



## **Interim Condensed Consolidated Financial Statements**

**For the three and six months ended June 30, 2014 and 2013**

# Strategic Oil & Gas Ltd.

Interim condensed consolidated balance sheets (unaudited)

(\$000)	Note	June 30, 2014	December 31, 2013
<b>Assets</b>			
Current assets			
Cash and cash equivalents		\$ 6,693	\$ 226
Inventory		410	379
Trade and other receivables		10,675	9,080
		<b>17,778</b>	<b>9,685</b>
Long-term receivable	8	3,001	-
Property, plant, and equipment, net	4, 6	287,367	249,841
Exploration and evaluation assets	5	15,876	14,695
<b>Total Assets</b>		<b>\$ 324,022</b>	<b>\$ 274,221</b>
<b>Liabilities</b>			
Current Liabilities:			
Accounts payable and accrued liabilities		\$ 21,085	\$ 28,457
Bank indebtedness	7	75,000	63,775
Deferred price premium on flow-through shares		266	1,619
Risk management contracts	14	10,580	7,276
		<b>\$ 106,931</b>	<b>\$ 101,127</b>
Long term Liabilities:			
Risk management contracts	14	\$ 773	1,481
Decommissioning liabilities	8	43,283	35,932
<b>Total Liabilities</b>		<b>\$ 150,987</b>	<b>\$ 138,540</b>
<b>Shareholders' Equity</b>			
Share capital	9	247,474	197,970
Contributed surplus		9,456	9,227
Deficit		(83,895)	(71,516)
		<b>\$ 173,035</b>	<b>\$ 135,681</b>
<b>Total Liabilities and Shareholders' Equity</b>		<b>\$ 324,022</b>	<b>\$ 274,221</b>

See accompanying notes to the Interim Condensed Consolidated Financial Statements

# Strategic Oil & Gas Ltd.

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

(\$000, except per share amounts)	Note	Three months ended June 30,		Six months ended June 30,	
		2014	2013	2014	2013
<b>Revenue</b>					
Petroleum and natural gas sales		\$ 23,723	\$ 23,770	\$ 45,483	\$ 41,657
Royalties		(5,235)	(4,805)	(9,722)	(8,973)
<b>Revenues, net of royalties</b>					
Unrealized gain (loss) on risk management contracts	14	663	(2,875)	(2,597)	(3,704)
Net realized (loss) gain on risk management contracts	14	(2,918)	341	(5,482)	393
		\$ 16,233	\$ 16,431	\$ 27,682	\$ 29,373
<b>Expenses</b>					
Production		\$ 9,392	\$ 8,604	\$ 20,539	\$ 16,032
General and administrative		1,905	1,498	3,594	3,403
Finance	11	1,011	738	2,172	1,342
Stock-based compensation	10	124	452	295	864
Depletion, depreciation and amortization		8,562	7,475	17,116	13,441
Gain on disposal of property, plant and equipment	4, 13	(1,960)	-	(2,304)	-
		\$ 19,034	\$ 18,767	\$ 41,412	\$ 35,082
<b>Operating loss before taxes</b>					
		\$ (2,801)	\$ (2,336)	\$ (13,730)	\$ (5,709)
Deferred tax recovery		84	-	1,351	-
<b>Net loss and comprehensive loss for the period</b>					
		\$ (2,717)	\$ (2,336)	\$ (12,379)	\$ (5,709)
<b>Net loss per weighted average share</b>					
Basic		\$ (0.01)	\$ (0.01)	\$ (0.04)	\$ (0.03)
Diluted		\$ (0.01)	\$ (0.01)	\$ (0.04)	\$ (0.03)
<b>Weighted average shares outstanding - Basic</b>	9(c)	<b>360,959</b>	210,404	<b>311,646</b>	200,121
<b>Weighted average shares outstanding - Diluted</b>	9(c)	<b>360,959</b>	210,404	<b>311,646</b>	200,121

See accompanying notes to the Interim Condensed Consolidated Financial Statements.

# Strategic Oil & Gas Ltd.

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

(\$000)	Note	Share Capital	Contributed Surplus	Deficit	Total equity
<b>Balance January 1, 2014</b>		\$ 197,970	\$ 9,227	\$ (71,516)	\$ 135,681
Issue of shares		50,000	-	-	50,000
Share issue costs	9(b)	(701)	-	-	(701)
Stock options exercised	9(b)	205	(66)	-	139
Stock based compensation		-	295	-	295
Net loss		-	-	(12,379)	(12,379)
<b>Balance June 30, 2014</b>		\$ 247,474	\$ 9,456	\$ (83,895)	\$ 173,035

(\$000)	Note	Share Capital	Contributed Surplus	Deficit	Total equity
<b>Balance January 1, 2013</b>		\$ 122,999	\$ 7,958	\$ (49,200)	\$ 81,757
Issue of shares	9	29,000	-	-	29,000
Share issue costs	9(b)	(851)	-	-	(851)
Stock options exercised	9(b)	1,132	(455)	-	677
Stock based compensation		-	864	-	864
Net loss		-	-	(5,709)	(5,709)
<b>Balance June 30, 2013</b>		\$ 152,280	\$ 8,367	\$ (54,909)	\$ 105,738

See accompanying notes to the Interim Condensed Consolidated Financial Statements.

# Strategic Oil & Gas Ltd.

## Interim condensed consolidated statements of cash flow (unaudited)

(\$000)	Note	Three months ended June 30		Six months ended June 30	
		2014	2013	2014	2013
<b>Operating activities:</b>					
Net loss for the period		\$ (2,717)	\$ (2,336)	\$ (12,379)	\$ (5,709)
Non-cash items:					
Depletion, depreciation, and amortization		8,562	7,475	17,116	13,441
Accretion of decommissioning liabilities		279	207	552	397
Stock-based compensation		124	452	295	864
Unrealized loss on risk management contracts	14	(663)	2,875	2,597	3,704
Deferred tax recovery		(84)	-	(1,351)	-
Gain on acquisition		-	-	-	(61)
Gain on disposal of property, plant and equipment	4, 13	(1,960)	-	(2,304)	-
Other non-cash items		-	(1)	-	(6)
<b>Funds from operations</b>		<b>\$ 3,541</b>	<b>\$ 8,672</b>	<b>\$ 4,526</b>	<b>\$ 12,629</b>
Expenditures on decommissioning liabilities					
		(20)	28	(1,301)	(645)
Change in non-cash working capital	12	(9,148)	(1,576)	1,251	(2,022)
<b>Cash provided by operating activities</b>		<b>\$ (5,627)</b>	<b>\$ 7,124</b>	<b>\$ 4,476</b>	<b>\$ 9,962</b>
<b>Financing activities:</b>					
Issue of common shares		\$ -	\$ -	\$ 50,000	\$ 29,000
Increase in bank loan		-	22,950	11,225	36,675
Exercise of options		71	-	139	677
Share issuance costs	9	(35)	-	(701)	(851)
<b>Cash provided by financing activities</b>		<b>\$ 36</b>	<b>\$ 22,950</b>	<b>\$ 60,663</b>	<b>\$ 65,501</b>
<b>Investing activities:</b>					
Expenditures – property, plant and equipment		\$ (13,223)	\$ (12,861)	\$ (49,557)	\$ (58,540)
Expenditures – exploration and evaluation assets		(317)	(1,924)	(2,436)	(6,510)
Acquisitions		-	-	-	(10,098)
Proceeds on disposal of property, plant and equipment	4, 13	3,478	-	3,821	-
Changes in non-cash working capital	12	(15,642)	(20,195)	(10,500)	(1,439)
<b>Cash used in investing activities</b>		<b>\$ (25,704)</b>	<b>\$ (34,980)</b>	<b>\$ (58,672)</b>	<b>\$ (76,587)</b>
<b>(Decrease) increase in cash and cash equivalents during the period</b>		<b>\$ (31,295)</b>	<b>\$ (4,906)</b>	<b>\$ 6,467</b>	<b>\$ (1,123)</b>
<b>Cash and cash equivalents, beginning of the period</b>		<b>37,988</b>	<b>6,293</b>	<b>226</b>	<b>2,510</b>
<b>Cash and cash equivalents, end of the period</b>		<b>\$ 6,693</b>	<b>\$ 1,387</b>	<b>\$ 6,693</b>	<b>\$ 1,387</b>

See accompanying notes to the Interim Condensed Consolidated Financial Statements.

