



## **Interim Condensed Consolidated Financial Statements**

**For the three and nine months ended September 30, 2013 and 2012**

# Strategic Oil & Gas Ltd.

Interim condensed consolidated balance sheets (unaudited)

| (\$000)   | Note | September 30, 2013 | December 31, 2012 |
|---|------|--------------------|-------------------|
| <b>Assets</b>                                     |      |                    |                   |
| Current assets                                    |      |                    |                   |
| Cash and cash equivalents                         |      | \$ 207             | \$ 2,510          |
| Inventory   |      | 388                | 179               |
| Trade and other receivables                       |      | 9,650              | 8,972             |
|   |      | <b>10,245</b>      | 11,661            |
| Property, plant, and equipment, net               | 6    | 220,428            | 136,928           |
| Exploration and evaluation assets                 | 5    | 15,346             | 11,129            |
| <b>Total Assets</b>                               |      | <b>\$ 246,019</b>  | <b>\$ 159,718</b> |
| <b>Liabilities</b>                                |      |                    |                   |
| Current Liabilities:                              |      |                    |                   |
| Accounts payable and accrued liabilities          |      | \$ 29,754          | \$ 24,576         |
| Bank indebtedness                                 | 7    | 62,057             | 34,125            |
| Decommissioning liabilities                       | 8    | -                  | 263               |
| Risk management contracts                         | 14   | 5,097              | 224               |
|   |      | <b>\$ 96,908</b>   | <b>\$ 59,188</b>  |
| Long term Liabilities:                            |      |                    |                   |
| Risk management contracts                         | 14   | \$ 2,159           | -                 |
| Decommissioning liabilities                       | 8    | 28,450             | 18,773            |
| <b>Total Liabilities</b>                          |      | <b>\$ 127,517</b>  | <b>\$ 77,961</b>  |
| <b>Shareholders' Equity</b>                       |      |                    |                   |
| Share capital                                     | 9    | 171,362            | 122,999           |
| Contributed surplus                               |      | 8,804              | 7,958             |
| Deficit   |      | (61,664)           | (49,200)          |
|   |      | <b>\$ 118,502</b>  | <b>\$ 81,757</b>  |
| <b>Total Liabilities and Shareholders' Equity</b> |      | <b>\$ 246,019</b>  | <b>\$ 159,718</b> |

See accompanying notes to the Interim Condensed Consolidated Financial Statements

Commitments (Note 16)

Subsequent event (Note 17)

# Strategic Oil & Gas Ltd.

Interim condensed consolidated statements of income (loss) and comprehensive income (loss) (unaudited)

| (\$000, except per share amounts)                                       | Note | Three months ended September 30, |                  | Nine months ended September 30, |                   |
|---|------|----------------------------------|------------------|---------------------------------|-------------------|
|   |      | 2013                             | 2012             | 2013                            | 2012              |
| <b>Revenue</b>  |      |                                  |                  |                                 |                   |
| Petroleum and natural gas sales   |      | \$ 22,628                        | \$ 12,520        | \$ 64,285                       | \$ 40,649         |
| Royalties   |      | (5,218)                          | (1,898)          | (14,191)                        | (6,147)           |
|   |      | 17,410                           | 10,622           | 50,094                          | 34,502            |
| Unrealized loss on risk management contracts                            | 14   | (3,330)                          | (215)            | (7,032)                         | (215)             |
| Net realized loss on risk management contracts                          | 14   | (2,567)                          | -                | (2,174)                         | -                 |
| Other income  |      | 2                                | 19               | 94                              | 91                |
| <b>Revenues</b>   |      | <b>\$ 11,515</b>                 | <b>\$ 10,426</b> | <b>\$ 40,982</b>                | <b>\$ 34,378</b>  |
| <b>Expenses</b>   |      |                                  |                  |                                 |                   |
| Operating costs   |      | \$ 6,458                         | \$ 2,555         | \$ 19,624                       | \$ 8,664          |
| Transportation  |      | 1,256                            | 1,476            | 4,212                           | 4,462             |
| Exploration expenses  | 5    | -                                | -                | -                               | 30                |
| General and administrative  |      | 1,248                            | 2,251            | 4,651                           | 4,992             |
| Finance costs   | 11   | 1,243                            | 90               | 2,585                           | 254               |
| Stock-based compensation  | 10   | 438                              | 15               | 1,302                           | 1,014             |
| Depletion, depreciation and amortization                                |      | 7,631                            | 4,757            | 21,072                          | 16,108            |
|   |      | \$ 18,274                        | \$ 11,144        | \$ 53,446                       | \$ 35,524         |
| <b>Operating income (loss) before taxes</b>                             |      | <b>\$ (6,759)</b>                | <b>\$ (718)</b>  | <b>\$ (12,464)</b>              | <b>\$ (1,146)</b> |
| Deferred tax recovery   |      | -                                | -                | -                               | 2,275             |
| <b>Net income (loss) and comprehensive income (loss) for the period</b> |      | <b>\$ (6,759)</b>                | <b>\$ (718)</b>  | <b>\$ (12,464)</b>              | <b>\$ 1,129</b>   |
| <b>Net income (loss) per weighted average share</b>                     |      |                                  |                  |                                 |                   |
| Basic   |      | \$ (0.03)                        | \$ -             | \$ (0.06)                       | \$ 0.01           |
| Diluted   |      | \$ (0.03)                        | \$ -             | \$ (0.06)                       | \$ 0.01           |
| <b>Weighted average shares outstanding - Basic</b>                      | 9(c) | <b>211,282</b>                   | <b>186,884</b>   | <b>203,882</b>                  | <b>186,996</b>    |
| <b>Weighted average shares outstanding - Diluted</b>                    | 9(c) | <b>211,282</b>                   | <b>186,884</b>   | <b>203,882</b>                  | <b>187,761</b>    |

