
## MESSAGE TO SHAREHOLDERS

Pine Cliff Energy Ltd. is pleased to report its results for the second quarter and first half of 2014. In the second quarter of 2014, we experienced significant funds flow from operations from our portfolio of high quality, low cost, low decline assets and remained disciplined in our search for accretive opportunities that would fit our asset criteria. Subsequent to June 30, 2014, we were able to announce two such acquisitions.

Highlights during the second quarter are as follows:

- Attained average daily sales volumes of 6,371 boe per day as compared to 6,276 boe per day in the first quarter of 2014. The normal production decline was more than offset by operational improvements and production being brought back on after freeze-offs experienced in the first quarter as a result of cold winter weather;
- Realized operating expenses of $9.02 per boe, a reduction of 3% from the first quarter of 2014;
- Generated quarterly funds flow from operations of $9.2 million, a decrease of 9% as compared to the first quarter 2014 funds flow from operations of $10.1 million. This decrease is mainly a result of a lower natural gas price environment in the second quarter, partially offset by higher average sales volumes;
- Realized quarterly earnings of $2.3 million (first quarter of 2014 – earnings of $3.0 million);
- Exited the quarter with no debt and positive working capital of $34.0 million; and
- Announced, subsequent to quarter-end, the closing of an acquisition of certain oil and natural gas assets in the Carrot Creek / Edson area of Alberta and entering into a binding agreement to acquire certain natural gas assets in Southern Alberta and Southern Saskatchewan.

### Acquisition Update

Pine Cliff has been actively seeking opportunities to enhance shareholder value by adding low cost and low decline natural gas production. Subsequent to the quarter, Pine Cliff was pleased to announce two significant acquisitions that both complement our existing assets and are within our current two core areas.

On August 7, 2014, Pine Cliff completed the acquisition of certain oil and natural gas assets in the Carrot Creek/Edson area of Alberta. The total consideration of $33.25 million, prior to adjustments was financed through a combination of working capital and debt. The assets produce approximately 970 boe per day (May 2014 average provided by the vendor) and possess a predictable low cost production profile, long reserve life and a geographically focused asset base contiguous with Pine Cliff's current Carrot Creek/Edson core area. The Carrot Creek / Edson assets have multi-zone, potentially low risk drilling opportunities, including infill drilling that are characterized by liquids rich, high productivity wells and favourable royalties and operating costs. Subsequent to the closing of this acquisition, Pine Cliff has a combined asset production base of over 7,000 boe per day.

On July 17, 2014, Pine Cliff announced entering into a binding agreement to acquire certain shallow natural gas assets in Alberta and Southern Saskatchewan for $100.0 million, prior to adjustments. The cash consideration is expected to be financed through a combination of working capital and debt. The majority of the Alberta assets are located east of the City of Medicine Hat with some minor assets in Central Alberta near the City of Wetaskiwin. The Saskatchewan assets are located near the Town of Maple Creek. The assets produce approximately 5,300 boe per day (May 2014 average provided by the vendor) and possess a predictable production profile, long reserve life and a geographically focused asset base which is 100% weighted to natural gas and some low risk infill drill locations. This acquisition is presently expected to close on or before November 1, 2014 and subsequent to closing, Pine Cliff is expected to have a combined asset production base of over 12,000 boe per day.

### Outlook

As a result of the closing of the Carrot Creek/Edson acquisition in August 2014, Pine Cliff has increased its production guidance for 2014 to between 6,500 and 6,700 boe per day. Pine Cliff maintains its capital spending guidance of $13.6 million, which is substantially below Pine Cliff's funds flow from operations for the first six months of 2014, reserving excess funds flow to pay down debt or for future acquisitions. Pine Cliff is committed to maintaining a strong balance sheet and subsequent to the closing of the August and November 2014 acquisitions Pine Cliff's net debt to funds flow from operations is expected to be less than 1.5:1, using $4.00 per mcf natural gas pricing. Given its modest capital program, Pine Cliff expects to use its excess funds flow from operations to reduce this ratio further before the end of 2014.

We are very excited about the months ahead and I wish to take this opportunity to thank the staff and consultants for the extra effort that was provided by them during the past months. To our shareholders, thank you for your support and continued confidence in our business plan. We look forward to updating you in the near future on the next stage of our development.

Yours truly,

Phil Hodge
President and Chief Executive Officer
August 13, 2014

*Please refer to the attached Management's Discussion and Analysis for Reader Advisories regarding forward-looking information, non-IFRS measures and oil and gas measurements. This President's Message should be read in conjunction with the unaudited condensed consolidated interim financial statements of Pine Cliff Energy Ltd. together with Management's Discussion and Analysis for the three months ended June 30, 2014 and 2013, which can be found on www.sedar.com and is subject to the same cautionary statements as set out therein.*

| | Three months ended June 30 | | Six months ended June 30 | |
|---|---|---|---|---|
| | **2014** | 2013 | **2014** | 2013 |
| ($000s, unless otherwise indicated) | | | | |
| **FINANCIAL** | | | | |
| **Oil and gas sales** | **17,136** | 9,084 | **35,512** | 14,542 |
| **Cash flow from operating activities** | **7,242** | 3,751 | **17,281** | 6,852 |
| **Funds flow from operations** [1] | **9,180** | 3,721 | **19,269** | 6,122 |
| Basic per share ($/share) | **0.05** | 0.02 | **0.10** | 0.04 |
| Diluted per share ($/share) | **0.04** | 0.02 | **0.09** | 0.04 |
| **Earnings (loss)** | **2,333** | (183) | **5,302** | 8,088 |
| Basic per share ($/share) | **0.01** | (0.00) | **0.03** | 0.05 |
| Diluted per share ($/share) | **0.01** | (0.00) | **0.03** | 0.05 |
| **Capital expenditures, excluding acquisitions** | **1,990** | 1,740 | **3,110** | 4,055 |
| **Acquisitions** | **-** | - | **-** | 45,203 |
| **Working capital** | **34,047** | 37,062 | **34,047** | 37,062 |
| Weighted-average common shares outstanding (000s) | | | | |
| Basic | **203,138** | 157,119 | **201,931** | 155,236 |
| Diluted | **210,167** | 157,119 | **209,733** | 161,443 |
| **OPERATIONS** | | | | |
| **Production** [2] | | | | |
| Natural gas (mcf/d) | **36,877** | 24,352 | **36,499** | 19,068 |
| Crude oil (bbls/d) | **38** | 93 | **47** | 70 |
| Natural gas liquids (bbls/d) | **187** | 183 | **194** | 193 |
| Total (boe/d) | **6,371** | 4,335 | **6,324** | 3,440 |
| **Realized commodity sales prices** | | | | |
| Natural gas ($/mcf) | **4.56** | 3.37 | **4.86** | 3.32 |
| Crude oil ($/bbl) | **97.92** | 87.29 | **93.84** | 86.25 |
| Natural gas liquids ($/bbl) | **87.31** | 53.37 | **73.07** | 58.10 |
| Combined ($/boe) | **29.55** | 23.03 | **31.02** | 23.35 |
| **Netback ($/boe)** | | | | |
| Operating netback ($/boe) [3] | **17.45** | 10.75 | **18.62** | 10.56 |

[1] Funds flow from operations is a non-IFRS measure that represents the total of funds provided by operating activities, before adjusting for changes in non-cash working capital and changes in interest payable.
[2] The results for the six months ended June 30, 2013 include the results of the Southern Assets for the 131 day period of February 19 to June 30, 2013.
[3] Operating netback is a non-IFRS measure calculated as the Company's oil and gas sales, less royalties and operating expenses, averaged over the boe production of the Company.

August 13, 2014

**INTRODUCTION**

*The following Management's Discussion and Analysis ("MD&A") is a review of the operations and current financial position for the six months ended June 30, 2014 for Pine Cliff Energy Ltd. ("Pine Cliff" or the "Company") and should be read in conjunction with the unaudited condensed consolidated interim financial statements as at and for the three month period ended June 30, 2014 and 2013, together with the notes related thereto, and the audited consolidated financial statements as at and for the year ended December 31, 2013, together with the notes related thereto ("2013 Annual Financial Statements"). Additional information relating to the Company, including the Company's Annual Information Form, may be found on www.sedar.com and by visiting Pine Cliff's website at www.pinecliffenergy.com.*

*Pine Cliff's head office is based in Calgary, Alberta, Canada. Common shares of the Company are listed and posted for trading on the Toronto Stock Exchange Venture under the symbol "PNE".*

**READER ADVISORIES**

*This MD&A contains financial measures that are not defined under International Financial Reporting Standards ("IFRS") and forward-looking statements. Readers are cautioned that the MD&A should be read in conjunction with the Company's disclosure under "Non-IFRS Measures" and "Forward-Looking Information" included at the end of the MD&A.*

***Other Measurements***

*All amounts herein are presented in Canadian dollars unless otherwise specified. All references to C$ or $ are to Canadian dollars and references to US$ are to United States dollars.*

*Where amounts are expressed in a barrel of oil equivalent ("boe" or daily equivalent of "boe/d"), natural gas volumes have been converted to barrels of oil equivalent on the basis that nine thousand cubic feet of natural gas ("mcf" or daily equivalent of "mcf/d") is equal to one barrel of oil ("bbl" or daily equivalent of "bbl/d"). This conversion ratio is based on energy equivalence primarily at the burner tip and does not represent a value equivalency at the wellhead. The term boe may be misleading, particularly if used in isolation.*

**SENSITIVITIES**

Pine Cliff's results are sensitive to changes in the business environment in which it operates. The following chart shows the Company's sensitivity to key commodity price variables and interest rates. The sensitivity calculations are performed independently showing the effect of the change of one variable; all other variables are held constant.

| Business environment sensitivities | | Impact on annual funds flow from operations [1] | |
|---|---|---|---|
| | Change | $000s | $ per share [3] |
| Crude oil price - Edmonton par ($/bbl) [2] | $1.00 | 120 | 0.00 |
| Natural gas price - AECO ($/mcf) [2] | $0.10 | 1,460 | 0.01 |
| Foreign exchange (CAD/USD) | 1.0% | - | 0.00 |
| Interest rate on variable rate debt | 1.0% | - | 0.00 |

[1] This analysis does not adjust for changes in working capital and uses current royalty rates.
[2] Pine Cliff has prepared this analysis using its second quarter 2014 daily sales volumes annualized for twelve months.
[3] Based on the second quarter of 2014 basic weighted average shares outstanding of 203,137,556.

