PERPETUAL ENERGY INC.
Condensed Interim Consolidated Statements of Financial Position

As at	June 30, 2017	December 31, 2016
(*Cdn$ thousands unaudited*)		
Assets		
Current assets		
Cash and cash equivalents	**$ –**	$ 2,877
Restricted cash	**–**	2,000
Accounts receivable	**10,611**	11,473
Tourmaline Oil Corp. ("TOU") share investment (note 3)	**46,489**	66,343
Prepaid expenses and deposits	**1,523**	990
Fair value of derivatives (note 15)	**4,697**	8,326
	63,320	92,009
Fair value of derivatives (note 15)	**–**	2,351
Property, plant and equipment (note 4)	**234,821**	219,886
Exploration and evaluation (note 5)	**45,610**	47,159
Total assets	**$ 343,751**	$ 361,405
Liabilities		
Current liabilities		
Revolving bank debt (note 7)	**$ 4,404**	$ –
Accounts payable and accrued liabilities	**18,523**	21,257
Fair value of derivatives (note 15)	**2,920**	9,221
TOU share margin loans (notes 3 & 8)	**35,543**	39,953
Gas over bitumen royalty financing	**2,361**	3,390
Provisions (note 11)	**3,875**	7,656
	67,626	81,477
Fair value of derivatives (note 15)	**620**	2,023
Term loan (note 9)	**33,114**	–
Senior notes (note 10)	**32,755**	60,120
Gas over bitumen royalty financing	**3,251**	4,954
Provisions (note 11)	**33,311**	30,118
Total liabilities	**170,677**	178,692
Equity		
Share capital (note 12)	**1,335,828**	1,325,705
Warrants (note 12)	**923**	–
Contributed surplus	**43,705**	42,999
Deficit	**(1,207,382)**	(1,185,991)
Total equity	**173,074**	182,713
Total liabilities and equity	**$ 343,751**	$ 361,405

Subsequent events (note 6).

See accompanying notes to the condensed interim consolidated financial statements.

/s/ Robert A. Maitland	*/s/ Geoffrey C. Merritt*
Robert A. Maitland	**Geoffrey C. Merritt**
Director	Director

PERPETUAL ENERGY INC.
Condensed Interim Consolidated Statements of Income (Loss) and Comprehensive Income (Loss)

	Three months ended June 30,		Six months ended June 30,	
	2017	2016	**2017**	2016
(*Cdn$ thousands, except per share amounts, unaudited*)				
Revenue				
Oil and natural gas	**$ 19,728**	$ 16,501	**$ 37,886**	$ 41,195
Royalties	**(3,606)**	(1,851)	**(6,708)**	(4,128)
	16,122	14,650	**31,178**	37,067
Change in fair value of derivatives (note 15)	**1,291**	(5,917)	**5,284**	13,099
Gas over bitumen royalty credit and other	**773**	210	**1,698**	740
	18,186	8,943	**38,160**	50,906
Expenses				
Production and operating	**4,634**	9,480	**9,235**	23,849
Transportation	**1,226**	2,114	**2,241**	4,613
Exploration and evaluation (note 5)	**664**	1,081	**2,165**	2,446
General and administrative	**3,142**	3,727	**6,243**	9,670
Share based payments (note 13)	**985**	1,958	**2,517**	2,358
Depletion and depreciation (note 4)	**7,929**	16,146	**15,054**	33,693
Loss (gain) on dispositions (note 4a)	**1,032**	(892)	**3,223**	(7,965)
Loss from operating activities	**(1,426)**	(24,671)	**(2,518)**	(17,758)
Finance expense (note 14)	**(2,842)**	(7,731)	**(4,706)**	(16,307)
Change in fair value of TOU share investment (note 3)	**(2,951)**	21,430	**(14,167)**	55,384
Gain on exchange of senior notes for TOU shares (notes 3 & 10)	**–**	81,465	**–**	81,465
Loss on disposition of gas storage facility	**–**	(6,119)	**–**	(6,119)
Share of net income of equity-method investment	**–**	551	**–**	1,024
Net income (loss) and comprehensive income (loss)	**(7,219)**	64,925	**(21,391)**	97,689
Net income (loss) per share (note 12)				
Basic	**$ (0.12)**	$ 1.25	**$ (0.38)**	$ 2.00
Diluted	**$ (0.12)**	$ 1.23	**$ (0.38)**	$ 1.91

See accompanying notes to the condensed interim consolidated financial statements.

PERPETUAL ENERGY INC.
Condensed Interim Consolidated Statements of Changes in Equity

	Share capital *(thousands)*	Share capital *($thousands)*	Warrants	Contributed surplus	Deficit	Total equity
(Cdn$ thousands unaudited)						
Balance at December 31, 2016	53,421	$ 1,325,705	$ –	$ 42,999	$ (1,185,991)	$ 182,713
Net loss	–	–	–	–	(21,391)	(21,391)
Common shares and warrants issued (note 12)	5,861	10,384	923	(1,811)	–	9,496
Change to shares held in trust (note 12)	(247)	(261)	–	–	–	(261)
Share based payments (note 13)	–	–	–	2,517	–	2,517
Balance at June 30, 2017	**59,035**	**$ 1,335,828**	**$ 923**	**$ 43,705**	**$ (1,207,382)**	**$ 173,074**

	Share capital *(thousands)*	Share capital *($thousands)*	Share purchase rights	Contributed surplus	Deficit	Total equity
(Cdn$ thousands unaudited)						
Balance at December 31, 2015	19,068	$ 1,296,734	$ 5,290	$ 38,300	$ (1,293,140)	$ 47,184
Net income	–	–	–	–	97,689	97,689
Common shares issued (note 12)	33,354	27,537	(5,290)	(132)	–	22,115
Change to shares held in trust (note 12)	(213)	(134)	–	–	–	(134)
Share based payments (note 13)	–	–	–	2,358	–	2,358
Balance at June 30, 2016	**52,209**	**$ 1,324,137**	**$ –**	**$ 40,526**	**$ (1,195,451)**	**$ 169,212**

See accompanying notes to the condensed interim consolidated financial statements.

