Interim Condensed Consolidated Financial Statements
(Unaudited)

For the three and six months ended
June 30, 2016 and 2015

Virginia Hills Oil Corp.

Interim Condensed Consolidated Balance Sheets

(Canadian $000, Unaudited)

	Note	June 30, 2016	December 31, 2015
ASSETS			
Current assets			
Restricted cash		$ 1,000	$ 1,000
Trade and other receivables		3,462	4,906
Prepaids and deposits		860	374
Assets held for sale	4	133	467
		5,455	6,747
Non-current assets			
Exploration and evaluation assets	5	3,103	3,010
Property, plant and equipment	6	85,029	90,573
Total Assets		**$ 93,587**	**$ 100,330**
LIABILITIES			
Current liabilities			
Bank overdraft		$ 370	$ 228
Trade and other payables		9,635	10,527
Flow through share premium		250	250
Bank Debt	7	105,544	104,262
		115,799	115,267
Non-current liabilities			
Decommissioning provision	8	9,349	9,365
Total Liabilities		125,148	124,632
Shareholders' Deficit			
Share capital	10	284,449	284,183
Warrants	11	1,455	1,455
Contributed surplus	12	18,713	18,658
Deficit		(336,178)	(328,598)
Total Shareholders' Deficit		(31,561)	(24,302)
Total Liabilities and Shareholders' Deficit		**$ 93,587**	**$ 100,330**

Going Concern	1(b)
Commitments	17
Subsequent Events	18

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

Virginia Hills Oil Corp.

Interim Condensed Consolidated Statements of Net Loss and Comprehensive Loss

For the three and six months ended June 30

(Canadian $000, except per share amounts, Unaudited)

	Note	Three months ended 2016	Three months ended 2015	Six months ended 2016	Six months ended 2015
Revenue					
Petroleum and natural gas sales		$ 5,972	$ 8,287	$ 10,860	$ 15,436
Royalties		(330)	(302)	(778)	(1,269)
Petroleum and natural gas revenue		5,642	7,985	10,082	14,167
Other operating income		218	152	427	343
Total revenue and other operating income		5,860	8,137	10,509	14,510
Expenses					
Production		2,922	3,052	6,819	6,305
Transportation		387	452	799	893
Depletion and depreciation	6	2,495	3,602	5,244	7,569
General and administrative		536	963	1,120	2,152
Transaction costs		-	4,028	-	4,028
		6,340	12,097	13,982	20,947
Operating income (loss)		**(480)**	**(3,960)**	**(3,473)**	**(6,437)**
Finance expense					
Interest expense	7	1,850	2,093	3,755	3,691
Accretion of decommissioning provision	8	178	154	352	312
Total finance expense		**2,028**	**2,247**	**4,107**	**4,003**
Gain on disposition		-	(13,878)	-	(13,878)
Income (loss) before income tax		**(2,508)**	**7,671**	**(7,580)**	**3,438**
Income tax expense					
Deferred income tax expense	9	-	-	-	-
		-	-	-	-
Net Income (Loss) and Comprehensive Income (Loss)		**$ (2,508)**	**$ 7,671**	**$ (7,580)**	**$ 3,438**
Income (loss) per share	13				
Basic		**$(0.12)**	$0.55	**$(0.38)**	$0.42
Diluted		**$(0.12)**	$0.55	**$(0.38)**	$0.41

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

Virginia Hills Oil Corp.

Interim Condensed Consolidated Statements of Changes in Equity (Deficit)
For the three and six months ended June 30
(Canadian $000, Unaudited)

	Note	Three months ended 2016	Three months ended 2015	Six months ended 2016	Six months ended 2015
Share Capital	10				
Balance, beginning of period		$ 284,183	$ 281,308	$ 284,183	$ 281,308
Common shares issued:					
Corporate reorganization		-	853	-	853
Private Placement		-	2,994	-	2,994
Premium on flow-through shares		-	(748)	-	(748)
Fair value of warrants		-	(864)	-	(864)
Business acquisition	10	266	544	266	544
Share issue costs, net of tax		-	(39)	-	(39)
Balance, June 30		284,449	284,048	284,449	284,048
Warrants	11				
Balance, beginning of period		1,455	5,283	1,455	5,283
Warrants cancelled pursuant to corporate reorganization		-	(5,283)	-	(5,283)
Warrants issued:					
Corporate reorganization		-	98	-	98
Business acquisition	10	-	637	-	637
Fair value allocation of warrants		-	864	-	864
Warrant issue costs, net of tax		-	(9)	-	(9)
Balance, June 30		1,455	1,590	1,455	1,590
Contributed Surplus	12				
Balance, beginning of period		18,686	13,122	18,658	13,089
Corporate reorganization		-	5,283	-	5,283
Share-based payments		27	199	55	232
Balance, June 30		18,713	18,604	18,713	18,604
Deficit					
Balance, beginning of period		(333,670)	(314,917)	(328,598)	(310,684)
Total comprehensive income		(2,508)	7,671	(7,580)	3,438
Balance, June 30		(336,178)	(307,246)	(336,178)	(307,246)
Total Shareholders' Equity (Deficit)		**$ (31,561)**	**$ (3,004)**	**$ (31,561)**	**$ (3,004)**

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

Virginia Hills Oil Corp.

