



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

As at June 30, 2013 and for the three and six months ended June 30, 2013 and 2012

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# MANAGEMENT'S DISCUSSION AND ANALYSIS

This management's discussion and analysis ("MD&A") should be read in conjunction with Tourmaline's unaudited interim condensed consolidated financial statements and related notes for the six months ended June 30, 2013 and the consolidated financial statements for the year ended December 31, 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 August 7, 2013.

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)" and "net debt".

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 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 June 30,			Six Months Ended June 30,		
	2013	2012	Change	2013	2012	Change
Natural gas (mcf/d)	<b>378,872</b>	266,771	42%	<b>373,112</b>	256,631	45%
Oil and NGL (bbl/d)	<b>7,033</b>	6,560	7%	<b>7,226</b>	6,112	18%
Oil equivalent (boe/d)	<b>70,178</b>	51,022	38%	<b>69,411</b>	48,884	42%

Production for the three months ended June 30, 2013 averaged 70,178 boe/d, a 38% increase over the average production for the same quarter of 2012 of 51,022 boe/d. Production was 90% natural gas weighted in the second quarter of 2013. For the six months ended June 30, 2013, production increased 42% to 69,411 boe/d from 48,884 boe/d for the same period of 2012. The Company's significant production growth, when compared to 2012, can be attributed to new wells that have been brought on-stream since June 30, 2012, as well as property and corporate acquisitions.

Production guidance for 2013 remains unchanged at 80,000 boe/d despite the lower than anticipated production in the second quarter. The second quarter production was affected by a delay in the start-up of the NEBC Doe plant as well as some unscheduled downtime at third-party facilities.

## REVENUE

(000s)	Three Months Ended June 30,			Six Months Ended June 30,		
	2013	2012	Change	2013	2012	Change
Revenue from:						
Natural gas	\$ <b>135,068</b>	\$ 54,042	150%	\$ <b>250,777</b>	\$ 111,030	126%
Oil and NGL	<b>55,721</b>	46,419	20%	<b>114,999</b>	93,569	23%
Total revenue from gas, oil and NGL sales	\$ <b>190,789</b>	\$ 100,461	90%	\$ <b>365,776</b>	\$ 204,599	79%

Revenue for the three months ended June 30, 2013 increased 90% to \$190.8 million from \$100.5 million for the same quarter of 2012. For the six months ended June 30, 2013, revenue was \$365.8 million, a 79% increase over revenue of \$204.6 million for the same period of 2012. Revenue growth is consistent with the increase in production and increased commodity prices over the same periods. Revenue includes all petroleum, natural gas and NGL sales and realized gains on financial instruments.

### TOURMALINE PRICES:

	Three Months Ended June 30,			Six Months Ended June 30,		
	2013	2012	Change	2013	2012	Change
Natural gas (\$/mcf)	\$ <b>3.92</b>	\$ 2.23	76%	\$ <b>3.71</b>	\$ 2.38	56%
Oil and NGL (\$/bbl)	\$ <b>87.06</b>	\$ 77.75	12%	\$ <b>87.93</b>	\$ 84.11	5%
Oil equivalent (\$/boe)	\$ <b>29.88</b>	\$ 21.64	38%	\$ <b>29.11</b>	\$ 23.00	27%

The realized average natural gas price for the three and six months ended June 30, 2013 was 76% and 56%, respectively, higher than the same periods of the prior year. Realized crude oil and NGL prices increased 12% and 5% for the three and six months ended June 30, 2013, respectively, compared to the same periods of 2012.

The realized natural gas price for the quarter ended June 30, 2013 was 10% (June 30, 2012 – 17%) higher than the AECO index price of which approximately 8% (June 30, 2012 – 8%) relates to a premium received due to higher heat content. The realized gain on commodity contracts has decreased from the same period in the prior year as the market price of natural gas has increased relative to the prices per the commodity contracts settled in the period. 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 GAS AND OIL PRICES:**

	Three Months Ended June 30,		
	2013	2012	Change
Natural gas			
NYMEX Henry Hub (USD\$/mcf)	\$ 4.02	\$ 2.35	71%
AECO (CAD\$/mcf)	\$ 3.55	\$ 1.91	86%
Oil			
NYMEX (USD\$/bbl)	\$ 94.17	\$ 93.35	1%
Edmonton Par (CAD\$/bbl)	\$ 92.95	\$ 84.97	9%

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

(\$/mcf)	Three Months Ended June 30,		
	2013	2012	Change
AECO index	\$ 3.55	\$ 1.91	86%
Heat/quality differential	0.30	0.15	100%
Realized gain	0.07	0.17	(59)%
Tourmaline realized natural gas price	\$ 3.92	\$ 2.23	76%

**CURRENCY – EXCHANGE RATES:**

	Three Months Ended June 30,		
	2013	2012	Change
CAD\$/USD\$	\$ 0.9772	\$ 0.9898	(1)%

## ROYALTIES

(000s)	Three Months Ended June 30,			Six Months Ended June 30,		
	2013	2012		2013	2012	
Natural gas	\$ 7,512	\$ (3,072)		\$ 12,047	\$ (2,101)	
Oil and NGL	7,342	6,471		14,170	13,971	
Total royalties	\$ 14,854	\$ 3,399		\$ 26,217	\$ 11,870	
Royalties as a percentage of revenue	7.8%	3.4%		7.2%	5.8%	

For the quarter ended June 30, 2013, the average effective royalty rate increased to 7.8% compared to 3.4% for the same quarter of 2012. For the six months ended June 30, 2013, the average effective royalty was 7.2% compared to 5.8% for the same period of 2012.

The Company continues 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. The average effective royalty rate increased in 2013 over 2012 due to increased commodity prices, as well as the maximum allowable benefit has been reached on some higher producing wells resulting in increased royalties. Also, in 2012, there were additional royalty incentives received during the second quarter on some of the Company's producing wells which significantly reduced the royalty rate for that period.

The Company expects its royalty rate for 2013 to be approximately 10% as additional wells will no longer qualify for royalty incentive programs due to production maximums being reached and other wells coming off royalty holidays, thereby increasing the Company's overall royalty rate. The royalty rate is sensitive to commodity prices, however, and as such, a change in commodity prices will impact the actual rate.

## OTHER INCOME

For the quarter ended June 30, 2013, other income was \$1.2 million (three months ended June 30, 2012 - \$1.2 million), the majority of which relates to processing income.

For the six months ended June 30, 2013, other income was \$2.6 million (six months ended June 30, 2012 - \$2.7 million), which includes \$2.5 million in processing income (six months ended June 30, 2012 - \$2.0 million). The slight increase in processing income in 2013 is due to third party volumes processed at a Company-operated facility acquired in late 2012. Notwithstanding this, the Company expects processing income to decrease as the Company's production grows, thus reducing capacity for third-party volumes in Tourmaline owned-and-operated facilities.

