

# UNREALIZED **POTENTIAL** OPPORTUNITY **DRIVEN**

First Quarter Interim Report 2010



cequence  
energy ltd



## HIGHLIGHTS

(000's except per share amounts)	Three months ended March 31	
	2010	2009
<b>Financial (\$)</b>		
Production revenue, including realized hedge	\$ 10,093	\$ 6,627
Net income (loss)	(1,025)	3,440
Per share, basic and diluted	(0.03)	0.36
Funds flow from operations <sup>(1)</sup>	4,498	1,913
Per share, basic and diluted	0.11	0.20
<b>Production volumes</b>		
Natural gas (Mcf/d)	12,592	8,164
Crude oil (bbls/d)	268	140
Natural gas liquids (bbls/d)	78	104
Total (boe/d)	2,444	1,605
<b>Sales prices</b>		
Natural gas, including realized hedges (\$/Mcf)	\$ 6.83	\$ 7.71
Crude oil (\$/bbl)	76.80	50.26
Natural gas liquids (\$/bbl)	71.81	35.28
Total (\$/boe)	\$ 45.88	\$ 45.97
<b>Operating Netbacks (\$/boe)</b>		
Price	\$ 45.88	\$ 45.97
Royalties	(5.06)	(5.55)
Transportation	(3.38)	(1.71)
Operating costs	(13.07)	(15.86)
Operating Netback	\$ 24.37	\$ 22.85
Capital Expenditures	\$ 26,412	\$ 4,767
Property Acquisitions (net)	279	-
Total capital expenditures	\$ 26,691	\$ 4,767
Net working capital (deficiency) <sup>(2)</sup>	(16,289)	(18,251)
Long-term debt related to investments <sup>(3)</sup>	(18,000)	(18,000)
Weighted average shares outstanding (basic and diluted)	39,530	9,620
Undeveloped land (net acres)	143,200	121,000

(1) Funds flow from operations is calculated as cash flow from operating activities before adjustments for asset retirement expenditures and net changes in non-cash working capital.

(2) Net working capital is calculated as cash, net working capital less derivative contract asset and demand credit facilities.

(3) The long-term debt related to investments is a stand-alone credit facility with Cequence's lender to provide short term liquidity to the Company in light of the restructuring of the asset backed MAV II notes.

# MANAGEMENT'S DISCUSSION AND ANALYSIS

This Management's Discussion and Analysis ("MD & A") of the financial and operating results for Cequence Energy Ltd. ("Cequence" or the "Company") should be read in conjunction with the Company's unaudited consolidated financial statements (the "Financial Statements") and related notes for the three months ended March 31, 2010 as well as with the audited consolidated financial statements (the "Annual Financial Statements") and related notes and MD&A for the year ended December 31, 2009.

Additional information relating to the Company, including its MD&A for the prior year and the annual information form ("AIF") is available on SEDAR at [www.sedar.com](http://www.sedar.com).

This MD & A is dated May 13, 2010.

## BASIS OF PRESENTATION

The financial data presented below has been prepared in accordance with Canadian Generally Accepted Accounting Principles ("GAAP"). The financial information presented reflects the consolidated financial statements of Cequence.

The reporting and the measurement currency is the Canadian dollar. For the purpose of calculating unit costs, natural gas is converted to a barrel equivalent ("boe") using six thousand cubic feet of natural gas equal to one barrel of oil unless otherwise stated. The term barrels of oil equivalents (BOE) may be misleading, particularly if used in isolation. A BOE conversion ratio for gas of 6 Mcf:1 boe is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead.

Unless otherwise stated and other than per unit items, all figure are presented in thousands.

## NON-GAAP MEASUREMENTS

Within the MD & A references are made to terms commonly used in the oil and gas industry. Netback is not defined by GAAP in Canada and is referred to as a non-GAAP measure. Netbacks equal total revenue less royalties, operating costs and transportation costs. Management utilizes this measure to analyze operating performance.

Funds flow from operations is a non-GAAP term that represents cash flow from operating activities before adjustments for asset retirement expenditures and net changes in non-cash working capital. The Company evaluates its performance based on earnings and funds flow from operations. The Company considers funds flow from operations a key measure as it demonstrates the Company's ability to generate the cash flow necessary to fund future growth through capital investment and to repay debt. The Company's calculation of funds flow from operations may not be comparable to that reported by other companies. Funds flow from operations per share is calculated using the same weighted average number of shares outstanding used in the calculation of income (loss) per share.

Non-GAAP financial measures do not have a standardized meaning prescribed by GAAP and are therefore unlikely to be comparable to similar measures presented by other issuers.

## OVERVIEW

On July 30, 2009 the shareholders of Cequence (formerly Sabretooth Energy Ltd.) approved certain reorganization transactions to recapitalize the Company with new equity, appoint new management and restructure the board of directors. Also as part of the transaction the Company changed its name to Cequence Energy Ltd. and affected a four for one share consolidation (the "reorganization transactions"). These transactions were approved by the shareholders of the Company at the annual and special meeting of shareholders held on July 29, 2009.

The reorganization transactions included a private placement to new management, employees, directors and consultants; a rights offering to existing shareholders and a subscription receipt offering. Total cash proceeds from the equity offerings totalled \$65,315, a portion of which was used to eliminate the outstanding operating bank line and complete three property acquisitions in 2009.

On August 18, 2009, Cequence announced the entering into of two separate purchase and sale agreements, one with a private oil and gas company providing for the acquisition by Cequence of the Minor Assets and one with a subsidiary of a major publicly traded oil and gas company providing for the acquisition by Cequence of the Peace River Arch Assets (the "PRA Assets"). The purchase price for the Minor Assets was \$4,000 and the purchase price for the PRA Assets was \$13,250, both subject to adjustment. The acquisition of the PRA Assets was completed on September 24, 2009 with an effective date of June 1, 2009 and the acquisition of the Minor Assets was completed in late August with an effective date of August 1, 2009.

The Acquired Assets include 31,000 net acres of undeveloped land, various facility and pipeline working interests with the majority of production being operated. The acquisitions were financed through Cequence's existing working capital. Production at the time of acquisition of the acquired assets was approximately 850 BOE/d (90 percent natural gas).

On November 12, 2009, the Company acquired all of the issued and outstanding shares of HFG Holdings Inc, (“HFG”) not already held by Cequence for consideration of 2,645 common voting shares. The transaction was accounted for using the purchase method. The elimination of the non-controlling interest through an acquisition at a purchase price greater than HFG’s book value in the Company’s consolidated financial statements had the effect of increasing property and equipment assets, and decreasing future income tax assets. The accounts of the Company include the results of HFG for the year ended December 31, 2009. The non-controlling interest presented on the statement of operations includes the non-controlling interest’s share of the operations of HFG to the date of the acquisition.

The cost of acquisition was satisfied by 2,645 shares valued at \$3.97 per share based on the average trading price of the Company’s stock during the three days before and three days after the announcement of the transaction. Transaction costs were \$380 for total acquisition cost of \$10,882. The fair value assigned to assets and liabilities acquired was allocated as \$8,486 to non-controlling interest at date of acquisition, \$3,123 to property and equipment and a reduction of \$727 to future income tax asset for a total of \$10,882.

On April 21, 2010, Cequence announced that it had entered into an acquisition agreement (the “Agreement”) with Peloton Exploration Corp. (“Peloton”), a private oil and gas company with production of approximately 650 BOE/d. Pursuant to the Agreement, Cequence will, subject to certain conditions, make an offer to acquire all of the issued and outstanding common shares of Peloton. Under the terms of the Agreement, Peloton shareholders will receive 0.205 of a Cequence common share for each Peloton share held for a total of 12,059 Cequence common shares. The estimated value of the transaction is \$30,914 based on an ascribed value of \$2.51 per common share based on Cequence’s five day weighted average trading price on the TSX before and after the announcement of the transaction and estimated transaction costs.

### SELECTED FINANCIAL INFORMATION

Cequence recorded a loss of \$1,025 for the quarter ended March 31, 2010. Net income and funds flow from operations for the period were negatively impacted by low natural gas prices.

Funds flow from operations was \$4,498 for the quarter compared to \$1,913 in 2009. The increase in funds flow is due to an increase in revenue and a decrease in general and administrative expense and interest expense.

