



# **MANAGEMENT'S DISCUSSION AND ANALYSIS AND CONSOLIDATED FINANCIAL STATEMENTS**

**FOR THE YEARS ENDED DECEMBER 31, 2013 AND DECEMBER 31, 2012**

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# MANAGEMENT'S DISCUSSION AND ANALYSIS

## For the years ended December 31, 2013 and December 31, 2012

This management's discussion and analysis ("MD&A") should be read in conjunction with Tourmaline Oil Corp.'s consolidated financial statements and related notes for the years ended December 31, 2013 and 2012. Both the consolidated financial statements and the MD&A can be found at [www.sedar.com](http://www.sedar.com). This MD&A is dated March 17, 2014.

The financial information contained herein has been prepared in accordance with International Financial Reporting Standards ("IFRS") and sometimes referred to in this MD&A as Generally Accepted Accounting Principles ("GAAP") as issued by the International Accounting Standards Board ("IASB"). All dollar amounts are expressed in Canadian currency, unless otherwise noted.

Certain financial measures referred to in this MD&A are not prescribed by IFRS. See "Non-GAAP Financial Measures" for information regarding the following non-GAAP financial measures used in this MD&A: "cash flow", "operating netback", "working capital (adjusted for the fair value of financial instruments)", "net debt", "adjusted EBITDA", "senior debt", "total debt", and "total capitalization".

Additional information relating to Tourmaline can be found at [www.sedar.com](http://www.sedar.com).

**Forward-Looking Statements** - Certain information regarding Tourmaline set forth in this document, including management's assessment of the Company's future plans and operations, contains forward-looking statements that involve substantial known and unknown risks and uncertainties. The use of any of the words "anticipate", "continue", "estimate", "expect", "may", "will", "project", "should", "believe" and similar expressions are intended to identify forward-looking statements. Such statements represent Tourmaline's internal projections, estimates or beliefs concerning, among other things, an outlook on the estimated amounts and timing of capital investment, anticipated future debt, expenses, production, cash flow and revenues or other expectations, beliefs, plans, objectives, assumptions, intentions or statements about future events or performance. These statements are only predictions and actual events or results may differ materially. Although Tourmaline believes that the expectations reflected in the forward-looking statements are reasonable, it cannot guarantee future results, levels of activity, performance or achievement since such expectations are inherently subject to significant business, economic, competitive, political and social uncertainties and contingencies. Many factors could cause Tourmaline's actual results to differ materially from those expressed or implied in any forward-looking statements made by, or on behalf of, Tourmaline.

In particular, forward-looking statements included in this MD&A include, but are not limited to, statements with respect to: the size of, and future net revenues and cash flow from, crude oil, NGL (natural gas liquids) and natural gas reserves; future prospects; the focus of and timing of capital expenditures; expectations regarding the ability to raise capital and to continually add to reserves through acquisitions and development; access to debt and equity markets; projections of market prices and costs; the performance characteristics of the Company's crude oil, NGL and natural gas properties; crude oil, NGL and natural gas production levels and product mix; Tourmaline's future operating and financial results; capital investment programs; supply and demand for crude oil, NGL and natural gas; future royalty rates; drilling, development and completion plans and the results therefrom; future land expiries; dispositions and joint venture arrangements; amount of operating, transportation

and general and administrative expenses; treatment under governmental regulatory regimes and tax laws; and estimated tax pool balances. In addition, statements relating to "reserves" are deemed to be forward-looking statements, as they involve the implied assessment, based on certain estimates and assumptions, that the reserves described can be profitably produced in the future.

These forward-looking statements are subject to numerous risks and uncertainties, most of which are beyond the Company's control, including the impact of general economic conditions; volatility in market prices for crude oil, NGL and natural gas; industry conditions; currency fluctuation; imprecision of reserve estimates; liabilities inherent in crude oil and natural gas operations; environmental risks; incorrect assessments of the value of acquisitions and exploration and development programs; competition; the lack of availability of qualified personnel or management; changes in income tax laws or changes in tax laws and incentive programs relating to the oil and gas industry; hazards such as fire, explosion, blowouts, cratering, and spills, each of which could result in substantial damage to wells, production facilities, other property and the environment or in personal injury; stock market volatility; ability to access sufficient capital from internal and external sources; the receipt of applicable approvals; and the other risks considered under "Risk Factors" in Tourmaline's most recent annual information form available at [www.sedar.com](http://www.sedar.com).

With respect to forward-looking statements contained in this MD&A, Tourmaline has made assumptions regarding: future commodity prices and royalty regimes; availability of skilled labour; timing and amount of capital expenditures; future exchange rates; the impact of increasing competition; conditions in general economic and financial markets; availability of drilling and related equipment and services; effects of regulation by governmental agencies; and future operating costs.

Management has included the above summary of assumptions and risks related to forward-looking information provided in this MD&A in order to provide shareholders with a more complete perspective on Tourmaline's future operations and such information may not be appropriate for other purposes. Tourmaline's actual results, performance or achievement could differ materially from those expressed in, or implied by, these forward-looking statements and, accordingly, no assurance can be given that any of the events anticipated by the forward-looking statements will transpire or occur, or if any of them do so, what benefits that the Company will derive therefrom. Readers are cautioned that the foregoing lists of factors are not exhaustive.

These forward-looking statements are made as of the date of this MD&A and the Company disclaims any intent or obligation to update publicly any forward-looking statements, whether as a result of new information, future events or results or otherwise, other than as required by applicable securities laws.

Boe Conversions - Per barrel of oil equivalent amounts have been calculated using a conversion rate of six thousand cubic feet of natural gas to one barrel of oil equivalent (6:1). Barrel of oil equivalents (boe) may be misleading, particularly if used in isolation. A boe conversion ratio of 6 mcf:1 bbl is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead. In addition, as the value ratio between natural gas and crude oil based on the current prices of natural gas and crude oil is significantly different from the energy equivalency of 6:1, utilizing a conversion on a 6:1 basis may be misleading as an indication of value.

## PRODUCTION

	Three Months Ended December 31,			Years Ended December 31,		
	2013	2012	Change	2013	2012	Change
Natural gas (mcf/d)	<b>446,337</b>	303,040	47%	<b>397,487</b>	268,000	48%
Crude oil and NGL (bbl/d)	<b>11,700</b>	6,723	74%	<b>8,548</b>	6,137	39%
Oil equivalent (boe/d)	<b>86,089</b>	57,230	50%	<b>74,796</b>	50,804	47%

Production for the fourth quarter of 2013 averaged 86,089 boe/d, a 50% increase over the average production for the same quarter of 2012 of 57,230 boe/d. Production was 86% natural gas weighted in the fourth quarter of 2013, compared to 88% for the same quarter of the prior year. For the year ended December 31, 2013, production increased 47% to 74,796 boe/d from 50,804 boe/d in 2012. The Company's significant production growth when compared to 2012 can be primarily attributed to new wells that have been brought on-stream in 2013, as well as property acquisitions. The significant increase in liquids production can be attributed to growth in oil production in Spirit River and stronger NGL recoveries in both the Alberta Deep Basin and NEBC.

Tourmaline increased its 2014 production guidance from 118,000 boe/d to 120,000 boe/d in its February 19, 2014 press release. The production increase is a direct result of Tourmaline's continued success in the ongoing exploration and production program, as well as, continued investments in facilities and infrastructure.

## REVENUE

(000s)	Three Months Ended December 31,			Years Ended December 31,		
	2013	2012	Change	2013	2012	Change
Revenue from:						
Natural gas	\$ <b>157,800</b>	\$ 91,608	72%	\$ <b>529,124</b>	\$ 261,833	102%
Oil and NGL	<b>77,313</b>	51,509	50%	<b>259,739</b>	188,010	38%
Total revenue from natural gas, oil and NGL sales	\$ <b>235,113</b>	\$ 143,117	64%	\$ <b>788,863</b>	\$ 449,843	75%

Revenue for the three months ended December 31, 2013 increased 64% to \$235.1 million from \$143.1 million for the same quarter of 2012. Revenue for the year ended December 31, 2013 increased 75% to \$788.9 million from \$449.8 million in 2012. Revenue growth is consistent with the increase in production and increased natural gas prices over the same periods, offset by a small decrease in liquids prices. Revenue includes all natural gas, petroleum and NGL sales and realized gains on financial instruments.

### TOURMALINE PRICES:

	Three Months Ended December 31,			Years Ended December 31,		
	2013	2012	Change	2013	2012	Change
Natural gas (\$/mcf)	\$ <b>3.84</b>	\$ 3.29	17%	\$ <b>3.65</b>	\$ 2.67	37%
Oil and NGL (\$/bbl)	\$ <b>71.83</b>	\$ 83.28	(14)%	\$ <b>83.25</b>	\$ 83.71	(1)%
Oil equivalent (\$/boe)	\$ <b>29.69</b>	\$ 27.18	9%	\$ <b>28.90</b>	\$ 24.19	19%

The realized average natural gas prices for the quarter and year ended December 31, 2013 were 17% and 37%, respectively, higher than the same periods of the prior year.

Realized crude oil and NGL prices decreased 14% for the quarter ended December 31, 2013, compared to the same quarter in 2012 as a result of widening Canadian differentials for sour crude and liquids relative to Edmonton Par. Realized crude oil and NGL prices decreased 1% for the year ended December 31, 2013, compared 2012.

The realized natural gas price for the quarter ended December 31, 2013 was \$3.84/mcf, which is \$0.32/mcf higher than the AECO index price (three months ended December 31, 2012 – \$3.29/mcf and \$0.10/mcf higher than AECO). The higher realized price is primarily due to higher heat content (\$0.26/mcf and \$0.29/mcf for the fourth quarters of 2013 and 2012, respectively). The remainder of the premium in the fourth quarter of 2013 relates to positive hedging positions, where in the fourth quarter of 2012 hedging losses offset the premium received by \$0.19/mcf.

The realized natural gas price for the year ended December 31, 2013 was 15% (December 31, 2012 – 10%) higher than the AECO index as Tourmaline realized a gain on commodity contracts in combination with the higher heat content noted above. Realized prices exclude the effect of unrealized gains or losses. Once these gains and losses are realized they are included in the per-unit amounts.

**BENCHMARK OIL AND GAS PRICES:**

	Three Months Ended December 31,			Years Ended December 31,		
	2013	2012	Change	2013	2012	Change
Natural gas						
NYMEX Henry Hub (USD\$/mcf)	\$ 3.85	\$ 3.54	9%	\$ 3.73	\$ 2.83	32%
AECO (CAD\$/mcf)	\$ 3.52	\$ 3.19	10%	\$ 3.17	\$ 2.38	33%
Oil						
NYMEX (USD\$/bbl)	\$ 97.61	\$ 88.23	11%	\$ 98.05	\$ 94.15	4%
Edmonton Par (CAD\$/bbl)	\$ 87.00	\$ 84.97	2%	\$ 93.54	\$ 86.90	8%

**RECONCILIATION OF AECO INDEX TO TOURMALINE'S REALIZED GAS PRICES:**

(\$/mcf)	Three Months Ended December 31,			Years Ended December 31,		
	2013	2012	Change	2013	2012	Change
AECO index	\$ 3.52	\$ 3.19	10%	\$ 3.17	\$ 2.42	31%
Heat/quality differential	0.26	0.29	(10)%	0.30	0.20	50%
Realized gain (loss)	0.06	(0.19)	132%	0.18	0.05	260%
Tourmaline realized natural gas price	\$ 3.84	\$ 3.29	17%	\$ 3.65	\$ 2.67	37%

## CURRENCY – EXCHANGE RATES:

	Three Months Ended December 31,			Years Ended December 31,		
	2013	2012	Change	2013	2012	Change
CAD/USD <sup>(1)</sup>	\$ 0.9528	\$ 1.0088	(6)%	\$ 0.9708	\$ 1.0004	(3)%

<sup>(1)</sup> Average rates for the period

## ROYALTIES

(000s)	Three Months Ended December 31,			Years Ended December 31,	
	2013	2012		2013	2012
Natural gas	\$ 3,143	\$ 3,562		\$ 22,899	\$ 2,053
Oil and NGL	10,346	7,231		34,605	28,251
Total royalties	\$ 13,489	\$ 10,793		\$ 57,504	\$ 30,304
Royalties as a percentage of revenue	5.7%	7.5%		7.3%	6.7%

For the quarter ended December 31, 2013, the average effective royalty rate was 5.7% compared to 7.5% for the same quarter of 2012. The reduced royalty rate reflects additional drilling credits earned and recorded in the fourth quarter of 2013. In 2013 the Company continued to benefit from the New Well Royalty Reduction Program and the Natural Gas Deep Drilling Program in Alberta, as well as, the Deep Royalty Credit Program in British Columbia.

For the year ended December 31, 2013, the average effective royalty rate was 7.3% compared to 6.7% for the same period of 2012. The average effective royalty rate increased in 2013 over 2012 mainly due to increased natural gas prices, and the impact of some wells reaching production maximums or coming off royalty holidays.

The Company expects an increase in its royalty rate for 2014 to approximately 10% as some wells will continue to reach production maximums and come off royalty holidays partially offset by new wells coming on stream receiving some royalty relief. The royalty rate is sensitive to commodity prices, and as such, a change in commodity prices will impact the actual rate.

## OTHER INCOME

(000s) except per unit amounts	Three Months Ended December 31,			Years Ended December 31,		
	2013	2012	Change	2013	2012	Change
Other income	\$ 2,292	\$ 1,366	68%	\$ 6,523	\$ 5,039	29%

The increase in other income in 2013 compared to 2012 can be attributed to higher processing income due to temporary excess capacity at the new Doe gas plant and a processing facility acquired in NEBC in late 2012, which was partially utilized in 2013 by a third party.

## OPERATING EXPENSES

(000s) except per unit amounts	Three Months Ended December 31,			Years Ended December 31,		
	2013	2012	Change	2013	2012	Change
Operating expenses	\$ 35,177	\$ 21,576	63%	\$ 118,671	\$ 82,312	44%
Per boe	\$ 4.44	\$ 4.10	8%	\$ 4.35	\$ 4.43	(2)%

Operating expenses include all periodic lease and field-level expenses and exclude income recoveries from processing third-party volumes. For the fourth quarter of 2013, total operating expenses increased 63% from \$21.6 million in the fourth quarter of 2012 to \$35.2 million in 2013 due to the increased total costs relating to the growing production base. On a per-boe basis, the costs increased 8% from \$4.10/boe for the fourth quarter of 2012 to \$4.44/boe in the fourth quarter of 2013. The higher costs per boe can be attributed to additional turnarounds which were incurred in the fourth quarter of 2013. Tourmaline's operating expenses in the fourth quarter of 2013 include third-party processing, gathering and compression fees of approximately \$8.7 million or \$1.10/boe (December 31, 2012 - \$5.7 million or \$1.09/boe).

For the year ended December 31, 2013, total operating expenses were \$118.7 million, or \$4.35/boe, compared to \$82.3 million, or \$4.43/boe for the same period of 2012. Although total operating expenses increased with production, the cost per boe decreased 2% reflecting increased operational efficiencies. The Company's operating expenses were \$0.10 higher than expected on a per-boe basis due to slightly lower production than originally forecasted.