See accompanying notes to the Interim Condensed Consolidated Financial Statements.

Certain comparative figures have been reclassified to conform to the current year's presentation.

# Strategic Oil & Gas Ltd.

Interim condensed consolidated statements of changes in shareholders' equity (unaudited)

| (\$000)                           | Note | Share<br>Capital | Contributed<br>Surplus | Deficit     | Total<br>equity |
|-----------------------------------|------|------------------|------------------------|-------------|-----------------|
| <b>Balance January 1, 2013</b>    |      | \$ 122,999       | \$ 7,958               | \$ (49,200) | \$ 81,757       |
| Issue of shares                   |      | 48,185           | -                      | -           | 48,185          |
| Share issue costs                 | 9(b) | (954)            | -                      | -           | (954)           |
| Stock options exercised           | 9(b) | 1,132            | (455)                  | -           | 677             |
| Stock based compensation          | 9(b) | -                | 1,301                  | -           | 1,301           |
| Net loss                          |      | -                | -                      | (12,464)    | (12,464)        |
| <b>Balance September 30, 2013</b> |      | \$ 171,362       | \$ 8,804               | \$ (61,664) | \$ 118,502      |

| (\$000)                           | Note | Share<br>Capital | Contributed<br>Surplus | Deficit     | Total<br>equity |
|-----------------------------------|------|------------------|------------------------|-------------|-----------------|
| <b>Balance January 1, 2012</b>    |      | \$ 122,973       | \$ 6,310               | \$ (44,294) | \$ 84,989       |
| Share issue costs                 | 9    | (14)             | -                      | -           | (14)            |
| Share repurchases                 | 9(b) | (632)            | -                      | (118)       | (750)           |
| Stock options exercised           | 9(b) | 370              | (156)                  | -           | 214             |
| Stock based compensation          | 9(b) | -                | 1,014                  | -           | 1,014           |
| Net income                        |      | -                | -                      | 1,129       | 1,129           |
| <b>Balance September 30, 2012</b> |      | \$ 122,697       | \$ 7,168               | \$ (43,238) | \$ 86,582       |

See accompanying notes to the Interim Condensed Consolidated Financial Statements.

# Strategic Oil & Gas Ltd.

Interim condensed consolidated statements of cash flows (unaudited)

