Yangarra Resources Ltd.

Condensed Consolidated Financial Statements

March 31, 2014 and 2013

Yangarra Resources Ltd.
Condensed Consolidated Statements of Financial Position
As at:
(unaudited)

		March 31, 2014		December 31, 2013
Assets				
Current				
Accounts receivable	$	**16,446,307**	$	8,846,547
Prepaid expenses and deposits		**1,507,851**		1,493,124
Total current assets		**17,954,158**		10,339,671
Non-current				
Property and equipment *(note 3)*		**171,336,343**		152,971,016
Exploration and evaluation assets *(note 4)*		**6,487,334**		6,487,334
Total assets	$	**195,777,835**	$	169,798,021
Liabilities				
Current				
Bank debt *(note 5)*	$	**43,659,056**	$	32,112,455
Accounts payable and accrued liabilities		**22,327,047**		15,021,459
Subordinated debt *(note 5)*		**7,790,145**		–
Commodity contract *(note 12c iii)*		**5,913,290**		3,169,630
Interest rate contract		**26,278**		
Flow-through share premium liability		**790,212**		814,275
Total current liabilities		**80,506,028**		51,117,819
Non-current				
Subordinated debt *(note 5)*		–		7,786,632
Other long-term liabilities		**749,049**		758,248
Commodity contract *(note 12c iii)*		**3,020,308**		1,360,866
Interest rate contract		**261,128**		43,236
Decommissioning liability *(note 6)*		**6,059,051**		5,497,222
Deferred tax liability		**8,157,092**		7,650,411
Total liabilities		**98,752,656**		74,214,434
Shareholders' Equity				
Share capital *(note 7)*		**107,888,152**		107,590,652
Warrants		**241,826**		241,826
Contributed surplus		**10,453,412**		10,028,770
Deficit		**(21,558,211)**		(22,277,661)
Total shareholders’ equity		**97,025,179**		95,583,587
Total liabilities and shareholders’ equity	$	**195,777,835**	$	169,798,021

Contingency (note 15), Commitments (note 16), Subsequent Event (Note 17)

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

	2014	2013
Revenue		
Petroleum and natural gas sales	$ **15,694,979**	$ 6,518,381
Royalty income	**313,417**	369,338
Royalties	**(937,556)**	(261,092)
	15,070,840	6,626,627
Commodity price risk contracts *(note 12c iii)*		
Commodity contract settlement	**(1,723,339)**	430,418
Change in fair value of commodity contracts	**(4,403,102)**	(2,185,484)
	8,944,399	4,871,561
Expenses		
Production	**1,633,931**	1,309,798
Transportation	**333,211**	155,673
General and administrative	**326,679**	412,850
Finance *(note 14)*	**879,224**	417,861
Share-based compensation *(note 8)*	**410,000**	–
Depletion, depreciation and impairment *(note 3)*	**4,159,286**	2,968,665
	7,742,331	5,264,847
Income before tax	**1,202,068**	(393,286)
Deferred tax	**482,618**	(133,862)
Net income (loss) and total comprehensive income (loss)	$ **719,450**	$ (259,424)
Income (loss) per share *(note 9)*		
Basic & Diluted	$ **0.01**	$ 0.00
Weighted average number of shares *(note 9)*		
Basic	**147,410,341**	121,711,723
Diluted	**150,325,177**	121,711,723

	2014	2013
Share Capital		
Balance, beginning of period	$ **107,590,652**	$ 94,717,629
Exercise of options	**297,500**	–
Balance, end of period	**107,888,152**	94,717,629
Warrants		
Balance, beginning of period	**241,826**	241,826
Balance, end of period	**241,826**	241,826
Contributed Surplus		
Balance, beginning of period	**10,028,770**	9,593,670
Share-based compensation related to:		
Options granted in current period	**424,642**	–
Balance, end of period	**10,453,412**	9,593,670
Deficit		
Balance, beginning of period	**(22,277,661)**	(24,863,360)
Net income (loss)	**719,450**	(259,424)
Balance, end of period	**(21,558,211)**	(25,122,784)
Total Equity	$ **97,025,179**	$ 79,430,341