Third-party processing, gathering and compression fees for the year ended December 31, 2013, have increased year-over-year with production (\$33.2 million in 2013 versus \$21.7 million in 2012); the cost per boe has increased to \$1.22/boe in 2013 versus \$1.17/boe in 2012 due to the temporary use of higher cost third-party processing on certain volumes, as well as, increased oil and liquids production which is subject to higher processing fees.

During 2013, the Company commissioned a gas plant at Doe in NEBC, completed an expansion of the Spirit River battery in Alberta and two gas plant expansions at Wild River and Banshee in the Deep Basin. These projects allow for additional volumes to flow through Company owned-and-operated plants thereby reducing third-party charges on a go-forward basis.

The Company's operating cost target is \$4.15/boe in 2014. Actual costs per boe can change, however, depending on a number of factors, including the Company's actual production levels.



## TRANSPORTATION

(000s) except per unit amounts	Three Months Ended December 31,			Years Ended December 31,		
	2013	2012	Change	2013	2012	Change
Natural gas transportation	\$ 12,220	\$ 6,884	78%	\$ 38,671	\$ 25,246	53%
Oil and NGL transportation	5,635	2,927	93%	17,963	9,461	90%
Total transportation	\$ 17,855	\$ 9,811	82%	\$ 56,634	\$ 34,707	63%
Per boe	\$ 2.25	\$ 1.86	21%	\$ 2.07	\$ 1.87	11%

Transportation costs for the three months ended December 31, 2013 were \$17.9 million or \$2.25/boe (three months ended December 31, 2012 - \$9.8 million or \$1.86/boe). Transportation costs for the year ended December 31, 2013 were \$56.6 million or \$2.07/boe (year ended December 31, 2012 - \$34.7 million or \$1.87/boe). The increase in total transportation costs for the three months and year ended December 31, 2013 can be primarily attributed to increased production.

On a per-boe basis, transportation costs for the three and twelve months ended December 31, 2013 are higher as a result of the increased use of more expensive transportation due to pipeline and infrastructure constraints.

## GENERAL & ADMINISTRATIVE EXPENSES (“G&A”)

(000s)	Three Months Ended December 31,			Years Ended December 31,		
	2013	2012	Change	2013	2012	Change
G&A expenses	\$ 10,355	\$ 7,539	37%	\$ 37,582	\$ 27,089	39%
Administrative and capital recovery	(985)	(341)	189%	(2,317)	(1,163)	99%
Capitalized G&A	(3,951)	(3,123)	27%	(15,023)	(11,307)	33%
Total G&A expenses	\$ 5,419	\$ 4,075	33%	\$ 20,242	\$ 14,619	38%
Per boe	\$ 0.68	\$ 0.77	(12)%	\$ 0.74	\$ 0.79	(6)%

Total G&A expenses for the fourth quarter of 2013 were \$5.4 million compared to \$4.1 million for the same quarter of the prior year. G&A costs per boe for the fourth quarter of 2013 decreased 12% down to \$0.68/boe, compared to \$0.77/boe for the fourth quarter of 2012.

For the year ended December 31, 2013, total G&A expenses were \$20.2 million or \$0.74/boe compared to \$14.6 million or \$0.79/boe for the same period of 2012. The higher total G&A expenses in 2013 are directly attributable to managing a larger production, reserve and land base. The Company's G&A expenses per boe continue to trend downward as Tourmaline's production base continues to grow faster than its accompanying G&A costs.

G&A costs for 2014 are expected to be approximately \$0.60/boe. The Company expects G&A costs per boe to continue to decrease as the production base grows. Actual costs per boe can change, however, depending on a number of factors including the Company's actual production levels.

## SHARE-BASED PAYMENTS

(000s)	Three Months Ended December 31,		Years Ended December 31,	
	2013	2012	2013	2012
Share-based payments	\$ 11,588	\$ 7,710	\$ 38,614	\$ 29,892
Capitalized share-based payments	(5,794)	(3,855)	(19,307)	(14,946)
Total share-based payments	\$ 5,794	\$ 3,855	\$ 19,307	\$ 14,946

The Company uses the fair value method for the determination of non-cash related share-based payments expense. During the fourth quarter of 2013, 2,398,000 stock options were granted to employees, officers, directors and key consultants at a weighted-average exercise price of \$40.77, and 763,694 options were exercised, bringing \$8.7 million of cash into treasury. The Company recognized \$5.8 million of share-based payment expense in the fourth quarter of 2013 compared to \$3.9 million in the fourth quarter of 2012. Capitalized share-based payments for the fourth quarter of 2013 were \$5.8 million compared to \$3.9 million for the same quarter of the prior year.

For the year ended December 31, 2013, share-based payment expense totalled \$19.3 million and a further \$19.3 million in share-based payments were capitalized (2012 - \$14.9 million and \$14.9 million, respectively). The increase in share-based payment expense in 2013 compared to 2012 reflects the increased value attributed to the options and a higher number of options outstanding.

## DEPLETION, DEPRECIATION AND AMORTIZATION (“DD&A”)

(000s) except per unit amounts	Three Months Ended December 31,		Years Ended December 31,	
	2013	2012	2013	2012
Total depletion, depreciation and amortization	\$ 96,249	\$ 65,998	\$ 356,239	\$ 242,528
Less mineral lease expiries	(2,282)	–	(33,127)	–
Depletion, depreciation and amortization	\$ 93,967	\$ 65,998	\$ 323,112	\$ 242,528
Per boe	\$ 11.86	\$ 12.53	\$ 11.84	\$ 13.04

DD&A expense was \$94.0 million for the fourth quarter of 2013 compared to \$66.0 million for the same period of 2012 due to higher production volumes, as well as a larger capital asset base being depleted. The per-unit DD&A rate for the fourth quarter of 2013 was \$11.86/boe compared to \$12.53/boe for the same quarter of 2012.

For the year ended December 31, 2013, DD&A expense was \$323.1 million (December 31, 2012 - \$242.5 million) with a DD&A rate of \$11.84/boe (December 31, 2012 - \$13.04/boe). The lower DD&A rate for the quarter and year ended December 31, 2013 reflects strong reserve additions derived from Tourmaline’s exploration and production program.

Mineral lease expiries for the three months and year ended December 31, 2013 were \$2.3 million and \$33.1 million, respectively (December 31, 2012 – nil and nil, respectively). The increase in expiries is a result of mineral leases acquired via property and corporate acquisitions which were partially through their term at the date they were purchased, and have now begun to expire. The Company prioritizes drilling on what it believes to

be the most cost-efficient and productive acreage, and with such a large land base, the Company has chosen to not continue some of the expiring sections of land. Tourmaline expects to continue to see mineral lease expiries of a similar magnitude on a go-forward basis.

## FINANCE EXPENSES

(000s)	Three Months Ended December 31,			Years Ended December 31,		
	2013	2012	Change	2013	2012	Change
Interest expense	\$ 3,551	\$ 3,064	16%	\$ 12,220	\$ 10,484	17%
Accretion expense	626	388	61%	2,038	1,328	53%
Transaction costs on corporate and property acquisitions	9	974	(99)%	1,100	1,146	(4)%
Total finance expenses	\$ 4,186	\$ 4,426	(5)%	\$ 15,358	\$ 12,958	19%

Finance expenses totalled \$4.2 million and \$15.4 million for the quarter and year ended December 31, 2013, respectively, and are comprised of interest expense, transaction costs on corporate and property acquisitions and accretion of decommissioning obligations (December 31, 2012 - \$4.4 million and \$13.0 million, respectively). The increased finance expenses in 2013 are largely due to higher interest expense resulting from a higher balance drawn on the credit facility. The average bank debt outstanding and the average effective interest rate on the debt during 2013 were \$337.0 million and 3.0%, respectively (2012 - \$245.4 million and 3.34%, respectively). In the fourth quarter of 2013, this increase in interest expense was offset by a decrease in transaction costs on corporate acquisitions, with the fourth quarter of 2012 having costs related to a corporate acquisition.

## CASH FLOW FROM OPERATING ACTIVITIES, CASH FLOW AND NET EARNINGS

(000s) except per unit amounts	Three Months Ended December 31,			Years Ended December 31,		
	2013	2012	Change	2013	2012	Change
Cash flow from operating activities	\$ 128,852	\$ 104,671	23%	\$ 479,239	\$ 273,477	75%
Per share <sup>(1)</sup>	\$ 0.66	\$ 0.60	10%	\$ 2.55	\$ 1.64	55%
Cash flow <sup>(2)</sup>	\$ 160,732	\$ 93,807	71%	\$ 526,761	\$ 280,279	88%
Per share <sup>(1)(2)</sup>	\$ 0.83	\$ 0.54	54%	\$ 2.80	\$ 1.68	67%
Net earnings	\$ 56,763	\$ 16,301	248%	\$ 148,114	\$ 15,519	854%
Per share <sup>(1)</sup>	\$ 0.29	\$ 0.09	222%	\$ 0.79	\$ 0.09	778%
Operating netback per boe <sup>(2)</sup>	\$ 21.29	\$ 19.17	11%	\$ 20.37	\$ 16.27	25%

<sup>(1)</sup> Fully diluted

<sup>(2)</sup> See "Non-GAAP Financial Measures"

Cash flow for the three months ended December 31, 2013 was \$160.7 million or \$0.83 per diluted share compared to \$93.8 million or \$0.54 per diluted share for the same period of 2012. For the year ended December 31, 2013, cash flow was \$526.8 million or \$2.80 per diluted share, which is higher than the December 31, 2012

cash flow of \$280.3 million or \$1.68 per diluted share. The increase in cash flow in 2013 reflects increased production and higher natural gas prices.

The Company had after-tax earnings for the three months and year ended December 31, 2013 of \$56.8 million (\$0.29 per diluted share) and \$148.1 million (\$0.79 per diluted share), respectively, compared to earnings of \$16.3 million (\$0.09 per diluted share) and \$15.5 million (\$0.09 per diluted share), respectively, for the same periods of 2012. The significant increase is attributable to increased natural gas prices and production, as well as the \$77.0 million in gains realized on the sale of certain non-core assets in Alberta and NEBC (December 31, 2012 - \$7.6 million).

## CAPITAL EXPENDITURES

(000s)	Three Months Ended December 31,		Years Ended December 31,	
	2013	2012	2013	2012
Land and seismic	\$ 8,660	\$ 9,270	\$ 43,008	\$ 31,288
Drilling and completions	280,326	148,953	721,653	438,459
Facilities	122,801	52,917	386,601	184,406
Property acquisitions	82,180	81,778	226,926	88,619
Property dispositions	(24)	(49)	(78,069)	(12,682)
Other	3,998	3,239	15,297	11,550
<b>Total cash capital expenditures</b>	<b>\$ 497,941</b>	<b>\$ 296,108</b>	<b>\$ 1,315,416</b>	<b>\$ 741,640</b>

During the fourth quarter of 2013, the Company invested \$497.9 million of cash consideration, net of dispositions, compared to \$296.1 million for the same period of 2012. Expenditures on exploration and production were \$411.8 million compared to \$211.1 million for the same quarter of 2012, which is consistent with the Company's aggressive growth strategy. The growth in facilities expenditures includes costs related to the expansion of the Wild River and Banshee gas facilities both of which were completed in late 2013. The Company also continued to add to its overall asset base through strategic property acquisitions during the third and fourth quarters of 2013.

During 2013 the Company invested \$1,315.4 million of cash consideration, net of dispositions, compared to \$741.6 million in 2012. Expenditures on exploration and production were \$1,151.3 million compared to \$654.2 million for 2012.

The following table summarizes the drill, complete and tie-in activities for the period:

	Three Months Ended December 31, 2013		Year Ended December 31, 2013	
	Gross	Net	Gross	Net
Drilled	48	42.69	129	115.14
Completed	51	45.06	123	111.33
Tied-in	21	15.16	54	46.85

Capital expenditures in 2014 are forecast to be \$1.0 billion, which was revised upward from \$900 million in the February 19, 2014 press release. Major planned 2014 facility projects include expansions at Musreau in Alberta and Doe in NEBC, and a new gas plant in Spirit River, Alberta (in late 2014).

## LIQUIDITY AND CAPITAL RESOURCES

On March 12, 2013, the Company issued 5.78 million common shares at a price of \$34.25 per share and 0.835 million flow-through common shares at a price of \$42.15 per share, for total gross proceeds of \$233.2 million. The proceeds were used to temporarily reduce bank debt and to fund the Company's 2013 exploration and development program.

On October 8, 2013, the Company issued 3.495 million common shares at a price of \$41.75 per share and 0.925 million flow-through common shares at a price of \$51.60 per share, for total gross proceeds of \$193.6 million. The proceeds were used to temporarily reduce bank debt and to fund the Company's remaining 2013 and its upcoming 2014 exploration and development programs.

On February 12, 2014 the Company issued 4.615 million common shares at a price of \$47.50 per share for total gross proceeds of \$219.2 million. The proceeds will be used to temporarily reduce bank debt and to fund the Company's upcoming 2014 exploration and development programs.

The Company has a covenant-based bank credit facility in place with a syndicate of bankers, the details of which are described in note 9 of the Company's consolidated financial statements for the year ended December 31, 2013. In October 2013, the facility was increased to \$900 million from \$750 million, under the same terms and covenants, with an initial maturity of June 2016.

At December 31, 2013, Tourmaline had negative working capital of \$242.6 million, after adjusting for the fair value of financial instruments (the unadjusted working capital deficiency was \$245.3 million) (December 31, 2012 – \$103.7 million and \$98.9 million, respectively). Management believes the Company has sufficient liquidity and capital resources to fund the 2014 exploration and development program through expected cash flow from operations, its unutilized bank credit facility and the financings described above. As at December 31, 2013, the Company's bank debt balance was \$590.3 million (December 31, 2012 - \$360.6 million), and net debt was \$832.9 million (December 31, 2012 - \$464.3 million).

## SHARES AND STOCK OPTIONS OUTSTANDING

As at March 17, 2014, the Company has 195,138,903 common shares outstanding and 15,654,810 stock options granted and outstanding.

## COMMITMENTS AND CONTRACTUAL OBLIGATIONS

In the normal course of business, Tourmaline is obligated to make future payments. These obligations represent contracts and other commitments that are known and non-cancellable.

### Payments Due by Year (000s)

	1 Year	2-3 Years	4-5 Years	>5 Years	Total
Operating leases	\$ 3,591	\$ 9,552	\$ 10,163	\$ 6,168	\$ 29,474
Firm transportation and processing agreements	55,539	262,358	143,562	344,206	805,665
Bank debt <sup>(1)</sup>	–	639,271	–	–	639,271
	\$ 59,130	\$ 911,181	\$ 153,725	\$ 350,374	\$ 1,474,410

<sup>(1)</sup> Includes interest expense at an annual rate of 3.06% being the rate applicable to outstanding bank debt at December 31, 2013.

## OFF BALANCE SHEET ARRANGEMENTS

The Company has certain lease arrangements, all of which are reflected in the commitments and contractual obligations table, which were entered into in the normal course of operations. All leases have been treated as operating leases whereby the lease payments are included in operating expenses or general and administrative expenses depending on the nature of the lease.