A reconciliation of cash flow from operating activities to funds flow from operations is as follows:

\$(000’s)	Three months ended March 31	
	2010	2009
Cash flow from operating activities	\$ 959	\$ 1,841
Asset retirement expenditures	56	7
Net change in non-cash working capital	3,483	65
Funds flow from operations	\$ 4,498	\$ 1,913

### RESULTS OF OPERATIONS

#### PRODUCTION

Production for the quarter ended March 31, 2010 averaged 2,444 boe/d compared to production of 1,605 boe/d in 2009. The increase in production is due to property acquisitions completed in 2009 as well as new drilling and recompletions in the quarter.

Average production volumes for the three month periods ended March 31, 2010 and 2009 are outlined below:

	Three months ended March 31			
	2010		2009 <sup>(1)</sup>	
	Total	Per Day	Total	Per Day
Natural Gas (Mcf)	1,133,315	12,592	733,686	8,164
Crude Oil (bbls)	24,102	268	12,556	140
NGLs (boe)	6,998	78	9,334	104
Total (boe)	219,985	2,444	144,171	1,605

(1) Includes royalty volumes

#### PRICING

Benchmark natural gas prices were consistent with the comparative period in 2009 whereas crude oil prices increased from the comparative period in 2009. Cequence realized a natural gas price including hedge for the three month period ended March 31, 2010 of \$6.83. The realized prices are significantly above prevailing market prices as 6,000 gj per day of the Company’s natural gas production in the quarter was sold at a price of \$7.85 under a fixed price contract. Further, 2,800 Mcf/d of the Company’s natural gas production in the quarter was sold at Chicago which was at a premium to AECO. Cequence’s production is approximately 86 percent natural gas and fluctuations in natural gas prices have a significant impact on the Company.

Oil prices for the first quarter of 2010 were \$76.80 per barrel, up 53 percent from the same time period in 2009. Natural gas liquids prices for the first quarter of 2010 were \$71.81 per barrel, up 104 percent from the same time period in 2009.

The following tables detail the Company's average sales prices and benchmark indices:

Average Selling Price	Three months ended March 31	
	2010	2009
Natural gas (\$/Mcf)	\$ 5.32	\$ 4.91
Realized natural gas hedge \$/Mcf)	1.51	2.80
Natural gas including realized hedge gains and losses (\$/Mcf)	6.83	7.71
Crude Oil (per bbl)	76.80	50.26
Natural gas liquids (per bbl)	71.81	35.28
Average sales price before hedge (per boe)	\$ 38.11	\$ 31.70
Average sales price including hedge (per boe)	\$ 45.88	\$ 45.97

Benchmark Pricing	Three months ended March 31	
	2010	2009
AECO-C Spot (CDN\$/Mcf)	4.92	4.93
WTI crude oil (US\$/bbl)	78.64	43.18
Edmonton par price (CDN\$/bbl)	81.02	51.14
US\$/CDN\$ exchange rate	0.96	0.80

## COMMODITY PRICE MANAGEMENT

Cequence has a commodity price risk management program and it intends to enter into derivative and physical commodity contracts to protect future cash flows or planned capital expenditures. The Company had a natural gas contract in place that expired in March 31, 2010 for the sale of 6,000 gj per day of natural gas for a price of \$7.85 per gj. The fair value of derivative commodity contracts at March 31, 2010 is \$nil compared to \$6,767 in 2009. As at March 31, 2010, the Company had no commodity contracts in place.

	Three months ended March 31	
	2010	2009
Realized gain on commodity contracts	1,709	2,057
Unrealized gain (loss) on commodity contracts	(1,420)	3,733
Total	289	5,790

## REVENUE

Total revenue was \$10,093 in the first quarter of 2010 compared to \$6,627 for the comparable period in 2009. The increase in revenue is mainly attributable to the 53 percent increase in production.

\$(000's)	Three months ended March 31	
	2010	2009
Natural gas	\$ 6,030	\$ 3,608
Realized gains on natural gas contracts	1,709	2,057
Total natural gas	7,739	5,665
Oil	1,851	632
Natural gas liquids	503	330
Total Revenue	\$ 10,093	\$ 6,627

## ROYALTY EXPENSE

Royalty expense in the first quarter of 2010 was \$1,114 or 13 percent of revenue compared to \$800 or 18 percent of revenue in the first quarter of 2009. Royalties as a percentage of revenue are lower for the first quarter of 2010 compared to 2009. On a per barrel basis royalties decreased in the quarter primarily due to higher gas cost allowance compared to the prior year. Based on the nature of the Company's production and facilities, at current commodity prices Cequence reduces a significant portion of its crown royalties with gas cost allowance. The Company expects that based on forecast oil and gas prices that royalties will average approximately 10 percent of revenue for the remainder of 2010.

\$ (000's)	Three months ended March 31	
	2010	2009
Crown	\$ 1,092	\$ 788
Freehold / Overriding	22	12
	\$ 1,114	\$ 800
<b>As a % of revenue, before hedging activity</b>		
Crown	13%	17%
Freehold / Overriding	0%	1%
	13%	18%
<b>Per Unit of Production (\$/boe)</b>		
Crown	\$ 4.96	\$ 5.46
Freehold / Overriding	0.10	0.09
	\$ 5.06	\$ 5.55

### TRANSPORTATION EXPENSE

Transportation costs for the quarter ended March 31, 2010 were \$3.38 per boe, an increase of 98 percent from the comparative period in 2009. Beginning in the fourth quarter, approximately 2,800 Mcf/d of natural gas is being shipped on the Alliance pipeline. The approximate transportation charge for this transportation is \$1.50 per Mcf. Cequence realized a higher sales price on these volumes in the quarter as they are sold at Chicago. Transportation costs for the quarter are in line with Cequence's expectation of \$3.50 per boe in 2010.

\$ (000's)	Three months ended March 31	
	2010	2009
Transportation (\$)	\$ 744	\$ 247
Per Unit of Production (\$/boe)	\$ 3.38	\$ 1.71

### OPERATING COSTS

Operating costs during the first quarter of 2010 were \$2,875 or \$13.07 per boe compared to \$2,286 or \$15.86 per boe for the same time period in 2009. Operating costs decreased in the first quarter of 2010 compared to 2009 as production levels increased and through lower operating costs on the properties acquired in the third quarter of 2009. Operating costs for the quarter are in line with Cequence's expectation of approximately \$13-\$15/boe in 2010.

\$ (000's)	Three months ended March 31	
	2010	2009
Operating Costs (\$)	\$ 2,875	\$ 2,286
Per Unit of Production (\$/boe)	\$ 13.07	\$ 15.86

### OPERATING NETBACKS

Cequence's netback for the first quarter of 2010 increased to \$24.37 per boe from \$22.85 in 2009. In comparison to 2009, the increase in the netback in the three month period is primarily due to lower operating expenses and royalty expenses.

	Three months ended March 31	
	2010	2009
Production revenue, including realized hedge gains (losses)	\$ 45.88	\$ 45.97
Royalty expense	(5.06)	(5.55)
Transportation Expense	(3.38)	(1.71)
Operating Costs	(13.07)	(15.86)
Netback, \$/boe	\$ 24.37	\$ 22.85
Netback, excluding realized hedge gains (losses) \$/boe	\$ 16.60	\$ 8.58

### GENERAL AND ADMINISTRATIVE EXPENSES

General and administrative ("G&A") expenses were \$774 or \$3.52 per boe for the three months ended March 31, 2010. On a per barrel basis, G&A expenses decreased 44 percent from the same period in 2009 as a result of lower costs and increased sales volumes. G&A expenses for the quarter are in line with Cequence's expectation of approximately \$3.00 - \$3.75 per boe in 2010.

\$ (000's)	Three months ended March 31	
	2010	2009
G&A Expenses (\$)	\$ 774	\$ 913
Total G&A (\$/boe)	\$ 3.52	\$ 6.34

## INTEREST EXPENSE

Interest expense for the three months ended March 31, 2010 was \$73 compared to \$469 for the comparative period in 2009. The decrease in interest expense is attributable to the decrease in bank debt and lower interest rates. As part of the reorganization of Sabretooth the Company repaid all of its outstanding current debt and; as a result, interest expense has decreased in the first quarter of 2010.

\$ (000's)	Three months ended March 31	
	2010	2009
Interest Expense (\$)	\$ 73	\$ 469
Per Unit of Production (\$/boe)	\$ 0.33	\$ 3.25

## DEPLETION, DEPRECIATION AND AMORTIZATION ("DD&A")

DD&A expense for the three months ended March 31, 2010 was \$5,040 or \$22.91 per boe. DD&A rates are comparable with the prior year.