	2014	2013
Operating		
Net income (loss) for the period	$ **719,450**	$ (259,424)
Add back non-cash items:		
Change in fair value of commodity contracts	**4,403,102**	2,185,484
Change in fair value of interest rate contracts	**244,170**	–
Share-based compensation *(note 8)*	**410,000**	–
Depletion, depreciation and impairment *(note 3)*	**4,159,286**	2,968,665
Accretion expense *(note 6)*	**41,066**	53,320
Deferred tax	**482,618**	(133,862)
	10,459,692	4,814,183
Change in non-cash working capital *(note 10)*	**(4,450,913)**	(361,304)
Net cash from operating activities	**6,008,779**	4,452,879
Financing		
Issue of equity instruments, net of costs	**297,500**	–
Bank debt advance *(note 5)*	**11,546,601**	8,617,071
Subordinated debt advance *(note 5)*	**3,513**	–
Other long-term liabilities repayment	**(9,199)**	(8,828)
Change in non-cash working capital *(note 10)*	–	–
Net cash from financing activities	**11,838,415**	8,608,243
Investing		
Expenditures on property and equipment	**(21,989,208)**	(10,799,492)
Expenditures on exploration and evaluation assets	–	–
Change in non-cash working capital *(note 10)*	**4,142,014**	(2,261,630)
Net cash used in investing activities	**(17,847,194)**	(13,061,122)
Change in cash and cash equivalents	–	–
Cash, beginning of the period	–	–
Cash, end of the period	$ –	$ –
Supplemental cash flow information		
Interest paid	$ **635,067**	$ 552,328

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

1. Basis of preparation, adoption of IFRS and statement of compliance

Yangarra Resources Ltd. (the "Company") is a publicly traded company involved in the production, exploration and development of resource properties in Western Canada. The address of the registered office is 1530, 715 – 5 Avenue SW, Calgary Alberta, T2P 2X6.

These condensed consolidated interim financial statements include the accounts of the Company and its wholly owned subsidiary, Yangarra Resources Corp. ("YRC"), after the elimination of intercompany transactions and balances.

Statement of compliance and authorization

These condensed consolidated financial statements, including comparatives, have been prepared in accordance with International Accounting Standard 34 "Interim Financial Reporting" and using the accounting policies outlined by the Company in its annual consolidated financial statements for the year ended December 31, 2013, except as identified below. These condensed consolidated financial statements do not include all of the information required for full annual financial statements.

The consolidated financial statements were authorized for issue by the Board of Directors on May 13, 2014.

2. New Accounting Standards

On January 1, 2014 the Company adopted the following new standards:

The IASB issued International Financial Reporting Interpretations Committee Interpretation ("IFRIC") 21, "Levies". The IFRIC clarifies that an entity should recognize a liability for a levy when the activity that triggers payment occurs. The adoption of this interpretation had no significant impact on the Company's consolidated financial statements.

IAS 32, "Financial Instruments: Presentation", which clarifies the requirements for offsetting financial assets and liabilities. The amendments clarify when an entity has a legally enforceable right to offset and certain other requirements that are necessary to present a net financial asset or liability. There was no impact to the Company on adoption of this standard.

3. Property and equipment

	Oil and Natural Gas Interests	*Well and plant equipment*	*Other Assets*	*Total*
Cost or Deemed Cost				
Balance at December 31, 2012	125,550,753	28,004,352	1,299,471	154,854,576
Cash Additions	36,646,975	7,595,294	318,233	44,560,502
Transfers	–	463,100	–	463,100
Capitalized share based compensation	145,497	–	–	145,497
Decommissioning liability	51,342	–	–	51,342
Balance at December 31, 2013	162,394,567	36,062,746	1,617,704	200,075,017
Cash Additions	**19,666,099**	**2,324,948**	**(1,839)**	**21,989,208**
Capitalized share based compensation	**14,642**	–	–	**14,642**
Decommissioning liability	**520,763**	–	–	**520,763**
Balance at March 31, 2014	**182,596,071**	**38,387,694**	**1,615,865**	**222,599,630**

3. Property and equipment (continued)

Depletion, depreciation and impairment

Balance at December 31, 2012	29,432,771	3,198,400	381,027	33,012,198
Depletion and depreciation	12,189,400	1,663,000	239,403	14,091,803
Balance at December 31, 2013	$ 41,622,171	$ 4,861,400	$ 620,430	$ 47,104,001
Depletion and depreciation	**3,662,000**	**446,300**	**50,986**	**4,159,286**
Balance at March 31, 2014	**$ 45,284,171**	**$ 5,307,700**	**$ 671,416**	**$ 51,263,287**

At December 31, 2013	$ 120,772,396	$ 31,201,346	$ 997,274	$ 152,971,016
At March 31, 2014	**$ 137,311,900**	**$ 33,079,994**	**$ 944,449**	**$ 171,336,343**

The depletion, depreciation and impairment of property and equipment, and any eventual reversal thereof, are recognized in depletion and depreciation in the statement of income and comprehensive income. At March 31, 2014 all of the Company's properties are pledged as security for the bank loans.