PERPETUAL ENERGY INC.
Condensed Interim Consolidated Statements of Cash Flows

	Three months ended June 30, **2017**	2016	Six months ended June 30, **2017**	2016
(*Cdn$ thousands, unaudited*)				
Cash flows from (used in) operating activities				
Net income (loss)	**$ (7,219)**	$ 64,925	**$ (21,391)**	$ 97,689
Adjustments to add (deduct) non-cash items:				
Depletion and depreciation (note 4)	**7,929**	16,146	**15,054**	33,693
Exploration and evaluation (note 5)	**505**	498	**1,818**	1,340
Share based payments (note 13)	**985**	1,958	**2,517**	2,358
Change in fair value of derivatives (note 15)	**(1,129)**	9,491	**(4,375)**	(1,522)
Change in fair value of TOU share investment (note 3)	**2,951**	(21,430)	**14,167**	(55,384)
Loss (gain) on dispositions (note 4a)	**1,032**	(892)	**3,223**	(7,965)
Finance expenses (note 14)	**921**	3,250	**888**	4,893
Gain on exchange of senior notes for TOU shares (notes 3 & 10)	**–**	(81,572)	**–**	(81,572)
Share of net income of equity-method investment	**–**	(551)	**–**	(1,024)
Loss on disposition of gas storage facility	**–**	6,119	**–**	6,119
Dividends from gas storage facility investment	**–**	501	**–**	501
Expenditures on decommissioning obligations (note 11)	**26**	(912)	**(537)**	(2,006)
Payments of restructuring costs (note 11)	**(555)**	–	**(1,899)**	–
Change in non-cash working capital	**(718)**	(927)	**(7,026)**	(7,286)
Net cash from (used in) operating activities	**4,728**	(3,396)	**2,439**	(10,166)
Cash flows from (used in) financing activities				
Change in revolving bank debt	**4,404**	(31,368)	**4,404**	(31,368)
Change in Term Loan	**21**	–	**33,749**	–
Change in TOU share margin Loans	**–**	–	**(5,835)**	–
Change in senior notes, net of issue costs	**(27,170)**	–	**(27,514)**	–
Change in gas over bitumen royalty financing	**(710)**	(306)	**(1,526)**	(956)
Common shares and warrants issued	**87**	26	**9,032**	22,143
Shares purchased and held in trust (note 12)	**(566)**	–	**(566)**	(162)
Change in non-cash working capital	**–**	–	**(216)**	–
Net cash from (used in) financing activities	**(23,934)**	(31,648)	**11,528**	(10,343)
Cash flows from (used in) investing activities				
Capital expenditures	**(4,006)**	(1,286)	**(28,596)**	(6,100)
Acquisitions	**–**	–	**(208)**	–
Net proceeds on dispositions (note 4a)	**(609)**	302	**(564)**	6,768
Net proceeds on sale of gas storage facility investment	**–**	19,750	**–**	19,750
Proceeds on sale of TOU share investment (note 3)	**–**	–	**5,687**	7,354
Restricted cash	**–**	(2,000)	**2,000**	(2,000)
Change in non-cash working capital	**(14,410)**	(1,605)	**4,837**	(1,231)
Net cash from (used in) investing activities	**(19,025)**	15,161	**(16,844)**	24,541
Change in cash and cash equivalents	**(38,231)**	(19,883)	**(2,877)**	4,032
Cash and cash equivalents, beginning of period	**38,231**	26,031	**2,877**	2,116
Cash and cash equivalents, end of period	**$ –**	$ 6,148	**$ –**	$ 6,148

See accompanying notes to the condensed interim consolidated financial statements.

1. REPORTING ENTITY

Perpetual Energy Inc. ("Perpetual" or the "Company") is a Canadian corporation engaged in the exploration, development and marketing of oil and natural gas based energy in Alberta, Canada. The Company operates a diversified asset portfolio that includes liquids-rich natural gas, shallow natural gas and conventional heavy oil producing properties, as well as undeveloped bitumen resource properties.

The address of the Company's registered office is 3200, 605 – 5 Avenue S.W., Calgary, Alberta, T2P 3H5.

The condensed interim consolidated financial statements of the Company as at and for the three and six months ended June 30, 2017 are comprised of the accounts of Perpetual Energy Inc. and its wholly owned subsidiaries: Perpetual Operating Corp. and Perpetual Operating Trust, which are incorporated in Canada.

2. BASIS OF PREPARATION

These condensed interim consolidated financial statements have been prepared in accordance with IAS 34 Interim Financial Reporting and do not include all of the information required for full annual financial statements. These condensed interim consolidated financial statements should be read in conjunction with the Company's consolidated financial statements as at and for the year ended December 31, 2016 which were prepared in conformity with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB").

The accounting policies, basis of measurement, critical accounting judgments and significant estimates used to prepare the annual consolidated financial statements as at and for the year ended December 31, 2016 have been applied in the preparation of these condensed interim consolidated financial statements.

These condensed interim consolidated financial statements of the Corporation were approved and authorized for issue by the Board of Directors on August 10, 2017.

3. TOURMALINE OIL CORP. ("TOU") SHARE INVESTMENT

	June 30, 2017		December 31, 2016	
	Shares *(thousands)*	**Amount *($thousands)***	Shares *(thousands)*	Amount *($thousands)*
Balance, beginning of period	**1,847**	**$ 66,343**	6,500	$ 145,275
Sold	**(180)**	**(5,687)**	(250)	(7,354)
Exchange for senior notes	**–**	**–**	(4,403)	(130,475)
Unrealized change in fair value	**–**	**(14,167)**	–	58,897
Balance, end of period	**1,667**	**$ 46,489**	1,847	$ 66,343

During the first quarter of 2017, the Company sold 180,000 shares of its investment in TOU at $31.63 per TOU share for net cash proceeds of $5.7 million.

At June 30, 2017, the Company held 1.67 million (December 31, 2016 – 1.85 million) TOU shares with a fair value of $46.5 million (December 31, 2016 - $66.3 million) based on a June 30, 2017 closing price of $27.88 per share (December 31, 2016 - $35.91 per share). Net income for the six months ended June 30, 2017 included an unrealized loss of $14.2 million (2016 - $55.4 million unrealized gain) representing the change in fair value of TOU shares held during the period. As at June 30, 2017, a $1.00 per share increase in the market price of TOU shares would increase the Company's after tax net income by $1.7 million.