\$ (000's)	Three months ended March 31	
	2010	2009
Depletion expense (\$)	\$ 5,040	\$ 3,584
Per Unit of Production (\$/boe)	\$ 22.91	\$ 24.86

## ASSET RETIREMENT OBLIGATIONS

Total asset retirement obligations at March 31, 2010 were \$4,560 compared to \$4,059 at December 31, 2009. Additions to asset retirement obligations in the first quarter totalled \$475 which related to drilling activity, facility additions and change in estimates. During the three month period ended March 31, 2010, the Company recorded accretion expense of \$82 (2009 - \$40).

## STOCK-BASED COMPENSATION

The Company recognizes stock-based compensation expense for stock options and performance warrants. For the three months ended March 31, 2010, Cequence recorded \$222 (2009 - \$195) in stock-based compensation expense related to stock options, with a corresponding increase to contributed surplus.

The Company issued 183 options in the quarter. Total stock-based compensation expense of \$240 was determined using the Black-Scholes option pricing model and will be expensed over the four year vesting period of the options.

As part of the reorganization, certain officers and directors of the Company were awarded a total of 5,200 performance warrants that are exercisable into a non-voting share of Cequence at a price of \$1.88. At the time the performance warrants were negotiated the market price of the Company's shares was \$1.48. The performance warrants are divided into three equal tranches with the first one-third having a four year term and vest once the 20 day weighted average share price of Cequence exceeds \$3.20. The second tranche has a 4.5 year term and vests if the 20 day weighted average share price of Cequence exceeds \$4.40. The final third of the performance warrants have a five year term and vest if the 20 day weighted average share price of Cequence exceeds \$5.60. The performance warrants are convertible to non-voting shares of Cequence.

The performance warrants are considered stock based compensation and have been valued using a Black-Scholes option pricing model. As of March 31, 2010 the first two performance criteria had been met and the Company recognized the full compensation expense related to the first two tranches of the performance warrants in 2009. The Company recognized \$8 of stock-based compensation for the performance warrants in the quarter ended March 31, 2010.

## COMMON SHARES OUTSTANDING

Issued common voting shares (000's)	Number	Stated Value
Balance, December 31, 2009	39,530	\$ 267,908
Future income tax on renouncing expenditures for flow-through shares	-	(512)
Balance, March 31, 2010	39,530	267,396

As part of the reorganization transactions in the third quarter of 2009, the Company consolidated its common shares on a four for one basis. All historical amounts have been restated.

On October 26, 2009 the Company issued 500 common shares on a CDE "flow-through" basis for total proceeds of \$2,025. In accordance with the terms of the agreement and pursuant to certain provisions of the Income Tax Act (Canada), the Company renounced, for income tax purposes, development expenditures of \$2,025 to the holders of the flow-through common shares effective December 31, 2009. Future tax of approximately \$512 associated with renouncing the expenditures was recorded on the date of renunciation in the first quarter of 2010. As at December 31, 2009 the Company had incurred all of the qualifying expenditures.

As of the date of this MD&A, Cequence had the following securities outstanding: 39,530 common voting shares, 5,200 warrants and 996 stock options.

## CAPITAL EXPENDITURES

\$(000's)	Three months ended March 31	
	2010	2009
Property Acquisitions	\$ 453	\$ -
Property Dispositions	(174)	-
Corporate Acquisitions	-	-
Land	2,058	140
Geological & geophysical and capitalized overhead	426	477
Drilling, completions and workovers	21,328	3,863
Equipment and facilities	2,558	287
Office furniture & equipment	42	-
<b>Total capital expenditures</b>	<b>\$ 26,691</b>	<b>\$ 4,767</b>

For the quarter ended March 31, 2010, drilling, completion and workover expenditures totalled \$21,328 and included one net horizontal well and three net vertical wells. In addition, Cequence completed two net horizontal wells and one net vertical well that were drilled in the fourth quarter. For the quarter ended March 31, 2009, drilling, completion and workover expenditures were limited to the completion of one horizontal well.

In the quarter ended March 31, 2010, the Company earned \$2,263 in Alberta crown drilling credits that may be claimed against future crown royalties. The drilling credits are earned at a rate of \$200 per metre of eligible drilling and can be claimed against Alberta crown royalties paid by Cequence between April 1, 2009 and March 31, 2011. No amount has been recognized in the March 31, 2010 financial statements for these credits as it is uncertain whether Cequence will incur sufficient Alberta crown royalties to claim these credits.

Cequence has budgeted capital expenditures of \$45,000 for 2010 with 59% of expenditures occurring in the first quarter. Capital expenditures will be funded out of cash flow and existing credit lines.

## INCOME TAXES

At March 31, 2010 a future income tax asset of \$5,165 (December 31, 2009 - \$5,575) has been recognized as the Company believes, based on estimated cash flows, it is more likely than not to be realized. At March 31, 2010, Cequence has the following tax pools:

Classification	Amount \$(000's)
UCC	\$ 23,336
COGPE	35,403
CEE	44,552
CDE	20,658
Share issue costs	3,718
SRED	22,704
Non-capital losses	32,218
ITCs	3,981
	<b>\$ 186,570</b>

The non-capital losses and investment tax credits expire as follows:

Year of expiry	Non-capital losses \$(000's)	Investment tax credits \$(000's)
2010	\$ -	\$ 930
2011	-	1,280
2012	-	672
2013	6,812	761
2014	2,791	338
2015+	22,615	-
	<b>\$ 32,218</b>	<b>\$ 3,981</b>

Based on the Company's expected cash flow and available tax pools, Cequence does not expect to be taxable in 2010.

## INVESTMENTS

The Company owns Asset Backed Notes ('MAV Notes') with a face value of \$24,138. These MAV Notes were issued in replacement of Third Party Asset Backed Commercial Paper ('ABCP') formerly held by the Company. In August 2007, this ABCP matured but was not redeemed as a result of liquidity issues in the ABCP market. The outstanding ABCP became the subject of a restructuring process overseen by the Pan Canadian Investor Committee. The restructuring was concluded on January 21, 2009 when the ABCP was replaced with long term asset backed securities - the MAV Notes.

Using publicly available information received from the Pan Canadian Investor Committee as well as Ernst & Young, the court appointed monitor of the restructuring, and Blackrock, the asset administrator, the Company has been able to determine the key characteristics of each class of MAV Notes it received: par value; credit rating; interest rate and projected interest payments; and maturity date. The Company then engaged an ABCP expert to help it estimate the return that a prospective investor would require for each class of MAV Notes (Required Yield). Lastly, it calculated the net present value of the cash flows for each class of MAV Notes using the Required Yield as the discount factor.

During the quarter, the Fair Market Value of the MAV Notes was positively impacted by three factors.

The largest impact on price was due to the continued improvement in general corporate credit market conditions over the quarter. There was some volatility in credit spreads, especially in February, as the market reacted to the sovereign debt crisis in Greece. The concerns about the situation in Greece and the worries about contagion spilling-over to corporate credit markets had largely abated by the end of March. In total, bond cohorts experienced a decline in yield from the beginning of the quarter to the end. The decrease in credit risk impacts the intrinsic value of the MAV Notes due to a general lowering of default risk and a decrease in the likelihood that credit risk limits built into the MAV Notes will be exceeded (specifically, the spread-based margin triggers). Accordingly, the Required Yields on the MAV Notes has been generally reduced to reflect easing in the credit markets, which in turn increased their fair market price as at March 31, 2010.

The MAV2 Notes Classes A-1 and A-2 accrue interest at a rate of 3-month CDOR minus 50 basis points. In assessing the fair value of the Notes, it has been predicted that they will not pay interest so long as the prevailing market interest rates persist at the currently very low levels. This assumption was borne out in the payment period ending January 7, 2010, for which no interest was accrued or payable on these Notes. Based on signals from the Bank of Canada and movements in the interest rate market, we continue to predict that these Notes will not pay interest until mid-2010 or for the next 2 quarterly payment periods. This change in assumption (the reduction of assumed future missed payments from 3 to 2) causes an increase in the valuation of the A-1 and A-2 Notes.

Lastly, the simple passage of time has a positive effect on fair market value. As with all debt instruments, the value of these MAV Notes will approach par as the date of maturity approaches and assuming that they do not default. The reduction in the time-to-maturity is a factor that increases the Fair Market Value of the MAV Notes this period.