During the three months ended March 31, 2013, the Company capitalized $520,763 (2013 – $51,342) related to the decommissioning liability of property and equipment and $14,642 (2013 – $178,772) of share-based compensation. The Company also capitalized $272,924 (2013 - $929,708) of recoveries related to the Company's working interest in operated capital expenditure programs on which overhead has been charged in accordance with standard industry operating agreements.

4. Exploration and evaluation assets

Cost or Deemed Cost	
Balance at December 31, 2012	8,391,115
Additions	2,461,506
Balance at December 31, 2013	$ 10,852,621
Additions	–
Balance at March 31, 2014	**$ 10,852,621**
Depletion, depreciation and impairment losses	
Balance at December 31 2013 and March 31, 2014	$ **4,365,287**
Net book value	
At December 31, 2013 and March 31, 2014	**$ 6,487,334**

Exploration and evaluation ("E&E") assets consist of the Company's undeveloped land which are pending the determination of proven or probable reserves. Additions represent the Company's share of costs incurred on E&E assets during the period.

5. Bank debt and Subordinated Debt

As at March 31, 2014, the $43,659,054 (December 31, 2013 – $32,112,455) reported amount of bank debt with Alberta Treasury Branches ("ATB") was comprised of $6,550,000 (December 31, 2013 – $9,850,000) drawn on the revolving operating demand loan, $29,929,735 (December 31, 2013 – $19,963,177) of guaranteed notes and $7,179,319 (December 31, 2013 – $2,299,280) of outstanding cheques. The Company is subject to a financial covenant requiring an adjusted working capital ratio above 1 : 1 (current assets plus the undrawn availability under the revolving facility plus the undrawn availability under the subordinated term loan, divided by the current liabilities less the drawn portion of the revolving facility and the subordinated term loan, excluding unrealized commodity contracts and flow-through share premium liability). The facility is secured by a general security agreement.

As at March 31, 2014, the maximum amount available under the revolving operating demand loan was $45,000,000 (December 31, 2013 – $45,000,000) at an interest rate of bank prime plus 1.5% per annum on the operating demand loan, payable monthly, or a credit spread of 2.5% on guaranteed notes. The next scheduled review is May 31, 2014. A decrease in the borrowing base could result in a reduction to the credit facility, which may require repayment to the lenders. During the year, the weighted average effective interest rate for the bank debt was approximately 4.8% (2013 – 4.9%).

As at March 31, 2014 $7,800,000 was drawn on the $20,000,000 subordinated term loan facility with Alberta Treasury Branches ("ATB"). The subordinated term loan has a two year committed term (subject to an extension for an additional year upon mutual consent). There were two remaining tranches ($6,420,000 to be drawn on or before May 31, 2014 and $5,780,000 to be drawn on or before July 31, 2014) at an interest rate of bank prime plus 7.0% per annum, payable monthly, or a credit spread of 8.0% on guaranteed notes. Full payment of the principal is due on September 3, 2015.

The Company is subject to financial covenants on the subordinated term facility requiring an adjusted working capital ratio greater than 1 : 1 (calculation consistent with the calculation disclosed above) and a Debt to EBITDA ratio below 4 : 1 (debt is defined as all obligations, liabilities and indebtedness on the balance sheet and EBITDA is defined as earnings plus interest expense and other financing costs, depletion and depreciation and income taxes). In addition the Company is required to comply with a PV10 proved developed producing to debt ratio of not less than 0.92 : 1 on specified dates and a PV10 total proved to debt ratio of not less than 1.5 : 1 on specified dates. This facility is secured with a pledge of a general demand debenture and a general security agreement. During the quarter, the weighted average effective interest rate for the subordinated debt was approximately 9.22% (2013 – nil).

Subsequent to March 31, 2014, the Company entered into an amended and restated credit facility agreement which increases its operating demand loan to $70 million from the existing $45 million. Also subsequent to March 31, 2014, the Company entered into an amended and restated subordinated facility agreement resulting in the $20 million subordinated debt facility with ATB remaining in place. The $7.8 million previously drawn on the subordinated debt will be repaid with the increased operating demand loan. As a result, the subordinated term facility was classified as a current liability as at March 31, 2014.

The Company is in compliance with all covenants as at March 31, 2014.