At June 30, 2017, 1.5 million TOU shares (December 31, 2016 – 1.5 million TOU shares) were pledged as security for the TOU share margin loans (note 8). On July 31, 2017, Perpetual entered into a new $18.7 million margin loan secured by 1.67 million TOU shares that matures in July 2018 (note 8).

During the second quarter of 2016, 4.4 million TOU shares valued at $130.5 million were exchanged for the Company's senior notes (note 10).

4. PROPERTY, PLANT AND EQUIPMENT

	Oil and Gas Properties	Corporate Assets	Total
Cost			
December 31, 2015	$ 2,430,568	$ 7,090	$ 2,437,658
Additions	14,170	92	14,262
Change in decommissioning obligations (note 11)	5,213	–	5,213
Dispositions	(1,838,905)	–	(1,838,905)
December 31, 2016	611,046	7,182	618,228
Additions	28,483	52	28,535
Change in decommissioning obligations (note 11)	1,462	–	1,462
Dispositions	(8)	–	(8)
June 30, 2017	**$ 640,983**	**$ 7,234**	**$ 648,217**
Accumulated depletion, depreciation and impairment losses			
December 31, 2015	(2,083,135)	(6,620)	(2,089,755)
Depletion and depreciation	(54,034)	(283)	(54,317)
Dispositions	1,738,830	–	1,738,830
Impairment reversal	6,900	–	6,900
December 31, 2016	(391,439)	(6,903)	(398,342)
Depletion and depreciation	(14,950)	(104)	(15,054)
June 30, 2017	**$ (406,389)**	**$ (7,007)**	**$ (413,396)**
Carrying amount			
December 31, 2016	$ 219,607	$ 279	$ 219,886
June 30, 2017	**$ 234,594**	**$ 227**	**$ 234,821**

At June 30, 2017, property, plant and equipment included $1.2 million (December 31, 2016 – $1.4 million) of costs currently not subject to depletion.

a) Dispositions

Proceeds on dispositions

	Three months ended June 30,		Six months ended June 30,	
($ thousands)	**2017**	2016	**2017**	2016
Proceeds on dispositions of oil and gas properties	**–**	302	**436**	6,768
Proceeds on retained shallow gas marketing arrangements	**331**	–	**869**	–
Payments on fixed portion of retained shallow gas marketing arrangements	**(940)**	–	**(1,869)**	–
Net proceeds (payments) on dispositions	**(609)**	302	**(564)**	6,768

Loss (gain) on dispositions

	Three months ended June 30,		Six months ended June 30,	
($ thousands)	**2017**	2016	**2017**	2016
Realized gain on retained shallow gas marketing arrangements	**(331)**	–	**(869)**	–
Unrealized loss on retained shallow gas marketing arrangements	**1,363**	–	**4,520**	–
	1,032	–	**3,651**	–
Gains on oil and gas property dispositions	**–**	(892)	**(428)**	(7,965)
Loss (gain) on dispositions	**1,032**	(892)	**3,223**	(7,965)

Dispositions during the six months ended June 30, 2017 consisted of gains of $0.4 million related to the sale of certain gross overriding royalties and non-core undeveloped land for proceeds of $0.4 million.

The Shallow Gas Disposition which closed October 1, 2016 included retained marketing arrangements whereby the Company provided floor price protection at $2.58/GJ to the purchaser and retained price participation to the extent average monthly AECO prices exceed $2.81/GJ on 33,611 GJ/d through to August 31, 2018. The Company entered into marketing arrangements prior to closing to fix the cost of the floor price protection through to March 31, 2018.

On May 18, 2017, the Company amended the marketing arrangements whereby the $2.81/GJ ceiling price was reset to $3.50 on 10,000 GJ/d for the periods between November 1, 2017 and March 31, 2018 in exchange for proceeds of $0.3 million.

As at June 30, 2017, the net retained shallow gas marketing arrangements have been summarized as follows:

Term	Volumes at AECO (*GJ/d*)	Floor price (*$/GJ*)	Ceiling price (*$/GJ*)	Fair value (*$ thousands*)
July 2017 – August 2018	33,611	–	2.81	1,660
November 2017 – March 2018	(10,000)	–	(2.81)	(345)
November 2017 – March 2018	10,000	–	3.50	116
April 2018 – August 2018	33,611	2.58	–	(2,142)

Realized and unrealized gains and losses on these marketing arrangements are recognized as adjustments to gains/losses on dispositions and included as cash flows from investing activities on the consolidated statement of cash flows.

5. EXPLORATION AND EVALUATION ("E&E")

	June 30, 2017	December 31, 2016
Balance, beginning of period	**$ 47,159**	$ 56,407
Additions	**61**	318
Acquisitions	**208**	12
Dispositions	**–**	(6,851)
Non-cash exploration and evaluation expense	**(1,818)**	(2,727)
Balance, end of period	**$ 45,610**	$ 47,159

During the six months ended June 30, 2017, $0.3 million (2016 – $1.1 million) in costs were charged directly to E&E expense in the consolidated statements of net income (loss).

6. CAPITAL MANAGEMENT

Perpetual's strategy includes maintaining a strong capital base so as to retain investor, creditor and market confidence to support the execution of its business plans. The Company manages its capital structure and makes adjustments to its capital spending in light of changes in economic conditions and the risk characteristics of its underlying oil and natural gas assets. The Company considers its capital structure to include share capital, senior notes, revolving bank debt, a second lien senior secured term loan facility (the "Term Loan"), TOU share margin loans and net working capital, with value and liquidity enhanced through the current ownership of TOU shares. In order to manage its capital structure, the Company may from time to time issue equity or debt securities, enter into business transactions including the sale of its TOU shares or other assets and adjust its capital spending to manage current and projected debt levels.

