

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

Second Quarter Interim Report 2010



cequence
energy ltd

HIGHLIGHTS

(000's except per share amounts)	Three months ended June 30		Six months ended June 30	
	2010	2009	2010	2009
Financial (\$)				
Production revenue, including realized hedge	\$ 9,174	\$ 6,547	\$ 19,267	\$ 13,174
Net income (loss)	(3,751)	(2,444)	(4,776)	996
Per share, basic and diluted	(0.09)	(0.25)	(0.12)	0.10
Funds flow from operations ⁽¹⁾	2,842	1,517	7,340	3,429
Per share, basic and diluted	0.07	0.16	0.18	0.36
Production volumes				
Natural gas (Mcf/d)	16,559	8,077	14,587	8,031
Crude oil (bbls/d)	253	106	260	121
Natural gas liquids (bbls/d)	184	96	131	99
Total (boe/d)	3,197	1,548	2,823	1,559
Sales prices				
Natural gas, including realized hedges (\$/Mcf)	\$ 4.21	\$ 7.50	\$ 5.34	\$ 7.61
Crude oil (\$/bbl)	70.22	68.00	73.59	57.91
Natural gas liquids (\$/bbl)	72.07	52.12	71.99	43.36
Total (\$/boe)	\$ 31.53	\$ 47.00	\$ 37.71	\$ 46.44
Operating Netbacks (\$/boe)				
Price	\$ 31.53	\$ 47.00	\$ 37.71	\$ 46.44
Royalties	(2.40)	(2.76)	(3.55)	(4.18)
Transportation	(2.88)	(1.71)	(3.10)	(1.71)
Operating costs	(11.66)	(15.88)	(12.27)	(15.86)
Operating Netback	\$ 14.59	\$ 26.65	\$ 18.79	\$ 24.69
Capital Expenditures	\$ 5,007	\$ 209	\$ 31,419	\$ 4,976
Corporate Acquisitions ⁽⁴⁾	29,369	-	29,369	-
Property Acquisitions (net)	-	-	279	-
Total capital expenditures	\$ 34,376	\$ 209	\$ 61,067	\$ 4,976
Net working capital (deficiency) ⁽²⁾	(25,226)	(16,863)	(25,226)	(16,863)
Long-term debt related to investments ⁽³⁾	(18,000)	(18,120)	(18,000)	(18,120)
Weighted average shares outstanding (basic and diluted)	42,048	9,615	40,796	9,618
Undeveloped land (net acres)	179,000	142,000	179,000	142,000

(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. As at June 30, 2010 the MAV II notes have an estimated fair value of \$14,100.

(4) Corporate acquisitions for the three and six months ended June 30, 2010 includes \$29,319 related to the acquisition of Peloton Exploration Corp. (\$695 cash).

MANAGEMENT'S DISCUSSION AND ANALYSIS

This Management's Discussion and Analysis ("MD & A") of the financial and operating results of 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 and six months ended June 30, 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.

This MD & A is dated August 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 of oil 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 ("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 the issuance of 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 June 11, 2010, the Company acquired all of the issued and outstanding shares of Peloton Exploration Corp. ("Peloton"), a private oil and gas company, for consideration of 12,059 common voting shares. The shares were valued based on Cequence's five day weighted average trading price on the TSX before and after the announcement of the transaction. The transaction was accounted for using the purchase method whereby the assets acquired and liabilities assumed are recorded at their fair value. The accounts of the Company include the results of Peloton effective June 11, 2010. The estimated purchase price allocation is as follows:

Cost of Acquisition	\$(000's)
Common shares (12,059 at \$2.51)	30,269
Transaction costs	645
Total	30,914

Fair Value of the Assets and Liabilities Acquired	\$(000's)
Property and equipment	29,319
Fair value of commodity contracts	339
Bank debt	(4,984)
Working capital deficiency	(1,031)
Asset retirement obligations	(552)
Future income tax assets – non-current	7,918
Future income tax liabilities – current	(95)
Total	30,914

SUBSEQUENT EVENTS

On July 27, 2010, Cequence sold certain non-producing gas weighted properties in the Sinclair region of Northwest Alberta for total cash consideration of \$36,900, subject to final adjustments.

On July 28, 2010, Cequence announced that it had entered into an agreement with a syndicate of underwriters (the "Underwriters") pursuant to which Cequence will issue 18,545 subscription receipts at a price of \$2.10 per subscription receipt for total proceeds of \$38,945. Each subscription receipt will be convertible into one common share of Cequence without payment of additional consideration. Cequence granted the Underwriters an over allotment option to purchase up to an additional 2,500 subscription receipts at \$2.10 per subscription receipt for total proceeds of \$5,250. The subscription receipts agreement is contingent on the successful closing of the acquisition of the Deep Basin Assets, as described below, and there can be no assurance that it will be completed, nor is there any assurance that the over allotment option will be exercised.

On July 28, 2010, Cequence further announced that it had entered into a definitive purchase and sale agreement to purchase certain gas weighted properties located in Northwest Alberta (the "Deep Basin Assets") for cash consideration of approximately \$85,000, subject to closing and final adjustments. The acquisition is expected to close on September 8, 2010, provided that all conditions are satisfied or waived by the party for whose benefit such conditions exist.

On July 28, 2010, Cequence also announced that it had entered into a plan of arrangement (the "Plan of Arrangement") with Temple Energy Inc. ("Temple"), a private oil and gas company. Pursuant to the Plan of Arrangement, Cequence will, subject to certain conditions, acquire all of the issued and outstanding common shares of Temple. Under the terms of the Plan of Arrangement, Temple shareholders will receive 0.355 of a Cequence common share for each Temple share held for a total of 46,711 Cequence common shares. The estimated value of the transaction is \$109,983, including transaction costs, based on an ascribed value of \$2.28 per common share based on Cequence's five day weighted average trading price on the TSX before and after the announcement of the transaction. The arrangement is expected to close on September 10, 2010. The arrangement is subject to shareholder approval and there can be no assurance it will be completed. Cequence further announced that it had entered into an agreement with a syndicate of agents (the "Agents") to sell, on a private placement basis, common and flow-through shares totalling 7,020 shares for total consideration of \$16,196.

SELECTED FINANCIAL INFORMATION

Cequence recorded a loss of \$3,751 for the quarter ended June 30, 2010. Net income and funds flow from operations for the period were negatively impacted by low natural gas prices.