| (\$000)   | Note | Three months ended<br>September 30 |                   | Nine months ended<br>September 30 |                    |
|---|------|------------------------------------|-------------------|-----------------------------------|--------------------|
|   |      | 2013                               | 2012              | 2013                              | 2012               |
| <b>Operating activities:</b>  |      |                                    |                   |                                   |                    |
| Net income (loss) for the period  |      | \$ (6,759)                         | \$ (718)          | \$ (12,464)                       | \$ 1,129           |
| Non-cash items:   |      |                                    |                   |                                   |                    |
| Depletion, depreciation, and amortization                                 |      | 7,631                              | 4,757             | 21,072                            | 16,108             |
| Accretion of decommissioning liabilities                                  |      | 222                                | 85                | 619                               | 237                |
| Stock-based compensation  |      | 438                                | 15                | 1,301                             | 1,014              |
| Unrealized loss on risk management contracts                              | 14   | 3,330                              | 215               | 7,032                             | 215                |
| Exploration expense   |      | -                                  | -                 | -                                 | 30                 |
| Deferred tax recovery   |      | -                                  | -                 | -                                 | (2,275)            |
| Gain on acquisition   |      | -                                  | -                 | (61)                              | -                  |
| Other non-cash items  |      | (9)                                | (5)               | (16)                              | (15)               |
| <b>Funds from operations</b>  |      | <b>\$ 4,853</b>                    | <b>\$ 4,349</b>   | <b>\$ 17,483</b>                  | <b>\$ 16,443</b>   |
|   |      |                                    |                   |                                   |                    |
| Expenditures on decommissioning liabilities                               |      | (14)                               | (130)             | (659)                             | (130)              |
| Change in non-cash working capital  | 12   | 1,570                              | 4,125             | (452)                             | 748                |
| <b>Cash provided by operating activities</b>                              |      | <b>\$ 6,409</b>                    | <b>\$ 8,344</b>   | <b>\$ 16,372</b>                  | <b>\$ 17,061</b>   |
|   |      |                                    |                   |                                   |                    |
| <b>Financing activities:</b>  |      |                                    |                   |                                   |                    |
| Issue of common shares  |      | \$ 19,185                          | \$ -              | \$ 48,185                         | \$ -               |
| Increase (decrease) in bank loan  |      | (8,743)                            | -                 | 27,932                            | -                  |
| Exercise of options   |      | -                                  | -                 | 677                               | 214                |
| Repurchase of own shares  |      | -                                  | (750)             | -                                 | (750)              |
| Share issuance costs  | 9    | (103)                              | -                 | (954)                             | (14)               |
| <b>Cash provided by (used in) financing activities</b>                    |      | <b>\$ 10,339</b>                   | <b>\$ (750)</b>   | <b>\$ 75,840</b>                  | <b>\$ (550)</b>    |
|   |      |                                    |                   |                                   |                    |
| <b>Investing activities:</b>  |      |                                    |                   |                                   |                    |
| Expenditures – property, plant and equipment                              |      | \$ (24,249)                        | \$ (12,811)       | \$ (82,789)                       | \$ (44,748)        |
| Expenditures – exploration and evaluation assets                          |      | (368)                              | (1,271)           | (6,878)                           | (2,396)            |
| Acquisitions  |      | -                                  | -                 | (10,098)                          | -                  |
| Changes in non-cash working capital                                       | 12   | 6,689                              | 7,469             | 5,250                             | 1,167              |
| <b>Cash used in investing activities</b>                                  |      | <b>\$ (17,928)</b>                 | <b>\$ (6,613)</b> | <b>\$ (94,515)</b>                | <b>\$ (45,977)</b> |
| <b>(Decrease) increase in cash and cash equivalents during the period</b> |      | <b>\$ (1,180)</b>                  | <b>\$ 981</b>     | <b>\$ (2,303)</b>                 | <b>\$ (29,466)</b> |
| <b>Cash and cash equivalents, beginning of the period</b>                 |      | <b>1,387</b>                       | <b>1,361</b>      | <b>2,510</b>                      | <b>31,808</b>      |
| <b>Cash and cash equivalents, end of the period</b>                       |      | <b>\$ 207</b>                      | <b>\$ 2,342</b>   | <b>\$ 207</b>                     | <b>\$ 2,342</b>    |

# Strategic Oil & Gas Ltd.

Notes to the interim condensed consolidated financial statements (unaudited)  
September 30, 2013 and 2012

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## 1. Corporate information

Strategic Oil & Gas Ltd. ("Strategic") was incorporated under the laws of the Province of British Columbia on December 30, 1987 and continued as an Alberta corporation on September 9, 2010. On March 29, 2006, Strategic incorporated a United States of America (USA) subsidiary, Strategic Oil & Gas, Inc. ("US Subsidiary") through which all oil and gas activities in the USA are conducted. ZinMac Inc. ("ZinMac"), a private oil and gas consulting corporation, was acquired on March 10, 2009, and Steen River Oil & Gas Ltd. ("Steen River"), a private oil and gas exploration and production corporation, was acquired on December 22, 2010 by Strategic. ZinMac and Steen River were amalgamated with Strategic on April 1, 2012. On February 28, 2013, Strategic acquired all the outstanding common shares of Strategic Transmission Ltd. in conjunction with the acquisition of oil and gas assets in northwest Alberta and the Northwest Territories (see note 4). Strategic Transmission Ltd. has nominal assets and no liabilities.

Strategic is a publicly traded corporation whose shares are listed on the TSX Venture Exchange. Strategic, together with its subsidiaries, (collectively referred to as the "Corporation") is engaged in the exploration for and development of petroleum and natural gas reserves in Western Canada with minor operations in the Western United States. The Corporation is headquartered in Canada at Suite 1100, 645 – 7th Avenue SW, Calgary, Alberta.

## 2. Basis of presentation

### a) Statement of compliance:

These interim condensed consolidated financial statements (the "financial statements") have been prepared in accordance with International Accounting Standard ("IAS" 34 "Interim Financial Reporting" using accounting policies consistent with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Boards ("IASB"). These financial statements are condensed as they do not include all of the information required IFRS for annual financial statements and therefore should be read in conjunction with the Corporation's audited consolidated financial statements for the year ended December 31, 2012.

All accounting policies and methods of computation followed in the preparation of these financial statements are consistent with those of the audited consolidated financial statements for the year ended December 31, 2012, except as noted in the Note 3 "New accounting policies" in these financial statements.

These financial statements were authorized for issue by the Board of Directors on November 13, 2013.

### b) Basis of measurement:

These financial statements have been prepared on the historical cost basis except for cash and cash equivalents, certain stock based compensation transactions and risk management contracts, which are measured at fair value.

### c) Functional and presentation currency:

These financial statements are presented in Canadian dollars, the Corporation's functional currency.