Interim Condensed Consolidated Statements of Cash Flows
For the three and six months ended June 30
(Canadian $000, Unaudited)

		Three months ended		Six months ended	
	Note	2016	2015	2016	2015
Cash flows from operating activities					
Net income (loss)		$ (2,508)	$ 7,671	$ (7,580)	$ 3,438
Adjustments for:					
Deferred taxes		-	-	-	-
Gain on disposition		-	(13,878)	-	(13,878)
Accretion of decommissioning provision		178	154	352	312
Amortized deferred finance charges		335	623	732	740
Depletion and depreciation		2,495	3,602	5,244	7,569
Share-based payments		27	192	55	214
Non-cash gain on settlement of working capital		165		165	
Change in non-cash working capital	16	(979)	607	990	1,266
		(287)	**(1,029)**	**(42)**	**(339)**
Cash flows from investing activities					
Exploration and evaluation assets		(40)	(332)	(93)	(399)
Property, plant and equipment		24	(1,534)	(68)	(2,448)
Proceeds on assets held for sale		-	-	252	-
Proceeds on corporate reorganization		-	22,500	-	22,500
Net working capital deficit acquired in business acquisition		-	609	-	609
Change in non-cash working capital	16	(470)	(128)	(742)	(827)
		(486)	**21,115**	**(651)**	**19,435**
Cash flows from financing activities					
Proceeds from bank debt		7,220	96,115	12,030	104,615
Repayment of bank debt		(6,690)	(117,795)	(11,470)	(125,165)
Debt issue costs		(4)	(1,464)	(9)	(1,861)
Issue of common shares, net of costs		-	3,800	-	3,800
Change in non-cash working capital	16	-	242	-	535
		526	**(19,102)**	**551**	**(18,076)**
Net decrease in cash		**(247)**	**984**	**(142)**	**1,020**
Bank overdraft, beginning of period		(123)	(223)	(228)	(259)
Bank overdraft/Cash, end of period		**$ (370)**	**$ 761**	**$ (370)**	**$ 761**

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

1. REPORTING ENTITY AND GOING CONCERN

a) Reporting Entity: Virginia Hills Oil Corp. ("Virginia Hills" or the "Company") is engaged in the acquisition, exploration, and development of oil and gas properties in western Canada. Virginia Hills was incorporated under the Business Corporations Act (*Alberta*) on November 5, 2014, and became a reporting issuer on April 15, 2015 through the completion of a corporate reorganization of Pinecrest Energy Inc. ("Pinecrest"). The Company's head office and principal place of business is located at 1500, 202-6th Avenue S.W., Calgary, Alberta T2P 2R9. The common shares of the Company are listed on the TSX Venture Exchange under the symbol "VHO".

These interim condensed consolidated financial statements include the accounts of Virginia Hills and its wholly owned subsidiary Dolomite Energy Inc. ("Dolomite"). All intercompany balances and transactions have been eliminated.

b) Going Concern: These interim condensed consolidated financial statements have been prepared on a going concern basis in accordance with International Financial Reporting Standards ("IFRS"), which contemplates the realization of assets and settlement of liabilities in the normal course of business as they come due. Should the Company be unable to continue as a going concern, it may be unable to realize the carrying amounts of its assets and to meets its liabilities as they become due.

At June 30, 2016, Virginia Hills had a working capital deficiency of $110.3 million (December 31, 2015: $108.5 million) and an accumulated deficit of $31.6 million (December 31, 2015: $24.3 million). During the three and six months ended June 30, 2016, the Company reported net loss of $2.5 million and $7.6 million, respectively (June 30, 2015 net income: $7.7 million and $3.4 million) and generated negative cash from operating activities of $0.3 million and $0.1 million, respectively (June 30, 2015: $1.0 million and $0.3 million). Starting April 1, 2016, principal repayments were due on the syndicated facility based on the prior month's available cash flow (as defined by the credit agreement). As at June 30, 2016 no principal repayments have been made. In addition to its working capital requirements, the Company must secure sufficient funds to meet its on-going operations and commitments (Note 17).

The Company's cash flows and compliance with debt covenants are dependent upon realized current period net revenues. Operating cash flows were lower than the prior period due to depressed commodity prices and lower production volumes. The recent decrease in revenues, operating cash flow and recent history of losses indicates the existence of a material uncertainty that may cast significant doubt about the Company's ability to continue as a going concern and accordingly, the appropriateness of the use of accounting principles applicable to a going concern. In addition, the lending value of the credit facility is dependent upon the Company's reserves which are directly linked to oil and natural gas forecasted benchmark prices that are expected to remain low for the immediate future. The senior bank debt had its term extended from September 30, 2016 to January 31, 2017 while the subsidiary bank debt is due on September 30, 2016, and there is no assurance the credit facilities will be renewed at the current terms or levels once a bank review is completed (Note 7). During the first half of 2016, the Company and its lenders entered into an amending agreement, which reset the syndicated portion of the senior credit facility to $89.5 million effective August 2, 2016, included certain non-financial covenants and redefined the Company's limits on capital spending to be an aggregate of $9.3 million from April 15, 2015 to March 31, 2016, an aggregate of $0.1 million from April 1, 2016 to July 31, 2016 and an aggregate of $2.2 million from August 1, 2016 to January 31, 2017. During this time, a waiver and conditional waiver were executed for the production covenant breach that occurred at December 31, 2015 and for the months ended February through to May 2016 and the operating cash flow and adjusted EBITDA covenant breach that occurred for the months ended February through to May 2016.