During the first half of 2017, the Company completed a number of financing transactions to strengthen Perpetual's liquidity and debt repayment profile and secure funding for the Company's 2017 and 2018 business plan. The significant financing transactions are as follows:

- Partial repayment and refinancing of its existing TOU share put option margin loan previously maturing in March 2017, reducing the loan amount outstanding to $18.9 million, extending the maturity to August 1, 2017 and increasing the number of shares pledged as collateral to 0.9 million TOU shares, with a new floor price on these shares of $21.14 per TOU share (note 8);
- Exchange of $17.4 million aggregate principal amount of its existing senior notes maturing in 2018 and 2019 for new 8.75% senior notes having an extended maturity date of January 23, 2022 (the "2022 Senior Notes") (note 10);
- Establishment of the Term Loan bearing annual interest at 8.1% and maturing March 14, 2021 (note 9). The initial draw on the Term Loan was $35 million with the remaining $10 million to be drawn prior to November 30, 2017. In addition, for no additional consideration, 5.4 million warrants were issued and valued at $0.8 million which entitle the lender to acquire common shares on a one for one basis for a period of up to three years, at an exercise price of $2.34 per share;
- Issuance of 5.1 million common shares and 1.1 million additional warrants at $1.75 per Equity Unit for aggregate gross proceeds of $9 million;
- Extension of the Company's reserve based, revolving bank debt (the "Credit Facility") to October 31, 2017, while providing for a $14 million increase in total borrowing capacity under the Credit Facility to $20 million (note 7). Restricted cash of $2.0 million was released by Perpetual's lender pursuant to this extension; and
- The early redemption of all $27.6 million of its senior notes maturing in 2018 with repayment of $27.1 million in cash and $0.5 million through an exchange for new 2022 Senior Notes (note 10).

Significant financing transactions subsequent to June 30, 2017 were as follows:

- On July 4, 2017, total borrowing capacity under the Credit Facility was increased from $20 million to $40 million. The maturity date was extended to May 31, 2019 (note 7); and
- On July 31, 2017, Perpetual entered into a new $18.7 million margin loan secured by 1.67 million TOU shares that matures in July 2018. Proceeds on the new margin loan along with borrowings under its Credit Facility were used to repay the $36.5 million TOU share put option margin loans that were scheduled to mature in August and November of 2017. Proceeds of $1.0 million were realized from the sale of underlying put options.

These financing transactions provide the Company with enhanced optionality and flexibility to manage near term obligations while at the same time, creating opportunities to continue pursuing exploration and development projects. The Company will continue to regularly assess changes to its capital structure and repayment alternatives, with considerations for both short term liquidity and longer term financial sustainability.

7. REVOLVING BANK DEBT

As at June 30, 2017, the Company's Credit Facility had a borrowing limit (the "Borrowing Limit") of $20.0 million (December 31, 2016 - $6.0 million) under which $4.4 million was drawn (December 31, 2016 – nil). Additionally, $4.0 million of letters of credit had been issued under the Credit Facility (December 31, 2016 - $4.0 million). Borrowings under the Credit Facility bear interest at its lenders' prime rate or Banker's Acceptance rates, plus applicable margins and standby fees. The applicable margins range between 2.25% and 4.75%.

On July 4, 2017, the Borrowing Limit was increased from $20 million to $40 million and the applicable margins were adjusted to range between 2.0% and 4.5%. The maturity date of the Credit Facility was extended from October 31, 2017 to May 31, 2018 and may be extended for a further 364 day period subject to approval by the syndicate. If not extended the Credit Facility will cease to revolve and all outstanding advances will be repayable on May 31, 2019. The next Borrowing Limit redetermination is scheduled for November 30, 2017.

Borrowings are secured by general security agreements covering all of the Company's assets with the exception of TOU shares pledged as security for the TOU share margin loans (note 8) and certain lands pledged to the gas over bitumen royalty financing counterparty.

For the periods ended June 30, 2017 and 2016, if interest rates changed by 1% with all other variables held constant, the impact on interest expense and net income (loss) would be nominal, as the Company's revolving bank debt, subject to floating interest rates, was minimal.

Prior to the July 4, 2017 Borrowing Limit redetermination, the Credit Facility was subject to a working capital covenant which required the Company to maintain net working capital plus outstanding letters of credit not exceeding the Borrowing Limit. Net working capital includes the sum of cash and cash equivalents, restricted cash, accounts receivable, prepaid expenses and unpledged TOU shares less accounts payable and accrued liabilities and accrued interest on senior notes and the Term Loan up to the Credit Facility maturity date. On July 4, 2017, as part of the Borrowing Limit redetermination, Perpetual's lenders removed this working capital covenant. The Credit Facility also contains provisions which restrict the ability to pay dividends on or repurchase its common shares. The Company was in compliance with all Credit Facility covenants at June 30, 2017.

8. TOU SHARE MARGIN LOANS

At June 30, 2017, $18.9 million TOU share put option margin loans mature in August 2017 and $17.6 million mature in November 2017. For the August 2017 maturity, 0.9 million TOU shares have been pledged as collateral with a put option floor price of $21.14 per share. For the November 2017 maturity, 0.65 million TOU shares have been pledged as collateral with a put option floor price of $27.38 per share.

The TOU share put option margin loans are hybrid financial instruments comprising a debt host with an embedded TOU put option derivative related to indexation of the future settlement amount to changes in the market price of TOU shares pledged as collateral. The Company has designated the TOU share put option margin loans as financial liabilities which are measured at fair value through profit and loss. For the six months ended June 30, 2017, an unrealized loss of $1.4 million (2016 - $3.1 million unrealized loss) is included in finance expense, representing the change in fair value of the TOU put options during the year.

On July 31, 2017, Perpetual entered into a new $18.7 million margin loan secured by 1.67 million TOU shares that matures on July 31, 2018. Interest rates are indexed to the same applicable margins as the Credit Facility (note 7) ranging between 1.5% and 4.0%. Proceeds on the new margin loan along with borrowings under its Credit Facility were used to repay the $36.5 million TOU share put option margin loans that were scheduled to mature in August and November of 2017. Proceeds of $1.0 million were realized from the sale of underlying put options.

9. TERM LOAN

On March 14, 2017, Perpetual entered into the Term Loan which included the issuance of 5.4 million warrants to purchase common shares (note 12).

	June 30, 2017
Balance, beginning of period	$ –
Principal amount of Term Loan issued	35,000
Value allocated to warrants	(769)
Issue costs	(1,251)
Amortization of issue costs	134
Balance, end of period	$ 33,114

The Term Loan matures on March 14, 2021 and bears interest at 8.1% per annum with semi-annual interest payments due June 30 and December 31 of each year. The Term Loan has a cross-default provision with the Credit Facility and contains substantially similar provisions and covenants as the Credit Facility.