## OPERATING EXPENSES

(000s) except per unit amounts	Three Months Ended June 30,			Six Months Ended June 30,		
	2013	2012	Change	2013	2012	Change
Operating expenses	\$ 27,409	\$ 22,419	22%	\$ 53,776	\$ 44,500	21%
Per boe	\$ 4.29	\$ 4.83	(11)%	\$ 4.28	\$ 5.00	(14)%

Operating expenses include all periodic lease and field-level expenses and exclude income recoveries from processing third-party volumes. For the second quarter of 2013, total operating expenses increased 22% from

\$22.4 million in the second quarter of 2012 to \$27.4 million in 2013 due to the increased variable costs relating to new production. On a per-boe basis, the costs decreased 11% from \$4.83/boe for the second quarter of 2012 to \$4.29/boe in the second quarter of 2013 due to increased production and increased operational efficiencies.

Tourmaline's operating expenses in the second quarter of 2013 include third-party processing, gathering and compression fees of approximately \$7.5 million or 27% of total operating costs (June 30, 2012 - \$4.0 million or 18% of total operating costs). Production in NEBC has increased since 2012, and volumes offloaded to third-party facilities in this area are subject to higher processing costs. The start up of the NEBC Doe gas plant in July 2013 will allow for additional volumes to flow through this Company owned-and-operated facility thereby reducing third party processing charges. Additionally, the Company expects to complete a new natural gas and liquids handling facility in late 2014 at Spirit River, which is also expected to reduce overall third-party processing charges.

For the six months ended June 30, 2013, total operating expenses were \$53.8 million, or \$4.28/boe, compared to \$44.5 million, or \$5.00/boe for the same period of 2012. Although total operating expenses increased along with production, the costs per boe decreased 14% reflecting increased operational efficiencies.

The Company expects its full year 2013 operating costs to average approximately \$4.25/boe, which is consistent with previous guidance. 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 June 30,			Six Months Ended June 30,		
	2013	2012	Change	2013	2012	Change
Gas transportation	\$ 8,762	\$ 6,215	41%	\$ 17,047	\$ 12,083	41%
Oil and NGL transportation	3,845	2,396	60%	8,030	4,076	97%
Total transportation	\$ 12,607	\$ 8,611	46%	\$ 25,077	\$ 16,159	55%
Per boe	\$ 1.97	\$ 1.85	6%	\$ 2.00	\$ 1.82	10%

Transportation costs for the three months ended June 30, 2013 were \$12.6 million or \$1.97/boe (three months ended June 30, 2012 - \$8.6 million or \$1.85/boe, respectively). Transportation costs for the six months ended June 30, 2013 were \$25.1 million or \$2.00/boe (six months ended June 30, 2012 - \$16.2 million or \$1.82/boe, respectively). The increase in total transportation costs for the three and six months ended June 30, 2013 can be attributed to increased production as well as increased oil and NGL transportation costs. Pipeline and infrastructure constraints have resulted in a greater use of more expensive truck transportation.



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

(000s) except per unit amounts	Three Months Ended June 30,			Six Months Ended June 30,		
	2013	2012	Change	2013	2012	Change
G&A expenses	\$ 8,829	\$ 6,043	46%	\$ 17,436	\$ 12,883	35%
Administrative and capital recovery	(312)	(149)	109%	(726)	(338)	115%
Capitalized G&A	(3,301)	(2,698)	22%	(6,553)	(5,499)	19%
Total G&A expenses	\$ 5,216	\$ 3,196	63%	\$ 10,157	\$ 7,046	44%
Per boe	\$ 0.82	\$ 0.69	19%	\$ 0.81	\$ 0.79	3%

G&A expenses for the second quarter of 2013 were \$5.2 million (\$0.82/boe) compared to \$3.2 million (\$0.69/boe) for the same quarter of the prior year. For the six months ended June 30, 2013, G&A expenses were \$10.2 million (\$0.81/boe) compared to \$7.0 million (\$0.79/boe) for the same period of 2012. The higher costs relate to increased staffing levels, which have been put in place primarily to support a larger exploration and production program in 2013 and 2014.

G&A costs for 2013 are expected to be similar to 2012 on a dollar-per-boe basis. Actual costs per boe can change, however, depending on a number of factors including the Company’s actual production levels.

## SHARE-BASED PAYMENTS

(000s) except per unit amounts	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Share-based payments	\$ 8,964	\$ 7,416	\$ 16,144	\$ 15,032
Capitalized share-based payments	(4,482)	(3,708)	(8,072)	(7,516)
Total share-based payments	\$ 4,482	\$ 3,708	\$ 8,072	\$ 7,516
Per boe	\$ 0.70	\$ 0.80	\$ 0.64	\$ 0.84

Tourmaline uses the fair value method for the determination of non-cash related share-based payments expense. During the second quarter of 2013, 1,845,000 stock options were granted to employees, officers, directors and key consultants at a weighted-average exercise price of \$40.86, and 766,861 options were exercised, bringing \$9.5 million of cash into treasury. The Company recognized \$4.5 million of share-based payment expense in the second quarter of 2013 compared to \$3.7 million in the second quarter of 2012. Capitalized share-based payment expense for the second quarter of 2013 was \$4.5 million compared to \$3.7 million for the same quarter of the prior year.

For the six months ended June 30, 2013, share-based compensation expense totalled \$8.1 million and capitalized share-based payments were \$8.1 million (2012 - \$7.5 million and \$7.5 million, respectively). The increase in share-based compensation in 2013 compared to 2012 reflects the increased number of employees due to increased activity along with an overall increase in the fair value of options granted.

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

(000s) except per unit amounts	Three Months Ended June 30,			Six Months Ended June 30,		
	2013	2012		2013	2012	
Total depletion, depreciation and amortization	\$ 82,317	\$ 61,790		\$ 163,740	\$ 117,797	
Less mineral lease expiries	(7,444)	–		(15,026)	–	
Depletion, depreciation and amortization	\$ 74,873	\$ 61,790		\$ 148,714	\$ 117,797	
Per boe	\$ 11.72	\$ 13.31		\$ 11.84	\$ 13.24	

DD&A expense, net of mineral lease expiries expense, was \$74.9 million for the second quarter of 2013 compared to \$61.8 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 (excluding the impact of mineral lease expiries) for the second quarter of 2013 was \$11.72/boe compared to \$13.31/boe for the second quarter of 2012.

For the six months ended June 30, 2013, DD&A expense was \$148.7 million (June 30, 2012 - \$117.8 million) with an effective rate of \$11.84/boe (June 30, 2012 - \$13.24/boe). The lower DD&A rate, for the three and six months ended June 30, 2013, compared to the same periods of 2012, reflects strong reserve additions derived from Tourmaline's exploration and production program.