As further described in Note 7 and Note 18, the Company's Facility A under the senior bank debt was renewed at $89.5 million (for a total credit facility of $96.5 million) to January 31, 2017 and the Company has initiated a process to review strategic alternatives to improve the liquidity satisfactory to the Lenders of the Company. This may include, among other alternatives, the addition of further capital, the sale of the Company or a portion of the assets, a merger, farm-in or joint venture or other such option. The Company has not set a definitive schedule to complete its evaluation and any strategy, if taken, is subject to material uncertainty and could have a material

adverse impact on the Company's financial position and results of operations. There is no guarantee that the process will result in a transaction of any form. These interim condensed consolidated financial statements do not reflect the adjustments to the carrying values of assets and liabilities and reported revenues, expenses and balance sheet classifications that would be necessary if the Company were unable to realize its assets and settle its liabilities as a going concern in the normal course of operations. Such adjustments could be material.

2. BASIS OF PREPARATION

a) Statement of compliance: These interim condensed consolidated financial statements have been prepared in accordance with IFRS as issued by the International Accounting Standards Board ("IASB") applicable to the preparation of interim financial statements, including *IAS 34*, *Interim Financial Reporting*. The policies applied in these interim condensed consolidated financial statements are consistent with the accounting policies as set out in Note 5 to the audited annual financial statements for the year ended December 31, 2015. The interim condensed consolidated financial statements were authorized for issuance by the Board of Directors on August 25, 2016.

b) Basis of measurement and functional currency: These interim condensed consolidated financial statements are presented in Canadian dollars and have been prepared on the historical cost basis, except for derivative financial instruments and share-based payments, which are measured at fair value. The methods used to measure fair values are discussed in Note 5(e) to the audited annual financial statements for the year ended December 31, 2015. Certain prior period amounts have been reclassified for presentation purposes. The policies applied in these interim condensed consolidated financial statements are based on IFRS issued, effective and outstanding as of August 25, 2016.

c) Use of estimates and judgements: The preparation of financial statements requires Management to make certain judgements, accounting estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual outcomes could differ from those estimates. Estimates and assumptions are reviewed on a continual basis. Changes to such estimates based on historical experience, and other factors, including expectations of future events that are believed to be reasonable under the circumstances. The impact of these estimate, assumption and judgment revisions are recognized in the year in which they occur. The effect on the financial statements in future periods could be material. Significant judgements, estimates and assumptions made by Management in the preparation of these interim condensed consolidated financial statements are consistent with those described in Note 4 to the audited annual financial statements for the year ended December 31, 2015.

3. SIGNIFICANT ACCOUNTING POLICIES

The Company's accounting policies are described in Note 5 to the audited annual consolidated financial statements for the year ended December 31, 2015. Those accounting policies have been applied consistently to all periods presented in these interim condensed consolidated financial statements.

Future Accounting Policy Changes: The following accounting standards are currently being evaluated by Management to determine their impact on the financial statements and have not yet been implemented:

- ***IFRS 9 Financial Instruments ("IFRS 9"):*** IFRS 9 was amended to introduce a single, forward-looking "expected loss" impairment model for financial assets which will require more timely recognition of expected credit losses, and a fair value through other comprehensive income category for financial assets that are debt instruments and supplements the new hedge accounting principles published in 2013. These amendments are effective for annual periods beginning on or after January 1, 2018 and are available for early adoption.

- ***IFRS 15 Revenue From Contracts With Customers ("IFRS 15")*:** IFRS 15 provides clarification for recognizing revenue from contracts with customers and establishes a single revenue recognition and measurement framework and replaces *IAS 18 Revenue, IAS 11 Construction Contracts* and related interpretations. The standard requires an entity to recognize revenue to reflect the transfer of goods and services

for the amount it expects to receive, when control is transferred to the purchaser. The new standard will be effective for annual periods beginning on or after January 1, 2018, with early adoption permitted. The standard may be applied retrospectively, or using a modified retrospective approach.

- ***IFRS 16 Leases ("IFRS 16"):*** IFRS 16 replaces *IAS 17 Leases* with a single recognition and measurement model which will be applied to leases for lessees, with required recognition of assets and liabilities being required for most leases. The standard is effective for annual periods beginning on or after January 1, 2019, with early adoption permitted if the entity is also applying IFRS 15.