# Strategic Oil & Gas Ltd.

Notes to the interim condensed consolidated financial statements (unaudited)  
September 30, 2013 and 2012

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## 3. New accounting policies

### Future accounting policy changes

The IASB issued amendments to IAS 36, "Impairment of Assets" that require retrospective application and will be adopted by the Corporation on January 1, 2014. The adoption of these amended standards is not expected to have a material impact on the Corporation's consolidated financial statements.

These unaudited condensed interim financial statements have been prepared by management following the same accounting policies as disclosed in the notes of financial statements as at and for the year ended December 31, 2012. The Corporation adopted IFRS 11, 12 and 13 including the amendments to IAS 27, IAS 28, and IAS 32 on January 1, 2013; there was no material impact to the Corporation's financial statements as a result of the adoption of these standards.

## 4. Acquisition

- a) On February 28, 2013, the Corporation acquired oil and gas assets in northwest Alberta and the Northwest Territories ("Cameron Hills and Bistcho Assets") for a total cash consideration of \$9.7 million.

| (\$000)                             | September 30, 2013 |
|-------------------------------------|--------------------|
| Property, plant and equipment       | \$ 23,874          |
| Inventory                           | 490                |
| Decommissioning obligations assumed | (14,580)           |
| Gain on acquisition of assets       | (61)               |
| Purchase Price paid in cash         | \$ 9,723           |

- b) On January 28, 2013, the Corporation acquired a royalty interest at Steen River for cash consideration of \$0.4 million.

The purpose of the acquisition was to complement the Corporation's asset portfolio in Northern Alberta and the Northwest Territories, provide additional opportunities for improved operational efficiencies as well as increase drilling flexibility.

The Corporation has allocated the purchase price paid based on management's best estimates of fair values to the various assets acquired. The purchase price allocation to the fair values of the various assets acquired remains subject to final adjustments.

For the nine months ended September 30, 2013, the Corporation recorded total revenues of \$8.1 million and the net income of \$1.3 million in respect of the acquired assets, from the date of acquisition.

The amount of revenue and net income (loss) of the Corporation inclusive of the acquisitions from January 1, 2013 to September 30, 2013, has not been disclosed as the production, revenue and expense information prior to the date of acquisition is not available and cannot be reliably estimated.

# Strategic Oil & Gas Ltd.

Notes to the interim condensed consolidated financial statements (unaudited)  
September 30, 2013 and 2012

## 5. Exploration and evaluation assets

| (\$000)                        | September 30, 2013 | December 31, 2012 |
|--------------------------------|--------------------|-------------------|
| Opening balance                | \$ 11,129          | \$ 9,328          |
| E&E expenditures               | 6,879              | 4,430             |
| E&E transfer to D&P            | (683)              | -                 |
| E&E expensed during the period | -                  | (30)              |
| Amortization                   | (1,979)            | (2,599)           |
| Closing balance                | \$ 15,346          | \$ 11,129         |

During the nine months ended September 30, 2013, the Corporation expensed \$nil (2012 - \$0.03 million) related to seismic expenditures on land which is not intended to be developed in the future.

## 6. Property, plant, and equipment

| (\$000)  |                   |                 |                   |
|--|-------------------|-----------------|-------------------|
| Carrying value before accumulated depletion and depreciation | D&P assets        | Office          | Total             |
| As at December 31, 2012                                      | \$ 193,163        | \$ 858          | \$ 194,021        |
| Additions  | 82,539            | 248             | 82,787            |
| E&E transfer   | 683               | -               | 683               |
| Acquisitions   | 24,249            | -               | 24,249            |
| Change in decommissioning costs                              | (5,125)           | -               | (5,125)           |
| <b>As at September 30, 2013</b>                              | <b>\$ 295,509</b> | <b>\$ 1,106</b> | <b>\$ 296,615</b> |

| (\$000)                                |                  |               |                  |
|--|------------------|---------------|------------------|
| Accumulated depletion and depreciation | D&P assets       | Office        | Total            |
| As at December 31, 2012                | \$ 56,582        | \$ 511        | \$ 57,093        |
| Depreciation and depletion             | 18,907           | 187           | 19,094           |
| <b>As at September 30, 2013</b>        | <b>\$ 75,489</b> | <b>\$ 698</b> | <b>\$ 76,187</b> |

| (\$000)                         |                   |               |                   |
|---------------------------------|-------------------|---------------|-------------------|
| Net carrying value              | D&P assets        | Office        | Total             |
| As at December 31, 2012         | \$ 136,581        | \$ 347        | \$ 136,928        |
| <b>As at September 30, 2013</b> | <b>\$ 220,020</b> | <b>\$ 408</b> | <b>\$ 220,428</b> |

Substantially all of the Corporation's development and production ("D&P") assets are located within Canada. The cost of property, plant and equipment includes amounts in respect of the provision for decommissioning obligations.

Future capital costs of \$62.2 million (September 30, 2012 - \$12.19 million) have been included in the depletable balance as at September 30, 2013. Depletion has been calculated using proved plus probable reserves. Major components account for \$33.1 million (September 30, 2012 - \$8.5 million) and are depreciated and tested for impairment separately.