## FINANCIAL RISK MANAGEMENT

The Board of Directors has overall responsibility for the establishment and oversight of the Company's risk management framework. The Board has implemented and monitors compliance with risk management policies.

The Company's risk management policies are established to identify and analyze the risks faced by the Company, to set appropriate risk limits and controls, and to monitor risks and adherence to market conditions and the Company's activities. The Company's financial risks are discussed in note 5 of the Company's consolidated financial statements for the year ended December 31, 2013.

As at December 31, 2013, the Company has entered into certain financial derivative contracts in order to manage commodity risk. These instruments are not used for trading or speculative purposes. The Company has not designated its financial derivative contracts as effective accounting hedges, even though the Company considers all commodity contracts to be effective economic hedges. Such financial derivative commodity contracts are recorded on the consolidated statement of financial position at fair value, with changes in the fair value being recognized as an unrealized gain or loss on the consolidated statement of income and comprehensive income. The contracts that the Company entered into in 2013 are detailed in note 5 of the Company's consolidated financial statements for the year ended December 31, 2013.

The following table provides a summary of the unrealized gains and losses on financial instruments for the year ended December 31, 2013:

(000s)	Three Months Ended December 31,		Years Ended December 31,	
	2013	2012	2013	2012
Unrealized gain (loss) on financial instruments	\$ (4,847)	\$ 1,174	\$ (10,046)	\$ 2,600
Unrealized (loss) on investments held for trading	–	–	–	(103)
<b>Total</b>	<b>\$ (4,847)</b>	<b>\$ 1,174</b>	<b>\$ (10,046)</b>	<b>\$ 2,497</b>

The Company has entered into physical contracts to manage commodity risk. These contracts are considered normal sales contracts and are not recorded at fair value in the consolidated financial statements. Physical contracts in place at December 31, 2013 have been disclosed in note 5 of the Company's consolidated financial statements for the year ended December 31, 2013.

Financial derivative and physical delivery contracts entered into subsequent to December 31, 2013 are detailed in note 5 of the Company's consolidated financial statements for the year ended December 31, 2013.

## APPLICATION OF CRITICAL ACCOUNTING ESTIMATES

Certain accounting policies require that management make appropriate decisions with respect to the formulation of estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. Management reviews its estimates on a regular basis. The emergence of new information and changed circumstances may result in actual results or changes to estimates that differ materially from current estimates. The Company's use of estimates and judgments in preparing the consolidated financial statements is discussed in note 1 of the consolidated financial statements for the year ended December 31, 2013.

## DISCLOSURE CONTROLS AND PROCEDURES AND INTERNAL CONTROLS OVER FINANCIAL REPORTING

The Company's Chief Executive Officer and Chief Financial Officer have designed, or caused to be designed under their supervision, disclosure controls and procedures ("DC&P"), as defined by National Instrument 52-109 – *Certification of Disclosure in Issuers' Annual and Interim Filings* ("NI 52-109"), to provide reasonable assurance that: (i) material information relating to the Company is made known to the Company's Chief Executive Officer and Chief Financial Officer by others, particularly during the periods in which the annual and interim filings are being prepared; and (ii) information required to be disclosed by the Company in its annual filings, interim filings or other reports filed or submitted by it under securities legislation is recorded, processed, summarized and reported within the time period specified in securities legislation. All control systems by their nature have inherent limitations and, therefore, the Company's DC&P are believed to provide reasonable, but not absolute, assurance that the objectives of the control systems are met.

The Company's Chief Executive Officer and Chief Financial Officer have designed, or caused to be designed under their supervision, internal controls over financial reporting ("ICFR"), as defined by NI 52-109, to provide reasonable assurance regarding the reliability of the Company's financial reporting and the preparation of financial statements for external purposes in accordance with GAAP.

The Company's Chief Executive Officer and Chief Financial Officer have evaluated the effectiveness of the Company's DC&P and ICFR. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that, as at December 31, 2013, the Company's DC&P and ICFR are effective. There were no changes in the Company's DC&P or ICFR during the period beginning on October 1, 2013 and ending December 31, 2013 that have materially affected, or are reasonably likely to materially affect, the Company's DC&P or ICFR. It should be noted that a control system, including the Company's disclosure and internal controls and procedures, no matter how well conceived can provide only reasonable, but not absolute assurance that the objectives of the control system will be met and it should not be expected that the disclosure and internal controls and procedures will prevent all errors or fraud.

The design and assessment of the Company's DC&P and ICFR were based on the framework in 'Internal Control – Integrated Framework (1992)' issued by the Committee of Sponsoring Organizations of the Treadway Commission.

## BUSINESS RISKS AND UNCERTAINTIES

Tourmaline monitors and complies with current government regulations that affect its activities, although operations may be adversely affected by changes in government policy, regulations or taxation. In addition, Tourmaline maintains a level of liability, property and business interruption insurance which is believed to be adequate for Tourmaline's size and activities, but is unable to obtain insurance to cover all risks within the business or in amounts to cover all possible claims.

See "Forward-Looking Statements" in this MD&A and "Risk Factors" in Tourmaline's most recent annual information form for additional information regarding the risks to which Tourmaline and its business and operations are subject.

## IMPACT OF NEW ENVIRONMENTAL REGULATIONS

The oil and gas industry is currently subject to regulation pursuant to a variety of provincial and federal environmental legislation, all of which is subject to governmental review and revision from time to time. Such legislation provides for, among other things, restrictions and prohibitions on the spill, release or emission of various substances produced in association with certain oil and gas industry operations, such as sulphur dioxide and nitrous oxide. In addition, such legislation sets out the requirements with respect to oilfield waste handling and storage, habitat protection and the satisfactory operation, maintenance, abandonment and reclamation of well and facility sites. Compliance with such legislation can require significant expenditures and a breach of such requirements may result in suspension or revocation of necessary licenses and authorizations, civil liability and the imposition of material fines and penalties.

The use of fracture stimulations has been ongoing safely in an environmentally responsible manner in western Canada for decades. With the increase in the use of fracture stimulations in horizontal wells there is increased communication between the oil and natural gas industry and a wider variety of stakeholders regarding the responsible use of this technology. This increased attention to fracture stimulations may result in increased regulation or changes of law which may make the conduct of the Company's business more expensive or prevent the Company from conducting its business as currently conducted. Tourmaline focuses on conducting transparent, safe and responsible operations in the communities in which its people live and work.



## CHANGES IN ACCOUNTING POLICIES

The following new accounting standards and amendments to existing standards, as issued by the International Accounting Standards Board (“IASB”), have been adopted by the Company effective January 1, 2013.

*IFRS 9 – Financial instruments* addresses the classification and measurement of financial assets.

*IFRS 10 – Consolidated Financial Statements* builds on existing principles and standards and identifies the concept of control as the determining factor in whether an entity should be included within the consolidated financial statements of the parent company.

*IFRS 11 – Joint Arrangements* establishes the principles for financial reporting by entities when they have an interest in arrangements that are jointly controlled.

*IFRS 12 – Disclosure of Interest in Other Entities* provides the disclosure requirements for interests held in other entities including joint arrangements, associates, special purpose entities and other off balance sheet entities.

*IFRS 13 – Fair Value Measurement* defines fair value, requires disclosure about fair value measurements and provides a framework for measuring fair value when it is required or permitted within the IFRS standards.

## NON-GAAP FINANCIAL MEASURES

This MD&A or documents referred to in this MD&A make reference to the terms “cash flow”, “operating netback”, “working capital (adjusted for the fair value of financial instruments)”, “net debt”, “adjusted EBITDA”, “senior debt”, “total debt”, and “total capitalization” which are not recognized measures under GAAP, and do not have a standardized meaning prescribed by GAAP. Accordingly, the Company’s use of these terms may not be comparable to similarly defined measures presented by other companies. Management uses the terms “cash flow”, “operating netback”, “working capital (adjusted for the fair value of financial instruments)” and “net debt”, for its own performance measures and to provide shareholders and potential investors with a measurement of the Company’s efficiency and its ability to generate the cash necessary to fund a portion of its future growth expenditures or to repay debt. Investors are cautioned that the non-GAAP measures should not be construed as an alternative to net income determined in accordance with GAAP as an indication of the Company’s performance. The terms “adjusted EBITDA”, “senior debt”, “total debt”, and “total capitalization” are not used by management in measuring performance but are used in the financial covenants under the Company’s credit facility. Under the Company’s credit facility “adjusted EBITDA” means generally net income or loss, excluding extraordinary items, plus interest expense and income taxes and adjusted for non-cash items and gains or losses on dispositions, “senior debt” means generally the indebtedness, liabilities and obligations of the Company to the lenders under the credit facility and certain other secured indebtedness, liabilities and obligations of the Company (“bank debt”), “total debt” means generally bank debt plus any other indebtedness of the Company, and “total capitalization” means generally the sum of the Company’s shareholders’ equity and all other indebtedness of the Company including bank debt, all determined on a consolidated basis in accordance with GAAP.

## Cash Flow

A summary of the reconciliation of cash flow from operating activities (per the statement of cash flow), to cash flow, is set forth below:

(000s)	Three Months Ended December 31,		Years Ended December 31,	
	2013	2012	2013	2012
Cash flow from operating activities (per GAAP)	\$ 128,852	\$ 104,671	\$ 479,239	\$ 273,477
Change in non-cash working capital	31,880	(10,864)	47,522	6,802
Cash flow	\$ 160,732	\$ 93,807	\$ 526,761	\$ 280,279

## Operating Netback

Operating netback is calculated on a per-boe basis and is defined as revenue (excluding processing income) less royalties, transportation costs and operating expenses, as shown below:

(\$/boe)	Three Months Ended December 31,		Years Ended December 31,	
	2013	2012	2013	2012
Revenue, excluding processing income	\$ 29.69	\$ 27.18	\$ 28.90	\$ 24.19
Royalties	(1.70)	(2.05)	(2.11)	(1.63)
Transportation costs	(2.25)	(1.86)	(2.07)	(1.87)
Operating expenses	(4.44)	(4.10)	(4.35)	(4.43)
Operating netback <sup>(1)</sup>	\$ 21.29	\$ 19.17	\$ 20.37	\$ 16.27

<sup>(1)</sup> May not add due to rounding.

## Working Capital (Adjusted for the Fair Value of Financial Instruments)

A summary of the reconciliation of working capital to working capital (adjusted for the fair value of financial instruments) is set forth below:

(000s)	As at December 31, 2013	As at December 31, 2012
Working capital (deficit)	\$ (245,314)	\$ (98,913)
Fair value of financial instruments – short-term (asset) liability	2,691	(4,814)
Working capital (deficit) (adjusted for the fair value of financial instruments)	\$ (242,623)	\$ (103,727)

## Net Debt

A summary of the reconciliation of net debt is set forth below:

(000s)	As at December 31, 2013	As at December 31, 2012
Bank debt	\$ (590,319)	\$ (360,573)
Working capital (deficit)	(245,314)	(98,913)
Fair value of financial instruments – short-term (asset) liability	2,691	(4,814)
Net debt	\$ (832,942)	\$ (464,300)

## SELECTED QUARTERLY INFORMATION

(\$000s, unless otherwise noted)	2013				2012			
	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1
<b>PRODUCTION</b>								
Natural gas (mcf)	<b>41,062,993</b>	36,486,443	34,477,391	33,055,857	27,879,639	23,501,484	24,276,149	22,430,621
Oil and NGL(bbls)	<b>1,076,395</b>	735,727	640,001	667,907	618,483	515,157	596,992	515,408
Oil equivalent (boe)	<b>7,920,228</b>	6,816,800	6,386,233	6,177,216	5,265,090	4,432,071	4,643,016	4,253,845
Natural gas (mcf/d)	<b>446,337</b>	396,592	378,872	367,287	303,040	255,451	266,771	246,490
Oil and NGL (bbls/d)	<b>11,700</b>	7,997	7,033	7,421	6,723	5,600	6,560	5,664
Oil equivalent (boe/d)	<b>86,089</b>	74,096	70,178	68,636	57,230	48,175	51,022	46,746
<b>FINANCIAL</b>								
Revenue, net of royalties	<b>219,069</b>	167,138	180,505	161,124	134,864	91,863	105,567	94,781
Cash flow from operating activities	<b>128,852</b>	128,192	128,432	93,763	104,671	66,713	42,566	59,527
Cash flow <sup>(1)</sup>	<b>160,732</b>	120,560	128,870	116,599	93,807	63,515	61,121	61,836
Per diluted share	<b>0.83</b>	0.64	0.68	0.64	0.54	0.38	0.37	0.38
Net earnings (loss)	<b>56,763</b>	9,163	30,004	52,184	16,301	(4,770)	1,012	2,976
Per basic share	<b>0.30</b>	0.05	0.16	0.29	0.10	(0.03)	0.01	0.02
Per diluted share	<b>0.29</b>	0.05	0.16	0.29	0.09	(0.03)	0.01	0.02
Total assets	<b>4,696,471</b>	4,210,171	3,811,192	3,735,641	3,580,253	2,992,552	2,862,502	2,878,261
Working capital (deficit)	<b>(245,314)</b>	(206,250)	(50,851)	(165,385)	(98,913)	(98,184)	(15,311)	(176,029)
Working capital (deficit)(adjusted for the fair value of financial instruments) <sup>(1)</sup>	<b>(242,623)</b>	(204,507)	(53,676)	(166,049)	(103,727)	(101,577)	(19,809)	(175,696)
Cash capital expenditures	<b>497,941</b>	468,261	158,751	190,463	296,108	175,277	53,831	216,424
Total outstanding shares (000s)	<b>189,805</b>	184,621	184,175	183,408	174,813	165,678	160,459	158,807
<b>PER UNIT</b>								
Natural gas (\$/mcf)	<b>3.84</b>	3.30	3.92	3.50	3.29	2.52	2.23	2.54
Oil and NGL (\$/bbl)	<b>71.83</b>	91.65	87.06	88.75	83.28	83.34	77.75	91.48
Revenue (\$/boe)	<b>29.69</b>	27.58	29.88	28.33	27.18	23.04	21.64	24.48
Operating netback (\$/boe) <sup>(1)</sup>	<b>21.29</b>	18.59	21.28	20.20	19.17	15.68	14.22	15.52

<sup>(1)</sup> See Non-GAAP Financial Measures.

The oil and gas exploration and production industry is cyclical in nature. The Company's financial position, results of operations and cash flows are principally impacted by production levels and commodity prices, particularly natural gas prices.

Overall, the Company has had continued annual growth over the last two years summarized in the table above. The small decrease in production from the second quarter to the third quarter of 2012 was due to weather-related tie-in delays, as well as production disruptions related to sour gas handling issues at Spirit River and a one-time equipment issue at Sunrise. The Company's average annual production has increased from 50,804 boe per day in 2012 to 74,796 boe per day in 2013. The production growth can be attributed primarily to the Company's exploration and development activities, as well as from acquisitions of producing properties.