**PINE CLIFF'S STRATEGIC OBJECTIVES AND ACQUISITIONS**

Pine Cliff is a growth oriented oil and gas exploration and production company seeking to acquire material asset positions in the Western Canadian Sedimentary Basin ("WCSB") to enlarge its current core areas and create new core areas of production with significant reserves and drilling inventories. The Company's vision is to deliver long-term value to shareholders by building a portfolio of high-return assets for future growth focusing on counter cyclical natural gas opportunities while also accelerating current oil and liquids drilling and optimization opportunities.

The Company has executed five key transactions in the past two years, including: the acquisition of certain oil and natural gas assets in the Carrot Creek area of Alberta (the "Carrot Creek Assets"); the combination of its operations with those of Geomark Exploration Ltd. ("Geomark"); the acquisition of Skope Energy Ltd. (the "Skope Acquisition"); the acquisition of additional working interests in the Monogram Unit (the "Monogram Unit") that is a portion of the Southern Assets, as defined herein, and related infrastructure (the "Monogram Asset Acquisition"); and the acquisition of additional interests in the Southern Assets (the "Additional Interests Acquisition").

Management is pleased with its progress and believes that the assets that have been assembled to date provide Pine Cliff with significant opportunities for returns correlated with increases in the price of natural gas. In the near-term, Pine Cliff will continue to maintain a strong statement of financial position, drill selected strategic wells and aggressively pursue, evaluate and attempt to execute on accretive business acquisitions. On July 17 and July 29, 2014, the Company announced two acquisitions. Refer to the disclosure under "Subsequent Events" for further details.

**PINE CLIFF'S OPERATIONS**

Pine Cliff's operations include the exploration, development and production of natural gas, crude oil and natural gas liquids ("liquids" or "NGLs"). Pine Cliff's main areas of production are as follows:

- Southern Assets – At June 30, 2014, Pine Cliff holds an approximate 95% working interest in a package of high-quality, low decline, producing shallow gas assets in southeast Alberta and southwest Saskatchewan (collectively, the "Southern Assets"). The majority of the producing zones in these properties are from the upper Cretaceous Milk River, Medicine Hat and Second White Specks sands, which together constitute a small interest for Pine Cliff in one of the largest Canadian gas fields in Western Canada. These fields are characterized by their shallow depths, low-permeability and clay-rich sands; and

- Carrot Creek – Pine Cliff holds a working interest in the Carrot Creek Assets which are located southeast of the town of Edson, Alberta that produce liquids rich natural gas as well as a small amount of oil. In addition to the producing assets, Pine Cliff has, in aggregate, 14.5 gross (6.81 net) sections of undeveloped land in this area. Pine Cliff increased its land position in the Carrot Creek area in the third quarter of 2013 through a farm-in deal that has earned Pine Cliff 5.75 gross (3.375 net) sections of land. The Carrot Creek area has multi-zone potential which can be further exploited using horizontal drilling technology. Pine Cliff is the operator of approximately 90% of the Company's production in the area;

- Other – the balance of Pine Cliff's 2014 production comes from non-operated properties in the Sundance area in northwest Alberta (the "Sundance Assets") and from non-operated properties in the Harmatten, Garrington and Carstairs areas in central Alberta (the "Central Alberta Assets"), however the Company does not currently have large enough land positions or working interests in these areas to consider them significant core areas.

**GUIDANCE FOR 2014**

The 2014 guidance provides information as to management's expectation for results of operations for 2014. Readers are cautioned that the 2014 guidance may not be appropriate for other purposes. The Company's expected results are sensitive to fluctuations in the business environment and may vary accordingly. This guidance contains forward-looking information and should be read in conjunction with the Company's disclosure under "Forward-Looking Information" included on the final page of the MD&A.

**Production**

| | 2014 Guidance | Six months ended June 30, 2014 |
|---|---|---|
| Barrels of oil equivalent per day | 6,500 - 6,700 | 6,324 |

As a result of the closing of the acquisition of the Carrot Creek/Edson Assets, as defined herein, on August 7, 2014, Pine Cliff has increased its production guidance for 2014 to between 6,500 – 6,700 boe/d. On July 17, 2014, the Company announced an additional acquisition of the Shallow Gas Assets, as defined herein, that is expected to close on or before November 1, 2014. Pine Cliff expects to further revise its production guidance for 2014 upon the closing of that acquisition.

**Capital Expenditures**

| | 2014 Guidance | Six months ended June 30, 2014 |
|---|---|---|
| ($000's) | | |
| Total | 13,600 | 3,110 |

Pine Cliff remains committed to an accretive acquisition program in 2014 while continuing to focus on maintaining a strong statement of financial position. Capital expenditures during the first six months of 2014 were $3.1 million. Pine Cliff plans to fund its 2014 capital expenditures from funds flow from operations.

Pine Cliff maintains its capital guidance and plans to spend $13.6 million in 2014. Pine Cliff's capital expenditure program is sensitive to commodity pricing and Pine Cliff's budget is designed to be flexible to balance capital expenditures against available funds flow. This program is anticipated to be substantially less than the Company's estimated 2014 funds flow from operations, which remains dependent on natural gas prices.

**SELECTED QUARTERLY FINANCIAL INFORMATION**

| | **2014** | | 2013 | | | | 2012 | |
|---|---|---|---|---|---|---|---|---|
| ($000s, unless otherwise indicated) | **Q2** | Q1 | Q4 | Q3 [1] | Q2 | Q1 [2] | Q4 [3] | Q3 |
| Average sales volumes (boe/d) | **6,371** | 6,276 | 6,443 | 5,784 | 4,335 | 2,536 | 832 | 895 |
| Operating netback ($/boe) [4] | **17.45** | 19.82 | 10.26 | 7.32 | 10.75 | 10.26 | 11.94 | 13.36 |
| Oil and gas sales | **17,136** | 18,376 | 12,621 | 9,719 | 9,084 | 5,458 | 2,319 | 2,197 |
| Oil and gas sales, net of royalties | **15,339** | 16,447 | 11,634 | 8,595 | 8,546 | 4,584 | 1,894 | 1,824 |
| Total revenue | **15,540** | 16,634 | 11,839 | 8,783 | 8,727 | 5,346 | 2,752 | 1,824 |
| Cash flow from operating activities | **7,242** | 10,039 | 6,631 | 2,579 | 3,751 | 3,101 | 660 | 246 |
| Funds flow from operations [5] | **9,180** | 10,089 | 5,564 | 3,014 | 3,721 | 2,401 | 775 | 442 |
| Per share - basic ($/share) | **0.05** | 0.05 | 0.03 | 0.02 | 0.02 | 0.02 | 0.01 | 0.01 |
| Per share - diluted ($/share) | **0.04** | 0.05 | 0.02 | 0.02 | 0.02 | 0.02 | 0.01 | 0.01 |
| Earnings (loss) | **2,333** | 2,969 | 3,722 | (709) | (183) | 8,271 | (862) | (472) |
| Per share - basic ($/share) | **0.01** | 0.01 | 0.01 | 0.00 | 0.00 | 0.05 | (0.01) | (0.01) |
| Per share - diluted ($/share) | **0.01** | 0.01 | 0.01 | 0.00 | 0.00 | 0.05 | (0.01) | (0.01) |

[1] The results for Q3-2013 include the results of the Monogram Asset Acquisition for the 68 day period of July 24 to September 30, 2013, and Additional Interests Acquisition for the 31 day period of August 30 to September 30, 2013.
[2] The results for Q1-2013 include the results of the Southern Assets Acquisition for the 40 day period of February 19 to March 31, 2013.
[3] The sales volumes for Q4-2012 include the results of the Central Alberta Assets for the 73 day period of October 19 to December 31, 2012.
[4] Operating netback is a non-IFRS measure calculated as the Company's oil and gas sales, less royalties and operating expenses, averaged over the boe production of the Company.
[5] Funds flow from operations is a non-IFRS measure that represents the total of funds provided by operating activities, before adjusting for changes in non-cash working capital.

### Second quarter 2014 highlights

During the second quarter of 2014, Pine Cliff reports that it:

- Attained average daily sales volumes of 6,371 boe/d as compared to 6,276 boe/d in the first quarter of 2014. The increase is mainly a result of production being brought back on from freeze-offs experienced in the first quarter as a result of the cold weather;
- Achieved quarterly funds flow from operations of $9.2 million, a decrease of 9% as compared to the first quarter 2014 funds flow from operations of $10.1 million. This decrease is mainly a result of a lower natural gas price environment, partially offset by higher average sales volumes; and
- Realized quarterly earnings of $2.3 million, a decrease of 21% as compared to the first quarter 2014 earnings of $3.0 million. This decrease is mainly a result of higher non-cash depletion and depreciation, a lower natural gas price environment, partially offset by lower share based payment expense.

**SALES VOLUMES**

| | Three months ended June 30 | | Six months ended June 30 | |
|---|---|---|---|---|
| **Total sales volumes by product** | **2014** | 2013 | **2014** | 2013 |
| Natural gas (mcf) | **3,355,797** | 2,216,022 | **6,606,257** | 3,451,338 |
| Crude oil (bbls) | **3,479** | 8,484 | **8,497** | 12,603 |
| NGLs (bbls) | **17,055** | 16,696 | **35,152** | 34,884 |
| Barrels of oil equivalent | **579,834** | 394,517 | **1,144,692** | 622,710 |
| Oil and liquids weighting | **4%** | 6% | **4%** | 8% |

| Average daily sales volumes by product | Three months ended June 30 **2014** | 2013 | Six months ended June 30 **2014** | 2013 |
|---|---|---|---|---|
| Natural gas (mcf/d) | **36,877** | 24,352 | **36,499** | 19,068 |
| Crude oil (bbls/d) | **38** | 93 | **47** | 70 |
| NGLs (bbls/d) | **187** | 183 | **194** | 193 |
| Total (boe/d) | **6,371** | 4,335 | **6,324** | 3,440 |

| Average daily sales volumes by property | Three months ended June 30 **2014** | 2013 | Six months ended June 30 **2014** | 2013 |
|---|---|---|---|---|
| (boe/d) | | | | |
| Southern Assets | **5,260** | 3,336 | **5,283** | 2,426 |
| Carrot Creek | **944** | 801 | **818** | 817 |
| Central Alberta | **87** | 130 | **143** | 127 |
| Sundance | **80** | 68 | **80** | 70 |
| Total | **6,371** | 4,335 | **6,324** | 3,440 |

Pine Cliff's sales volumes increased by 47% and 84% in the three and six month periods ended June 30, 2014, respectively as compared to the same periods of 2013. The significant increase was mainly a result of two acquisitions in the Southern Assets core area in the latter half of 2013.