## FINANCE EXPENSES

(000s)	Three Months Ended June 30,			Six Months Ended June 30,		
	2013	2012	Change	2013	2012	Change
Interest expense	\$ 2,321	\$ 2,284	2%	\$ 5,580	\$ 3,753	49%
Accretion expense	488	308	58%	879	615	43%
Transaction costs on corporate and property acquisitions	–	–	–%	670	172	290%
Other	219	213	3%	397	396	–%
Total finance expenses	\$ 3,028	\$ 2,805	8%	\$ 7,526	\$ 4,936	52%

Finance expenses are comprised of interest expense, accretion of provisions and transaction costs associated with corporate and property acquisitions. Finance expenses for the three months ended June 30, 2013 totalled \$3.0 million, which are consistent with 2012 second quarter finance expenses of \$2.8 million. Finance expenses for the six month period increased from \$4.9 million in 2012 to \$7.5 million in 2013, primarily due to a \$1.8 million increase in interest expense resulting from a higher balance drawn on the credit facility during the first quarter of 2013. The effective interest rate of 3.28% for the second quarter of 2013 is relatively unchanged from the 3.33% for the same period in 2012.

## DEFERRED INCOME TAXES

For the three and six months ended June 30, 2013, the provision for deferred income tax expense was \$14.3 million and \$33.9 million, respectively, compared to an expense of \$1.8 million and \$5.0 million, respectively, for the same periods in 2012. The increase was due to higher pre-tax earnings in 2013 and an increase in the

Company's effective tax rate during the second quarter of 2013 due to the Province of British Columbia increasing its provincial tax rate from 10% to 11%.

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

(000s) except per unit amounts	Three Months Ended June 30,			Six Months Ended June 30,		
	2013	2012	Change	2013	2012	Change
Cash flow from operating activities	\$ 128,432	\$ 42,566	202%	\$ 222,195	\$ 102,093	118%
Per share <sup>(1)</sup>	\$ 0.68	\$ 0.26	162%	\$ 1.20	\$ 0.62	94%
Cash flow <sup>(2)</sup>	\$ 128,870	\$ 61,121	111%	\$ 245,469	\$ 122,957	100%
Per share <sup>(1)(2)</sup>	\$ 0.68	\$ 0.37	84%	\$ 1.32	\$ 0.75	76%
Net earnings	\$ 30,004	\$ 1,012	2,865%	\$ 82,188	\$ 3,988	1,961%
Per share <sup>(1)</sup>	\$ 0.16	\$ 0.01	1,500%	\$ 0.44	\$ 0.02	2,100%
Operating netback per boe <sup>(2)</sup>	\$ 21.28	\$ 14.22	50%	\$ 20.75	\$ 14.84	40%

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

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

Cash flow for the three months ended June 30, 2013 was \$128.9 million or \$0.68 per diluted share compared to \$61.1 million or \$0.37 per diluted share for the same period of 2012. Cash flow for the six months ended June 30, 2013 increased to \$245.5 million or \$1.32 per diluted share compared to June 30, 2012 cash flow of \$123.0 million or \$0.75 per diluted share. The increase in cash flow in 2013 reflects higher commodity prices over 2012, as well as increased production.

After-tax earnings for the three months ended June 30, 2013 are higher at \$30.0 million (\$0.16 per diluted share) compared to \$1.0 million (\$0.01 per diluted share) for the same period of 2012, due mainly to higher commodity prices and increased production. After-tax earnings for the six month period ending June 30, 2013 were \$82.2 million (\$0.44 per diluted share) compared to \$4.0 million (\$0.02 per diluted share) in 2012. The significant increase is attributable to increased commodity prices and production as well as the gain realized on the sale of a non-core asset in Elmworth, Alberta.

## CAPITAL EXPENDITURES

(000s)	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Land and seismic	\$ 8,277	\$ 4,461	\$ 16,782	\$ 15,299
Drilling and completions	54,975	24,490	236,003	172,785
Facilities	58,568	22,149	131,703	88,156
Property acquisitions	33,533	58	35,983	974
Property dispositions	–	(50)	(77,945)	(12,568)
Other	3,398	2,723	6,688	5,609
Total cash capital expenditures	\$ 158,751	\$ 53,831	\$ 349,214	\$ 270,255

During the second quarter of 2013, the Company invested \$158.8 million of cash consideration compared to \$53.8 million for the same period of 2012. Expenditures on exploration and production were \$121.8 million compared to \$51.1 million for the same quarter of 2012, which is consistent with the Company's aggressive growth strategy and includes expenditures on Phase 1 of the Spirit River gas facility expansion, which was completed in June 2013. The increase in expenditures also includes costs related to the NEBC gas facility, which started up in July 2013.

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

	<b>Three Months Ended June 30, 2013</b>	
	<b>Gross</b>	<b>Net</b>
Drilled	<b>10</b>	<b>8.73</b>
Completed	<b>9</b>	<b>7.80</b>
Tied-in	<b>10</b>	<b>10.00</b>

## **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 will be used to fund the Company's 2013 exploration and development program.

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, 2012. In June 2013, the facility was increased to \$750 million from \$575 million, under the same terms and covenants, with an initial maturity of June 2016.

At June 30, 2013, Tourmaline had negative working capital of \$53.7 million, after adjusting for the fair value of financial instruments (the unadjusted working capital deficiency was \$50.9 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 remainder of its 2013 exploration and development program through expected cash flow from operations and its unutilized bank credit facility. As at June 30, 2013, the Company's bank debt balance was \$291.8 million (December 31, 2012 - \$360.6 million), and net debt was \$345.5 million (December 31, 2012 - \$464.3 million).

## **SHARES OUTSTANDING**

As at August 7, 2013, the Company has 184,468,636 common shares outstanding and 14,333,544 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.

<b>Payments Due by Year (000s)</b>	<b>1 Year</b>	<b>2-3 Years</b>	<b>4-5 Years</b>	<b>&gt; 5 Years</b>	<b>Total</b>
Operating leases	\$ 2,365	\$ 7,928	\$ 10,166	\$ 8,635	\$ 29,094
Flow-through obligations	19,189	35,195	–	–	54,384
Firm transportation and processing agreements	38,369	83,701	83,720	242,316	448,106
Bank debt <sup>(1)</sup>	–	320,447	–	–	320,447
	\$ 59,923	\$ 447,271	\$ 93,886	\$ 250,951	\$ 852,031

<sup>(1)</sup> Includes interest expense at an annual rate of 2.88% being the rate applicable to outstanding bank debt at June 30, 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 audited consolidated financial statements for the year ended December 31, 2012.