# Strategic Oil & Gas Ltd.

Notes to the interim condensed consolidated financial statements (unaudited)  
September 30, 2013 and 2012

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## 7. Bank indebtedness

The Corporation has a \$100 million credit facility (the "Facility") with a Canadian Chartered bank, comprised of an \$80 million revolving operating loan and a \$20 million acquisition/development demand loan. As of September 30, 2013 the Corporation had drawn \$7 million of the acquisition/development demand loan. Amounts outstanding under the Facility are repayable on demand, and bear interest at a rate of 0.5% to 2.5% over the bank's prime lending rate for prime loans, or at bankers' acceptance rates plus a stamping fee ranging from 1.75% to 3.75%, depending on Strategic's debt to cash flow ratio. The Facility is secured by a general security agreement including a floating charge on all lands. The Facility contains a financial covenant that requires the Corporation to maintain an adjusted working capital ratio of not less than 1:1, but for the purpose of the calculation the unused portion of the revolving operating line is included in current assets and, the current portion of debt and risk management liabilities are both excluded from current liabilities. Subsequent to the reporting date the Facility was renewed, with the next review date scheduled for January 1, 2014. As at September 30, 2013, the Corporation was in compliance with all covenants.

## 8. Decommissioning liabilities

Total future decommissioning liabilities are estimated based on the Corporation's net working interest in all wells and facilities, the estimated costs to abandon and reclaim the wells and facilities and the estimated timing of the costs to be incurred in future periods. These costs are expected to be incurred over a range from 2 to 42 years, depending on the estimated reserve life. The undiscounted amount of the estimated costs at September 30, 2013 were \$50.8 million (December 31, 2012 - \$25.1 million). The estimated costs have been discounted at a risk free rate from 1.21% to 3.09% (December 31, 2012 - 1.12% to 2.37%) and an inflation rate of 2% (December 31, 2012 - 2%) was applied.

The following table reconciles the changes to the Corporation's decommissioning liabilities:

| (\$000)  | Note | September 30, 2013 | December 31, 2012 |
|--|------|--------------------|-------------------|
| Balance beginning of the period                    |      | \$ 19,036          | \$ 12,523         |
| Liabilities incurred during the period             |      | 414                | 1,802             |
| Acquisition of liabilities from asset acquisitions | 4    | 14,579             | 4,356             |
| Expenditures on existing liabilities               |      | (659)              | (202)             |
| Change in estimated future cash flows              |      | (2,116)            | (113)             |
| Change in discount rate                            |      | (3,423)            | 343               |
| Accretion  |      | 619                | 327               |
| Balance end of the period                          |      | \$ 28,450          | \$ 19,036         |
| Current  |      | -                  | 263               |
| Long term  |      | \$ 28,450          | \$ 18,773         |

# Strategic Oil & Gas Ltd.

Notes to the interim condensed consolidated financial statements (unaudited)  
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## 9. Share capital

### a) Authorized

The Corporation is authorized to issue an unlimited number of common shares without par value.

### b) Issued and outstanding

| (\$000, except for share amounts) | Number of shares | Nine months ended<br>September 30, 2013 |         |
|-----------------------------------|------------------|---|---------|
|                                   |                  |   | Amount  |
| Balance beginning of the period   | 186,415,268      | \$                                      | 122,999 |
| Exercise of options               | 788,333          |   | 1,132   |
| Shares issued                     | 43,395,000       |   | 48,185  |
| Share issue costs                 | -                |   | (954)   |
| Balance end of the period         | 230,598,601      | \$                                      | 171,362 |

On March 20, 2013, the Corporation issued 23.2 million common shares via a private placement at a price of \$1.25 per common share for gross proceeds of \$29.0 million (net proceeds of \$28.2 million after transaction costs). Of the \$29.0 million gross proceeds, \$18.9 million (15.2 million common shares) were acquired by entities that share a common director with the Corporation.

On September 26, 2013, the Corporation issued 20.2 million common shares via a private placement with an entity that shares a common director with the Corporation at a price of \$0.95 per common share for gross proceeds of \$19.2 million.

### c) Weighted average shares

| (000)                             | Three months ended September |         | Nine months ended September 30 |         |
|-----------------------------------|------------------------------|---------|--------------------------------|---------|
|                                   | 2013                         | 2012    | 2013                           | 2012    |
| Weighted average shares (basic)   | 211,282                      | 186,884 | 203,882                        | 186,996 |
| Weighted average shares (diluted) | 211,282                      | 186,884 | 203,882                        | 187,761 |

## 10. Stock-based compensation

The Corporation has a stock option plan under which officers, directors, consultants and employees are eligible to receive stock options. The Corporation may reserve for issuance under the plan up to 10% of the issued and outstanding common shares. Options granted under the plan generally have a term of five years and vest at terms to be determined by the directors. Vesting terms have varied from immediate vesting to a five year vesting period.

For the nine months ended September 30, 2013, the Corporation issued 1,480,000 common share options which will vest over three years.