# Strategic Oil & Gas Ltd.

Notes to the interim condensed consolidated financial statements (unaudited)  
June 30, 2014 and 2013

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## 1. Corporate information

Strategic Oil & Gas Ltd. ("Strategic") is a company registered and domiciled in Alberta. 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. Strategic Transmission Ltd. has nominal assets and no liabilities.

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

## 2. Basis of presentation

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 Company's annual consolidated financial statements for the year ended December 31, 2013. These financial statements are presented in Canadian dollars, the Company's functional currency.

The financial statements have been prepared on a historical cost basis except for cash and cash equivalents, trade and other receivables, long-term receivable, bank debt, accounts payable and accrued liabilities, certain share-based payment transactions and risk management contracts, which are measured at fair value. All accounting policies and methods of computation followed in the preparation of these financial statements are consistent with those disclosed in the Company's annual consolidated financial statements for the year ended December 31, 2013, except as noted in Note 3 "Changes in accounting policies" in these financial statements. There have been no changes in the application or use of estimates or judgments since December 31, 2013.

During the period, the Company combined its operating and transportation expense to present them as production expense. All comparative periods reflect this reclassification.

The financial statements include the accounts of the Company and its wholly owned subsidiaries, Strategic Oil & Gas Inc., Jed Oil (USA) Inc. and Strategic Transmission Ltd. All inter-entity transactions have been eliminated.

These financial statements were authorized for issue by the Board of Directors on August 13, 2014.

The accompanying interim condensed consolidated financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the payment of liabilities in the ordinary course of business. See note 15 for additional information.

# Strategic Oil & Gas Ltd.

Notes to the interim condensed consolidated financial statements (unaudited)  
June 30, 2014 and 2013

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### 3. Changes in accounting policies

As of January 1, 2014, the Company adopted several new IFRS interpretations and amendments in accordance with the transitional provisions of each standard. A brief description of each new accounting policy and its impact on the Company's financial statements follows below:

- IAS 36 "Impairment of Assets" has been amended to reduce the circumstances in which the recoverable amount of cash generating units ("CGUs") is required to be disclosed and clarify the disclosures required when an impairment loss has been recognized or reversed in the period. The retrospective adoption of these amendments will only impact the Company's disclosures in the notes to the financial statements in periods when an impairment loss or impairment reversal is recognized.
- IAS 39 "Financial Instruments: Recognition and Measurement" has been amended to clarify that there would be no requirement to discontinue hedge accounting if a hedging derivative was novated, provided certain criteria are met. The retrospective adoption of the amendments does not have any impact on the Company's financial statements.
- IFRIC 21 "Levies" was developed by the IFRS Interpretations Committee ("IFRIC") and is applicable to all levies imposed by governments under legislation, other than outflows that are within the scope of other standards (e.g., IAS 12 "Income Taxes") and fines or other penalties for breaches of legislation. The interpretation clarifies that an entity recognizes a liability for a levy when the activity that triggers payment, as identified by the relevant legislation, occurs. It also clarifies that a levy liability is accrued progressively only if the activity that triggers payment occurs over a period of time, in accordance with the relevant legislation. Lastly, the interpretation clarifies that a liability should not be recognized before the specified minimum threshold to trigger that levy is reached. The retrospective adoption of this interpretation did not have any impact on the Company's financial statements.

#### Future accounting policy changes

In February 2014, the IASB tentatively decided to require an entity to apply IFRS 9 "Financial Instruments" for annual periods beginning on or after January 1, 2018. IFRS 9 is still available for early adoption. The full impact of the standard on the Company's financial statements will not be known until changes are finalized.

In May 2014, the IASB issued IFRS 15 "Revenue from Contracts with Customers," which replaces IAS 18 "Revenue," IAS 11 "Construction Contracts," and related interpretations. The standard is required to be adopted either retrospectively or using a modified transition approach for fiscal years beginning on or after January 1, 2017, with earlier adoption permitted. The Company is currently evaluating the impact of the standard on its financial statements.

### 4. Disposition

On June 16, 2014, the Company sold certain oil and gas assets in central Alberta for a total cash consideration of \$3.48 million.

(\$000)	June 30, 2014
Property, plant and equipment net book value	\$ 1,688
Decommissioning obligations on assets sold	(170)
Gain on sale of assets	1,960
Purchase price paid in cash	\$ 3,478

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## 5. Exploration and evaluation ("E&E") assets

(\$000)	June 30, 2014	December 31, 2013
Opening balance	\$ 14,695	\$ 11,129
E&E expenditures	2,436	6,927
E&E transfer to property, plant and equipment	-	(683)
Amortization	(1,255)	(2,678)
Closing balance	\$ 15,876	\$ 14,695

## 6. Property, plant, and equipment ("PPE")

(\$000)			
Carrying value before accumulated depletion and depreciation	D&P assets	Office	Total
As at December 31, 2013	\$ 332,280	\$ 1,106	\$ 333,386
Additions	49,557	-	49,557
Dispositions (Note 4)	(5,639)	(5)	(5,644)
Change in decommissioning costs	5,429	-	5,429
<b>As at June 30, 2014</b>	<b>\$ 381,627</b>	<b>\$ 1,101</b>	<b>\$ 382,728</b>

(\$000)			
Accumulated depletion and depreciation	D&P assets	Office	Total
As at December 31, 2013	\$ 82,777	\$ 768	\$ 83,545
Depreciation and depletion	15,776	85	15,861
Dispositions (Note 4)	(4,040)	(5)	(4,045)
<b>As at June 30, 2014</b>	<b>\$ 94,513</b>	<b>\$ 848</b>	<b>\$ 95,361</b>

(\$000)			
Net carrying value	D&P assets	Office	Total
As at December 31, 2013	\$ 249,503	\$ 338	\$ 249,841
<b>As at June 30, 2014</b>	<b>\$ 287,114</b>	<b>\$ 253</b>	<b>\$ 287,367</b>

Substantially all of the Company'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. For the six month period ended June 30, 2014, \$1.23 million of direct general and administrative expenses were capitalized to PPE (\$1.20 million for the six month period ended June 30, 2013).

Future capital costs of \$139.9 million (June 30, 2013 - \$71.1 million) have been included in the depletable balance as at June 30, 2014. Major components account for \$54.5 million (June 30, 2013 - \$33.1 million) and are depreciated and tested for impairment separately.



# Strategic Oil & Gas Ltd.

Notes to the interim condensed consolidated financial statements (unaudited)  
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## 7. Bank indebtedness

At June 30, 2014, the Company had 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. Subsequent to the reporting period, the Facility was adjusted to remove the \$20 million acquisition/development component. Strategic had not accessed the acquisition/development loan in 2014. 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 property, plant and equipment. The Facility contains a financial covenant that requires the Company 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. In addition to the Facility, the Company has \$4.1 million letters of credit outstanding with third parties which reduce the amount of funds available under the Facility. The Facility has a renewal date of September 30, 2014.

At June 30, 2014, the Company's adjusted working capital ratio was 0.88, and therefore the financial covenant was not met. Subsequent to period end, the Company has received from the lender a waiver of the covenant violation at June 30, 2014.

## 8. Decommissioning liabilities

Total future decommissioning liabilities are estimated based on the Company's net working interest in all wells and facilities, the estimated costs to abandon and reclaim the wells, pipelines 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 1 to 27 years, depending on the estimated reserve life. The undiscounted amount of the estimated costs at June 30, 2014 were \$72.4 million (December 31, 2013 - \$59.8 million). The estimated costs have been discounted at a risk free rate from 1.11% to 2.82% (December 31, 2013 - 1.13% to 3.20%) and an inflation rate of 2% (December 31, 2013 - 2%) was applied.

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

(\$000)	Six months ended	Year ended
	June 30, 2014	December 31, 2013
Balance beginning of the period	\$ 35,932	\$ 19,036
Liabilities incurred during the period	448	875
Acquisition of liabilities from asset acquisitions	-	14,579
Disposition of liabilities from asset disposition	(170)	-
Expenditures on existing liabilities	(1,301)	(762)
Change in estimated future cash flows	4,350	5,263
Change in discount rate	3,472	(3,928)
Accretion	552	869
Balance end of the period	\$ 43,283	\$ 35,932

During the six months ended June 30, 2014, the change in estimated future cash flows includes \$4.11 million of additional decommissioning liabilities which were recorded related to Steen River (\$2.71 million) and Bistcho (\$1.40 million) assets. The Steen River amounts are to be expended by the end of 2016. The Company has accrued \$3.0 million for amounts due from its insurer for certain decommissioning liabilities. The Bistcho amounts are expected to be expended by the end of 2034.