Funds flow from operations was \$2,842 for the quarter compared to \$1,517 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 June 30		Six months ended June 30	
	2010	2009	2010	2009
Cash flow from operating activities	\$ (368)	\$ 2,181	\$ 592	\$ 4,022
Asset retirement expenditures	10	10	66	17
Net change in non-cash working capital	3,200	(674)	6,682	(610)
Funds flow from operations	\$ 2,842	\$ 1,517	\$ 7,340	\$ 3,429

RESULTS OF OPERATIONS

PRODUCTION

Production for the six months ended June 30, 2010 averaged 2,823 boe/d compared to production of 1,559 boe/d in 2009. Production for the three months ended June 30, 2010 averaged 3,197 boe/d compared to production of 1,548 boe/d in the second quarter of 2009. The increase in production is due to property acquisitions completed in 2009, the acquisition of Peloton completed in the second quarter of 2010 as well as new drilling and recompletions in the first and second quarters of 2010. The Peloton acquisition was completed on June 11, 2010, at which time Peloton was producing approximately 650 boe/d. Since the Peloton acquisition was completed late in the quarter, the effect was to increase production by 134 boe/d for the quarter ended June 30, 2010. Consolidated production subsequent to the completion of the Peloton acquisition was approximately 3,760 boe/d.

Average production volumes for the three and six month periods ended June 30, 2010 and 2009 are outlined below:

	Three months ended June 30			
	2010		2009 ⁽¹⁾	
	Total	Per Day	Total	Per Day
Natural Gas (Mcf)	1,506,886	16,559	726,935	8,077
Crude Oil (bbls)	23,026	253	9,514	106
NGLs (boe)	16,789	184	8,621	96
Total (boe)	290,963	3,197	139,291	1,548

	Six months ended June 30			
	2010		2009 ⁽¹⁾	
	Total	Per Day	Total	Per Day
Natural Gas (Mcf)	2,640,201	14,587	1,461,724	8,031
Crude Oil (bbls)	47,127	260	22,071	121
NGLs (boe)	23,787	131	17,968	99
Total (boe)	510,948	2,823	283,660	1,559

(1) Includes royalty volumes

PRICING

Benchmark natural gas, crude oil and natural gas liquids prices were higher than the six month comparative period in 2009. Cequence realized a natural gas price including hedging gain (as described below) for the three and six month periods ended June 30, 2010 of \$4.21 and \$5.34, respectively. The realized prices for the six months ended June 30, 2010 are above prevailing market prices as 6,000 gj per day of the Company's natural gas production in the first quarter was sold at a price of \$7.85 under a fixed price contract, which expired March 31, 2010. Further, 2,800 Mcf/d of the Company's natural gas production in the six months ended June 30, 2010 was sold at Chicago which was at a premium to AECO. Cequence's production is approximately 86 percent natural gas and consequently, fluctuations in natural gas prices have a significant impact on the Company.

Oil prices for the second quarter of 2010 were \$70.22 per barrel, up 3 percent from the same time period in 2009. Oil prices for the six months ended June 30, 2010 were \$73.59, up 27 percent from the same period in 2009. Natural gas liquids prices for the second quarter of 2010 were \$72.07 per barrel, up 38 percent from the same time period in 2009. Natural gas liquids prices for the six months ended June 30, 2010 were \$71.99, up 66 percent from the same period in 2009.

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

	Three months ended June 30		Six months ended June 30	
	2010	2009	2010	2009
Average Selling Price				
Natural gas (\$/Mcf)	\$ 4.17	\$ 4.07	\$ 4.66	\$ 4.49
Realized natural gas hedge \$/Mcf)	0.04	3.43	0.68	3.12
Natural gas including realized hedge gains and losses (\$/Mcf)	4.21	7.50	5.34	7.61
Crude Oil (per bbl)	70.22	68.00	73.59	57.91
Natural gas liquids (per bbl)	72.07	52.12	71.99	43.36
Average sales price before hedge (per boe)	\$ 31.31	\$ 29.13	\$ 34.24	\$ 30.42
Average sales price including hedge (per boe)	\$ 31.53	\$ 47.00	\$ 37.71	\$ 46.44

	Three months ended June 30		Six months ended June 30	
	2010	2009	2010	2009
Benchmark Pricing				
AECO-C Spot (CDN\$/Mcf)	\$ 3.91	\$ 3.48	\$ 4.41	\$ 4.20
WTI crude oil (US\$/bbl)	77.88	59.69	78.26	51.44
Edmonton par price (CDN\$/bbl)	75.86	66.90	78.44	59.02
US\$/CDN\$ exchange rate	0.97	0.86	0.97	0.83

COMMODITY PRICE MANAGEMENT

Sequence has a commodity price risk management program which provides the Company flexibility to enter into derivative and physical commodity contracts to protect future cash flows for 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. As part of the acquisition of Peloton, Sequence assumed natural gas contracts for the sale of 1,800 gj per day of natural gas at prices ranging from \$4.69 per gj to \$5.32 per gj. The fair value of derivative commodity contracts at June 30, 2010 is \$296 compared to \$5,455 in 2009.

	Three months ended June 30		Six months ended June 30	
	2010	2009	2010	2009
Realized gain on commodity contracts	63	2,489	1,772	4,546
Unrealized gain (loss) on commodity contracts	(42)	(1,326)	(1,462)	2,407
Total	21	1,163	310	6,953

REVENUE

Total revenue was \$9,174 in the second quarter of 2010 compared to \$6,547 for the comparable period in 2009. The increase in revenue is mainly attributable to the 109 percent increase in production, offset by a 33 percent decrease in realized sales prices. For the six months ended June 30, 2010, total revenue increased 46 percent to \$19,267 from \$13,174 in the prior year. The increase is a result of a 80 percent increase in production volumes, offset by a 19 percent decrease in realized sales prices.