For the valuation as at March 31, 2010, the Company engaged an ABCP expert and it has adopted the valuation model of that advisor. The methodology used takes into consideration market and other events affecting the MAV Notes and is expected to reflect the evolution of these Notes on a going-forward basis. As a result of this analysis, the Company has estimated the fair market value of its MAV Notes investment to be \$14,490 as at March 31, 2010. Accordingly, the Company has recorded an increase to long-term investments of \$756 in the quarter.

Management believes that an appropriate methodology has been used to estimate fair value; however, given the volatility of global credit markets there can be no assurance that management's estimate of potential recovery as at March 31, 2010 is accurate. Subsequent adjustments, either materially higher or lower, may be required in future reporting periods. Management will continue to seek all avenues to recover the maximum value from the original investments and interest due. The secondary market for the MAV Notes is developing. However, it is not yet a fully-'active market' given the limited number of bidders, the small number of disclosed transactions, and the persistence of prices below the intrinsic value of the Notes. It is uncertain if or when a fully-liquid secondary market for the MAV Notes will develop.

There are currently no market quotations available for the ABCP or the new MAV 2 notes and uncertainties exist regarding the value of the assets which underlie the MAV 2 notes, the amount and timing of cash flows, the evolution of the liquidity of the market for the new notes issued following the restructuring and the evolution of the prevailing economy could give rise to a further change in the value of the Company's investment in the MAV 2 notes. It is reasonably possible that changes in future conditions in the near term could require a material change in the recognized amount. A 1.0 percent increase in the discount rate will decrease the fair value of the MAV 2 notes by approximately \$842 before tax.

## LIQUIDITY AND CAPITAL RESOURCES

The Company has established two credit facilities with a Canadian chartered bank. Credit facility A is a \$40,000 revolving operating demand loan by way of prime rate based loans, Banker's Acceptances and letters of credit/guarantee, which bears interest at the bank prime rate plus 0.25 percent to 2.5 percent on a sliding scale, depending on the Company's debt to cash flow ratio (ranging from being less than 1.0:1.0 to greater than or equal to 3:1). Credit facility B is a \$5,000 non-revolving acquisition/development demand loan, which bears interest at the bank prime rate plus 0.75 percent to 3.0 percent on the same sliding scale as credit facility A. Both credit facilities are subject to periodic review by the bank and are secured by a general assignment of book debts and a \$165,000 demand debenture with a first floating charge over all assets of the Company. The Company is required to meet certain financial based covenants under the terms of this facility. The Company is also required to hedge no more than 70 percent of its production under the lending agreement. As at March 31, 2010, the Company has drawn \$109 under the revolving operating demand loan and \$nil under the acquisition/development demand loan

(December 31, 2009 - \$nil for both facilities) and is in compliance with all covenants. The next scheduled bank review is expected to take place in May 2010.

On March 31, 2009, the Company's bank provided the Company with an additional credit facility to provide liquidity in respect to the MAV 2 Notes. The credit facility is structured to a maximum of \$18,120 with an initial maturity date of March 30, 2012 with an option to extend the term to seven years on a year by year basis if agreed to by both parties. The facility provides lending against the restructuring notes held by the Company and was computed in two tranches:

Tranche A: \$10,800 revolving credit facility, which represents an amount equal to approximately 45 percent of the face value of the restructuring notes.

Tranche B: \$7,200 revolving credit facility, which represents an amount equal to approximately 30 percent of the face value of the restructuring notes.

Interest is payable at preferred rates. Prime rate loans are at the bank prime rate less 1 percent or by bankers acceptance at discounted bankers' acceptance rates plus a stamping fee of 0.65 percent. The credit facility is secured by the MAV 2 Notes as well as a hypothecation/pledge of the notes and all cash proceeds the Company receives on the sale of MAV 2 Notes will reduce the available amount of the facility commencing with Tranche A. The Company is required to meet certain financial based covenants under the terms of this facility. The credit facility provides for the ability of the Company to assign to the bank the MAV 2 Notes in payment of the principal due under Tranche A only.

At March 31, 2010 the Company had borrowed \$18,000 using this facility. The effective interest rate for the period ended March 31, 2010 was 1.13 percent.

### CONTRACTUAL OBLIGATIONS

	2010	2011	2012	2013	2014+	Total
Office lease	262	351	135	-	-	748
Pipeline transportation	1,187	1,575	1,575	1,575	3,017	8,929
Drilling services commitment	1,500	1,500	-	-	-	3,000
Total	2,949	3,426	1,710	1,575	3,017	12,677

The Company acquired a pipeline transportation contract in a property acquisition that expires on November 30, 2015.

The Company has a commitment to use the services of the Claimant of a lawsuit settled in the first quarter of 2010, at fair market value, in the amount of \$3,000 over the two years following the date of settlement. Cequence is obligated to spend a minimum of \$1,500 in each of the two years following the date of settlement to avoid any penalties under the commitment.

### SUBSEQUENT EVENTS

On April 21, 2010, Cequence announced that it had entered into an acquisition agreement (the "Agreement") with Peloton Exploration Corp. ("Peloton"), a private oil and gas company with production of approximately 650 BOE/d. Pursuant to the Agreement, Cequence will, subject to certain conditions, make an offer to acquire all of the issued and outstanding common shares of Peloton. Under the terms of the Agreement, Peloton shareholders will receive 0.205 of a Cequence common share for each Peloton share held for a total of 12,059 Cequence common shares. The estimated value of the transaction is \$30,914 based on an ascribed value of \$2.51 per common share based on Cequence's five day weighted average trading price on the TSX before and after the announcement of the transaction and estimated transaction costs.

The offer is open until June 10, 2010, the date of Cequence's annual general meeting. The offer is subject to shareholder approval and there can be no assurance it will be completed.

### DISCLOSURE CONTROLS AND INTERNAL CONTROLS OVER FINANCIAL REPORTING

The President and Chief Executive Officer and the Vice President, Finance and Chief Financial Officer are responsible for designing internal controls over financial reporting or causing them to be designed under their supervision in order to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with Canadian GAAP. The Company's Chief Executive Officer and Chief Financial Officer have designed, or caused to be designed under their supervision, disclosure controls and procedures 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 period in which the annual 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.

The COSO framework provides the basis for management's design of internal controls over financial reporting. Management and the Board work to mitigate the risk of a material misstatement in financial reporting; however, a control system, no matter how well conceived or operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met and it should not be expected that the disclosure and internal control procedures will prevent all errors or fraud.

As at March 31, 2010, the Chief Executive Officer and the Chief Financial Officer have concluded, based on their evaluation of the design and operating effectiveness of the Company's disclosure controls and internal controls over financial reporting ("ICFR") that disclosure controls and ICFR are effective.

## QUARTERLY INFORMATION

### FINANCIAL

(\$ thousands except per share data)	2010 Q1	2009 Q4	2009 Q3	2009 Q2	2009 Q1	2008 Q4	2008 Q3	2008 Q2
<b>Production Revenues</b>								
including realized gains (losses) on financial commodity contract	\$10,093	\$ 8,847	\$5,962	\$ 6,548	\$ 6,627	\$ 8,079	\$11,503	\$13,228
Royalties	\$ 1,114	809	1,170	385	800	894	1,437	1,350
Operating expenses	2,875	2,702	2,609	2,212	2,286	2,831	3,995	2,782
Transportation expenses	744	781	309	238	247	342	319	329
Reorganization expenses	-	-	3,295	-	-	-	-	-
Net income (loss)	(1,025)	(2,656)	(6,994)	(2,444)	3,440	(987)	6,113	(2,486)
Per share - basic	(0.03)	(0.07)	(0.26)	(0.25)	0.36	(0.10)	0.63	(0.25)
Per share - diluted	(0.03)	(0.07)	(0.26)	(0.25)	0.36	(0.10)	0.63	(0.25)
Funds flow	4,498	3,161	(2,663)	1,517	1,913	1,278	4,900	6,558
Per share - basic	0.11	0.08	(0.10)	0.16	0.20	0.13	0.50	0.67
Per share - diluted	0.11	0.08	(0.10)	0.16	0.20	0.13	0.50	0.67
Capital expenditures, net	26,412	16,526	3,334	209	4,767	6,024	(11,983)	9,522
Acquisition, net	279	6,374	15,421	-	-	(14,437)	-	-
Total expenditures	\$26,691	\$22,900	\$18,755	\$ 209	\$ 4,767	\$(8,413)	\$(11,983)	\$ 9,522