The Company's cash flows from operating activities were \$273.5 million in 2012 and \$479.2 million in 2013. Cash flows have increased with higher production and strengthening natural gas prices in 2013 over 2012. Commodity price changes can indirectly impact expected production by changing the amount of funds available to reinvest in exploration, development and acquisition activities in the future. Decreases in commodity prices not only reduce revenues and cash flows available for exploration, they may also challenge the economics of potential capital projects by reducing the quantities of reserves that are commercially recoverable. The Company's capital program is dependent on cash flows generated from operations and access to capital markets.

## SELECTED ANNUAL INFORMATION

(\$000s unless otherwise noted)	2013	2012	2011
<b>PRODUCTION</b>			
Natural gas (mcf)	145,082,684	98,087,893	60,577,481
Oil and NGL (bbls)	3,120,030	2,246,040	1,221,268
Oil equivalent (boe)	27,300,477	18,594,022	11,317,515
Natural gas (mcf/d)	397,487	268,000	165,966
Oil and NGL (bbls/d)	8,548	6,137	3,346
Oil equivalent (boe/d)	74,796	50,804	31,007
<b>FINANCIAL</b>			
Revenue, net of royalties	727,836	427,075	346,104
Cash flow from operating activities	479,239	273,477	228,421
Cash flow <sup>(1)</sup>	526,761	280,279	241,352
Per diluted share	2.80	1.68	1.58
Net earnings	148,114	15,519	42,681
Per basic share	0.81	0.10	0.29
Per diluted share	0.79	0.09	0.28
Total assets	4,696,471	3,580,253	2,711,024
Working capital (deficit)	(245,314)	(98,913)	(146,317)
Working capital (deficit) (adjusted for the fair value of financial instruments) <sup>(1)</sup>	(242,623)	(103,727)	(146,593)
Cash capital expenditures	1,315,416	741,640	828,956
Basic outstanding shares (000s)	189,805	174,813	158,578
<b>PER UNIT</b>			
Natural gas (\$/mcf)	3.65	2.67	4.17
Oil and NGL (\$/bbl)	83.25	83.71	90.24
Revenue (\$/boe)	28.90	24.19	32.07
Operating netback (\$/boe)	20.37	16.27	22.35

<sup>(1)</sup> See Non-GAAP Financial Measures.

The changes to the financial information summarized above are due primarily to the continuing growth in the Company's crude oil, natural gas and NGL production over the periods, from the Company's exploration and development activities and from the acquisition of producing properties.

## MANAGEMENT'S REPORT

### To the Shareholders of Tourmaline Oil Corp.:

The accompanying consolidated financial statements of Tourmaline Oil Corp. and all the information in the Annual Report are the responsibility of management and have been approved by the Board of Directors. The financial statements have been prepared by management in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board. When alternative accounting methods exist, management has chosen those it deems most appropriate in the circumstances. Financial statements are not precise since they include certain amounts based on estimates and judgments. Management has determined such amounts on a reasonable basis in order to ensure that the financial statements are presented fairly, in all material respects. The financial information contained elsewhere in this report has been reviewed to ensure consistency with the financial statements.

Management has established systems of internal controls, which are designed to provide reasonable assurance that assets are safeguarded from loss or unauthorized use and to produce reliable accounting records for the preparation of financial information. The Board of Directors is responsible for ensuring that management fulfills its responsibilities for financial reporting and internal control. It exercises its responsibilities primarily through the Audit Committee, with some assistance from the Reserves Committee regarding the annual evaluation of the Company's petroleum and natural gas reserves. The Audit Committee has reviewed the financial statements with management and the auditors, and has reported to the Board of Directors. The external auditors have access to the Audit Committee without the presence of management.

The financial statements have been audited on behalf of the shareholders by KPMG LLP, the external auditors. Their examination included such tests and procedures, as they considered necessary, to provide reasonable assurance that the consolidated financial statements are presented fairly in accordance with International Financial Reporting Standards. The Board of Directors has approved the financial statements.

*(signed)*

Michael L. Rose  
*President and  
Chief Executive Officer*  
Calgary, Alberta

March 17, 2014

*(signed)*

Brian G. Robinson  
*Vice-President, Finance and  
Chief Financial Officer*  
Calgary, Alberta

## AUDITOR'S REPORT

### To the Shareholders of Tourmaline Oil Corp.:

We have audited the accompanying consolidated financial statements of Tourmaline Oil Corp., which comprise the consolidated statements of financial position as at December 31, 2013 and December 31, 2012 and the consolidated statements of income and comprehensive income, changes in equity and cash flows for the years then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

### Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

### Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

### Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of Tourmaline Oil Corp. as at December 31, 2013 and December 31, 2012 and its consolidated financial performance and its consolidated cash flows for the years then ended in accordance with International Financial Reporting Standards.

(Signed) "KPMG LLP"  
Chartered Accountants  
March 17, 2014  
Calgary, Canada

# CONSOLIDATED FINANCIAL STATEMENTS

## CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

(000s) December 31, 2013 December 31, 2012

### Assets

#### Current assets:

Accounts receivable	\$ 136,041	\$ 83,868
Assets held for sale	–	33,007
Prepaid expenses and deposits	6,918	5,309
Fair value of financial instruments (notes 4 and 5)	166	4,814

Total current assets	143,125	126,998
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Fair value of financial instruments (notes 4 and 5)	663	–
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Long-term asset	2,373	2,580
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Exploration and evaluation assets (note 6)	700,525	639,933
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Property, plant and equipment (note 7)	3,849,785	2,810,742
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Total Assets	\$ 4,696,471	\$ 3,580,253
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### Liabilities and Shareholders' Equity

#### Current liabilities:

Accounts payable and accrued liabilities	\$ 385,582	\$ 225,911
Fair value of financial instruments (notes 4 and 5)	2,857	–

Total current liabilities	388,439	225,911
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Bank debt (note 9)	590,319	360,573
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Long-term obligation	3,414	7,139
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Fair value of financial instruments (notes 4 and 5)	5,216	2,012
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Deferred premium on flow-through shares	–	8,755
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Decommissioning obligations (note 8)	76,037	64,757
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Deferred taxes (note 12)	265,025	176,391
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#### Shareholders' equity:

Share capital (note 11)	3,062,432	2,599,614
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Non-controlling interest (note 10)	17,877	16,298
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Contributed surplus	91,718	70,923
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Retained earnings	195,994	47,880
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Total shareholders' equity	3,368,021	2,734,715
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Total Liabilities and Shareholders' Equity	\$ 4,696,471	\$ 3,580,253
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Commitments (note 19)

Subsequent events (notes 5, 19 and 21)

See accompanying notes to the consolidated financial statements.



## CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME

(000s) except per-share amounts	Years Ended December 31,	
	2013	2012
<b>Revenue:</b>		
Oil and natural gas sales	\$ 759,153	\$ 441,888
Royalties	(57,504)	(30,304)
Net revenue from oil and natural gas sales	701,649	411,584
Realized gain on financial instruments	29,710	7,955
Unrealized gain (loss) on financial instruments (note 5)	(10,046)	2,497
Other income (note 15)	6,523	5,039
Total net revenue	727,836	427,075
<b>Expenses:</b>		
Operating	118,671	82,312
Transportation	56,634	34,707
General and administration	20,242	14,619
Share-based payments	19,307	14,946
(Gain) on divestitures	(76,990)	(7,634)
Depletion, depreciation and amortization	356,239	242,528
Total expenses	494,103	381,478
<b>Income from operations</b>	<b>233,733</b>	<b>45,597</b>
Finance expenses (note 16)	15,358	12,958
<b>Income before taxes</b>	<b>218,375</b>	<b>32,639</b>
Deferred taxes (note 12)	68,682	15,901
<b>Net income and comprehensive income before non-controlling interest</b>	<b>149,693</b>	<b>16,738</b>
Net income and comprehensive income attributable to:		
Shareholders of the Company	148,114	15,519
Non-controlling interest (note 10)	1,579	1,219
	\$ 149,693	\$ 16,738
<b>Net income per share attributable to common shareholders (note 13)</b>		
Basic	\$ 0.81	\$ 0.10
Diluted	\$ 0.79	\$ 0.09

See accompanying notes to the consolidated financial statements.

## CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

(000s)

	Share Capital	Contributed Surplus	Retained Earnings	Non-Controlling Interest	Total Equity
Balance at December 31, 2012	\$ 2,599,614	\$ 70,923	\$ 47,880	\$ 16,298	\$ 2,734,715
Issue of common shares (note 11)	411,099	–	–	–	411,099
Share issue costs, net of tax	(13,123)	–	–	–	(13,123)
Share-based payments	–	19,307	–	–	19,307
Capitalized share-based payments	–	19,307	–	–	19,307
Options exercised (note 11)	64,842	(17,819)	–	–	47,023
Income attributable to common shareholders	–	–	148,114	–	148,114
Income attributable to non-controlling interest	–	–	–	1,579	1,579
<b>Balance at December 31, 2013</b>	<b>\$ 3,062,432</b>	<b>\$ 91,718</b>	<b>\$ 195,994</b>	<b>\$ 17,877</b>	<b>\$ 3,368,021</b>

(000s)

	Share Capital	Contributed Surplus	Retained Earnings	Non-Controlling Interest	Total Equity
Balance at December 31, 2011	\$ 2,140,660	\$ 47,776	\$ 32,361	\$ 15,079	\$ 2,235,876
Issue of common shares (note 11)	441,620	–	–	–	441,620
Share issue costs, net of tax	(7,123)	–	–	–	(7,123)
Share-based payments	–	14,946	–	–	14,946
Capitalized share-based payments	–	14,946	–	–	14,946
Options exercised (note 11)	24,457	(6,745)	–	–	17,712
Income attributable to common shareholders	–	–	15,519	–	15,519
Income attributable to non-controlling interest	–	–	–	1,219	1,219
<b>Balance at December 31, 2012</b>	<b>\$ 2,599,614</b>	<b>\$ 70,923</b>	<b>\$ 47,880</b>	<b>\$ 16,298</b>	<b>\$ 2,734,715</b>

See accompanying notes to the consolidated financial statements.

## CONSOLIDATED STATEMENTS OF CASH FLOW

(000s)	Years Ended December 31,	
	2013	2012
<b>Cash provided by (used in):</b>		
<b>Operations:</b>		
Net income	\$ 148,114	\$ 15,519
Items not involving cash:		
Depletion, depreciation and amortization	356,239	242,528
Accretion	2,038	1,328
Share-based payments	19,307	14,946
Deferred taxes	68,682	15,901
Unrealized (gain) loss on financial instruments (note 5)	10,046	(2,497)
Realized gain on sale of investments	–	(38)
(Gain) on divestitures	(76,990)	(7,634)
Non-controlling interest	1,579	1,219
Decommissioning expenditures	(2,254)	(993)
Changes in non-cash operating working capital (note 18)	(47,522)	(6,802)
<b>Total cash flow from operating activities</b>	<b>479,239</b>	<b>273,477</b>
<b>Financing:</b>		
Issue of common shares	473,830	231,367
Share issue costs	(17,633)	(9,497)
Increase in bank debt	229,746	246,607
<b>Total cash flow from financing activities</b>	<b>685,943</b>	<b>468,477</b>
<b>Investing:</b>		
Exploration and evaluation	(154,431)	(79,295)
Property, plant and equipment	(1,012,128)	(586,408)
Property acquisitions	(226,926)	(88,619)
Proceeds from divestitures	78,069	12,682
Proceeds from sale of investments	–	168
Net repayment of long-term obligation	(3,462)	(3,725)
Changes in non-cash investing working capital (note 18)	153,696	3,243
<b>Total cash flow from investing activities</b>	<b>(1,165,182)</b>	<b>(741,954)</b>
<b>Changes in cash</b>	<b>–</b>	<b>–</b>
<b>Cash, beginning of year</b>	<b>–</b>	<b>–</b>
<b>Cash, end of year</b>	<b>\$ –</b>	<b>\$ –</b>

Cash is defined as cash and cash equivalents.

See accompanying notes to the consolidated financial statements.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

## For the years ended December 31, 2013 and 2012

*(tabular amounts in thousands of dollars, unless otherwise noted)*

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### Corporate Information:

Tourmaline Oil Corp. (the “Company”) was incorporated under the laws of the Province of Alberta on July 21, 2008. The Company is engaged in the acquisition, exploration, development and production of petroleum and natural gas properties and conducts many of its activities jointly with others. These consolidated financial statements reflect only the Company’s proportionate interest in such activities.

The Company’s registered office is located at Suite 2400, 525 – 8<sup>th</sup> Avenue S.W., Calgary, Alberta, Canada T2P 1G1.

## 1. BASIS OF PREPARATION

### (a) Statement of compliance:

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (“IFRS”) as issued by the International Accounting Standards Board (“IASB”).

Certain prior year amounts have been reclassified for consistency with the current period presentation. These reclassifications had no effect on the reported results of operations.

The consolidated financial statements were authorized for issue by the Board of Directors on March 17, 2014.

### (b) Basis of measurement:

The consolidated financial statements have been prepared on the historical-cost basis except for the following:

- (i) derivative financial instruments are measured at fair value; and
- (ii) held for trading financial assets are measured at fair value with changes in fair value recorded in earnings.

The methods used to measure fair values are discussed in note 4.

Operating expenses in the consolidated statements of income and comprehensive income are presented as a combination of function and nature in conformity with industry practice. Depletion, depreciation and amortization are presented in separate lines by their nature, while operating expenses and net administrative expenses are presented on a functional basis. Significant expenses such as salaries and benefits are presented by their nature in the notes to the financial statements.

### (c) Functional and presentation currency:

These consolidated financial statements are presented in Canadian dollars, which is the Company’s functional currency.

**(d) Use of estimates and judgments:**

The timely preparation of the financial statements requires management to make judgments, estimates and assumptions that affect the application of accounting policies and reported amounts of assets and liabilities and income and expenses. Accordingly, actual results may differ from these estimates. Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimates are revised and in any future periods affected. Significant estimates and judgments made by management in the preparation of these financial statements are outlined below.

***Critical judgments in applying accounting policies:***

The following are the critical judgments, apart from those involving estimations (see below), that management has made in the process of applying the Company's accounting policies and that have the most significant effect on the amounts recognized in these consolidated financial statements:

*(i) Identification of cash-generating units:*

The Company's assets are aggregated into cash-generating units ("CGU") for the purpose of calculating impairment. A CGU is comprised of assets that are grouped together into the smallest group of assets that generate cash inflows from continuing use that are largely independent of the cash inflows of other assets or groups of assets. By their nature, these estimates and assumptions are subject to measurement uncertainty and may impact the carrying value of the Company's assets in future periods.

*(ii) Impairment of petroleum and natural gas assets:*

Judgements are required to assess when impairment indicators exist and impairment testing is required. For the purposes of determining whether impairment of petroleum and natural gas assets has occurred, and the extent of any impairment or its reversal, the key assumptions the Company uses in estimating future cash flows are forecasted petroleum and natural gas prices, expected production volumes and anticipated recoverable quantities of proved and probable reserves. These assumptions are subject to change as new information becomes available. Changes in economic conditions can also affect the rate used to discount future cash flow estimates. Changes in the aforementioned assumptions could affect the carrying amounts of assets. Impairment charges and reversals are recognized in profit or loss.