4. ASSETS HELD FOR SALE

	Cost
At December 31, 2015	$ 467
Proceeds on assets sold	(334)
At June 30, 2016	**$ 133**

5. EXPLORATION AND EVALUATION ASSETS

	Cost
At December 31, 2015	$ 3,010
Additions	93
At June 30, 2016	**$ 3,103**

6. PROPERTY, PLANT AND EQUIPMENT

Cost	Petroleum and natural gas properties	Office furniture and equipment	Total
At December 31, 2015	$ 460,825	$ 600	$ 461,425
Additions	68	-	68
Changes in decommissioning estimates	(368)	-	(368)
At June 30, 2016	460,525	600	461,125
Accumulated Depletion, Depreciation and Impairment			
At December 31, 2015	370,447	405	370,852
Depletion and depreciation	5,215	29	5,244
At June 30, 2016	375,662	434	376,096
Carrying Value			
At December 31, 2015	$ 90,378	$ 195	$ 90,573
At June 30, 2016	$ 84,863	$ 166	**$ 85,029**

Administrative costs of $0.03 million were capitalized during the six months ended June 30, 2016 (December 31, 2015 - $0.2 million). At June 30, 2016, future development costs of $78.4 million (December 31, 2015 - $78.4 million) were included in the depletion calculation and costs of $1.7 million (December 31, 2015 - $1.7 million) relating to capital spare inventory were excluded from the depletion calculation.

7. BANK DEBT

		June 30, 2016	December 31, 2015
Senior bank debt			
Facility A - syndicated revolving loan	a)	$ 90,000	$ 90,000
Facility B - revolving operating loan		5,000	4,500
Subtotal		95,000	94,500
Less: unamortized deferred financing charges		(309)	(915)
		94,691	93,585
Subsidiary bank debt			
Credit facility – non-revolving operating loan	b)	5,000	5,000
Credit facility – revolving term loan		5,877	5,818
Fair value allocated to embedded derivative		-	(260)
Accretion on credit facility		-	194
		10,877	10,752
Less: unamortized deferred financing charges		(24)	(75)
		10,853	10,677
Outstanding bank debt		**$ 105,544**	**$ 104,262**

At June 30, 2016 the Company had a total of $105.9 million (December 31, 2015: $105.3 million) outstanding on its credit facilities. At June 30, 2016, the interest rate on the Company's credit facilities was 5.7%. During the three and six months ended June 30, 2016, the Company incurred interest expense of $1.9 million and $3.8 million, respectively (June 30, 2015: $2.1 million and $3.7 million). The Senior Bank Debt term has been extended from September 30, 2016 to January 31, 2017 with no review scheduled until that time. The Subsidiary Bank Debt has a term to September 30, 2016, with no review scheduled until September 30, 2016.

a) Senior Bank Debt: Facilities A and B

The Company's $97.0 million credit facility is comprised of a $90.0 million (reduced to $89.5 million effective August 2, 2016) syndicated revolving facility ("Facility A") and a $7.0 million non-syndicated operating facility ("Facility B"), together the "Facilities", both of which have a term to January 31, 2017. The Facilities are secured by a general security agreement and a first floating charge debenture of $300.0 million covering all of the Company's assets. Starting April 1, 2016, principal repayments were due on the syndicated facility based on the prior month's available cash flow. As at June 30, 2016, no principal repayments have been made.

Advances under the Facilities may be made by way of Canadian prime rate loans, US base rate loans and letters of credit. Amounts borrowed under the Facilities bear interest on a floating rate based on the applicable Canadian prime rate plus a sliding scale pricing grid tied to the Company's trailing debt to earnings before interest, taxes, depreciation and amortization ("EBITDA") ratio. The interest pricing margin ranges from 1% to 3% and is dependent upon the form of borrowing. If at any time, the Company is in default under the Facilities, the interest margin will be increased by 2%, at the discretion of the lenders. At June 30, 2016 the Facilities' interest rate was 5.7%.

The Company incurred $1.6 million ($1.5 million in cash fees and $0.1 million in non-cash fees paid in the form of warrants) to establish the Facilities which were deferred and amortized over the term of the Facilities. The Company issued a total of 1,972,416 common share purchase warrants to the lenders ("Series D Warrants") representing 10% of the issued and outstanding shares of the Company as at May 15, 2015. The warrants are exercisable at a price of $0.30 per common share for a period ending on the earlier of five years from the date of issue or 30 days following the date on which the facilities mature (Note 11). A total of $0.5 million remains payable at June 30, 2016 which is included in trade and other payables.

For the duration of the Facilities, the Company is also subject to certain non–financial covenants, including but not limited to: monthly reporting requirements which include reporting actual monthly results against the bank

approved business plan, strategic alternatives process milestones, permitted indebtedness, permitted hedging, permitted encumbrances, permitted dispositions and a requirement that daily production volumes may not vary below the bank approved business plan by more than 10% in any month up to May 31, 2016 after which the daily production volumes must meet a prescribed rate that varies during the period of the Facilities to maturity.

Prior to the recent amendment to the Facilities effective July 29, 2016, the Company was subject to financial covenants, based on cash flow and EBITDA which restricted the variance from the bank-approved business plan over the periods from:

- April 1, 2015 to September 30, 2015 to a maximum of $0.7 million;
- October 1, 2015 to March 31, 2016 to the lesser of 25% and $1.5 million and
- April 1, 2016 to September 30, 2016 to the lesser of 25% and $2.0 million.