### OPERATIONS

	2010 Q1	2009 Q4	2009 Q3	2009 Q2	2009 Q1	2008 Q4	2008 Q3	2008 Q2
<b>Production Volumes</b>								
Natural gas (Mcf/day)	12,592	10,696	6,734	8,077	8,164	9,480	10,918	12,422
Oil (bbl/day)	268	230	128	106	140	186	197	179
NGLs (bbl/day)	78	76	67	96	104	122	107	107
Total boe/day	2,444	2,089	1,317	1,548	1,602	1,887	2,123	2,357
<b>Average selling price</b>								
Natural gas (\$per Mcf)	6.83	6.97	7.69	7.50	7.71	7.34	8.33	8.91
Oil (\$per bbl)	76.80	71.65	66.85	68.00	50.26	53.55	112.39	125.19
NGLs (\$per bbl)	71.81	68.82	66.76	52.12	35.28	67.98	112.16	113.55
Combined (\$per boe)	45.88	46.05	49.20	47.00	45.97	46.52	58.88	61.67
Royalties (\$per boe)	5.06	4.21	9.66	2.76	5.55	5.15	7.36	6.29
Operation expense (\$per boe)	13.07	14.06	21.53	15.88	15.86	16.30	20.45	12.97
Transportation (\$per boe)	3.38	4.07	2.55	1.71	1.71	1.97	1.63	1.53
Netback (\$per boe)	24.37	23.71	15.46	26.65	22.85	23.10	29.44	40.88

## FUTURE ACCOUNTING PRONOUNCEMENTS

The Company has assessed new and revised accounting pronouncements that have been issued that are not yet effective and determined that the following may have an impact on the Company:

### I) INTERNATIONAL FINANCIAL REPORTING STANDARDS

On January 1, 2011 International Financial Reporting Standards ("IFRS") will become the generally accepted accounting principles in Canada. The adoption date of January 1, 2011 will require the restatement, for comparative purposes, of amounts reported by Cequence for the year ended December 31, 2010, including the opening balance sheet as at January 1, 2010. Throughout 2009 and 2010 the Company has assessed the impact of adopting IFRS and is continuing to implement plans for transition. The project is being managed by in-house accounting professionals who have engaged in IFRS educational programs and continue to develop the Company's adoption to IFRS. The Company's auditors will be involved throughout the process to ensure the Company's policies are in accordance with these new standards.

Management has not yet finalized its accounting policies and as such is unable to quantify the impact on the financial statements of adopting IFRS. In addition, due to anticipated changes to IFRS and International Accounting Standards prior to Cequence's adoption of IFRS, Management's plan is subject to change based on new facts and circumstances that arise after the date of the MD&A.

In July 2009 an amendment to IFRS 1 First Time Adoption of International Reporting Standards was issued that applies to oil and gas assets. The amendment allows an entity that used full cost accounting under its previous GAAP to elect, at its time of adoption, to measure exploration and evaluation assets at the amount determined under the entity's previous GAAP and to measure oil and gas assets in the development and production phases by allocating the amount determined under the entity's previous GAAP for those assets to the underlying assets pro rata using reserve volumes or reserve values as of that date. Cequence currently anticipates that it will use this exemption. IFRS 1 also provides a number of other optional exemptions and mandatory exceptions in certain areas to the general requirement for full retrospective application. Management is analyzing the various accounting policy choices available and will implement those determined to be the most appropriate for the Company which other than the full cost accounting exemption noted above are:

*Business Combinations* – IFRS 1 would allow Cequence to use the IFRS rules for business combinations on a prospective basis rather than re-stating all business combinations.

*Borrowing Costs* – IFRS 1 would allow Cequence to apply the transitional provisions of IAS 23 in lieu of full retrospective application.

*Share-based payments* – IFRS 1 would allow Cequence an exemption on IFRS 2, "Share-Based Payments" to equity instruments which vested before Cequence's transition date to IFRS.

The transition from Canadian GAAP to IFRS is significant and may materially affect our reported financial position and results of operations. At this time, Cequence has identified key differences that will impact the financial statements as follows:

- Exploration and Evaluation ("E&E") expenditures – On transition to IFRS Cequence will re-classify all E&E expenditures that are currently included in the PP&E balance on the Consolidated Balance Sheet. This will consist of the book value of undeveloped land that relates to exploration properties. E&E assets will not be depleted and must be assessed for impairment when indicators of impairment exist.
- Depletion expense – On transition to IFRS Cequence has the option to base the depletion calculation on either proved reserves or proved and probable reserves. Cequence has not concluded at this time which method it will use.
- Impairment of PP&E assets – Under IFRS, impairment tests of PP&E must be performed on specific portions of PP&E as opposed to the entire PP&E balance which is currently required under Canadian GAAP through the full cost ceiling test. Impairment calculations will be performed at the cash generating unit level using either total proved or proved plus probable reserves.
- Due to the recent withdrawal of the exposure draft on IAS 12 Income Taxes in November 2009 and the issuance of the exposure draft on IAS 37 Provisions, Contingent Liabilities and Contingent Assets in January 2010, Management is still determining the impact of these revised standards on its IFRS transition.

In regards to internal controls over financial reporting ("ICOFR"), Cequence will be determining which additional changes to ICOFR will be required to deal with the changes in accounting policies. This will be ongoing through 2010 to ensure all changes in accounting policies include appropriate additional controls and procedures for future IFRS reporting requirements.

In regards to disclosure controls and procedures, Cequence will be assessing stakeholders' information requirements and ensure that appropriate and timely information is provided once available.

The Company is currently evaluating updates to its systems in regards to IFRS, which primarily involved updates to its accounting system. The modifications are not anticipated to be significant, however, they will allow the Company to report both Canadian GAAP and IFRS statements and track E&E costs, transfers from E&E to PP&E and allocation of PP&E into cash generating units.

The Company will have an opening January 1, 2010 balance sheet, which is in accordance with IFRS. The Company will maintain both Canadian GAAP and IFRS compliant financial statements in 2010.

## CURRENT ECONOMIC CONDITIONS

Recent market events and conditions, including disruptions in the international credit markets and other financial systems and the deterioration of global economic conditions, have caused significant volatility to commodity prices. These conditions persisted throughout 2009 and 2010, causing a loss of confidence in the global credit and financial markets and resulting in the collapse of, and government intervention in, major banks, financial institutions and insurers and creating a climate of greater volatility, less liquidity, widening of credit spreads, a lack of price transparency, increased credit losses and tighter credit conditions. Notwithstanding various actions by governments, concerns about the general condition of the capital markets, financial instruments, banks, investment banks, insurers and other financial institutions caused the broader credit markets to further deteriorate and stock markets to decline substantially. These factors have negatively impacted company valuations and will impact the performance of the global economy going forward. Petroleum and natural gas prices are expected to remain volatile for the near future as a result of market uncertainties over the supply and demand of these commodities due to the current state of the world economies, OPEC actions and the ongoing global credit and liquidity concerns.

## ROYALTY REGIMES

### Alberta

On March 11, 2010 the Alberta government announced further changes to its royalty regime which will take effect beginning January 1, 2011, as a result of its "Competitiveness Review". The key changes are: 1) the current incentive program of five percent for the first year of production on new natural gas and conventional oil wells will become permanent with the current time and volume limits; 2) the maximum royalty rate for conventional oil will be reduced at higher price levels from 50 percent to 40 percent; 3) the maximum royalty rate for conventional and unconventional natural gas will be reduced at higher price levels from 50 percent to 36 percent; 4) new royalty curves, which determine royalty rates at certain commodity price levels, will be finalized by May 2010; and 5) the transitional royalty framework will continue until its original announced expiration on December 31, 2013, however, effective January 1, 2011, no new wells will be allowed to select the transitional royalty rates.