*(iii) Deferred taxes:*

Deferred tax assets (if any) are recognized only to the extent it is considered probable that those assets will be recoverable. This involves an assessment of when those deferred tax assets are likely to reverse and a judgment as to whether or not there will be sufficient taxable profits available to offset the tax assets when they do reverse. This requires assumptions regarding future profitability and is therefore inherently uncertain. To the extent assumptions regarding future profitability change, there can be an increase or decrease in the amounts recognized in respect of deferred tax assets as well as the amounts recognized in profit or loss in the period in which the change occurs.

***Key sources of estimation uncertainty:***

The following are the key assumptions concerning the sources of estimation uncertainty at the end of the reporting period, that have a significant risk of causing adjustments to the carrying amounts of assets and liabilities.

*(i) Reserves:*

Estimation of reported recoverable quantities of proved and probable reserves include judgmental assumptions regarding production profile, commodity prices, exchange rates, remediation costs, timing and amount of future development costs, and production, transportation and marketing costs for future cash flows. It also requires interpretation of geological and geophysical models in anticipated recoveries. The economical, geological and technical factors used to estimate reserves may change from period to period. Changes in reported reserves can impact the carrying values of the Company's petroleum and natural gas properties and equipment, the calculation of depletion and depreciation, the provision for decommissioning obligations, and the recognition of deferred tax assets due to changes in expected future cash flows. The recoverable quantities of reserves and estimated cash flows from the Company's petroleum and natural gas interests are independently evaluated by reserve engineers at least annually.

The Company's petroleum and natural gas reserves represent the estimated quantities of petroleum, natural gas and natural gas liquids which geological, geophysical and engineering data demonstrate with a specified degree of certainty to be economically recoverable in future years from known reservoirs and which are considered commercially producible. Such reserves may be considered commercially producible if management has the intention of developing and producing them and such intention is based upon (i) a reasonable assessment of the future economics of such production; (ii) a reasonable expectation that there is a market for all or substantially all of the expected petroleum and natural gas production; and (iii) evidence that the necessary production, transmission and transportation facilities are available or can be made available. Reserves may only be considered proven and probable if producibility is supported by either production or conclusive formation tests. The Company's petroleum and gas reserves are determined pursuant to National Instrument 51-101, Standard of Disclosures for Oil and Gas Activities.

*(ii) Share-based payments:*

All equity-settled, share-based awards issued by the Company are recorded at fair value using the Black-Scholes option-pricing model. In assessing the fair value of equity-based compensation, estimates have to be made regarding the expected volatility in share price, option life, dividend yield, risk-free rate and estimated forfeitures at the initial grant date.

*(iii) Decommissioning obligations:*

The Company estimates future remediation costs of production facilities, wells and pipelines at different stages of development and construction of assets or facilities. In most instances, removal of assets occurs many years into the future. This requires judgment regarding abandonment date, future environmental and regulatory legislation, the extent of reclamation activities, the engineering methodology for estimating cost, future removal technologies in determining the removal cost and liability-specific discount rates to determine the present value of these cash flows.

*(iv) Deferred taxes:*

Tax provisions are based on enacted or substantively enacted laws. Changes in those laws could affect amounts recognized in profit or loss both in the period of change, which would include any impact on cumulative provisions, and in future periods.

## 2. SIGNIFICANT ACCOUNTING POLICIES

The accounting policies set out below have been applied consistently to all periods presented in these consolidated financial statements, and have been applied consistently by the Company and its subsidiaries.

### **(a) Consolidation:**

The consolidated financial statements include the accounts of Tourmaline Oil Corp. and Exshaw Oil Corp., of which the Company owns 90.6% (note 10).

*(i) Subsidiaries:*

Subsidiaries are entities controlled by the Company. Control exists when the Company has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, substantive potential voting rights that currently are exercisable are taken into account. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases.

*(ii) Transactions eliminated on consolidation:*

Intercompany balances and transactions, and any unrealized income and expenses arising from intercompany transactions, are eliminated in preparing the consolidated financial statements.

*(iii) Jointly-controlled operations and jointly-controlled assets:*

Substantially all of the Company's oil and natural gas activities involve jointly-controlled assets. The consolidated financial statements include the Company's share of these jointly-controlled assets and a proportionate share of the relevant revenue and related costs.

### **(b) Business Combinations:**

The purchase method of accounting is used to account for acquisitions of subsidiaries and assets that meet the definition of a business under IFRS. The cost of an acquisition is measured as the fair value of the assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date. If the cost of acquisition is less than the fair value of the net assets of the subsidiary acquired, the difference is recognized immediately in the income statement. Acquisition costs incurred are expensed.

### **(c) Financial instruments:**

*(i) Non-derivative financial instruments:*

Non-derivative financial instruments comprise accounts receivable, cash and cash equivalents, investments, bank overdrafts, bank debt, and accounts payable and accrued liabilities. Non-derivative financial instruments are recognized initially at fair value plus, for instruments not at fair value through profit or loss, any directly

attributable transaction costs. Subsequent to initial recognition, non-derivative financial instruments are measured as described below:

*Cash and cash equivalents:*

Cash and cash equivalents comprise cash on hand, term deposits held with banks, other short-term highly-liquid investments with original maturities of three months or less, and are measured similar to other non-derivative financial instruments.

*Investments:*

An instrument is classified at fair value through profit or loss if it is held for trading or is designated as such upon initial recognition. Tourmaline's investments in public companies are designated as held for trading. Financial instruments are designated at fair value through profit or loss if the Company manages such investments and makes purchase and sale decisions based on their fair value in accordance with the Company's risk management or investment strategy. Upon initial recognition, attributable transaction costs are recognized in profit or loss when incurred. Financial instruments at fair value through profit or loss are measured at fair value, and changes therein are recognized in profit or loss.

*Other:*

Other non-derivative financial instruments, such as accounts receivable, bank debt, and accounts payable and accrued liabilities, are measured at amortized cost using the effective interest method, less any impairment losses. The bank debt has a floating rate of interest and therefore the carrying value approximates the fair value.

(ii) *Derivative financial instruments:*

The Company has entered into certain financial derivative contracts in order to manage the exposure to market risks from fluctuations in commodity prices and interest rates. These instruments are not used for trading or speculative purposes. The Company has not designated its financial derivative contracts as effective accounting hedges, and thus not applied hedge accounting, even though the Company considers all commodity contracts to be economic hedges. As a result, all financial derivative contracts are classified as fair value through profit or loss and are recorded on the statement of financial position at fair value. Transaction costs are recognized in profit or loss when incurred.

The Company has accounted for its forward physical delivery sales contracts, which were entered into and continue to be held for the purpose of receipt or delivery of non-financial items in accordance with its expected purchase, sale or usage requirements as executory contracts. As such, these contracts are not considered to be derivative financial instruments and have not been recorded at fair value on the statement of financial position. Settlements on these physical sales contracts are recognized in oil and natural gas revenue.

Embedded derivatives are separated from the host contract and accounted for separately if the economic characteristics and risks of the host contract and the embedded derivative are not closely related, a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative, and the combined instrument is not measured at fair value through earnings. Changes in the fair value of separable embedded derivatives are recognized immediately in earnings.



(iii) *Share capital:*

Common shares are classified as equity. Incremental costs directly attributable to the issue of common shares and share options are recognized as a deduction from equity, net of any tax effects.

**(d) Property, plant and equipment and intangible exploration assets:**

(i) *Recognition and measurement:*

*Exploration and evaluation expenditures:*

Pre-license costs are recognized in the statement of operations as incurred.

Exploration and evaluation costs, including the costs of acquiring licenses and directly attributable general and administrative costs, initially are capitalized as either tangible or intangible exploration and evaluation assets according to the nature of the assets acquired. The costs are accumulated in cost centers by well, field or exploration area pending determination of technical feasibility and commercial viability.

Exploration and evaluation assets are assessed for impairment if (i) sufficient data exists to determine technical feasibility and commercial viability, and (ii) facts and circumstances suggest that the carrying amount exceeds the recoverable amount. For purposes of impairment testing, exploration and evaluation assets are allocated to cash-generating units.

The technical feasibility and commercial viability of extracting a mineral resource is considered to be determinable when proven and/or probable reserves are determined to exist. A review of each exploration licence or field is carried out, at least annually, to ascertain whether proven or probable reserves have been discovered. Upon determination of proven and/or probable reserves, intangible exploration and evaluation assets attributable to those reserves are first tested for impairment and then reclassified from exploration and evaluation assets to a separate category within tangible assets referred to as oil and natural gas interests. The cost of undeveloped land that expires or any impairment recognized during a period is charged as additional depletion and depreciation expense.

*Development and production costs:*

Items of property, plant and equipment, which include oil and gas development and production assets, are measured at cost less accumulated depletion and depreciation and accumulated impairment losses. Development and production assets are grouped into CGUs for impairment testing. The Company allocated its property, plant and equipment to the following CGUs: 'Deep Basin', 'Spirit River' and 'BC Montney'. When significant parts of an item of property, plant and equipment, including oil and natural gas interests, have different useful lives, they are accounted for as separate items (major components).

Gains and losses on disposal of an item of property, plant and equipment, including oil and natural gas interests, are measured as the difference between the fair value of the proceeds received or given up and the carrying value of the assets disposed, and are recognized in profit or loss.

*(ii) Subsequent costs:*

Costs incurred subsequent to the determination of technical feasibility and commercial viability and the costs of replacing parts of property, plant and equipment are recognized as oil and natural gas interests only when they increase the future economic benefits embodied in the specific asset to which they relate. All other expenditures are recognized in profit or loss as incurred. Such capitalized oil and natural gas interests generally represent costs incurred in developing proved and/or probable reserves and bringing in or enhancing production from such reserves, and are accumulated on a field or geotechnical area basis. The carrying amount of any replaced or sold component is derecognized. The costs of the day-to-day servicing of property, plant and equipment are recognized in profit or loss as incurred.

*(iii) Depletion and depreciation:*

The net carrying value of development or production assets is depleted using the unit-of-production method by reference to the ratio of production in the year to the related proved-plus-probable reserves, taking into account estimated future development costs necessary to bring those reserves into production. Future development costs are estimated taking into account the level of development required to produce the reserves. These estimates are reviewed by independent reserve engineers at least annually.

Proved-plus-probable reserves are estimated annually by independent qualified reserve evaluators and represent the estimated quantities of crude oil, natural gas and natural gas liquids which geological, geophysical and engineering data demonstrate with a specified degree of certainty to be recoverable in future years from known reservoirs and which are considered commercially producible. For interim consolidated financial statements, internal estimates of changes in reserves and future development costs are used for determining depletion for the period.

For other assets, depreciation is recognized in profit or loss on a straight-line basis over the estimated useful lives of each part of an item of property, plant and equipment. Leased assets are depreciated over the shorter of the lease term and their useful lives unless it is reasonably certain that the Company will obtain ownership by the end of the lease term. Land is not depreciated.

The estimated useful lives for depreciable assets are as follows:

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Plants and facilities	30 years
Office equipment	25% declining
Furniture and fixtures	25% declining

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Depreciation methods, useful lives and residual values are reviewed at each reporting date.

**(e) Impairment:**

*(i) Financial assets:*

A financial asset is assessed at each reporting date to determine whether there is any objective evidence that it is impaired. A financial asset is considered to be impaired if objective evidence indicates that one or more events have had a negative effect on the estimated future cash flows of that asset.

An impairment loss in respect of a financial asset measured at amortized cost is calculated as the difference between its carrying amount and the present value of the estimated future cash flows discounted at the original effective interest rate.

Individually significant financial assets are tested for impairment on an individual basis. The remaining financial assets are assessed collectively in groups that share similar credit risk characteristics.

All impairment losses are recognized in profit or loss.

An impairment loss is reversed if the reversal can be related objectively to an event occurring after the impairment loss was recognized. For financial assets measured at amortized cost, the reversal is recognized in profit or loss.

(ii) *Non-financial assets:*

The carrying amounts of the Company's non-financial assets, other than E&E assets and deferred tax assets, are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, then the asset's recoverable amount is estimated. For goodwill and other intangible assets that have indefinite lives, or that are not yet available for use, an impairment test is completed each year. E&E assets are assessed for impairment when they are reclassified to property, plant and equipment, as oil and natural gas interests, and also if facts and circumstances suggest that the carrying amount exceeds the recoverable amount.

For the purpose of impairment testing, assets are grouped into CGUs. The recoverable amount of an asset or a CGU is the greater of its value in use and its fair value less costs to sell.

In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. Value in use is generally computed by reference to the present value of the future cash flows expected to be derived from production of proven-plus-probable reserves. Fair value less costs to sell is determined as the amount that would be obtained from the sale of an asset in an arm's length transaction between knowledgeable and willing parties.

The goodwill acquired in an acquisition, for the purpose of impairment testing, is allocated to the CGUs that are expected to benefit from the synergies of the combination. E&E assets are allocated to the related CGUs when they are assessed for impairment, both at the time of triggering facts and circumstances as well as upon their eventual reclassification to property, plant and equipment.

An impairment loss is recognized if the carrying amount of an asset or its CGU exceeds its estimated recoverable amount. Impairment losses are recognized in profit or loss. Impairment losses recognized in respect of CGUs are allocated first to reduce the carrying amount of any goodwill allocated to the units and then to reduce the carrying amounts of the assets in the unit (group of units) on a pro-rata basis. Impairment losses recognized in prior years are assessed at each reporting date for any indications that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depletion and depreciation or amortization, if no impairment loss had been recognized.

**(f) Provisions:**

A provision is recognized if, as a result of a past event, the Company has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are determined by discounting the expected future cash flows at a pre-tax “risk-free” rate that reflects current market assessments of the time value of money. Provisions are not recognized for future operating losses.

*(i) Decommissioning obligations:*

The Company recognizes the decommissioning obligations for the future costs associated with removal, site restoration and decommissioning costs. The fair value of the liability for the Company’s decommissioning obligation is recorded in the period in which it is incurred, discounted to its present value using the risk-free interest rate and the corresponding amount recognized by increasing the carrying amount of petroleum and natural gas assets. The asset recorded is depleted on a unit-of-production basis over the life of the reserves. The liability amount is increased each reporting period due to the passage of time and the amount of accretion is charged to earnings in the period. Revisions to the estimated timing of cash flows or to the original estimated undiscounted cost could also result in an increase or decrease to the obligation. Actual costs incurred upon settlement of the decommissioning obligation are charged against the obligation to the extent of the liability recorded.

*(ii) Onerous contracts:*

A provision for onerous contracts is recognized when the expected benefits to be derived by the Company from a contract are lower than the unavoidable cost of meeting its obligations under the contract. The provision is measured at the present value of the lower of the expected cost of terminating the contract and the expected net cost of continuing with the contract. Before a provision is established, the Company recognizes any impairment loss on associated assets.

**(g) Revenue recognition:**

Revenue from the sale of oil and natural gas is recorded when the significant risks and rewards of ownership of the product is transferred to the buyer, which is usually when legal title passes to the external party. This is generally at the time product enters the pipeline. Revenue is measured net of discounts, customs duties and royalties. With respect to the latter, the entity is acting as a collection agent on behalf of others.