6. Decommissioning liability

The following table presents the reconciliation of the carrying amount of the liability associated with the decommissioning of the Company's property and equipment:

		March 31, 2014		*December 31, 2013*
Balance, beginning of period	$	**5,497,222**	$	5,297,166
Liabilities incurred		**323,995**		871,164
Liabilities disposed		–		(31,275)
Effect of change in discount rate		**196,768**		(788,547)
Accretion		**41,066**		148,714
Balance, end of period	$	**6,059,051**	$	5,497,222

The following significant assumptions were used to estimate the decommissioning liability:

		March 31, 2014		*December 31, 2013*
Undiscounted cash flows	$	**8,689,186**	$	8,745,195
Discount rate		**2.03% - 2.96%**		1.80% - 3.24%
Inflation rate		**2%**		2%
Weighted average expected timing of cash flows		**15 years**		15 years

7. Share capital

a. Authorized

Unlimited number of common shares, without nominal or par value
Unlimited number of preferred shares, without nominal or par value

b. Common shares issued

	Number of shares		*Amount*
Balance, December 31, 2012	121,711,723	$	94,717,629
Equity financing	13,855,370		7,481,900
CDE Flow-through financing	3,394,915		2,003,000
CDE Flow-through premium liability			(170,000)
CEE Flow-through financing	7,755,000		5,001,975
CEE Flow-through premium liability	–		(814,275)
Share issue costs (net of $264,026 in tax)	–		(792,077)
Exercise of options	400,000		162,500
Balance, December 31, 2013	147,117,008	$	107,590,652
Exercise of options *(i)*	**825,000**		**297,500**
Balance, March 31, 2014	**147,942,008**	**$**	**107,888,152**

i) In 2014, The Company issued 825,000 common shares on the exercise of options at an average of $0.36 per share for cash proceeds of $297,500.

8. Share-based payments

The Company has an equity settled stock option plan under which the Board of Directors may grant options to directors, officers, other employees and key consultants. The purpose of the plan is to advance the interests of the Company by encouraging these individuals to acquire shares in the Company and thereby remain associated with, and seek to maximize the value of, the Company. Under the plan, the number of shares reserved for issuance pursuant to the exercise of all options under the plan may not exceed 10% of the issued and outstanding common shares on a non-diluted basis at any time. The options expire not more than five years from the date of grant, or earlier if the individual ceases to be associated with the Company, and vest over terms determined at the time of grant.

During the three months ended March 31, 2014, the Company granted options to purchase 3,675,000 common shares, (1,000,000 of the options vested immediately and 2,675,000 of the options will vest equally over three years with the first tranche vesting one year after the grant date). The fair value of the options was estimated at $1,575,500 ($0.43 per option) using the Black-Scholes pricing model.

The following tables summarize information about stock options outstanding as at:

	March 31, 2014		*December 31, 2013*	
	Options	***Weighted – average exercise price***	*Options*	*Weighted – average exercise price*
Opening	**10,635,000**	**$0.53**	11,840,000	$0.59
Granted	**3,675,000**	**0.83**	2,540,000	0.32
Exercised	**(825,000)**	**0.36**	(400,000)	0.41
Forfeited	**–**	**–**	(2,965,000)	0.49
Expired	**–**	**–**	(380,000)	0.50
Closing	**13,485,000**	**$0.62**	10,635,000	$0.53

The following provides a summary of the stock option plan as at March 31, 2014:

Range of exercise price	*Number outstanding*	*Weighted-average remaining contractual life (years)*	*Weighted-average exercise price*	*Number exercisable*
$ 0.25 – $ 0.50	4,765,000	3.06	$ 0.38	4,765,000
$ 0.51 – $ 0.75	4,550,000	2.08	0.65	4,050,000
$ 0.76 – $ 1.00	4,170,000	4.18	0.86	1,995,000
	13,485,000	3.08	$ 0.62	10,810,000

8. Share-based payments (continued)

The Black-Scholes pricing model was used to estimate the fair value of options granted issued based on the following significant assumptions:

	2014	*2013*
Weighted average exercise price per option	**$0.83**	$0.32
Risk-free interest rate	**1.61% - 1.71%**	1.24% - 1.86%
Expected volatility	**63%**	64% - 65%
Expected life	**5 years**	5 years
Forfeiture rate	**5%**	0%
Weighted average fair value per option	**$0.43**	$0.31

9. Net (loss) income per common share

Basic earnings per share was calculated as follows:

	Three months ended March 31, 2014	Three months ended March 31, 2013
Net (loss) income for the period	$ **719,450**	$ (259,424)
Weighted average number of shares (basic)		
Issued common shares at beginning of period	**147,117,008**	121,711,723
Stock options exercised	**293,333**	–
Weighted average number of common shares - basic	**147,410,341**	121,711,723