	Three months ended June 30		Six months ended June 30	
	2010	2009	2010	2009
\$(000's)				
Natural gas	\$ 6,285	\$ 2,962	\$ 12,315	\$ 6,571
Realized gains on natural gas contracts	63	2,489	1,772	4,546
Total natural gas	6,348	5,451	14,087	11,117
Oil	1,617	647	3,468	1,278
Natural gas liquids	1,209	449	1,712	779
Total Revenue	\$ 9,174	\$ 6,547	\$ 19,267	\$ 13,174

ROYALTY EXPENSE

Royalty expense in the second quarter of 2010 was \$699 or 8 percent of revenue compared to \$385 or 9 percent of revenue in the second quarter of 2009. For the six months ended June 30, 2010, royalties as a percentage of revenue were 11 percent compared to 14 percent in the comparative period in 2009. On a per barrel basis, royalties are relatively consistent with the comparative periods in 2009. 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, 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 June 30		Six months ended June 30	
	2010	2009	2010	2009
Crown	\$ 620	\$ 301	\$ 1,712	\$ 1,089
Freehold / Overriding	79	84	101	96
	\$ 699	\$ 385	\$ 1,813	\$ 1,185
As a % of revenue, before hedging activity				
Crown	7%	7%	10%	13%
Freehold / Overriding	1%	2%	1%	1%
	8%	9%	11%	14%
Per Unit of Production (\$/boe)				
Crown	\$ 2.13	\$ 2.16	\$ 3.35	\$ 3.84
Freehold / Overriding	0.27	0.60	0.20	0.34
	\$ 2.40	\$ 2.76	\$ 3.55	\$ 4.18

TRANSPORTATION EXPENSE

Transportation costs for the six months ended June 30, 2010 were \$3.10 per boe, an increase of 81 percent from the comparative period in 2009 primarily due to the gas transportation contract described below. In the second quarter of 2010, transportation costs increased to \$2.88 per boe from \$1.71 per boe in the comparative period in 2009. Beginning in the fourth quarter of 2009, approximately 2,800 Mcf/d of natural gas is being shipped on the Alliance pipeline at a cost of \$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 six months ended June 30, 2010 are lower than Cequence's expectation of \$3.50 per boe in 2010 due mainly to lower costs on new wells drilled and recompleted and lower costs on properties acquired through the acquisition of Peloton. Cequence expects transportation costs to average \$2.50/boe for the remainder of 2010.

\$(000's)	Three months ended June 30		Six months ended June 30	
	2010	2009	2010	2009
Transportation (\$)	\$ 840	\$ 238	\$ 1,584	\$ 485
Per Unit of Production (\$/boe)	\$ 2.88	\$ 1.71	\$ 3.10	\$ 1.71

OPERATING COSTS

For the six months ended June 30, 2010, operating costs decreased to \$12.27 per boe from \$15.86 in the comparative period in 2009. Operating costs during the second quarter of 2010 were \$3,392 or \$11.66 per boe compared to \$2,212 or \$15.88 per boe for the same time period in 2009. Operating costs decreased in the three and six months ended June 30, 2010 compared to the same periods in 2009 due mainly to lower costs on new wells drilled and recompleted in the period and on wells acquired through the acquisition of Peloton as well as increased efficiencies on existing wells. Accordingly, operating costs for the six months ended June 30, 2010 are lower than Cequence's expectation of approximately \$13–\$15 per boe in 2010. Cequence expects operating costs to average \$11–\$13 per boe for the remainder of 2010.

\$(000's)	Three months ended June 30		Six months ended June 30	
	2010	2009	2010	2009
Operating Costs (\$)	\$ 3,392	\$ 2,212	\$ 6,267	\$ 4,498
Per Unit of Production (\$/boe)	\$ 11.66	\$ 15.88	\$ 12.27	\$ 15.86

OPERATING NETBACKS

Cequence's netback for the second quarter of 2010 decreased to \$14.59 per boe from \$26.65 in 2009. For the six months ended June 30, 2010 the netback decreased to \$18.79 per boe from \$24.69 in the comparative period. In comparison to 2009, the decrease in the netback in the three and six month periods is primarily due to a lower realized sales price resulting from the expiry of the Company's 6,000 gj/day commodity contract at March 31, 2010.

Prior to hedging, Cequence's netbacks increased in both the three and six month periods ended June 30, 2010 due to an increase in sales prices and a decrease in operating costs.

	Three months ended June 30		Six months ended June 30	
	2010	2009	2010	2009
Production revenue, including realized hedge gains (losses)	\$ 31.53	\$ 47.00	\$ 37.71	\$ 46.44
Royalty expense	(2.40)	(2.76)	(3.55)	(4.18)
Transportation Expense	(2.88)	(1.71)	(3.10)	(1.71)
Operating Costs	(11.66)	(15.88)	(12.27)	(15.86)
Netback, \$/boe	\$ 14.59	\$ 26.65	\$ 18.79	\$ 24.69
Netback, excluding realized hedge gains (losses) \$/boe	\$ 14.37	\$ 8.78	\$ 15.32	\$ 8.67

GENERAL AND ADMINISTRATIVE EXPENSES

For the six months ended June 30, 2010 general and administrative ("G&A") expenses decreased to \$1,963 from \$2,797 in 2009. On a per barrel basis, general and administrative costs decreased for the six months ended June 30, 2010 compared to 2009 to \$3.84 per boe from \$9.86 per boe, respectively, as the production base of the Company has increased and expenditures have decreased from prior year. The reorganization of the Company in August 2009 led to a reduction in overall G&A expenses.

G&A expenses were \$1,189 or \$4.09 per boe for the three months ended June 30, 2010. On a per barrel basis, G&A expenses decreased 70 percent from the same period in 2009 as a result of lower costs and increased sales volumes. G&A expenses for the year continue to be in line with Cequence's expectation of approximately \$3.00 – \$3.75 per boe in 2010.

\$(000's)	Three months ended June 30		Six months ended June 30	
	2010	2009	2010	2009
G&A Expenses (\$)	\$ 1,189	\$ 1,884	\$ 1,963	\$ 2,797
Total G&A (\$/boe)	\$ 4.09	\$ 13.52	\$ 3.84	\$ 9.86

INTEREST EXPENSE

Interest expense for the three months ended June 30, 2010 was \$215 compared to \$294 for the comparative period in 2009. For the six months ended June 30, 2010 interest expense was \$288 compared to \$763 in 2009. The decrease in interest expense in both periods 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 resulting in interest expense decreasing in the first six months of 2010.