Tariffs and tolls charged to other entities for use of pipelines and facilities owned by the Company are recognized as revenue as they accrue in accordance with the terms of the service or tariff and tolling agreements.

Royalty income is recognized as it accrues in accordance with the terms of the overriding royalty agreements.

**(h) Finance income and expenses:**

Finance expense comprises interest expense on borrowings, accretion of the discount on provisions, transaction costs on business combinations and impairment losses recognized on financial assets.

Interest income is recognized as it accrues in profit or loss, using the effective-interest method.

**(i) Deferred taxes:**

Income tax expense comprises current and deferred tax. Income tax expense is recognized in profit or loss except to the extent that it relates to items recognized directly in equity, in which case it is recognized in equity.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous years.

Deferred tax is recognized on the temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is not recognized on the initial recognition of assets or liabilities in a transaction that is not a business combination. In addition, deferred tax is not recognized for taxable temporary differences arising on the initial recognition of goodwill. Deferred tax is measured at the tax rates that are expected to be applied to temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date. Deferred-tax assets and liabilities are offset if there is a legally enforceable right to offset, and they relate to income taxes levied by the same tax authority on the same taxable entity, or on different tax entities, but they intend to settle current tax liabilities and assets on a net basis or their tax assets and liabilities will be realized simultaneously.

A deferred-tax asset is recognized to the extent that it is probable that future taxable profits will be available against which the temporary difference can be utilized. Deferred-tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realized.

**(j) Flow-through common shares:**

Periodically, the Company finances a portion of its exploration and development activities through the issuance of flow-through shares. The resource expenditure deductions for income tax purposes related to exploratory development activities are renounced to investors in accordance with tax legislation. Flow-through shares issued are recorded in share capital at the fair value of common shares on the date of issue. The premium received on issuing flow-through shares is initially recorded as a deferred liability. As qualifying expenditures are incurred, the premium is reversed and a deferred income tax liability is recorded. The net amount is then recognized as deferred income tax expense.

**(k) Share-based payments:**

The Company applies the fair-value method for valuing share option grants. Under this method, compensation cost attributable to all share options granted are measured at fair value at the grant date and expensed over the vesting period with a corresponding increase to contributed surplus. A forfeiture rate is estimated on the grant date and is adjusted to reflect the actual number of options or units that vest. Upon the exercise of the share options, consideration received, together with the amount previously recognized in contributed surplus, is recorded as an increase to share capital.

**(l) Per-share information:**

Basic per-share information is computed by dividing income by the weighted average number of common shares outstanding for the period. The treasury-stock method is used to determine the diluted per share amounts, whereby any proceeds from the share options, warrants or other dilutive instruments are assumed to be used to purchase common shares at the average market price during the period. The weighted average number of shares outstanding is then adjusted by the net change.

**(m) Leased assets:**

Leases where the Company assumes substantially all the risks and rewards of ownership are classified as finance leases. Upon initial recognition, the leased asset is measured at an amount equal to the lower of its fair value and the present value of the minimum lease payments. Subsequent to initial recognition, the asset is accounted for in accordance with the accounting policy applicable to that asset.

Minimum lease payments made under finance leases are apportioned between the finance expenses and the reduction of the outstanding liability. The finance expenses are allocated to each year during the lease term so as to produce a constant periodic rate of interest on the remaining balance of the liability.

Other leases are operating leases, which are not recognized on the Company's statement of financial position.

### 3. ACCOUNTING CHANGES

**(a) Changes in Accounting Policies:**

The following new accounting standards and amendments to existing standards, as issued by the International Accounting Standards Board ("IASB"), have been adopted by the Company effective January 1, 2013:

*IFRS 9 - Financial Instruments* addresses the classification and measurement of financial assets.

*IFRS 10 - Consolidated Financial Statements* builds on existing principles and standards and identifies the concept of control as the determining factor in whether an entity should be included within the consolidated financial statements of the parent company.

*IFRS 11 - Joint Arrangements* establishes the principles for financial reporting by entities when they have an interest in arrangements that are jointly controlled.

*IFRS 12 - Disclosure of Interest in Other Entities* provides the disclosure requirements for interests held in other entities including joint arrangements, associates, special purpose entities and other off balance sheet entities.

*IFRS 13 - Fair Value Measurement* defines fair value, requires disclosure about fair value measurements and provides a framework for measuring fair value when it is required or permitted within the IFRS standards.

### 4. DETERMINATION OF FAIR VALUE

A number of the Company's accounting policies and disclosures require the determination of fair value, for both financial and non-financial assets and liabilities. Fair values have been determined for measurement and/or disclosure purposes based on the following methods. When applicable, further information about the assumptions made in determining fair values is disclosed in the notes specific to that asset or liability.

*(i) Property, plant and equipment and intangible exploration assets:*

The fair value of property, plant and equipment recognized in a business combination, is based on market values. The market value of property, plant and equipment is the estimated amount for which property, plant and equipment could be exchanged on the acquisition date between a willing buyer and a willing seller in an arm's-length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently and

without compulsion. The market value of oil and natural gas interests (included in property, plant and equipment) and intangible exploration assets is estimated with reference to the discounted cash flow expected to be derived from oil and natural gas production based on externally prepared reserve reports. The risk-adjusted discount rate is specific to the asset with reference to general market conditions.

The market value of other items of property, plant and equipment is based on the quoted market prices for similar items.

*(ii) Cash and cash equivalents, accounts receivable, bank debt and accounts payable and accrued liabilities:*

The fair value of cash and cash equivalents, accounts receivable, bank debt and accounts payable and accrued liabilities is estimated as the present value of future cash flow, discounted at the market rate of interest at the reporting date. At December 31, 2013 and December 31, 2012, the fair value of these balances approximated their carrying value due to their short term to maturity. The bank debt has a floating rate of interest and therefore the carrying value approximates the fair value.

*(iii) Derivatives:*

The fair value of commodity price risk management contracts is determined by discounting the difference between the contracted prices and published forward price curves as at the statement of financial position date, using the remaining contracted oil and natural gas volumes and a risk-free interest rate (based on published government rates). The fair value of options and costless collars is based on option models that use published information with respect to volatility, prices and interest rates.

*(iv) Share options:*

The fair value of employee share options is measured using a Black-Scholes option-pricing model. Measurement inputs include share price on measurement date, exercise price of the instrument, expected volatility (based on weighted average historic volatility adjusted for changes expected due to publicly available information), weighted average expected life of the instruments (based on historical experience and general option holder behaviour), expected dividends, and the risk-free interest rate (based on government bonds).

*(v) Measurement:*

Tourmaline classifies the fair value of these transactions according to the following hierarchy based on the amount of observable inputs used to value the instrument.

- Level 1 – Quoted prices are available in active markets for identical assets or liabilities as of the reporting date. Active markets are those in which transactions occur in sufficient frequency and volume to provide pricing information on an ongoing basis.
- Level 2 – Pricing inputs are other than quoted prices in active markets included in Level 1. Prices are either directly or indirectly observable as of the reporting date. Level 2 valuations are based on inputs, including quoted forward prices for commodities, time value and volatility factors, which can be substantially observed or corroborated in the marketplace.
- Level 3 – Valuations in this level are those with inputs for the asset or liability that are not based on observable market data.

The following tables provide fair value measurement information for financial assets and liabilities as of December 31, 2013 and December 31, 2012. The carrying value of cash and cash equivalents, trade and other receivables and trade and other payables included in the consolidated statement of financial position approximate fair value due to the short-term nature of those instruments. These assets and liabilities are not included in the following tables.

December 31, 2013 (000s)	Carrying Amount		Fair Value
Financial Assets:			
Commodity price risk contracts <sup>(1)</sup>	\$	829	\$ 829
Financial Liabilities:			
Bank debt		590,319	590,319
Commodity price risk contracts <sup>(1)</sup>		8,073	8,073

December 31, 2012 (000s)	Carrying Amount		Fair Value
Financial assets:			
Commodity price risk contracts <sup>(1)</sup>	\$	4,814	\$ 4,814
Financial liabilities:			
Bank debt		360,573	360,573
Commodity price risk contracts <sup>(1)</sup>		2,012	2,012

<sup>(1)</sup>Commodity price contracts are fair valued using Level 2 information.

## 5. FINANCIAL RISK MANAGEMENT

The Board of Directors has overall responsibility for the establishment and oversight of the Company's risk management framework. The Board has implemented and monitors compliance with risk management policies.

The Company's risk management policies are established to identify and analyze the risks faced by the Company, to set appropriate risk limits and controls, and to monitor risks and adherence to market conditions and the Company's activities.

### (a) Credit risk:

Credit risk is the risk of financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Company's receivables from joint venture partners and petroleum and natural gas marketers. As at December 31, 2013, Tourmaline's receivables consisted of \$19.5 million (December 31, 2012 - \$22.7 million) from joint venture partners, \$99.9 million (December 31, 2012 - \$52.8 million) from petroleum and natural gas marketers and \$16.6 million (December 31, 2012 - \$8.4 million) from provincial governments.

Receivables from petroleum and natural gas marketers are normally collected on the 25th day of the month following production. The Company sells a significant portion of its oil and gas to a limited number of counterparties. In 2013, Tourmaline had three counterparties that individually accounted for more than ten percent of annual revenues. The Company's policy to mitigate credit risk associated with these balances is to establish marketing relationships with creditworthy purchasers. Tourmaline historically has not experienced any



collection issues with its petroleum and natural gas marketers. Joint venture receivables are typically collected within one to three months of the joint venture bill being issued to the partner. The Company attempts to mitigate the risk from joint venture receivables by obtaining partner approval of significant capital expenditures prior to expenditure. The receivables, however, are from participants in the petroleum and natural gas sector, and collection of the outstanding balances are dependent on industry factors such as commodity price fluctuations, escalating costs and the risk of unsuccessful drilling. In addition, further risk exists with joint venture partners as disagreements occasionally arise that increase the potential for non-collection. The Company does not typically obtain collateral from petroleum and natural gas marketers or joint venture partners; however, the Company does have the ability to withhold production from joint venture partners in the event of non-payment.

The Company monitors the age of, and investigates issues behind, its receivables that have been past due for over 90 days. At December 31, 2013, the Company had \$0.8 million (December 31, 2012 - \$1.1 million) over 90 days. The Company is satisfied that these amounts are substantially collectible.

The carrying amount of accounts receivable, cash and cash equivalents and commodity price risk management contracts represents the maximum credit exposure. The Company does not have an allowance for doubtful accounts as at December 31, 2013 (December 31, 2012 - nil) and did not provide for any doubtful accounts nor was it required to write-off any receivables during the year ended December 31, 2013 (December 31, 2012 – nil).

**(b) Liquidity risk:**

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they come due. The Company's approach to managing liquidity is to ensure that it will have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions without incurring unacceptable losses or risking harm to the Company's reputation. Liquidity risk is mitigated by cash on hand, when available, and access to credit facilities.

The Company's accounts payable and accrued liabilities balance at December 31, 2013 is approximately \$385.6 million (December 31, 2012 - \$225.9 million). It is the Company's policy to pay suppliers within 45-75 days. These terms are consistent with industry practice. As at December 31, 2013, substantially all of the account balances were less than 90 days.

The Company prepares annual capital expenditure budgets, which are regularly monitored and updated as considered necessary. Further, the Company utilizes authorizations for expenditures on both operated and non-operated projects to further manage capital expenditures. The Company also attempts to match its payment cycle with collection of petroleum and natural gas revenues on the 25th of each month.

The following are the contractual maturities of financial liabilities, including estimated interest payments, at December 31, 2013:

(000s)	Carrying Amount	Contractual Cash Flow	Less Than One Year	One – Two Years	Two – Five Years	More Than Five Years
Non-derivative financial liabilities:						
Trade and other payables	\$ 381,857	\$ 381,857	\$ 381,857	\$ –	\$ –	–
Bank debt <sup>(1)</sup>	590,319	639,271	–	–	639,271	–
Transportation liability	7,139	7,139	3,725	3,414	–	–
Derivative financial liabilities:						
Financial commodity contracts	8,073	8,073	2,857	–	5,216	–
	\$ 987,388	\$ 1,036,340	\$ 388,439	\$ 3,414	\$ 644,487	–

<sup>(1)</sup> Includes interest expense at 3.06% being the rate applicable at December 31, 2013.

### (c) Market risk:

Market risk is the risk that changes in market conditions, such as commodity prices, interest rates and foreign exchange rates will affect the Company's net income or value of financial instruments. The objective of market risk management is to manage and curtail market risk exposure within acceptable limits, while maximizing the Company's returns.

The Company utilizes both financial derivatives and physical delivery sales contracts to manage market risks. All such transactions are conducted in accordance with the risk management policy that has been approved by the Board of Directors.

Currency risk has minimal impact on the value of the financial assets and liabilities on the consolidated statement of financial position at December 31, 2013. Changes in the US to Canadian exchange rate, however, could influence future petroleum and natural gas prices which could impact the value of certain derivative contracts. This influence cannot be accurately quantified.

Interest rate risk is the risk that future cash flows will fluctuate as a result of changes in market interest rates. The Company is exposed to interest rate risk to the extent that changes in market interest rates will impact the Company's bank debt which is subject to a floating interest rate. Assuming all other variables remain constant, an increase or decrease of 1% in market interest rates for the year ended December 31, 2013 would have decreased or increased shareholders' equity and net income by \$2.5 million (December 31, 2012 - \$1.8 million). The unrealized loss on the interest rate swap has been included on the consolidated statement of financial position with changes in the fair value included in the unrealized gain or loss on financial instruments on the consolidated statement of income and comprehensive income.

Commodity price risk is the risk that the fair value or future cash flow will fluctuate as a result of changes in commodity prices. Commodity prices for oil and natural gas are impacted by not only the relationship between the Canadian and United States dollar, but also world economic events that dictate the levels of supply and demand. As at December 31, 2013, the Company has entered into certain financial derivative and physical

delivery sales contracts in order to manage commodity risk. These instruments are not used for trading or speculative purposes. The Company has not designated its financial derivative contracts as effective accounting hedges, even though the Company considers all commodity contracts to be effective economic hedges. As a result, all such commodity contracts are recorded on the consolidated statement of financial position at fair value, with changes in the fair value being recognized as an unrealized gain or loss on the consolidated statement of income and comprehensive income. The Company has not offset any financial assets and liabilities, in the consolidated statements of financial position.

The Company has the following financial derivative contracts in place as at December 31, 2013<sup>(1)</sup>:

		2014	2015	2016	2017	2018	Fair Value
<b>Gas</b>							
Fixed Price	mmbtu/d	36,753	-	-	-	-	\$ (609)
	USD\$/mmbtu	\$4.12					
Nymex Call Options (Writer)	mmbtu/d	-	-	-	20,000	20,000	(4,535)
	USD\$/mmbtu				\$5.00	\$5.00	
<b>Oil</b>							
Financial Swaps	bbls/d	773	400	-	-	-	273
	USD\$/bbl	\$95.49	\$91.10				
Costless Collars	bbls/d	1,100	-	-	-	-	(962)
	USD\$/bbl	\$80.91 - \$97.57					
Financial Call Swaptions <sup>(2)</sup>	bbls/d	226	674	400	-	-	(730)
	USD\$/bbl	\$100.00	\$104.43	\$91.10			
<b>Total Fair Value (000s)</b>							<b>\$ (6,563)</b>

<sup>(1)</sup>The volumes and prices reported are the weighted average volumes and prices for the period.

