenture issue.

Accretion expense is a reflection of an increase in Strategic's discounted decommissioning liability due to the passage of time. Accretion of decommissioning liabilities was consistent for the first quarters of 2016 and 2015.

**Stock based compensation**

Stock based compensation is a non-cash charge which reflects the estimated value of stock options granted. The Company uses the fair value method of accounting for stock options granted to directors, officers, employees and consultants. The fair value of all stock options granted is recorded as a charge to net loss over the period from the grant date to the vesting date of the option. The fair value of common share options granted is estimated on the date of grant using the Black-Scholes options pricing model.

For the first quarter of 2016 stock based compensation expense increased by $0.1 million from the first three months of 2015 as 10.6 million stock options were issued during the current period. A third of the options granted vested when granted; therefore, the fair value of the vested options is expensed on grant date.

**Depletion, depreciation, amortization and exploration costs**

| | Three months ended March 31 | |
|---|---|---|
| **($thousands, except per boe amounts)** | **2016** | 2015 |
| Depreciation, depletion and amortization ("DD&A") | **3,485** | 7,993 |
| Per boe | **19.46** | 27.18 |

DD&A is computed individually for each producing area on a unit of production basis, using proved and probable reserves and including future development expenditures in the cost base subject to depletion. DD&A expense also includes amortization of undeveloped land costs. Major components, such as facilities and pipelines, are separated from oil and gas properties and depreciated on a straight-line basis over their estimated useful lives. DD&A expense decreased to $3.5 million for the three months ending March 31, 2016 from $8.0 million for the 2015 period as a result of lower production levels and a reduction in property, plant and equipment balances stemming from impairment charges recorded in the third and fourth quarters of 2015.

**Funds from operations and net loss**

| | Three months ended March 31 | |
|---|---|---|
| **($thousands, except per share amounts)** | **2016** | 2015 |
| Funds from (used in) operations | **(2,180)** | 1,439 |
| Per share – basic & diluted | **(0.00)** | 0.00 |
| Cash flow used in operating activities | **(1,474)** | (3,598) |
| Per share – basic & diluted | **(0.00)** | (0.01) |
| Net loss for the period | **(7,259)** | (8,610) |
| Per share – basic & diluted | **(0.01)** | (0.02) |

Funds used in operations was $2.2 million for the first quarter of 2016 compared to funds from operations of $1.4 million for the same period in 2015, primarily due to lower oil revenues partially offset by lower royalties, operating costs and G&A. Strategic continues to implement cost-cutting initiatives and implement operational efficiencies to mitigate the impact of low commodity prices. Funds from operations in the first quarter of 2015 also benefited from realized risk management gains of $2.0 million.

Net loss decreased to $7.3 million ($0.01 per basic and diluted common share) for the three months ended March 31, 2016 compared to $8.6 million ($0.02 per basic and diluted common share) due to a significant reduction in DD&A expense, partially offset by lower funds from operations in the current period. Net loss for the priod period was affected by an unrealized loss on risk management contracts of $1.6 million.

**Capital expenditures**

| | Three months ended March 31 | |
|---|---|---|
| **($thousands)** | **2016** | 2015 |
| Drilling, completions and equipping | **3,428** | 7,123 |
| Pipelines and facilities | **423** | 322 |
| | **3,851** | 7,445 |
| Dispositions | **(15)** | - |
| Total property, plant and equipment | **3,836** | 7,445 |
| Total exploration and evaluations ("E&E") | **4,445** | 81 |
| Net capital expenditures | **8,281** | 7,526 |

Capital expenditures increased to $8.3 million for the first quarter of 2016 from $7.5 million for the comparative period in 2015. Capital expenditures for the current quarter were focused on a four well drilling program designed to preserve undeveloped lands, increase reserves and further delineate the Muskeg play at Marlowe.