\$(000's)	Three months ended June 30		Six months ended June 30	
	2010	2009	2010	2009
Interest Expense (\$)	\$ 215	\$ 294	\$ 288	\$ 763
Per Unit of Production (\$/boe)	\$ 0.74	\$ 2.11	\$ 0.56	\$ 2.68

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

DD&A expense for the three months ended June 30, 2010 was \$6,341 or \$21.79 per boe. For the six months ended June 30, 2010, DD&A was \$11,381 or \$22.27 per boe. DD&A rates are lower than in comparable periods in 2009 due mainly to drilling in the period and the acquisition of Peloton, both completed at a lower cost per boe than Cequence's existing resource base.

\$(000's)	Three months ended June 30		Six months ended June 30	
	2010	2009	2010	2009
Depletion expense (\$)	\$ 6,341	\$ 3,339	\$ 11,381	\$ 6,923
Per Unit of Production (\$/boe)	\$ 21.79	\$ 23.97	\$ 22.27	\$ 24.41

ASSET RETIREMENT OBLIGATIONS

Total asset retirement obligations at June 30, 2010 were \$5,170 compared to \$4,059 at December 31, 2009. Additions to asset retirement obligations in the first six months of 2010 totalled \$1,009 which relates to liabilities assumed on the acquisition of Peloton as well as to drilling activity, facility additions and changes in estimates. During the three and six month periods ended June 30, 2010, the Company recorded accretion expense of \$86 and \$168, respectively (2009- \$39 and \$79, respectively).

STOCK-BASED COMPENSATION

The Company recognizes stock-based compensation expense for stock options and performance warrants. For the three months ended June 30, 2010, Cequence recorded \$251 (2009 - \$134) in stock-based compensation expense related to stock options, with a corresponding increase to contributed surplus. For the six months ended June 30, 2010, stock-based compensation expense related to stock options was \$473 compared to \$328 in 2009.

The Company issued 538 options in the first six months of 2010. Total stock-based compensation expense of \$541 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 of Sabretooth, 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 June 30, 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 \$16 of stock-based compensation for the performance warrants in the six months ended June 30, 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)
Corporate acquisitions	12,059	30,269
Share issue costs, net of taxes of \$13	-	(37)
Balance, June 30, 2010	51,589	\$ 297,628

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.

On June 11, 2010, the Company completed the acquisition of Peloton, as described above, and issued 12,059 common voting shares with a deemed value of \$2.51 per share for total deemed consideration of \$30,269.

As of the date of this MD&A, Cequence had the following securities outstanding: 51,589 common voting shares, 5,200 warrants and 1,352 stock options.

CAPITAL EXPENDITURES

\$(000's)	Three months ended		Six months ended	
	2010	2009	2010	2009
Property Acquisitions	\$ -	\$ -	\$ 453	\$ -
Property Dispositions	-	-	(174)	-
Corporate Acquisitions ⁽¹⁾	695	-	695	-
Land, net	624	(113)	2,682	27
Geological & geophysical and capitalized overhead	316	465	742	942
Drilling, completions and workovers	2,703	(544)	24,031	3,319
Equipment and facilities	1,356	401	3,914	688
Office furniture & equipment	8	-	50	-
Total capital expenditures	\$ 5,702	\$ 209	\$ 32,393	\$ 4,976

(1) Corporate acquisitions for the three and six months ended June 30, 2010 do not include \$28,674 in non-cash items related to the acquisition of Peloton.

For the six months ended June 30, 2010, drilling, completion and workover expenditures totalled \$24,031 which included 1.6 net horizontal wells and 3.5 net vertical wells. In addition, Cequence completed one net horizontal well and one net vertical well that were drilled in the fourth quarter of 2009. For the six months ended June 30, 2009, drilling, completion and workover expenditures were limited to the completion of one horizontal well and one re-entry.

In the six months ended June 30, 2010, the Company earned \$2,401 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 June 30, 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 71% of expenditures occurring in the first two quarters. Capital expenditures will be funded out of cash flow and existing credit lines.

INCOME TAXES

At June 30, 2010, a future income tax asset of \$13,609 (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. There is also a future income tax liability recognized at June 30, 2010 of \$81 (December 31, 2009 – \$424). At June 30, 2010, Cequence has the following tax pools:

Classification	Amount \$(000's)
CEE	\$ 62,002
Non-capital losses	55,642
COGPE	42,930
CDE	31,568
UCC	27,623
SRED	22,704
Share issue costs	3,697
ITCs	3,051
	<u>\$ 249,217</u>

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	\$ -	\$ -
2011	-	1,280
2012	-	672
2013	6,812	761
2014	2,791	338
2015+	46,039	-
	<u>\$ 55,642</u>	<u>\$ 3,051</u>

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

INVESTMENTS

As at June 30, 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.

Subsequent to June 30, 2010, Cequence has actively undertaken a plan to dispose of its interest in MAV 2 notes, whereby the Company plans to sell the MAV 2 notes into the currently developing market for such instruments. As a result, the Company has written down the MAV 2 notes to prevailing market bid prices for similar instruments. This has resulted in an estimated fair value of the Company's MAV 2 notes of \$14,100 at June 30, 2010 (December 31, 2009 – \$13,738).

The market for MAV 2 notes continues to evolve and there can be no certainty that Cequence will be able to sell the MAV 2 notes. Prevailing market prices vary with 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. It is reasonably possible that changes in future conditions in the near term could result in a material change in the recognized amount of the MAV 2 notes.

Changes to the estimated fair value of the MAV 2 Notes resulted in a \$390 loss and \$366 gain recognized in income for the three and six month periods ended June 30, 2010, respectively. As a result of low current interest rates, interest for the current period was considered nominal and has not been accrued.

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 \$145,000 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 50 percent of its production under the lending agreement. As at June 30, 2010, the Company has drawn \$20,451 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 September 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 completed 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. All cash proceeds of the Company received 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 June 30, 2010, the Company had borrowed \$18,000 using this facility. The effective interest rate for the three and six month periods ended June 30, 2010 was 1.26 and 1.20 percent, respectively.

CONTRACTUAL OBLIGATIONS

	2010	2011	2012	2013	2014+	Total
Office lease	175	351	135	-	-	661
Pipeline transportation	795	1,594	1,594	1,594	3,052	8,629
Drilling services commitment	1,441	1,500	-	-	-	2,941
Total	2,411	3,445	1,729	1,594	3,052	12,231

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 drilling and related 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. Cequence has incurred \$59 as at June 30, 2010.