As at June 30, 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. 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 has entered into in the first six months of 2013 are detailed in note 3 of the Company's interim condensed consolidated financial statements for the three and six months ended June 30, 2013.

The following table provides a summary of the unrealized gains and losses on financial instruments for the three and six months ended June 30, 2013 and 2012:

(000s)	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Unrealized gain (loss) on financial instruments	\$ 3,321	\$ 7,343	\$ (498)	\$ 4,977
Unrealized (loss) on investments held for trading	–	(84)	–	(103)
Total	\$ 3,321	\$ 7,259	\$ (498)	\$ 4,874

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 entered into since December 31, 2012 to June 30, 2013 have been disclosed in note 3 of the Company's interim condensed consolidated financial statements for the three and six months ended June 30, 2013.

The Company has entered into several financial derivative and physical delivery sales contracts subsequent to June 30, 2013. These contracts are detailed in note 3 of the Company's interim condensed consolidated financial statements for the quarter ended June 30, 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 interim condensed consolidated financial statements is discussed in note 1 of the consolidated financial statements for the year ended December 31, 2012.

## 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, 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 National Instrument 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 IFRS. There were no changes in the Company's ICFR during the period beginning on April 1, 2013 and ending on June 30, 2013 that have materially affected, or are reasonably likely to materially affect, the Company's 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.

## **ADOPTION OF NEW ACCOUNTING STANDARDS**

On January 1, 2013, the Company adopted new standards with respect to consolidations (IFRS 10), joint arrangements (IFRS 11), disclosure of interests in other entities (IFRS 12), fair value measurements (IFRS 13) and amendments to financial instrument disclosures (IFRS 7). The adoption of these standards had no impact on the amounts recorded in the interim condensed consolidated financial statements or on the comparative periods.

## **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**

Environmental legislation, including the Kyoto Accord, the federal government's "EcoACTION" plan and Alberta's Bill 3 - *Climate Change and Emissions Management Amendment Act*, is evolving in a manner expected to result in stricter standards and enforcement, larger fines and liability and potentially increased capital expenditures and operating costs. Given the evolving nature of the debate related to climate change and the resulting requirements, it is not possible to determine the operational or financial impact of those requirements on Tourmaline.

## **NON-GAAP FINANCIAL MEASURES**

This MD&A includes references to financial measures commonly used in the oil and gas industry such as "cash flow", "operating netback", "working capital (adjusted for the fair value of financial instruments)" and "net debt", which do not have any standardized meaning prescribed by GAAP. Management believes that in addition to net income and cash flow from operating activities, the aforementioned non-GAAP financial measures are useful

supplemental measures in assessing Tourmaline's ability to generate the cash necessary to repay debt or fund future growth through capital investment. Readers are cautioned, however, that these measures should not be construed as an alternative to net income or cash flow from operating activities determined in accordance with GAAP as an indication of Tourmaline's performance. Tourmaline's method of calculating these measures may differ from other companies and accordingly, they may not be comparable to measures used by other companies. For these purposes, Tourmaline defines cash flow as cash flow from operating activities before changes in non-cash operating working capital, defines operating netback as revenue (excluding processing income) less royalties, transportation costs and operating expenses and defines working capital (adjusted for the fair value of financial instruments) as working capital adjusted for the fair value of financial instruments. Net debt is defined as long-term bank debt plus working capital (adjusted for the fair value of financial instruments).

### Cash Flow

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

(000s)	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Cash flow from operating activities (per GAAP)	\$ 128,432	\$ 42,566	\$ 222,195	\$ 102,093
Change in non-cash operating working capital	438	18,555	23,274	20,864
Cash flow	\$ 128,870	\$ 61,121	\$ 245,469	\$ 122,957

### 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 June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Revenue, excluding processing income	\$ 29.88	\$ 21.64	\$ 29.11	\$ 23.00
Royalties	(2.33)	(0.73)	(2.09)	(1.33)
Transportation costs	(1.97)	(1.85)	(2.00)	(1.82)
Operating expenses	(4.29)	(4.83)	(4.28)	(5.00)
Operating netback <sup>(1)</sup>	\$ 21.28	\$ 14.22	\$ 20.75	\$ 14.84

<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)		<b>As at June 30, 2013</b>		As at December 31, 2012
Working capital (deficit)	\$	<b>(50,851)</b>	\$	(98,913)
Fair value of financial instruments – short-term asset		<b>(2,825)</b>		(4,814)
Working capital (deficit) (adjusted for the fair value of financial instruments)	\$	<b>(53,676)</b>	\$	(103,727)

### Net Debt

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

(000s)		<b>As at June 30, 2013</b>		As at December 31, 2012
Bank debt	\$	<b>(291,849)</b>	\$	(360,573)
Working capital (deficit)		<b>(50,851)</b>		(98,913)
Fair value of financial instruments – short-term asset		<b>(2,825)</b>		(4,814)
Net debt	\$	<b>(345,525)</b>	\$	(464,300)

## SELECTED QUARTERLY INFORMATION

(\$000s, unless otherwise noted)	2013		2012				2011	
	Q2	Q1	Q4	Q3	Q2	Q1	Q4	Q3
<b>PRODUCTION</b>								
Natural gas (mcf)	<b>34,477,391</b>	33,055,857	27,879,639	23,501,484	24,276,149	22,430,621	18,437,079	17,058,132
Oil and NGL(bbls)	<b>640,001</b>	667,907	618,483	515,157	596,992	515,408	415,074	316,890
Oil equivalent (boe)	<b>6,386,233</b>	6,177,216	5,265,090	4,432,071	4,643,016	4,253,845	3,487,920	3,159,912
Natural gas (mcf/d)	<b>378,872</b>	367,287	303,040	255,451	266,771	246,490	200,403	185,414
Oil and NGL (bbls/d)	<b>7,033</b>	7,421	6,723	5,600	6,560	5,664	4,512	3,444
Oil equivalent (boe/d)	<b>70,178</b>	68,636	57,230	48,175	51,022	46,746	37,912	34,347
<b>FINANCIAL</b>								
Revenue, net of royalties	<b>180,505</b>	161,124	134,864	91,863	105,567	94,781	98,309	98,225
Cash flow from operating activities	<b>128,432</b>	93,763	104,671	66,713	42,566	59,527	61,801	77,622
Cash flow <sup>(1)</sup>	<b>128,870</b>	116,599	93,807	63,515	61,121	61,836	73,311	62,686
Per diluted share	<b>0.68</b>	0.64	0.54	0.38	0.37	0.38	0.45	0.40
Net earnings (loss)	<b>30,004</b>	52,184	16,301	(4,770)	1,012	2,976	16,074	8,688
Per basic share	<b>0.16</b>	0.29	0.10	(0.03)	0.01	0.02	0.10	0.06
Per diluted share	<b>0.16</b>	0.29	0.09	(0.03)	0.01	0.02	0.10	0.06
Total assets	<b>3,811,192</b>	3,735,641	3,580,253	2,992,552	2,862,502	2,878,261	2,711,024	2,517,607
Working capital	<b>(50,851)</b>	(165,385)	(98,913)	(98,184)	(15,311)	(176,029)	(146,317)	(120,080)
Working capital (adjusted for the fair value of financial instruments) <sup>(1)</sup>	<b>(53,676)</b>	(166,049)	(103,727)	(101,577)	(19,809)	(175,696)	(146,593)	(123,858)
Capital expenditures	<b>158,751</b>	190,463	296,108	175,277	53,831	216,424	232,167	249,162
Total outstanding shares (000s)	<b>184,175</b>	183,408	174,813	165,678	160,459	158,807	158,578	151,906
<b>PER UNIT</b>								
Natural gas (\$/mcf)	<b>3.92</b>	3.50	3.29	2.52	2.23	2.54	3.76	4.25
Oil and NGL (\$/bbl)	<b>87.06</b>	88.75	83.28	83.34	77.75	91.48	93.05	87.01
Revenue (\$/boe)	<b>29.88</b>	28.33	27.18	23.04	21.64	24.48	30.95	31.67
Operating netback (\$/boe) <sup>(1)</sup>	<b>21.28</b>	20.20	19.17	15.68	14.22	15.52	21.39	21.21