Although many of the production issues experienced in the first quarter of 2014 that related to freeze-offs were resolved; in the second quarter of 2014, Pine Cliff's production was negatively impacted by scheduled maintenance and turnarounds conducted on the Southern Assets in April and May. The increase in Carrot Creek production is primarily due to the Company's sour gas wells being on production for the full second quarter, while these wells were shut-in for approximately half of the first quarter of 2014. Production from the new Sundance well offset production declines in the area, resulting in production over the three and six months ended June 30, 2014 remaining flat.

**OPERATING AND CORPORATE NETBACKS**

The components of the operating and corporate netback are summarized as follows:

| | Three months ended June 30 **2014** | 2013 | Six months ended June 30 **2014** | 2013 |
|---|---|---|---|---|
| ($ per boe) | | | | |
| Oil and gas sales | **29.55** | 23.03 | **31.02** | 23.35 |
| Royalties | **(3.08)** | (1.36) | **(3.25)** | (2.27) |
| Operating expenses | **(9.02)** | (10.92) | **(9.15)** | (10.52) |
| Operating netback | **17.45** | 10.75 | **18.62** | 10.56 |
| General and administrative expense | **(2.01)** | (1.65) | **(2.14)** | (2.13) |
| Interest and bank charges | **0.07** | (0.03) | **0.02** | (0.06) |
| Finance and dividend income | **0.33** | 0.46 | **0.34** | 1.51 |
| Corporate netback | **15.84** | 9.53 | **16.84** | 9.88 |

Pine Cliff generated an operating netback of $17.45 and $18.62 per boe for the three and six months ended June 30, 2014, respectively, as compared to $10.75 and $10.56 per boe for the three and six months ended June 30, 2013, respectively. Overall, Pine Cliff generated a corporate netback of $15.84 and $16.84 per boe for the three and six months ended June 30, 2014, as compared to $9.53 and $9.88 per boe in the same period of 2013. This increase is mainly due to higher commodity prices and lower operating expenses per boe which were partially offset by higher royalties per boe and a lower liquids weighting.

**OIL AND GAS SALES**

| | Three months ended June 30 | | | | Six months ended June 30 | | | |
|---|---|---|---|---|---|---|---|---|
| | **2014** | | 2013 | | **2014** | | 2013 | |
| (000s, except per boe amounts) | **$** | **$ per boe** | $ | $ per boe | **$** | **$ per boe** | $ | $ per boe |
| Natural gas [1] | **15,306** | **4.56** | 7,453 | 3.37 | **32,146** | **4.86** | 11,459 | 3.32 |
| Crude oil | **341** | **97.92** | 741 | 87.29 | **797** | **93.84** | 1,087 | 86.25 |
| NGLs | **1,489** | **87.31** | 890 | 53.37 | **2,569** | **73.07** | 2,027 | 58.10 |
| Total sales | **17,136** | **29.55** | 9,084 | 23.03 | **35,512** | **31.02** | 14,542 | 23.35 |

[1] Per unit values are expressed in $ per mcf.

Oil and gas sales for the three and six months ended June 30, 2014 increased by 89% and 144%, respectively, as compared to the same periods of 2013, reflecting increased sales volumes from acquisitions completed subsequent to the second quarter of 2013 and a higher commodity price environment in 2014. Conversely, in the second quarter of 2013, oil and gas sales were mainly comprised of revenue from the Carrot Creek Assets and a portion of the Southern Assets that were purchased in February of 2013. Pine Cliff's realized price in the three and six months ended June 30, 2014 was $29.55 and $31.02 per boe, respectively, as compared to $23.03 and $23.35 per boe in the three and six months ended June 30, 2013, respectively, reflecting an overall increase in the commodity price environment.

**Commodity prices and foreign exchange rates**

Pine Cliff's financial results are significantly influenced by fluctuations in commodity prices, including price differentials. The following table shows select market benchmark average prices and foreign exchange rates in the last eight quarters to assist in understanding the volatility in prices and foreign exchange rates that have impacted Pine Cliff's business.

| | **Q2-2014** | Q1-2014 | Q4-2013 | Q3-2013 | Q2-2013 | Q1-2013 | Q4-2012 | Q3-2012 |
|---|---|---|---|---|---|---|---|---|
| **Natural gas** | | | | | | | | |
| NYMEX (US$/mmbtu) [1] | **4.56** | 4.90 | 3.63 | 3.60 | 4.09 | 3.35 | 3.36 | 2.81 |
| AECO (C$/mcf) | **4.76** | 5.42 | 3.52 | 2.43 | 3.52 | 3.18 | 3.20 | 2.31 |
| **Crude oil** | | | | | | | | |
| WTI (US$/bbl) | **102.99** | 98.68 | 97.44 | 105.82 | 94.22 | 94.37 | 88.18 | 92.22 |
| Edmonton light (C$/bbl) | **105.33** | 100.23 | 86.75 | 105.18 | 93.03 | 88.65 | 84.47 | 84.79 |
| **Foreign exchange** | | | | | | | | |
| C$/US$ | **1.0905** | 1.1035 | 1.0498 | 1.0385 | 1.0234 | 1.0089 | 0.9913 | 0.9948 |

[1] mmbtu is the abbreviation for millions of British thermal units. One mcf of natural gas is approximately 1.02 mmbtu.

The natural gas pricing environment improved in the second quarter of 2014 with the benchmark AECO natural gas price in Canada increasing by 35% in the second quarter of 2014 as compared to the second quarter of 2013, and average NYMEX gas price in the United States increasing by 11% in the same period. The AECO monthly strip for the next 12 months is currently trading in the $4.00 per mcf range, and although this is in line with the average price for the previous 12 months, the forward strip has weakened substantially in recent weeks likely due to storage being filled at a faster rate than anticipated as a cool summer has reduced usage. Pine Cliff's realized natural gas price during the second quarter of 2014 was $4.56 per mcf, a decrease of 12% over the first quarter of 2014 and an increase of 35% over the second quarter of 2013.

WTI oil prices averaged US$102.99 per bbl in the second quarter of 2014 as compared to US$94.22 per bbl in the second quarter of 2013. Canadian crude prices are based upon refiner postings at Edmonton, Alberta and are linked to WTI through transportation tariffs to common markets and the foreign exchange rate. There remains potential for the price differentials to remain volatile in future periods. In the three months ended June 30, 2014, the realized price of Pine Cliff's oil was $97.92 per bbl, as a result of quality adjustments to the average posted Edmonton light crude oil price of $105.33 per bbl.

Historically, the average price of NGLs has tracked the price of oil. However, changes in the supply and demand for certain NGLs such as ethane, propane and butane have impacted the relationship between the price of NGLs and the price of oil. In the three months ended June 30, 2014, the realized price of Pine Cliff's NGLs was $87.31 per bbl, representing approximately 83% of the Edmonton light crude oil prices as compared to 60% in the three months ended June 30, 2013.

Pine Cliff currently does not utilize a hedging strategy and thereby does not eliminate any of the upside, or potential downside, of price fluctuations for its shareholders. The Company continues to monitor the fluctuating commodity prices closely and their impact on our results and strategies.

**ROYALTIES**

| | Three months ended June 30 | | | | Six months ended June 30 | | | |
|---|---|---|---|---|---|---|---|---|
| | **2014** | | 2013 | | **2014** | | 2013 | |
| (000s, except per boe amounts) | **$** | **$ per boe** | $ | $ per boe | **$** | **$ per boe** | $ | $ per boe |
| Total | **1,797** | **3.10** | 538 | 1.36 | **3,726** | **3.26** | 1,412 | 2.27 |
| % of oil and gas sales | **10%** | | 6% | | **10%** | | 10% | |

Royalties for the three and six months ended June 30, 2014 were $3.10 and $3.26 per boe, respectively, as compared to $1.36 and $2.27 per boe for the three and six months ended June 30, 2013, respectively. As a percentage of oil and gas sales, royalties averaged 10% for the three and six months ended June 30, 2014, as compared to 6% and 10% for the three and six months ended June 30, 2013, respectively. The increase in royalties as a percentage of oil and gas sales for the three months ended June 30, 2014 as compared to the three months ended June 30, 2013 is a result of higher than anticipated royalty credits received on the Carrot Creek Assets in the prior year.

**OPERATING EXPENSES**

| | Three months ended June 30 | | | | Six months ended June 30 | | | |
|---|---|---|---|---|---|---|---|---|
| | **2014** | | 2013 | | **2014** | | 2013 | |
| (000s, except per boe amounts) | **$** | **$ per boe** | $ | $ per boe | **$** | **$ per boe** | $ | $ per boe |
| Operating expenses | **5,231** | **9.02** | 4,307 | 10.92 | **10,477** | **9.15** | 6,551 | 10.52 |
| % of oil and gas sales | **31%** | | 47% | | **30%** | | 45% | |

Operating expenses for the three and six months ended June 30, 2014 decreased by 17% and 13% per boe, respectively, as compared to the same periods of 2013. The decrease is due in part to lower average operating expenses per boe on the Southern Assets which make up a larger percentage of Pine Cliff's 2014 production.

Pine Cliff is committed to seeking ways to increase efficiencies in the field on its operated properties and is working with its partners on its non-operated properties to attempt to decrease the operating expenses per boe in future periods.

**GENERAL AND ADMINISTRATIVE EXPENSES**

| | Three months ended June 30 | | | | Six months ended June 30 | | | |
|---|---|---|---|---|---|---|---|---|
| | **2014** | | 2013 | | **2014** | | 2013 | |
| (000s, except per boe amounts) | **$** | **$ per boe** | $ | $ per boe | **$** | **$ per boe** | $ | $ per boe |
| Total | **1,169** | **2.02** | 651 | 1.65 | **2,446** | **2.14** | 1,329 | 2.13 |
| Less: non-recurring transaction costs | **-** | **-** | 19 | 0.05 | **-** | **-** | 154 | 0.25 |
| | **1,169** | **2.02** | 632 | 1.60 | **2,446** | **2.14** | 1,175 | 1.89 |
| % of oil and gas sales | **7%** | | 7% | | **7%** | | 8% | |

General and administrative expenses ("G&A"), excluding non-recurring transaction costs, increased 26% and 13% per boe in the three and six months ended June 30, 2014, respectively, as compared to the same periods of 2013. On an absolute dollar basis, G&A has increased in 2014 mainly due to increased staffing requirements associated with the 2013 acquisitions. To keep G&A at a low level, Pine Cliff shares some common expenses with Bonterra Energy Corp. ("Bonterra"), a related party.

