Osum Oil Sands Corp.

Q2 2017 Interim Report to Shareholders

Dated August 3, 2017

Q2 2017 Interim Report | **Page**

Review and Outlook

The directors, management and staff of Osum Oil Sands Corp. ("Osum" or the "Company") are saddened by the passing of the Company's Chairman, Rick George, on August 1, 2017. Rick was a champion of Osum and its people. His optimism for the future was balanced by a realistic view of the present – a perspective that has helped the Company through the recent downturn. He was a great friend and mentor and he will be missed.

The Governance and Compensation Committee of the Board is undertaking a review of how the Chairman's role will be filled.

Q2 2017 Review

During the second quarter of 2017, Osum continued to advance its Orion Phase 2A expansion projects on budget and on schedule.

Osum completed the drilling of three well pairs and commenced steam circulation, which will continue through the third quarter with start-up and first production anticipated in the fourth quarter. The addition of these wells should position Orion for a meaningful increase in production and cash flow in 2018.

Drilling rig at Orion site – Image by Zack Cooper, March 2017

Also during the second quarter, off-site fabrication of the waste crystallizer unit was completed and modules were delivered to the Orion site. On-site construction, installation and tie-in continued in the third quarter and is expected to be completed in September. The waste crystallizer unit will concentrate the evaporator waste stream, lower trucking and disposal costs, and increase the water recycle rate.

Despite capital expenditures of $18.4 million in the quarter primarily related to the expansion projects, Osum continued to maintain a strong liquidity position with $154.6 million of cash on hand at June 30, 2017 and net working capital (excluding net unrealized hedging liabilities) of $144.7 million.

Production

Average production at Orion in the quarter of 7,478 bbl/d was lower than the forecast average for the year of 7,700 bbl/d and down 2% from the prior quarter's average of 7,654 bbl/d. The decrease from the prior quarter's average was mainly due to downtime on one well pad to complete the tie-in of two of the three new well pairs.

Operating netback

Despite the slight decrease in average production, Osum generated an operating netback in the period of $12.1 million or $17.73/bbl, compared with $11.0 million or $16.02/bbl in the prior quarter. Including realized net financial hedging losses, the netback in the second quarter was $10.5 million or $15.41/bbl, compared with $9.3 million or $13.53/bbl in the first quarter. The following factors contributed to the higher total and per unit netbacks:

- While the average index price of US-dollar West Texas Intermediate oil decreased 7% from the prior quarter, changes to quality differentials and the foreign exchange rate were favourable and led to the average index price of Cold Lake Blend in Canadian dollars being 2% higher than the prior quarter. Osum's realized bitumen price on a barrel of production basis was also positively impacted by lower blending costs in the quarter and by a draw on blend inventory compared to an inventory build in the prior quarter. The average realized bitumen price of $37.74/bbl was higher than the prior quarter, up $3.45/bbl or 10%.
- Average Provincial royalties of $0.98/bbl or 2.5% of bitumen sales decreased from $1.06/bbl or 2.9% of bitumen sales in the prior quarter. Royalties were impacted by differences between the timing of bitumen production and blended bitumen sales, as well as by a decrease in the calculated Canadian dollar oil price.
- Average total operating costs of $20.77/bbl were 10% or $1.82/bbl higher than the prior quarter.
    - Average non-fuel operating costs of $15.74/bbl were 15% or $2.07/bbl higher than the previous quarter. The increase in unit costs was primarily due to the reallocation of certain personnel costs for the first six months of 2017 from general and administrative expenses to operating expenses, as well as higher boiler maintenance and evaporator washing costs.
    - Average fuel costs of $5.03/bbl were 5% or $0.25/bbl lower than the prior quarter due to a 2% decrease in the average AECO gas price and from less usage due to 5% lower steam generation, slightly offset by lower production.
- Realized net losses on financial hedges totaled $1.6 million or $2.32/bbl, compared with $1.7 million or $2.49/bbl in the prior quarter.

Other noteworthy items

- Capital expenditures in the quarter were $18.4 million, of which $17.6 million related to the Orion expansion projects.
- Net general and administrative expenses were $2.9 million, down from $3.9 million in the prior quarter. The decrease was mainly due to the reallocation of certain personnel costs for the first six months of 2017 from general and administrative expenses to operating expenses.
- Net unrealized hedging assets totaled $6.3 million at June 30, 2017, due mainly to the weakening of West Texas Intermediate future oil prices, partially offset by the narrowing of future quality differentials, since the time that the outstanding hedges were put in place.

Outlook

With Orion Phase 2A nearing completion, Osum is eagerly anticipating the positive impact that these projects should have on production and operating costs beginning in the latter part of 2017. While year-to-date average production of 7,565 bbl/d is 2% less than the full year target average of 7,700 bbl/d, the expected contribution from the three new well pairs in the fourth quarter should allow Osum to make up the lost ground.

The success to date in managing costs and maintaining schedule in the execution of Phase 2A demonstrates the effectiveness of the Company's disciplined execution strategy. Osum continues to look for opportunities to advance and accelerate the next expansion phases.