These cash flow and EBITDA covenants have been removed with the recent amendment. Other financial covenants include a restriction on the Company's capital expenditures as follows:

- to a maximum of $9.3 million from April 1, 2015 to March 31, 2016;
- limitation on the aggregate amount of capital spent from April 1, 2016 to July 2016 to a maximum of $85 thousand, on a cash basis;
- limitation on the aggregate amount of capital spending from August 1, 2016 to October 31, 2016 to a maximum of $2.2 million, on an accrual basis, of which a maximum of $0.2 million may be spent on water-flood related expenditures, not more than $1.9 million may be spent on drilling, completing and equipping a well and $0.1 million for a contingency.

There is also a requirement that net debt may not exceed $100.5 million ($100 million after August 2, 2016), being the Facilities commitment total plus an estimated working capital deficiency of $3.5 million.

During the six months ended June 30, 2016, the Company was not in compliance with its minimum monthly production covenant for the months of February through May 2016. The Company was also not in compliance with cash flow and EBITDA covenants for the months ended February through May 2016. During the six months ended June 30, 2016, the lenders waived the covenant breaches.

b) Subsidiary Bank Debt

Virginia Hills' subsidiary has an $11.0 million credit facility that provides for a $6.0 million revolving operating loan and a $5.0 million non-revolving reducing term loan. Total fees of $0.1 million were paid for amending the credit agreement during 2015. Interest is payable on the loans based on Canadian prime plus 3%. At June 30, 2016 the interest rate was 5.7%. Both facilities are due on September 30, 2016.

From April 1, 2016 through to and including April 15, 2016, the lender, at their option, may convert up to $4.0 million of the non-revolving reducing term loan into common shares of Virginia Hills at a deemed price of the greater of $0.30 per share or the market price based on a 20-day volume weighted average price. The lender did not exercise this conversion option and the option has since expired. This conversion feature was treated as an embedded derivative and was reported separately as a current derivative financial liability on the Balance Sheets. The embedded derivative was revalued and marked to market on each reporting date, with the resulting difference being recorded as a financing gain or loss in the Statements of Net Loss and Comprehensive Loss. At June 30, 2016 and December 31, 2015, the derivative had a fair value of $nil. The bank debt is carried at amortized cost, using the effective interest method, which will accrete the liability up to full value of the outstanding bank debt at the expiry of the conversion feature; this amount is recorded as a non-cash finance expense.

The subsidiary is subject to customary monthly reporting covenants, and a financial covenant that restricts the subsidiary's monthly working capital deficit to a maximum of $1.3 million from November 30, 2015 to March 31, 2016, and $1.2 million from April 2016 to September 30, 2016. The Company was not in compliance with its subsidiary bank debt financial covenant for the reporting periods ended April through to June 30, 2016. During the six months ended June 30, 2016, the lender waived the covenant breach for the period in breach through to June 30, 2016.

The senior debt and subsidiary debt agreements contain customary events of default, including: events based on

bankruptcy and insolvency, non-payment of principal, interest or fees when due, change in control, material inaccuracy of representations and warranties, and a cross-default provision for breach of covenants. In the event of default, the total outstanding principal amounts of the credit facilities plus all accrued interest and costs become immediately due and payable by the Company, at the discretion and upon request from the lenders.

8. DECOMMISSIONING PROVISION

	Six months ended June 30, 2016	December 31, 2015
Balance, beginning of period	$ 9,365	$ 11,245
Capital Reorganization (Note 1(b))	-	(1,184)
Assumed in Dolomite acquisition	-	939
Obligations incurred	-	145
Revision of discount and inflation rates	(368)	146
Changes in estimated future cash flows	-	(2,521)
Accretion expense	352	632
Expenditures incurred	-	(37)
Balance, end of period	**$ 9,349**	**$ 9,365**

The Company estimated the total undiscounted cash flows required to settle its asset obligations is approximately $16.4 million at June 30, 2016 (December 31, 2015: $16.4 million). Settlement of the obligation is expected to be funded from general corporate funds at the time of retirement which is expected to occur between 2017 and 2040. At June 30, 2016, a credit-adjusted risk-free rate of 7.5% and an inflation rate of 1.5% were used to calculate the fair value of the decommissioning obligation (December 31, 2015: 7.6% and 2.0% respectively).

9. TAXATION

Income tax expense is recognized based on Management's best estimate of the weighted average annual income tax rate expected for the full financial year. The Company used an annualized effective tax rate of 27.0% to determine its current period tax expense (June 30, 2015: 25.0%). Deferred taxes reflect the tax effects of differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts reported for tax purposes. At June 30, 2016, the Company has $25 million of unrecognized deferred tax assets, and has approximately $175 million of tax pools available for deduction against future taxable income.