## FORWARD-LOOKING STATEMENTS

Certain statements contained within this MD & A constitute forward-looking statements. These statements relate to future events or our future performance. All statements other than statements of historical fact may be forward-looking statements. Forward-looking statements are often, but not always, identified by the use of words such as "seek", "anticipate", "budget", "plan", "continue", "estimate", "expect", "forecast", "may", "will", "project", "predict", "potential", "targeting", "intend", "could", "might", "should", "believe", and similar expressions. Forward-looking statements in this MD & A include, but are not limited to, statements with respect to: the potential impact of implementation of the Alberta Royalty Framework on Cequence's condition and projected 2010 capital investments; the Company's ability to realize its investments in MAV 2 Notes; projections with respect to growth of natural gas production; the projected impact of land access and regulatory issues; projections relating to the volatility of crude oil prices in 2010 and beyond and reasons therefore; the Company's projected capital investment levels for 2010 and the source of funding therefore; the effect of the Company's risk management program, including the impact of derivative financial instruments; the Company's defence of lawsuits; the impact of the climate change initiatives on operating costs; the impact of Western Canada pipeline constraints; projections that the Company will fully recover from its MAV 2 Notes. Readers are cautioned not to place undue reliance on forward-looking statements, as there can be no assurance that the plans, intentions or expectations upon which they are based will occur.

By their nature, forward-looking statements involve numerous assumptions, known and unknown risks and uncertainties, both general and specific, that contribute to the possibility that the predictions, forecast, projects and other forward-looking statements will not occur, which may cause the Company's actual performance and financial results in future periods to differ materially from any estimates or projects of future performance or results expressed or implied by such forward-looking statements. These assumptions, risks and uncertainties include, among other things: volatility of and assumptions regarding oil and gas prices; assumptions based upon Cequence's current guidance; fluctuations in currency and interest rates; the Company's ability to realize its investment in MAV 2 Notes; product supply and demand; market competition; risk inherent in the Company's marketing operations, including credit risks; imprecision of reserves estimates and estimates of recoverable quantities of oil, natural gas and liquids from resource plays and other sources not currently classified as proved; the Company's ability to replace and expand oil and gas reserves; the Company's ability to generate sufficient cash flow from operations to meet its current and future obligations; the Company's ability to access external sources of debt and equity capital; the timing and cost of well and pipeline constructions; the Company's ability to secure adequate product transportation; changes in royalty, tax, environmental and other laws or regulations or the interpretations of such laws or regulations; risks associated with existing and potential future lawsuits and regulatory actions made against the Company; and other risks and uncertainties described from time to time in the reports and filings made with securities regulatory authorities by Cequence. 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 resources and reserves described can be profitably produced in the future.

The forward looking statements contained herein concerning production, sales prices, and capital spending are based on Cequence's 2010 capital program. The material assumptions supporting the 2010 capital program are: i) 2010 annual production of approximately 3,250 boe/day; ii) a \$5.00 CAD/GJ AECO gas price; iii) capital spending of approximately \$45,000 in 2010.

Financial outlook information contained in this MD & A about prospective results of operations, financial position or cash flows is based on assumptions about future events, including economic conditions and proposed courses of action, based on management's assessment of the relevant information currently available. The purpose of such financial outlook is to enrich this MD&A. Readers are cautioned that such financial outlook information contained in this MD & A should not be used for purposes other than for which it is disclosed herein.

Although Cequence believes that the expectations represented by such forward-looking statements are reasonable, there can be no assurance that such expectation will prove to be correct. Readers are cautioned that the foregoing list of important factors is not exhaustive. Furthermore, the forward-looking statements contained in this MD & A are made as of the date of this MD & A, and except as required by law Cequence does not undertake any obligation to update publicly or to revise any of the included forward-looking statements, whether as a result of new information, future events or otherwise. The forward-looking statements contained in this MD&A are expressly qualified by this cautionary statement.

**CEQUENCE ENERGY LTD.****CONSOLIDATED FINANCIAL STATEMENTS****CONSOLIDATED BALANCE SHEETS***(Unaudited)*

(Expressed in thousands of Canadian dollars)	March 31, 2010 \$	December 31, 2009 \$
<b>ASSETS</b>		
<b>CURRENT</b>		
Cash	-	18,128
Accounts receivable	9,753	10,144
Deposits and prepaid expenses	952	913
Commodity contracts	-	1,420
	10,705	30,605
Investments (Note 2)	14,490	13,920
Property and equipment (Note 3)	180,136	158,011
Future income taxes	5,165	5,575
	210,496	208,111
<b>LIABILITIES</b>		
<b>CURRENT</b>		
Demand credit facilities (Note 4)	109	-
Accounts payable and accrued liabilities	26,885	23,175
Future income taxes	-	424
	26,994	23,599
Long-term debt related to investments (Note 2)	18,000	18,204
Asset retirement obligations (Note 5)	4,560	4,059
	49,554	45,862
CONTINGENCIES AND COMMITMENTS (Note 10)		
SUBSEQUENT EVENTS (Note 14)		
<b>SHAREHOLDERS' EQUITY</b>		
Share capital (Note 6)	267,396	267,908
Contributed surplus (Note 8)	8,048	7,818
Deficit	(114,502)	(113,477)
	160,942	162,249
	210,496	208,111

**APPROVED BY THE BOARD**

"Donald Archibald"

Donald Archibald, Director

"Doug Dafoe"

Doug Dafoe, Director

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

**CEQUENCE ENERGY LTD.****CONSOLIDATED FINANCIAL STATEMENTS****CONSOLIDATED STATEMENTS OF OPERATIONS, COMPREHENSIVE INCOME (LOSS) AND DEFICIT***(Unaudited)*

(Expressed in thousands of Canadian dollars except per share amounts)	March 31, 2010 \$	March 31, 2009 \$
<b>REVENUE</b>		
Production revenue	8,384	4,570
Royalties	(1,114)	(800)
Realized gain on derivative financial instruments	1,709	2,057
Unrealized gain (loss) on derivative financial instruments	(1,420)	3,733
Other income (expense)	(49)	1
	<b>7,510</b>	<b>9,561</b>
<b>EXPENSES</b>		
Accretion expense (Note 5)	82	40
Depletion, depreciation, and amortization (Note 3)	5,040	3,584
General and administrative (Note 3)	774	913
Interest	73	469
Operating costs	2,875	2,286
Stock-based compensation (Note 7)	230	195
Transportation	744	247
Valuation gain on investment (Note 2)	(756)	-
	<b>9,062</b>	<b>7,734</b>
<b>INCOME (LOSS) BEFORE INCOME TAXES</b>	<b>(1,552)</b>	<b>1,827</b>
<b>INCOME TAXES</b>	<b>(527)</b>	<b>(1,700)</b>
<b>INCOME (LOSS) BEFORE NON-CONTROLLING INTEREST</b>	<b>(1,025)</b>	<b>3,527</b>
Non-controlling interest	-	(87)
<b>NET INCOME (LOSS) AND COMPREHENSIVE INCOME (LOSS)</b>	<b>(1,025)</b>	<b>3,440</b>
<b>DEFICIT, BEGINNING OF PERIOD</b>	<b>(113,477)</b>	<b>(104,823)</b>
<b>DEFICIT, END OF PERIOD</b>	<b>(114,502)</b>	<b>(101,383)</b>
Net Income (Loss) per share, basic and diluted (Note 9)	\$ (0.03)	\$ 0.36

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

**CEQUENCE ENERGY LTD.****CONSOLIDATED FINANCIAL STATEMENTS****CONSOLIDATED STATEMENTS OF CASH FLOWS***(Unaudited)*

(Expressed in thousands of Canadian dollars)	March 31, 2010 \$	March 31, 2009 \$
<b>CASH FLOWS RELATED TO THE FOLLOWING ACTIVITIES:</b>		
<b>OPERATING</b>		
Net income (loss)	(1,025)	3,440
Adjustments for non-cash items:		
Depletion, depreciation, and amortization	5,040	3,584
Accretion expense	82	40
Stock-based compensation	230	195
Valuation gain on investment (Note 2)	(756)	-
Unrealized loss (gain) on derivative financial instruments	1,420	(3,733)
Write-down of loan premium and other derivative financial instruments	32	-
Future income tax recovery	(525)	(1,700)
Non-controlling interest	-	87
	4,498	1,913
Asset retirement expenditures (Note 5)	(56)	(7)
Net change in non-cash working capital (Note 12)	(3,483)	(65)
	959	1,841
<b>INVESTING</b>		
Corporate acquisitions	-	-
Property and equipment expenditures	(26,412)	(4,767)
Acquisition of assets	(453)	-
Proceeds from sale of assets	174	-
Principal Repayments of Investments	4	-
Net change in non-cash working capital (Note 12)	7,545	(109)
	(19,142)	(4,876)
<b>FINANCING</b>		
Proceeds from demand credit facilities	109	-
Repayment of demand credit facilities	-	(15,451)
Proceeds from long-term debt related to investments	-	18,000
Repayment of long-term debt related to investments	(54)	-
Repurchase of common shares under NCIB	-	(85)
	55	2,464
<b>NET DECREASE IN CASH</b>	<b>(18,128)</b>	<b>(571)</b>
<b>CASH, BEGINNING OF PERIOD</b>	<b>18,128</b>	<b>15,437</b>
<b>CASH, END OF PERIOD</b>	<b>-</b>	<b>14,866</b>
<b>SUPPLEMENTARY INFORMATION</b>		
Income taxes paid	-	-
Interest paid	367	469

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

**CEQUENCE ENERGY LTD.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****THREE MONTH PERIOD ENDED MARCH 31, 2010**

(All figures expressed in thousands except per share amounts unless otherwise noted)

**1. BASIS OF PRESENTATION**

These interim consolidated financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles ("Canadian GAAP") and follow the same accounting policies as the most recent audited annual financial statements. The disclosures provided below are incremental to those included with the annual consolidated financial statements and certain disclosures, which are normally required to be included in the notes to the annual consolidated financial statements, have been condensed or omitted. These interim consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto in the Company's annual filings for the year ended December 31, 2009.