Financial and Operational Summary

Estimates and Judgments

The preparation of the financial and operational summary below and the interim consolidated financial statements on which they are based require management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the reported amounts of revenues and expenses during the period. Actual results may differ from these estimates. In preparing these figures, the significant judgments made by management in applying the Company's accounting policies and the key sources of estimation uncertainty were the same as those applied to and described in the audited consolidated financial statements for the year ended December 31, 2016.

	Three months ended			Six months ended	
	June 30, 2017	March 31, 2017	June 30, 2016	June 30, 2017	June 30, 2016
Business Environment [1]					
West Texas Intermediate (WTI) – US$/bbl	48.29	51.86	45.60	50.07	39.56
Cold Lake Blend (CLB) – US$/bbl	36.35	36.34	31.03	36.35	24.84
Differential – WTI less CLB – US$/bbl	11.94	15.52	14.57	13.72	14.72
Differential – CLB % of WTI	24.7%	29.9%	32.0%	27.4%	37.2%
Foreign exchange rate – C$/US$	1.3449	1.3234	1.2888	1.3342	1.3318
CLB – $/bbl	48.89	48.09	39.99	48.50	33.08
AECO – $/mcf	2.65	2.70	1.40	2.67	1.78
Operational [1] [2]					
Bitumen production – bbl/d	7,478	7,654	7,018	7,565	6,813
Blended bitumen sales [3] – bbl/d	10,201	10,564	9,606	10,381	9,488
Blended bitumen sales less diluent and transportation costs [3] – $/bbl	39.48	36.03	31.30	37.74	23.33
Royalties – $/bbl	(0.98)	(1.06)	(0.40)	(1.02)	(0.28)
Non-fuel operating costs – $/bbl	(15.74)	(13.67)	(13.35)	(14.70)	(14.96)
Fuel costs – $/bbl	(5.03)	(5.28)	(2.78)	(5.15)	(3.18)
Netback [3] [4] – $/bbl	17.73	16.02	14.77	16.87	4.91
Realized gain (loss) on financial risk management contracts – $/bbl	(2.32)	(2.49)	9.99	(2.41)	15.91
Adjusted netback [3] [4] – $/bbl	15.41	13.53	24.76	14.46	20.82
Financial					
Netback [3] [4]	12,061	11,036	9,432	23,097	6,088
Adjusted netback [3] [4]	10,481	9,318	15,809	19,799	25,812
Funds flow [5]	3,135	748	5,767	3,882	6,219
Cash flows from operating activities	1,211	1,909	3,980	3,119	3,266
Net and comprehensive income (loss)	7,108	3,599	(18,384)	10,706	(17,033)
Net income (loss) per share (basic) – $ [6]	0.05	0.03	(0.15)	0.08	(0.14)
Capital investment [7]	18,439	15,895	4,305	34,333	7,507
General and administrative expenses (net) [8]	2,933	3,883	5,050	6,816	10,188
Cash and cash equivalents [9]	154,589	172,910	99,025	154,589	99,025
Adjusted working capital [10]	144,698	160,706	96,157	144,698	96,157
Adjusted working capital plus available capital from outstanding callable warrants [10][11]	144,698	160,706	196,157	144,698	196,157
Outstanding principal – long-term debt [12]	262,075	269,910	263,961	262,075	263,961
Shareholders' equity	495,499	487,686	413,487	495,499	413,487
Weighted average common shares outstanding	130,915	127,623	122,413	129,278	122,407

See footnotes on the next page.

(1) Business environment and operational metrics are averages for the period.
(2) Dollar per barrel metrics are calculated based on bitumen production volumes. Quarter-over-quarter per barrel metrics may be affected by differences between the timing of bitumen production and blended bitumen sales.
(3) Blended bitumen sales, blended bitumen sales less diluent and transportation costs, netback and adjusted netback include $308 of realized losses and $243 of realized gains on physical risk management contracts for the three and six month periods ended June 30, 2016, respectively.
(4) Netback is calculated by deducting the related diluent, transportation, royalties and field operating costs from blend sales revenue. Adjusted netback is calculated by adjusting the netback to include realized gains and losses on financial risk management contracts.
(5) Funds flow is calculated as cash flows from operating activities before changes in non-cash operating working capital, which is presented on the consolidated statement of cash flows.
(6) For the three and six month periods ended June 30, 2017 and 2016 along with the three month period ended March 31, 2017, diluted net income (loss) per share was equal to basic net income (loss) per share.
(7) Capital investment includes capitalized general and administrative expenses and excludes capitalized stock based compensation.
(8) General and administrative expenses (net) is calculated after reductions for capitalized salaries and benefits, onerous lease payments and exploration costs.
(9) Cash and cash equivalents include restricted cash of $11,220 at June 30, 2017 (March 31, 2017 – $11,188, June 30, 2016 – $11,105).
(10) Adjusted working capital is calculated as working capital adjusted to exclude risk management contracts, which are fair value estimates of unrealized gains and losses and are subject to a high degree of volatility prior to ultimate settlement.
(11) At June 30, 2016, adjusted working capital plus available capital from outstanding callable warrants included $100,000 associated with the aggregate exercise value of the 8,000,000 then outstanding callable common share purchase warrants. On December 1, 2016, the Company called all of the outstanding callable common share purchase warrants and proceeds were received in February of 2017.
(12) Outstanding principal of long-term debt consists of the non-current portion of the outstanding principal balance of the US$210,000 term loan and any amounts outstanding under the US$15,000 revolving loan, translated to C$ at the period-end foreign exchange rate of 1.2966 (March 31, 2017 – 1.3319, June 30, 2016 – 1.2925), and presented before unamortized transaction costs.