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 Committee of Sponsoring Organizations ("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 June 30, 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 Q2	2010 Q1	2009 Q4	2009 Q3	2009 Q2	2009 Q1	2008 Q4	2008 Q3
Production Revenues								
including realized gains (losses) on financial commodity contract	\$ 9,174	\$10,093	\$8,847	\$5,962	\$6,548	\$6,627	\$8,079	\$11,503
Royalties	699	1,114	809	1,170	385	800	894	1,437
Operating expenses	3,392	2,875	2,702	2,609	2,212	2,286	2,831	3,995
Transportation expenses	840	744	781	309	238	247	342	319
Reorganization expenses	-	-	-	3,295	-	-	-	-
Net income (loss)	(3,751)	(1,025)	(2,656)	(6,994)	(2,444)	3,440	(987)	6,113
Per share – basic	(0.09)	(0.03)	(0.07)	(0.26)	(0.25)	0.36	(0.10)	0.63
Per share – diluted	(0.09)	(0.03)	(0.07)	(0.26)	(0.25)	0.36	(0.10)	0.63
Funds flow	2,842	4,498	3,161	(2,663)	1,517	1,913	1,278	4,900
Per share – basic	0.07	0.11	0.08	(0.10)	0.16	0.20	0.13	0.50
Per share – diluted	0.07	0.11	0.08	(0.10)	0.16	0.20	0.13	0.50
Capital expenditures, net	5,007	26,412	16,526	3,334	209	4,767	6,024	(11,983)
Acquisition, net ⁽¹⁾	695	279	6,374	15,421	-	-	(14,437)	-
Total expenditures	\$5,702	\$26,691	\$22,900	\$18,755	\$ 209	\$4,767	\$(8,413)	\$(11,983)

(1) Acquisitions for the three months ended June 30, 2010 do not include \$28,674 in non-cash items related to the acquisition of Peloton.

	2010 Q2	2010 Q1	2009 Q4	2009 Q3	2009 Q2	2009 Q1	2008 Q4	2008 Q3
OPERATIONS								
Production Volumes								
Natural gas (Mcf/day)	16,559	12,592	10,696	6,734	8,077	8,164	9,480	10,918
Oil (bbl/day)	253	268	230	128	106	140	186	197
NGLs (bbl/day)	184	78	76	67	96	104	122	107
Total (boe/day)	3,197	2,444	2,089	1,317	1,548	1,602	1,887	2,123
Average selling price								
Natural gas (\$per Mcf)	4.21	6.83	6.97	7.69	7.50	7.71	7.34	8.33
Oil (\$per bbl)	70.22	76.80	71.65	66.85	68.00	50.26	53.55	112.39
NGLs (\$per bbl)	72.07	71.81	68.82	66.76	52.12	35.28	67.98	112.16
Combined (\$per boe)	31.53	45.88	46.05	49.20	47.00	45.97	46.52	58.88
Royalties (\$per boe)	2.40	5.06	4.21	9.66	2.76	5.55	5.15	7.36
Operating expenses (\$per boe)	11.66	13.07	14.06	21.53	15.88	15.86	16.30	20.45
Transportation (\$per boe)	2.88	3.38	4.07	2.55	1.71	1.71	1.97	1.63
Netback (\$per boe)	14.59	24.37	23.71	15.46	26.65	22.85	23.10	29.44

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 Financial 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.

Decommissioning Liabilities – IFRS 1 would allow Cequence to measure decommissioning liabilities as at the transition date in accordance with IAS 37, "Provisions, Contingent Liabilities and Contingent Assets" and recognize directly in deficit the difference between that amount and the carrying amount of those liabilities at the date of transition determined under Canadian GAAP.

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.
- Property and equipment – This includes oil and gas assets in the development and production phases. The Company has allocated the amount recognized under current Canadian GAAP as at January 1, 2010 using reserve values to the assets at an area level. Cequence is evaluating the outcome of each calculation.
- 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 expects to base the depletion calculation on proved plus probable reserves.
- 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. Cequence has determined its cash generating units for the purpose of impairment testing and anticipates using proved plus probable values for impairment tests.

- Provisions – The major difference between the current Canadian GAAP standard and IFRS, as it affects Cequence, relates to the discount rate used to measure the decommissioning liabilities. Under current Canadian GAAP a credit-adjusted risk-free rate is used, whereas the IFRS standard indicates the use of a risk-free rate. A lower discount rate will increase the decommissioning liability on the date of transition and the difference will be charged to deficit.
- 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 addition to the accounting policy differences above, Cequence's transition to IFRS will impact the internal controls over financial reporting, the disclosure controls and procedures and information technology systems as follows:

Internal controls over financial reporting – As the review and analysis of Cequence's accounting policies under IFRS is completed, an assessment will be made to determine the changes required to internal controls over financial reporting. This will be an ongoing process in 2010 to ensure that changes in accounting policies include the appropriate additional controls and procedures for future IFRS reporting requirements.

Disclosure controls and procedures – Throughout the transition process, Cequence will be assessing stakeholders' information requirements and will ensure that adequate and timely information is provided while ensuring the Company maintains its due process regarding information that is disclosed.

Information Technology systems – The Company is currently evaluating updates to its systems in regards to IFRS, which primarily involve 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.

Management is continuing to finalize its accounting policies and choices 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, certain items may be subject to change based on new facts and circumstances that arise after the date of this MD&A.

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; and 4) 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.