10. SHARE CAPITAL

a) Authorized

At June 30, 2016, the Company was authorized to issue an unlimited number of common shares without nominal or par value and an unlimited number of preferred shares, issuable in series, with rights and privileges to be determined at time of issue. The holders of common shares are entitled to receive dividends as declared by the Board of Directors and are entitled to one vote per share.

b) Issued

Share Capital Issued:	Number (000's)	Stated Value ($)
Balance, December 31, 2015	19,724	284,183
Common shares issued on Dolomite acquisition [(1)]	1,230	266
Balance, June 30, 2016	**20,954**	**284,449**

[(1)] On April 27, 2015, as part of the acquisition of Dolomite, a total of 983,624 common shares were issued at a price of $0.25 per common share for a total of $0.2 million, to the former executive officers of Dolomite as satisfaction of a portion of their change in control payments. The balance of the change in control payments of $0.6 million was due on April 27, 2016, and was settled by the issuance of a maximum of an additional 1,229,530 common shares issued at a deemed price of the greater of $0.30 per share or the market price, at the time of issuance. The shares were issued in two separate tranches with the market price being lower than the deemed price. The resulting difference of $0.2 million was recorded against general and administrative expenses on the Statements of Net Loss and Comprehensive Loss.

11. WARRANTS

	Number (000's)	Stated Value ($)
Balance, December 31, 2015	29,920	1,455
Balance, June 30, 2016	**29,920**	**1,455**

Issued and outstanding	Number (000's)	Exercise Price ($)	Expiry date
Series A – Private Placement	11,974	0.30	April 27, 2020
Series B – Private Placement	11,974	0.35	April 27, 2020
Series C – Dolomite acquisition	4,000	0.50	April 27, 2018
Series D – Bank facilities	1,972	0.30	May 15, 2020
Total	**29,920**	**-**	**-**

There were no warrants exercisable at June 30, 2016.

12. SHARE-BASED PAYMENTS

a) Stock-Option Plan

The Company has a stock option plan whereby options may be granted from time to time to directors, officers, employees and consultants of the Company, with shares to be reserved for issuance as options not to exceed 10% of the issued and outstanding common shares. Options vest as to one-third on each of the first, second and third anniversary from the date of grant. The maximum term of an option grant is five years. At June 30, 2016 the following share options were issued and outstanding:

	Number (000's)	Exercise Price ($) [(1)]	Remaining Expected life (years)
Outstanding, December 31, 2015	1,773	0.26	3.9
Granted	61	0.21	4.8
Outstanding, June 30, 2016	**1,834**	**0.25**	**3.9**

[(1)] *Weighted average*

The fair value of the options granted was estimated using the Black-Scholes option pricing model and the following weighted average assumptions: fair value at grant date of $0.19, exercise price of $0.21, risk-free interest rate of 0.7%, forecast volatility of 143.4%, forfeiture rate of 3.9%, expected average life of 5.0 years, and dividend yield of 0%.

During the three and six months ended June 30, 2016, the Company recorded share-based payment compensation of $0.03 million and $0.06 million, respectively, which has been expensed (June 30, 2015: $0.2 million and $0.2 million).

b) Performance Warrants
There were no Performance Warrants issued and outstanding as at June 30, 2016 or December 31, 2015.

c) Share Incentive Plan
There were no issued and outstanding Share Incentive Awards outstanding on June 30, 2016 or December 31, 2015.

13. PER SHARE AMOUNTS

The average market value of the Company's shares for the purposes of calculating the dilutive effect of share options and warrants was based on quoted market prices for the period that the options and warrants were outstanding. The effect of 31.8 million stock options and warrants are excluded from the calculation in periods where the company reported a loss, as they are anti-dilutive. The following table summarizes the weighted average shares used in calculating the net loss per share:

	Three months ended		Six months ended	
June 30	**2016**	**2015**	**2016**	**2015**
Issued common shares, beginning of period	19,724	2,172	19,724	2,172
Shares issued during the period	654	11,888	327	5,977
Basic: weighted average number of common shares	**20,378**	**14,060**	**20,051**	**8,149**
Effect of incentive awards outstanding	-	-	-	288
Weighted average number of common shares - diluted	**20,378**	**14,060**	**20,051**	**8,437**

14. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

The following table summarizes the carrying amount of Virginia Hills' financial instruments:

	Hierarchy Level	Classification[1]	June 30, 2016		December 31, 2015	
			Carrying Amt ($)	Fair Value ($)	Carrying Amt ($)	Fair Value ($)
Financial Assets						
Restricted cash	1	LAR	1,000	1,000	1,000	1,000
Trade and other receivables[2]	1	LAR	3,462	3,462	4,906	4,906
Financial Liabilities						
Bank overdraft	1	OFL	370	370	228	228
Trade and other payables[2]	1	OFL	9,635	9,635	10,527	10,527
Bank debt[3]	2	OFL	105,544	105,544	104,262	104,262

(1) LAR = Loans and receivables; OFR = Other Financial Liabilities; FVTPL = Fair value through profit and loss

(2) Carried at cost which approximates the fair value due to the short-term nature of the accounts.

(3) The bank debt carries interest based on specified benchmark interest rates plus a margin for the Company's own credit risk. The fair values of the bank debt approximate its carrying amount due to the fact that interest is adjusted periodically based on changes in the relevant benchmark interest rates and Company credit risk and is based on Level 2 in the fair value measurement hierarchy.