Osum Oil Sands Corp.

Consolidated Statements of Financial Position
(Unaudited, expressed in thousands of Canadian dollars)

	June 30, 2017	December 31, 2016
Assets		
Current assets:		
Cash and cash equivalents	143,369	72,333
Restricted cash	11,220	11,192
Accounts receivable	14,880	16,957
Financial risk management contracts (note 4)	12,547	3,215
Prepaid expenses and other assets	2,522	1,037
Total current assets	184,538	104,734
Non-current assets:		
Property, plant and equipment (note 5)	522,658	507,423
Exploration, evaluation and other intangible assets (note 6)	78,594	78,510
Deferred tax asset (note 7)	33,705	33,548
Financial risk management contracts (note 4)	4,692	—
Abandonment deposits	329	322
Total assets	**824,516**	**724,537**
Liabilities		
Current liabilities:		
Accounts payable, accrued liabilities and provision (note 8)	24,377	21,897
Financial risk management contracts (note 4)	9,352	13,768
Current portion of long-term debt (note 9)	2,723	2,823
Share unit liabilities (note 11)	193	113
Total current liabilities	36,645	38,601
Non-current liabilities:		
Long-term debt (note 9)	255,811	265,945
Decommissioning liabilities (note 10)	31,801	31,861
Provision (note 8)	1,146	1,848
Financial risk management contracts (note 4)	1,578	1,752
Share unit liabilities (note 11)	2,036	1,180
Total non-current liabilities	292,372	302,586
Shareholders' equity		
Common shares (note 11)	1,032,130	932,094
Contributed surplus (note 11)	63,061	61,654
Cumulative deficit	(599,692)	(610,398)
Total shareholders' equity	495,499	383,350
Total liabilities and shareholders' equity	**824,516**	**724,537**

Contractual obligations and commitments (note 13)

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

Vincent Chahley
Director

George Crookshank
Director

Osum Oil Sands Corp.

Consolidated Statements of Net and Comprehensive Income

(Unaudited, expressed in thousands of Canadian dollars, except share and per share amounts)

	Three months ended June 30,		Six months ended June 30,	
	2017	**2016**	**2017**	**2016**
Revenue:				
Blended bitumen sales	45,433	34,943	90,771	56,767
Royalties	(670)	(256)	(1,400)	(347)
	44,763	34,687	89,371	56,420
Gain (loss) on financial risk management contracts (note 4)	6,486	(13,520)	15,318	(8,954)
Revenue net of gain or loss on financial risk management contracts	51,249	21,167	104,689	47,466
Expenses:				
Diluent and transportation	18,570	14,954	39,089	27,837
Operating expenses	14,132	10,301	27,185	22,495
Depletion and depreciation (notes 5, 6)	9,506	10,158	19,201	19,768
General and administrative expenses	2,933	5,050	6,816	10,188
Share-based compensation expense (note 11)	1,133	3,059	2,102	3,485
Exploration costs	5	36	14	57
Onerous contract expense (recovery) (note 8)	(7)	—	(8)	2,403
	46,272	43,558	94,399	86,233
Other expenses (income):				
Net finance costs (note 12)	4,536	4,691	9,160	9,502
Unrealized foreign exchange gain on long-term debt (note 9)	(7,228)	(1,652)	(9,753)	(18,947)
Accretion (notes 8, 10)	164	146	334	290
Total other expenses (income)	(2,528)	3,185	(259)	(9,155)
Net income (loss) before taxes	**7,505**	**(25,576)**	**10,549**	**(29,612)**
Deferred income tax recovery (note 7)	(397)	7,192	157	12,579
Net and comprehensive income (loss)	**7,108**	**(18,384)**	**10,706**	**(17,033)**
Net income (loss) per share, basic and diluted (note 11)	$0.05	($0.15)	$0.08	($0.14)
Weighted average number of common shares outstanding (thousands):				
Basic	130,915	122,413	129,278	122,407
Diluted	132,550	123,419	130,622	123,272

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

Osum Oil Sands Corp.

Consolidated Statements of Changes in Equity
(Unaudited, expressed in thousands of Canadian dollars)

	Number of common shares (thousands)	Share capital	Contributed surplus	Cumulative deficit	Total equity
Balance – January 1, 2017	122,914	932,094	61,654	(610,398)	383,350
Net income for the period	—	—	—	10,706	10,706
Share-based compensation	—	—	1,443	—	1,443
Share issuance on exercise of callable common share purchase warrants	8,000	100,000	—	—	100,000
Share issuance on vesting of share units	4	—	—	—	—
Reallocation on vesting of share units	—	36	(36)	—	—
Balance – June 30, 2017	**130,918**	**1,032,130**	**63,061**	**(599,692)**	**495,499**
Balance – January 1, 2016	122,401	929,927	58,975	(561,781)	427,121
Net loss for the period	—	—	—	(17,033)	(17,033)
Share-based compensation	—	—	3,384	—	3,384
Share issuance on exercise of stock options	15	15	—	—	15
Reallocation on exercise of stock options	—	12	(12)	—	—
Balance – June 30, 2016	**122,416**	**929,954**	**62,347**	**(578,814)**	**413,487**

The accompanying condensed notes are an integral part of these interim consolidated financial statements. Refer to note 11 for further details on share capital.