These statements include all assets, liabilities, revenues and expenses of Cequence Energy Ltd. and its wholly-owned subsidiary, 1175043 Alberta Ltd.

**2. INVESTMENTS AND LONG-TERM DEBT RELATED THERETO**

As at March 31, 2010, the Company held long-term floating rate notes ("MAV 2" notes) issued as a result of the restructuring discussed below. At December 31, 2008, the Company held the original Canadian asset-backed commercial paper ("ABCP") with an original cost of \$24,147. These investments matured during the third quarter of 2007 but, as a result of the liquidity issues in the ABCP market, did not settle on maturity.

On January 21, 2009, the Pan-Canadian Investors Committee announced that the restructuring had been completed to extend the maturity of the ABCP to provide for a maturity similar to that of the underlying assets. As a result, the Company received new replacement MAV 2 notes with a total face value of \$24,142.

The valuation technique used by the Company to estimate the fair value of its investment in MAV 2 notes at March 31, 2010 incorporates probability-weighted discounted cash flows considering the best available public information regarding market conditions and other factors that a market participant would consider for such investments. Discount rates used in the valuation at March 31, 2010 were 6.92 percent for Class A1 notes, 10.13 percent for Class A2 notes, 24.56 percent for Class B notes and 29.91 percent for subordinated notes (December 31, 2009 - 7.12 percent for Class A1 notes, 10.57 percent for Class A2 notes, 26.09 percent for Class B notes and 31.84 percent for subordinated notes). The probability weighted discounted cash flows resulted in an estimated fair value of the Company's MAV 2 notes of \$14,490 at March 31, 2010 (December 31, 2009 - \$13,738). As the estimated fair value was increased during the period, \$756 was recognized in income. As a result of low current interest rates, interest for the current period was considered nominal and has not been accrued. A 1.0 percent increase in the discount rate will decrease the fair value of the MAV 2 notes by approximately \$842 before tax.

There are currently no market quotations available for the ABCP or the new MAV 2 notes and uncertainties exist regarding the value of the assets which underlie the MAV 2 notes, the amount and timing of cash flows, the evolution of the liquidity of the market for the new notes issued following the restructuring and the evolution of the prevailing economy could give rise to a further change in the value of the Company's investment in the MAV 2 notes. It is reasonably possible that changes in future conditions in the near term could require a material change in the recognized amount.

On March 31, 2009, the Company's bank provided the Company with an additional credit facility to provide liquidity in respect to the MAV 2 notes. As at March 31, 2010 Cequence had borrowed \$18,000 under the facility.

The credit facility is secured by the MAV 2 notes as well as a hypothecation/pledge of the notes and all cash proceeds the Company receives on the sale of MAV 2 notes will reduce the available amount of the facility commencing with Tranche A. The Company is required to meet certain financial based covenants under the terms of this facility. As at March 31, 2010, the Company is in compliance with all covenants. The effective interest rate for the period ended March 31, 2010 was 1.13 percent. Interest expense on long-term debt related to investments included as interest expense in the consolidated statement of operations for the period ended March 31, 2010 was \$50 (March 31, 2009 - \$nil).

**CEQUENCE ENERGY LTD.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**THREE MONTH PERIOD ENDED MARCH 31, 2010**

(All figures expressed in thousands except per share amounts unless otherwise noted)

**3. PROPERTY AND EQUIPMENT**

	March 31, 2010	December 31, 2009
Petroleum and natural gas properties	251,690	224,525
Accumulated Depletion, Depreciation and Amortization	(71,554)	(66,514)
	<b>180,136</b>	<b>158,011</b>

Unproved properties and seismic not subject to depletion amounted to approximately \$17,823 at March 31, 2010 (March 31, 2009 - \$25,573).

The Company capitalized general and administrative costs related to exploration and development of approximately \$nil for the period ended March 31, 2010 (March 31, 2009 - \$483).

Costs subject to depletion include \$26,781 of estimated future capital costs (March 31, 2009 - \$16,968).

**4. DEMAND CREDIT FACILITIES**

The Company has established two credit facilities with a Canadian chartered bank; a \$40,000 revolving operating demand loan and a \$5,000 non-revolving acquisition/development demand loan. As at March 31, 2010, the Company has drawn \$109 under the revolving operating demand loan and \$nil under the acquisition/development demand loan (December 31, 2009 - \$nil for both facilities) and is in compliance with all covenants. The next scheduled review is to take place in May 2010.

**5. ASSET RETIREMENT OBLIGATIONS**

The following table summarizes the changes in asset retirement obligations for the period ended March 31, 2010 and year ended December 31, 2009:

	March 31, 2010	December 31, 2009
Balance - Beginning of period	4,059	2,515
Property acquisitions	-	1,165
Accretion expense	82	207
Liabilities incurred	213	190
Abandonment cost incurred	(56)	(75)
Revision in estimated cash flows	262	57
Balance - End of period	<b>4,560</b>	<b>4,059</b>

The total estimated, undiscounted cash flows, inflated at 2 percent, required to settle the obligations are \$15,360 (December 31, 2009 - \$13,648) which have been discounted using a weighted average credit-adjusted risk-free interest rate of 7.53 percent (December 31, 2009 - 7.47 percent). The Company expects these obligations to be settled in approximately 2 to 19 years. As at March 31, 2010, no funds have been set aside to settle these obligations.

**6. SHARE CAPITAL**

Cequence has an unlimited number of common voting shares and common non-voting shares.

	2010	
	Number (000's)	Stated Value \$
<b>Issued common voting shares</b>		
Balance, beginning of period	39,530	267,908
Future income tax on renouncing expenditures for flow-through shares	-	(512)
Balance, end of period	39,530	267,396

As at March 31, 2010, there were no issued or outstanding non-voting shares (December 31, 2009 - none).

**CEQUENCE ENERGY LTD.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****THREE MONTH PERIOD ENDED MARCH 31, 2010**

(All figures expressed in thousands except per share amounts unless otherwise noted)

**7. STOCK BASED COMPENSATION PLANS***Stock options*

During the quarter ended March 31, 2010, the Company issued 183 stock options at prices ranging from \$2.99 to \$3.13 to employees. The options have a five year life and 25 percent vest annually commencing in one year following the grant date. The Company utilized a Black-Scholes option pricing model to price the options.

A summary of the inputs used to value stock options is as follows:

	March 31, 2010 \$	December 31, 2009 \$
Risk-free interest rate	2.5% - 2.9%	2.7%
Expected life of options	5 years	5 years
Expected volatility	50%	50%
Expected dividend rate	0%	0%
Expected forfeiture rate	6%	14%
Weighted average fair value	\$ 1.40	\$ 2.00

A summary of the status of the Company's stock option plan and changes during the period ended March 31, 2010 and year ended December 31, 2009 is as follows:

	March 31, 2010		December 31, 2009	
	Number of Options (000's)	Weighted Average Exercise Price, \$	Number of Options (000's)	Weighted Average Exercise Price, \$
Outstanding, beginning of period	839	4.40	789	8.56
Granted	183	3.03	900	4.32
Exercised	-	-	-	-
Repurchased	-	-	-	-
Forfeited	-	-	(850)	8.19
Cancelled	-	-	-	-
Outstanding, end of period	1,022	4.16	839	4.40

The following table summarizes information about stock options outstanding at March 31, 2010:

Range of Exercise Price, \$	Options Outstanding			Options Exercisable	
	Weighted Average Exercise Price, \$	Number of Options Outstanding (000's)	Weighted Average Contractual Life Remaining (years)	Number of Options (000's)	Weighted Average Exercise Price, \$
2.99 - 4.32	4.09	1,008	4.5	0	0
8.36-10.68	8.93	14	7.8	6	8.91
	4.16	1,022	4.5	6	8.91

During the period ended March 31, 2010, \$222 (March 31, 2009 - \$195) in compensation expense related to stock options has been recognized in the consolidated statement of operations.