In the three and six months ended June 30, 2013, Pine Cliff incurred $0.02 million and $0.2 million, respectively, in transaction costs related to the acquisition of Skope. The transaction costs are comprised of legal, accounting, consulting and regulatory expenses associated with those business transactions.

**SHARE-BASED PAYMENTS**

| | Three months ended June 30 | | | | Six months ended June 30 | | | |
|---|---|---|---|---|---|---|---|---|
| | **2014** | | 2013 | | **2014** | | 2013 | |
| (000s, except per boe amounts) | **$** | **$ per boe** | $ | $ per boe | **$** | **$ per boe** | $ | $ per boe |
| Total | **346** | **0.60** | 536 | 1.36 | **1,043** | **0.91** | 1,098 | 1.76 |
| % of oil and gas sales | **2%** | | 6% | | **3%** | | 8% | |

The Company has an equity settled stock-based compensation plan. Stock options are granted to certain officers, directors, employees and consultants, with the term and vesting period of the options granted being determined at the discretion of the Company's board of directors. An option's maximum term is five years.

In the six months ended June 30, 2014, Pine Cliff granted stock options to purchase 1,399,500 common shares at a weighted average exercise price of $1.44 per share. As at June 30, 2014, the Company had 11,791,500 stock options outstanding (June 30, 2013 - 10,675,000) which represents 5.8% of common shares outstanding. In the three and six months ended June 30, 2014, Pine Cliff recorded share-based payment expense of $0.3 million and $1.0 million, respectively, (three and six months ended June 30, 2013 - $0.5 million and $1.1 million, respectively) related to the stock options issued.

**DEPLETION AND DEPRECIATION**

| | Three months ended June 30 | | | | Six months ended June 30 | | | |
|---|---|---|---|---|---|---|---|---|
| | **2014** | | 2013 | | **2014** | | 2013 | |
| (000s, except per boe amounts) | **$** | **$ per boe** | $ | $ per boe | **$** | **$ per boe** | $ | $ per boe |
| Oil and gas assets | **5,266** | **9.08** | 3,375 | 8.55 | **10,285** | **8.98** | 5,243 | 8.42 |
| Office furniture and equipment | **54** | **0.09** | 1 | - | **102** | **0.09** | 1 | - |
| Total | **5,320** | **9.17** | 3,376 | 8.55 | **10,387** | **9.07** | 5,244 | 8.42 |
| % of oil and gas sales | **31%** | | 37% | | **29%** | | 36% | |

Pine Cliff's depletion and depreciation expense increased 7% and 8% on a per boe basis in the three and six months ended June 30, 2014, respectively, as compared to the same periods in 2013. The increase in depletion and depreciation expense per boe in 2014 is mainly a result of a higher depletion rate on the Southern Assets which contributed approximately 83% and 84% of the total production for the three and six months ended June 30, 2014, respectively, as compared to 77% and 71% in the three and six months ended June 30, 2013, respectively.

**FINANCE EXPENSES**

| | Three months ended June 30 | | | | Six months ended June 30 | | | |
|---|---|---|---|---|---|---|---|---|
| | **2014** | | 2013 | | **2014** | | 2013 | |
| (000s, except per boe amounts) | **$** | **$ per boe** | $ | $ per boe | **$** | **$ per boe** | $ | $ per boe |
| Unwinding of the discounted value of decommissioning liabilities | **323** | **0.56** | 235 | 0.60 | **652** | **0.57** | 328 | 0.53 |
| Interest and bank charges | **(40)** | **(0.07)** | 13 | 0.03 | **(18)** | **(0.02)** | 36 | 0.06 |
| Total | **283** | **0.49** | 248 | 0.63 | **635** | **0.55** | 364 | 0.59 |
| % of oil and gas sales | **2%** | | 3% | | **2%** | | 3% | |

In the three and six months ended June 30, 2014, Pine Cliff incurred finance expenses of $0.3 million and $0.6 million, respectively, as compared to $0.2 million $0.4 million in the three and six months ended June 30, 2013, respectively. Finance expenses in 2014 primarily relate to the unwinding of the discounted value of decommissioning liabilities which has increased as a result of the significant decommissioning liabilities associated with the Southern Assets.

**FINANCE AND DIVIDEND INCOME**

| | Three months ended June 30 | | | | Six months ended June 30 | | | |
|---|---|---|---|---|---|---|---|---|
| | **2014** | | 2013 | | **2014** | | 2013 | |
| (000s, except per boe amounts) | **$** | **$ per boe** | $ | $ per boe | **$** | **$ per boe** | $ | $ per boe |
| Finance income | **20** | **0.03** | 9 | 0.02 | **23** | **0.02** | 607 | 0.97 |
| Dividend income | **181** | **0.31** | 172 | 0.44 | **365** | **0.32** | 336 | 0.54 |
| Total | **201** | **0.34** | 181 | 0.46 | **388** | **0.34** | 943 | 1.51 |
| % of oil and gas sales | **1%** | | 2% | | **1%** | | 6% | |

In the three and six months ended June 30, 2014, Pine Cliff received $0.2 million and $0.4 million, respectively, in dividends from its investment in Bonterra (three and six months ended June 30, 2013 - $0.2 million and $0.3 million, respectively) The investment in Bonterra common shares was acquired through the Geomark Transaction. During the six months ended June 30, 2013, Pine Cliff collected interest on monies loaned as part of the Skope Acquisition. This interest collection ceased on February 19, 2013, when Skope Energy Ltd. became a wholly-owned subsidiary of Pine Cliff.

**INCOME TAXES**

| | Three months ended June 30 | | | | Six months ended June 30 | | | |
|---|---|---|---|---|---|---|---|---|
| | **2014** | | 2013 | | **2014** | | 2013 | |
| (000s, except per boe amounts) | **$** | **$ per boe** | $ | $ per boe | **$** | **$ per boe** | $ | $ per boe |
| Deferred tax expense | **858** | **1.48** | (262) | (0.66) | **1,884** | **1.65** | 2,437 | 3.91 |

During the three and six months ended June 30, 2014, Pine Cliff recorded deferred tax expense of $0.9 million and $1.9 million, respectively (three and six months ended June 30, 2013 - $0.3 million and $2.4 million, respectively). The movement to a deferred tax expense in the three months ended June 30, 2014 from a deferred tax recovery in the same period in 2013 is a result of earnings recognized in the current period as compared to a loss in the respective prior period. The reduction in deferred tax expense in the six months ended June 30, 2014 is due to the absence of the one-time gain recognized on the Skope Acquisition in the same period of 2013.

Pine Cliff has approximately $166.0 million in tax pools at June 30, 2014 (December 31, 2013 - $195.4 million) available for future use as deductions from taxable income.

**EARNINGS**

Year to date to year to date variance analysis:

| ($000s) | |
|---|---|
| **Earnings for the six months ended June 30, 2013** | **8,088** |
| Price variance | 4,776 |
| Volume variance | 16,194 |
| Royalties | (2,314) |
| Operating expenses | (3,891) |
| General and administrative | (1,117) |
| Share-based payments | 55 |
| Depletion and depreciation | (5,143) |
| Finance expenses | (271) |
| Gain on acquisition | (11,117) |
| Dividend income | 29 |
| Finance income | (584) |
| Deferred tax expense (recovery) | 553 |
| Impairment of investment | 44 |
| **Earnings for the six months ended June 30, 2014** | **5,302** |

In the six months ended June 30, 2014, earnings decreased by $2.8 million to $5.3 million as compared to the six months ended June 30, 2013. The decrease in earnings is mainly due to higher depletion expense in the second quarter of 2014 and a one-time $11.1 million gain on acquisition in the prior year, offset by positive volume and price variances in 2014 as compared to 2013. The increase in volumes is attributed to increased production from the Additional Interests Acquisition on the Southern Assets in the latter half of 2013 and increased production from the Southern Assets in 2014. The commodity price environment has also increased in the second quarter of 2014 as compared to the same period of 2013. Refer to further discussion in "Oil and Gas Sales".

**Other comprehensive earnings**

Other comprehensive earnings relates to the increase and decrease in fair value of Pine Cliff's investment in Bonterra, Nighthawk Gold Corp. and another public corporation. At June 30, 2014, Pine Cliff's investments have a fair value of $13.5 million as compared to $11.3 million at December 31, 2013.

**FUNDS FLOW FROM OPERATIONS**

| | Three months ended June 30 | | Six months ended June 30 | |
|---|---|---|---|---|
| | **2014** | 2013 | **2014** | 2013 |
| ($000s, except per boe amounts) | | | | |
| Earnings (loss) for the period | **2,333** | (183) | **5,302** | 8,088 |
| Adjustments for: | | | | |
| Share-based payments | **346** | 536 | **1,043** | 1,098 |
| Depletion and depreciation | **5,320** | 3,376 | **10,387** | 5,244 |
| Impairment of investment | **-** | 19 | **-** | 44 |
| Unwinding of the discount on decommissioning liabilities | **323** | 235 | **652** | 328 |
| Gain on acquisition | **-** | - | **-** | (11,117) |
| Deferred tax expense (recovery) | **858** | (262) | **1,884** | 2,437 |
| Funds flow from operations | **9,180** | 3,721 | **19,269** | 6,122 |
| Funds flow from operations ($/boe) | **15.82** | 9.43 | **16.82** | 9.83 |

Funds flow from operations, which represents cash flow from operating activities before changes in non-cash working capital, was $9.2 million and $19.3 million in the three and six months ended June 30, 2014, respectively, as compared to $3.7 million and $6.1 million in the same periods of 2013. The increase in funds flow from operations is primarily due to the additional revenue from increased production from the Southern Assets acquisition and higher commodity pricing in the current periods.

**SHARE CAPITAL**

As of June 30, 2014, a total of 203,589,259 Pine Cliff shares were issued and outstanding. In the second quarter of 2014, Pine Cliff issued 3,396,500 common shares as a result of stock option exercises.