The Term Loan is made available by way of two draws consisting of an initial draw of $35 million completed upon closing with the remaining $10 million to be drawn prior to November 30, 2017. Amounts borrowed under the Term Loan that are repaid or prepaid are not available for re-borrowing. The Company may not prepay the Term Loan prior to the second anniversary thereof, except with payment of a make whole premium.

The Term Loan is secured by a general security agreement over all present and future property of the Company and its subsidiaries on a second priority basis, subordinate only to liens securing loans under the Credit Facility, TOU shares secured in favor of the TOU share margin loan lenders and certain lands pledged to the gas over bitumen royalty financing counterparty.

The Company was in compliance with all Term Loan covenants at June 30, 2017.

10. SENIOR NOTES

			June 30, 2017		December 31, 2016	
	Maturity date	**Interest rate**	**Principal**	**Carrying Amount**	Principal	Carrying amount
2018 Senior Notes	March 15, 2018	8.75%	**$ –**	**$ –**	$ 36,013	$ 35,847
2019 Senior Notes	July 23, 2019	8.75%	**15,572**	**15,440**	24,560	24,273
2022 Senior Notes	January 23, 2022	8.75%[1]	**17,918**	**17,315**	–	–
			$ 33,490	**$ 32,755**	$ 60,573	$ 60,120

(1) Annual interest rate through to January 23, 2018 is 9.75% and 8.75% thereafter.

On January 23, 2017, the Company exchanged $8.4 million and $9.0 million aggregate principal amount of 2018 Senior Notes and 2019 Senior Notes respectively for $17.4 million new 8.75% senior notes with a maturity date of January 23, 2022. Included in the exchange were $3.7 million 2018 Senior Notes and $4.3 million 2019 Senior Notes held by directors and officers of the Company or entities controlled by them. The 2022 Senior Notes bear a fixed rate of 9.75% for the first year of issuance and 8.75% thereafter, and have identical covenants and rights as the existing 2018 and 2019 Senior Notes.

On April 17, 2017, Perpetual completed the early redemption of $27.1 million aggregate outstanding principal amount of its 8.75% senior notes maturing March 15, 2018 and exchanged $0.5 million for an equal amount of 2022 Senior Notes.

During the second quarter of 2016, the Company repurchased and cancelled $114.0 million of outstanding 2018 Senior Notes and $100.4 million of outstanding 2019 Senior Notes through the exchange of 4.4 million TOU shares and cash payments of $3.9 million for accrued interest. The fair market value of TOU shares exchanged was $130.5 million based on an average closing price of $29.64 per share. Included in the exchange were $81.6 million 2018 Senior Notes and $57.0 million 2019 Senior Notes held by directors and officers of the Company or entities controlled by them. The Company recorded a net gain of $81.5 million, representing the difference between the carrying amount of senior notes cancelled of $212.0 million ($214.4 million principal amount) and the fair market value of TOU shares exchanged of $130.5 million, net of transaction costs.

The senior notes are direct senior unsecured obligations of the Company, ranking pari passu with all other present and future unsecured and unsubordinated indebtedness of the Company. At any time prior to three years before the senior note maturity date, the Company can redeem up to 35 percent of the principal amount of the senior notes at a premium to face value. Within three years of maturity, the Company may redeem up to 100 percent of the senior notes at a premium to face value. Within one year of maturity, the Company may redeem up to 100 percent of the senior notes at the principal amount.

The senior notes have a cross-default provision with the Company's credit facility (note 7). In addition, the senior notes indenture contains restrictions on certain payments including dividends, retirement of subordinated debt and stock repurchases. The permitted amount of any restricted payment is limited to:

i) To the extent the Company's Consolidated Debt (defined as the sum of the period end balance of revolving bank debt, Term Loan, TOU share margin loans and gas over bitumen royalty financing) to trailing twelve months income before interest, taxes, depletion and depreciation and non-cash items ("TTM EBITDA") is less than 3.0 to 1.0 (the "Consolidated Debt Ratio"), the sum of 50 percent of TTM EBITDA from January 1, 2011 to the end of the most recently completed fiscal quarter plus 100 percent of the fair market value of any equity contributions made to the Company during that period less the sum of all restricted payments during that period; and

ii) To the extent the Company's Consolidated Debt Ratio is greater than or equal to 3.0 to 1.0 pro forma for the proposed restricted payment, $50 million plus 100 percent of the fair market value of any equity contributions made to the Company.

The Company was in compliance with all covenants at June 30, 2017.

At June 30, 2017 the senior notes are presented net of $0.7 million in issue costs which are amortized using a weighted average effective interest rate of 9.6 percent.

11. PROVISIONS

	June 30, 2017	December 31, 2016
Decommissioning obligations, beginning of period	**$ 33,620**	$ 159,169
Obligations incurred	**772**	177
Obligations settled	**(537)**	(3,803)
Accretion (note 14)	**386**	2,643
Obligations disposed	**–**	(129,602)
Change in risk free interest rate	**690**	10,184
Change in estimates	**–**	(5,148)
Decommissioning obligations, end of period	**34,931**	33,620
Restructuring costs (b)	**2,255**	4,154
Balance, end of period	**$ 37,186**	$ 37,774
Provisions – current	**3,875**	7,656
Provisions – non-current	**33,311**	30,118
	$ 37,186	$ 37,774

a) Decommissioning obligations

The following significant assumptions were used to estimate decommissioning obligations:

	June 30, 2017	December 31, 2016
Undiscounted obligations	**$ 38,210**	$ 37,877
Average risk free interest rate	**2.1%**	2.3%
Inflation rate	**1.5%**	1.5%
Expected timing of settling obligations	**1 to 25 years**	1 to 25 years

b) Restructuring costs

	Employee downsizing costs	Onerous office lease contract	Lease inducement	Total
Balance, December 31, 2016	$ 1,606	$ 2,548	$ –	$ 4,154
Transferred	–	(1,764)	1,764	–
Payments	(1,417)	(392)	(90)	(1,899)
Balance, June 30, 2017	189	392	1,674	2,255
Restructuring costs – current	189	392	216	797
Restructuring costs – non-current	–	–	1,458	1,458
Total	$ 189	$ 392	$ 1,674	$ 2,255

On February 1, 2017, Perpetual entered into a new head office lease at its current location for a 98 month period expiring March 31, 2025. As consideration, the landlord agreed to release the Company from all remaining obligations under its existing lease with remaining term to March 31, 2018 with remaining payments of $1.8 million deferred over the 98 month term of the new lease. This lease inducement is comprised of $1.8 million related to surplus office space which was recognized as an onerous contract provision in 2016. The lease inducement will be amortized on a straight-line basis over the 98 month term of the new head office lease.