Diluted earnings per share was calculated as follows:

Weighted average number of shares (basic)	**147,410,341**	121,711,723
Effect of outstanding options	**2,509,122**	–
Effect of outstanding warrants	**405,714**	–
Weighted average number of common shares - diluted	**150,325,177**	121,711,723

The average market value of the Company's shares for purposes of calculating the dilutive effect of share options was based on quoted market prices for the period that the options were outstanding. Excluded from diluted earnings per share is the effect of 2,717,500 options (2013 – 6,740,000 options) and nil warrants (2013 – 1,420,000) as they are out of the money.

10. Change in non-cash working capital

		2014		2013
Accounts receivable	$	**(7,599,760)**	$	(4,340,897)
Prepaid expenses and deposits		**(14,727)**		415,721
Accounts payable and accrued liabilities		**7,305,588**		1,302,242
	$	**(308,899)**	$	(2,622,934)

The changes in non-cash working capital has been allocated to the following activities:				
Operating	$	**(4,450,913)**	$	(361,304)
Financing		–		–
Investing		**4,142,014**		(2,261,630)
	$	**(308,899)**	$	(2,622,934)

11. Related party disclosure

The consolidated financial statements include the financial statements of the Company and the subsidiary listed below:

Name	*Country of Incorporation*	*% equity interest 2014*	*2013*
Yangarra Resources Corp.	Canada	100%	100%

Balances between the Company and its subsidiary have been eliminated on consolidation and are not disclosed in this note. Details of transactions between the Company and other related parties are disclosed below.

During the three months ended March 31, 2014 and 2013, the Company was charged or invoiced the following amounts by certain of its officers and directors and by companies controlled by certain of the Company's officers and directors:

	Three Months Ended March 31,			
		2014		2013
Administration and consulting fees	$	**99,000**	$	50,602
Production and capital expenditures		**6,250**		87,286
	$	**105,250**	$	137,888

Included in accounts payable and accrued liabilities at March 31, 2014 is $8,472 (December 31, 2013 – $7,727) relating to the above transactions. These transactions were in the normal course of operations and were measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

Other long-term liabilities include a mortgage for $319,346 (December 31, 2013 - $328,545) held in the name of an officer of the Company for a property that is used as a field office. The Company is the beneficial owner through a trust agreement of the property against which the mortgage is secured. All mortgage payments are made by the Company.

12. Financial instruments and financial risk management

The Company's financial instruments include accounts receivable, bank debt, subordinated debt, accounts payable and accrued liabilities, other long term liabilities, interest rate contracts and commodity contracts. The carrying values of accounts receivable, accounts payable and accrued liabilities, other long term liabilities and bank debt approximate their fair values due to their relatively short periods to maturity. The fair value of the subordinated debt is approximately equal to the carrying value as the debt is subject to a floating interest rate.

The Company is required to classify fair value measurements using a hierarchy that reflects the significance of the inputs used in making the measurements. The fair value hierarchy is as follows:

- Level 1 - quoted prices in active markets for identical assets or liabilities;
- Level 2 - inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly; and
- Level 3 - inputs for the asset or liability that are not based on observable market data.

The fair value of the interest rate contracts and the commodity contracts is classified at level 2. The fair value is calculated using the forward price curves as at March 31, 2014.

The Company's risk management policies are established to identify and analyze the risks faced by the Company, to set appropriate risk limits and controls, and to monitor risks and adherence to market conditions and the Company's activities. The Company has exposure to credit risk, liquidity risk and market risk as a result of its use of financial instruments. This note presents information about the Company's exposure to each of the above risks and the Company's objectives, policies and processes for measuring and managing these risks. Further quantitative disclosures are included throughout these financial statements. 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 the risk management policies as set out herein:

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. A substantial portion of the Company's accounts receivable are with natural gas and liquids marketers and joint venture partners in the oil and gas industry and are subject to normal industry credit risks.

Purchasers of the Company's natural gas and liquids are subject to credit review to minimize the risk of non-payment. As at March 31, 2014, the maximum credit exposure is the carrying amount of the accounts receivable of $16,446,307 (December 31, 2013 – $8,846,547).