On May 27, 2010 the Alberta government released the new royalty curves associated with the changes announced on March 11, 2010, which determine the royalty rates at certain commodity price levels, and revised the natural gas deep drilling credit to wells deeper than 2,000 metres, compared to 2,500 metres previously. The deep drilling credit is \$625 per metre for wells between 2,000 metres and 3,500 metres with higher rates thereafter, increasing incrementally with increased depth. The Alberta government also announced an extension to the five percent new well rate to 18 production months and a volume limit of 500 MMcf for horizontal gas wells and time and volume limit extensions on horizontal oil wells, dependent on depth

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, projections 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 projections 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)	June 30, 2010 \$	December 31, 2009 \$
ASSETS		
CURRENT		
Cash	600	18,128
Accounts receivable	8,767	10,144
Deposits and prepaid expenses	1,017	913
Commodity contracts (Note 12)	296	1,420
	10,680	30,605
Investments (Note 3)	14,100	13,920
Property and equipment (Note 4)	208,154	158,011
Future income taxes	13,609	5,575
	246,543	208,111
LIABILITIES		
CURRENT		
Demand credit facilities (Note 5)	20,451	-
Accounts payable and accrued liabilities	15,159	23,175
Future income taxes	81	424
	35,691	23,599
Long-term debt related to investments (Note 3)	18,000	18,204
Asset retirement obligations (Note 6)	5,170	4,059
	58,861	45,862
CONTINGENCIES AND COMMITMENTS (Note 11)		
SUBSEQUENT EVENTS (Note 15)		
SHAREHOLDERS' EQUITY		
Share capital (Note 7)	297,628	267,908
Contributed surplus (Note 9)	8,307	7,818
Deficit	(118,253)	(113,477)
	187,682	162,249
	246,543	208,111

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

APPROVED BY THE BOARD

"Donald Archibald"

Donald Archibald, Director

"Doug Dafoe"

Doug Dafoe, Director

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)	Three months ended June 30,		Six months ended June 30,	
	2010 \$	2009 \$	2010 \$	2009 \$
REVENUE				
Production revenue	9,111	4,058	17,495	8,628
Royalties	(699)	(385)	(1,813)	(1,185)
Realized gain on derivative financial instruments (Note 12)	63	2,489	1,772	4,546
Unrealized gain (loss) on derivative financial instruments (Note 12)	(42)	(1,326)	(1,462)	2,407
Other income (expense)	3	-	(46)	-
	8,436	4,836	15,946	14,396
EXPENSES				
Accretion expense (Note 6)	86	39	168	79
Depletion, depreciation, and amortization (Note 4)	6,341	3,339	11,381	6,923
General and administrative (Note 4)	1,189	1,884	1,963	2,797
Interest	215	294	288	763
Operating costs	3,392	2,212	6,267	4,498
Stock-based compensation (Note 8)	259	134	489	328
Transportation	840	238	1,584	485
Valuation loss (gain) on investment (Note 3)	390	-	(366)	-
	12,712	8,140	21,774	15,873
LOSS BEFORE INCOME TAXES	(4,276)	(3,304)	(5,828)	(1,477)
INCOME TAXES	(525)	(836)	(1,052)	(2,536)
INCOME (LOSS) BEFORE NON-CONTROLLING INTEREST	(3,751)	(2,468)	(4,776)	1,059
Non-controlling interest	-	24	-	(63)
NET INCOME (LOSS) AND COMPREHENSIVE INCOME (LOSS)	(3,751)	(2,444)	(4,776)	996
DEFICIT, BEGINNING OF PERIOD	(114,502)	(101,383)	(113,477)	(104,823)
DEFICIT, END OF PERIOD	(118,253)	(103,827)	(118,253)	(103,827)
Net Income (Loss) per share, basic and diluted (Note 10)	\$(0.09)	\$(0.25)	\$(0.12)	\$0.10

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

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

	Three months ended June 30,		Six months ended June 30,	
(Expressed in thousands of Canadian dollars)	2010 \$	2009 \$	2010 \$	2009 \$
CASH FLOWS RELATED TO THE FOLLOWING ACTIVITIES:				
OPERATING				
Net income (loss)	(3,751)	(2,444)	(4,776)	996
Adjustments for non-cash items:				
Depletion, depreciation, and amortization	6,341	3,339	11,381	6,923
Accretion expense	86	39	168	79
Stock-based compensation	259	134	489	328
Valuation loss (gain) on investment (Note 3)	390	-	(366)	-
Unrealized loss (gain) on derivative financial instruments (Note 12)	42	1,326	1,462	(2,407)
Write-down and amortization of loan premium and other derivative financial instruments	-	(17)	32	(17)
Future income tax recovery	(525)	(836)	(1,050)	(2,536)
Non-controlling interest	-	(24)	-	63
	2,842	1,517	7,340	3,429
Asset retirement expenditures (Note 6)	(10)	(10)	(66)	(17)
Net change in non-cash working capital (Note 13)	(3,200)	674	(6,682)	610
	(368)	2,181	592	4,022
INVESTING				
Corporate acquisitions	(695)	-	(695)	-
Property and equipment expenditures	(5,007)	(209)	(31,419)	(4,976)
Acquisition of assets	-	-	(453)	-
Proceeds from sale of assets	-	-	174	-
Principal Repayments of Investments	-	-	4	-
Net change in non-cash working capital (Note 13)	(8,638)	(2,057)	(1,094)	(2,166)
	(14,340)	(2,266)	(33,483)	(7,142)
FINANCING				
Proceeds from demand credit facilities	15,358	-	15,467	-
Repayment of demand credit facilities	-	(2,779)	-	(18,230)
Proceeds from long-term debt related to investments	-	120	-	18,120
Repayment of long-term debt related to investments	-	-	(54)	-
Share issue costs	(50)	(30)	(50)	(30)
Repurchase of common shares under NCIB	-	-	-	(85)
Net change in non-cash working capital (Note 13)	-	(315)	-	(315)
	15,308	(3,004)	15,363	(540)
NET INCREASE (DECREASE) IN CASH	600	(3,089)	(17,528)	(3,660)
CASH, BEGINNING OF PERIOD	-	14,866	18,128	15,437
CASH, END OF PERIOD	600	11,777	600	11,777
SUPPLEMENTARY INFORMATION				
Income taxes paid	-	-	-	-
Interest paid	218	311	585	779

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

CEQUENCE ENERGY LTD.**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****THREE AND SIX MONTH PERIODS ENDED JUNE 30, 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. ("Cequence" or the "Company") and its wholly-owned subsidiaries, 1175043 Alberta Ltd. and Peloton Exploration Corp. ("Peloton").

2. CORPORATE ACQUISITION

On June 11, 2010, the Company acquired all of the issued and outstanding shares of Peloton, a private oil and gas company, for consideration of 12,059 common voting shares. The shares were valued based on Cequence's five day weighted average trading price on the TSX before and after the announcement of the transaction. The transaction was accounted for using the purchase method whereby the assets acquired and liabilities assumed are recorded at their fair value. The accounts of the Company include the results of Peloton effective June 11, 2010.