The outstanding number and weighted average exercise price of stock options are as follows:

|                               | Number of options | Weighted average<br>Exercise Price |      |
|-------------------------------|-------------------|------------------------------------|------|
| Balance at December 31, 2012  | 12,483,333        | \$                                 | 0.96 |
| Issued                        | 1,480,000         |                                    | 1.19 |
| Exercised                     | (788,333)         |                                    | 0.86 |
| Expired                       | (185,000)         |                                    | 1.29 |
| Balance at September 30, 2013 | 12,990,000        | \$                                 | 0.99 |

# Strategic Oil & Gas Ltd.

Notes to the interim condensed consolidated financial statements (unaudited)  
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The following table sets out the outstanding and exercisable options as at September 30, 2013:

| Number of Options | Options price |      | Outstanding Options             |                             | Exercisable Options |                                 |
|-------------------|---------------|------|---------------------------------|-----------------------------|---------------------|---------------------------------|
|                   | From          | To   | Weighted Average Exercise Price | Weighted Average Life Years | Number of Options   | Weighted Average Exercise Price |
| 1,245,000         | \$ 0.25       | 0.59 | \$ 0.44                         | 0.77                        | 1,245,000           | \$ 0.44                         |
| 1,250,000         | 0.60          | 0.79 | 0.68                            | 1.21                        | 1,216,665           | 0.68                            |
| 2,670,000         | 0.80          | 0.99 | 0.89                            | 3.54                        | 2,256,666           | 0.90                            |
| 3,095,000         | 1.00          | 1.18 | 1.11                            | 2.89                        | 2,425,014           | 1.10                            |
| 4,730,000         | \$ 1.19       | 1.30 | 1.20                            | 4.17                        | 1,576,654           | 1.20                            |
| 12,990,000        |               |      | \$ 0.99                         | 3.12                        | 8,719,999           | \$ 0.91                         |

The fair value of options granted was estimated on the date of grant using a Black-Scholes option pricing model with the following weighted average inputs:

|   | Nine months ended September 30 |        |
|---|--------------------------------|--------|
|   | 2013                           | 2012   |
| Assumptions   |                                |        |
| Risk free interest rate (%)                         | 1.67                           | 2.56   |
| Expected life (years)                               | 3.80                           | 5.00   |
| Expected volatility (%)                             | 81.94                          | 104.23 |
| Forfeiture rate (%)                                 | 6.42                           | 8.17   |
| Weighted average fair value of options granted (\$) | 1.05                           | 0.89   |

Forfeiture rate is calculated based on historical forfeiture data of the Corporation. The weighted average share price at the date of exercise for share options exercised during the nine months ended September 30, 2013 was \$1.27 (year ended December 31, 2012 - \$0.93).

## 11. Finance costs

| (\$000)                                  | Three months ended September 30 |       | Nine months ended September 30 |        |
|--|---------------------------------|-------|--------------------------------|--------|
|  | 2013                            | 2012  | 2013                           | 2012   |
| Interest expense                         | \$ 1,021                        | \$ 5  | \$ 2,020                       | \$ 17  |
| Foreign exchange gain realized           | -                               | -     | (54)                           | -      |
| Accretion of decommissioning liabilities | 222                             | 85    | 619                            | 237    |
|  | \$ 1,243                        | \$ 90 | \$ 2,585                       | \$ 254 |

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## 12. Supplemental cash flow information

| (\$000)                                      | Three months ended September 30 |        | Nine months ended September 30 |          |
|--|---------------------------------|--------|--------------------------------|----------|
|  | 2013                            | 2012   | 2013                           | 2012     |
| Interest paid                                | \$ 1,021                        | \$ 14  | \$ 2,020                       | \$ 17    |
| Taxes paid                                   | -                               | -      | -                              | -        |
| Total  | \$ 1,021                        | \$ 14  | \$ 2,020                       | \$ 17    |
| Changes in non-cash working capital          |                                 |        |                                |          |
| Trade and other receivables                  | 1,918                           | 1,555  | (679)                          | (542)    |
| Inventory                                    | (135)                           | -      | (208)                          | -        |
| Inventory acquired                           | -                               | -      | 490                            | -        |
| Accounts payable and accrued liabilities (1) | 6,468                           | 10,039 | 5,179                          | 2,457    |
|  | 8,251                           | 11,594 | \$ 4,782                       | \$ 1,915 |
| Operating                                    | 1,570                           | 4,125  | (452)                          | 748      |
| Investing                                    | 6,689                           | 7,469  | 5,250                          | 1,167    |
|  | \$ 8,259                        | 11,594 | \$ 4,798                       | \$ 1,915 |

(1) : included in the accounts payable and accrued liabilities is \$.0008 (2012-\$nil) and \$.0014 (2012-\$nil) of non-cash lease inducements for the three and nine months ended September 30, 2013

## 13. Transactions with related parties

Legal fees in the amount of \$0.34 million (September 30, 2012 - \$0.15 million) were incurred to a legal firm of which a director is a partner, and are included as general and administrative expenses or share issue costs. Software charges of \$0.15 million (September 30, 2012 - \$0.09 million) were charged to a company controlled by an officer. Accounts payable and accrued liabilities at September 30, 2013 include \$0.22 million (December 31, 2012 - \$0.01 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 Corporation and the related parties.