<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 31,007 boe per day in 2011 to 50,804 boe per day in 2012 and 69,411 boe per day in the first six months of 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 \$228.4 million in 2011, \$273.5 million in 2012 and 2013 estimated cash flows (based on the first six months annualized) are \$444.4 million, due mainly to strong growth in production levels and strengthening commodity prices. 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. Changes in commodity prices impact revenues and cash flows available for exploration, and also the economics of potential capital projects as low commodity prices can potentially reduce 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.

# CONSOLIDATED FINANCIAL STATEMENTS

## CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

(000s) (unaudited) June 30, 2013 December 31, 2012

### Assets

Current assets:

Accounts receivable	\$ 75,151	\$ 83,868
Assets held for sale	–	33,007
Prepaid expenses and deposits	5,886	5,309
Fair value of financial instruments (notes 2 and 3)	2,825	4,814
<b>Total current assets</b>	<b>83,862</b>	<b>126,998</b>
Long-term asset	2,580	2,580
Exploration and evaluation assets (note 4)	685,577	639,933
Property, plant and equipment (note 5)	3,039,173	2,810,742
<b>Total Assets</b>	<b>\$ 3,811,192</b>	<b>\$ 3,580,253</b>

### Liabilities and Shareholders' Equity

Current liabilities:

Accounts payable and accrued liabilities	\$ 134,713	\$ 225,911
<b>Total current liabilities</b>	<b>134,713</b>	<b>225,911</b>
Bank debt (note 7)	291,849	360,573
Decommissioning obligations (note 6)	69,032	64,757
Long-term obligation	5,276	7,139
Fair value of financial instruments (notes 2 and 3)	521	2,012
Deferred premium on flow-through shares	10,523	8,755
Deferred taxes	212,686	176,391
Shareholders' equity:		
Share capital (note 9)	2,865,254	2,599,614
Non-controlling interest (note 8)	16,943	16,298
Contributed surplus	74,327	70,923
Retained earnings	130,068	47,880
<b>Total shareholders' equity</b>	<b>3,086,592</b>	<b>2,734,715</b>
<b>Total Liabilities and Shareholders' Equity</b>	<b>\$ 3,811,192</b>	<b>\$ 3,580,253</b>

Commitments (note 12)

Subsequent events (note 3)

See accompanying notes to the interim condensed consolidated financial statements.

## CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME

	Three Months Ended June 30,		Six Months Ended June 30,	
(000s) except per-share amounts (unaudited)	2013	2012	2013	2012
<b>Revenue:</b>				
Oil and natural gas sales	\$ 186,821	\$ 96,324	\$ 359,312	\$ 195,097
Royalties	(14,854)	(3,399)	(26,217)	(11,870)
Net revenue from oil and natural gas sales	171,967	92,925	333,095	183,227
Realized gain on financial instruments	3,968	4,137	6,464	9,502
Unrealized gain (loss) on financial instruments (note 3)	3,321	7,259	(498)	4,874
Other income	1,249	1,246	2,568	2,745
<b>Total net revenue</b>	<b>180,505</b>	<b>105,567</b>	<b>341,629</b>	<b>200,348</b>
<b>Expenses:</b>				
Operating	27,409	22,419	53,776	44,500
Transportation	12,607	8,611	25,077	16,159
General and administration	5,216	3,196	10,157	7,046
Share-based payments	4,482	3,708	8,072	7,516
(Gain) loss on divestitures	777	(66)	(43,410)	(7,272)
Depletion, depreciation and amortization	82,317	61,790	163,740	117,797
<b>Total expenses</b>	<b>132,808</b>	<b>99,658</b>	<b>217,412</b>	<b>185,746</b>
<b>Income from operations</b>	<b>47,697</b>	<b>5,909</b>	<b>124,217</b>	<b>14,602</b>
Finance expenses	3,028	2,805	7,526	4,936
<b>Income before taxes</b>	<b>44,669</b>	<b>3,104</b>	<b>116,691</b>	<b>9,666</b>
Deferred taxes	14,265	1,781	33,858	4,955
<b>Net income and comprehensive income for the period before non-controlling interest</b>	<b>30,404</b>	<b>1,323</b>	<b>82,833</b>	<b>4,711</b>
Net income and comprehensive income attributable to:				
Shareholders of the Company	30,004	1,012	82,188	3,988
Non-controlling interest (note 8)	400	311	645	723
	<b>\$ 30,404</b>	<b>\$ 1,323</b>	<b>\$ 82,833</b>	<b>\$ 4,711</b>
<b>Net income per share attributable to common shareholders (note 10)</b>				
Basic	\$ 0.16	\$ 0.01	\$ 0.46	\$ 0.03
Diluted	\$ 0.16	\$ 0.01	\$ 0.44	\$ 0.02

See accompanying notes to the interim condensed consolidated financial statements.

## CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

(000s) (unaudited)

	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 9)	226,564	–	–	–	226,564
Share issue costs, net of tax	(7,175)	–	–	–	(7,175)
Share-based payments	–	8,072	–	–	8,072
Capitalized share-based payments	–	8,072	–	–	8,072
Options exercised (note 9)	46,251	(12,740)	–	–	33,511
Income attributable to common shareholders	–	–	82,188	–	82,188
Income attributable to non-controlling interest	–	–	–	645	645
<b>Balance at June 30, 2013</b>	<b>\$ 2,865,254</b>	<b>\$ 74,327</b>	<b>\$ 130,068</b>	<b>\$ 16,943</b>	<b>\$ 3,086,592</b>

(000s) (unaudited)

	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 9)	31,867	–	–	–	31,867
Share issue costs, net of tax	(1,608)	–	–	–	(1,608)
Share-based payments	–	7,516	–	–	7,516
Capitalized share-based payments	–	7,516	–	–	7,516
Options exercised (note 9)	5,871	(1,636)	–	–	4,235
Income attributable to common shareholders	–	–	3,988	–	3,988
Income attributable to non-controlling interest	–	–	–	723	723
<b>Balance at June 30, 2012</b>	<b>\$ 2,176,790</b>	<b>\$ 61,172</b>	<b>\$ 36,349</b>	<b>\$ 15,802</b>	<b>\$ 2,290,113</b>

See accompanying notes to the interim condensed consolidated financial statements.

## CONSOLIDATED STATEMENTS OF CASH FLOW

	Three Months Ended June 30,		Six Months Ended June 30,	
(000s) (unaudited)	2013	2012	2013	2012
<b>Cash provided by (used in):</b>				
<b>Operations:</b>				
Net income	\$ 30,004	\$ 1,012	\$ 82,188	\$ 3,988
Items not involving cash:				
Depletion and depreciation	82,317	61,790	163,740	117,797
Accretion	488	308	879	615
Share-based payments	4,482	3,708	8,072	7,516
Deferred taxes	14,265	1,781	33,858	4,955
Unrealized (gain) loss on financial instruments (note 3)	(3,321)	(7,259)	498	(4,874)
Realized (gain) on sale of investments	–	(38)	–	(38)
(Gain) loss on divestitures	777	(66)	(43,410)	(7,272)
Non-controlling interest	400	311	645	723
Decommissioning expenditures	(542)	(426)	(1,001)	(453)
Changes in non-cash operating working capital	(438)	(18,555)	(23,274)	(20,864)
Total cash flow from operating activities	128,432	42,566	222,195	102,093
<b>Financing:</b>				
Issue of common shares	9,547	42,673	266,671	44,613
Share issue costs	–	(1,700)	(9,566)	(2,145)
Increase (decrease) in bank debt	133,638	108,388	(68,724)	233,309
Total cash flow from financing activities	143,185	149,361	188,381	275,777
<b>Investing:</b>				
Exploration and evaluation	(29,949)	(8,413)	(56,810)	(34,031)
Property, plant and equipment	(95,269)	(45,410)	(334,366)	(247,818)
Property acquisitions	(33,533)	(58)	(35,983)	(974)
Proceeds from divestitures	–	50	77,945	12,568
Proceeds from sale of investments	–	168	–	168
Repayment of long-term obligation	(931)	(932)	(1,863)	(1,863)
Changes in non-cash investing working capital	(111,935)	(137,332)	(59,499)	(105,920)
Total cash flow from investing activities	(271,617)	(191,927)	(410,576)	(377,870)
<b>Changes in cash</b>	–	–	–	–
<b>Cash, beginning of period</b>	–	–	–	–
<b>Cash, end of period</b>	\$ –	\$ –	\$ –	\$ –

Cash is defined as cash and cash equivalents.

See accompanying notes to the interim condensed consolidated financial statements.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

**As at June 30, 2013 and for the three and six months ended June 30, 2013 and 2012**

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

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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. 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**

These unaudited interim condensed consolidated financial statements have been prepared in accordance with International Accounting Standard (“IAS”) 34, “Interim Financial Reporting”. These unaudited interim condensed consolidated financial statements do not include all of the information and disclosure required in the annual financial statements and should be read in conjunction with the Company’s consolidated financial statements for the year ended December 31, 2012.

The accounting policies and significant accounting judgments, estimates, and assumptions used in these unaudited interim condensed consolidated financial statements are consistent with those described in Notes 1 and 2 of the Company’s consolidated financial statements for the year ended December 31, 2012, except as detailed below.

On January 1, 2013, the Company adopted new standards with respect to consolidations (IFRS 10), joint arrangements (IFRS 11), disclosure of interests in other entities (IFRS 12), fair value measurements (IFRS 13) and amendments to financial instrument disclosures (IFRS 7). The adoption of these standards had no impact on the amounts recorded in the interim condensed consolidated financial statements or on the comparative periods.

The unaudited interim condensed consolidated financial statements were authorized for issue by the Board of Directors on August 7, 2013.



## 2. 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 purposes based on the following method. When applicable, further information about the assumptions made in determining fair values is disclosed in the notes specific to that asset or liability.

### *Measurement:*

Tourmaline classifies the fair value of 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.

## 3. 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 consistent with those discussed in note 5 of the Company's audited consolidated financial statements for the year ended December 31, 2012.

As at June 30, 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 interim consolidated statement of financial position at fair value, with changes in the fair value being recognized as an unrealized gain or loss on the interim consolidated statement of income and comprehensive income.

The Company has entered into the following financial derivative contracts from December 31, 2012 to June 30, 2013:

(000s)

Type of Contract	Quantity	Time Period <sup>(1)</sup>	Contract Price	Fair Value
Financial Swap	200 bbls/d	April 2013 – March 2014 <sup>(2)</sup>	USD\$97.865/bbl average	134
Financial Swap	200 bbls/d	July 2013 – June 2014 <sup>(3)</sup>	USD\$98.00/bbl	341
Financial Swap	200 bbls/d	January – December 2014 <sup>(4)</sup>	USD\$94.50/bbl	219
Financial Swap	5,000 mmbtu/d	April 2013 – March 2014	USD\$4.12/mmbtu	568
Financial Costless Collar	900 bbls/d	January – December 2014	USD\$80.00/bbl floor USD\$97.74/bbl ceiling average	(22)

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

<sup>(2)</sup> The counter-party to these contracts holds options at March 31, 2014 to extend a swap on 100 bbls/d (per contract) of oil for one year at WTI USD\$100/bbl.

<sup>(3)</sup> The counter-party to this contract holds an option at December 31, 2014 to extend a swap on 200 bbls/d of oil for one year at WTI USD\$114.95/bbl.

<sup>(4)</sup> The counter-party to this contract holds an option at December 31, 2014 to extend a swap on 200 bbls/d of oil for one year at WTI USD\$100/bbl.

The following contracts were entered into subsequent to June 30, 2013 and are therefore not reflected in the consolidated statements of income and comprehensive income:

Type of Contract	Quantity	Time Period	Contract Price
Financial Costless Collar	200 bbls/d	January – December 2014	USD\$85.00/bbl floor USD\$96.80/bbl ceiling
Financial Swap	400 bbls/d	October – December 2013	USD\$97.55/bbl
Financial Swap	200 bbls/d	January – December 2014 <sup>(1)</sup>	USD\$95.15/bbl
Financial Swap	200 bbls/d	January – December 2014	USD\$94.75/bbl

<sup>(1)</sup> The counter-party to this contract holds an option at December 31, 2014 to extend a swap on 200 bbls/d of oil for one year at WTI USD\$100/bbl.