12. SHARE CAPITAL

	June 30, 2017		December 31, 2016	
	Shares *(thousands)*	**Amount *($thousands)***	Shares *(thousands)*	Amount *($thousands)*
Balance, beginning of period	**53,421**	**$ 1,325,705**	19,068	$ 1,296,734
Issued pursuant to private placement (c)	**5,143**	**8,878**	491	839
Issued pursuant to share based payment plans	**718**	**1,506**	807	1,184
Issued pursuant to share purchase rights	**–**	**–**	33,268	27,082
Shares held in trust purchases (b)	**(345)**	**(566)**	(218)	(162)
Shares held in trust issued (b)	**98**	**305**	5	28
Balance, end of period	**59,035**	**$ 1,335,828**	53,421	$ 1,325,705

a) Authorized

Authorized capital consists of an unlimited number of common shares.

b) Shares held in trust

The Company has compensation agreements in place with employees whereby they may be entitled to receive shares of the Company purchased on the open market by a trustee (note 13d). Share capital is presented net of the number and cumulative cost of shares held by the trustee for the benefit of employees that have not been issued to employees.

c) Warrants and equity private placement

On March 14, 2017, the Company completed a private placement of 5.1 million equity units for gross proceeds of $9.0 million, of which $8.9 million has been allocated to share capital and $0.1 million to warrants. Each equity unit consisted of 1 common share and 0.21 warrants. Included in the issuance were 1.6 million common shares and 0.4 million warrants issued to directors and officers of the Company or entities controlled by them, for proceeds of $2.9 million. In addition, 5.4 million warrants valued at $0.8 million were issued in connection with the Term Loan (note 9). Each warrant entitles the holder to acquire common shares on a one for one basis at an exercise price of $2.34 per share prior to March 14, 2020.

If the volume weighted average price of Perpetual's common shares is greater than the Exercise Price for 60 consecutive calendar days, Perpetual shall have the option to require warrant holders to exercise all or any portion of the warrants at any time thereafter from time to time.

d) Per share information

	Three months ended June 30,		Six months ended June 30,	
	2017	2016	**2017**	2016
(*thousands, except per share amounts*)				
Net income (loss) – basic	**$ (7,219)**	$ 64,925	**$ (21,391)**	$ 97,689
Effect of dilutive securities	**–**	–	**–**	–
Net income (loss) – diluted	**$ (7,219)**	$ 64,925	**$ (21,391)**	$ 97,689
Weighted average shares				
Issued common shares	**59,391**	52,402	**57,072**	49,102
Effect of shares held in trust	**(346)**	(262)	**(303)**	(246)
Weighted average common shares outstanding – basic	**59,045**	52,140	**56,769**	48,856
Effect of dilutive securities	**–**	764	**–**	2,313
Weighted average common shares outstanding – diluted	**59,045**	52,904	**56,769**	51,169
Net income (loss) per share – basic	**$ (0.12)**	$ 1.25	**$ (0.38)**	$ 2.00
Net income (loss) per share – diluted	**$ (0.12)**	$ 1.23	**$ (0.38)**	$ 1.91

In computing per share amounts for the three and six months ended June 30, 2017, potentially issuable common shares through the share based compensation plans and warrants were excluded as the Corporation had a net loss. In computing per share amounts for the three and six months ended June 30, 2016, 3.6 million and 6.2 million potentially issuable common shares through the share based compensation plans, respectively, were excluded as they had an anti-dilutive effect on calculated per share amounts.

13. SHARE BASED PAYMENTS

The components of share based payments are as follows:

	Three months ended June 30,		Six months ended June 30,	
	2017	2016	**2017**	2016
Share options	**185**	260	**504**	447
Restricted rights	**–**	128	**73**	128
Performance share rights	**187**	122	**477**	(124)
Compensation awards	**613**	1,448	**1,463**	1,907
Share based payments	**985**	1,958	**2,517**	2,358

a) Share option plan

Perpetual's share option plan provides a long-term incentive to employees and directors to reward them on the basis of the Company's long-term performance. The Board of Directors administers the share option plan and determines participants, number of share options and terms of vesting. The exercise price of the share options granted shall not be less than the value of the weighted average trading price for the Company's common shares for the five trading days immediately preceding the date of grant. Share options granted have a maximum term of 5 years and vest evenly on each of the first, second, third and fourth grant anniversary dates.

The following tables summarize information about share options outstanding:

	June 30, 2017		December 31, 2016	
	Average Exercise Price (*$/share*)	**Share Options (*thousands*)**	Average Exercise Price (*$/share*)	Share Options (*thousands*)
Balance, beginning of period	**1.71**	**2,068**	1.23	14,794
Granted	**1.72**	**1,975**	1.42	2,275
Cancelled/forfeited	**–**	**–**	1.69	(682)
Expired	**3.51**	**(3)**	3.41	(386)
Modification	**–**	**–**	1.11	(13,933)
Balance, end of period	**1.72**	**4,040**	1.71	2,068

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	**Number of Share Options (*thousands*)**	**Average Contractual Life (*years*)**	**Weighted Average Exercise Price (*$/share*)**	**Number of Share Options (*thousands*)**	**Weighted Average Exercise Price (*$/share*)**
$1.42 to $1.57	1,805	3.93	$ 1.42	451	$ 1.42
$1.58 to $1.86	1,975	4.90	1.72	–	–
$1.87 to $2.61	83	3.14	2.00	21	2.00
$2.62 to $4.60	93	0.14	3.22	93	3.22
$4.61 to $5.97	84	1.13	5.97	56	5.97
Total	**4,040**	**4.24**	**$ 1.72**	**621**	**$ 2.12**

The Company used the Black Scholes pricing model to calculate the estimated fair value of the outstanding share options. The following assumptions were used to arrive at the estimate of fair value as at the date of grant:

	June 30, 2017	December 31, 2016
Dividend yield (%)	**0.0**	0.0
Forfeiture rate (%)	**5.0**	20.6
Expected volatility (%)	**60.0**	60.7
Risk-free interest rate (%)	**0.8**	0.5
Expected life (years)	**3.2**	3.2
Vesting period (years)	**4.0**	4.0
Contractual life (years)	**5.0**	5.0
Weighted average grant date fair value	**$ 0.65**	$ 0.73

b) Restricted rights plan

The Company has a restricted rights plan for certain officers, employees and consultants. Restricted rights granted under the restricted rights plan may be exercised during a period (the "Exercise Period") not exceeding five years from the date upon which the restricted rights were granted. The restricted rights typically vest on a graded basis over two years. At the expiration of the Exercise Period, any restricted rights which have not been exercised shall expire. Upon vesting, the plan participant is entitled to receive one common share for each right held at no cost.