# Strategic Oil & Gas Ltd.

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

### a) Authorized

The Company 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	Six months ended June 30, 2014	
			Amount
Balance beginning of the period	260,600,646	\$	197,970
Exercise of options	400,000		205
Shares issued	100,000,000		50,000
Share issue costs	-		(701)
Balance end of the period	361,000,646	\$	247,474

(\$000, except for share amounts)	Number of shares	Year ended December 31, 2013	
			Amount
Balance beginning of the year	186,415,268	\$	122,999
Exercise of options	788,333		1,132
Shares issued	73,397,045		76,687
Share issue costs	-		(2,848)
Balance end of the year	260,600,646	\$	197,970

On March 31, 2014, the Company issued 100.0 million common shares via a private placement at a price of \$0.50 per common share for gross proceeds of \$50.0 million (net proceeds of \$49.3 million after transaction costs). Of the \$50.0 million gross proceeds, \$40 million (80 million common shares) was purchased by entities controlled by a director of the Company and an additional \$0.29 million (575,200 common shares) were purchased by directors and officers of the Company.

### c) Weighted average shares

(000)	Three months ended June 30		Six months ended June 30	
	2014	2013	2014	2013
Weighted average shares (basic)	360,959	210,404	311,646	200,121
Weighted average shares (diluted)	360,959	210,404	311,646	200,121

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## 10. Stock-based compensation

For the six months ended June 30, 2014, the Company issued 120,000 common share options which will vest over three years. These options expire five years from the date of issue.

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

	Number of options	Weighted average Exercise Price	
<b>Balance at December 31, 2013</b>	<b>13,235,000</b>	\$	0.98
Issued	120,000		0.54
Exercised	(400,000)		0.35
Forfeited	(383,332)		0.97
Expired	(845,000)		0.76
<b>Balance at June 30, 2014</b>	<b>11,726,668</b>	\$	1.01

The following table sets out the outstanding and exercisable options as at June 30, 2014:

	Outstanding Options			Exercisable Options	
	Number of Options	Weighted Average Exercise Price	Weighted Average Life Years	Number of Options	Weighted Average Exercise Price
	738,334	\$ 0.50	0.80	678,338	\$ 0.49
	880,000	0.65	0.83	826,668	0.65
	605,000	0.84	3.52	425,000	0.84
	1,885,000	0.90	2.00	1,885,000	0.90
	248,334	0.97	3.27	208,336	0.96
	2,050,000	1.10	1.10	2,046,667	1.10
	4,935,000	1.16	3.38	3,178,328	1.16
	10,000	1.19	3.90	6,667	1.19
	75,000	1.24	3.78	50,000	1.24
	300,000	1.31	3.56	200,000	1.31
	<b>11,726,668</b>	<b>\$ 1.01</b>	<b>2.42</b>	<b>9,505,004</b>	<b>\$ 0.99</b>

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:

	Six months ended June 30	
	2014	2013
Assumptions		
Risk free interest rate (%)	<b>1.65</b>	1.67
Expected life (years)	<b>3.79</b>	3.81
Expected volatility (%)	<b>81.28</b>	82.44
Forfeiture rate (%)	<b>9.08</b>	6.46
Weighted average fair value of options granted (\$)	<b>0.52</b>	1.04

Forfeiture rate is calculated based on historical forfeiture data of the Company. The weighted average share price at the date of exercise for share options exercised during the six months ended June 30, 2014 was \$0.35 (June 30, 2013 - \$1.27).

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Notes to the interim condensed consolidated financial statements (unaudited)  
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## 11. Finance costs

(\$000)	Three months ended June 30		Six months ended June 30	
	2014	2013	2014	2013
Interest expense	732	\$ 530	\$ 1,620	\$ 999
Foreign exchange gain realized	-	2	-	(54)
Accretion of decommissioning liabilities	279	207	552	397
	<b>1,011</b>	<b>\$ 739</b>	<b>\$ 2,172</b>	<b>\$ 1,342</b>

## 12. Supplemental cash flow information

(\$000)	Six months ended June 30	
	2014	2013
Interest paid	\$ 1,620	\$ 999
Total	\$ 1,620	\$ 999
Changes in non-cash working capital		
Trade and other receivables <sup>(1)</sup>	(1,846)	(2,597)
Inventory	(31)	(73)
Inventory acquired	-	490
Accounts payable and accrued liabilities	(7,372)	(1,289)
	\$ (9,249)	\$ (3,469)
Operating	1,251	(2,022)
Investing	(10,500)	(1,439)
	\$ (9,249)	\$ (3,461)

(1): included in the trade and other receivables is \$0.25 million of transfer to long-term receivable.

## 13. Transactions with related parties

Legal fees in the amount of \$0.19 million (June 30, 2013 - \$0.30 million) were incurred with a legal firm of which a director is a partner, and these amounts included as general and administrative expenses or share issue costs. Software charges of \$0.10 million (June 30, 2013 - \$0.10 million) were charged to a company controlled by an officer. Trade and other receivables at June 30, 2014 include \$0.28 million (December 31, 2013 - \$nil) receivable from related parties. Accounts payable and accrued liabilities at June 30, 2014 include \$0.02 million (December 31, 2013 - \$0.31 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.

During the six months ended June 30, 2014, the Company disposed of a working interest in a minor non-producing property to a company controlled by a director for consideration of \$0.3 million, which was the deemed fair value of the property at the sale date. As the property had a \$nil carrying value, a \$0.3 million gain on disposition of property, plant and equipment was recorded in the period.

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## 14. Financial instruments and financial risk management

The Company's financial instruments include cash and cash equivalents, trade and other receivables, long-term receivable, bank indebtedness, accounts payable and accrued liabilities, and risk management contracts. The carrying values of cash and cash equivalents, trade and other receivables, long-term receivable, accounts payable and accrued liabilities and bank indebtedness are carried at fair values.

The Company 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 indebtedness is measured at level 1. The fair value of risk management contracts is measured at level 2.

The Company's risk management policies are established to identify and analyze the risks faced by the Company, to set appropriate risk limits and controls, and to monitor risks and adherence to market conditions and the Company's activities. The Company 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 Company's exposure to each of the above risks and the Company's objectives, policies and processes for measuring and managing commodity risks. Further quantitative disclosures are included throughout these financial statements.

### 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 Company may, in certain circumstances, enter into forward oil or natural gas sales contracts to mitigate commodity price risk.

At June 30, 2014, the following risk management contracts were outstanding with a mark-to-market liability value of \$11.0 million (June 30, 2013 - \$3.93 million).

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June 30, 2014 and 2013

## Financial WTI crude oil contracts

Term	Contract Type	Volume (bbl/d)	Fixed Price (\$/bbl)	Index
01-Jan-2014 31-Dec-2014	Swap	1,500	CAD\$92.00	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> Counterparty has an option to convert into a swap at the fixed price indicated. The 600 bbl/d option expires on the last business day before the term begins, while the 250 bbl/d option expires monthly during the contract term.

The Company has also entered into a contract to fix the WTI – Edmonton light differential at CAD\$9.25/bbl on 1,000 bbl/d for August to December 2014.

## Financial AECO gas contracts

Term	Contract Type	Volume (GJ/d)	Fixed Price (\$/GJ)	Index
01-Jan-2014 31-Dec-2014	Swap	1,500	3.50	AECO
01-Jan-2014 31-Dec-2014	Swap	300	3.75	AECO
01-Apr-2014 31-Oct-2014	Swap	500	4.41	AECO

The Company 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 loss and comprehensive loss. For the three months ended June 30, 2014, Strategic recorded unrealized gains on risk management contracts of \$0.66 million (June 30, 2013 – loss of \$2.87 million). For the six months ended June 30, 2014, Strategic recorded unrealized losses on risk management contracts of \$2.60 million (June 30, 2013 - \$3.70 million).