The first well drilled was a horizontal well drilled 5 kilometres south of the Company's existing Muskeg production at West Marlowe. Over the last 48 hours of a nine day production test the well flowed at an average rate of 1,060 boe/d (460 bbl/d of 36 API light oil and 3.6 MMcf/d of natural gas). Data from the well indicates excellent reservoir permeability similar to the wells in west Marlowe. The second well was a vertical drilled which was drilled and cored, with the core over the Muskeg interval showing net oil pay of 12.6 meters (41 feet). The third and fourth wells in the program were horizontal wells required to maximize the retention of highly prospective Muskeg acreage at Marlowe.

The Company believes that the first well in the program will add proved and probable reserves to the reserves base. The last 3 wells were not completed and are a significant distance from existing infrastructure, and therefore the related costs have been included in E&E expenditures. Also included in E&E expenditures is the acquisition of 8 sections of land in South Marlowe along the Muskeg fairway for nominal consideration.

Strategic executed a non-cash asset swap in the Bistcho area in the first quarter of 2016, assuming a 100% interest in the Bistcho gas processing facility and 14 wells and assigning 68 wellbores to its joint venture partner. The Company recorded a nominal gain on sale related to this transaction.

**Decommissioning liabilities**

Decommissioning liabilities increased to $55.8 million at March 31, 2016 from $53.9 million at December 31, 2015 primarily due to lower discount rates, partially offset by current quarter expenditures. The current portion of the decommissioning liabilities at March 31, 2016 includes $5.3 million which relates to remediation of the site of a prior year pipeline spill at Marlowe. Strategic has claimed this amount, in addition to amounts already incurred with respect to the remediation effort, from its insurer. The Company has received an offer from the insurer to settle this claim for a total payment of $6.0 million, and as such this amount has been included in accounts receivable at March 31, 2016. The insurance receivable was collected in full in May 2016.

## SUMMARY OF QUARTERLY FINANCIAL DATA

The following table summarizes quarterly financial results:

| **Quarter ended ($thousands, except where noted)** | **Mar 31, 2016** | Dec 31, 2015 | Sept 30, 2015 | Jun 30, 2015 |
|---|---|---|---|---|
| Oil and natural gas sales | **4,705** | 7,349 | 7,783 | 10,942 |
| Net loss | **(7,259)** | (31,790) | (63,918) | (5,797) |
| Net loss per share – basic & diluted | **(0.01)** | (0.06) | (0.12) | (0.01) |
| Average daily production (boed) | **1,968** | 2,194 | 2,113 | 2,480 |
| Average price ($/boe) | **26.26** | 36.41 | 40.04 | 48.49 |

| **Quarter ended ($thousands, except where noted)** | Mar 31, 2015 | Dec 31, 2014 | Sept 30, 2014 | Jun 30, 2014 |
|---|---|---|---|---|
| Oil and natural gas sales | 10,422 | 18,790 | 19,394 | 23,384 |
| Net income (loss) | (8,610) | (117,321) | 213 | (2,717) |
| Net income (loss) per share – basic & diluted | (0.02) | (0.22) | 0.00 | (0.01) |
| Average daily production (boed) | 3,267 | 3,925 | 3,234 | 3,538 |
| Average price ($/boe) | 35.45 | 52.04 | 65.18 | 72.61 |

Oil and natural gas sales are a function of average daily production levels, the oil/gas production mix and commodity prices and decreased significantly with reduced production levels and lower oil prices in the first quarter of 2016. Sales were highest in the second and third quarters of 2014 as average realized prices are over $65/boe for those periods.

Net income (loss) varies with funds from operations, as well as non-cash expenses incurred such as unrealized losses and gains on risk management contracts, DD&A and impairment. Net losses are highest in the fourth quarter of 2014 and third and fourth quarters of 2015 due to impairment charges of $114.0 million, $60.0 million and $27.7 million, respectively. The Company realized net income of $0.2 million for the three months ended September 30, 2014 due to a realized gain on risk management contracts of $6.8 million. Maintaining positive net income on a consistent basis will depend on the Company's ability to increase sales volumes and reduce unit production costs and DD&A, as well as on an increase in commodity prices.