The estimated purchase price allocation is as follows:

Cost of Acquisition	(\$000's)
Common shares (12,059 at \$2.51)	30,269
Transaction costs	645
Total	30,914
Fair Value of the Assets and Liabilities Acquired	(\$000's)
Property and equipment	29,319
Fair value of commodity contracts	339
Bank debt	(4,984)
Working capital deficiency	(1,031)
Asset retirement obligations	(552)
Future income tax assets – non-current	7,918
Future income tax liabilities – current	(95)
Total	30,914

The attributed values of the common shares issued have been excluded from the consolidated statement of cash flows as a non-cash transaction.

CEQUENCE ENERGY LTD.**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****THREE AND SIX MONTH PERIODS ENDED JUNE 30, 2010**

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

3. INVESTMENTS AND LONG-TERM DEBT RELATED THERETO

As at June 30, 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.

As at June 30, 2010 Cequence has written down the MAV 2 notes to prevailing market bid prices for similar instruments. This has resulted in an estimated fair value of the Company's MAV 2 notes of \$14,100 at June 30, 2010 (December 31, 2009 - \$13,738).

The market for MAV 2 notes continues to evolve and prevailing market prices vary with 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. It is reasonably possible that changes in future conditions in the near term could require a material change in the recognized amount of the MAV 2 notes.

Changes to the estimated fair value of the MAV 2 Notes resulted in a \$390 loss and \$366 gain recognized in income for the three and six month periods ended June 30, 2010, respectively. As a result of low current interest rates, interest for the current period was considered nominal and has not been accrued.

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 June 30, 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 June 30, 2010, the Company is in compliance with all covenants. The effective interest rate for the three and six month periods ended June 30, 2010 was 1.26 and 1.20 percent. Interest expense on long-term debt related to investments included as interest expense in the consolidated statement of operations for the three and six month periods ended June 30, 2010 was \$46 and \$96 (\$52 for the three and six months ended June 30, 2009).

4. PROPERTY AND EQUIPMENT

	June 30, 2010	December 31, 2009
Petroleum and natural gas properties	286,049	224,525
Accumulated Depletion, Depreciation and Amortization	(77,895)	(66,514)
	208,154	158,011

Unproved properties and seismic not subject to depletion amounted to approximately \$20,943 at June 30, 2010 (June 30, 2009 – \$25,709).

The Company capitalized general and administrative costs related to exploration and development of approximately \$nil for the six month period ended June 30, 2010 (June 30, 2009 – \$942).

Costs subject to depletion include \$46,004 of estimated future capital costs (June 30, 2009 – \$16,968).

CEQUENCE ENERGY LTD.**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****THREE AND SIX MONTH PERIODS ENDED JUNE 30, 2010**

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

5. 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 June 30, 2010, the Company has drawn \$20,451 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 September 2010.

6. ASSET RETIREMENT OBLIGATIONS

The following table summarizes the changes in asset retirement obligations for the six months ended June 30, 2010 and year ended December 31, 2009:

	June 30, 2010	December 31, 2009
Balance – Beginning of period	4,059	2,515
Acquisitions	552	1,165
Accretion expense	168	207
Liabilities incurred	234	190
Abandonment cost incurred	(66)	(75)
Revision in estimated cash flows	223	57
Balance – End of period	5,170	4,059

The total estimated, undiscounted cash flows, inflated at 2 percent, required to settle the obligations are \$16,767 (December 31, 2009 – \$13,648) which have been discounted using a weighted average credit-adjusted risk-free interest rate of 7.67 percent (December 31, 2009 – 7.47 percent). The Company expects these obligations to be settled in approximately 2 to 30 years. As at June 30, 2010, no funds have been set aside to settle these obligations.

7. SHARE CAPITAL

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

	2010	
	Number (000's)	Stated Value \$
Issued common voting shares		
Balance, beginning of period	39,530	267,908
Future income tax on renouncing expenditures for flow-through shares	-	(512)
Corporate acquisition	12,059	30,269
Share issue costs, net of taxes of \$13	-	(37)
Balance, end of period	51,589	297,628

On June 11, 2010, the Company completed the acquisition of Peloton (note 2) and issued 12,059 common voting shares with a deemed value of \$2.51 per share for total deemed consideration of \$30,269.

As at June 30, 2010 there were no issued or outstanding non-voting shares (December 31, 2009 – none).

CEQUENCE ENERGY LTD.**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****THREE AND SIX MONTH PERIODS ENDED JUNE 30, 2010**

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

8. STOCK BASED COMPENSATION PLANS**STOCK OPTIONS**

During the six months ended June 30, 2010, the Company issued 538 stock options at prices ranging from \$2.06 to \$3.13 to employees and directors. 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:

	June 30, 2010 \$	December 31, 2009 \$
Risk-free interest rate	2.3% – 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	\$ 1.07	\$2.00

A summary of the status of the Company's stock option plan and changes during the six months ended June 30, 2010 and year ended December 31, 2009 is as follows:

	June 30, 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	538	2.39	900	4.32
Forfeited	(25)	4.32	(850)	8.19
Outstanding, end of period	1,352	3.60	839	4.40

The following table summarizes information about stock options outstanding at June 30, 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, \$
2.06	2.06	355	4.9	-	-
2.99 – 4.32	4.08	983	4.2	-	-
8.36 – 10.68	8.93	14	7.5	7	8.93
	3.60	1,352	4.5	7	8.93

During the six months ended June 30, 2010, \$473 (June 30, 2009 – \$328) 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 \$16 of stock based compensation for the performance warrants in the six months ended June 30, 2010 (June 30, 2009 – \$nil).

CEQUENCE ENERGY LTD.**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****THREE AND SIX MONTH PERIODS ENDED JUNE 30, 2010**

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

9. CONTRIBUTED SURPLUS

	June 30, 2010 \$	December 31, 2009 \$
Opening balance	7,818	5,596
Stock-based compensation expense (note 8)	489	712
Share repurchase under NCIB	-	912
Warrants expired unexercised	-	598
Ending balance	8,307	7,818

10. 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 three and six month periods ended June 30, 2010 (June 30, 2009 – none) as their inclusion would be anti-dilutive.