The following table summarizes the fair value as at June 30, 2014 and the change in fair value for the three and six months ended June 30, 2014:

(\$000)	June 30, 2014	December 31, 2013
Net derivative liabilities, beginning of period	\$ (8,757)	\$ (224)
Unrealized change in fair value	(2,597)	(8,533)
Net derivative liabilities, end of period	(11,354)	(8,757)
Derivative assets, end of period	-	-
Gross derivative liabilities, end of period	\$ (11,354)	\$ (8,757)

Net realized losses on risk management contracts for the three and six months ended June 30, 2014 were \$2.92 million (June 30, 2013 – gain of \$0.34 million) and \$5.48 million (June 30, 2013 – gain of \$0.39 million).

# Strategic Oil & Gas Ltd.

Notes to the interim condensed consolidated financial statements (unaudited)  
June 30, 2014 and 2013

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## 15. Capital management

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

The Company 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:

<b>(\$000)</b>	<b>June 30, 2014</b>	<b>December 31, 2013</b>
Operating loan ( <i>Note 8</i> )	\$ <b>80,000</b>	\$ 80,000
Amount drawn	<b>(75,000)</b>	(63,775)
Letters of credit	<b>(4,139)</b>	(4,139)
<b>Unutilized portion of debt facility</b>	<b>861</b>	12,086

As at June 30, 2014, the Company has a working capital deficit of \$89.1 million. The unutilized portion of the debt facility of \$20 million was only available for pre-approved capital expenditures and not available for general working capital purposes. Subsequent to June 30, 2014, in conjunction with the bank providing a waiver for the covenant violation at June 30, 2014 (Note 7), the Facility was amended to eliminate the \$20 million acquisition/development portion of the Facility. Based on expected cash flows and planned capital expenditures management has determined that the Company will need to pursue additional financing in order to complete capital activities and to fund liabilities as they come due. The Company is in the process of evaluating various financing arrangements. In the event that adequate funds from these arrangements are not available, the Company may be required to scale back or eliminate certain projects.



## Management's Discussion and Analysis

### Three and six months ended June 30, 2014

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 and six months ended June 30, 2014, 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 August 12, 2014. This MD&A should be read in conjunction with the Company's interim condensed consolidated financial statements for the three and six months ended June 30, 2014 and 2013, together with the accompanying notes, which have been prepared in accordance with International Financial Reporting Standards ("IFRS"). Further information with respect to the Company can be found on its website at [www.sgoil.com](http://www.sgoil.com) and on the SEDAR website: [www.sedar.com](http://www.sedar.com).

#### FINANCIAL AND OPERATIONAL SUMMARY

	Three Months Ended June 30			Six Months Ended June 30		
	2014	2013	% change	2014	2013	% change
<b>Financial (\$thousands, except per share amounts)</b>						
Oil and natural gas sales	23,723	23,770	-	45,483	41,657	9
Funds from operations <sup>(1)</sup>	3,541	8,672	(59)	4,526	12,629	(64)
Per share basic & diluted <sup>(1)</sup>	0.01	0.04	(75)	0.01	0.06	(83)
Cash provided by (used in) operating activities	(5,627)	7,124	(179)	4,476	9,962	(55)
Per share basic & diluted	(0.02)	(0.03)	(33)	0.01	0.05	(80)
Net loss	(2,717)	(2,336)	16	(12,379)	(5,709)	117
Per share basic & diluted	(0.01)	(0.01)	-	(0.04)	(0.02)	100
Capital expenditures (excluding acquisitions)	13,540	14,782	(8)	51,993	65,050	(20)
Net acquisitions (dispositions)	(3,478)	-	-	(3,821)	10,098	(138)
Bank debt	75,000	70,800	6	75,000	70,800	6
Net debt <sup>(1)</sup>	78,307	80,879	(3)	78,307	80,879	(3)
<b>Operating</b>						
Average daily production						
Crude oil (bbl per day)	2,294	2,768	(17)	2,327	2,544	(9)
Natural gas (mcf per day)	7,461	6,936	8	6,098	4,916	24
Barrels of oil equivalent (boe per day)	3,538	3,924	(10)	3,343	3,364	(1)
Average prices						
Oil & NGL, before risk management (\$ per bbl)	98.21	85.22	15	92.83	83.63	112
Oil & NGL, including risk management (\$ per bbl)	84.23	86.58	(3)	81.74	84.49	(3)
Natural gas (\$ per mcf)	4.75	3.65	30	5.05	3.54	43
Netback (\$ per boe) <sup>(1)</sup>						
Oil and natural gas sales	73.68	66.57	11	75.16	68.41	10
Royalties	(16.26)	(13.46)	21	(16.07)	(14.74)	9
Production expenses	(29.17)	(24.15)	21	(33.94)	(26.48)	28
Operating Netback	28.25	28.96	(2)	25.15	27.19	(8)
<b>Common Shares (thousands)</b>						
Common shares outstanding, end of period	361,001	210,404	72	361,001	210,404	72
Weighted average common shares (basic)	360,959	210,404	72	311,646	200,121	56
Weighted average common shares (diluted)	360,959	210,404	72	311,646	200,121	56

<sup>(1)</sup> Funds from operations, net debt and operating netback are non-IFRS measurements; see "Non-IFRS Measurements" in this MD&A.



## SUMMARY

- Capital expenditures of \$13.5 million for the second quarter of 2014 were directed towards the Bistcho pipeline project and related infrastructure expansion, as well as completion of the 10-24 Muskeg well drilled in the first quarter and the initiation of the Company's summer 2014 drilling program in June.
- Average daily production increased 12 percent to 3,538 boe/d for the three months ended June 30, 2014 from 3,147 boe/d for the first quarter of the year, as the three Muskeg wells drilled during the first quarter achieved over 95 percent uptime and are performing at or above the Company's type curve. Sales volumes for the current period decreased by 10 percent from the second quarter of 2013 due to unanticipated facility downtime at Bistcho/Cameron Hills, the sale of 90 boe/d of non-operated production in June 2014 and the impact of 9,000 barrels of oil production at Marlowe used to fill the Bistcho sales oil pipeline, and no new wells being tied in during the quarter.
- Funds from operations increased to \$3.5 million (\$0.01 per share) in the current quarter from \$1.0 million (\$nil per share) for the first three months of 2014, due to higher production levels and a decrease of \$1.7 million in production costs. Cash flow provided by (used in) operating activities decreased to (\$5.6) million from \$10.1 million for the first quarter of 2014 due to the payment of accrued liabilities resulting from the winter capital program. Funds from operations for the current quarter was impacted by \$2.9 million of realized losses on risk management contracts related to the Company's oil sales hedging program.
- Strategic closed a disposition of non-core oil and gas assets in southern Alberta for proceeds of \$3.5 million. The sold assets consisted of approximately 2 sections of land and 90 boe/d of production (94% natural gas and associated liquids). The proceeds were allocated towards the Company's Muskeg stack development at Marlowe.
- The Company's operating netback increased from \$21.61/boe for the first quarter of 2014 to \$28.25/boe for the three months ended June 30, 2014 as a result of several factors:
  - A decrease in production costs of \$10.20/boe due to higher production levels, cost reduction initiatives focused on the Company's northern operations and the start-up of the Bistcho sales pipeline, which transports oil production from the Marlowe core area a total distance of 115 km to the Rainbow pipeline system;
  - The effect of these cost decreases was partially offset by an increase in the Company's royalty rate to 22.1 percent from 20.6 percent in the first quarter of 2014, as no new wells benefiting from the 5% first year royalty rate were drilled in the current quarter, as well as a decrease of \$3.14 in revenues per boe due to a higher portion of natural gas in Strategic's production mix.
- The Company realized a \$41.00/boe operating netback in the Marlowe core area in the current period, a 46 percent improvement from the first quarter of 2014 and a 4 percent improvement over the second quarter of 2013.

## 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 measurements

The Company utilizes the following terms for measurement within the MD&A that do not have a standardized meaning or definition as prescribed by GAAP 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 GAAP.

The following table reconciles funds from operations to cash flow generated by operating activities:

(\$thousands)	Three months ended June 30		Six months ended June 30	
	2014	2013	2014	2013
Cash provided by operating activities	(5,627)	7,124	4,476	9,962
Expenditures on decommissioning liabilities	20	(28)	1,301	645
Changes in non-cash working capital	9,148	1,576	(1,251)	2,022
Funds from operations	3,541	8,672	4,526	12,629

"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 GAAP measurement that would be directly comparable to operating netbacks.