The Company has entered into two interest rate swap arrangements. The following table outlines the realized and unrealized losses on these interest rate contracts recorded on the consolidated statement of income and comprehensive income for the six months ended June 30, 2013:

(000s)

Term	Type (Floating to Fixed)	Amount	Company Fixed Interest Rate (%)	Counter Party Floating Rate Index	Six Months Ended June 30, 2013	
					Realized (Loss)	Unrealized Gain (Loss)
May 29, 2012- May 29, 2014	Swap	\$150,000	1.35%	Floating Rate	(95)	55
May 29, 2014- May 29, 2015	Swap	\$150,000	1.72%	Floating Rate	–	(57)

The following table provides a summary of the unrealized gains and losses on financial instruments for the three and six months ended June 30, 2013 and 2012:

(000s)	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Unrealized gain (loss) on financial instruments	\$ 3,321	\$ 7,343	\$ (498)	\$ 4,977
Unrealized (loss) on investments held for trading	–	(84)	–	(103)
Total	\$ 3,321	\$ 7,259	\$ (498)	\$ 4,874

As at June 30, 2013, if the future strip prices for oil were \$1.00/bbl higher and prices for natural gas were \$0.10/mcf higher, with all other variables held constant, an adjustment would have been recorded to unrealized gain (loss) on financial instruments resulting in a reduction to before-tax earnings of \$2.2 million (June 30, 2012 - \$0.6 million). An equal and opposite impact would have occurred to unrealized gain (loss) and the fair value of the derivative contracts liability if oil prices were \$1.00/bbl lower and gas prices were \$0.10/mcf lower.

Financial assets and liabilities are only offset if Tourmaline has the current legal right to offset and intends to settle on a net basis or settle the asset and liability simultaneously. Tourmaline offsets derivative contracts assets and liabilities when the counterparty, commodity, currency and timing of settlement are the same. The following table provides a summary of the Company's offsetting derivative contracts positions.

(000s)	June 30, 2013			December 31, 2012		
	Derivative Contracts			Derivative Contracts		
	Asset	Liability	Net	Asset	Liability	Net
Gross amount	\$ 7,889	\$ (5,585)	\$ 2,304	\$ 7,623	\$ (4,821)	\$ 2,802
Amount offset	(5,064)	5,064	–	(2,809)	2,809	–
Net amount	\$ 2,825	\$ (521)	\$ 2,304	\$ 4,814	\$ (2,012)	\$ 2,802

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 entered into the following physical contracts from December 31, 2012 to June 30, 2013:

Type of Contract	Quantity	Time Period <sup>(1)</sup>	Contract Price
AECO Fixed Price	20,000 gjs/d	April 2013 – March 2014 <sup>(2)</sup>	CAD\$3.31/gj average
AECO Fixed Price	25,000 gjs/d	April – October 2013 <sup>(3)</sup>	CAD\$3.72/gj average
AECO Fixed Price	10,000 gjs/d	April – October 2013	CAD\$3.36/gj
AECO Fixed Price	25,000 gjs/d	November 2013 – March 2014	CAD\$3.84/gj average
AECO Fixed Price	20,000 gjs/d	January – December 2014 <sup>(4)</sup>	CAD\$3.7394/gj
AECO Fixed Price	5,000 gjs/d	January – December 2014	CAD\$4.00/gj
AECO Fixed Price	5,000 gjs/d	January – December 2015	CAD\$4.00/gj
(Buyer) AECO/Nymex Differential Swap	30,000 mmbtu/d	April – October 2013	Nymex less USD\$0.42/mmbtu average
(Buyer) AECO/Nymex Differential Swap	10,000 mmbtu/d	January 2015 – December 2022	Nymex less USD\$0.445/mmbtu average
AECO Call Option	8,000 gjs/d	January – December 2016	CAD\$5.00/gj strike price

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

<sup>(2)</sup> The counter-party to these contracts holds options at March 31, 2014 to extend a swap on these contracts (one for 10,000 gjs/d and two for 5,000 gjs/d each) for one year at an average of CAD\$3.75/gj.

<sup>(3)</sup> The counter-party to these contracts hold options at October 31, 2013 to extend a swap on these contracts (two for 10,000 gjs/d and one for 5,000 gjs/d) for one year at an average of \$4.00/gj. Subsequently, the counter-party to these contracts holds another option at October 31, 2014 to extend a further swap on these contracts (two for 10,000 gjs/d and one for 5,000 gjs/d) at an average of \$4.00/gj.

<sup>(4)</sup> The counter-party to these contracts holds the option at December 31, 2013 to fix the average price of CAD\$3.7513/gjs on 10,000 gjs/d of this contract or allow the price to follow the month-ahead index.

The Company has entered into the following physical contracts subsequent to June 30, 2013:

Type of Contract	Quantity	Time Period <sup>(1)</sup>	Contract Price
AECO Fixed Price	20,000 gjs/d	April – October 2014	CAD\$3.41/gj average
AECO Fixed Price	20,000 gjs/d	August – October 2013	CAD\$3.10/gj
AECO Call Option	20,000 gjs/d	November 2013 – October 2014	CAD\$4.00/gj strike price
(Buyer) AECO/Nymex Differential Swap	10,000 mmbtu/d	November 2013 – March 2014	Nymex less USD\$0.47/mmbtu
(Buyer) AECO/Nymex Differential Swap	10,000 mmbtu/d	January – December 2014	Nymex less USD\$0.50/mmbtu
(Buyer) AECO/Nymex Differential Swap	5,000 mmbtu/d	January 2015 – December 2022	Nymex less USD\$0.4775/mmbtu
(Buyer) AECO/SoCal GDD Differential Swap	10,000 mmbtu/d	November 2013 – October 2016	SoCal GDD less USD\$0.725/mmbtu

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

## 4. EXPLORATION AND EVALUATION ASSETS

(000s)

As at December 31, 2012	\$	639,933
Capital expenditures		59,281
Transfers to property, plant and equipment (note 5)		(17,802)
Acquisitions		20,602
Divestitures		(1,411)
Expired mineral leases		(15,026)
As at June 30, 2013	\$	685,577

General and administrative expenditures for the six months ended June 30, 2013 of \$2.7 million (December 31, 2012 - \$5.2 million) have been capitalized and included as exploration and evaluation assets. Non-cash share-based payment expenses in the amount of \$2.5 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.