The maximum exposure to credit risk for receivables at the reporting date by type of customer was:

Oil and natural gas marketers	$	5,164,739
Joint venture partners		2,691,529
Other		8,590,039
	$	16,446,307

12. Financial instruments and financial risk management (continued)

Receivables from petroleum and natural gas marketers are typically collected on the 25th day of the month following production. The Company's policy to mitigate credit risk associated with these balances is to establish marketing relationships with large purchasers. The Company historically has not experienced any significant collection issues with its petroleum and natural gas marketers. All of the revenue accruals and receivables from petroleum and natural gas marketers were received in April 2014.

Joint venture receivables are typically collected within one to three months of the joint venture bill being issued to the partner. The Company mitigates the risk from joint venture receivables by obtaining partner approval of capital expenditures prior to starting a project. However, the receivables are from participants in the petroleum and natural gas sector, and collection is dependent on typical industry factors such as commodity price fluctuations, escalating costs and the risk of unsuccessful drilling. Further risk exists with joint venture partners as disagreements occasionally arise which increases the potential for non-collection. For properties that are operated by the Company, production can be withheld from joint venture partners who are in default of amounts owing. In addition, the Company often has offsetting amounts payable to joint venture partners from which it can net receivable balances.

The Company did not provide for any doubtful accounts nor was it required to write-off any accounts receivable during the three months ended March 31, 2014.

As at March 31, 2014, the Company considers its receivables to be aged as follows:

Not past due	$	10,416,110
Past due by less than 90 days		595,316
Past due by more than 90 days		5,434,881
	$	16,446,307

b. Liquidity risk

Liquidity risk is the risk that the Company will incur difficulties meeting its financial obligations as they are due. The Company's approach to managing liquidity is to ensure, as far as possible, 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. The Company prepares annual capital expenditure budgets, which are regularly monitored and updated as considered necessary. The Company uses authorizations for expenditures on both operated and non-operated projects to further manage capital expenditures.

To facilitate the capital expenditure program, the Company has a credit facility agreement which is regularly reviewed by the lender. The Company monitors its total debt position monthly. The Company also attempts to match its payment cycle with collection of petroleum and natural gas revenues on the 25th of each month. The Company anticipates it will have adequate liquidity to fund its financial liabilities through its future cash flows. The Company's financial liabilities are comprised of accounts payable and accrued liabilities, commodity contracts, interest rate contracts, bank debt and subordinated debt, which are classified as current or non-current on the balance based on their maturity dates.

Yangarra intends to fund the 2014 budget (which includes the $4.9 million of CEE commitments) with cash flow from operations and the increased availability on the revolving operating demand loan, the subordinated term loan and the recently announced equity financing.

12. Financial instruments and financial risk management (continued)

As at March 31, 2014	Carrying Amount	Contractual Cash Flows	Less than 1 year	1-2 Years	2-5 Years	More than 5 years
A/P and accrued liabilities	22,327,047	22,327,047	22,327,047	–	–	–
Bank debt [(1)]	43,659,054	43,659,054	43,659,054	–	–	–
Subordinated debt [(2)]	7,790,145	7,790,145	7,790,145	–	–	–
Other long-term liabilities	749,049	749,049	37,760	471,732	128,253	111,304
Commodity contracts	8,933,598	8,933,598	5,913,290	3,020,308	–	–
Interest rate contract	287,406	287,406	26,278	71,851	189,277	–
Estimated interest payments [(1)]	–	1,346,253	1,046,603	299,650	–	–
	83,746,299	85,092,552	80,800,177	3,863,541	317,530	111,304

(1) Assumes the revolving credit facility was not renewed May 2014

c. Market risk

Market risk consists of interest rate risk, currency risk and commodity price risk. The objective of market risk management is to manage and control market risk exposures within acceptable limits, while maximizing returns. The Company may use both financial derivatives and physical delivery sales contracts to manage market risks. All such transactions are conducted in accordance with a risk management policy as set out herein:

i. Interest rate risk

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 fluctuations on its bank debt and subordinated debt which bears interest at a floating rate and to mitigate this risk, the Company has entered into interest rate contracts. For the three months ended March 31, 2014, if interest rates had been 1% lower with all other variables held constant, income for the period would have been $588,851 (March 31, 2013 - $421,205) higher, due to lower interest expense. An equal and opposite impact would have occurred had interest rates been higher by the same amount.