"Adjusted net working capital (deficiency)" and "net debt" are used to assess capital requirements and leverage, as well as evaluate funds available on the Company's credit facility. Adjusted net working capital (deficiency) is calculated as current assets less current liabilities, excluding bank debt, deferred price premium on flow through shares and any assets or liabilities related to risk management contracts. Net debt is calculated as bank debt plus adjusted net working capital deficiency, or less adjusted net working capital. A reconciliation of adjusted net working capital and net debt to working capital deficiency is as follows:

(\$thousands)	June 30, 2014	December 31, 2013
Current liabilities	106,930	101,127
Current assets	(17,778)	(9,685)
Working capital deficiency	89,152	91,442
Less: deferred price premium on flow-through shares	(265)	(1,619)
Risk management contract liability	(10,580)	(7,276)
Net debt	78,307	82,547
Bank debt	(75,000)	(63,775)
Adjusted net working capital deficiency	3,307	18,772

## 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 Steen River, Alberta.

## RESERVES SUMMARY

The Company obtained an updated evaluation of its oil, natural gas and natural gas liquids ("NGL") reserves by McDaniel and Associates ("McDaniel") as at July 1, 2014. With only three new wells drilled in the first half of 2014, Strategic increased proved plus probable reserves by 32% to 16.0 MMboe (66% oil) after accounting for year to date production, and increased the net present value of proved and probable reserves, discounted at 10% to \$251 million from \$180 million at year-end 2013. The reserves are summarized below.

Gross Reserves <sup>(1)</sup>	Light and Medium Crude Oil (Mbbl)	Heavy Oil (Mbbl)	Natural Gas (MMcf)	Natural Gas Liquids (Mbbl)	Oil Equivalent (MBoe <sup>(2)</sup> )
Proved Producing	3,036	84	8,749	9	4,587
Proved Non-Producing	128	0	3,323	0	682
Proved Undeveloped	1,400	0	3,107	0	1,918
<b>Total Proved</b>	<b>4,564</b>	<b>84</b>	<b>15,179</b>	<b>9</b>	<b>7,187</b>
<b>Total Probable</b>	<b>5,926</b>	<b>38</b>	<b>17,248</b>	<b>4</b>	<b>8,842</b>
<b>Total Proved and Probable</b>	<b>10,489</b>	<b>123</b>	<b>32,427</b>	<b>12</b>	<b>16,029</b>

<sup>(1)</sup> Gross Corporate reserves are the Company's total working interest share before the deduction of any royalties and without including any royalty interests of the Company. The July 1, 2014 reserves report has been prepared in accordance with the definitions, procedures and standards contained in the Canadian Oil and Gas Evaluation Handbook and NI 51-101- Standards of Disclosure for Oil and Gas Activities.

<sup>(2)</sup> The Company's aggregate proved and probable 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.

Proved and probable producing reserves represent 40 percent of total proved and probable reserves. Strategic's light and medium oil, natural gas and NGL reserves were evaluated by McDaniel using McDaniel's product price forecasts effective July 1, 2014 prior to provision for financial risk management contracts, income taxes, interest, debt service charges and general and administrative expenses. The following table summarizes the net present

value from recognized reserves at July 1, 2014, assuming various discount rates, and incorporating future development costs and abandonment liabilities. **It should not be assumed that the discounted future net revenues estimated by McDaniel represent the fair market value of the Company's assets or future production from its assets.**

**Summary of Before Tax Net Present Value of Future Net Revenue (Forecast Pricing) <sup>(1)</sup>**

(\$ thousands)	Discounted at			
	Undiscounted	5%	10%	15%
Proved Producing	112,286	93,931	81,625	72,827
Proved Non-Producing	9,817	7,630	6,130	5,060
Proved Undeveloped	47,460	31,505	20,901	13,496
<b>Total Proved</b>	<b>169,563</b>	<b>133,066</b>	<b>108,657</b>	<b>91,382</b>
<b>Total Probable</b>	<b>323,693</b>	<b>202,742</b>	<b>142,506</b>	<b>107,908</b>
<b>Total Proved and Probable</b>	<b>493,256</b>	<b>335,808</b>	<b>251,163</b>	<b>199,291</b>

<sup>(1)</sup> Tables may not add due to rounding. There is no assurance that the forecast prices and costs assumptions will be attained and variances could be material. The recovery and reserve estimates of Strategic's crude oil, natural gas liquids and natural gas reserves provided herein are estimates only and there is no guarantee that the estimated reserves will be recovered. Actual crude oil, natural gas and natural gas liquids reserves may be greater than or less than the estimates provided herein.

## OUTLOOK

Strategic initiated its summer Muskeg drilling program on June 13, 2014, and has since drilled three wells and spud a fourth. Strategic made enhancements in the Muskeg well design that have proven successful in reducing drilling times and associated costs while boosting production rates. As a result of the efficiencies, the Company is well ahead of schedule and anticipates having five Muskeg wells drilled, completed and on stream by the end of the third quarter and intends to keep one rig active for the remainder of the year.

On January 17, 2014, Strategic provided annual guidance of 4,400-4,600 Boe/d of production (70% oil) and \$35-40 million in funds from operations. The Company spent a significant portion of the capital program during the first half of 2014 on facility and pipeline projects. During the first half of 2014, Strategic planned to drill seven wells however drilling was limited to three Muskeg wells in order to manage debt levels and as a result the Company's production and funds from operations did not meet guidance. On June 17, 2014 Strategic provided an exit guidance of 4,000 Boe/d.

With the efficiency data drawn from its recent successful summer drilling program, Strategic is evaluating financing alternatives to capitalize on the positive momentum and accelerate development. The Company plans to drill up to 10 wells during the second half of the year. Strategic is encouraged by its recent success in the Muskeg program and is increasing its 2014 exit production guidance from 4,000 Boe/d to 4,600 Boe/d.

Strategic is planning a 20 well program for 2015 focused on further Muskeg development and 3 exploratory Keg River tests.

## RESULTS OF OPERATIONS

### Production

Average daily production	Three months ended June 30		Six months ended June 30	
	2014	2013	2014	2013
Oil & NGL (bbl/d)	2,294	2,768	2,327	2,544
Natural gas (mcf/d)	7,461	6,936	6,098	4,916
Total (boed)	3,538	3,924	3,343	3,364

Average daily production for the three months ended June 30, 2014 decreased 10 percent from the second quarter of 2013 due to unanticipated facility downtime at Bistcho/Cameron Hills, the sale of 90 boe/d of non-operated production in June 2014 and the impact of 9,000 barrels of oil production at Marlowe used to fill the Bistcho sales oil pipeline, partially offset by additions from Muskeg drilling during second half of 2013 and first quarter of 2014. Over the past 12 months the Company has been focused on infrastructure construction to allow for production growth at Marlowe and efficient deliverability of product to major pipeline systems, and as such has had limited capital available for drilling activities. Strategic drilled just three wells in the first six months of 2014, but intends to spend the majority of its capital budget on drilling and completions for the remainder of the year and in future years. Average daily production for the first six months of 2014 decreased 21 boe/d or 1% from 2013.

The oil & NGL weighting of Strategic's production mix dropped to 65 percent oil in the second quarter of 2014 from 71 percent for the comparative quarter in 2013 due to the higher natural gas content of the Muskeg Stack horizontal oil wells relative to the Keg River wells drilled in previous years.

### Revenue

(\$thousands, except where noted)	Three months ended June 30		Six months ended June 30	
	2014	2013	2014	2013
Sales				
Oil & NGL	20,501	21,465	39,912	38,511
Natural gas	3,222	2,305	5,571	3,146
Oil and natural gas sales	23,723	23,770	45,483	41,657
Unrealized gain (loss) on risk management contracts	663	(2,876)	(2,597)	(3,704)
Realized gain (loss) on risk management contracts	(2,918)	341	(5,482)	393
	21,468	21,235	37,404	38,346
Average prices <sup>(1)</sup>				
Oil & NGL, before realized gain (loss) on risk management contracts (\$/bbl)	98.21	85.22	92.83	83.63
Oil & NGL, including realized gain (loss) on risk management contracts (\$/bbl)	84.23	86.58	81.74	84.49
Natural gas (\$/mcf)	4.75	3.65	5.05	3.54
Oil equivalent (\$/boe)	73.68	66.57	75.16	68.41
Reference prices				
Oil – WTI (\$US/bbl)	102.99	94.22	100.84	94.30
Natural gas – AECO Daily Index (\$/MMBtu)	4.68	3.52	5.20	3.35

<sup>(1)</sup> Average prices do not include unrealized losses on risk management contracts or other revenue.