**ADDITIONS TO PROPERTY, PLANT AND EQUIPMENT AND EXPLORATION AND EVALUATION ASSETS**

| ($000s) | **Six months ended June 30, 2014** | Year ended December 31, 2013 |
|---|---|---|
| Exploration and evaluation assets - oil and gas division | **-** | 170 |
| Exploration and evaluation assets - minerals division | **27** | 990 |
| Oil and gas assets | **2,920** | 10,468 |
| Vehicles and administrative assets | **163** | 185 |
| Acquistions | **-** | 94,348 |
| Dispositions | **-** | (1,202) |
| Capitalized asset retirement costs | **3,560** | 5,148 |
| Total | **6,670** | 110,107 |

In the six months ended June 30, 2014, Pine Cliff added $6.7 million in capital assets to its balance sheet as compared to $110.1 million in the year ended December 31, 2013.

In the second quarter of 2014, Pine Cliff participated in one gross gas well (0.15 net) drilled in the Sundance area. This well was completed in April 2014 and came onto production on May 13, 2014. Additionally, Pine Cliff recompleted an existing wellbore on the Carrot Creek Assets and conducted major turnovers and upgrades on facilities on the Southern Assets and Carrot Creek Assets.

**RELATED PARTY TRANSACTIONS**

Related party transactions are in the normal course of operations and are measured at the exchange amount, which is the amount of the consideration established and agreed to by the related parties.

**Management services agreement**

Pine Cliff has a management services agreement with Bonterra, an oil and gas corporation that is publicly traded on the Toronto Stock Exchange with some common directors and management, to provide executive services, technical services, accounting services, oil and gas administration and office administration for Pine Cliff. Total fees for each of the three and six month periods ended June 30, 2014 and 2013 were $0.02 million and $0.03 million, respectively, plus certain administrative costs. The management services agreement may be cancelled by either party with 90 days notice. As at June 30, 2014, Pine Cliff owed Bonterra $0.2 million (December 31, 2013 – $0.2 million).

**Investment in Bonterra**

As at June 30, 2014, Pine Cliff owns 204,633 common shares in Bonterra (December 31, 2012 – 204,633) representing less than 1% of the outstanding shares of Bonterra at that date. The shares, as of June 30, 2014, have a fair value of approximately $13.3 million (December 31, 2013 – $11.1 million). For the three and six months ended June 30, 2014, Pine Cliff received dividend income of $0.2 million and $0.4 million, respectively (three and six months ended June 30, 2013 - $0.2 million and $0.3 million, respectively).

**LIQUIDITY**

Liquidity describes a company's ability to access cash. Growth companies operating in the upstream oil and gas business, such as Pine Cliff, require sufficient cash to fund exploration and development projects, to increase production and reserves and to acquire strategic oil and gas assets.

The following table highlights Pine Cliff's sources and uses of cash for the three and six month periods ended June 30, 2014 and 2013:

| | Three months ended June 30 | | Six months ended June 30 | |
|---|---|---|---|---|
| | **2014** | 2013 | **2014** | 2013 |
| ($000s) | | | | |
| Funds flow from operations | **9,180** | 3,721 | **19,269** | 6,122 |
| Bank debt repayment | **-** | (65) | **(200)** | (3,037) |
| Purchase of term deposit | **-** | (21,500) | **-** | (21,500) |
| Issuance of common shares, net of share issue costs | **-** | 23,703 | **-** | 23,703 |
| Exercise of stock options | **1,092** | - | **2,063** | - |
| Loan to a related party from acquisition | **-** | 185 | **-** | 185 |
| Cash from acquisitions | **-** | - | **-** | 1,476 |
| Increase (decrease) in non-cash working capital | **(1,139)** | (3,149) | **(3,481)** | (2,125) |
| Decrease (increase) in cash | **(7,143)** | (1,155) | **(14,541)** | (769) |
| Total capital expenditures, including acquisitions | **1,990** | 1,740 | **3,110** | 4,055 |
| Capital expenditures, including acquisitions: | | | | |
| Oil and gas | **1,966** | 1,059 | **3,083** | 3,374 |
| Minerals | **24** | 681 | **27** | 681 |

In the second quarter of 2014, Pine Cliff funded its capital expenditures from funds flow from operations. The existing banking arrangements at June 30, 2014 are comprised of a revolving demand credit facility in the amount of $40.0 million, of which none is drawn at June 30, 2014. The current revolving period will end on May 31, 2015 and if the revolving demand credit facility is not renewed any amounts owing will become payable in full on demand. Pine Cliff has a $4.9 million letter of credit issued against its revolving term credit facility in connection with its limited liability rating in the Province of Saskatchewan. The Company was in compliance with its bank debt covenants during the three and six month periods ended June 30, 2014 and will take steps to ensure that it remains in compliance with its covenants in future periods and anticipates renewing the credit facility at the end of the revolving period.

Funds flow from operations and the unused portion of the credit facility will allow Pine Cliff to meet its short-term financial liabilities, as well as future capital requirements, at a reasonable cost. The Company believes it has sufficient funding and access to capital to meet its obligations as they come due and, if required, will consider additional short-term financing or issuing equity in order to meet its future liabilities.

Working capital is calculated as current assets minus current liabilities and represents the ability of a company to satisfy both maturing short-term debt and upcoming operational expenses. The capital intensive nature of the oil and gas business may result in working capital deficiencies from time to time. Pine Cliff manages its working capital ratio to ensure that it has sufficient unused funds under its credit facility and access to capital to accommodate such circumstances. Additionally, the revolving demand credit facility requires Pine Cliff to maintain a working capital ratio computed as current assets less current liabilities, excluding the current portion of bank debt and inclusive of unused funds under the credit facility, of greater than 1:1. As at June 30, 2014, the Company had working capital of $34.0 million (December 31, 2013 – $13.6 million).

## COMMITMENTS AND CONTINGENCIES

In the normal course of business, Pine Cliff has entered into arrangements and incurred obligations that will impact the Company's future operations and liquidity. The maturity dates of the Company's commitments include trade and other payables of $5.8 million that are due in less than six months from the balance sheet date.

## OFF BALANCE SHEET TRANSACTIONS

Pine Cliff was not involved in any off-balance sheet transactions during the periods presented, nor have we entered into any such arrangements as of the effective date of this MD&A.

## FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

The Company faces both financial and non-financial risks inherent in the oil and gas business. Financial risks include: commodity price risk, foreign exchange risk, interest rate risk, and credit risk. Financial risks can be managed, at least to a degree, through the utilization of financial instruments. Certain non-financial risks can be mitigated through the use of insurance and/or other risk transfer mechanisms, good business practices and process controls, while others must simply be borne. All risks can have an impact upon the financial performance of the Company.

A comprehensive discussion of Pine Cliff's financial instruments and risk management is provided in the Company's MD&A for the year ended December 31, 2013.

**CRITICAL ACCOUNTING ESTIMATES**

The preparation of financial statements in conformity with IFRS requires management to make judgments, assumptions and estimates that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements, and revenues and expenses for the period reported. The significant accounting policies used by the Company are disclosed in the notes to the consolidated financial statements. Management believes that the most critical accounting policies that may have an impact on the Company's financial results are those that specifically relate to the accounting for its oil and gas interests, including amounts recorded for depletion and the impairment test which are both based on estimates of proved and probable reserves, production rates, oil prices, future costs and other relevant assumptions. Actual results could differ materially from such estimates.

A comprehensive discussion of the judgments, assumptions and estimates made by management is provided in the Company's annual MD&A for the year ended December 31, 2013.

**ACCOUNTING POLICY AND STANDARD CHANGES**

The accounting policies and method of computation followed in the preparation of the Financial Statements are the same as those followed in the preparation of Pine Cliff's 2013 Annual Financial Statements, except for the adoption of new standards and interpretations effective as of January 1, 2014.

The nature and impact of each new standard or amendment is described below:

**IAS 32 *Financial Instruments: Presentation* ("IAS 32")**
Effective January 1, 2014, the Company applied the amendment to IAS 32 clarifying certain of the criteria required to be met in order to permit the offsetting of financial assets and financial liabilities. The amendment has been applied retrospectively and did not result in any adjustments for the three months ended June 30, 2014 or any prior periods.

**IAS 39 *Financial Instruments: Recognition and Measurement* ("IAS 39")**
Effective January 1, 2014, the Company applied the amendment to IAS 39 under which there is no need to discontinue hedge accounting if a hedging derivative was novated, provided certain criteria are met. The amendment has been applied prospectively as required by transitional provisions. The application had no impact on the financial statements for the three months ended June 30, 2014.

**IAS 36 *Impairment of Assets* ("IAS 36")**
Effective January 1, 2014, the Company applied the amendment to IAS 36 under which certain disclosure requirements were altered. The amendment has been applied retrospectively and did not result in any changes to the financial statements for the three months ended June 30, 2014 or any prior periods.

**IFRIC 21 *Levies* ("IFRIC 21")**
Effective January 1, 2014, the Company retrospectively adopted IFRIC 21, 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 (for example, 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 pronouncements**

**IFRS 15 *Revenue from Contracts with Customers* ("IFRS 15")**
In May 2014, the IASB published the new revenue standard, IFRS 15, which specifies how and when revenue should be recognized and requires more informative and relevant disclosures. The standard is required to be applied on first interim periods beginning on or after January 1, 2017, with early application permitted. The Company is currently assessing the impact the adoption of this standard will have on the Financial Statements.

## SUBSEQUENT EVENTS

### Agreement to acquire Southern Alberta and Southern Saskatchewan natural gas assets

On July 17, 2014, Pine Cliff announced entering into a binding agreement (the "Agreement") to acquire certain shallow natural gas assets in Alberta and Saskatchewan (the "Shallow Gas Assets") for cash consideration of $100.0 million, prior to any adjustments (the "Proposed Transaction"), of which Pine Cliff paid a deposit of $10.0 million on July 18, 2014. The majority of the Alberta assets are located east of the City of Medicine Hat with some minor assets in Central Alberta near the City of Wetaskiwin. The Saskatchewan assets are located near the Town of Maple Creek.

The Proposed Transaction has an effective date of July 1, 2014 and is presently expected to close on or before November 1, 2014. Although the Agreement is binding between the parties, completion of the Proposed Transaction is subject to numerous conditions, including negotiation and execution of definitive agreements, due diligence, title and environmental review and board of directors and regulatory approvals. No assurances can be given that the Proposed Transaction will be completed as proposed or at all.