<sup>(2)</sup>This is a European swaption whereby the Company provides the option to extend an oil swap into the period subsequent to the call date.

The Company has entered in to the following financial derivative contracts subsequent to December 31, 2013:

Type of Contract	Quantity	Time Period	Contract Price
Fixed Price - Nymex	5,000 mmbtu/d	April 2014 – October 2014	USD\$4.33/mmbtu
Fixed Price - Nymex	5,000 mmbtu/d	January – December 2015	USD\$4.205/mmbtu

The Company has entered into four interest rate swap arrangements:

(000s)

Term	Type (Floating to Fixed)	Amount	Company Fixed Interest Rate (%)	Counter Party Floating Rate Index	Fair Value
May 29, 2012- May 29, 2014	Swap	\$150,000	1.35%	Floating Rate	\$ (86)
May 29, 2014- May 29, 2015	Swap	\$150,000	1.72%	Floating Rate	(740)
May 29, 2014 – May 29, 2015	Swap	\$100,000	1.27%	Floating Rate	(48)
May 29, 2015 – May 29, 2016	Swap	\$250,000	1.645%	Floating Rate	193
Total Fair Value (000s)					\$ (681)

The following table provides a summary of the unrealized gains and losses on financial instruments for the years ended December 31, 2013 and 2012:

(000s)	Years Ended December 31,	
	2013	2012
Unrealized gain (loss) on financial instruments	\$ (10,046)	\$ 2,600
Unrealized (loss) on investments held for trading	–	(103)
Total	\$ (10,046)	\$ 2,497

As at December 31, 2013, if the future strip prices for oil were \$1.00 per bbl higher and prices for natural gas were \$0.10 per mcf higher, with all other variables held constant, after-tax earnings would have been \$3.8 million (December 31, 2012 - \$1.3 million) lower. An equal and opposite impact would have occurred to after-tax earnings if oil prices were \$1.00 per bbl lower and gas prices were \$0.10 per mcf lower. In addition to the financial commodity contracts discussed above, the Company has entered into physical contracts to manage commodity risk. These contracts are considered normal sales contracts and are not recorded at fair value in the consolidated financial statements.

The Company has the following physical contracts in place at December 31, 2013<sup>(1)</sup>:

		2014	2015	2016	2017	2018
<b>Gas</b>						
Fixed Price - AECO	mcf/d	69,960	4,741	-	-	-
	CAD\$/mcf	\$3.81	\$4.22			
Costless Collars	mcf/d	4,676	-	-	-	-
	CAD\$/mcf	\$3.23 - \$4.08				
Basis Differentials <sup>(2)</sup>	mmbtu/d	84,932	50,000	48,333	20,000	20,000
	USD\$/mmbtu	\$(0.49)	\$(0.49)	\$(0.48)	\$(0.49)	\$(0.49)
AECO Call Options (Writers)/Call Swaptions <sup>(3)</sup>	mcf/d	36,889	35,577	11,597	14,223	-
	CAD\$/mcf	\$4.16	\$4.39	\$5.41	\$4.90	

<sup>(1)</sup> Transactions with common terms have been aggregated and presented at the weighted average price.

<sup>(2)</sup> Tourmaline also has 20 mmcf/d of Nymex-AECO basis differentials at \$0.40 from 2019-2022.

<sup>(3)</sup> A Financial call swaption is a European swaption whereby the Company provided the option to extend a gas swap into the period subsequent to the call date.

The Company has entered into the following physical contracts subsequent to December 31, 2013<sup>(1)</sup>:

Type of Contract	Quantity	Time Period	Contract Price
Fixed Price - AECO	35,000 GJs/d	April – October 2014	CAD\$3.93/gj average
Fixed Price - AECO	30,000 GJs/d	April 2014 – March 2015	CAD\$4.11/gj average
Fixed Price - AECO	10,000 GJs/d	February 2014 – March 2015	CAD\$3.78/gj average
Fixed Price - AECO	10,000 GJs/d	January – December 2014	CAD\$3.76/gj average
Fixed Price - AECO	5,000 GJs/d	January – December 2015	CAD\$3.86/gj average
Fixed Price - AECO	5,000 GJs/d	March – December 2014	CAD\$4.84/gj average
Fixed Price - AECO	5,000 GJs/d	April – December 2014	CAD\$4.43/gj average
Call Writer <sup>(2)</sup>	10,000 GJs/d	January – December 2016	CAD\$4.15/gj
Call Writer <sup>(3)</sup>	10,000 GJs/d	January – December 2017	CAD\$4.15/gj
Basis Differential	5,000 mmbtu/d	November 2014 – March 2015	Nymex less USD\$0.22/mmbtu

<sup>(1)</sup> Transactions with common terms have been aggregated and presented as the weighted average price.

<sup>(2)</sup> This option can be called on December 31, 2015.

<sup>(3)</sup> This option can be called on December 31, 2016.

#### (d) Capital management:

The Company's policy is to maintain a strong capital base to maintain investor, creditor and market confidence and to sustain the future development of the business. The Company considers its capital structure to include shareholders' equity, bank debt and working capital. In order to maintain or adjust the capital structure, the Company may from time to time issue shares and adjust its capital spending to manage current and projected debt levels. The annual and updated budgets are approved by the Board of Directors.

The key measure that the Company utilizes in evaluating its capital structure is net debt to annualized cash flow, which is defined as long-term bank debt plus working capital (adjusted for the fair value of financial instruments), to annualized cash flow (based on the most recent quarter), defined as cash flow from operating activities before changes in non-cash working capital. Net debt to annualized cash flow represents a measure of the time it is expected to take to pay off the debt if no further capital expenditures were incurred and if cash flow in the next year were equal to the amount in the most recent quarter annualized.

The Company monitors this ratio and endeavours to maintain it at, or below, 2.0 to 1.0 in a normalized commodity price environment. This ratio may increase at certain times as a result of acquisitions or low commodity prices. As shown below, as at December 31, 2013, the Company's ratio of net debt to annualized cash flow was 1.3 to 1.0 (December 31, 2012 - 1.24 to 1.0).

(000s)	<b>As at December 31, 2013</b>	As at December 31, 2012
Net debt:		
Bank debt	\$ (590,319)	\$ (360,573)
Working capital (deficit)	(245,314)	(98,913)
Fair value of financial instruments – short-term (asset) liability	2,691	(4,814)
<b>Net debt</b>	<b>\$ (832,942)</b>	<b>\$ (464,300)</b>
Annualized cash flow:		
Cash flow from operating activities for Q4	\$ 128,852	\$ 104,671
Change in non-cash working capital	31,880	(10,864)
Cash flow for Q4	\$ 160,732	\$ 93,807
<b>Annualized cash flow (based on most recent quarter annualized)</b>	<b>\$ 642,928</b>	<b>\$ 375,228</b>
<b>Net debt to annualized cash flow</b>	<b>1.30</b>	<b>1.24</b>

The Company has not paid or declared any dividends since the date of incorporation, nor are any contemplated in the foreseeable future. There have been no changes in the Company's approach to capital management since December 31, 2012.

## 6. EXPLORATION AND EVALUATION ASSETS

(000s)

As at January 1, 2012	\$	620,515
Capital expenditures		85,135
Transfers to property, plant and equipment (note 7)		(118,515)
Acquisitions		62,165
Divestitures		(6,255)
Reclassified to assets held for sale		(3,112)
As at December 31, 2012	\$	639,933
Capital expenditures		158,264
Transfers to property, plant and equipment (note 7)		(96,594)
Acquisitions		35,405
Divestitures		(3,356)
Expired mineral leases		(33,127)
As at December 31, 2013	\$	700,525

Exploration and evaluation (“E&E”) assets consist of the Company’s exploration projects which are pending the determination of proven and/or probable reserves. Additions represent the Company’s share of costs on E&E assets during the year.

General and administrative expenditures for the year ended December 31, 2013 of \$3.9 million (December 31, 2012 - \$5.2 million) have been capitalized and included as exploration and evaluation assets. Non-cash share-based payment expense in the amount of \$3.8 million (December 31, 2012, \$5.8 million) were also capitalized and included in exploration and evaluation assets. Expired mineral lease expenses have been included in the “Depletion, depreciation and amortization” line item on the consolidated statements of income and comprehensive income.

## 7. PROPERTY, PLANT AND EQUIPMENT

### Cost

(000s)

As at January 1, 2012	\$	2,276,303
Capital expenditures		595,514
Transfers from exploration and evaluation (note 6)		118,515
Change in decommissioning liabilities (note 8)		9,920
Acquisitions		342,320
Divestitures		(6,992)
Reclassified to assets held for sale		(29,895)
As at December 31, 2012	\$	3,305,685
Capital expenditures		1,027,602
Transfers from exploration and evaluation (note 6)		96,594
Change in decommissioning liabilities (note 8)		5,109
Acquisitions		287,512
Divestitures		(57,702)
As at December 31, 2013	\$	4,664,800

### Accumulated Depletion, Depreciation and Amortization

(000s)

As at January 1, 2012	\$	252,415
Depletion, depreciation and amortization		242,528
As at December 31, 2012	\$	494,943
Depletion, depreciation and amortization		323,112
Divestitures		(3,040)
As at December 31, 2013	\$	815,015

### Net Book Value

(000s)

As at December 31, 2012	\$	2,810,742
As at December 31, 2013	\$	3,849,785

General and administrative expenditures for the year ended December 31, 2013 of \$11.1 million (December 31, 2012 – \$6.1 million) have been capitalized and included as costs of oil and natural gas properties. Also included in oil and natural gas properties is non-cash share-based payment expense of \$15.5 million (December 31, 2012 - \$9.1 million).



Future development costs for the year ended December 31, 2013 of \$3,197 million (December 31, 2012 - \$2,233 million) were included in the depletion calculation.

### Impairment Assessment

The Company has performed an impairment assessment of its property, plant, and equipment on a CGU basis and has determined that there are no indicators of impairment at December 31, 2013; therefore an impairment test was not performed. For the year ended December 31, 2012 the Company identified impairment triggers due to weak natural gas prices. The Company tested for and did not identify any impairment.

### Corporate Acquisitions

#### *Huron Energy Corporation*

On November 30, 2012, the Company acquired all of the issued and outstanding shares of Huron Energy Corporation (“Huron”). As consideration, the Company issued 7,401,682 common shares at a price of \$33.02 per share. Total transaction costs incurred by the Company of \$1.0 million associated with this acquisition were expensed in the consolidated statement of income and comprehensive income.

The acquisition of Huron provided for an increase in lands and production in Tourmaline’s core and designated growth area of Sunrise, NEBC.

Results from operations for Huron are included in the Company’s consolidated financial statements from the closing date of the transaction. The value attributed to the property, plant and equipment acquired was supported by an engineering report prepared as at August 31, 2012 by independent reserve engineers using proved plus probable reserves discounted at a rate of 10% and updated internally to the date of the corporate acquisition of November 30, 2012. The allocation of net assets acquired is based on the best available information at the time and could be subject to further change. The acquisition has been accounted for using the purchase method based on estimated fair values as follows:

(000s)	Huron Energy Corporation	
Fair value of net assets acquired:		
Property, plant and equipment	\$	251,481
Exploration and evaluation		59,085
Working capital		6,585
Bank debt		(32,217)
Decommissioning obligations		(4,643)
Deferred income tax liabilities		(35,887)
<b>Total</b>	<b>\$</b>	<b>244,404</b>
Consideration:		
Common shares issued	\$	244,404

Included in the consolidated statements of income and comprehensive income for the year ended December 31, 2012 are the following amounts relating to Huron Energy Corporation since November 30, 2012:

(000s)

Oil and natural gas sales	\$	3,466
Net income and comprehensive income	\$	1,985

If Tourmaline had acquired Huron on January 1, 2012, the pro-forma results of the oil and gas sales and net income for the year ended December 31, 2012 would have been as follows:

(000s)	As Stated		Huron		Pro Forma Year Ended December 31, 2012
Oil and natural gas sales	\$	441,888	\$	22,027	\$ 463,915
Net income and comprehensive income	\$	16,738	\$	3,893	\$ 20,631

#### **Acquisition of Oil and Natural Gas Properties**

For the year ended December 31, 2013, the Company completed property acquisitions for total cash consideration of \$226.9 million (December 31, 2012 - \$88.6 million) and an additional \$88.6 million in non-cash consideration (December 31, 2012 - \$5.3 million). The Company also assumed \$7.3 million in decommissioning liabilities (December 31, 2012 - \$4.2 million).

## 8. DECOMMISSIONING OBLIGATIONS

The Company's decommissioning obligations result from net ownership interests in petroleum and natural gas assets including well sites, gathering systems and processing facilities. The Company estimates the total undiscounted amount of cash flow required to settle its decommissioning obligations is approximately \$118.9 million (December 31, 2012 – \$92.7 million), with some abandonments expected to commence in 2021. A risk-free rate of 3.24% (December 31, 2012 – 2.49%) and an inflation rate of 2.0% (December 31, 2012 – 2.0%) were used to calculate the fair value of the decommissioning obligations. The decommissioning obligations at December 31, 2013 have been adjusted by approximately \$5.1 million due to changes in estimates during the year (December 31, 2012 – nil).

(000s)	Years Ended December 31,	
	2013	2012
Balance, beginning of year	\$ 64,757	\$ 50,463
Obligation incurred	10,193	5,685
Obligation incurred on corporate acquisitions	–	4,643
Obligation incurred on property acquisitions	7,347	4,235
Obligation divested	(960)	(319)
Obligation settled	(2,254)	(993)
Reclassification of obligation associated with assets held for sale	–	(285)
Accretion expense	2,038	1,328
Change in future estimated cash outlays	(5,084)	–
Balance, end of year	\$ 76,037	\$ 64,757

## 9. BANK DEBT

The Company has a covenant-based bank credit facility in place with a syndicate of bankers. This facility is a three-year extendible revolving facility in the amount of \$875 million plus a \$25 million operating revolver with an initial maturity date of June 2016. The maturity date may, at the request of the Company and with the consent of the lenders, be extended on an annual basis. The facility is secured by a first ranking floating charge over all assets of the Company and its material subsidiaries. The facility can be drawn in either Canadian or U.S. funds and bears interest at the bank's prime lending rate, bankers' acceptance rates or LIBOR (for U.S. borrowings), plus applicable margins, which range from 2.00 to 4.00 percent over bankers' acceptance rates depending on the Company's senior debt to adjusted EBITDA ratio.

Under the terms of the bank credit facility, Tourmaline has provided its covenant that, on a rolling four quarter basis: (i) the ratio of adjusted EBITDA to interest expense shall equal or exceed 3.5:1, (ii) the ratio of senior debt to adjusted EBITDA shall not exceed 3:1, (iii) the ratio of total debt to adjusted EBITDA shall not exceed 4:1, and (iv) the ratio of senior debt to total capitalization shall not exceed 0.5:1. At December 31, 2013, adjusted EBITDA for the purposes of the above noted covenant calculations was \$540.4 million (December 31, 2012 - \$289.8 million), on a rolling four quarter basis. As at, and for the periods ending December 31, 2013 and December 31, 2012 the Company is in compliance with all debt covenants.