The Corporation's oil and natural gas revenues decreased to \$23.7 million for the three months ended June 30, 2014 from \$23.8 million for the second quarter of 2013 primarily due to a ten percent decrease in production offset by higher commodity prices. Oil and natural gas revenues totaled \$45.5 million for the first half of 2014, a 9 percent increase from \$41.7 million for the 2013 period, driven by an \$11.12/bbl increase in oil & NGL prices and a \$1.51/mcf rise in natural gas prices.

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. Strategic's average oil & NGL prices for the three and six months ended June 30, 2014 increased

12 percent and 13 percent, respectively due to higher WTI oil prices and a higher CDN/US exchange rate compared to the prior periods. Strategic's average natural gas prices for the second quarter and first six months of 2014 increased 30 percent and 43 percent, respectively from the corresponding periods in 2013 due to higher AECO Daily Index prices. Substantially all of the Company's natural gas production is sold at the AECO Daily Index price, adjusted for fuel charges.

### 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 up to 60 percent of expected production levels, depending on current commodity prices, price volatility and the size and nature of the Company's capital spending programs.

Strategic's risk management program resulted in realized losses on oil and natural gas contracts of \$2.9 million or \$9.05/boe for the current quarter and \$5.5 million or \$9.06/boe for the first six months of 2014 (three and six months ended June 30, 2013 - \$0.3 million and \$0.4 million realized gains, respectively). A summary of Strategic's commodity price risk management contracts as at June 30, 2014 is as follows:

### Financial WTI crude oil contracts

Term	Contract Type	Volume (bbl/d)	Fixed Price (\$/bbl)	Index
01-Jul-2014 31-Dec-2014	Swap	1,500	CAD\$92.00	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> Counterparty has an option to convert into a swap at the fixed price indicated. The 600 bbl/d option expires on the last business day before the term begins, while the 250 bbl/d option expires monthly during the contract term.

The Company has also entered into a contract to fix the WTI - Edmonton light differential at CAD\$9.25/bbl on 1,000 bbl/d for August to December 2014.

### Financial AECO gas contracts

Term	Contract Type	Volume (GJ/d)	Fixed Price (\$/GJ)	Index
01-Jul-2014 31-Dec-2014	Swap	1,500	3.50	AECO Daily
01-Jul-2014 31-Dec-2014	Swap	300	3.75	AECO Daily
01-Jul-2014 31-Oct-2014	Swap	500	4.41	AECO Daily

Unrealized gains and losses on risk management contracts are related to previously unrealized losses becoming realized in the current period, as well as fluctuations in the forward price curves for oil and natural gas. Strategic recorded an unrealized gain on risk management contracts of \$0.7 million and an unrealized loss of \$2.6 million for the three and six months ended June 30, 2014 (loss for three and six months ended June 30, 2013 - \$2.9 million and \$3.7 million, respectively). Strategic employs risk management contracts in order to mitigate commodity price volatility and protect cash flows. Although Strategic believes its risk management program provides an effective hedge against WTI and AECO price volatility, the Company does not follow hedge accounting for these contracts. As a result, the contracts are marked to market at each reporting date, with the change in market value included in net income (loss) for the period.

## Royalties

(\$thousands, except where noted)	Three months ended June 30		Six months ended June 30	
	2014	2013	2014	2013
Crown royalties	5,006	4,487	9,235	8,450
Freehold and overriding royalties	229	318	487	523
Total royalties	5,235	4,805	9,722	8,973
Per boe	16.26	13.46	16.07	14.74
Percentage of oil and natural gas sales	22.1%	20.2%	21.4%	21.5%

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. Generally royalty rates in western Canada vary based on volume produced by individual wells, prices received 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 3,000 metres in depth.

Royalties increased to \$5.2 million or 22.1 percent of revenues in the current period from \$4.8 million or 20.2 percent of revenues for the three months ended June 30, 2013 due to higher oil prices and wells drilled as part of the 2013 winter capital program coming off the reduced first year royalty rate. Royalties for the first six months of 2014 were 21.4 percent of revenues as compared to 21.5 percent of revenues in the comparative period for 2013. At current oil and gas prices, crown royalty rates on natural gas are 5-10%, compared to rates of 5-40% for Steen River oil, depending on well productivity and vintage.

## Production expenses

(\$thousands, except per boe amounts)	Three months ended June 30		Six months ended June 30	
	2014	2013	2014	2013
Production expenses	9,392	8,604	20,539	15,523
Per boe	29.17	24.15	33.94	26.48

Production expenses increased to \$9.4 million (\$29.17/boe) in the current quarter from \$8.6 million (\$24.15/boe) for the comparative period in 2013 due to higher chemicals and fuel charges and repair costs related to short-term facility shut-downs at Bistcho/Cameron Hills, partially offset by tucking cost savings related to the start-up of the Bistcho oil sales pipeline.

Production costs for the six months ended June 30, 2014 increased to \$20.5 million from \$15.5 million in 2013 due to a full quarter of production costs for Bistcho/Cameron Hills, increased workover, chemicals and fuel expenditures and costs related to regulatory compliance.

## Netbacks

(\$/boe)	Three months ended June 30		Six months ended June 30	
	2014	2013	2014	2013
Revenue	73.68	66.57	75.16	68.41
Royalties	(16.26)	(13.46)	(16.07)	(14.74)
Production expenses	(29.17)	(24.15)	(33.94)	(26.48)
Operating netback	28.25	28.96	25.15	27.19

Strategic's operating netback decreased to \$28.25/boe and \$25.15/boe for the second quarter and first six months of 2014 from \$28.96/boe and \$27.19/boe respectively for the comparative periods in 2013. Higher oil and gas prices experienced in the current year were more than offset by an increase in royalty rates caused by higher commodity prices and increased unit production costs due to workovers, regulatory compliance costs and facility repairs at Bistcho/Cameron Hills.

Strategic's 100 percent owned and operated focus area is Marlowe, which continues to generate a competitive netback. The Company expects the operating netback at Marlowe to continue to improve as production from newly drilled wells is brought onstream, benefiting from the lower royalty rate and adding volumes to offset fixed costs at processing facilities in the area. The breakdown of Strategic's operating netback for the three months ended June 30, 2014 is as follows:

<b>Operating netback (\$/boe)</b>	Marlowe	Other	Total
Revenue	85.17	47.56	<b>73.68</b>
Royalties	(21.92)	(3.37)	<b>(16.26)</b>
Production expenses	(22.25)	(44.91)	<b>(29.17)</b>
Operating netback	41.00	(0.72)	<b>28.25</b>

#### **General and administrative expense**

<b>(\$thousands, except per boe amounts)</b>	Three months ended June 30		Six months ended June 30	
	<b>2014</b>	2013	<b>2014</b>	2013
General and administrative expense	<b>1,905</b>	1,498	<b>3,594</b>	3,403
Per boe	<b>5.92</b>	4.20	<b>5.94</b>	5.59

General and administrative ("G&A") expense increased to \$1.9 million (\$5.92/boe) and \$3.6 million (\$5.94/boe), respectively, for the three and six months of 2014 from \$1.5 million (\$4.20/boe) and \$3.4 million (\$5.59/boe), respectively, in 2013. Current period costs include \$0.4 million in severance charges related to the office staff reductions announced in April 2014.

#### **Finance expense**

<b>(\$thousands, except per boe amounts)</b>	Three months ended June 30		Six months ended June 30	
	<b>2014</b>	2013	<b>2014</b>	2013
Interest expense	<b>732</b>	531	<b>1,620</b>	945
Accretion expense	<b>279</b>	207	<b>552</b>	397
Total	<b>1,011</b>	738	<b>2,172</b>	1,342
Per boe	<b>3.14</b>	2.07	<b>3.59</b>	2.20

Interest expense increased to \$0.7 million and \$1.6 million for the three and six months ended June 30, 2014 from \$0.5 million and \$0.9 million for 2013 due to higher average bank debt levels in the current period.