Osum Oil Sands Corp.

Consolidated Statements of Cash Flows
(Unaudited, expressed in thousands of Canadian dollars)

	Three months ended June 30,		Six months ended June 30,	
	2017	**2016**	**2017**	**2016**
Cash provided by (used in)				
Operating activities:				
Net income (loss) for the period	7,108	(18,384)	10,706	(17,033)
Items not involving cash:				
Depletion and depreciation (notes 5, 6)	9,506	10,158	19,201	19,768
Unrealized foreign exchange gain on long-term debt (note 9)	(7,228)	(1,652)	(9,753)	(18,947)
Shared-based compensation expense (note 11)	1,133	3,059	2,102	3,485
Amortization of deferred transaction costs (note 12)	453	425	899	844
Accretion (notes 8,10)	164	146	334	290
Change in fair value of financial risk management contracts (note 4)	(8,066)	19,285	(18,616)	28,066
Onerous contract expense (note 8)	(7)	—	(8)	2,403
Deferred income tax recovery (note 7)	397	(7,192)	(157)	(12,579)
Settlements of onerous contract (note 8)	(313)	(78)	(537)	(78)
Settlements of decommissioning liabilities (note 10)	(12)	—	(289)	—
Funds flow from operating activities before changes in non-cash working capital	3,135	5,767	3,882	6,219
Change in non-cash operating working capital (note 14)	(1,924)	(1,787)	(763)	(2,953)
Total cash flows from operating activities	**1,211**	**3,980**	**3,119**	**3,266**
Investing activities:				
Property, plant and equipment expenditures (note 5)	(18,728)	(3,339)	(34,193)	(6,364)
Exploration, evaluation and other intangible assets (note 6)	289	(966)	(140)	(1,143)
Change in abandonment deposits	(1)	(5)	(7)	(5)
Change in non-cash investing working capital (note 14)	(411)	1,144	3,665	(4,821)
Total cash used in investing activities	**(18,851)**	**(3,166)**	**(30,675)**	**(12,333)**
Financing activities:				
Proceeds from share issuance (note 11)	—	15	100,000	15
Principal repayments of long-term debt (note 9)	(681)	(681)	(1,380)	(1,364)
Total cash flows from (used in) financing activities	**(681)**	**(666)**	**98,620**	**(1,349)**
Increase (decrease) in cash in period	(18,321)	148	71,064	(10,416)
Cash and cash equivalents – beginning of period	161,722	87,694	72,333	98,258
Restricted cash – beginning of period	11,188	11,183	11,192	11,183
Cash and cash equivalents – end of period	**143,369**	**87,920**	**143,369**	**87,920**
Restricted cash – end of period	**11,220**	**11,105**	**11,220**	**11,105**

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

1. The Company

Osum Oil Sands Corp. ("Osum" or the "Company") is a private company formed under the Alberta Business Corporations Act on June 24, 2005. The Company's primary activities are the operation and development of its in-situ bitumen properties in Alberta, Canada. These unaudited interim consolidated financial statements encompass the Company and its wholly-owned subsidiaries, Osum Production Corp. ("OPC") and Osum Holdings Corp. ("OHC").

The address of the Company's head office is Suite 1900, 255-5th Avenue SW, Calgary, Alberta, Canada, T2P 3G6.

2. Basis of Preparation

These unaudited interim consolidated financial statements are in compliance with International Accounting Standard 34, Interim Financial Reporting ("IAS 34"). These interim consolidated financial statements do not include the information and disclosures required in annual audited financial statements and therefore should be read in conjunction with the Company's annual audited consolidated financial statements for the year ended December 31, 2016.

The timely preparation of interim consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the reported amounts of revenues and expenses during the period. Actual results may differ from these estimates. In preparing these financial statements, the significant judgments made by management in applying the Company's accounting policies and the key sources of estimation uncertainty were the same as those that applied to and described in the audited consolidated financial statements for the year ended December 31, 2016.

These interim consolidated financial statements are presented in Canadian dollars ("C$"), the Company's functional currency, and all financial information is reported in thousands of dollars unless otherwise noted.

These interim consolidated financial statements reflect the activities of the Company and its wholly-owned subsidiaries. All intercompany transactions, balances, income and expenses have been eliminated on consolidation.

These interim consolidated financial statements were authorized for issue by the Board of Directors on August 3, 2017.

3. Significant Accounting Policies

These interim consolidated financial statements have been prepared using the same significant accounting policies outlined in the Company's annual audited consolidated financial statements for the year ended December 31, 2016.

Future Accounting Policies

(a) IFRS 15 – Revenue from contracts with customers

IFRS 15 – *Revenue from contracts with customers*, intended to replace IAS 18 – *Revenue*, IAS 11 – *Construction Contracts*, and related interpretations, specifies how and when an IFRS reporter will recognize revenue as well as requiring more informative, relevant disclosures. The standard provides a single, principles-based five-step model to be applied to all contracts with customers. IFRS 15 was issued in May 2014 and applies to annual reporting periods beginning on or after January 1, 2018, with early adoption permitted. The Company intends to adopt IFRS 15 in its financial statements for the annual period beginning on January 1, 2018. The Company is currently assessing and evaluating the impact of the standard on the consolidated financial statements.