The Company had the following interest rate contracts in place at March 31, 2014:

Contracts		**Fair Value**
Pay a floating rate to receive a 2.35% (plus a 2.50% credit spread) fixed rate on $10 million (June 2014-June 2018)	$	(175,683)
Pay a floating rate to receive a 2.15% (plus a 2.50% credit spread) fixed rate on $10 million (May 2014-May 2018)	$	(111,723)
	$	**(287,406)**

12. Financial instruments and financial risk management (continued)

ii. Currency risk

Foreign currency exchange rate risk is the risk that the fair value or future cash flows will fluctuate as a result of changes in foreign exchange rates. All of the Company's petroleum and natural gas sales are denominated in Canadian dollars, however, the underlying market prices in Canada for petroleum and natural gas are impacted by changes in the exchange rate between the Canadian and United States dollar. The Company had no outstanding forward exchange rate contracts in place at March 31, 2014.

iii. Commodity price risk

Commodity price risk is the risk that the fair value or future cash flows will fluctuate as a result of changes in commodity prices. Commodity prices for petroleum and natural gas are impacted by world economic events that dictate the levels of supply and demand as well as the relationship between the Canadian and United States dollar, as outlined above.

As at March 31, 2014, the Company was committed to the following commodity price risk contracts:

Contracts		Fair Value
<u>2014 Oil</u>		
100 bbl/d from January 1 to December 31, 2014 at a fixed price of $98.30 CAD/bbl	$	(318,770)
100 bbl/d from January 1 to December 31, 2014 at a fixed price of $100.00 CAD/bbl	$	(267,017)
100 bbl/d from January 1 to December 31, 2014 at a fixed price of $91.40 CAD/bbl	$	(528,824)
100 bbl/d from January 1 to December 31, 2014 at a fixed price of $91.35 CAD/bbl	$	(530,346)
200 bbl/d from January 1 to December 31, 2014 at a fixed price of $92.00 USD/bbl	$	(406,951)
100 bbl/d from January 1 to December 31, 2014 at a fixed price of $90.00 USD/bbl	$	(271,058)
200 bbl/d from January 1 to December 31, 2014 at a fixed price of $93.52 CAD/bbl	$	(928,571)
100 bbl/d from January 1 to December 31, 2014 at a fixed price of $98.20 CAD/bbl	$	(321,814)
100 bbl/d from January 1 to June 30, 2014 at a fixed price of $100.00 CAD/bbl	$	(276,360)
Sold Swaption on 100 bbl/d @ $100.00 WTI/CAD for July – December 2014	$	(312,475)
<u>2015 Oil</u>		
100 bbl/d from January 1 to December 31, 2015 at a fixed price of $86.05 USD/bbl	$	(153,100)
100 bbl/d from January 1 to December 31, 2015 at a fixed price of $91.20 CDN/bbl	$	(330,915)
200 bbl/d from January 1 to December 31, 2015 at a fixed price of $90.37 CDN/bbl	$	(721,384)
200 bbl/d from January 1 to December 31, 2015 at a fixed price of $90.10 CDN/bbl	$	(740,757)
100 bbl/d from January 1 to December 31, 2015 at a fixed price of $92.25 CDN/bbl	$	(293,245)
200 bbl/d from January 1 to December 31, 2015 at a fixed price of $92.45 CDN/bbl	$	(572,141)
<u>2016 Oil</u>		
Sold Swaption on 200 bbl/d @ $95.00 WTI/USD for January – December 2016	$	(208,766)

12. Financial instruments and financial risk management (continued)

2014 AECO		
1,000 GJ/d at $3.11/GJ for Jan – Dec 2014	$	(442,515)
1,000 GJ/d at $3.05/GJ for Jan – Dec 2014	$	(460,780)
1,000 GJ/d at $3.54/GJ for Jan – Dec 2014	$	(311,611)
1,000 GJ/d at $3.54/GJ for Jan – Dec 2014	$	(311,611)
1,000 GJ/d at $3.73/GJ for Jan – Dec 2014	$	(253,770)
2014 Propane		
100 bbl/d @ $45.99 WTI/CAD for Apr – Sep 2014	$	29,183
Total	**$**	**(8,933,598)**

The following table summarizes the fair value and the change in fair value for three months ended March 31, 2014:

		2014		2013
Commodity contract (liability) asset, beginning of period	**$**	**(4,530,496)**	$	2,398,111
Unrealized change in fair value		**(4,403,102)**		(2,185,484)
Commodity contract (liability) asset, end of period	**$**	**(8,933,598)**	$	212,627

The following table summarizes the sensitivity of the fair value of the Company's derivative positions as at March 31, 2014 to fluctuations in commodity prices, with all other variables held constant. When assessing the potential impact of these commodity price changes, the Company believes 10 percent volatility is a reasonable measure ($0.47/mcf for natural gas and $11/bbl for oil). Fluctuations in commodity prices potentially could have resulted in unrealized gains (losses) impacting income before tax as follows:

	Impact on Income Before Tax	
	Increase 10%	Decrease 10%
Crude oil	(6,917,202)	6,917,202
Natural Gas	(649,000)	649,000

13. Capital disclosures

The Company's objective when managing capital is to maintain a flexible capital structure which will allow it to execute its capital expenditure program, which includes expenditures in oil and gas activities which may or may not be successful. Therefore, the Company monitors the level of risk incurred in its capital expenditures to balance the proportion of debt and equity in its capital structure.