## 14. Financial instruments and financial risk management

The Corporation's financial instruments include cash and cash equivalents, trade and other receivables, bank debt, accounts payable and accrued liabilities, and risk management contracts. The carrying values of cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities and bank debt approximate their fair values due to their relatively short periods to maturity.

The Corporation is required to classify fair value measurements using a hierarchy that reflects the significance of the inputs used in making the measurements. The fair value hierarchy is as follows:

- Level 1 - quoted prices in active markets for identical assets or liabilities;
- Level 2 - inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly; and
- Level 3 - inputs for the asset or liability that are not based on observable market data.

The fair value of cash and cash equivalents bank debt is measured at level 1. The fair value of risk management contracts is measured at level 2.

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The Corporation's risk management policies are established to identify and analyze the risks faced by the Corporation, to set appropriate risk limits and controls, and to monitor risks and adherence to market conditions and the Corporation's activities. The Corporation has exposure to credit risk, liquidity risk and market risk as a result of its use of financial instruments. The following presents information about the Corporation's exposure to each of the above risks and the Corporation's objectives, policies and processes for measuring and managing commodity risks. Further quantitative disclosures are included throughout these financial statements.

## **Liquidity risk**

Liquidity risk is the risk that an entity will encounter difficulty in meeting obligations associated with financial liabilities. The Corporation's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Corporation's reputation.

Typically the Corporation ensures that it has sufficient cash on demand to meet expected operational expenses for a period of 30 days, including the servicing of financial obligations; this excludes the potential impact of extreme circumstances that cannot reasonably be predicted, such as natural disasters. To achieve this objective, the Corporation prepares annual capital expenditure budgets, which are regularly monitored and updated as considered necessary. Further, the Corporation utilizes authorizations for expenditures on both operated and non-operated projects to further manage capital expenditure. The Corporation also attempts to match its payment cycle with collection of oil and natural gas revenue on the 25th of each month. In addition, the Corporation maintains the appropriate reserves based credit facility to provide access to capital as needed.

## **Market risk**

Market risk consists of interest rate risk, currency risk and commodity price risk. The objective of market risk management is to manage and control market risk exposures within acceptable limits, while maximizing returns. The Corporation may use both financial derivatives and physical delivery sales contracts to manage market risks.

## **Commodity price risk**

Commodity price risk is the risk that the fair value of assets or liabilities or future cash flows will fluctuate as a result of changes in commodity prices. Commodity prices for petroleum and natural gas are impacted by world economic events that dictate the levels of supply and demand as well as the relationship between the Canadian and United States dollar. The Corporation may, in certain circumstances, enter into forward oil or natural gas sales contracts to mitigate commodity price risk.

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At September 30, 2013, the following risk management contracts were outstanding with a mark-to-market liability value of \$7.3 million (September 30, 2012 - \$0.22 million).

## Financial WTI crude oil contracts

| Term        |             | Contract Type         | Volume (bbl/d) | Fixed Price (\$/bbl) | Index       |
|-------------|-------------|-----------------------|----------------|----------------------|-------------|
| 01-Oct-2013 | 31-Dec-2013 | Swap                  | 200            | US\$90.00            | WTI - NYMEX |
| 01-Oct-2013 | 31-Dec-2013 | Swap                  | 500            | US\$99.00            | WTI - NYMEX |
| 01-Oct-2013 | 31-Dec-2013 | Swap                  | 1,850          | CAD\$100.12          | WTI - NYMEX |
| 01-Jan-2014 | 31-Dec-2014 | Swap                  | 1,500          | CAD\$92.00           | WTI - NYMEX |
| 01-Jan-2014 | 31-Dec-2014 | Option <sup>(1)</sup> | 500            | US\$99.00            | WTI - NYMEX |
| 01-Jan-2015 | 30-Jun-2015 | Swap                  | 750            | CAD\$90.15           | WTI - NYMEX |
| 01-Jan-2015 | 31-Dec-2015 | Option <sup>(1)</sup> | 600            | CAD\$90.00           | WTI - NYMEX |
| 01-Jul-2015 | 31-Dec-2015 | Option <sup>(1)</sup> | 250            | CAD\$90.00           | WTI - NYMEX |

<sup>(1)</sup> The counterparty may elect to convert this option to a swap contract with the Corporation at the fixed price indicated.

The Corporation does not apply hedge accounting to these risk management contracts and they are recorded as fair value with changes in fair value included in the condensed consolidated statement of income (loss). For the three and nine months ended September 30, 2013, Strategic recorded unrealized losses on risk management contracts of \$3.33 million (September 30 2012 - \$nil) and \$7.03 million (September 30, 2012 - \$nil).