## LIQUIDITY AND CAPITAL RESOURCES

The Company considers its capital structure to include shareholders' equity, working capital, bank debt and convertible debentures. The objectives of the Company are to maintain financial flexibility to achieve goals of continued growth and access to capital. In order to maintain or adjust the capital structure, Strategic may issue new common shares, issue or repay debt, or adjust exploration and development capital expenditures. The Company monitors its capital structure based on net debt and working capital (deficiency), as calculated below:

| **($thousands)** | **March 31, 2016** | December 31, 2015 |
|---|---|---|
| Current assets | **40,514** | 9,347 |
| Accounts payable and accruals | **(8,094)** | (5,029) |
| Promissory notes | **-** | (9,703) |
| Current decommissioning liabilities | **(5,936)** | (5,782) |
| Bank indebtedness | **-** | (42,857) |
| Net working capital (deficiency) | **26,484** | (54,024) |
| Convertible debentures | **(79,399)** | - |
| Net debt | **(52,915)** | (54,024) |

At March 31, 2016, the Company had $26.5 million in working capital, compared to a working capital deficiency of $54.0 million at December 31, 2015. A financing of convertible debentures closed in the first quarter allowed Strategic to repay its credit facility and promissory notes and provide funding for operations. The credit facility was cancelled after repayment. Approximately $4.6 million of the working capital balance is held in term deposits which serve as collateral against outstanding letters of credit.

On February 29, 2016, Strategic issued a total of $94.9 million in secured senior convertible debentures via private placement (the "Debentures"), for net proceeds of $92.6 million after issue costs. Approximately $58.8 million of the offering was acquired by entities controlled by a director of the Company and an additional $4.1 million was acquired by directors and officers of the Company. The Debentures have a five-year term and bear an annual interest rate of 8.0%, payable semi-annually in arrears, with an option for the Company to pay the interest an equivalent principal amount of debentures for the first two years ("PIK feature"). The Debentures are convertible into common shares at a conversion price of $0.09 per share, subject to adjustment in certain events.

The Debentures can be called prior to the maturity date by the Company if either a) the 90-day weighted average trading price of Strategic common shares is over $0.36 per share, or b) anytime in the fifth year of the term. If the Company elects to call the Debentures under option b), interest must be paid from the date the Debentures are called up to the original maturity date.

The convertible debentures have been classified as a financial liability, net of issue costs and net of the equity component of $13.3 million. The initial carrying amount of the financial liability was determined by discounting the stream of future payments of interest and principal, using a discount rate of 12% which was the estimated rate for debt with similar terms without conversion features. The issue costs were split between liabilities and equity in proportion to each component. The liability component is being accreted to the face value of $94.9 million to the principal amount at maturity.

It is Strategic's intent to use the PIK feature available on the Debentures for at least the first interest payment due on August 31, 2016. As such, the Debenture interest expense for this period will not reduce funds from operations.

At current commodity prices and production levels, Strategic's cash from operations is approximately break-even. Any capital expenditures undertaken by the Company will be funded by existing working capital, and potentially new equity or debt issuances as required.

**SHARE CAPITAL**

| | Three months ended March 31 | |
|---|---|---|
| | **2016** | 2015 |
| Weighted average common shares outstanding (thousands) | | |
| Basic | **542,319** | 542,319 |
| Diluted | **542,319** | 542,319 |

| | **March 31, 2016** | December 31, 2015 |
|---|---|---|
| Outstanding securities (thousands) | | |
| Common shares | **542,319** | 542,319 |
| Stock options | **21,240** | 11,365 |

During the first three months of 2016, 10.6 million stock options were granted at an average price of $0.09 per common share, 755,000 options had expired and 10,000 options were forfeited. No common shares have been issued in 2016.

As of May 16, 2016 there were 542,318,629 common shares outstanding and 21,240,000 stock options outstanding. If all of the outstanding Debentures were converted into common shares, an additional 1,053,900,000 common shares would be issued.