## 5. PROPERTY, PLANT AND EQUIPMENT

### Cost

(000s)

As at December 31, 2012	\$	3,305,685
Capital expenditures		339,967
Transfers from exploration and evaluation (note 4)		17,802
Change in decommissioning liabilities (note 6)		4,403
Acquisitions		17,641
Divestitures		(3,640)
As at June 30, 2013	\$	3,681,858

### Accumulated Depletion, Depreciation and Amortization

(000s)

As at December 31, 2012	\$	494,943
Depletion, depreciation and amortization expense (net of mineral lease expiries)		148,714
Divestitures		(972)
As at June 30, 2013	\$	642,685

### Net Book Value

(000s)

As at December 31, 2012	\$	2,810,742
As at June 30, 2013	\$	3,039,173

General and administrative expenditures for the six months ended June 30, 2013 of \$3.9 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 \$5.6 million (December 31, 2012 - \$9.1 million).

Future development costs for the six months ended June 30, 2013 of \$2,471 million (December 31, 2012 - \$2,233 million) were included in the depletion calculation.

## 6. 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 \$103.2 million (December 31, 2012 – \$92.7 million), with some abandonments expected to commence in 2021. A risk-free rate of 2.89% (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.

(000s)	<b>Six Months Ended</b>		Year Ended
	<b>June 30, 2013</b>		December 31, 2012
Balance, beginning of period	\$	64,757	\$ 50,463
Obligation incurred		3,483	5,685
Obligation incurred on corporate acquisitions		–	4,643
Obligation incurred on property acquisitions		3,542	4,235
Obligation divested		(6)	(319)
Obligation settled		(1,001)	(993)
Reclassification of obligation associated with assets held for sale		–	(285)
Accretion expense		879	1,328
Change in future estimated cash outlays		(2,622)	–
Balance, end of period	\$	69,032	\$ 64,757

## 7. BANK DEBT

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, 2012. In June 2013, the facility was increased, under the same terms and covenants, to \$750 million with an initial maturity of June 2016.

As at June 30, 2013, Tourmaline's bank debt balance was \$291.8 million (December 31, 2012 - \$360.6 million). In addition, Tourmaline has outstanding letters of credit of \$4.2 million (December 31, 2012 - \$4.4 million), which reduce the credit available on the facility. As at June 30, 2013, the Company is in compliance with all debt covenants.

## 8. 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)	Six Months Ended June 30, 2013		Year Ended December 31, 2012	
Balance, beginning of period	\$	16,298	\$	15,079
Share of subsidiary's net income for the period		645		1,219
Balance, end of period	\$	16,943	\$	16,298

## 9. 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 per-share amounts)	Six Months Ended June 30, 2013		Year Ended December 31, 2012	
	Number of Shares	Amount	Number of Shares	Amount
Balance, beginning of period	174,813,059	\$ 2,599,614	158,577,586	\$ 2,140,660
For cash on public offering of common shares <sup>(2)(4)</sup>	5,780,000	197,965	4,639,000	134,531
For cash on public offering of flow-through common shares <sup>(1)(3)(4)</sup>	835,000	28,599	2,452,000	62,685
Issued on corporate acquisitions	–	–	7,401,682	244,404
For cash on exercise of stock options	2,746,744	33,511	1,742,791	17,712
Contributed surplus on exercise of stock options	–	12,740	–	6,745
Share issue costs	–	(9,566)	–	(9,497)
Tax effect of share issue costs	–	2,391	–	2,374
Balance, end of period	184,174,803	\$ 2,865,254	174,813,059	\$ 2,599,614

<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 June 30, 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 0.05 million shares were purchased by insiders. As at June 30, 2013, the Company had spent \$19.5 million on eligible expenditures and is committed to spend the remainder of \$19.2 million on qualified exploration and development expenditures by December 31, 2013. 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 and 85,000 flow-through common shares were purchased by insiders. As at June 30, 2013, the Company had not incurred any eligible expenditures and is committed to spend the entire \$35.2 million on qualified exploration and development expenditures by December 31, 2014. The expenditures will be renounced to investors with an effective renunciation date of December 31, 2013.

## 10. EARNINGS PER SHARE

Basic earnings-per-share was calculated as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Net earnings for the period (000s)	\$ 30,004	\$ 1,012	\$ 82,188	\$ 3,988
Weighted average number of common shares - basic	183,942,946	160,236,254	180,480,753	159,426,316
Earnings-per-share – basic	\$ 0.16	\$ 0.01	\$ 0.46	\$ 0.03

Diluted earnings-per-share was calculated as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Net earnings for the period (000s)	\$ 30,004	\$ 1,012	\$ 82,188	\$ 3,988
Weighted average number of common shares – diluted	189,201,205	164,627,751	185,301,611	163,921,951
Earnings-per-share – fully diluted	\$ 0.16	\$ 0.01	\$ 0.44	\$ 0.02

There were 4,032,000 options excluded from the weighted-average share calculation for the six months ended June 30, 2013 because they were anti-dilutive (June 30, 2012 – 4,673,024).

## 11. 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 18,417,480 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.

	Six Months Ended June 30,			
	2013		2012	
	Number of Options	Weighted Average Exercise Price	Number of Options	Weighted Average Exercise Price
Stock options outstanding, beginning of period	15,325,232	\$ 19.87	14,213,523	\$ 16.82
Granted	2,105,000	40.19	905,000	23.13
Exercised	(2,746,744)	12.19	(479,701)	8.83
Forfeited	(56,111)	24.95	–	–
Stock options outstanding, end of period	14,627,377	\$ 24.19	14,638,822	\$ 17.47



The following table summarizes stock options outstanding and exercisable at June 30, 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	2,052,349	0.74	\$ 8.99	2,052,349	\$ 8.99
\$12.00 - \$18.35	4,069,290	1.78	16.55	3,381,401	16.18
\$20.68 - \$29.93	3,940,072	3.39	26.80	1,547,910	26.96
\$30.76 - \$41.89	4,565,666	4.45	35.60	138,999	30.92
	14,627,377	2.90	\$ 24.19	7,120,659	\$ 16.74

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:

	June 30, 2013	June 30, 2012
Fair value of options granted (weighted average)	\$ 13.94	\$ 7.95
Risk-free interest rate	2.57%	2.37%
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

## 12.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	\$ 2,365	\$ 7,928	\$ 10,166	\$ 8,635	\$ 29,094
Flow-through obligations	19,189	35,195	–	–	54,384
Firm transportation and processing agreements	38,369	83,701	83,720	242,316	448,106
Bank debt <sup>(1)</sup>	–	320,447	–	–	320,447
	\$ 59,923	\$ 447,271	\$ 93,886	\$ 250,951	\$ 852,031

<sup>(1)</sup> Includes interest expense at an annual rate of 2.88% being the rate applicable to outstanding bank debt at June 30, 2013.