As at December 31, 2013, Tourmaline's bank debt balance was \$590.3 million (December 31, 2012 - \$360.6 million). In addition, Tourmaline has outstanding letters of credit of \$2.2 million (December 31, 2012 - \$4.4 million), which reduce the credit available on the facility. The effective interest rate on the Company's borrowings under the bank facility for the year ended December 31, 2013 was 3.06% (December 31, 2012 – 3.31%).

## 10. NON-CONTROLLING INTEREST

Tourmaline owns 90.6 percent of Exshaw Oil Corp., a private company engaged in oil and gas exploration in Canada.

A reconciliation of the non-controlling interest is provided below:

(000s)	Years Ended December 31,	
	2013	2012
Balance, beginning of year	\$ 16,298	\$ 15,079
Share of subsidiary's net income for the year	1,579	1,219
Balance, end of year	\$ 17,877	\$ 16,298

## 11.SHARE CAPITAL

### (a) Authorized

Unlimited number of Common Shares without par value.

Unlimited number of non-voting Preferred Shares, issuable in series.

### (b) Common Shares Issued

(000s) except share amounts	Year Ended December 31, 2013		Year Ended December 31, 2012	
	Number of Shares	Amount	Number of Shares	Amount
Balance, beginning of year	174,813,059	\$ 2,599,614	158,577,586	\$ 2,140,660
For cash on public offering of common shares <sup>(2)(4)(5)</sup>	9,275,000	343,881	4,639,000	134,531
For cash on public offering of flow-through common shares <sup>(1)(3)(4)(5)</sup>	1,760,000	67,218	2,452,000	62,685
Issued on corporate acquisitions	—	—	7,401,682	244,404
For cash on exercise of stock options	3,956,805	47,023	1,742,791	17,712
Contributed surplus on exercise of stock options	—	17,819	—	6,745
Share issue costs	—	(17,633)	—	(9,497)
Tax effect of share issue costs	—	4,510	—	2,374
<b>Balance, end of year</b>	<b>189,804,864</b>	<b>\$ 3,062,432</b>	<b>174,813,059</b>	<b>\$ 2,599,614</b>

<sup>(1)</sup> On April 4, 2012, the Company issued 1.4 million flow-through common shares at \$28.80 per share for total gross proceeds of \$40.4 million. The implied premium on the flow-through common shares was determined to be \$8.5 million or \$6.07 per share. A total of 0.15 million shares were purchased by insiders. As at December 31, 2013, the Company had spent the full committed amount. The expenditures were renounced to investors in February 2013 with an effective renunciation date of December 31, 2012.

<sup>(2)</sup> On August 30, 2012, the Company issued 4.039 million common shares at a price of \$29.00 per share for total gross proceeds of \$117.1 million. A total of 39,000 shares were purchased by insiders. Subsequently, on September 19, 2012, the underwriters exercised their over-allotment Option and purchased a further 0.6 million shares at a price of \$29.00 per share for total gross proceeds of \$17.4 million.

<sup>(3)</sup> On November 1, 2012, the Company issued 1.05 million flow-through common shares at \$36.90 per share for total gross proceeds of \$38.7 million. The implied premium on the flow-through common shares was determined to be \$7.9 million or \$7.55 per share. A total of 50,000 shares were purchased by insiders. As at December 31, 2013, the Company had spent the full committed amount. The expenditures were renounced to investors in February 2013 with an effective renunciation date of December 31, 2012.

<sup>(4)</sup> On March 12, 2013, the Company issued 5.78 million common shares at a price of \$34.25 per share and 0.835 million flow-through common shares at a price of \$42.15 per share, for total gross proceeds of \$233.2 million. The implied premium on the flow-through common shares was determined to be \$6.6 million or \$7.90 per share. A total of 30,000 common shares and 85,000 flow-through common shares were purchased by insiders. As at December 31, 2013, the Company had spent the full committed amount. The expenditures were renounced to investors in February 2014 with an effective renunciation date of December 31, 2013.

<sup>(5)</sup> On October 8, 2013, the Company issued 3.495 million common shares at a price of \$41.75 per share and 0.925 million flow-through common shares at a price of \$51.60 per share, for total gross proceeds of \$193.6 million. The implied premium on the flow-through common shares was determined to be \$9.1 million or \$9.85 per share. A total of 45,000 common shares and 75,000 flow-through common shares were purchased by insiders. As at December 31, 2013, the Company had spent the full committed amount. The expenditures were renounced to investors in February 2014 with an effective renunciation date of December 31, 2013.

## 12. DEFERRED TAXES

The provision for deferred taxes in the consolidated statements of income and comprehensive income reflect an effective tax rate which differs from the expected statutory tax rate. Differences were accounted for as follows:

(000s)	Years Ended December 31,	
	2013	2012
Income before taxes	\$ 218,375	\$ 32,639
Canadian statutory rate <sup>(1)</sup>	25.14%	25.0%
Expected income taxes at statutory rates	54,906	8,160
Effect on income tax of:		
Share-based payments	4,865	3,736
Flow-through shares	7,161	3,809
Effect of change in corporate tax rate and other	1,750	196
Deferred income tax	\$ 68,682	\$ 15,901

<sup>(1)</sup>The statutory rate consists of the combined statutory tax rate for the Company and its subsidiary for the year ended December 31, 2013. The Company's combined statutory tax rate increased from 25% to 25.14% because the Province of British Columbia increased their tax rate from 10% to 11% effective April 1, 2013.

The movement in deferred tax balances during the years ended December 31, 2013 and 2012 are as follows:

(000s)	Balance January 1, 2013	Recognized in Net Earnings	Recognized in Liabilities	Recognized in Equity	Balance December 31, 2013
Deferred tax liabilities:					
Exploration and evaluation and property, plant and equipment	\$ 269,606	\$ 128,649	\$ 24,462	\$ –	\$ 422,717
Assets held for sale	8,181	(8,181)	–	–	–
Long-term asset	645	(47)	–	–	598
Deferred tax assets:					
Decommissioning obligations	(16,189)	(2,969)	–	–	(19,158)
Short-term obligation	(37)	37	–	–	–
Risk management contracts	700	(2,525)	–	–	(1,825)
Long-term obligations	(2,716)	917	–	–	(1,799)
Non-capital losses	(75,056)	(51,996)	–	–	(127,052)
Share issue costs	(8,743)	4,797	–	(4,510)	(8,456)
Deferred tax liability (asset)	\$ 176,391	\$ 68,682	\$ 24,462	\$ (4,510)	\$ 265,025

(000s)	Balance January 1, 2012	Recognized in Net Earnings	Recognized in Liabilities	Recognized in Equity	Acquired in Business Combination	Balance December 31, 2012
Deferred tax liabilities:						
Exploration and evaluation and property, plant and equipment	\$ 165,171	\$ 39,642	\$ 19,000	\$ –	\$ 45,793	\$ 269,606
Assets held for sale	–	8,181	–	–	–	8,181
Risk management contracts	76	624	–	–	–	700
Long-term Asset	–	645	–	–	–	645
Deferred tax assets:						
Decommissioning obligations	(12,616)	(2,435)	–	–	(1,138)	(16,189)
Short-term obligation	–	–	–	–	(37)	(37)
Long-term obligations	(3,647)	931	–	–	–	(2,716)
Non-capital losses	(30,550)	(35,796)	–	–	(8,710)	(75,056)
Share issue costs	(10,457)	4,109	–	(2,374)	(21)	(8,743)
Deferred tax liability (asset)	\$ 107,977	\$ 15,901	\$ 19,000	\$ (2,374)	\$ 35,887	\$ 176,391

As at December 31, 2013, the Company has estimated federal tax pools of \$3.4 billion (2012 - \$2.7 billion) available for deduction against future taxable income. The Company has \$505 million of unused tax losses expiring between 2023 and 2033.

### 13. EARNINGS PER SHARE

Basic earnings-per-share was calculated as follows:

	Years Ended December 31,	
	2013	2012
Net earnings for the year (000s)	\$ 148,114	\$ 15,519
Weighted average number of common shares – basic	183,710,423	162,559,931
Earnings per share – basic	\$ 0.81	\$ 0.10

Diluted earnings-per-share was calculated as follows:

	Years Ended December 31,	
	2013	2012
Net earnings for the year (000s)	\$ 148,114	\$ 15,519
Weighted average number of common shares – diluted	188,244,300	167,028,522
Earnings per share – fully diluted	\$ 0.79	\$ 0.09

There were 4,703,000 options excluded from the weighted-average share calculation for the year ended December 31, 2013 because they were anti-dilutive (December 31, 2012 – 6,147,524).

## 14.SHARE-BASED PAYMENTS

The Company has a rolling stock option plan. Under the employee stock option plan, the Company may grant options to its employees up to 18,980,486 shares of common stock. The exercise price of each option equals the volume-weighted average market price for the five days preceding the issue date of the Company's stock on the date of grant and the option's maximum term is five years. Options are granted throughout the year and vest 1/3 on each of the first, second and third anniversaries from the date of grant.

	Years Ended December 31,			
	2013		2012	
	Number of Options	Weighted Average Exercise Price	Number of Options	Weighted Average Exercise Price
Stock options outstanding, beginning of year	15,325,232	\$ 19.87	14,213,523	\$ 16.82
Granted	4,843,000	40.47	2,907,000	29.16
Exercised	(3,956,805)	11.88	(1,742,791)	10.16
Forfeited	(182,776)	28.69	(52,500)	30.39
Stock options outstanding, end of year	16,028,651	\$ 27.95	15,325,232	\$ 19.87

The weighted average trading price of the Company's common shares was \$39.28 during the year ended December 31, 2013 (December 31, 2012 – \$26.19).

The following table summarizes stock options outstanding and exercisable at December 31, 2013:

Range of Exercise Price	Number Outstanding at Period End	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Number Exercisable at Period End	Weighted Average Exercise Price
\$7.00 - \$10.00	1,211,499	0.39	\$ 9.79	1,211,499	\$ 9.79
\$12.00 - \$18.35	3,809,290	1.29	16.61	3,809,290	16.61
\$20.68 - \$29.93	3,784,196	2.89	26.89	2,123,393	27.36
\$30.76 - \$32.78	2,520,666	3.62	31.66	948,666	31.57
\$38.07 - \$41.89	4,703,000	4.65	40.67	–	–
	16,028,651	2.95	\$ 27.95	8,092,848	\$ 20.16



The fair value of options, granted during the year, was estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted average assumptions and resulting values:

	Years Ended December 31,	
	2013	2012
Fair value of options granted (weighted average)	\$ 14.22	\$ 10.01
Risk-free interest rate	2.88%	2.33%
Estimated hold period prior to exercise	4 years	4 years
Expected volatility	40%	40%
Forfeiture rate	2%	2%
Dividend per share	\$ 0.00	\$ 0.00

## 15. OTHER INCOME

(000s)	Years Ended December 31,	
	2013	2012
Processing income	\$ 6,400	\$ 4,310
Interest income	193	138
Other	(70)	591
Total other income	\$ 6,523	\$ 5,039

## 16. FINANCE EXPENSES

(000s)	Years Ended December 31,	
	2013	2012
Finance expenses:		
Interest on loans and borrowings	\$ 12,220	\$ 10,484
Transaction costs on corporate and property acquisitions	1,100	1,146
Accretion of decommissioning obligations	2,038	1,328
Total finance expenses	\$ 15,358	\$ 12,958

## 17. SUPPLEMENTAL DISCLOSURES

Tourmaline's consolidated statement of income and comprehensive income is prepared primarily by nature of the expenses, with the exception of salaries and wages which are included in both the operating and general and administrative expense line items as follows:

(000s)	Years Ended December 31,	
	2013	2012
Operating	\$ 16,275	\$ 12,032
General and administration	11,640	7,952
Total employee compensation costs	\$ 27,915	\$ 19,984

## 18.SUPPLEMENTAL CASH FLOW INFORMATION

Changes in non-cash working capital is comprised of:

(000s)	Years Ended December 31,	
	2013	2012
Source/(use) of cash:		
Trade and other receivables	\$ (52,173)	\$ (23,069)
Deposit and prepaid expenses	(1,609)	4
Trade and other payables	159,956	12,921
	106,174	(10,144)
Working capital (deficiency)/surplus acquired	–	6,585
	\$ 106,174	\$ (3,559)
Related to operating activities	\$ (47,522)	\$ (6,802)
Related to investing activities	\$ 153,696	\$ 3,243

Cash interest paid was \$8.9 million for the year ended December 31, 2013 (December 31, 2012 - \$11.8 million).

## 19.COMMITMENTS

In the normal course of business, Tourmaline is obligated to make future payments. These obligations represent contracts and other commitments that are known and non-cancellable:

Payments Due by Year (000s)	1 Year	2-3 Years	4-5 Years	>5 Years	Total
Operating leases	\$ 3,591	\$ 9,552	\$ 10,163	\$ 6,168	\$ 29,474
Firm transportation and processing agreements	55,539	262,358	143,562	344,206	805,665
Bank debt <sup>(1)</sup>	–	639,271	–	–	639,271
	\$ 59,130	\$ 911,181	\$ 153,725	\$ 350,374	\$ 1,474,410

<sup>(1)</sup> Includes interest expense at an annual rate of 3.06% being the rate applicable at December 31, 2013.

## 20. KEY MANAGEMENT PERSONNEL COMPENSATION

Key management personnel are persons who have the authority and responsibility for planning, directing and controlling the activities of the Company, directly or indirectly. Key management includes all directors and executives of the Company. The table below summarizes all key management personnel compensation paid during the years ended December 31, 2013 and 2012. Non-executive directors do not receive short-term compensation.

### Compensation of Key Management

(000s)	Years Ended December 31,	
	2013	2012
Short-term compensation <sup>(1)</sup>	\$ 3,463	\$ 1,511
Share-based payments <sup>(2)</sup>	6,968	5,302
<b>Total compensation paid to key management</b>	<b>\$ 10,431</b>	<b>\$ 6,813</b>

<sup>(1)</sup> Short-term compensation includes employee benefits provided to key management personnel.

<sup>(2)</sup> Based on the grant date fair value of the applicable awards. The fair value of options granted is estimated at the date of grant using a Black-Scholes Option-Pricing Model. The total share-based payment of options issued in 2013 is based on a weighted average fair value estimated to be \$14.45 per option (2012- \$7.99 per option).

## 21. SUBSEQUENT EVENTS

On February 12, 2014 the Company issued 4.615 million common shares at a price of \$47.50 per share for total gross proceeds of \$219.2 million. A total of 15,198 common shares were purchased by insiders.

On March 4, 2014, Tourmaline entered into an agreement with Santonia Energy Inc. ("Santonia"), pursuant to which Tourmaline will acquire all of the issued and outstanding shares of Santonia. The transaction is expected to close on or prior to April 30, 2014. The deal is subject to approval by the regulators and shareholders of Santonia.