The following table shows changes in the Restricted Rights outstanding under the Restricted Rights Plan:

	June 30, 2017	December 31, 2016
(thousands)		
Balance, beginning of period	**273**	40
Granted	**468**	1,082
Exercised	**(726)**	(811)
Modification	**–**	(38)
Balance, end of period	**15**	273

c) Performance share rights plan

The Company has a performance share rights plan for the Company's senior management team. Performance rights granted under the Performance share rights plan vest two years after the date upon which the performance rights were granted. The performance rights that vest and become redeemable are a multiple of the performance rights granted dependent upon the achievement of certain performance metrics over the vesting period. Vested performance rights can be settled in cash or restricted rights, at the discretion of the Board of Directors. Should participants of the performance share rights plan leave the organization other than through retirement or termination without cause prior to the vesting date, the performance rights would be forfeited.

The following table shows changes in the performance share rights outstanding under the performance share rights plan:

	June 30, 2017	December 31, 2016
(thousands)		
Balance, beginning of period	**1,048**	2,251
Granted	**430**	830
Exercised	**(418)**	(285)
Cancelled/forfeited	**–**	(1,193)
Modification	**–**	(555)
Balance, end of period	**1,060**	1,048

d) Compensation awards

The Company has agreements in place with certain employees whereby over a period of three years they may be entitled to receive shares of the Company purchased on the open market by an independent trustee if they remain employees of the Company during such time. This does not dilute equity or involve the issuance of shares from treasury. The shares purchased by the independent trustee are reported as shares held in trust (note 12b).

The following table shows changes to these awards:

	June 30, 2017	December 31, 2016
(thousands)		
Balance, beginning of period	**1,072**	4,024
Granted	**1,380**	1,151
Cancelled/forfeited	**(84)**	(354)
Modification	**–**	(3,749)
Balance, end of period	**2,368**	1,072

The Company also has agreements in place with directors and certain employees whereby, in the case of directors, upon retirement from the board of directors, or in the case of employees, over a period of two years if they remain employees of the Company during such time, may be entitled to receive at the discretion of the Board, cash, a grant of Restricted Rights or shares of the Company purchased on the open market by an independent trustee. The shares purchased by the independent trustee are reported as shares held in trust (note 12b).

The following table shows changes to these awards:

	June 30, 2017	December 31, 2016
(thousands)		
Balance, beginning of period	**2,197**	3,534
Granted	**663**	2,244
Exercised	**(313)**	(554)
Cancelled/forfeited	**(85)**	(979)
Modification	**–**	(2,048)
Balance, end of period	**2,462**	2,197

14. FINANCE EXPENSE

The components of finance expense are as follows:

	Three months ended June 30,		Six months ended June 30,	
	2017	2016	**2017**	2016
Cash interest				
Interest on Revolving bank debt	**204**	1,204	**384**	2,122
Interest on TOU share margin loans	**87**	–	**301**	–
Interest on Term Loan	**709**	–	**854**	–
Interest on senior notes	**921**	3,277	**2,279**	9,292
Total cash interest	**1,921**	4,481	**3,818**	11,414
Non-cash finance expense				
Amortization of debt issue costs	**189**	136	**283**	399
Accretion on decommissioning obligations (note 11)	**195**	818	**386**	1,735
Change in fair value of gas over bitumen royalty financing	**33**	1,234	**(1,206)**	(344)
Change in fair value of TOU share margin loans (note 8)	**504**	1,062	**1,425**	3,103
Total non-cash finance expense	**921**	3,250	**888**	4,893
Finance expenses recognized in net income (loss)	**2,842**	7,731	**4,706**	16,307

15. FINANCIAL RISK MANAGEMENT

Realized gains on commodity price derivatives recognized in net income for the six months ended June 30, 2017 were $0.9 million (2016 – $11.6 million). The realized gains on commodity price derivatives for the six months ended June 30, 2017 included early settlement of fixed price oil contracts and foreign exchange contracts for a loss of $5.2 million which was offset by gains of $4.9 million related to the early settlement of natural gas basis differential contracts.

Natural gas contracts

At June 30, 2017 the Company had entered into the following physical fixed natural gas sales arrangements at AECO:

Term	Sold/bought	Volumes (*GJ/d*)	Average price (*$/GJ*)	Fair Value (*$ thousands*)
July 2017 – December 2017	Sold	22,500	3.14	3,028
July 2017 – December 2017	Bought	2,500	2.92	(237)
November 2017 – March 2018	Sold	12,500	2.94	574

At June 30, 2017 the Company had entered into the following financial fixed natural gas sales arrangements at AECO:

Term	Sold/bought	Volumes (*GJ/d*)	Average price (*$/GJ*)	Fair Value (*$ thousands*)
July 2017 - December 2017	Sold	7,500	3.16	1,044

Natural gas contracts - sensitivity analysis

As at June 30, 2017, if future natural gas prices change by $0.25 per GJ with all other variables held constant, the fair value of commodity price derivatives and after tax net income for the period would change by $1.25 million. Fair value sensitivity was based on published forward AECO and NYMEX prices.

Oil contracts

At June 30, 2017, the Company had entered into the following costless collar oil sales arrangements which settle in $USD.

Term	Volumes at WTI (*bbls/d*)	Floor price (*$USD/bbl*)	Ceiling price (*$USD/bbl*)	Fair Value (*$ thousands*)
July 2017 – December 2017	250	50.00	61.50	269
July 2017 – December 2017	500	50.00	59.40	530

At June 30, 2017, the Company had entered into the following oil basis differential contracts between WTI and WCS trading.