(Unaudited, Expressed in thousands of Canadian dollars)

(b) IFRS 9 – Financial instruments

IFRS 9 – *Financial Instruments,* intended to replace IAS 39 – *Financial Instruments: Recognition and Measurement*, uses a single approach to determine whether a financial asset is measured at amortized cost or fair value, replacing the multiple rules in IAS 39. The new standard also requires a single impairment method to be used, replacing the multiple impairment methods in IAS 39, and incorporates a substantially reformed approach to hedge accounting. IFRS 9 is effective for annual periods beginning on or after January 1, 2018, with early adoption permitted. The Company intends to adopt IFRS 9 in its financial statements for the annual period beginning on January 1, 2018. The Company is currently assessing and evaluating the impact of the standard on the consolidated financial statements.

(c) IFRS 16 – Leases

IFRS 16 – *Leases*, intended to replace IAS 17 – *Leases,* brings most leases on-balance sheet for lessees under a single model, eliminating the distinction between operating and finance leases. Lessor accounting however remains largely unchanged and the distinction between operating and finance leases is retained. IFRS 16 is effective for annual periods beginning on or after January 1, 2019 and the Company intends to adopt IFRS 16 in its financial statements for the annual period beginning on January 1, 2019. The extent of the impact of adoption of the standard has not yet been determined.

4. Risk Management Contracts

Financial risk management contracts

The Company recorded the following net gains (losses) related to its financial risk management contracts:

	Three months ended June 30,		Six months ended June 30,	
	2017	2016	2017	2016
Realized gain (loss)	(1,580)	6,377	(3,298)	19,724
Change in fair value	8,066	(19,285)	18,616	(28,066)
Premiums paid	—	(612)	—	(612)
Gain (loss) on financial risk management contracts	6,486	(13,520)	15,318	(8,954)

(Unaudited, Expressed in thousands of Canadian dollars)

The following financial risk management contracts were in place as at June 30, 2017, and the related fair values were recorded on the consolidated statement of financial position:

Contract	Notional	Price	Remaining Term	Fair Value
Swap – WTI	4,300 bbl/d	$65.50	Jul 1/17 - Sep 30/17	2,159
Swap – WTI	4,300 bbl/d	$70.80	Oct 1/17 - Dec 31/17	3,886
Swap – WTI	2,025 bbl/d	$70.15	Jan 1/18 - Mar 31/18	1,537
Swap – WTI	2,375 bbl/d	$73.50	Jan 1/18 - Dec 31/18	9,657
Total unrealized financial risk management assets				17,239

Contract	Notional	Price	Remaining Term	Fair Value
Swap – WTI/WCS differential	5,500 bbl/d	$(19.10)	Jul 1/17 - Sep 30/17	(2,862)
Swap – WTI/WCS differential	5,800 bbl/d	$(21.88)	Oct 1/17 - Dec 31/17	(2,977)
Swap – WTI/WCS differential	2,700 bbl/d	$(21.39)	Jan 1/18 - Mar 31/18	(799)
Swap – WTI/WCS differential	1,000 bbl/d	($20.95)	Apr 1/18 - Jun 30/18	(202)
Swap – WTI/WCS differential	3,240 bbl/d	$(22.70)	Jan 1/18 - Dec 31/18	(4,090)
Total unrealized financial risk management liabilities				(10,930)

The fair market value measurements are categorized as level 2 as they are based on quoted WTI and WCS differential prices from independent pricing services in active markets for similar assets or liabilities.

The following table sets out the impact of changes in forward commodity prices on net income before taxes related to changes in the fair value of financial risk management contracts in place as at June 30, 2017:

Price or rate	Change	Impact on net income before taxes
WTI	$1.00/bbl	1,840
WTI/WCS differential	$1.00/bbl	2,556

Subsequent to June 30, 2017, the Company entered into financial risk management contracts with the following terms:

Contract	Notional	Price	Term
Swap – WTI	2,325 bbl/d	$60.85	Apr 1/18 - Jun 30/18
Swap – WTI/WCS differential	2,060 bbl/d	$(19.00)	Apr 1/18 - Jun 30/18

Credit and counterparty concentration risks related to the financial risk management contracts are considered acceptable due to the size and financial strength of the counterparties.

Physical risk management contracts

For the three and six month periods ended June 30, 2017, the Company did not have any physical risk management contracts in place. For the three months ended June 30, 2016, the Company recorded a realized loss of $308 within blended bitumen sales related to its physical risk management contracts. For the six months ended June 30, 2016, the Company recorded a realized gain of $243.