Accretion expense is a reflection of an increase in the Company's discounted decommissioning liability due to the passage of time. Accretion expense and the decommissioning liability have increased from the prior year due to Strategic's expanding asset base as a result of acquisitions and drilling activity over the past year.

#### **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 second quarter and first six months of 2014 the Company incurred \$0.1 million and \$0.3 million in stock based compensation expense, a decrease from \$0.5 million and \$0.9 million for the corresponding periods in 2013, as no stock options were issued and 1.2 million options were forfeited or expired during the current year. A portion of all options granted generally vest immediately, therefore the fair value of the vested options is expensed on the grant date.

#### Depletion, depreciation and amortization

(\$thousands, except per boe amounts)	Three months ended June 30		Six months ended June 30	
	2014	2013	2014	2013
Depreciation, depletion and amortization ("DD&A")	8,562	7,474	17,116	13,441
Per boe	26.59	20.93	28.29	22.08

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 increased to \$8.6 million and \$17.1 million for the three and six months ending June 30, 2014 from \$7.5 million and \$13.4 million, respectively for the 2013 periods due to higher DD&A rates. DD&A expense per boe in 2014 increased by 27 percent for the current quarter from 2013 as a result of significant capital expenditures in the current year on infrastructure projects such as the Bistcho oil sales pipeline. These projects, while critical to improving profitability and executing the Company's growth strategy, do not increase reserves and therefore will increase the DD&A rate per boe at current production levels.

#### Deferred taxes

Strategic recorded a deferred tax recovery of \$0.1 million and \$1.4 million, respectively for the three and six months ended June 30, 2014. The Company issued \$17.0 million of flow-through common shares in October 2013, with a related price premium of \$2.3 million recorded on the balance sheet on the issue date. As eligible flow-through expenditures are incurred by the Company, the price premium is reduced and a deferred tax recovery is recorded. As of June 30, 2014, Strategic has approximately \$2.0 million in commitments for flow-through expenditures remaining, and intends to fulfill this commitment prior to December 31, 2014.

#### Funds from operations and net loss

(\$thousands, except per share amounts)	Three months ended June 30		Six months ended June 30	
	2014	2013	2014	2013
Funds from operations	3,541	8,672	4,526	12,629
Per share – basic & diluted	0.01	0.04	0.01	0.06
Cash flow provided by (used in) operating activities	(5,627)	7,124	4,476	9,962
Net loss	(2,717)	(2,336)	(12,379)	(5,709)
Per share – basic & diluted	(0.01)	(0.01)	(0.04)	(0.03)

Funds from operations decreased from \$8.7 million for the three months ended June 30, 2013 to \$3.5 million for the current quarter due to realized risk management losses of \$2.9 million, higher production costs, royalties and severance costs for office staff. Cash flow used in operating activities totaled \$5.6 million for the current period as compared to cash flow provided by operating activities of \$7.1 million for the second quarter of 2013, due to lower funds from operations and an increase in payments for production and capital costs in the quarter, caused by the closing of an equity financing at the end of the first quarter of 2014.

For the six months ended June 30, 2014, funds from operations decreased 64 percent and cash flow provided by operating activities decreased 55 percent from the first half of 2013, primarily related to a \$5.5 million realized loss on risk management contracts and higher production costs.

Net loss increased to \$2.7 million (\$0.01 per basic and diluted common share) and \$12.4 million (\$0.04 per basic and diluted common share) for the three and six months ended June 30, 2014 from \$2.3 million (\$0.01 per basic and diluted common share) and \$5.7 million (\$0.03 per basic and diluted common share), respectively for the 2013 period, as a result of lower funds from operations and higher DD&A expenses, partially offset by lower unrealized losses on risk management contracts and gains on disposals of property, plant and equipment.

### Capital expenditures

(\$thousands)	Three months ended June 30		Six months ended June 30	
	2014	2013	2014	2013
Drilling and completions	4,971	4,199	23,498	35,144
Equipping and facilities	8,252	8,573	26,059	23,150
Other	-	87	-	246
	13,223	12,859	49,557	58,540
Acquisitions, net of dispositions	(3,478)	-	(3,821)	10,098
Total property, plant and equipment	9,745	12,859	45,736	68,638
Total exploration and evaluations	317	1,923	2,436	6,510
Total capital expenditures	10,062	14,782	48,172	75,148

Total capital expenditures decreased to \$10.1 million for the second quarter of 2014 from \$14.8 million for the three months ended June 30, 2013, due to a property disposition and a reduction in undeveloped land purchases in the current period.

Drilling and completions in the current three month period include the completion of the third well drilled the first quarter of 2014 and drilling costs for the first well in Strategic's summer drilling program, which was spud in June 2014 and completed in the third quarter. The Company has significantly decreased drilling days and other associated well costs with the summer drilling program. Strategic drilled and completed the 11-24 well for \$3.9 million, a reduction of over \$1.0 million from the average cost of the wells drilled during the first quarter of 2014. A shift change in the overall well plan has been the first step in Strategic's continued focus on cost reductions.

Equipping and facilities expenditures of \$8.3 million were focused on the Bistcho sales oil pipeline project and related infrastructure expansion. Strategic's two facilities in the Marlowe area are capable of processing up to 8,500 bbls/d of oil, 18,000 bbls/d of total fluid and 10 MMcf/d of natural gas production.

During the quarter the Company disposed of a non-core property for proceeds of \$3.5 million. The sold assets consisted of approximately 2 sections of land and 90 boe/d of production (94% natural gas and associated liquids).

Exploration and evaluation expenditures decreased to \$0.3 million and \$2.4 million for the three and six months ended June 30, 2014 from \$1.9 million and \$6.5 million, respectively in the comparative periods for 2013. Significant 2D and 3D seismic programs were executed in the first quarter of 2013. Strategic anticipates that exploration and evaluation expenditures will be minimal for the remainder of 2014 as capital expenditures are focused on drilling and production related activities, to take advantage of the significant infrastructure build undertaken by the Company over the last year.

## SUMMARY OF QUARTERLY FINANCIAL DATA

The following table summarizes quarterly financial results:

<b>Quarter ended (\$thousands, except where noted)</b>	<b>Jun 30, 2014</b>	Mar 31, 2014	Dec 31, 2013	Sept 30, 2013
Oil and natural gas sales	<b>23,723</b>	21,759	15,660	22,628
Net loss	<b>(2,703)</b>	(9,664)	(9,852)	(6,759)
Net loss per share – basic	<b>(0.01)</b>	(0.04)	(0.04)	(0.03)
Net loss per share – diluted	<b>(0.01)</b>	(0.04)	(0.04)	(0.03)
Average daily production (boed)	<b>3,538</b>	3,147	2,847	3,510
Average price (\$/boe)	<b>73.68</b>	76.82	59.80	62.12

<b>Quarter ended (\$thousands, except where noted)</b>	Jun 30, 2013	Mar 31, 2013	Dec 31, 2012	Sept 30, 2012
Oil and natural gas sales	23,770	17,887	15,863	12,520
Net income (loss)	(2,338)	(3,371)	(5,917)	(718)
Net income (loss) per share – basic	(0.01)	(0.02)	(0.03)	(0.00)
Net income (loss) per share – diluted	(0.01)	(0.02)	(0.03)	(0.00)
Average daily production (boed)	3,924	2,797	2,282	1,930
Average price (\$/boe)	67.53	71.05	75.57	70.52

Oil and natural gas sales are a function of average daily production levels, the oil/gas production mix and commodity prices, and increased significantly with higher production levels in 2013 and the first quarter of 2014 and higher prices in the first two quarters of 2014 compared to the 2012. The fourth quarter of 2013 is an exception as production volumes were impacted by facility downtime and extremely cold weather in December. Net income (loss) varies with sales and fund from operations, as well as non-cash expenses incurred such as unrealized losses on risk management contracts, DD&A and impairment. Net losses are highest in the fourth quarter of 2013 and first quarter of 2014 due to lower funds from operations and higher DD&A expenses relative to the other quarters presented. The net loss in the second quarter of 2014 was positively impacted by a gain on disposal of property of \$2.0 million. Maintaining positive net income on a consistent basis will depend on the Company's ability to increase production and reserves and reduce unit production costs, transportation costs and DD&A.