The following table summarizes the fair value as at September 30, 2013 and the change in fair value for the nine months ended September 30, 2013:

| (\$000)   | September 30, 2013 | December 31, 2012 |
|---|--------------------|-------------------|
| Net derivative liabilities, beginning of period | \$ (224)           | \$ -              |
| Unrealized change in fair value                 | (7,032)            | (224)             |
| Net derivative liabilities, end of period       | (7,256)            | (224)             |
| Derivative assets, end of period                | -                  | 380               |
| Gross derivative liabilities, end of period     | \$ (7,256)         | \$ (604)          |

Net realized losses on risk management contracts for the three and nine months ended September 30, 2013 were \$2.57 million (September 30, 2012 - \$nil) and \$2.17 million (September 30, 2012 - \$nil) respectively.

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## Offsetting financial assets and liabilities

The Corporation's risk management contracts are subject to master agreements that create a legally enforceable right to offset by counterparty the related financial assets and financial liabilities simultaneously. The following table summarizes the gross asset and liability positions of the Corporation's risk management contracts that are offset on the balance sheet as at September 30, 2013 and December 31, 2012.

| (\$000)             | September 30, 2013 |                  |  |                           |                   |
|---------------------|--------------------|------------------|--|---------------------------|-------------------|
|                     | Gross<br>Amount    | Amount<br>Offset | Net Amount Prior<br>to Credit Risk<br>Adjustment | Credit Risk<br>Adjustment | Net Amount        |
| Current asset       | \$ -               | \$ -             | \$ -   | \$ -                      | \$ -              |
| Long term asset     | -                  | -                | -  | -                         | -                 |
| Current liability   | (5,097)            | -                | (5,097)  | -                         | (5,097)           |
| Long term liability | (2,159)            | -                | (2,159)  | -                         | (2,159)           |
| <b>Net position</b> | <b>\$ (7,256)</b>  | <b>\$ -</b>      | <b>\$ (7,256)</b>                                | <b>\$ -</b>               | <b>\$ (7,256)</b> |

| (\$000)             | December 31, 2012 |                  |  |                           |                 |
|---------------------|-------------------|------------------|--|---------------------------|-----------------|
|                     | Gross<br>Amount   | Amount<br>Offset | Net Amount Prior<br>to Credit Risk<br>Adjustment | Credit Risk<br>Adjustment | Net Amount      |
| Current asset       | \$ 380            | \$ (380)         | \$ -   | \$ -                      | \$ -            |
| Long term asset     | -                 | -                | -  | -                         | -               |
| Current liability   | (604)             | 380              | (224)  | -                         | (224)           |
| Long term liability | -                 | -                | -  | -                         | -               |
| <b>Net position</b> | <b>\$ (224)</b>   | <b>\$ -</b>      | <b>\$ (224)</b>                                  | <b>\$ -</b>               | <b>\$ (224)</b> |

## 15. Capital management

Strategic considers its capital structure to include shareholders' equity and working capital including bank debt. The objectives of the Corporation are to maintain a strong balance sheet affording the Corporation financial flexibility to achieve goals of continued growth and access to capital. In order to maintain or adjust the capital structure, the Corporation may issue new common shares, issue new debt, or adjust exploration and development capital expenditures.

The Corporation monitors its capital program based on available funds, which is the combination of working capital (excluding risk management contracts) and remaining unused line of credit, as calculated below:

| (\$000)                                  | September 30, 2013 | December 31, 2012 |
|--|--------------------|-------------------|
| Current assets                           | 10,245             | 11,661            |
| Accounts payable and accrued liabilities | (29,754)           | (25,063)          |
| Net working capital deficit              | (19,509)           | (13,402)          |
| Total line of credit                     | 100,000            | 48,500            |
| Amount drawn                             | (62,057)           | (34,125)          |
| Authorized Letters of Guarantee          | (5,142)            | (20)              |
| Unutilized line of credit                | 32,801             | 14,355            |
| <b>Net available funds</b>               | <b>13,292</b>      | <b>953</b>        |

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The Corporation's exploration and development activities are conducted primarily during colder weather, as ground conditions provide improved access to lease and more efficient execution of its capital expenditure activities. Significant expenditures are made during these periods and the related benefit is realized in future periods.

## 16. Commitments

The Corporation has lease agreements for office space and office equipment resulting in the following commitments:

| Year ended |    | (\$000) |
|------------|----|---------|
| 2013       | \$ | 128     |
| 2014       | \$ | 338     |
| 2015       | \$ | 311     |
| 2016       | \$ | 10      |
|            | \$ | 787     |

## 17. Subsequent events

On October 7, 2013, the Corporation completed a bought deal equity financing. The Corporation issued 12.7 million common shares at a price of \$0.95 per common shares and 15.5 million common shares issued on a "flow-through" basis pursuant to the Income Tax Act (Canada) (the "Flow-Through Shares") at a price of \$1.10 per Flow-Through Share, for net proceeds of \$29.3 million after deducting related costs. In addition, the underwriters exercised the over-allotment option in full purchasing an additional 1.9 million common shares at a price of \$0.95 per common share for additional gross proceeds of \$1.8 million.