	Three months ended June 30,		Six months ended June 30,	
	2010	2009	2010	2009
Basic weighted average shares	42,048	9,615	40,796	9,618
Effect of dilutive stock options and warrants	-	-	-	-
Diluted weighted average shares	42,048	9,615	40,796	9,618

11. CONTINGENCIES AND COMMITMENTS

	2010	2011	2012	2013	2014+	Total
Office lease	175	351	135	-	-	661
Pipeline transportation	795	1,594	1,594	1,594	3,052	8,629
Drilling services	1,441	1,500	-	-	-	2,941
Total	2,411	3,445	1,729	1,594	3,052	12,231

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 drilling and related 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. Cequence has incurred \$59 as at June 30, 2010.

CEQUENCE ENERGY LTD.**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****THREE AND SIX MONTH PERIODS ENDED JUNE 30, 2010**

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

12. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

The Company's financial instruments recognized in the consolidated balance sheet consist of cash, accounts receivable, commodity contracts, 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 commodity contracts and 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 commodity contracts is determined by discounting the difference between the contracted price and published forward price curves as at the balance sheet date, using the remaining contracted petroleum and natural gas volumes at a credit-adjusted risk-free rate of 6 percent.

The fair value of the Company's investment in MAV 2 notes, as disclosed in note 3, is determined by reference to recent market bid prices and recent transactions for similar instruments 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 other than as noted below:

As part of the acquisition of Peloton (note 2), Cequence assumed the following commodity derivative financial instruments:

	Type	Volume	Price	Basis
January 1, 2010 to December 31, 2010	Swap	500 GJ/day	\$ 4.69	AECO
January 1, 2010 to December 31, 2010	Swap	800 GJ/day	\$ 5.07	AECO
April 1, 2010 to October 31, 2010	Swap	500 GJ/day	\$ 5.32	AECO

For the three and six months ended June 30, 2010 realized gains from commodity derivative contracts recognized in income were \$63 and \$1,772 compared to gains of \$2,489 and \$4,546 for the three and six months ended June 30, 2009.

The fair value of the commodity contracts outstanding at June 30, 2010 was an asset of \$296 (December 31, 2009 – \$1,420). For the three and six months ended June 30, 2010 the Company recorded an unrealized loss of \$42 and \$1,462 from derivative commodity contracts compared to a loss of \$1,326 and a gain of \$2,407 for the three and six months ended June 30, 2009. An estimate of credit risk has been made in the valuation of all derivative commodity contracts.

As at June 30 2010, an increase in gas price of \$0.50/gj results in a decrease in the fair value of the commodity contract of \$148 (\$106 after tax) and a commensurate increase to net loss.

13. CHANGES IN NON-CASH WORKING CAPITAL

	Three months ended June 30,		Six months ended June 30,	
	2010 \$	2009 \$	2010 \$	2009 \$
Accounts receivable	1,887	2,019	2,278	4,010
Deposits and prepaid expenses	379	117	340	325
Accounts payable and accrued liabilities	(14,104)	(3,834)	(10,394)	(6,206)
Net change in non-cash working capital	(11,838)	(1,698)	(7,776)	(1,871)
Allocated to:				
Operating activities	(3,200)	674	(6,682)	610
Investing activities	(8,638)	(2,057)	(1,094)	(2,166)
Financing Activities	-	(315)	-	(315)
	(11,838)	(1,698)	(7,776)	(1,871)

CEQUENCE ENERGY LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

THREE AND SIX MONTH PERIODS ENDED JUNE 30, 2010

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

14. 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 3, 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 June 30, 2010 Cequence has a negative net consolidated working capital of \$24,930 (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 June 30, 2010, the ratio was calculated as 2.2:1 (December 31, 2009 – 0:1) based on annualized quarterly results. Cequence's debt to cash flow ratio for the current quarter is above 2:1 due mainly to the acquisition of Peloton (note 2) where Cequence acquired Peloton's net debt on June 11, 2010 but did not realize the full effect of Peloton's cash flows as the acquisition occurred late in the quarter.

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 June 30, 2010 the adjusted working capital ratio was calculated as 1.97:1 (December 31, 2009 – 2.99:1).

15. SUBSEQUENT EVENTS

On July 27, 2010, Cequence sold certain non-producing gas weighted properties in the Sinclair region of Northwest Alberta for total cash consideration of \$36,900, subject to final adjustments.

On July 28, 2010, Cequence announced that it had entered into an agreement with a syndicate of underwriters (the "Underwriters") pursuant to which Cequence will issue 18,545 subscription receipts at a price of \$2.10 per subscription receipt for total proceeds of \$38,945. Each subscription receipt will be convertible into one common share of Cequence without payment of additional consideration. Cequence granted the Underwriters an over allotment option to purchase up to an additional 2,500 subscription receipts at \$2.10 per subscription receipt for total proceeds of \$5,250. The subscription receipts agreement is contingent on the successful closing of the acquisition of the Deep Basin Assets, as described below, and there can be no assurance that it will be completed, nor is there any assurance that the over allotment option will be exercised.

On July 28, 2010, Cequence further announced that it had entered into a definitive purchase and sale agreement to purchase certain gas weighted properties located in Northwest Alberta (the "Deep Basin Assets") for cash consideration of approximately \$85,000, subject to closing and final adjustments. The acquisition is expected to close on September 8, 2010, provided that all conditions are satisfied or waived by the party for whose benefit such conditions exist.

On July 28, 2010, Cequence also announced that it had entered into a plan of arrangement (the "Plan of Arrangement") with Temple Energy Inc. ("Temple"), a private oil and gas company. Pursuant to the Plan of Arrangement, Cequence will, subject to certain conditions, make an offer to acquire all of the issued and outstanding common shares of Temple. Under the terms of the Plan of Arrangement, Temple shareholders will receive 0.355 of a Cequence common share for each Temple share held for a total of 46,711 Cequence common shares. The estimated value of the transaction is \$109,983, including transaction costs, based on an ascribed value of \$2.28 per common share based on Cequence's five day weighted average trading price on the TSX before and after the announcement of the transaction. The arrangement is expected to close on September 10, 2010. The arrangement is subject to shareholder approval and there can be no assurance it will be completed. Cequence further announced that it had entered into an agreement with a syndicate of agents (the "Agents") to sell, on a private placement basis, common and flow-through shares totalling 7,020 shares for total consideration of \$16,196.

CORPORATE INFORMATION

MANAGEMENT

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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

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