Risk Management:

The Company is exposed to credit, market and liquidity risks from its use of financial instruments. The risk management policy is established by the Board of Directors and is implemented and monitored by senior management.

a) Credit risk: Credit risk results from the possibility that parties may default on their financial obligations. As at June 30, 2016, Virginia Hill's maximum exposure to credit risk was $3.5 million (December 31, 2015: $4.9 million) which is the aggregate of trade and other receivables. Virginia Hills manages its credit risk and exposure by entering into sales contracts with only established, creditworthy counterparties. In addition, cash equivalent investments and risk management transactions with counterparties are, at the time of transaction, not less than investment grade.

(i) Trade and other receivables: The Company's accounts receivable are subject to concentration of credit risk as all of the Company's customers are in the oil and gas sector. The majority of the Company's trade and other receivables are from joint interest partners and crude oil and natural gas marketers. Receivables from oil and gas marketers are typically collected on the 25th day of the month following production. Receivables from joint interest partners are typically collected within one to three months from the joint venture billing date. The Company attempts to mitigate collection risk from joint interest partners by obtaining partner pre-approval of significant capital expenditures prior to initiation of the capital project. However, joint interest partners are exposed to various oil and gas industry risks that could impact the Company's ability to collect these amounts.
The following table illustrates the Company's maximum credit exposure for receivables:

	June 30, 2016	December 31, 2015
Petroleum and natural gas sales	$ 2,055	$ 2,979
Joint venture receivables	1,421	1,593
Other receivables [1]	1	347
Provision for bad debt	(15)	(13)
	$ 3,462	**$ 4,906**

Accounts Receivable Aging	June 30, 2016	December 31, 2015
Current to 90 days	2,945	4,632
Greater than 90 days	517	274
	$ 3,462	**$ 4,906**

(1) At June 30, 2016, the Company's trade and other receivables include $1.9 million from crude oil and natural gas marketers which has substantially been collected subsequent to June 30, 2016. Collectability of the accounts receivable balances are assessed at each period end by Management by reviewing the counterparty's creditworthiness and assessing the frequency of payments collected. The majority of the balances over 90 days are from an industry partner that has a history of consistent monthly payments.

b) Liquidity risk: Liquidity risk is the risk that the Company will not be able to meet a demand for cash, fund its financial liabilities as they come due, or not being able to liquidate assets in a timely manner at a reasonable price. The Company monitors its liquidity requirements by preparing an annual budget, which anticipates operating, investing and financing activities. The Company generates a certain level of cash flows which is used to partially fund operating, investing and financing activities. In addition, the Company has a revolving credit facility which is disclosed in Note 7. Virginia Hills' liquidity could be significantly impacted, should the bank determine that the credit facility will not be renewed. Management is limiting expenditures to its bank-approved budget, which outlines permitted capital and operating expenditures, and is currently exploring business alternatives, including potential asset sales, joint venture opportunities and a corporate sale or reorganization, which could result in additional available funds for the Company (see Going Concern Note 1(b)). The following table shows the nature of Virginia Hills' payment obligations in the next year and beyond, in addition see Commitments (Note 17):

	June 30, 2016	December 31, 2015
Trade payables - production	$ 7,971	$ 6,495
Trade payables - capital	433	1,252
Other payables	546	2,007
Joint venture payables	685	773
Total trade and other payables	9,635	10,527
Flow-through share premium	250	250
Bank overdraft	370	228
Bank debt, before deduction of debt issue costs	105,878	105,318
Total current liabilities, due within 1 year	**$ 116,133**	**$ 116,323**

c) Market risk: Market risk is the risk that changes in market prices, such as commodity prices, interest rates and foreign exchange rates will impact the Company's net earnings, future cash flows or the value of the Company's financial assets and financial liabilities. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimizing return. The Company may use both financial derivatives and physical delivery sales contracts to manage market risks. All such transactions are conducted within the risk management tolerances as established by the Board of Directors.

(i) Interest Rate Risk: Interest rate risk is the risk that future cash flows will fluctuate as a result of changes in market interest rates. The interest charged on Virginia Hills' credit facility fluctuates with the interest rates posted by lenders, plus a margin. The Company has not entered into any mitigating interest rate swaps or hedges as at June 30, 2016 or December 31, 2015. Assuming all other variables remain constant, had the borrowing rate been 1 percent (100 basis points) higher (lower) for the three and six months ended June 30, 2016, net income would have decreased or increased by approximately $0.3 million and $0.5 million, respectively, based on the average outstanding bank debt balance for the period.

(ii) Commodity Price Risk: Commodity prices for petroleum and natural gas are impacted by global economic events that dictate the levels of supply and demand, as well as the relationship between the Canadian dollar and the United States dollar ("USD"). Significant changes in commodity prices may materially impact the Company's ability to raise capital. In the past, the Company has used physical delivery contracts, which committed the delivery of fixed volumes per month, at a fixed price. These contracts are not considered financial instruments, and are not fair valued each period end. There were no physical delivery contracts in place during the three or six months ended June 30, 2016 (December 31, 2015: $nil).