(Unaudited, Expressed in thousands of Canadian dollars)

5. Property, Plant and Equipment

	Development and production assets	Corporate assets	Total
Cost			
Balance – December 31, 2016	611,794	5,238	617,032
Additions	32,078	115	32,193
Capitalized general and administrative expenses	2,000	—	2,000
Capitalized share-based compensation	272	—	272
Changes to decommissioning assets	(40)	—	(40)
Balance – June 30, 2017	**646,104**	**5,353**	**651,457**
Accumulated depletion and depreciation			
Balance – December 31, 2016	(104,731)	(4,878)	(109,609)
Depletion and depreciation	(19,051)	(139)	(19,190)
Balance – June 30, 2017	**(123,782)**	**(5,017)**	**(128,799)**
Carrying amounts			
Balance – December 31, 2016	507,063	360	507,423
Balance – June 30, 2017	**522,322**	**336**	**522,658**

During the six months ended June 30, 2017, the Company recorded $18,822 (2016 – $18,681) of depletion and $229 (2016 – $925) of depreciation related to its Orion oil sands project. The Company included $1,465,478 of future development costs associated with proved and probable reserves in its depletion calculation for the three months ended June 30, 2017 (2016 – $1,607,211).

(Unaudited, Expressed in thousands of Canadian dollars)

6. Exploration, Evaluation and Other Intangible Assets

	Exploration and evaluation assets	Other Intangible assets	Total
Cost			
Balance – December 31, 2016	482,157	416	482,573
Additions	110	—	110
Capitalized depreciation	787	—	787
Capitalized general and administrative expenses	31	—	31
Capitalized share-based compensation	4	—	4
Changes to decommissioning assets	(51)	—	(51)
Balance – June 30, 2017	**483,038**	**416**	**483,454**
Accumulated depletion, depreciation and impairment			
Balance – December 31, 2016	(403,812)	(251)	(404,063)
Depletion and depreciation	(787)	(10)	(797)
Balance – June 30, 2017	**(404,599)**	**(261)**	**(404,860)**
Carrying amounts			
Balance – December 31, 2016	78,345	165	78,510
Balance – June 30, 2017	**78,439**	**155**	**78,594**

7. Deferred Taxes

The Company's net deferred tax asset resides in the OPC legal entity and is comprised of the following, which are classified by source of temporary differences:

	June 30, 2017	December 31, 2016
Non-capital losses	67,314	55,412
Petroleum & natural gas properties	(3,095)	2,511
Decommissioning liabilities	428	358
Risk management contracts	(1,704)	3,322
Unrealized foreign exchange on account of capital	(36,324)	(35,337)
Unrecognized deferred tax assets	7,086	7,282
Deferred tax asset	33,705	33,548

As at June 30, 2017, the Company had approximately $1,097,830 (December 31, 2016 – $1,066,661) in consolidated available tax pools, including operating loss carry forwards for income tax purposes in the amount of $461,700 (December 31, 2016 – $424,845) which are available to offset future taxable income. These operating losses start to expire in 2031.

(Unaudited, Expressed in thousands of Canadian dollars)

The provision for income taxes reported differs from the amounts computed by applying the cumulative federal and provincial income tax rates to the income before tax provision due to the following:

	Three months ended June 30,		Six months ended June 30,	
	2017	2016	2017	2016
Income (loss) before income taxes	7,505	(25,576)	10,549	(29,612)
Statutory tax rate	27%	27%	27%	27%
	2,026	(6,906)	2,848	(7,995)
Permanent differences	(976)	(223)	(1,310)	(2,551)
Stock based compensation	306	826	568	941
Change in unrecognized deferred tax assets	(947)	(939)	(2,425)	(3,087)
Other	(12)	50	162	113
Deferred tax expense (recovery)	397	(7,192)	(157)	(12,579)

The Canadian statutory tax rate from the rate reconciliation above represents the combined federal and provincial corporate tax rate. The federal corporate tax rate is 15.0% and the Alberta provincial tax rate is 12.0%.

8. Provision

Provision for onerous contract

At June 30, 2017, the total provision for an onerous lease contract related to the Company's Calgary head office lease was $2,473, of which $1,327 was recorded within accounts payable, accrued liabilities and provision, and $1,146 as a non-current provision.

	Six months ended June 30, 2017
Balance – beginning of period	3,005
Change in estimated future cash flows	(8)
Liabilities settled	(537)
Accretion	13
Balance – end of period	2,473
Less: current portion of provision	1,327
Non-current portion of provision	1,146

The provision represented the present value of the difference between the estimated minimum future lease payments that the Company is obligated to make under the lease until its expiry on March 31, 2019, less estimated sublease recoveries. At June 30, 2017, these cashflows were discounted using a risk-free discount rate of 1.17%. This estimate may fluctuate in future periods as a result of changes in estimated sublease recoveries and actual lease payments.

(Unaudited, Expressed in thousands of Canadian dollars)

9. Long-term Debt

	June 30, 2017	December 31, 2016
Senior secured term loan – US$	204,225	205,275
Period end exchange rate – US$1 = C$	1.2966	1.3442
Senior secured term loan – C$	264,798	275,931
Less: unamortized deferred debt issue costs	(6,264)	(7,163)
	258,534	268,768
Less: current portion of long-term debt	(2,723)	(2,823)
Long-term debt	255,811	265,945

During the six months ended June 30, 2017 and 2016, the Company made scheduled principal repayments totaling US$1,050 (2017 – C$1,380, 2016 – C$1,364) on the term loan. During the six months ended June 30, 2017, $899 (2016 – $844) of deferred debt issue costs were amortized against the loan balance.