### Acquisition of Carrot Creek/Edson area oil and natural gas assets

On August 7, 2014, Pine Cliff completed the acquisition of certain oil and natural gas assets in the Carrot Creek/Edson area in the Province of Alberta (the "Carrot Creek/Edson Assets"). The total consideration of $33.25 million, prior to adjustments was financed through a combination of working capital and debt. The purchase price allocation using the acquisition method for the Carrot Creek/Edson Assets is incomplete as of the date hereof. These details will be disclosed in Pine Cliff's September 30, 2014 interim financial statements.

### Issuance of stock options

Subsequent to June 30, 2014, Pine Cliff granted 130,500 stock options to employees with a weighted average exercise price of $1.69, based on the market price immediately preceding the date of grant. The options vest between one and three years and expire between January 7, 2016 and February 6, 2018.

## NON-IFRS MEASURES

*This MD&A uses the terms "funds flow from operations", "operating netbacks", "corporate netbacks" and "net debt" which are not recognized under IFRS and may not be comparable to similar measures presented by other companies. The Company uses these measures to evaluate its performance, leverage and liquidity, as well as to assess potential acquisitions.*

*The Company considers funds flow from operations a key performance measure as it demonstrates the Company's ability to generate the funds necessary to repay debt and fund future growth through capital investment. Funds flow from operations and funds flow from operations per share should not be considered as an alternative to, or more meaningful than, cash flow from operating activities as per the statement of cash flows which is considered the most directly comparable measure under IFRS. Funds flow from operations is calculated as cash flow from operating activities before changes in non-cash working capital and changes in interest payable. Funds flow from operations per share is calculated using the same weighted average number of shares outstanding as in the case of the earnings per share calculation for a reporting period.*

| | Three months ended June 30 | | Six months ended June 30 | |
|---|---|---|---|---|
| | **2014** | 2013 | **2014** | 2013 |
| ($000s) | | | | |
| Cash flow from operating activities | **7,242** | 3,751 | **17,281** | 6,852 |
| Adjusted by: | | | | |
| Increase (decrease) in non-cash working capital | **(1,938)** | 30 | **(1,988)** | 730 |
| Funds flow from operations | **9,180** | 3,721 | **19,269** | 6,122 |

*The Company considers operating netback to be a key indicator of profitability relative to current commodity prices. Operating netback and operating netback per boe are calculated as oil and gas sales, less royalties and operating expenses on an absolute and a per boe basis, respectively.*

*The Company considers corporate netback to be a key indicator of overall profitability. Corporate netback and corporate netback per boe are calculated as operating netback, less G&A and interest expense plus finance and dividend income on an absolute and on an absolute and a per boe basis, respectively.*

*Net debt is a term used in the context of liquidity in this MD&A. Net debt is the total of bank debt, related party note payable and trade and other payables, less trade and other receivables, cash and term deposit. There is no IFRS measure that is reasonably comparable to net debt.*

**FORWARD-LOOKING INFORMATION**

*Certain statements contained in this MD&A include statements which contain words such as "anticipate", "could", 'should", "expect", 'seek", "may", "intend", "likely", "will", "believe" and similar expressions, statements relating to matters that are not historical facts, and such statements of our beliefs, intentions and expectations about development, results and events which will or may occur in the future, constitute "forward-looking information" within the meaning of applicable Canadian securities legislation and are based on certain assumptions and analysis made by us derived from our experience and perceptions. Forward-looking information in this MD&A includes, but is not limited to: expected production levels; future capital expenditures, including the amount and nature thereof; oil and natural gas prices and demand; expansion and other development trends of the oil and natural gas industry; business strategy and guidance; the closing of the Proposed Transaction; expansion and growth of our business and operations; maintenance of existing customer, supplier and partner relationships; supply channels; accounting policies; risks; and other such matters.*

*All such forward-looking information is based on certain assumptions and analyses made by us in light of our experience and perception of historical trends, current conditions and expected future developments, as well as other factors we believe are appropriate in the circumstances. The risks, uncertainties and assumptions are difficult to predict and may affect operations, and may include, without limitation: foreign exchange fluctuations; equipment and labour shortages and inflationary costs; general economic conditions; industry conditions; changes in applicable environmental, taxation and other laws and regulations as well as how such laws and regulations are interpreted and enforced; the ability of oil and natural gas companies to raise capital; the effect of weather conditions on operations and facilities; the existence of operating risks; volatility of oil and natural gas prices; oil and gas product supply and demand; risks inherent in the ability to generate sufficient cash flow from operations to meet current and future obligations; increased competition; stock market volatility; opportunities available to or pursued by us; and other factors, many of which are beyond our control. The foregoing factors are not exhaustive.*

*Actual results, performance or achievements could differ materially from those expressed in, or implied by, this forward-looking information and, accordingly, no assurance can be given that any of the events anticipated by the forward-looking information will transpire or occur, or if any of them do, what benefits will be derived there from. Except as required by law, Pine Cliff disclaims any intention or obligation to update or revise any forward-looking information, whether as a result of new information, future events or otherwise.*

*The forward-looking information contained in this MD&A is expressly qualified by this cautionary statement.*

The information provided in this report, including the interim condensed consolidated financial statements, is the responsibility of Pine Cliff's management. In the preparation of these statements, estimates are sometimes necessary to make a determination of future values for certain assets or liabilities. Management believes such estimates have been based on careful judgments and have been properly reflected in the accompanying financial statements.

Management maintains a system of internal controls to provide reasonable assurance that the Company's assets are safeguarded and to facilitate the preparation of relevant and timely information.

The audit committee has reviewed these interim condensed consolidated financial statements with management and has reported to the Board of Directors. The Board of Directors have approved the consolidated financial statements as presented in this interim report.

**CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL POSITION**
(Canadian dollars, 000s)
(unaudited)

| | Note | **As at June 30, 2014** | As at December 31, 2013 |
|---|---|---|---|
| **ASSETS** | | | |
| Current assets | | | |
| Cash and cash equivalents | | **15,846** | 1,305 |
| Trade and other receivables | | **10,186** | 9,217 |
| Prepaid expenses and deposits | | **728** | 591 |
| Investments | 3 | **13,494** | 11,287 |
| Total current assets | | **40,254** | 22,400 |
| Exploration and evaluation assets | 4 | **7,442** | 7,415 |
| Property, plant and equipment | 5 | **116,272** | 120,016 |
| Restricted cash | | **33** | 33 |
| Goodwill | | **3,535** | 3,535 |
| Deferred taxes | | **24,927** | 27,087 |
| Total assets | | **192,463** | 180,486 |
| **LIABILITIES** | | | |
| Current liabilities | | | |
| Trade and other payables | | **6,207** | 8,579 |
| Bank debt | 6 | **-** | 200 |
| Total current liabilities | | **6,207** | 8,779 |
| Decommissioning liabilities | | **46,897** | 42,685 |
| Total liabilities | | **53,104** | 51,464 |
| **SHAREHOLDERS' EQUITY** | | | |
| Share capital | 7 | **131,731** | 127,002 |
| Contributed surplus | | **2,233** | 3,856 |
| Accumulated other comprehensive earnings | | **3,496** | 1,567 |
| Retained earnings (deficit) | | **1,899** | (3,403) |
| Total shareholders' equity | | **139,359** | 129,022 |
| Total liabilities and shareholders' equity | | **192,463** | 180,486 |

The accompanying notes are an integral part of these interim condensed consolidated financial statements.

**CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS (LOSS)**
(Canadian dollars, 000s except per share data)
(unaudited)

| | Note | Three months ended June 30 | | Six months ended June 30 | |
|---|---|---|---|---|---|
| | | **2014** | 2013 | **2014** | 2013 |
| Oil and gas sales | | **17,136** | 9,084 | **35,512** | 14,542 |
| Royalties | | **(1,797)** | (538) | **(3,726)** | (1,412) |
| Dividend income | 3 | **181** | 172 | **365** | 336 |
| Finance income | | **20** | 9 | **23** | 607 |
| **REVENUE** | | **15,540** | 8,727 | **32,174** | 14,073 |
| **EXPENSES** | | | | | |
| Operating | | **5,231** | 4,342 | **10,477** | 6,586 |
| General and administration | | **1,169** | 651 | **2,446** | 1,329 |
| Depletion and depreciation | 5 | **5,320** | 3,376 | **10,387** | 5,244 |
| Share-based payments | 7 | **346** | 536 | **1,043** | 1,098 |
| Impairment of investment | | **-** | 19 | **-** | 44 |
| Finance expenses | | **283** | 248 | **635** | 364 |
| Total expenses | | **12,349** | 9,172 | **24,988** | 14,665 |
| Earnings (loss) before other income and income taxes | | **3,191** | (445) | **7,186** | (592) |
| Gain on acquisition | | **-** | - | **-** | 11,117 |
| Earnings (loss) before income taxes | | **3,191** | (445) | **7,186** | 10,525 |
| Deferred tax expense (recovery) | | **858** | (262) | **1,884** | 2,437 |
| **EARNINGS (LOSS) FOR THE PERIOD** | | **2,333** | (183) | **5,302** | 8,088 |
| **Earnings (loss) per share ($)** | 7 | | | | |
| Basic | | **0.01** | (0.00) | **0.03** | 0.05 |
| Diluted | | **0.01** | (0.00) | **0.03** | 0.05 |

The accompanying notes are an integral part of these interim condensed consolidated financial statements.

**CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE EARNINGS (LOSS)**
(Canadian dollars, 000s)
(unaudited)

| | Three months ended June 30 | | Six months ended June 30 | |
|---|---|---|---|---|
| | **2014** | 2013 | **2014** | 2013 |
| Earnings (loss) for the period | **2,333** | (183) | **5,302** | 8,088 |
| **OTHER COMPREHENSIVE EARNINGS** | | | | |
| Unrealized gain on investment | **2,267** | 23 | **2,229** | 782 |
| Deferred taxes on unrealized gain on investment | **(306)** | (3) | **(300)** | (98) |
| **OTHER COMPREHENSIVE EARNINGS FOR THE PERIOD** | **1,961** | 20 | **1,929** | 684 |
| **COMPREHENSIVE EARNINGS (LOSS) FOR THE PERIOD** | **4,294** | (163) | **7,231** | 8,772 |

The accompanying notes are an integral part of these interim condensed consolidated financial statements.