Term	Volumes at WTI (*bbls/d*)	WTI-WCS differential (*$USD/bbl*)	Fair Value (*$ thousands*)
July 2017 – December 2017	250	(14.85)	(152)
July 2017 – December 2017	500	(15.40)	(359)

Oil contracts - sensitivity analysis

As at June 30, 2017, if future WTI oil prices increased by $5.00 per boe with all other variables held constant, the fair value of commodity price derivatives and after tax net income for the period would increase by $0.9 million. If future oil prices decreased by $5.00 per boe with all other variables held constant, the fair value of commodity price derivatives and after tax net income for the period would be unchanged. Fair value sensitivity was based on published forward WTI and WCS prices.

The following table is a summary of the fair value of the Company's derivative contracts by type:

	June 30, 2017	December 31, 2016
Physical natural gas contracts	**3,365**	1,876
Financial natural gas contracts	**1,044**	4,606
Financial oil contracts	**288**	(1,138)
Financial foreign exchange contracts	**–**	(5,022)
Fixed portion of retained shallow gas marketing arrangements(1)	**(2,829)**	(4,698)
Non-fixed portion of retained shallow gas marketing arrangements	**(711)**	3,809
Fair value of derivatives	**1,157**	(567)
Derivative assets – current	**4,697**	8,326
Derivative assets – non-current	**–**	2,351
Derivative liabilities – current	**(2,920)**	(9,221)
Derivative liabilities – non-current	**(620)**	(2,023)
Fair value of derivatives	**1,157**	(567)

(1) At June 30, 2017 the term of the put option between the periods of July 1, 2017 and March 31, 2018 was fixed at a cost of $2.8 million which settles monthly over the term. This portion of the contract is recorded at amortized cost. During the six months ended June 30, 2017, payments of $1.9 million were recorded as a reduction to this liability.

The following table details the Company's changes in fair value of commodity price derivatives:

	Three months ended June 30,		Six months ended June 30,	
	2017	2016	**2017**	2016
Unrealized gain (loss) on financial oil contracts	**188**	(3,151)	**1,425**	(3,532)
Unrealized gain (loss) on financial natural gas contracts	**59**	(7,727)	**(3,561)**	(2,137)
Unrealized gain (loss) on physical natural gas contracts	**882**	(144)	**1,489**	25
Unrealized gain on forward foreign exchange contracts	**–**	1,531	**5,022**	7,166
Unrealized change in fair value of commodity price derivatives	**1,129**	(9,491)	**4,375**	(1,522)
Realized gain (loss) on financial oil contracts	**(192)**	69	**(1,166)**	1,332
Realized gain on financial natural gas contracts	**354**	3,794	**6,253**	11,798
Realized loss on forward foreign exchange contracts	**–**	(289)	**(4,178)**	(1,553)
Change in fair value of commodity price derivatives	**1,291**	(5,917)	**5,284**	13,099

Fair value of financial assets and liabilities

The Company's fair value measurements are classified as one of the following levels of the fair value hierarchy:

Level 1 – inputs represent unadjusted quoted prices in active markets for identical assets and liabilities. An active market is characterized by a high volume of transactions that provides pricing information on an ongoing basis.

Level 2 – inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. These valuations are based on inputs that can be observed or corroborated in the marketplace, such as market interest rates or forward prices for commodities.

Level 3 – inputs for the asset or liability are not based on observable market data.

The Company aims to maximize the use of observable inputs when preparing calculations of fair value. Classification of each measurement into the fair value hierarchy is based on the lowest level of input that is significant to the fair value calculation.

The fair value of cash and cash equivalents, accounts receivable, and accounts payable and accrued liabilities approximate their carrying amounts due to their short terms to maturity. Revolving bank debt bears interest at a floating market rate and accordingly the fair market value approximates the carrying amount.

The fair value of the gas over bitumen royalty financing is estimated by discounting future cash payments based on the forecasted Alberta gas reference price multiplied by the contracted deemed volume. This fair value measurement is classified as level 3 as significant unobservable inputs, including the discount rate and forecasted Alberta gas reference prices, are used in determination of the carrying amount. The discount rate of 12.2% was determined on inception of the agreement based on the characteristics of the instrument. The forecasted Alberta gas reference prices for the remaining term are based on AECO forward market pricing with adjustments for historical differences between the Alberta reference price and market prices.

The fair value of the TOU share margin loans are estimated using significant unobservable inputs including discount rates and measures of future volatility required to fair value the embedded TOU share price put options. This fair value measurement is classified as level 3 as significant unobservable inputs, including discount rates and measures of future volatility are used in determination of the carrying amount.

The fair value of financial assets and liabilities, excluding working capital, is attributable to the following fair value hierarchy levels:

As at June 30, 2017	Gross	Netting[1]	Carrying Amount	Fair value Level 1	Level 2	Level 3
Financial assets						
Fair value through profit and loss						
TOU share investment	**46,489**	**–**	**46,489**	**46,489**	**–**	**–**
Derivatives – current	**6,985**	**(2,288)**	**4,697**	**–**	**4,697**	**–**
Derivatives – current	**237**	**(237)**	**–**	**–**	**–**	**–**
Financial liabilities						
Financial liabilities at amortized cost						
Revolving bank debt - current	**4,404**	**–**	**4,404**	**4,404**	**–**	**–**
Senior notes – non-current	**32,755**	**–**	**32,755**	**–**	**33,400**	**–**
Term Loan – non-current	**33,114**	**–**	**33,114**	**–**	**–**	**33,114**
Fair value through profit and loss						
Derivatives – current	**5,208**	**(2,288)**	**2,920**	**–**	**2,920**	**–**
Derivatives – non-current	**857**	**(237)**	**620**	**–**	**620**	**–**
Gas over bitumen royalty financing – current	**2,361**	**–**	**2,361**	**–**	**–**	**2,361**
Gas over bitumen royalty financing – non-current	**3,251**	**–**	**3,251**	**–**	**–**	**3,251**
TOU share margin loans – current	**35,543**	**–**	**35,543**	**–**	**–**	**35,543**

(1) Derivative assets and liabilities presented in the statement of financial position are shown net of offsetting assets or liabilities where the arrangement provides for the legal right and intention for net settlement exists.