The fair market value of the Company's long-term debt as at June 30, 2017 was approximately $215,106 (December 31, 2016 – $208,889), compared with a carrying amount of $264,798 (December 31, 2016 – $275,931). The fair market value measurement is categorized as level 2 as it is based on quoted prices in inactive markets.

As at June 30, 2017 and December 31, 2016, the revolving loan was undrawn. The senior secured credit facilities are subject to certain covenants by OPC, including maintaining minimum ratios of asset values to net senior secured debt. OPC was in compliance with all loan covenants as at June 30, 2017 and December 31, 2016.

10. Decommissioning Liabilities

	Six months ended June 30, 2017
Balance – beginning of period	31,861
Liabilities incurred	400
Liabilities settled	(289)
Changes to discount rates	(72)
Changes in estimates	(420)
Accretion	321
Balance – end of period	31,801

As at June 30, 2017, the Company estimated that the expenditures required to settle the decommissioning liabilities will be made over the next 38 years with the majority of payments being made around 2045. As at June 30, 2017, the Company used discount rates ranging from 1.1% to 2.1% (December 31, 2016 – 0.7% to 2.3%) based on the Bank of Canada’s long-term risk-free bond rate and an inflation rate of 1.6% (December 31, 2016 – 1.8%) to calculate the present value of the decommissioning liabilities.

(Unaudited, Expressed in thousands of Canadian dollars)

11. Share Capital

(a) Authorized

Unlimited number of voting common shares without nominal or par value.

(b) Callable common share purchase warrants

In connection with previous equity financings, the Company issued callable common share purchase warrants to investors who concurrently subscribed for an equivalent number of common shares.

On December 31, 2016, the Company called all of the 8,000,000 then outstanding common share purchase warrants with an exercise price of $12.50 per warrant and the related proceeds of $100,000 were received in February of 2017.

(c) Stock options

During the six months ended June 30, 2017, the Company's Board of Directors approved the issuance of 555,500 stock options to employees and directors at an exercise price of $2.25 per share with an effective grant date of March 30, 2017. The stock options expire six years from the grant date and vest in four equal tranches: 25% on the grant date and 25% on each of the three subsequent anniversary dates. A fair value of $0.99 per stock option was estimated on the date of the grant based on the following assumptions:

Assumption	March 30, 2017
Share price on grant date	$ 2.25
Exercise price	$ 2.25
Expected volatility	50%
Expected life	5 years
Risk-free interest rate	1.10%
Expected forfeiture rate	12%

A summary of the changes in options outstanding under the stock option plan is as follows:

	Six months ended June 30, 2017	
	Number of options (thousands)	Weighted average exercise price
Balance – beginning of period	5,578	3.02
Granted	556	2.25
Forfeited	(79)	2.41
Balance – end of period	6,055	2.96

(Unaudited, Expressed in thousands of Canadian dollars)

The following is a summary of the number of stock options outstanding and exercisable as at June 30, 2017:

Exercise price	Number outstanding (thousands)	Exercisable (thousands)	Weighted average remaining life
$0.15	75	75	3.5 years
$1.00	25	25	3.5 years
$2.25	4,768	2,274	4.8 years
$3.00	564	564	3.5 years
$8.11	170	170	1.9 years
$9.00	453	440	3.6 years
	6,055	3,548	4.5 years

(d) Performance warrants

At June 30, 2017 and December 31, 2016, the Company had 11,895 vested and exercisable performance warrants outstanding at an exercise price of $0.15 per performance warrant. All unexercised performance warrants expire in October 2018.

(e) Restricted Share Units ("RSUs") and Performance Share Units ("PSUs")

During the six months ended June 30, 2017, the Company's Board of Directors approved the issuance of 789,100 RSUs and 1,154,350 PSUs to employees and directors of the Company with an effective grant date of March 30, 2017. The RSUs and PSUs granted vest all at once on the third anniversary date. The number of PSUs that ultimately vest is subject to the Company satisfying certain performance criteria within a target range set by the Company's Board of Directors. A multiplier (ranging from 0.5 to 2.0) will be applied to any vested PSUs to the extent such performance criteria are satisfied. The performance factor for the PSUs granted in the period was assumed to be 1.0.

Notwithstanding the Board's discretion to settle vested units in cash or with shares, according to the terms of the share unit plan, a unitholder may elect to receive up to 50 percent of their vested units in the form of a cash payment. The Company therefore treats the share units 50% equity-settled and 50% cash-settled.

A summary of the changes in RSUs and PSUs outstanding is as follows:

For the six months ended June 30,	2017		2016	
(thousands)	RSUs	PSUs	RSUs	PSUs
Balance – beginning of period	1,237	1,956	387	307
Granted	789	1,154	1,127	1,893
Forfeited	(33)	(20)	(29)	(17)
Vested and settled	(8)	(14)	—	—
Balance – end of period	1,985	3,076	1,485	2,183

As at June 30, 2017, the Company's share unit liabilities for those RSUs and PSUs expected to be settled in cash were recorded using an estimated fair value of $2.25 per share unit (December 31, 2016 – $2.25) and a performance factor for the PSUs of 1.0 (2016 – 1.0).