(iii) Foreign Exchange Risk: The Company's functional and reporting currency is Canadian dollars. The Company does not sell or transact in any foreign currency, however commodity prices are largely denominated in USD, and as a result the prices that the Company receives are affected by fluctuations in the exchange rates between the USD and the Canadian dollar. The exchange rate effect cannot be quantified, but generally an increase in the value of the Canadian dollar compared to the USD will reduce the prices received by the Company for its crude oil and natural gas sales. The Company did not have any foreign exchange rate swaps or related financial contracts in place as at June 30, 2016 or December 31, 2015.

d) Capital Management: Virginia Hill's capital structure includes working capital, bank debt and shareholders' equity, which is not subject to external restrictions. The Company's objectives for managing its capital structure are to: meet its financial obligations; internally finance future capital projects, including property and corporate acquisitions, and preserve its ability to access capital markets. The Company's overall objective in managing its capital structure has not changed during the six months ended June 30, 2016.

Virginia Hills monitors its capital structure using a non-GAAP financial measure, which is the ratio of net debt to funds flow from operations. Net debt is defined as total bank debt plus working capital. Funds flow from operations is defined as cash flow from operating activities adjusted for changes in non-cash working capital, decommissioning expenditures and transaction costs. This ratio is calculated by dividing the net debt at the end of the period by the annualized current monthly funds flow from operations. This ratio may increase at certain times due to the timing of capital expenditures, acquisitions and changes in market conditions.

Management prepares production and capital expenditures budgets and forecasts, which are updated on a regular basis depending on factors such as current and forecast crude oil and natural gas prices, capital deployment and general industry conditions. The budget is approved by the Board of Directors and monitored by Management throughout the year. In addition, the Company regularly reports to its lender group compared to budgets. In order to maintain or adjust its capital structure, the Company may issue common shares if available upon acceptable terms, repay existing debt, seek additional debt financing, adjust its capital spending and/or seek strategic alternatives.

15. RELATED PARTY BALANCES AND TRANSACTIONS

The Company has retained the law firm of Burnet, Duckworth and Palmer LLP to provide legal services. The current Chairman of the Board is a partner and the Corporate Secretary is an associate at the law firm. During the three and six months ended June 30, 2016, the Company incurred legal fees and disbursements of $0.04 million (June 30, 2015: $0.7 million) related to general corporate matters. A total of $0.2 million was outstanding at June 30, 2016 (December 31, 2015: $0.2 million). These transactions were in the normal course of business and have been measured at the exchange amount.

16. SUPPLEMENTARY CASH FLOW INFORMATION

	Three months ended		Six months ended	
As at June 30	**2016**	**2015**	**2016**	**2015**
Provided by (used in):				
Trade and other receivables	$ 251	$ (1,126)	$ 1,444	$ 524
Prepaids and deposits	(487)	(541)	(486)	(228)
Trade and other payables	(1,398)	2,388	(892)	678
	$ (1,634)	$ 721	$ 66	$ 974
Provided by (used in)				
Operating activities	(979)	$ 607	$ 990	$ 1,266
Investing activities	(470)	(128)	(742)	(827)
Financing activities	-	242	-	535
	$ (1,449)	$ 721	$ 248	$ 974
Non-cash settlement of accounts payable	(185)	-	(182)	-
	$ (1,634)	$ 721	$ 66	$ 974
Interest received	$ -	$ -	$ -	$ -
Interest paid	$ 1,515	$ 1,763	$ 3,023	$ 2,951

17. COMMITMENTS AND CONTINGENCIES

The Company had the following commitments at June 30, 2016:

($000's)	**2017**	**2018**	**2019**	**2020**	**Thereafter**
Office lease	145	145	193	16	-
Field office lease	40	7	-	-	-
Equipment rentals	12	12	7	-	-
Electrification agreements	288	288	-	-	-
Flow-through share expenditures	1,000	-	-	-	-
Commitments	**1,485**	**452**	**200**	**16**	**-**

The Company has $0.6 million in commitments to install electrical service to a number of its well sites over the next 24 months. The agreements may be cancelled by the Company upon providing written notice at any time, but will be responsible for costs incurred by the vendor from date of contract up to date of cancellation.

During 2015, the Company issued flow through units, at a price of $0.25 per Unit for gross proceeds of $3.0 million. As at June 30, 2016, the Company had incurred qualifying expenditures of $2.0 million, and is committed to spend $1.0 million on qualifying expenditures by December 31, 2016.

18. SUBSEQUENT EVENTS

a) Subsequent to June 30, 2016, the Company entered into an amending credit agreement with the lenders of the senior bank debt extending the agreement from September 30, 2016 to January 31, 2017 and reducing the commitment amount of Facility A to $89.5 million from $90.0 million effective August 2, 2016 (see Note 7).

b) Subsequent to June 30, 2016, the Company initiated a process to review strategic alternatives to improve its liquidity position and engaged a financial advisor to assist in the process. This may include, among other alternatives, the addition of further capital, the sale of the Company or a portion of the assets, a merger, farm-in or joint venture or other such option. The Company has not set a definitive schedule to complete its evaluation and no decision on any particular alternative has been reached at this time.