The Company considers its capital structure to include shareholders equity and debt:

	March 31, 2014	*December 31, 2013*
Shareholders' equity	$ 97,025,179	$ 95,583,587
Bank debt	$ 43,659,056	$ 32,112,455
Subordinated debt	$ 7,790,145	$ 7,786,632

The Company monitors capital based on annual cash from operations before changes in non-cash working capital and capital expenditure budgets, which are updated as necessary and are reviewed and periodically approved by the Board of Directors.

The Company manages its capital structure and makes adjustments by continually monitoring its business conditions including the current economic conditions, the risk characteristics of the Company's petroleum and natural gas assets, the depth of its investment opportunities, current and forecasted net debt levels, current and forecasted commodity prices and other facts that influence commodity prices and funds from operations such as quality and basis differentials, royalties, operating costs and transportation costs.

In order to maintain or adjust the capital structure, the Company considers its forecasted cash from operations before changes in non-cash working capital while attempting to finance an acceptable capital expenditure program including acquisition opportunities, the current level of bank credit available from the Company's lender, the level of bank credit that may be attainable from its lender as a result of petroleum and natural gas reserve growth, the availability of other sources of debt with different characteristics than existing debt, the sale of assets, limiting the size of the capital expenditure program and the issue of new equity if available on favorable terms. At March 31, 2014, the Company's capital structure was not subject to external restrictions. No changes have been made to the capital policy since 2013.

14. Finance Expenses

During the three months ended March 31, 2014 and 2013, the following items were included in the finance expense on the Condensed Consolidated Interim Statements of Income (loss) and Comprehensive Income (loss):

	Three months ended March 31,	
	2013	2013
Interest	$ **593,988**	$ 364,541
Change in fair value of interest rate contracts	**244,170**	–
Accretion	**41,066**	53,320
	$ **879,224**	$ 417,861

15. Contingency

In December 2009, the Company terminated the Standstill Agreement that it had with an industry partner regarding a joint producing property and served that industry partner with a Statement of Claim issued from The Court of Queen's Bench of Alberta, by which the Company claims breach of the agreements between the parties, gross negligence and default of the operator. The Company seeks judgment for specified and such further damages to be determined by the Court, as well as appointment as operator. The Company increased the statement of claim based on the information provided by the defendant. The potential outcome of the lawsuit and claims are undetermined, however, they could be material.

In the normal conduct of operations, there are other pending claims by and against the Company. Litigation is subject to many uncertainties, and the outcome of individual matters is not predictable with assurance. In the opinion of management, based on the advice and information provided by its legal counsel, the final determination of these other litigations will not materially affect the Company's financial position or results of operations.

16. Commitments

The Company has until December 31, 2014 to incur $4.9 million of qualifying CEE flow-through expenditures related to CEE flow-through shares issued in December 2013.

The Company has entered into lease agreements for office premises, field equipment and Company vehicles with estimated minimum annual payments as follows:

2014	$	180,958
2015	$	241,277
2016	$	241,277

17. Subsequent Event

On April 23, 2014 the Company entered into an equity financing agreement, on a bought deal basis, led jointly by AltaCorp Capital Inc. and Clarus Securities Inc., with AltaCorp Capital Inc. as sole book-runner. The full syndicate also includes Dundee Capital Markets, Acumen Capital Finance Partners Limited, Industrial Alliance Securities Inc. and Paradigm Capital Inc. (collectively, the "Underwriters").

Under the terms of the agreement Yangarra will issue 22,727,500 common shares ("Common Shares") at a price of $1.10 per Common Share for gross proceeds of $25,000,250. The Underwriters will also have the option, exercisable in whole or in part, to acquire up to an additional 2,272,750 Common Shares at a price of $1.10 per Common Share at any time from closing of the Offering and ending 30 days following the closing date for additional gross proceeds of up to $2,500,025.

The financing is expected to close on or about May 15, 2014 and is subject to approval of the TSX Venture Exchange, receipt of all necessary regulatory approvals and other customary conditions