**TRANSACTIONS WITH RELATED PARTIES**

For the three months ended March 31, 2016, legal fees in the amount of $0.1 million (March 31, 2015 - $0.02 million) were incurred with a legal firm of which a director is a partner, and these amounts are included as general and administrative expenses. Software rentals of $0.05 million (March 31, 2015 - $0.05 million) were incurred with a company controlled by an officer. Accounts payable and accrued liabilities at March 31, 2016 include $0.02 million (December 31, 2015 - $0.2 million) due to related parties. The above transactions were conducted in the normal course of operations and were recorded at exchange amounts which were agreed upon between the Company and the related parties.

**COMMITMENTS**

The Company has lease agreements for office space, office equipment and natural gas transportation resulting in the following commitments:

| Year | Office ($000) | | Gas transportation ($000) | |
|---|---|---|---|---|
| 2016 | $ | 98 | $ | 343 |
| 2017 | | 68 | | 458 |
| 2018 | | - | | 201 |
| 2019 | | - | | 90 |
| 2020 | | - | | 72 |
| 2021 and thereafter | | - | | 25 |
| | $ | 166 | $ | 1,189 |

**FUTURE ACCOUNTING PRONOUNCEMENTS**

Future accounting pronouncements are unchanged from those identified in note 3(n) the Company's consolidated financial statements for the year ended December 31, 2015.

**CRITICAL ACCOUNTING ESTIMATES**

This MD&A is based on Strategic's interim condensed consolidated financial statements, which have been prepared in accordance with IFRS. A summary of the Company's significant accounting policies is contained in *Note 3* to the Company's consolidated financial statements for the year ended December 31, 2015. These accounting policies are subject to estimates and key judgments about future events, many of which are beyond the Company's control. Actual results may differ from these estimates and the differences may be significant. A discussion of specific estimates employed in the preparation of the Company's interim condensed consolidated financial statements is included in Strategic's MD&A for the year ended December 31, 2015.

**BUSINESS RISKS**

There are numerous risks facing participants in the oil and gas industry. Some of the risks are common to all businesses while others are specific to a sector. While Strategic realizes that these risks cannot be eliminated, it is committed to monitoring and mitigating these risks.

**Substantial capital requirements and liquidity**

The Company anticipates that it will make substantial capital expenditures for the acquisition, exploration, development and production of oil and natural gas reserves in the future. If the Company's future revenues or reserves decline, the Company's ability to expend the capital necessary to undertake or complete future drilling programs may be limited. There can be no assurance that debt or equity financing or cash generated by operations will be available or sufficient to meet these requirements or for other corporate purposes or, if debt or equity financing is available, that it will be on terms acceptable to the Company. Moreover, future activities may require Strategic to alter its capitalization significantly, and potentially increase the Company's debt levels above industry standards. The inability of the Company to access sufficient capital for its operations could have a material adverse effect on the Company's financial condition, results of operations or prospects.

The Company has $95 million in Debentures outstanding and current funds from operations are minimal. Strategic will need to increase production levels and cash flows in order to manage the repayment of the Debentures by the maturity date.

**Oil and natural gas prices and marketing**

The Company's revenues are dependent upon prevailing prices for oil and natural gas. Oil and natural gas prices can be extremely volatile and are affected by the actions of domestic and international markets, foreign governments, international cartels and the Canadian federal and provincial governments. Petroleum prices have fallen precipitously over the last 15 months due to global oversupply, caused primarily by growth in North American oil production and lack of a voluntary production curtailment by the Organization of Petroleum Exporting Countries ("OPEC"). In addition, the marketability of the production depends upon the availability and capacity of gathering systems and pipelines, the effect of federal and provincial regulation (including tax and royalty regimes) on such production and general economic conditions. All of these factors are beyond the control of the Company. Any decline in oil or natural gas prices could have a material adverse effect on the Company's operations, financial condition, proved reserves and the level of expenditures undertaken for the development of its oil and natural gas reserves.