## LIQUIDITY AND CAPITAL RESOURCES

The Company considers its capital structure to include shareholders' equity and working capital, including bank debt. The objectives of the Company are to maintain a strong balance sheet affording the Company financial flexibility to achieve goals of continued growth and access to capital.

In order to maintain or adjust the capital structure, the Company may issue new common shares, issue or repay debt, or adjust exploration and development capital expenditures.

The Company monitors its capital program based on available funds, which is the combination of working capital and remaining unused line of credit, as calculated below:

<b>(\$thousands)</b>	<b>June 30, 2014</b>	December 31, 2013
Current assets	<b>17,778</b>	9,685
Accounts payable and accruals	<b>(21,085)</b>	(28,457)
Adjusted working capital deficiency	<b>(3,307)</b>	(18,772)
Bank indebtedness	<b>(75,000)</b>	(63,775)
Net debt	<b>(78,307)</b>	(82,547)

At June 30, 2014 the Company had 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. Subsequent to the reporting date the acquisition/development loan component was removed from the Facility, which will reduce bank fees incurred by the Company. Strategic had not accessed the acquisition/development loan to date in 2014. 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 property, plant and equipment. The Facility contains a financial covenant that requires the Company 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. In addition to \$75 million drawn on the Facility at June 30, 2014, the Company has \$4.1 million letters of credit outstanding with third parties which reduce the amount of funds available under the Facility. The Facility has a renewal date of September 30, 2014.

At June 30, 2014, the Company's adjusted working capital ratio was 0.88, and therefore the financial covenant was not met. Subsequent to period end, the Company has received from the lender a waiver of the covenant violation at June 30, 2014, which was conditional on the removal of the acquisition/development loan described above.

Net debt decreased to \$78.3 million at June 30, 2014 from \$82.5 million at December 31, 2013. However bank indebtedness increased by \$11.2 million over the same period, due to draws on the Facility used to make payments to suppliers for drilling-related liabilities in the current quarter. A reconciliation of changes in net debt is as follows:

Net debt	\$ millions
Net debt, December 31, 2013	82.5
Funds from operations	(4.5)
Share issuances, net of costs	(49.2)
Capital expenditures	52.0
Expenditures on decommissioning obligations	1.3
Proceeds on disposal of property, plant and equipment	(3.8)
<b>Net debt, June 30, 2014</b>	<b>78.3</b>

Based on expected cash flows and planned capital expenditures in the second half of the year management has determined that the Company will need to pursue additional financing in order to complete capital activities and to fund liabilities as they come due. The Company is in the process of evaluating various financing arrangements. In the event that adequate funds from these arrangements are not available, the Company may be required to scale back or eliminate certain projects.

Going forward the Company intends to use funds from operations and equity or other financings to fund capital expenditure programs and acquisitions.

## SHARE CAPITAL

	Three months ended June 30		Three months ended June 30	
	2014	2013	2014	2013
Weighted average common shares outstanding (thousands)				
Basic	<b>360,959</b>	210,404	<b>311,646</b>	200,121
Diluted	<b>360,959</b>	210,404	<b>311,646</b>	200,121

	June 30, 2014	December 31, 2013
Outstanding securities (thousands)		
Common shares	361,001	260,601
Stock options	11,727	13,235

On March 31, 2014, the Company issued 100.0 million common shares via a private placement at a price of \$0.50 per common share for gross proceeds of \$50.0 million (net proceeds of \$49.3 million after transaction costs). Of the \$50.0 million gross proceeds, \$40.0 million (80.0 million common shares) were acquired by entities controlled by a director of the Company and another \$0.29 million (0.6 million common shares) were acquired by directors and officers of the Company. Proceeds from the private placement were primarily used to repay accounts payable and accrued liabilities incurred in executing the first quarter 2014 capital program.

In the first six months of 2014, 120,000 stock options were granted at an average price of \$0.57 per common share, and 400,000 stock options were exercised for common shares of the Company, for total proceeds of \$0.14 million.

As of August 12, 2014 there were 361,000,646 common shares outstanding and 11,535,000 stock options outstanding.

#### TRANSACTIONS WITH RELATED PARTIES

Legal fees in the amount of \$0.19 million (June 30, 2013 - \$0.30 million) were incurred with a legal firm of which a director is a partner, and these amounts included as general and administrative expenses or share issue costs. Software charges of \$0.10 million (June 30, 2013 - \$0.10 million) were charged to a company controlled by an officer. Trade and other receivables at June 30, 2014 include \$0.28 million (December 31, 2013 - \$nil) receivable from related parties. Accounts payable and accrued liabilities at June 30, 2014 include \$0.02 million (December 31, 2013 - \$0.31 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.

In the first quarter of 2014 the Company disposed of a working interest in a non-producing property to a company controlled by a director for consideration of \$0.3 million, which was the deemed fair value of the property at the sale date. As the property had a \$nil carrying value, a \$0.3 million gain on disposition of property, plant and equipment was recorded in the period.

#### COMMITMENTS

The Company has lease agreements for office space resulting in the following commitments at June 30, 2014:

Year ended June 30	(\$thousands)
2014	169
2015	311
2016	10
Total	490

#### CHANGES IN ACCOUNTING POLICIES

As of January 1, 2014, the Company adopted several new IFRS interpretations and amendments in accordance with the transitional provisions of each standard.

- IAS 36 "Impairment of Assets" has been amended to reduce the circumstances in which the recoverable amount of cash generating units ("CGUs") is required to be disclosed and clarify the

disclosures required when an impairment loss has been recognized or reversed in the period. The retrospective adoption of these amendments will only impact the Company's disclosures in the notes to the financial statements in periods when an impairment loss or impairment reversal is recognized.

- IAS 39 "Financial Instruments: Recognition and Measurement" has been amended to clarify that there would be no requirement to discontinue hedge accounting if a hedging derivative was novated, provided certain criteria are met. The retrospective adoption of the amendments does not have any impact on the Company's financial statements.
- IFRIC 21 "Levies" was developed by the IFRS Interpretations Committee ("IFRIC") and is applicable to all levies imposed by governments under legislation, other than outflows that are within the scope of other standards (e.g., IAS 12 "Income Taxes") and fines or other penalties for breaches of legislation. The interpretation clarifies that an entity recognizes a liability for a levy when the activity that triggers payment, as identified by the relevant legislation, occurs. It also clarifies that a levy liability is accrued progressively only if the activity that triggers payment occurs over a period of time, in accordance with the relevant legislation. Lastly, the interpretation clarifies that a liability should not be recognized before the specified minimum threshold to trigger that levy is reached. The retrospective adoption of this interpretation does not have any impact on the Company's financial statements.

In February 2014, the IASB tentatively decided to require an entity to apply IFRS 9 "Financial Instruments" for annual periods beginning on or after January 1, 2018. IFRS 9 is still available for early adoption. The full impact of the standard on the Company's financial statements will not be known until changes are finalized.

In May 2014, the IASB issued IFRS 15 "Revenue from Contracts with Customers," which replaces IAS 18 "Revenue," IAS 11 "Construction Contracts," and related interpretations. The standard is required to be adopted either retrospectively or using a modified transition approach for fiscal years beginning on or after January 1, 2017, with earlier adoption permitted. The Company is currently evaluating the impact of the standard on its financial statements.

## **CRITICAL ACCOUNTING ESTIMATES**

This MD&A is based on Strategic's 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, 2013. 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 consolidated financial statements is included in Strategic's MD&A for the year ended December 31, 2013.

## **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. Strategic's credit facility is in the form of a demand loan, which must be renewed periodically and may

be reduced at the option of the lender. 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.

Based on expected cash flows and planned capital expenditures in the second half of the year management has determined that the Company will need to pursue additional financing in order to complete capital activities and to fund liabilities as they come due. The Company is in the process of evaluating various financing arrangements. In the event that adequate funds from these arrangements are not available, the Company may be required to scale back or eliminate certain projects.

### **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. 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 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.

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, 2013.

### **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) total shareholder return; (xi) growth prospects; (xii) asset disposition plans; (xiii) 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, 2013 and other documents filed with Canadian provincial securities authorities and are available to the public at [www.sedar.com](http://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.