**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**
(Canadian dollars, 000s)
(unaudited)

| | Note | Three months ended June 30 2014 | Three months ended June 30 2013 | Six months ended June 30 2014 | Six months ended June 30 2013 |
|---|---|---|---|---|---|
| **CASH AND CASH EQUIVALENTS PROVIDED BY (USED IN):** | | | | | |
| **OPERATING ACTIVITIES** | | | | | |
| Earnings (loss) for the period | | **2,333** | (183) | **5,302** | 8,088 |
| Items not affecting cash: | | | | | |
| Share-based payments | | **346** | 536 | **1,043** | 1,098 |
| Depletion and depreciation | | **5,320** | 3,376 | **10,387** | 5,244 |
| Finance expenses | | **283** | 248 | **635** | 364 |
| Gain on acquisition | | **-** | - | **-** | (11,117) |
| Deferred tax expense (recovery) | | **858** | (262) | **1,884** | 2,437 |
| Impairment of investment | | **-** | 19 | **-** | 44 |
| Changes in non-cash working capital accounts | | **(1,938)** | 30 | **(1,988)** | 730 |
| Interest and bank charges paid | | **40** | (13) | **18** | (36) |
| Cash and cash equivalents provided by operating activities | | **7,242** | 3,751 | **17,281** | 6,852 |
| **INVESTING ACTIVITIES** | | | | | |
| Expenditures on property, plant and equipment | 5 | **(1,966)** | (1,227) | **(3,083)** | (3,334) |
| Expenditures on exploration and evaluation assets | 4 | **(24)** | (513) | **(27)** | (721) |
| Acquisitions, net of working capital acquired | | **-** | - | **-** | 1,476 |
| Purchase of term deposit | | **-** | (21,500) | **-** | (21,500) |
| Changes in non-cash working capital accounts | | **798** | (3,179) | **(1,494)** | (2,855) |
| Cash and cash equivalents used in investing activities | | **(1,192)** | (26,419) | **(4,604)** | (26,934) |
| **FINANCING ACTIVITIES** | | | | | |
| Issuance of common shares, net of share issue costs | | **-** | 23,703 | **-** | 23,703 |
| Exercise of stock options | 7 | **1,092** | - | **2,063** | - |
| Bank debt repayment | | **-** | (65) | **(200)** | (3,037) |
| Changes in non-cash working capital accounts | | **-** | 185 | **-** | 185 |
| Cash and cash equivalents provided by financing activities | | **1,092** | 23,823 | **1,863** | 20,851 |
| Increase in cash and cash equivalents | | **7,143** | 1,155 | **14,541** | 769 |
| Cash and cash equivalents - beginning of period | | **8,703** | 431 | **1,305** | 817 |
| **CASH AND CASH EQUIVALENTS - END OF PERIOD** | | **15,846** | 1,586 | **15,846** | 1,586 |

The accompanying notes are an integral part of these interim condensed consolidated financial statements.

**CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY**
(Canadian dollars, 000s)
(unaudited)

| | Note | Share capital | Contributed surplus [1] | Accumulated other comprehensive earnings [2] | Retained earnings (deficit) | Total equity |
|---|---|---|---|---|---|---|
| **BALANCE AT JANUARY 1, 2013** | | **83,542** | **1,749** | **43** | **(14,313)** | **71,021** |
| Issuance of shares | | 25,080 | - | - | | 25,080 |
| Share issue costs, net of tax | | (1,036) | - | - | | (1,036) |
| Comprehensive earnings for the period | | - | - | 684 | 8,088 | 8,772 |
| Share-based payments | 7 | - | 1,098 | - | - | 1,098 |
| Exercise of options | | 17 | - | - | - | 17 |
| **BALANCE AT JUNE 30, 2013** | | **107,603** | **2,847** | **727** | **(6,225)** | **104,952** |
| Issuance of shares | | 20,020 | - | - | - | 20,020 |
| Share issue costs, net of tax | | (765) | - | - | - | (765) |
| Comprehensive earnings for the period | | - | - | 840 | 2,822 | 3,662 |
| Share-based payments | 7 | - | 1,103 | - | - | 1,103 |
| Exercise of options | | 144 | (94) | - | - | 50 |
| **BALANCE AT DECEMBER 31, 2013** | | **127,002** | **3,856** | **1,567** | **(3,403)** | **129,022** |
| Comprehensive earnings (loss) for the period | | - | - | 1,929 | 5,302 | 7,231 |
| Share-based payments | 7 | - | 1,043 | - | - | 1,043 |
| Exercise of options | | 4,729 | (2,666) | | | 2,063 |
| **BALANCE AT JUNE 30, 2014** | | **131,731** | **2,233** | **3,496** | **1,899** | **139,359** |

[1] Contributed surplus is comprised of share-based payments.
[2] Accumulated other comprehensive earnings is comprised of unrealized gains and losses on available-for-sale investments.

The accompanying notes are an integral part of these interim condensed consolidated financial statements.

**NOTES TO THE INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**
As at June 30, 2014 and December 31, 2013 and for the three and six month periods ended June 30, 2014 and 2013 (unaudited)
(all tabular amounts in Canadian dollars 000s, unless otherwise indicated)

## 1. NATURE OF BUSINESS

Pine Cliff Energy Ltd. ("Pine Cliff" or the "Company") is a public company listed on the TSX Venture Exchange and incorporated under the Business Corporations Act (Alberta). The address of the Company's registered office is Suite 850, 1015 4th Street SW, Calgary, Alberta, T2R 1J4.

Pine Cliff is engaged in the exploration, development and production of oil and natural gas in the Western Canadian Sedimentary Basin and conducts many of its activities jointly with others; these interim condensed consolidated financial statements (the "Financial Statements") reflect only the Company's proportionate interest in such activities. The Company has historically been involved in the exploration for precious metals through its subsidiaries.

## 2. BASIS OF PREPARATION AND CHANGES TO PINE CLIFF'S ACCOUNTING POLICIES

### a) Basis of preparation

The Financial Statements have been prepared in accordance with IAS 34 – *Interim Financial Reporting* ("IAS 34") using International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB").

The Financial Statements do not include all of the information required for annual financial statements and should be read in conjunction with the Company's annual consolidated financial statements for the year ended December 31, 2013 ("2013 Annual Financial Statements").

The Financial Statements were authorized for issue by the Company's board of directors on August 13, 2014.

### b) New standards, interpretations and amendments adopted by Pine Cliff

The accounting policies and method of computation followed in the preparation of the Financial Statements are the same as those followed in the preparation of Pine Cliff's 2013 Annual Financial Statements, except for the adoption of new standards and interpretations effective as of January 1, 2014.

The nature and impact of each new standard or amendment is described below:

**IAS 32 *Financial Instruments: Presentation* ("IAS 32")**
Effective January 1, 2014, the Company applied the amendment to IAS 32 clarifying certain of the criteria required to be met in order to permit the offsetting of financial assets and financial liabilities. The amendment has been applied retrospectively and did not result in any adjustments to the Financial Statements for the three months ended June 30, 2014 or any prior periods.

**IAS 39 *Financial Instruments: Recognition and Measurement* ("IAS 39")**
Effective January 1, 2014, the Company applied the amendment to IAS 39 under which there is no need to discontinue hedge accounting if a hedging derivative was novated, provided certain criteria are met. The amendment has been applied prospectively as required by transitional provisions. The application had no impact on the Financial Statements for the three months ended June 30, 2014.

**IAS 36 *Impairment of Assets* ("IAS 36")**
Effective January 1, 2014, the Company applied the amendment to IAS 36 under which certain disclosure requirements were altered. The amendment has been applied retrospectively and did not result in any changes to the Financial Statements for the three months ended June 30, 2014 or any prior periods.

**IFRIC 21 *Levies* ("IFRIC 21")**
Effective January 1, 2014, the Company retrospectively adopted IFRIC 21, 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 (for example, 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 pronouncements**

**IFRS 15 *Revenue from Contracts with Customers* ("IFRS 15")**
In May 2014, the IASB published the new revenue standard, IFRS 15, which specifies how and when revenue should be recognized and requires more informative and relevant disclosures. The standard is required to be applied on first interim periods beginning on or after January 1, 2017, with early application permitted. The Company is currently assessing the impact the adoption of this standard will have on the Financial Statements.

## 3. TRANSACTIONS WITH RELATED PARTIES

**Management services agreement**
Pine Cliff has a management services agreement with Bonterra, an oil and gas corporation that is publicly traded on the Toronto Stock Exchange with some common directors and management, to provide executive services, technical services, accounting services, oil and gas administration and office administration for Pine Cliff. Total fees for each of the three and six month periods ended June 30, 2014 and 2013 were $0.02 million and $0.03 million, respectively, plus certain administrative costs. The management services agreement may be cancelled by either party with 90 days notice. As at June 30, 2014, Pine Cliff owed Bonterra $0.2 million (December 31, 2013 – $0.2 million).

**Investment in Bonterra**
As at June 30, 2014, Pine Cliff owns 204,633 common shares in Bonterra (December 31, 2013 – 204,633) representing less than 1% of the outstanding shares of Bonterra at that date. The shares as of June 30, 2014 have a fair value of approximately $13.3 million (December 31, 2013 – $11.1 million). For the three and six months ended June 30, 2014, Pine Cliff received dividend income of $0.2 and $0.4 million, respectively (three and six months ended June 30, 2013 - $0.2 million and $0.3 million, respectively).

Related party transactions are in the normal course of operations and are measured at the exchange amount, which is the amount of the consideration established and agreed to by the related parties.

## 4. EXPLORATION AND EVALUATION ASSETS

The following table reconciles Pine Cliff's exploration and evaluation assets:

| Cost: | Oil and gas properties | Minerals properties | Total |
|---|---|---|---|
| Balance at December 31, 2012 | 599 | 2,191 | 2,790 |
| Additions | 170 | 990 | 1,160 |
| Acquisitions | 4,667 | - | 4,667 |
| Dispositions | - | (1,202) | (1,202) |
| Balance at December 31, 2013 | 5,436 | 1,979 | 7,415 |
| Additions | - | 27 | 27 |
| **Balance at June 30, 2014** | **5,436** | **2,006** | **7,442** |

During the three and six months ended June 30, 2014, no directly attributable general and administration costs related to mineral exploration and evaluation assets were capitalized (three and six months ended June 30, 2013 - $0.04 million and $0.07 million, respectively).