The Company may manage the risk associated with changes in commodity prices and foreign exchange rates by, from time to time, entering into crude oil or natural gas price hedges and forward foreign exchange contracts. To the extent that the Company engages in risk management activities related to commodity prices and foreign exchange rates, it will be subject to credit risks associated with counterparties with which it contracts. The Company may be required to make cash payments to its counterparties in respect of these contracts, and therefore net income and cash flows will be affected by fluctuations in the value of these forward contracts, and the effect could be significant. In addition, a ceiling price on a risk management contract would restrict the Company from obtaining the full benefit of any commodity price appreciation.

**Environmental concerns**

The operation of oil and natural gas wells and pipelines involves a number of natural hazards that may result in blowouts, environmental damage or other unexpected or dangerous conditions resulting in liability to the Company and possibly liability to fourth parties. The oil and natural gas industry is subject to extensive environmental regulation that provides for restrictions and prohibitions on releases or emissions of various substances produced in association with certain oil and natural gas industry operations, and such regulations may be expanded to include regulation of, among other things, emissions of carbon dioxide. In addition, legislation requires that well and facility sites are abandoned and reclaimed to the satisfaction of provincial authorities. A breach of such legislation may result in fines or the issuance of clean-up orders. The Company carries insurance to mitigate the cost of remediating damage from environmental incidents, but there can be no assurance that the insurance will cover all types of incidents or that remediation costs will not exceed the limit of the insurance carried. In addition, the Company will make reasonable provisions for well abandonment, facility decommissioning and site remediation where appropriate; however there can be no assurance that such provisions will be sufficient to satisfy all such obligations. In addition, decommissioning expenditures that are planned for the first 12 months after the reporting date are classified as current liabilities on the balance sheet and affect the Company's net debt levels and debt covenant calculations.

Other business risks affecting Strategic's operations are substantially unchanged from those presented in the Company's MD&A for the year ended December 31, 2015.

**FORWARD-LOOKING STATEMENTS**

This report includes certain information, with management's assessment of Strategic's future plans and operations, and contains forward-looking statements which may include some or all of the following: (i) forecasted capital expenditures and plans; (ii) exploration, drilling and development plans, (iii) prospects and drilling inventory and locations; (iv) anticipated production rates; (v) expected royalty rate; (vi) anticipated production and service costs; (vii) the Company's financial strength; (viii) incremental development opportunities; (ix) reserve life index; (x) shareholder returns; (xi) growth prospects; (xii) sources of funding, which are provided to allow investors to better understand Strategic's business. By their nature, forward-looking statements are subject to numerous risks and uncertainties; some of which are beyond Strategic's control, including the impact of general economic conditions, industry conditions, operations risks, volatility of commodity prices, currency fluctuations, imprecision of reserve estimates, environmental risks, changes in environmental tax and royalty legislation, competition from other industry participants, the lack of availability of qualified personnel or management, stock market volatility and ability to access sufficient capital from internal and external sources, and other risks and uncertainties described under the heading 'Risk Factors' and elsewhere in the Company's Annual Information Form for the year ended December 31, 2015 and other documents filed with Canadian provincial securities authorities, available to the public at www.sedar.com. Readers are cautioned that the assumptions used in the preparation of such information, although considered reasonable at the time of preparation, may prove to be imprecise and, as such, undue reliance should not be placed on forward-looking statements. The principal assumptions Strategic has made includes security of land interests; drilling cost stability; royalty rate stability; oil and gas prices to remain in their current range; finance and debt markets continuing to be receptive to financing the Company and industry standard rates of geologic and operational success. Strategic's actual results, performance or achievement could differ materially from those expressed in, or implied by, these forward-looking statements or if any of them do so, what benefits that Strategic will derive there from. Strategic disclaims any intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, except as required by law.

Further information with respect to the Company can be found on its website at www.sogoil.com and on the SEDAR website: www.sedar.com.