(Unaudited, Expressed in thousands of Canadian dollars)

As at June 30, 2017, $193 of the Company's share unit liabilities were classified as current (December 31, 2016 – $113), relating to those RSUs and PSUs scheduled to vest in the next twelve months, while $2,036 (December 31, 2016 – $1,180) were classified as non-current.

(f) Contributed surplus

The table below summarizes activity in the contributed surplus account (excludes share-based compensation associated with share units expected to be settled in cash, which is reported as a liability on the consolidated statement of financial position):

	For the six months ended June 30, 2017
Balance – beginning of period	61,654
Share-based compensation	1,443
Share units vested	(36)
Balance – end of period	63,061

(g) Per share amounts

The table below summarizes the weighted average number of common shares outstanding used in the calculation of basic and diluted income (loss) per common share:

(thousands)	Three months ended June 30, 2017	Six months ended June 30, 2017
Weighted average common shares outstanding	130,915	129,278
Effect of dilutive securities	1,635	1,344
Weighted average common shares outstanding, diluted	132,550	130,622

Basic net income (loss) per share was calculated using the weighted average number of shares outstanding for the period. The Company uses the treasury stock method to calculate net income (loss) per share. The calculation of diluted weighted average common shares excludes shares related to stock options and warrants that are anti-dilutive. For the three and six month periods ended June 30, 2017 and 2016, the Company's net income (loss) per share did not differ from diluted earnings per share.

12. Net Finance Costs

	Three months ended June 30,		Six months ended June 30,	
	2017	2016	2017	2016
Interest expense, long-term debt (note 9)	4,587	4,426	9,102	9,162
Amortization of deferred transaction costs (note 9)	453	425	899	844
Interest income	(513)	(262)	(886)	(530)
Realized foreign exchange loss	9	102	45	26
Net finance costs	4,536	4,691	9,160	9,502

(Unaudited, Expressed in thousands of Canadian dollars)

13. Contractual Obligations and Commitments

The information presented in the table below reflects management's estimate of the contractual maturities of the Company's obligations for its oil sands properties and its general corporate activities as at June 30, 2017.

	Total	2017	2018	2019	2020+
Contracts and purchase orders (1)	10,375	9,673	672	10	20
Transportation agreements (2)	33,764	3,700	6,833	6,502	16,729
Operating leases (3)	3,104	763	1,805	476	60
Outstanding share units (4)	6,344	14	36	3,045	3,249
Interest and fees on term loan (5)	53,711	8,886	17,493	17,313	10,019
Repayment of term loan (5)	264,798	1,361	2,723	2,723	257,991
Total	372,096	24,397	29,562	30,069	288,068

(1) Contracts and purchase orders including commitments relating to the Orion expansion projects and costs for the storage of the evaporators procured for use at Taiga.
(2) Firm service gas and bitumen blend transportation commitments.
(3) Future commitments for the head office leases and field vehicles. The amounts reported are net of expected settlements of the onerous lease provision on the consolidated statement of financial position.
(4) Unaccrued fair value of outstanding share units expected to be settled for cash.
(5) Minimum obligations under the term loan using the foreign exchange and interest rates in effect at June 30, 2017.

14. Supplemental Cash Flow Information

	Three months ended June 30,		Six months ended June 30,	
	2017	2016	2017	2016
Changes in non-cash operating working capital				
Accounts receivable	1,696	(2,360)	2,477	(2,603)
Prepaid expenses and other assets	(1,491)	(608)	(1,485)	(420)
Accounts payable and accrued liabilities	(2,129)	1,181	(1,755)	70
	(1,924)	(1,787)	(763)	(2,953)
Changes in non-cash investing working capital				
Accounts receivable	(400)	827	(400)	—
Accounts payable and accrued liabilities	(11)	317	4,065	(4,821)
	(411)	1,144	3,665	(4,821)
Supplemental cash flow information				
Cash interest earned	501	242	861	489

15. Subsequent Event

Subsequent to June 30, 2017, the operator of the Company's Saleski Joint Venture entered into an agreement with a third party to dispose of a steam generator for gross proceeds of $5.3 million, or $2.1 million net to the Company. The transaction is expected to close in the third quarter of 2017. The carrying value of this asset at June 30, 2017 is lower than its fair value less costs to dispose, and is included in the Company's Exploration, Evaluation and Other Intangible Assets.

Corporate Information

Directors

Richard (Rick) George, OC - Chairman
Retired CEO and Director, Suncor Energy Inc.
Partner, Novo Investment Group

Angelo Acconcia
Senior Managing Director, Blackstone Capital Partners and Blackstone Energy Partners

Vincent Chahley
Independent Businessman

George Crookshank
Independent Businessman

William A. Friley
Independent Businessman

David Krieger
Managing Director, Warburg Pincus LLC

Gary Levin
Managing Director, Blackstone Capital Partners and Blackstone Energy Partners

Francesco Mele
Partner, Azimuth Capital Management

Brian Reinsborough
President and Chief Executive Officer, Venari Resources LLC

Steve Spence
President and Chief Executive Officer, Osum Oil Sands Corp.

Officers

Steve Spence, P.Eng.
President and CEO

Victor Roskey
Chief Financial Officer

Rick K. Walsh, P.Eng.
Chief Operating Officer

Dr. Peter Putnam, P.Geol.
Sr. Vice President, Geoscience

Dr. Jen Russel-Houston, P.Geol
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