## 5. PROPERTY, PLANT AND EQUIPMENT

The following table reconciles Pine Cliff's property, plant and equipment assets:

| Cost: | Oil and gas properties | Administrative assets | Total |
|---|---|---|---|
| Balance at December 31, 2012 | 36,287 | 5 | 36,292 |
| Additions | 15,616 | 185 | 15,801 |
| Acquisitions | 89,333 | 348 | 89,681 |
| Balance at December 31, 2013 | 141,236 | 538 | 141,774 |
| Additions | 6,480 | 163 | 6,643 |
| **Balance at June 30, 2014** | **147,716** | **701** | **148,417** |

| Accumulated depletion and depreciation: | Oil and gas properties | Administrative assets | Total |
|---|---|---|---|
| Balance at December 31, 2012 | (5,619) | - | (5,619) |
| Depletion and depreciation | (16,035) | (104) | (16,139) |
| Balance at December 31, 2013 | (21,654) | (104) | (21,758) |
| Depletion and depreciation | (10,285) | (102) | (10,387) |
| **Balance at June 30, 2014** | **(31,939)** | **(206)** | **(32,145)** |

| Carrying value at: | Oil and gas properties | Administrative assets | Total |
|---|---|---|---|
| December 31, 2013 | 119,582 | 434 | 120,016 |
| **June 30, 2014** | **115,777** | **495** | **116,272** |

## 6. BANK DEBT

Pine Cliff has a $40.0 million revolving demand credit facility (the "Credit Facility") with a Canadian chartered bank, of which none was drawn at June 30, 2014. The Credit Facility was renewed on May 27, 2014 and will end on May 31, 2015. If the Credit Facility is not renewed at that date it will become payable in full on demand. Amounts drawn under this Credit Facility are in the form of Canadian prime lending rate based loans, guaranteed notes or letters of credit. The Credit Facility bears interest at the prime lending rate plus 0.75% per annum. The Credit Facility is secured by a first priority security interest on all present and after acquired property of the Company.

The Credit Facility requires Pine Cliff to maintain a working capital ratio, excluding the related party note payable and the current portion of the bank debt and inclusive of unused funds under the Credit Facility, of greater than 1:1. The Company was in compliance with its bank debt covenants during the three and six month periods ended June 30, 2014.

Pine Cliff has a $4.9 million letter of credit issued against its Credit Facility in connection with its limited liability rating in the Province of Saskatchewan.

## 7. SHARE CAPITAL

### Authorized

The Company is authorized to issue an unlimited number of common shares without nominal or par value. The Company is also authorized to issue, in one or more series, an unlimited number of Class B Preferred Shares without nominal or par value.

### Issued

| Issued and outstanding share capital continuity: | Common shares (000s) | Share capital |
|---|---|---|
| Balance at January 1, 2013 | 153,332 | 83,542 |
| Shares issued pursuant to public share offerings | 46,700 | 45,100 |
| Exercise of options | 161 | 161 |
| Share issue costs, net of tax | - | (1,801) |
| Balance at December 31, 2013 | 200,193 | 127,002 |
| Exercise of options | 3,397 | 4,729 |
| Balance at June 30, 2014 | **203,590** | **131,731** |

### Per share calculations

The average market value of the Company's shares for the purposes of calculating the dilutive effect of share options was based on quoted market prices for the period that the options were outstanding. In calculating the weighted average number of diluted shares outstanding for six month period ended June 30, 2014, the Company excluded 1,050,000 options (June 30, 2013 – 350,000) as their effect is anti-dilutive. For the three month period ended June 30, 2014, the Company excluded 540,000 options, as their effect is anti-dilutive (June 30, 2013 – all options as there was a loss in the period then ended).

| | Three months ended June 30 | | Six months ended June 30 | |
|---|---|---|---|---|
| Loss per share calculation: | **2014** | 2013 | **2014** | 2013 |
| **Numerator** | | | | |
| Earnings (loss) for the period | **2,333** | (183) | **5,302** | 8,088 |
| **Denominator (000s)** | | | | |
| Weighted-average common shares outstanding - basic | **203,138** | 157,119 | **201,931** | 155,236 |
| Effect of options outstanding | **7,029** | - | **7,802** | 6,207 |
| Weighted-average common shares outstanding - diluted | **210,167** | 157,119 | **209,733** | 161,443 |
| Earnings (loss) per share - basic ($) | **0.01** | (0.00) | **0.03** | 0.05 |
| Earnings (loss) per share - diluted ($) | **0.01** | (0.00) | **0.03** | 0.05 |

**Share-based payments**

The Company provides an equity settled stock option plan (the "Option Plan") for its directors, employees and consultants. Under the Option Plan, the Company may grant options for up to 10% of outstanding common shares at June 30, 2014. The term and vesting period of the options granted are determined at the discretion of the board of directors. The exercise price of each option granted equals the market price of the Company's stock immediately preceding the date of grant and the option's maximum term is five years.

A summary of the status of the Company's stock option plan as at June 30, 2014 and changes during the period then ended is presented as follows:

| Stock options issued and outstanding: | Options (000s) | Weighted-average exercise price ($ per share) |
|---|---|---|
| Outstanding, December 31, 2012 | 10,240 | 0.58 |
| Granted | 5,268 | 1.05 |
| Exercised | (161) | 0.41 |
| Forfeited | (869) | 0.88 |
| Outstanding, December 31, 2013 | 14,478 | 0.73 |
| Granted | 1,400 | 1.44 |
| Exercised | (3,397) | 0.62 |
| Forfeited | (690) | 0.83 |
| Outstanding, June 30, 2014 | 11,792 | 0.85 |
| Exercisable, June 30, 2014 | 1,750 | 0.44 |

The following table summarizes information about stock options outstanding at June 30, 2014:

| Exercise price: | Stock options outstanding (000s) | Weighted-average remaining term (years) | Stock options exercisable (000s) | Weighted-average remaining term (years) |
|---|---|---|---|---|
| $0.38 | 1,955 | 2.0 | 1,300 | 2.0 |
| $0.50 - $0.65 | 4,058 | 1.3 | 190 | 1.4 |
| $0.66 - $1.07 | 1,581 | 1.2 | 260 | 1.1 |
| $1.08 - $1.66 | 4,198 | 2.1 | - | - |
| | 11,792 | 1.7 | 1,750 | 1.8 |

The Company records share-based payment expense over the vesting period, which ranges between one to three years, based on the fair value of the options granted to employees, directors and consultants. In the six months ended June 30, 2014, the Company granted 1,399,500 stock options with an estimated fair value of $1.0 million or $0.69 per option using the Black-Scholes option pricing model with the following key assumptions (weighted-average):

| Assumptions: | Six months ended June 30, 2014 |
|---|---|
| Exercise price ($) | 1.43 |
| Estimated volatility of underlying common shares (%) | 78% |
| Weighted average expected life (years) | 2.4 |
| Risk-free rate (%) | 1.1 |
| Forfeiture rate (%) | 3.8 |
| Expected dividend yield (%) | 0.0 |

Estimated volatility is measured as the standard deviation of expected share price returns based on statistical analysis of historical daily share prices for a representative period.

## 8. FINANCIAL INSTRUMENTS

**Financial instruments and fair value measurement**

Financial instruments of the Company consist of cash and cash equivalents, restricted cash, trade and other receivables, investments, trade and other payables and bank debt. The carrying values of the financial instruments presented in the Financial Statements approximate their respective fair values due to their short-term to maturity. Financial assets and liabilities are only offset if Pine Cliff has the current legal right to offset and intends to settle on a net basis or settle the asset and liability simultaneously.

**Risks associated with financial assets and liabilities**

The Company is exposed to a number of risks associated with its financial assets and liabilities. These risks include commodity price risk, interest rate risk, equity price risk, foreign exchange risk, credit risk and liquidity risk. The Company has several practices and policies in place to help mitigate these risks.

A description of the nature and extent of risks arising from Pine Cliff's financial assets and liabilities can be found in the 2013 Annual Financial Statements. The Company's exposure to these risks has not changed significantly since December 31, 2013.

## 9. SUBSEQUENT EVENTS

**Agreement to acquire Southern Alberta and Southern Saskatchewan natural gas assets**

On July 17, 2014, Pine Cliff announced entering into a binding agreement (the "Agreement") to acquire certain shallow natural gas assets in Alberta and Saskatchewan for cash consideration of $100.0 million, prior to any adjustments (the "Proposed Transaction"), of which Pine Cliff paid a deposit of $10.0 million on July 18, 2014. The majority of the Alberta assets are located east of the City of Medicine Hat with some minor assets in Central Alberta near the City of Wetaskiwin. The Saskatchewan assets are located near the Town of Maple Creek.

The Proposed Transaction will have an effective date of July 1, 2014 and is presently expected to close on or before November 1, 2014. Although the Agreement is binding between the parties, completion of the Proposed Transaction is subject to numerous conditions, including negotiation and execution of definitive agreements, due diligence, title and environmental review and board of directors and regulatory approvals. No assurances can be given that the Proposed Transaction will be completed as proposed or at all.

**Acquisition of Carrot Creek/Edson area oil and natural gas assets**

On August 7, 2014, Pine Cliff completed the acquisition of certain oil and natural gas assets in the Carrot Creek/Edson area in the Province of Alberta (the "Carrot Creek/Edson Assets"). The total consideration of $33.25 million, prior to adjustments was financed through a combination of working capital and debt. The purchase price allocation using the acquisition method for the Carrot Creek/Edson Assets is incomplete as of the date hereof. These details will be disclosed in Pine Cliff's September 30, 2014 interim financial statements.

**Issuance of stock options**

Subsequent to June 30, 2014, Pine Cliff granted 130,500 stock options to employees with a weighted average exercise price of $1.69, based on the market price immediately preceding the date of grant. The options vest between one and three years and expire between January 7, 2016 and February 6, 2018.

**BOARD OF DIRECTORS**

Gary J. Drummond
George F. Fink
Philip B. Hodge
Randy M. Jarock
Carl R. Jonsson

**OFFICERS**

George F. Fink
Executive Chairman of the Board

Philip B. Hodge
President and Chief Executive Officer

Robb D. Thompson
Chief Financial Officer and Secretary

Kristi L. Barr
Vice President, Finance and Controller

Terry L. McNeill
Vice President Operations

**HEAD OFFICE**

850, 1015 – 4th Street SW
Calgary, Alberta T2R 1J4

Phone: (403) 269-2289
Fax: (403) 265-7488

**REGISTRAR AND TRANSFER AGENT**

Olympia Trust Company
Calgary, Alberta

**AUDITORS**

Deloitte LLP
Calgary, Alberta

**BANKERS**

Alberta Treasury Branch
Calgary, Alberta

**STOCK EXCHANGE LISTING**

TSX Venture Exchange
Trading Symbol: PNE

**WEBSITE**

www.pinecliffenergy.com

Pine Cliff Energy Ltd.