**PERFORMANCE WARRANTS**

The Company has a total of 5,200 performance warrants that are exercisable into a common, non-voting share of Cequence at a price of \$1.88.

The Company recognized \$8 of stock based compensation for the performance warrants in the period ended March 31, 2010 (March 31, 2009 - \$nil).

**CEQUENCE ENERGY LTD.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**THREE MONTH PERIOD ENDED MARCH 31, 2010**

(All figures expressed in thousands except per share amounts unless otherwise noted)

**8. CONTRIBUTED SURPLUS**

	March 31, 2010 \$	December 31, 2009 \$
Opening balance	7,818	5,596
Stock-based compensation expensed (note 7)	230	712
Share repurchase under NCIB	-	912
Warrants unexercised	-	598
Ending balance	<b>8,048</b>	<b>7,818</b>

**9. INCOME (LOSS) PER SHARE**

Net income (loss) per share has been calculated based on the weighted average number of common shares outstanding during the period. The following table reconciles the denominators used for the basic and diluted net income (loss) per share calculations. No stock options or warrants have been included in the calculation of diluted shares outstanding for the period ended March 31, 2010 (March 31, 2009 – none) as their inclusion would be anti-dilutive.

	March 31, 2010	March 31, 2009
Basic weighted average shares	39,530	9,620
Effect of dilutive stock options and warrants	-	-
Diluted weighted average shares	<b>39,530</b>	<b>9,620</b>

**10. CONTINGENCIES AND COMMITMENTS**

	2010	2011	2012	2013	2014+	Total
Office lease	262	351	135	-	-	748
Pipeline transportation	1,187	1,575	1,575	1,575	3,017	8,929
Drilling services	1,500	1,500	-	-	-	3,000
Total	<b>2,949</b>	<b>3,426</b>	<b>1,710</b>	<b>1,575</b>	<b>3,017</b>	<b>12,677</b>

The Company acquired a pipeline transportation contract in a property acquisition in 2009 that expires on November 30, 2015.

The Company has a commitment to use the services of the Claimant of a lawsuit settled in the first quarter of 2010, at fair market value, in the amount of \$3,000 over the two years following the date of settlement. Cequence is obligated to spend a minimum of \$1,500 in each of the two years following the date of settlement to avoid any penalties under the commitment.

**11. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT**

The Company’s financial instruments recognized in the consolidated balance sheet consist of accounts receivable, investments, demand credit facilities, accounts payable and accrued liabilities and long-term debt related to investments. The fair value of these financial instruments, excluding the investments, approximate their carrying values due to their short terms to maturity and the floating interest rate on the Company’s debt.

The fair value of the Company’s investment in MAV 2 notes, as disclosed in note 2, is determined by probability-weighted discounted cash flows considering the best available public information regarding market conditions and other factors that a market participant would consider for such investments.

The Company has exposure to market risk, credit risk and liquidity risk from its use of financial instruments. There have not been any changes to the Company’s exposure to risks, or the objectives, policies and processes to manage these risks from December 31, 2009.

**CEQUENCE ENERGY LTD.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****THREE MONTH PERIOD ENDED MARCH 31, 2010**

(All figures expressed in thousands except per share amounts unless otherwise noted)

**12. CHANGES IN NON-CASH WORKING CAPITAL**

	March 31, 2010 \$	March 31, 2009 \$
Accounts receivable	391	1,990
Deposits and prepaid expenses	(39)	208
Accounts payable and accrued liabilities	3,710	(2,372)
Net change in non-cash working capital	4,062	(174)
Allocated to:		
Operating activities	(3,483)	(65)
Investing activities	7,545	(109)
	4,062	(174)

**13. CAPITAL MANAGEMENT**

Cequence's objectives are to maintain a flexible capital structure in order to meet its financial obligations and to execute on strategic opportunities throughout the business cycle. The Company's capital comprises shareholders' equity, demand credit facilities and working capital. As described in note 2, the Company has long-term debt with the specific purpose of providing short-term liquidity in light of the restructuring of the Company's ABCP for MAV 2 notes. As the long-term debt is related specifically to the MAV 2 notes, both the long-term debt and MAV 2 notes are excluded from what Cequence determines to be capital for the purposes of capital management. Cequence manages the capital structure and makes adjustments in light of economic conditions and the risk characteristics of the underlying assets.

In order to maintain or adjust the capital structure, Cequence may issue new common shares, issue new debt or replace existing debt, adjust capital expenditures and acquire or dispose of assets.

The Company evaluates its capital structure based on the non-GAAP measure of net debt to cash flow from operating activities and the current credit available to Cequence compared to its budgeted capital expenditures. At March 31, 2010 Cequence has a negative net consolidated working capital of \$16,289 (December 31, 2009 – 7,430 positive).

Net debt to cash flow provides a measure of the Company's ability to manage its debt levels under current operating conditions. The ratio is calculated as net debt, defined as current debt, long term debt excluding the long-term debt related to investments and working capital excluding commodity derivative assets or liabilities, divided by cash flow from operations before asset retirement expenditures and changes in non-cash working capital for the most recent quarter.

It is the Company's objective to maintain a net debt to annualized cash flow ratio of less than 2:1. As at March 31, 2010, the ratio was calculated as 0.9:1 (December 31, 2009 – 0:1) based on annualized quarterly results.

The Company's current borrowing capacity is based on the lenders' semi-annual review of the Company's oil and natural gas reserves. The Company is also subject to various covenants including a minimum adjusted working capital ratio of 1:1, defined as current assets adjusted for unrealized hedging gains and undrawn availability under the credit facility over current liabilities less current portion of bank debt, under its credit facilities. Compliance with these covenants is monitored on a regular basis and at March 31, 2010 the adjusted working capital ratio was calculated as 1.87:1 (December 31, 2009 – 2.99:1).

**14. SUBSEQUENT EVENTS**

On April 21, 2010, Cequence announced that it had entered into an acquisition agreement (the "Agreement") with Peloton Exploration Corp. ("Peloton"), a private oil and gas company with production of approximately six hundred and fifty barrels of oil equivalent per day. Pursuant to the Agreement, Cequence will, subject to certain conditions, make an offer to acquire all of the issued and outstanding common shares of Peloton. Under the terms of the Agreement, Peloton shareholders will receive 0.205 of a Cequence common share for each Peloton share held for a total of 12,059 Cequence common shares. The estimated value of the transaction is \$30,914 based on an ascribed value of \$2.51 per common share based on Cequence's five day weighted average trading price on the TSX before and after the announcement of the transaction and estimated transaction costs.

The offer is open until June 10, 2010, the date of Cequence's annual general meeting. The offer is subject to shareholder approval and there can be no assurance it will be completed.

## CORPORATE INFORMATION

### MANAGEMENT

**Howard Crone, P.Eng**

President & CEO

**Richard Thompson**

Executive Vice President

**David Gillis, CA**

Vice President, Finance & CFO

**Hany Beshry**

Vice President, Exploration

**Robin Bieraugle, P.Eng.**

Vice President, Operations

**Nathan MacBey**

Vice President, Land

**Erin Thorson, CMA**

Controller

### DIRECTORS

**Don Archibald**

Chairman

**Howard Crone**

**Richard Thompson**

**Paul Colborne**

**Peter Bannister**

**Doug Dafoe**

**Brent Perry**

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### AUDITORS

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### BANKERS

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Calgary, Alberta

### LEGAL COUNSEL

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Calgary, Alberta

### EVALUATION ENGINEERS

**GLJ Petroleum Consultants**

Calgary, Alberta

### STOCK EXCHANGE LISTING

**Toronto Stock Exchange**

Symbol: CQE

[WWW.CEQUENCE-ENERGY.COM](http://WWW.CEQUENCE-ENERGY.COM)



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